



AXIS Capital Holdings Limited  
2012 Annual Report

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### Financial Highlights

	As of and for the Year Ended December 31,				
	2012	2011	2010	2009	2008
<i>(in millions, except per share amounts)</i>					
Selected Statement of Operations Data:					
Gross premiums written	\$ 4,139.6	\$ 4,096.2	\$ 3,750.5	\$ 3,587.3	\$ 3,390.4
Net premiums written	3,337.5	3,419.4	3,147.5	2,816.4	2,666.9
Net premiums earned	3,415.5	3,315.0	2,947.4	2,791.8	2,687.2
Net investment income	381.0	362.4	406.9	464.5	247.2
Net realized investment gains (losses)	127.5	121.4	195.1	(311.6)	(85.3)
Net income available to common shareholders	495.0	9.4	819.8	461.0	350.5
Per Common Share Data:					
Basic earnings per common share	\$ 4.05	\$ 0.08	\$ 6.74	\$ 3.36	\$ 2.50
Diluted earnings per common share	4.00	0.07	6.02	3.07	2.26
Book value per common share	44.75	39.37	45.60	37.84	29.08
Diluted book value per common share	42.97	38.08	39.37	33.65	25.79
Dividends declared per common share	0.970	0.930	0.860	0.810	0.755
Operating Ratios:					
Net loss and loss expense ratio	61.4%	80.7%	56.9%	51.0%	63.7%
Expense ratio	34.8%	31.6%	31.8%	28.3%	26.1%
Combined ratio	<u>96.2%</u>	<u>112.3%</u>	<u>88.7%</u>	<u>79.3%</u>	<u>89.8%</u>
Selected Balance Sheet Data:					
Total assets	\$18,852.3	\$17,806.1	\$16,445.7	\$15,306.5	\$14,282.8
Senior notes	995.2	994.7	994.1	499.5	499.4
Preferred equity	502.8	500.0	500.0	500.0	500.0
Common equity	5,276.9	4,944.1	5,125.0	5,000.2	3,961.0
Total shareholders' equity	5,779.8	5,444.1	5,625.0	5,500.2	4,461.0
Total capital	6,775.0	6,438.7	6,619.1	5,999.7	4,960.4
Return on average common shareholders' equity ("ROACE")					
Operating ROACE	9.7%	0.2%	16.2%	10.3%	8.1%
	8.2%	(3.1%)	12.1%	17.8%	9.1%

Note: 2008 results include pre-tax net losses of \$408.0 million attributable to Hurricanes Gustav and Ike.  
 2010 results include pre-tax net losses of \$256.3 million attributable to the Chile and New Zealand I earthquakes.  
 2011 results include pre-tax net losses of \$944.3 million for 2011 natural catastrophe events including \$647.0 million for the Japanese earthquake and tsunami and the New Zealand II and III earthquakes.  
 2012 results include pre-tax net losses of \$331.3 million attributable to Storm Sandy.

### To Our Shareholders,

I am pleased to present our annual report for 2012. The economic backdrop remained difficult, but AXIS did well despite the many challenges it encountered.

The downturn that began in 2008 continued to be felt throughout the developed economies, extending far longer than one might reasonably have expected. For a service industry such as ours, which depends upon growth in the primary economy, this circumscribed our own opportunities. Furthermore, the persistence of subsidized low interest rates inhibited our ability – and that of most of our peers – to earn investment income at a level associated with more normal environments. The industry's speed of adjustment to this reality, however, and its correction through higher insurance rates, has been slow.

Nevertheless, AXIS structured itself to manage within such an environment. For the year, AXIS showed significant improvement over 2011, reporting a return on common equity just shy of 10%, nearly \$500 million of profit and a 13% increase in diluted book value per share. Although we may not have achieved the highest reaches of our expectations, for a year such as this – punctuated by the second-worst storm in U.S. history – our results demonstrated the strength of our Company and the professionalism of our management.

Trading for the year was cautious but our franchise continued to develop, both internally and externally. We implemented the succession of Albert Benchimol as chief executive officer, a move which had been carefully planned for quite some time. At this juncture, I would like to acknowledge the tremendous contribution of his predecessor, John Charman, who founded AXIS and served for ten years as CEO. John's industry knowledge and his accomplishments at AXIS were enormous; he established the Company upon a platform of exceptional strength and I am fortunate to have worked so closely with him for many years.

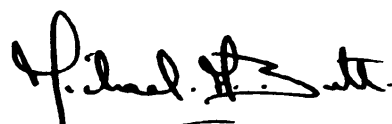
Now, AXIS has reached a new and vital phase, in which to further solidify the structure of our institution in order to continue on the path we originally envisioned and have heretofore so successfully pursued.

This year, AXIS was fortunate to attract several industry leaders to key positions within our management team. They will play a vital role as we move forward. I especially wish to welcome our newest Board members, Jane Boisseau, former co-chair of the Insurance Regulatory Department of the law firm Dewey & LeBoeuf LLP, and Alice Young, chair of Kaye Scholer LLP's Asia Pacific practice.

In terms of the regulatory environment, I am pleased that Bermuda continues to be at the forefront of international regulatory development. The deferral of Solvency II by the E.U., however, has added a level of complexity to our industry but also opportunity for Bermuda.

I look forward to working with my fellow Board members throughout the coming year for the benefit of our shareholders and to see AXIS continue to establish itself as one of the leading, most respected companies in our industry.

Sincerely,



Michael A. Butt  
Chairman of the Board



**To Our Shareholders,**

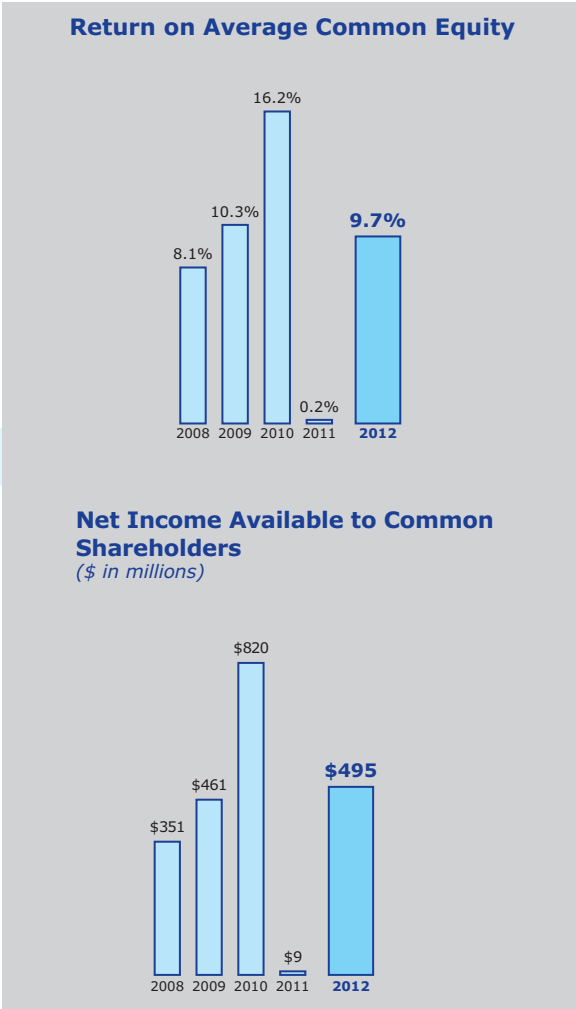
In last year’s annual report, I expressed my admiration for AXIS and its many competitive advantages, including a highly talented, entrepreneurial staff, a well-diversified portfolio of specialty products, and superior financial strength – highlighted by a solid balance sheet, strong reserves and a high quality investment portfolio. In my first months as Chief Executive, I visited with our staff in all our key offices, and met with the senior executives of our major brokers and distribution partners, as well as many of our clients. With the benefit of these experiences, I can both confirm my initial impressions, and add the insights that we also have an excellent reputation in the insurance and reinsurance marketplace, and very strong relationships with the brokerage community and our clients. In my view AXIS competes successfully with companies that have much longer histories, a greater number of staff, and substantially larger financial resources. We compete head-to-head with them, win more than our fair share of attractive business, and deliver excellent results. Undeniably, we “punch above our weight”, and have achieved positions of leadership in many attractive markets.

For this, I must give credit to our founding CEO, John Charman, and the outstanding team that he has put together over the years. While John resigned from our Board last year, we will always be grateful for his vision and his enormous contributions in building AXIS into an industry leader. Importantly, the team he assembled - more than 1,100 people in offices around the world – and who have delivered an exceptional decade of success, remain enthusiastic and committed to our founding vision: *to be the leading global diversified insurance and reinsurance company as measured by quality, sustainability and profitability.*

These qualities served the Company well in 2012. AXIS continued on a steady course, executed with the highest professionalism, and recorded a creditable year of profitable underwriting. We also delivered significant value to shareholders.

**Financial Highlights – A Good Performance Overall**

**Financial performance.** Financially, 2012 was a satisfactory year under the circumstances, though not a great one by our standards. We benefitted from improved underwriting results, given a lower incidence of large losses, and favorable prior year reserve development. This was partially offset by high property catastrophe losses late in the year from Storm Sandy - one of the costliest storms on record - and the continued headwind from lower fixed income yields. For the full year, we achieved net income



## A Letter from the Chief Executive Officer

available to common shareholders of \$495 million, or \$4.00 per diluted common share. Our return on average common equity came in at 9.7% – below our long-term average target of 15%, and the average ROE of 14.2% achieved in our first decade. Our 2012 operating profit rose to \$422 million, or \$3.41 per diluted common share, rebounding from a difficult 2011, which was plagued by numerous international property catastrophe events.

Book value per diluted common share, one of our most important metrics in terms of increasing shareholder wealth, grew a solid 13% to an all-time year-end high of \$42.97. This brings our 10-year compound annual growth in diluted book value per share, adjusted for accumulated dividends, to 13.6%.

Gross written premium grew 1% to \$4.1 billion, reflecting improved insurance pricing and strong growth in our AXIS Accident & Health line, offset by reductions associated with rebalancing of our catastrophe exposure, primarily in our reinsurance portfolio.

For the year, our combined ratio was a commendable 96.2%, inclusive of 12.7 percentage points from catastrophe and weather events – predominantly Storm Sandy – as compared to 2011's 112.3%, which included 28.2 percentage points from catastrophe and weather events.

**Investments.** On the investment side, we continued to maintain a conservative posture in our fixed-income portfolio, with a relatively short duration of approximately three years. Our fixed-income portfolio, representing 83% of our cash and invested assets, has an average credit rating of AA- and is composed mainly of highly rated corporate debt and agency mortgage-backed securities. During the year, we exited holdings in troubled economies. Meanwhile, to add to our diversification, we added exposure to high-quality emerging market countries and also to short-duration high-yield assets, both of which contributed positively to our investment results.

Our portfolio of equities and alternative investments – primarily hedge funds – comprised approximately 11% of our cash and invested assets and contributed meaningfully this year, producing \$100 million in income amidst a rising equity market.

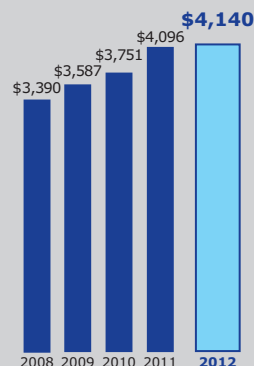
For the year, our cash and investments portfolio produced a total return of 5.4%, benefiting from the strong total return generated by equities and alternative investments.

**Diluted Book Value Per Share + Accumulated Dividends**



<sup>(1)</sup>Accumulated Dividends Declared since December 31, 2002

**Consolidated Gross Premiums Written**  
(\$ in millions)



## A Letter from the Chief Executive Officer

**Responsible capital management.** We never forget that our shareholders have entrusted us with their investment and depend on us to manage it wisely on their behalf. Our intent is to deliver to our shareholders annual dividend yields and book value growth at the top tier of our industry. We achieved that goal again this year with our ninth consecutive annual increase in our quarterly dividend, raising it 4% to \$0.25 per share, along with the 13% growth in diluted book value per common share. While our general preference is to use our capital in the pursuit of attractive growth opportunities, our profitability is such that we often generate more incremental capital than we can prudently deploy under current market conditions. In that event, our practice has been to return the excess capital back to our shareholders, generally in the form of share repurchases. During 2012, we repurchased 9.4 million shares at an aggregate cost of \$318 million. Together with our common dividends, we returned substantially all of our net income available to common shareholders in 2012.

Even with the year's large return of capital to shareholders, our total capital position rose to \$6.8 billion, underscoring the strength of our balance sheet. The financial ratings of our operating subsidiaries remained a solid A+ ("Strong") by Standard & Poor's and A ("Excellent"), with a positive outlook, by A.M. Best.

While we are pursuing a number of promising growth opportunities in 2013, we also expect to repurchase additional shares during the year. To that end, our Board has authorized up to \$750 million of share repurchases through December 2014. Through the end of February of this year, we have already repurchased 3 million shares at an aggregate cost of \$116 million. The exact amount and timing of any additional repurchases will, of course, depend on the state of the economy and the industry, our capital position, and the opportunities available to us at the time.

### Operational Highlights – Continued Growth and Diversification

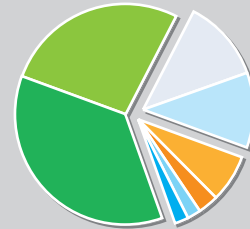
**AXIS Insurance.** AXIS Insurance, which accounted for 56% of our gross written premium in 2012, is a highly diversified specialty insurer both along product lines and geography. Gross written premium rose 9% to a record \$2.3 billion, due to overall better pricing and new business.

As we indicated in last year's annual report, the cumulative pain of several years of falling prices, higher frequency of large loss events and disappointing investment returns have moved the industry to start raising prices. While the increases are not uniform across all classes and geographies - and indeed some lines continue to exhibit disappointing reductions - the positive trend is clear. Overall, we estimate our pricing to have increased 5% across our insurance book in 2012. While recent pricing increases are encouraging, we hasten to add that in most cases, they are still not enough to offset the cumulative price reductions of prior years, nor the significant decline in yields in our investment portfolios. The industry must sustain ongoing price increases to return to earlier levels of profitability. We will continue to be selective in pursuing only those opportunities that meet our risk and return targets.

#### AXIS Insurance Gross Premiums Written

2012 Gross Premiums Written =  
\$ 2,309 million

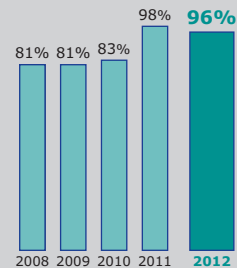
36%	Professional Lines
27%	Property
12%	Liability
11%	Marine
7%	Accident & Health
3%	Aviation
2%	Credit & Political Risk
2%	Terrorism



## A Letter from the Chief Executive Officer

At AXIS, we were particularly pleased with our growth in areas where we had recently launched new initiatives or significantly increased our investment. These included our international property and international casualty lines, written out of our London office. Although we reduced our exposure to U.S. catastrophe accounts, we increased our commercial property exposure worldwide, including in Europe, Latin America, Australia and the Middle East.

AXIS Insurance Combined Ratio



Once again, we were very satisfied with our growth in renewable energy, which is part of our large global energy specialization. Similarly, in professional lines, another key area of our specialty focus, we saw excellent reception for our expanded U.K. professional indemnity offering, and in the U.S. for our Design Professional & Environmental lines. In the U.S., our umbrella and excess casualty lines also showed strong growth with substantially improved pricing.

In terms of geographic diversification, we continued to develop our Canadian operations, where we have steadily grown our diversified property and casualty offering, especially in professional lines. In Australia, where we have diligently built up a presence and continually diversified our product offering, we did not grow premium volume due to the competitive environment.

One particular standout development was the rapid and successful installation of new technology enabling AXIS to enter the U.S. primary casualty market. With the technology and analytical tools in place to offer efficient pricing and binding for what otherwise would be a prohibitively labor-intensive underwriting task, we made this new capability available as of January 2013.

Our AXIS Accident & Health line focuses on the niche markets of accident, travel and specialty health coverages. During the year, we progressed according to plan in building the requisite product offerings, distribution relationships and infrastructure to establish AXIS Accident & Health as a global franchise. We continue to believe this market represents an opportunity for new participants unencumbered by outmoded legacy products, processes and technologies.

Accident & Health premium rose 26% to \$161 million and we increased the percentage of our revenues coming from the U.S. and primary insurance lines, reflecting our success in laying the groundwork for a fuller roll-out of product lines. Among our achievements, we essentially completed all the necessary state licensing to access the U.S. insurance market. A new distribution arrangement in the limited benefits arena was an important driver of our U.S. growth out of our Princeton, New York and Chicago offices. We also expanded our international presence, so that now, in addition to our London and Dublin hubs, we operate from branches in Paris, Madrid, Zurich, Barcelona and Singapore. All of this work positioned us well for further growth in 2013.



## A Letter from the Chief Executive Officer

**AXIS Reinsurance.** AXIS Reinsurance is a significant participant in the global reinsurance market. It accounted for 44% of our gross written premium in 2012, down 7% to \$1.8 billion, as a result of repositioning our property catastrophe portfolio.

This was a year of significant organizational change at AXIS Reinsurance. In April, we welcomed John “Jay” Nichols as the new CEO of our reinsurance business. We also reorganized our operations, integrating our New York, Bermuda and Zurich operations – which had previously functioned independently of each other – into a single coordinated unit focused on the customer.

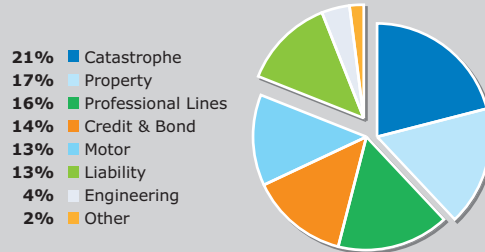
Into this, we added to the AXIS presence in Singapore, including the assignment of our Asia/Pacific book of business previously written in Bermuda to our team in Singapore. This has enabled us to begin servicing those customers from a closer vantage point. Importantly, our new office also establishes our reinsurance presence in this vital portal to the burgeoning Asian economy, to capture business opportunities that will increasingly be placed locally. As with our other business units, our presence in Singapore is an important step in establishing a venue for servicing this growing region over the next five to ten years, and will play a role in our efforts to diversify the portfolio.

We strengthened our analytics across all our lines of business, and provided our people with better tools for making underwriting decisions. The introduction of enhanced risk-and-return considerations was critical in the repositioning of our catastrophe portfolio during the year. In one example, we determined we were relatively overexposed to U.S. Northeast and Mid-Atlantic hurricane risk, in the context of our overall portfolio risk-and-return guidelines. We shifted some capacity to better compensated regions and layers. With this came increased participation in the Florida and Gulf wind regions, attractive areas where we had been historically under-represented. While some may have questioned the reduction in reinsurance premium written as a result of this shift, we were confident that the resulting portfolio construct was more capital-efficient and would generate more premium per unit of risk. Portfolio restructurings rarely show their value in the short term, but we are convinced that our Storm Sandy loss was lower than would have been the case had we not reduced exposure to the U.S. Mid-Atlantic zone earlier in the year.

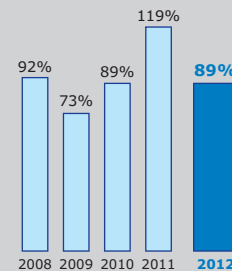
We made two other important investments in the year, as we brought on some of the highest caliber underwriting talent in agricultural and marine reinsurance. As it happened, we entered both these sectors at highly fortuitous moments. We were attracted by the anticipated strong growth in the global agriculture sector, and planned for gradual penetration of these markets. However, severe summer droughts in the U.S. have led to

### AXIS Reinsurance Gross Premiums Written

2012 Gross Premiums Written =  
\$ 1,830 million



### AXIS Reinsurance Combined Ratio



## A Letter from the Chief Executive Officer

a significant increase in demand, and we have already begun to assemble a significant book of business, both in the U.S. and internationally. We believe the fundamentals are very attractive and that agricultural reinsurance will continue to be in high demand worldwide for the foreseeable future.

Similarly, our acquisition of marine underwriting expertise came at the end of the most difficult year in marine reinsurance, most notably due to the Costa Concordia disaster and Storm Sandy, which sparked an increase in demand that enabled us to build this business more quickly than originally anticipated.

### Setting a Strategy for the Next Decade

Starting a new decade with a new chief executive provided us with an opportunity to challenge ourselves: Would the strategies, goals and attributes that we established at our founding, and which have served us and our shareholders so well, still point the right path for success in our second decade? The short answer to our long deliberations is “yes”. There is a real need and immense opportunity in our industry for a strong, professional underwriter of specialty lines; one that has the intellectual ability to evaluate, structure and price coverages for complex and volatile risks, and with the financial capacity to absorb the occasional large losses that come with leadership positions in these markets. AXIS is that underwriter, and we intend to accelerate our progress towards our original vision and in the process, create substantial value for our clients and shareholders.

Through this exercise, we articulated four strategic goals. At their essence, they focused on:

- Diversifying growth for better portfolio balance and lower volatility;
- Achieving higher risk-adjusted returns through improved data and analytics;
- Enhancing operational effectiveness; and
- Nurturing and developing our people.

***Diversifying growth for better balance and lower volatility.*** We started as a specialty insurer and reinsurer in Bermuda. It was the most effective and efficient way to access risk and build a substantial portfolio of business with limited infrastructure and geographic footprint. However, not all risks make their way to Bermuda, and the resulting portfolios are inherently volatile. We soon started to expand our geographic reach and now are present in five continents. We also expanded our line offerings and market a broad range of property, casualty and specialty lines on both an admitted and non-admitted basis in various jurisdictions. Historically a large-accounts underwriter in wholesale markets, we have in recent years modified our property and professional liability products (where we already have considerable expertise) to access more middle-market opportunities in the retail or admitted local markets primarily in the U.S, Canada, and Australia. We have recruited talented individuals and teams to add to our portfolio of skills and build out new franchises. While we continue to expect good growth in our established lines and markets, we are committed to further product and geographic expansion. This will provide profitable growth opportunities, greater strategic optionality and ultimately a less volatile book of business, as not all lines and geographies behave in unison.

### ***Achieving higher risk-adjusted returns through improved data and analytics.***

Notwithstanding the Company's exceptional talent for underwriting individual risks, we see significant opportunity for improvement by taking a holistic approach to our portfolio and paying closer attention to its overall construction.

This expresses itself in multiple ways. It means understanding how we can deliver value to our clients through various forms of risk transfer products and structures - be they primary insurance or excess layers, reinsurance or some other means of providing capital support - and then coordinating across the group to execute on the most attractive solutions.

This entails improving the metrics by which we evaluate our risks and providing better tools and analytics to do the job. Importantly, it leads to better understanding of how individual exposures and transactions might affect the entire portfolio's performance, in such vital aspects as balance and diversification, volatility, risk aggregation and optimization.

Going forward, we will continue to increase our use of constantly improving data, analytics and modeling. We will be informed, but not ruled, by the output of these tools. We are very aware of the limitations of models. Our industry has too often suffered from events whose likelihood, severity and economic impact were underestimated. At AXIS, our underwriting activities will benefit from a combination of experienced underwriters' judgment, state-of-the-art analytics, and prudent risk management.

***Enhancing operational effectiveness.*** Operational effectiveness is all about helping our staff succeed in an efficient, cost-effective manner. As part of our strategic review, we determined that our larger, more diversified, and increasingly global footprint created new organizational demands. In addition, as each of our main operating units is at its own stage of maturity, pursues its own markets and experiences its own particular operational needs, our prior approach to servicing and supporting each operation from a central corporate structure could become sub-optimal. In response, to improve operational focus, we introduced a new managerial structure, which we call our Federated Model. Insofar as they had not previously had them, we introduced functional groups into the business units, providing each with its own resources in areas such as finance, information technology, legal and actuarial, in addition to risk management. To ensure continued control and avoid the creation of silos, each business unit function leader maintains close coordination with his or her group-level counterpart.

This new structure has empowered each business to move quickly and focus its energy and resources where they will have the greatest impact. Already, we have seen numerous tangible improvements and new initiatives at the operating level, as well as a rejuvenated sense of ownership and entrepreneurialism.

The second component of operational effectiveness is a suite of information technology tools and systems to enable our teams to successfully pursue and service desirable market opportunities. Over the next several years, we will invest in improving, adding to, or replacing our existing systems, to insure that we make the most of available data and analytics, provide high-value service to our clients, and access new market segments.

## A Letter from the Chief Executive Officer

The final component of operational effectiveness is ensuring our staff stays focused on value-creating activities. With improved IT systems, partnering and outsourcing, we can eliminate, automate or delegate to others those functions and tasks they can do better or more efficiently than we can, allowing us to redeploy resources to business development activities, and freeing our people to concentrate on doing what they do best, for the benefit of our clients and shareholders.

***Nurturing and developing our people.*** Sustainable success requires having multiple generations of talented individuals and a strong culture. Since its foundation, AXIS has attracted some of the best and brightest in our industry. We have a terrific team of talented people, many who brought with them, or have since established, invaluable customer relationships. These professionals have been instrumental in enabling AXIS to rapidly become a major global, diversified company.

But looking ahead, we must cultivate a deep bench of expertise behind our senior leaders to ensure the continuation of our capabilities across generations. We will need to keep these younger recruits and mid-career professionals sufficiently satisfied in their careers to remain at AXIS as they grow, yet equally challenged and motivated in order to continually increase their value and contribution to the Company. We will make incremental investments in training and development programs to better recruit, promote and retain the best team possible, with a deep and diverse set of experiences and skills.

### **Change and Continuity**

As I noted earlier, AXIS experienced a number of important internal developments within our top-level personnel. In addition to the CEO transition, and John Charman's resignation, we recruited John "Jay" Nichols to become CEO of our reinsurance business, Joe Henry to replace me as Chief Financial Officer, and Eric Gesick to be our Company's first-ever Group Chief Actuary. All three of these talented individuals are recognized industry veterans, and they have already made their mark on our organization. They join a strong Executive Committee, whose long tenure with AXIS and wealth of experience are a distinct differentiating strength for our Company.

I am also pleased that Michael Butt agreed to come back as our Chairman, providing continuity and the same invaluable counsel he has provided since the Company's earliest days.

Throughout all these changes, I am proud of the unwavering diligence of our people at every level throughout AXIS who maintained their focus on their day-to-day responsibilities and on their commitment to fulfilling our mission for the sake of our clients and business partners.

### **Outlook – Challenges and Opportunities**

Looking ahead, we see numerous challenges as well as promising opportunities. Among our main concerns is the continuing weakness in general economic activity, which limits the creation of new assets in need of risk transfer solutions. That serves to intensify competition as insurers vie for a stagnant pool of opportunities. Low interest rates will also continue to put pressure on our investment income and reduce our near-term ability to achieve our targeted returns.

## A Letter from the Chief Executive Officer

On the regulatory front, the proliferation of regulation will increase our costs of doing business and potentially limit our pursuit of certain opportunities, as each jurisdiction adds its own set of hurdles and obstructs capital from flowing freely to where it is needed most. Furthermore, we continue to prepare for compliance with Solvency II, whose likely postponement has added to the climate of uncertainty that may impact certain business decisions.

And yet, I am very optimistic about our future. Our competitive positioning is strong. We have several new initiatives

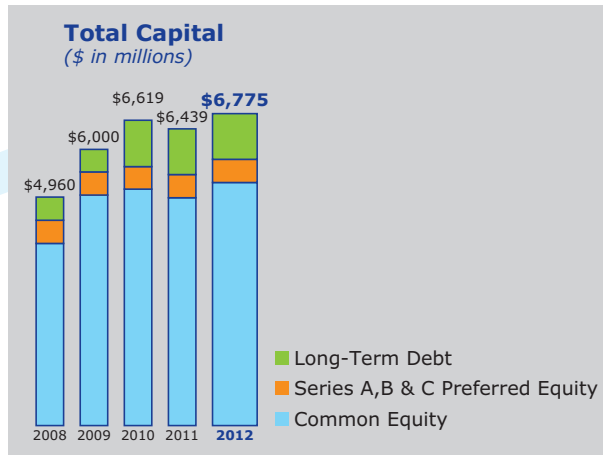
under development and also see plentiful avenues for growth in the existing markets in which we already participate. Pricing has improved over the past few quarters and we expect that trend to continue. The strength of our expertise and brand recognition, assisted by enhanced client outreach, will enable AXIS to further penetrate many sectors where we still have a relatively small market share, particularly in the United States.

In closing, I would like to thank all the employees at AXIS for their hard work during this eventful year. I would also like to extend my thanks to the Board for their insight and steadfast commitment in the interest of our shareholders. And, of course, I would like to thank our shareholders for their support as we work in earnest to maximize the value of their investment.

Sincerely,



Albert Benchimol  
President and Chief Executive Officer





**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**  
**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2012

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-31721

**AXIS CAPITAL HOLDINGS LIMITED**

(Exact name of registrant as specified in its charter)

**BERMUDA**

(State or other jurisdiction of incorporation or organization)

**98-0395986**

(I.R.S. Employer Identification No.)

**92 Pitts Bay Road, Pembroke, Bermuda HM 08**

(Address of principal executive offices and zip code)

**(441) 496-2600**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common shares, par value \$0.0125 per share	New York Stock Exchange
7.25% Series A preferred shares	New York Stock Exchange
6.875% Series C preferred shares	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the closing price as of the last business day of the registrant's most recently completed second fiscal quarter, June 30, 2012, was approximately \$3.5 billion.

At February 8, 2013, there were outstanding 122,053,575 common shares, \$0.0125 par value per share, of the registrant.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A relating to the annual meeting of shareholders to be held on May 3, 2013 are incorporated by reference in Part III of this Form 10-K.

# AXIS CAPITAL HOLDINGS LIMITED

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## Cautionary Statement Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the U.S. federal securities laws. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in the United States securities laws. In some cases, these statements can be identified by the use of forward-looking words such as “may”, “should”, “could”, “anticipate”, “estimate”, “expect”, “plan”, “believe”, “predict”, “potential” and “intend”. Forward-looking statements contained in this report may include information regarding our estimates of losses related to catastrophes and other large losses, measurements of potential losses in the fair value of our investment portfolio and derivative contracts, our expectations regarding pricing and other market conditions, our growth prospects, and valuations of the potential impact of movements in interest rates, equity prices, credit spreads and foreign currency rates. Forward-looking statements only reflect our expectations and are not guarantees of performance.

These statements involve risks, uncertainties and assumptions. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements. We believe that these factors include, but are not limited to, the following:

- the occurrence and magnitude of natural and man-made disasters,
- actual claims exceeding our loss reserves,
- general economic, capital and credit market conditions,
- the failure of any of the loss limitation methods we employ,
- the effects of emerging claims, coverage and regulatory issues, including uncertainty related to coverage definitions, limits, terms and conditions,
- the failure of our cedants to adequately evaluate risks,
- inability to obtain additional capital on favorable terms, or at all,
- the loss of one or more key executives,
- a decline in our ratings with rating agencies,
- loss of business provided to us by our major brokers,
- changes in accounting policies or practices,
- the use of industry catastrophe models and changes to these models,
- changes in governmental regulations,
- increased competition,
- changes in the political environment of certain countries in which we operate or underwrite business,
- fluctuations in interest rates, credit spreads, equity prices and/or currency values, and
- the other matters set forth under Item 1A, ‘*Risk Factors*’ and Item 7, ‘*Management’s Discussion and Analysis of Financial Condition and Results of Operations*’ included in this report.

We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

## PART I

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### ITEM 1. BUSINESS

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As used in this report, references to “we,” “us,” “our” or the “Company” refer to the consolidated operations of AXIS Capital Holdings Limited (“AXIS Capital”) and its direct and indirect subsidiaries and branches, including AXIS Specialty Limited (“AXIS Specialty Bermuda”), AXIS Specialty Limited (Singapore Branch), AXIS Specialty Europe SE (“AXIS Specialty Europe”), AXIS Specialty London, AXIS Specialty Australia, AXIS Specialty Insurance Company (“AXIS Specialty U.S.”), AXIS Re SE (“AXIS Re SE”), AXIS Reinsurance Company (“AXIS Re U.S.”), AXIS Reinsurance Company (Canadian Branch), AXIS Surplus Insurance Company (“AXIS Surplus”), AXIS Insurance Company (“AXIS Insurance Co.”), AXIS Re Europe, AXIS Specialty Finance LLC (“AXIS Specialty Finance”) and Dexta Corporation Pty Ltd (“Dexta”) unless the context suggests otherwise. Tabular dollars are in thousands. Amounts in tables may not reconcile due to rounding differences.

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#### **GENERAL**

AXIS Capital is the Bermuda-based holding company for the AXIS group of companies and was incorporated on December 9, 2002. AXIS Specialty Bermuda commenced operations on November 20, 2001. AXIS Specialty Bermuda and its subsidiaries became wholly owned subsidiaries of AXIS Capital pursuant to an exchange offer consummated on December 31, 2002. We provide a broad range of specialty (re)insurance on a worldwide basis, through operating subsidiaries and branch networks based in Bermuda, the United States, Canada, Europe, Australia and Singapore. We also maintain marketing offices in Brazil, France and Spain. Our business consists of two distinct global underwriting platforms, AXIS Insurance and AXIS Reinsurance.

The markets in which we operate have historically been cyclical. During periods of excess underwriting capacity, as defined by availability of capital, competition can result in lower pricing and less favorable policy terms and conditions for (re) insurers. During periods of reduced underwriting capacity, pricing and policy terms and conditions are generally more favorable for (re)insurers. Historically, underwriting capacity has been impacted by several factors, including industry losses, catastrophes, changes in legal and regulatory guidelines, investment results and the ratings and financial strength of competitors.

At December 31, 2012, we had common shareholders’ equity of \$5.3 billion, total capital of \$6.8 billion and total assets of \$18.9 billion.

#### **OUR BUSINESS STRATEGY**

We are a global insurer and reinsurer, with our mission being to provide our clients and distribution partners with a broad range of risk transfer products and services and meaningful capacity, backed by excellent financial strength. We manage our portfolio holistically, aiming to construct the optimum consolidated portfolio of funded and unfunded risks, consistent with our risk appetite and the development of our franchise. We nurture an ethical, entrepreneurial and disciplined culture that promotes outstanding client service, intelligent risk taking and the achievement of superior risk-adjusted returns for our shareholders. We believe that the achievement of our objectives will position us as a leading global, diversified specialty insurance and reinsurance company, as measured by quality, sustainability and profitability.

We aim to execute on the following six-point strategy:

*We offer a diversified range of products and services across market segments and geographies:* Our position as a well-balanced hybrid insurance and reinsurance company gives us insight into the opportunities and challenges in a variety of markets. With our origins in Bermuda, today we have locations across the U.S. and in Canada, while in Europe we have offices in Dublin, London and Zurich and newly established presences in Barcelona, Madrid and Paris. With a recently established reinsurance office in Sao Paulo, we are addressing opportunities throughout Latin America. We also operate a number of offices in Australia and our Singapore branch serves as our gateway to Asia.

*We underwrite a balanced portfolio of risks, including complex and volatile lines, moderating overall volatility with risk limits, diversification and risk management:* Risk management is a strategic priority embedded in our organizational structure and we are continuously monitoring, reviewing and refining our enterprise risk management practices. We combine judgment and experience with data-driven analysis, enhancing our overall risk selection process.

*We modulate our risk appetite and deployment of capital across the underwriting cycle, commensurate with available market opportunities and returns:* Closely attuned to market dynamics, we recognize opportunities as they develop and react quickly as new trends emerge. Our risk analytics provide important and continuous feedback, further assisting with the ongoing assessment of our risk appetite and strategic capital deployment. We have excelled in extending our product lines, finding new distribution channels and entering new geographies. When we do not find sufficiently attractive uses for our capital, we return excess capital back to our shareholders through share repurchases or dividends.

*We develop and maintain deep and trustful relationships with clients and distribution partners, offering outstanding service and effective solutions for risk management needs:* Our management team has extensive industry experience, deep product knowledge and long-standing market relationships. We primarily transact in specialty markets, where risks are complex. Our intellectual capital and proven client-service capability attract clients and distribution partners looking for solutions.

*We maintain excellent financial strength, characterized by financial discipline and transparency:* Our total capital of \$6.8 billion at December 31, 2012, our high-quality and liquid investment portfolio and our operating subsidiary ratings of "A+" ("Strong") by Standard & Poor's and "A" ("Excellent") with a positive outlook by A.M. Best are key indicators of our financial strength.

*We attract, develop, retain and motivate an excellent team:* We aim to attract and retain the best people in the industry and to motivate our employees to make decisions that are in the best interest of both our customers and shareholders. We nurture an ethical, risk-aware, achievement-oriented culture that promotes professionalism, responsibility, integrity, discipline and entrepreneurialism. As a result, we believe that our staff is well-positioned to make the best underwriting and strategic decisions for the Company.

Our key metrics for performance measurement include return on average common equity ("ROACE") and total value creation, which measures the growth in our diluted book value per common share plus accumulated dividends declared. We recognize that the nature of underwriting cycles and the frequency or severity of large loss events in any one year may make it difficult to achieve a profitability target in any specific period and, therefore, we set a ROACE target of 15% over the full underwriting cycle.

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## **SEGMENT INFORMATION**

Our underwriting operations are organized around two global underwriting platforms, AXIS Insurance and AXIS Reinsurance. Therefore we have two reportable segments, insurance and reinsurance. We do not allocate our assets by segment, with the exception of goodwill and intangible assets, as we evaluate the underwriting results of each segment separately from the results of our investment portfolio. For additional information relating to our reportable segments, see Note 3 to our Consolidated Financial Statements presented under Item 8, 'Financial Statements and Supplementary Data' and 'Management's Discussion and Analysis of Financial Condition and Results of Operations' under Item 7.

The table below presents gross premiums written in each of our reportable segments for each of the most recent three years.

<b>Year ended December 31,</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Insurance	\$ 2,309,481	\$ 2,121,829	\$ 1,916,116
Reinsurance	1,830,162	1,974,324	1,834,420
<b>Total</b>	<b>\$ 4,139,643</b>	<b>\$ 4,096,153</b>	<b>\$ 3,750,536</b>

## Insurance Segment

### Lines of Business and Distribution

Our insurance segment operates through offices in Bermuda, the United States, Canada, Europe, Australia and Singapore and offers specialty insurance products to a variety of niche markets on a worldwide basis. The following are the lines of business in our insurance segment:

- *Property*: provides physical loss or damage, business interruption and machinery breakdown coverage for virtually all types of property, including commercial buildings, residential premises, construction projects and onshore energy installations. This line of business consists of both primary and excess risks, some of which are catastrophe-exposed.
- *Marine*: provides coverage for traditional marine classes, including offshore energy, cargo, liability, recreational marine, fine art, specie, hull and war. Offshore energy coverage includes physical damage, business interruption, operators extra expense and liability coverage for all aspects of offshore upstream energy, from exploration and construction through the operation and distribution phases.
- *Terrorism*: provides coverage for physical damage and business interruption of an insured following an act of terrorism.
- *Aviation*: provides hull and liability and specific war coverage primarily for passenger airlines but also for cargo operations, general aviation operations, airports, aviation authorities, security firms and product manufacturers.
- *Credit and political risk*: provides credit and political risk insurance products for banks and corporations. Coverage is provided for a range of risks including sovereign default, credit default, political violence, currency inconvertibility and non-transfer, expropriation, aircraft non-repossession and contract frustration due to political events. The credit insurance coverage is primarily for lenders seeking to mitigate the risk of non-payment from their borrowers in emerging markets. For the credit insurance contracts, it is necessary for the buyer of the insurance (most often a bank) to hold an insured asset (most often an underlying loan) in order to claim compensation under the insurance contract. The traditional political risk coverage provides protection against sovereign actions that result in the impairment of cross-border investments for banks and major corporations (known as "CEND" coverages).
- *Professional lines*: provides coverage for directors' and officers' liability, errors and omissions liability, employment practices liability, fiduciary liability, crime, professional indemnity and other financial insurance related coverages for commercial enterprises, financial institutions and not-for-profit organizations. This business is predominantly written on a claims-made basis.
- *Liability*: primarily targets primary and low/mid-level excess and umbrella commercial liability risks in the U.S. excess and surplus lines markets. Target industry sectors include construction, manufacturing, transportation and trucking and other services. We also target middle to high excess liability business in the London and Bermuda wholesale markets and primary and excess business in the Canadian marketplace.
- *Accident & health*: includes accidental death, travel insurance and specialty health products for employer and affinity groups, financial institutions, schools and colleges, as well as accident & health reinsurance for catastrophic or per life events on a quota share and/or excess of loss basis, with aggregate and/or per person deductibles.

We produce business primarily through wholesale and retail brokers worldwide. Some of our insurance products are also distributed through managing general agents ("MGAs") and underwriters ("MGUs"). In the U.S., we have the ability to write business on an admitted basis using forms and rates as filed with state insurance regulators and on a non-admitted, or surplus lines, basis providing flexibility in forms and rates, as these are not filed with state regulators. Having non-admitted capability in the U.S. provides the pricing flexibility needed to write non-standard coverages. Substantially all of our insurance business is subject to aggregate limits, in addition to event limits.

Gross premiums written by broker, shown individually where premiums were 10% or more of the total in any of the last three years, were as follows:

Year ended December 31,	2012		2011		2010	
Aon	\$ 413,471	18%	\$ 397,189	19%	\$ 303,264	16%
Marsh	427,565	19%	388,834	18%	363,454	19%
Willis	217,631	9%	203,011	10%	180,583	9%
Other brokers	1,060,864	46%	881,285	41%	844,509	44%
Managing general agencies and underwriters	189,950	8%	251,510	12%	224,306	12%
<b>Total</b>	<b>\$ 2,309,481</b>	<b>100%</b>	<b>\$ 2,121,829</b>	<b>100%</b>	<b>\$ 1,916,116</b>	<b>100%</b>

No customer accounted for more than 10% of the gross premiums written in the insurance segment.

### Competitive Environment

We operate in highly competitive markets. In our insurance segment, where competition is focused on price as well as availability, service and other considerations, we compete with U.S.-based companies with global insurance operations, as well as non-U.S. global carriers and indigenous companies in regional and local markets. We believe we achieve a competitive advantage through a strong capital position and the strategic and operational linking of our practices, which allows us to design insurance programs on a global basis in alignment with the global needs of many of our clients.

### Reinsurance Segment

#### Lines of Business and Distribution

Our reinsurance segment operates through offices in Bermuda, the United States, Switzerland, Singapore, Brazil, and Canada. We write business on an excess of loss basis, whereby we typically provide an indemnification to the reinsured entity for a portion of losses, both individually and in the aggregate, in excess of a specified individual or aggregate loss deductible. We also write business on a proportional basis, receiving an agreed percentage of the underlying premium and accepting liability for the same percentage of incurred losses. Our business is written on a treaty basis and primarily produced through reinsurance brokers worldwide.

Our reinsurance segment provides non-life reinsurance to insurance companies on a worldwide basis. The following are the lines of business in our reinsurance segment:

- *Catastrophe*: provides protection for most catastrophic losses that are covered in the underlying insurance policies written by our cedants. The exposure in the underlying policies is principally property exposure but also covers other exposures including workers compensation, personal accident and life. The principal perils in this portfolio are hurricane and windstorm, earthquake, flood, tornado, hail and fire. In some instances, terrorism may be a covered peril or the only peril. We underwrite catastrophe reinsurance principally on an excess of loss basis.
- *Property*: provides coverage for property damage and related losses resulting from natural and man-made perils contained in underlying personal and commercial policies. While our predominant exposure is to property damage, other risks, including business interruption and other non-property losses, may also be covered when arising from a covered peril. While our most significant exposures typically relate to losses from windstorms, tornadoes and earthquakes, we are exposed to other perils such as freezes, riots, floods, industrial explosions, fires, hail and a number of other loss events. We assume business on both a proportional and excess of loss basis.
- *Professional Lines*: covers directors' and officers' liability, employment practices liability, medical malpractice, professional indemnity, environmental liability and miscellaneous errors and omissions insurance risks. The underlying business is predominantly written on a claims-made basis. Business is written on both a proportional and excess of loss basis.

- *Credit and Bond*: consists of reinsurance of trade credit insurance products and includes both proportional and excess of loss structures. The underlying insurance indemnifies sellers of goods and services in the event of a payment default by the buyer of those goods and services. Also included in this line of business is coverage for losses arising from a broad array of surety bonds issued by insurers to satisfy regulatory demands or contract obligation in a variety of jurisdictions around the world. Bonding is also known as surety insurance.
- *Motor*: provides coverage to cedants for motor liability and property damage losses arising out of any one occurrence. The occurrence can involve one or many claimants where the ceding insurer aggregates the claims from the occurrence.
- *Liability*: provides coverage to insurers of standard casualty business, excess and surplus casualty business and specialty casualty programs. The primary focus of the underlying business is general liability, although workers compensation and auto liability are also written.
- *Engineering*: provides coverage for all types of construction risks and risks associated with erection, testing and commissioning of machinery and plants during the construction stage. This line of business also includes coverage for losses arising from operational failures of machinery, plant and equipment and electronic equipment as well as business interruption.
- *Other*: includes aviation, marine, personal accident and crop reinsurance. Crop reinsurance provides coverage for risks associated with the production of food and fiber on a global basis for primary insurance companies writing multi-peril crop insurance, crop hail, and named peril covers, as well as custom risk transfer mechanisms for agricultural dependent industries with exposures to crop yield and/or price deviations. We provide both proportional and aggregate stop loss reinsurance.

Gross premiums written by broker, shown individually where premiums were 10% or more of the total in any of the last three years, were as follows:

Year ended December 31,	2012		2011		2010	
Aon	\$ 712,588	39%	\$ 727,102	37%	\$ 622,703	34%
Marsh	468,993	26%	566,451	29%	547,470	30%
Willis	299,097	16%	311,241	16%	305,474	16%
Other brokers	212,941	12%	185,632	9%	198,779	11%
Direct	136,543	7%	183,898	9%	159,994	9%
<b>Total</b>	<b>\$ 1,830,162</b>	<b>100%</b>	<b>\$ 1,974,324</b>	<b>100%</b>	<b>\$ 1,834,420</b>	<b>100%</b>

No customer accounted for more than 10% of the gross premiums written in the reinsurance segment.

#### Competitive Environment

In our reinsurance segment where competition tends to be focused on availability, service, financial strength and increasingly price, we compete with major U.S. and non-U.S. reinsurers as well as reinsurance departments of numerous multi-line insurance organizations. We believe that we achieve a competitive advantage through our strong capital position, as well as our technical expertise that allows us to respond quickly to customer needs and provide quality and innovative underwriting solutions. In addition, our customers highly value our exemplary service (including excellent claims management, promptly paying valid claims) and financial strength ratings.

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#### **RESERVE FOR UNPAID LOSSES AND LOSS EXPENSES**

We establish a reserve for losses and loss expenses (“loss reserves”) for claims that arise from our (re)insurance products. These loss reserves are balance sheet liabilities representing management’s best estimate of the amounts we will be required to pay in the future for claims that have occurred on or before the balance sheet date, whether already reported to us (“case reserves”) or not yet reported to us (“IBNR reserves”).

The table on the following page presents the development of our loss reserves since inception. This table does not present accident year or underwriting year development data.

The top line of the table shows our initial reported gross loss reserves at the end of each year and is reconciled to our net unpaid loss reserves by adjusting for reinsurance recoverable on unpaid losses. Our net unpaid loss reserves represent the estimated amount of net losses and loss expenses arising in the current year and all prior years that remain unpaid at the balance sheet date.

The next section of the table shows our re-estimated net unpaid loss reserves at the end of each succeeding year. The cumulative redundancies on net reserves reflect cumulative differences between our initial net loss reserve estimates and the currently re-estimated net loss reserves. Annual changes in these estimates are referred to as net prior year reserve development and are recognized in our Consolidated Statements of Operations during the year of the re-estimation; these amounts are the net result of a number of underlying movements, both favorable and adverse.

The lower portion of the table shows the portion of the net unpaid loss reserve estimate that was paid (i.e. claims paid) by the end of each subsequent year. This section of the table provides an indication of the portion of the re-estimated net unpaid loss reserve that is settled and is unlikely to develop in the future.

Our historical net paid losses and loss expenses are but one of many quantitative and qualitative factors considered in establishing the amount of our loss reserves; see the *'Critical Accounting Estimates – Reserve for Losses and Loss Expenses'* section of Item 7 for further information on the establishment of management's best estimate of loss reserves on a quarterly basis. For additional information regarding the significant underlying movements in our estimate of loss reserves during the most recent three years, refer to the *'Underwriting Results – Group – Underwriting Expenses'* section of Item 7. Note that the conditions and trends that affected the development of our loss reserves in the past may not necessarily recur in the future. Accordingly, it is not appropriate to project future redundancies based on the historical experience in this table.

Also included in the table is the impact of foreign exchange rate movements during each year presented. Portions of our loss reserves relate to claims expected to be paid in currencies other than our reporting currency, the U.S. dollar. Movements in foreign exchange rates, therefore, result in variations in our estimated net loss reserves. Such variations are recognized as they arise, in our Consolidated Statements of Operations. For example, during the year ended December 31, 2012, appreciation in the rates of exchange between the Sterling and the euro against the U.S. dollar drove a \$71 million increase in our net loss reserves established prior to and during 2012. To minimize the impact of foreign exchange driven volatility associated with our loss reserves denominated in foreign currencies, we generally hold cash and investments and/or derivative instruments denominated in the same currencies.

At the bottom of the table is a reconciliation of our re-estimated gross loss reserves with our re-estimated net unpaid loss reserves as of December 31, 2012. As our ceded reinsurance programs cover different lines of business and accident years, net and gross loss experience will not necessarily develop proportionately.

To facilitate an understanding of the information provided in the table, the following is an example using net loss reserves established at December 31, 2005. It can be seen from the top section of the table that at December 31, 2005, our estimate of loss reserves, net of unpaid reinsurance recoverable, was \$3,270 million.

The next section of the table shows that our current estimate of net unpaid loss reserves for events occurring on or before December 31, 2005 is \$2,329 million. The cumulative redundancy from our initial estimate of \$941 million was recognized over the course of the following seven calendar years: \$217 million in 2006, \$115 million in 2007, \$188 million in 2008, \$221 million in 2009, \$100 million in 2010, \$64 million in 2011 and the remaining \$36 million in 2012.

The following section of the table presents our cumulative claims paid at the end of each subsequent year. Of the net \$1,979 million we have paid subsequent to December 31, 2005, \$880 million was paid in 2006, \$413 million was paid in 2007, \$208 million in 2008, \$270 million in 2009, \$102 million in 2010, \$58 million in 2011 and the remaining \$48 million in 2012.

In summary, at December 31, 2005, we estimated our net loss reserves payable for claims arising from loss events occurring on or before that date were \$3,270 million. At December 31, 2012, we have paid \$1,979 million towards settlement of these claims and now believe that we will ultimately pay \$2,329 million for full settlement.

It is important to note that the redundancies in our loss reserves noted in the table are cumulative and, therefore, should not be added together. In 2012, we revised our cumulative December 31, 2005 estimate of net loss reserves from \$2,366 million to \$2,329 million. This favorable development is also included in each column to the right of the December 31, 2005 column, recognizing that the redundancy was also embedded in our estimated loss reserves at December 31 of each of the following years.

Year ended December 31,

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Gross reserves for losses and loss expenses	\$ 215,934	\$ 992,846	\$ 2,404,560	\$ 4,743,338	\$ 5,015,113	\$ 5,587,311	\$ 6,244,783	\$ 6,564,133	\$ 7,032,375	\$ 8,425,045	\$ 9,058,731
Reinsurance recoverable	(1,703)	(124,899)	(564,314)	(1,473,241)	(1,310,904)	(1,297,539)	(1,314,551)	(1,381,058)	(1,540,633)	(1,736,823)	(1,825,617)
Net reserves for unpaid losses and loss expenses	214,231	867,947	1,840,246	3,270,097	3,704,209	4,289,772	4,930,232	5,183,075	5,491,742	6,688,222	7,233,114
Net reserves re-estimated as of:											
1 Year later	\$ 158,443	\$ 686,235	\$ 1,457,250	\$ 3,053,561	\$ 3,367,232	\$ 3,913,485	\$ 4,507,061	\$ 4,870,020	\$ 5,234,281	\$ 6,443,382	
2 Years later	141,290	539,110	1,179,851	2,938,734	3,076,025	3,533,313	4,235,219	4,623,109	5,018,121		
3 Years later	109,711	434,221	1,080,083	2,750,476	2,773,158	3,281,011	4,007,046	4,440,229			
4 Years later	97,981	386,029	962,910	2,529,259	2,576,226	3,074,010	3,841,717				
5 Years later	96,864	347,544	889,190	2,429,724	2,445,150	2,957,939					
6 Years later	96,179	326,729	863,225	2,365,515	2,376,807						
7 Years later	92,517	315,548	839,214	2,328,729							
8 Years later	89,664	312,628	823,131								
9 Years later	89,218	303,022									
10 Years later	87,818										
Cumulative redundancy on net reserves	\$ 126,413	\$ 564,925	\$ 1,017,115	\$ 941,368	\$ 1,327,402	\$ 1,331,833	\$ 1,088,515	\$ 742,846	\$ 473,621	\$ 244,840	
Cumulative net paid losses as of:											
1 Year later	\$ 47,838	\$ 108,547	\$ 291,695	\$ 880,120	\$ 636,266	\$ 615,717	\$ 982,036	\$ 1,042,890	\$ 953,035	\$ 1,299,384	
2 Years later	56,781	169,853	432,963	1,292,738	999,280	1,147,990	1,539,713	1,592,741	1,601,082		
3 Years later	66,569	202,136	511,325	1,500,652	1,355,821	1,461,494	1,936,555	2,002,373			
4 Years later	63,835	221,644	574,874	1,771,039	1,513,350	1,655,688	2,221,221				
5 Years later	72,323	245,978	615,920	1,873,052	1,625,423	1,807,075					
6 Years later	80,099	254,676	650,110	1,930,682	1,705,987						
7 Years later	81,130	263,412	677,351	1,979,439							
8 Years later	83,276	269,909	698,846								
9 Years later	83,272	276,406									
10 Years later	83,409										
Impact of foreign exchange and other	\$ 961	\$ 3,240	\$ 4,664	\$ (13,329)	\$ 23,581	\$ 28,588	\$ (133,345)	\$ 82,018	\$ (25,282)	\$ (16,462)	\$ 71,084
Gross reserve for losses and loss expenses re-estimated	\$ 108,876	\$ 403,629	\$ 1,337,487	\$ 3,685,924	\$ 3,495,268	\$ 4,011,136	\$ 5,022,880	\$ 5,760,003	\$ 6,517,188	\$ 8,110,259	
Reinsurance recoverable re-estimated	(21,058)	(100,607)	(514,356)	(1,357,195)	(1,118,461)	(1,053,197)	(1,181,163)	(1,319,774)	(1,499,067)	(1,666,877)	
Net reserve for unpaid losses and loss expenses re-estimated	87,818	303,022	823,131	2,328,729	2,376,807	2,957,939	3,841,717	4,440,229	5,018,121	6,443,382	
Cumulative redundancy on gross reserve	\$ 107,058	\$ 589,217	\$ 1,067,073	\$ 1,057,414	\$ 1,519,845	\$ 1,576,175	\$ 1,221,903	\$ 804,130	\$ 515,187	\$ 314,786	



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## **CASH AND INVESTMENTS**

We seek to balance the investment portfolios' objectives of (1) increasing book value with (2) the generation of relatively stable investment income, while providing sufficient liquidity to meet our claims and other obligations. Liquidity needs arising from potential claims are of primary importance and are considered in asset class participation and the asset allocation process. Intermediate maturity investment grade fixed income securities have duration characteristics similar to our expected claim payouts and are, therefore, central to our investment portfolio's asset allocation. At December 31, 2012, the duration of our fixed maturities portfolio was approximately 3 years, which approximates the estimated duration of our net insurance liabilities.

To diversify risk and optimize the growth in our book value, we may invest in other asset classes such as equity securities, high yield securities and alternative investments (e.g. hedge funds) which provide higher potential total rates of return. Such individual investment classes involve varying degrees of risk, including the potential for more volatile returns and reduced liquidity. However, as part of a balanced portfolio, they also provide diversification from interest rate and credit risk.

With regard to our investment portfolio, we utilize third party investment managers for security selection and trade execution functions, subject to our guidelines and objectives for each asset class. This enables us to actively manage our investment portfolio with access to top talents specializing in various products and markets. We select the managers based on various criteria including investment style, performance history and corporate governance. Additionally, we monitor approved investment asset classes for each subsidiary through analysis of our operating environment, including expected volatility of cash flows, overall capital position, regulatory and rating agency considerations. The Finance Committee of our Board of Directors approves our overall group asset allocation targets and investment policy to ensure that they are consistent with our overall goals, strategies and objectives. We also have an Investment and Finance Committee, comprising senior management, which oversees the implementation of our investment strategy.

For additional information regarding the investment portfolio refer to the '*Management's Discussion and Analysis of Financial Condition and Results of Operations – Cash and Investments*' section under Item 7 and Note 5 – Investments to our Consolidated Financial Statements presented under Item 8.

Refer to '*Risk and Capital Management*' for details relating to the management of our investment risk.

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## RISK AND CAPITAL MANAGEMENT

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### **Risk management framework – Overview**

#### ***Mission and objectives***

The mission of Enterprise Risk Management (ERM) at AXIS is to promptly identify, measure, report and monitor risks that affect the achievement of our strategic, operational and financial objectives. The key objectives of our risk management framework are to:

- Protect our capital base and earnings by monitoring our risks against our stated risk tolerances;
- Promote a sound risk management culture through disciplined and informed risk taking;
- Enhance value creation and contribute to an optimal risk-return profile by providing the basis for efficient capital deployment;
- Support our group-wide decision making process by providing reliable and timely risk information; and
- Safeguard AXIS's reputation.

#### ***Risk governance***

At the heart of our risk management framework is a governance process with responsibilities for taking, managing, monitoring and reporting risks. We articulate the roles and responsibilities for risk management throughout the organization, from the Board of Directors and the Chief Executive Officer to our business and functional areas, thus embedding risk management throughout the business (see '*Risk Governance and Risk Management Organization*' section).

To support our governance process, we rely on our documented policies and guidelines. Our Risk Standards specify our principles, risk appetite and tolerances for managing individual and aggregate risks. We also have procedures to approve exceptions and procedures for referring risk issues to senior management and the Board of Directors. Our qualitative and quantitative risk reporting framework provides transparency and early warning indicators to senior management with regard to our overall risk profile, adherence to risk tolerances and improvement actions both at an operating entity and Group level.

Various governance and control bodies (such as Management Audit Committees) coordinate to help to ensure that objectives are being achieved, risks are identified and appropriately managed and internal controls are in place and operating effectively.

#### ***Internal capital model***

An important aspect to our risk management framework is our internal capital model. Utilizing this modeling framework provides us with a holistic view of the capital we put at risk in any year by allowing us to understand the relative interaction among the risks impacting us. This integrated approach recognizes that a single risk factor can affect different sub-portfolios and that different risk factors can have different mutual dependencies. We attempt to continually review and strengthen the capabilities, functionality and user benefits of our internal capital model framework as our business, risk landscape and external environment continue to evolve.

As well as being used to measure capital adequacy (see '*Capital Management*' section), our internal capital model is used as a tool in managing our business and for strategic planning via capital allocations and through to portfolio monitoring, investment asset allocations and transaction evaluations.

#### ***Risk diversification***

As a global (re)insurer offering a variety of products across different businesses, diversification is a key component of our business model and risk framework. Diversification enhances our ability to manage our risks by limiting the impact of a single event and contributing to relatively stable long-term results and general risk profile. The degree to which the diversification effect can be realized depends not only on the correlation between risks but also the level of relative concentration of those risks. Therefore, our aim is to maintain a balanced risk profile without any disproportionately large risks. Our internal capital model considers the level of correlation and diversification between individual risks and we

measure concentration risk consistently across our business units in terms of pre and post diversified internal risk capital requirements.

### ***Risk appetite and limit framework***

Our integrated risk management framework considers material risks in our business either from investments, underwriting or in our operations across the world. Large risks that might accumulate and have the potential to produce substantial losses are subject to our global risk appetite and limit framework. Our risk appetite, as authorized by our Board of Directors, represents the amount of risk that we are willing to accept within the constraints imposed by our capital resources as well as the expectations of our stakeholders as to the type of risk we hold within our business. At an annual aggregated level, we manage our total risk exposure so that the potential financial loss from all risks in any one year (at a group and operating entity level) is unlikely to exceed a defined percentage of our total capital at different return periods.

Specific risk limits are defined and translated into a consistent framework across our identified risk categories and across our operating entities, and are intended to limit the impact of individual risk types or accumulations of risk. Individual limits are established through an iterative process to ensure that the overall framework complies with our group-wide requirements on capital adequacy and risk accumulation.

We monitor risk, through, for example, risk dashboards and limit consumption reports. These are intended to allow us to detect potential deviations from our internal risk limits at an early stage.

### **External perspectives**

Various external stakeholders, among them regulators, rating agencies, investors and accounting bodies, are placing increasing emphasis on the importance of sound risk management in our industry.

Evolving regulatory regimes, such as Solvency II in the European Union (“EU”) and the equivalent framework in Bermuda, emphasize a risk-based and economic approach, based on comprehensive quantitative and qualitative assessments and reports. Our internal capital model framework, while incorporating our internal approach to managing risks, also reflects our current interpretation of the evolving Solvency II and related standards.

### **Risk governance and risk management organization**

The key elements of our governance framework, as it relates specifically to risk management, are described below.

#### ***Board of Directors’ Level***

Our Board of Directors has oversight responsibility for the Group’s risk management. It approves any changes to the guidelines and key principles of our risk framework. The Risk Committee of our Board (‘Risk Committee’) which serves as a focal point for this oversight, recommends to the Board any changes to the Group’s risk tolerances, reviews the measurement of adherence to these, monitors the aggregation of risk, and reviews top risk issues and exposures. The Risk Committee further reviews the Group’s general risk policies and procedures to satisfy itself that effective systems of risk management have been established and are maintained.

The Risk Committee assesses the independence and objectivity of our Group Risk Management function (‘Group Risk’), approves its terms of reference and reviews its ongoing activities. The Risk Committee receives regular reports from Group Risk and assesses whether significant risk issues are being addressed by management.

The Finance Committee of our Board oversees the Group’s investment of funds and adequacy of financing facilities. This includes approval of the Group’s strategic asset allocation plan. The Risk Committee ensures compliance with the Group’s risk framework. The Audit Committee of our Board, which is supported by our internal audit function, is responsible for overseeing internal controls and compliance procedures and also reviews with management and the Chairman of the Risk Committee the Group’s guidelines and policies regarding risk assessment and risk management.

### ***Group executive level***

Our management Executive Committee formulates our business objectives and risk strategy within the overall risk appetite set by our Board. It allocates capital resources and limits across the Group, with the objective of balancing return and risk. While the management Executive Committee is responsible overall for risk management, it has delegated some authority to various committees. Three Executive level committees focus on the Group's risk exposure:

- Our Risk Management Committee (RMC) has responsibility for reviewing the allocation of capital, approving individual risk limits and determining changes to our internal risk capital methodology. The RMC also reviews new business plans in the context of our risk framework and defined risk appetite. Further, the RMC reviews and advises management with respect to certain individual transactions in accordance with the quantitative and qualitative criteria outlined in our business referral guidelines.
- Our Investment & Finance Committee oversees the Group's investment activities by, among other things, monitoring market risks, the performance of our investment managers and the Group's asset-liability management, liquidity positions and investment policies and guidelines. The Investment & Finance Committee also prepares the Group's strategic asset allocation and presents it to the Finance Committee of the Board for approval.
- Our Reinsurance Security Committee (RSC) sets out the financial security requirements of our reinsurance counterparties and recommends tolerance levels for different types of ceded business.

### ***Group risk management organization***

As a general principle, management in each of our business units is responsible in the first instance for both the risks and returns of its decisions. Management is the 'owner' of risk management processes and is responsible for managing our business within defined risk tolerances.

Our Chief Risk Officer leads our independent Group Risk function, which is responsible for oversight of risk taking activity across the Group and providing guidance and support for risk management practices. Group Risk is responsible for developing methods and processes for identifying, measuring, managing and reporting risk. This forms the basis for informing the Risk Committee and RMC of the Group's risk profile. Group Risk develops our risk management framework and oversees the adherence to this framework at the Group and operating entity level. Our Chief Risk Officer regularly reports risk matters to the Chief Executive Officer, management Executive Committee and the Risk Committee.

Our global risk management network also includes Risk Officers within our business units and investment department. These local risk units, which have regular and close interaction with Group Risk, assist with embedding the risk management framework into our business.

Internal Audit, an independent, objective function, reports to the Audit Committee of the Board on the effectiveness of our risk management framework. This includes assurance that key business risks have been adequately identified and managed appropriately and that our system of internal control is operating effectively. Internal audit also provides an independent validation of our internal capital model and coordinates risk-based audits, compliance reviews, and other specific initiatives to evaluate and address risk within targeted areas of our business.

Our risk governance structure is further complemented by our Legal Department which seeks to mitigate legal and regulatory compliance risks with support from other departments. This includes ensuring that significant developments in law and regulations are observed and that we react appropriately to impending legislative changes and applicable court rulings.

### **Risk Landscape**

Our risk landscape comprises strategic, insurance, credit, market, operational, liquidity and other risks that arise as a result of doing business. We provide definitions of these risk categories in the following sections as well as our related risk management. Across these risk categories, we identify and evaluate emerging threats and opportunities through a systemic framework that includes the assessment of potential surprise factors that could affect known loss potentials.

## **Strategic Risk**

Strategic risk is the risk of loss arising from our inability to pursue an opportunity, implement appropriate business plans or adapt to changes in the external environment. We assess any strategic action in the context of our risk framework by reviewing the impact of the strategy, including any incremental risk, prior to the action taking place. Additionally, what we learn about risk through our monitoring, reporting and control processes provides important feedback in terms of reevaluating our risks and, therefore, reevaluating our business strategy.

We undertake a strategic business planning process on an annual basis which is overseen by our management Executive Committee, business unit leadership and our Board of Directors. Our internal capital model provides an input into this process by providing an assessment as to whether our prospective business and investment strategies are in line with our defined risk appetite and objectives, at both the group and operating entity level. The model also provides a basis for optimizing our risk-return profile by providing consistent risk measurement across the Group. The model outputs are reviewed and supplemented with management's judgment and business experience and expertise.

We specifically evaluate the risks of potential merger and acquisition transactions both from a quantitative and qualitative perspective. We conduct risk assessments of merger and acquisition transactions to evaluate risks specifically related to the integration of acquiring a business. Additionally, we have governance procedures in place to review and approve potential new initiatives within our existing businesses in order to evaluate whether the risks are well understood and justified by the potential rewards.

## **Insurance Risk**

Insurance risk is the inherent uncertainty as to the occurrence, amount and timing of insurance liabilities transferred to us through the underwriting process.

Since our inception in 2001, we have expanded our international underwriting presence, with offices in Bermuda, the U.S., Europe, Singapore, Canada, Latin America and Australia. Our disciplined underwriting approach coupled with a group-wide peer review process has enabled us to manage this growth in a controlled and consistent manner.

A critical element of our management of insurance risk is our peer review process which allows us to monitor market conditions and aggregations risk-by-risk, at the highest levels within the Group. Underwriting is also conducted in accordance with other protocols, including underwriting guidelines which provide a framework for consistent pricing and risk analysis and ensuring alignment to our risk appetite. Our business units set limits on underwriting capacity, and cascade authority to individuals based on their specific expertise.

We also have significant audit coverage across our business units, including Management Initiated Audits ("MIAs"). MIAs are audits of underwriting and claims files performed by teams independent of those who originated the transactions, the purpose of which is to test the robustness of our underwriting, claims and operating processes and to recognize any early indicators of future trends in our operational risk.

## ***Reinsurance purchasing***

Another key component of our mitigation of insurance risk is the purchase of reinsurance on both a treaty (covering a portfolio of risks) and facultative (single risk) basis. We primarily purchase reinsurance within AXIS Insurance, on both our short and long tail lines of business.

For treaty reinsurance, we purchase both proportional and non-proportional cover. Under proportional reinsurance, we cede an agreed proportion of the premiums and the losses and loss adjustment expenses on the policies we underwrite. We primarily use proportional reinsurance on our liability and professional lines portfolio, whereby we protect against higher loss frequency rather than specific events. We also use non-proportional reinsurance, whereby losses up to a certain amount (i.e. our retention) are borne by us. Using non-proportional reinsurance we can limit our liability with a retention which reflects our willingness and ability to bear risk, and therefore in line with our risk appetite. We primarily purchase the following forms of non-proportional reinsurance:

- Excess of loss per risk – the reinsurer indemnifies us for loss amounts of all individual policies effected, defined in the treaty terms and conditions. Per risk treaties are an effective means of risk mitigation against large single losses (e.g. a large fire claim).

- Catastrophe excess of loss – provides aggregate loss cover for our insurance portfolio against the accumulation of losses incurred from a single event (e.g. windstorm).

We have a centralized Ceded Reinsurance department which coordinates external treaty reinsurance purchasing across the Group and is overseen by our Reinsurance Purchasing Group (RPG), in conjunction with the RSC. The RPG, which includes among others, our Chief Executive Officer, Chief Risk Officer and business unit leadership, approves each treaty placement, and aims to ensure that appropriate diversification exists within our counterparty panels.

Facultative reinsurance is case by case risk transfer which we may also use to complement treaty reinsurance by covering additional risks above and beyond what is already covered in treaties. Facultative reinsurance is monitored through our peer review processes.

### *Natural peril catastrophe risk*

Natural catastrophes such as earthquakes, storms and floods represent a challenge for risk management due to their accumulation potential and occurrence volatility. In managing natural catastrophe risk, our internal risk tolerance framework aims to limit both the loss of capital due to a single event and the loss of capital that would occur from multiple (but perhaps smaller events) in any year. Within this framework, we have an established risk tolerance for single event, single zone probable maximum loss (PML) within defined zones and at various return periods. For example, at the 1-in-250 year return period, we are not willing to expose more than 25% of our prior quarter-end common-equity from a single event within a single zone.

The table below shows our mean PML estimates for certain defined single zones which correspond to peak industry catastrophe exposures at January 1, 2013 and 2012:

At January 1, (in millions of U.S. dollars)		2013			2012		
		50 Year Return Period	100 Year Return Period	250 Year Return Period	50 Year Return Period	100 Year Return Period	250 Year Return Period
Single zone/single event	Perils						
Southeast	U.S. Hurricane	\$ 500	\$ 714	\$ 955	\$ 488	\$ 689	\$ 981
Northeast	U.S. Hurricane	53	200	446	100	324	631
Mid-Atlantic	U.S. Hurricane	123	400	875	190	485	1,014
Gulf of Mexico	U.S. Hurricane	336	500	831	334	457	743
California	Earthquake	412	590	889	435	625	971
Europe	Windstorm	308	414	520	242	355	538
Japan	Earthquake	246	336	547	188	296	565
Japan	Windstorm	75	144	201	74	121	144

The return period refers to the frequency with which losses of a given amount or greater are expected to occur. A zone is a geographic area in which the insurance risks are considered to be correlated to a single catastrophic event. Estimated losses from a modeled event are grouped into a single zone, as shown above, based on where the majority of the total estimated industry loss is expected to occur. In managing zonal concentrations, we aim to ensure that the geography of single events is suitably captured, but distinct enough that they track specific types of events. For example, our definition of Southeast wind encompasses five states, including Florida, while our definition of Gulf Wind encompasses four states, including Texas.

Our PMLs take into account the fact that an event may trigger claims in a number of lines of business. For instance, our U.S. hurricane modeling includes the estimated pre-tax impact to our financial results arising from our catastrophe, property, engineering, energy, marine and aviation lines of business. Our PMLs include assumptions regarding the location, size and magnitude of an event, the frequency of events, the construction type and a property's susceptibility to damage, and the cost of rebuilding the property. Loss estimates for non-U.S. zones will be subject to foreign exchange rates, although we may mitigate this currency variability from a book value point of view.

As indicated in the table above, our modeled single occurrence 1-in-100 year return period PML for a Southeast U.S. hurricane, net of reinsurance, is approximately \$0.7 billion. According to our modeling, there is a one percent chance that on an annual basis, our losses incurred from a Southeast hurricane event could be in excess of \$0.7 billion. Conversely, there is a 99% chance that on an annual basis, the loss from a Southeast hurricane will fall below \$0.7 billion.

We have developed our PML estimates using multiple commercially available vendor models, including AIR and RMS (which we also use for pricing catastrophe risk). These models cover the major peril regions where we face potential exposure. We perform ongoing model validation on the vendor models, both within our business units and through our catastrophe model validation unit. These validation procedures include sensitivity testing of models to understand their key variables and, where possible, back testing model outputs to actual results. We combine the outputs of catastrophe models with our estimate of non-modeled perils and other factors which we believe, from our experience, provides us with a more complete view of catastrophe risk.

Our PML estimates are based on assumptions that are inherently subject to significant uncertainties and contingencies. These uncertainties and contingencies can affect actual losses and could cause actual losses to differ materially from those expressed above. We aim to reduce the potential for model error in a number of ways, the most important of which is by ensuring that management's judgment supplements the model outputs. We also perform ongoing model validation both within our business units and through our catastrophe model validation unit. These validation procedures include sensitivity testing of models to understand their key variables and, where possible, back testing the model outputs to actual results.

Our estimated net losses from peak zone catastrophes may change from period to period as a result of several factors, which include but are not limited to, updates to vendor catastrophe models, changes in our own modeling, changes in our underwriting portfolios, changes to our reinsurance purchasing strategy and changes in foreign exchange rates. During 2012, our PMLs changed moderately within certain regions, mostly reflecting the repositioning of our portfolio.

#### ***Man-made catastrophe risk***

Similar to our management of natural peril catastrophe exposures, we also take a similar focused and analytical approach to our management of man-made catastrophes. Man-made catastrophes, which include such risks as train collisions, airplane crashes, hotel fires or terrorism, are harder to model in terms of assumptions regarding intensity and frequency. For these risks we couple the vendor models (where available) with our bespoke modeling and underwriting judgment and expertise. This allows us to take advantage of business opportunities relating to man-made catastrophe exposures particularly where we can measure and limit the risk sufficiently as well as obtain risk-adequate pricing.

As an example of our approach, our assessment of terrorism risk is based on a mixture of qualitative and quantitative data (e.g. for estimating property damage, business interruption, mortality and morbidity subsequent to an attack of a predefined magnitude), which we use to control, limit and manage our aggregate terrorism exposure. We use commercially available vendor modeling and bespoke modeling tools to measure accumulations around potential terrorism accumulation zones on a deterministic and probabilistic basis. We supplement the results of our modeling with underwriting judgment.

#### ***Reserving risk***

Our loss reserving process demands data quality and reliability and requires a quantitative and qualitative review of both our overall reserves and individual large claims. Within a structured control framework, claims information is communicated on a regular basis throughout our organization, including to senior management, to provide an increased awareness regarding the losses that have taken place throughout the insurance markets. The detailed and analytical reserving approach that follows is designed to absorb and understand the latest information on our reported and unreported claims, to recognize the resultant exposure as quickly as possible, to make appropriate and realistic provisions in our financial statements. We have well established processes for determining carried reserves, which we endeavor to apply consistently over time.

Reserving for long-tail lines of business represents a significant component of reserving risk. When loss trends prove to be higher than those underlying our reserving assumptions, the risk is greater because of a stacking-up effect: we carry reserves to cover claims arising from several years of underwriting activity and these reserves are likely to be adversely affected by unfavorable loss trends. We manage and mitigate reserving risk on long-tail business in a variety of ways. First, we limit the amount of long-tail business we write in line with maintaining a well-balanced and diversified global portfolio of business. In 2012, our long-tail net premiums written (namely liability and motor business) represented 17% of our total premium written. We also purchase reinsurance on the liability business written in our insurance segment to reduce our net positions. Secondly, we follow a disciplined underwriting process that utilizes available information, including industry trends.

Another significant component of reserving risk relates to the estimation of losses in the aftermath of a major catastrophe event. For further discussion on this, as well as a description of our reserving process, refer to ‘*Critical Accounting Estimates – Reserve for Losses and Loss Expenses*’ under Item 7.

### ***Claims handling risk***

In accepting risk, we are committing to the payment of claims and therefore these risks must be understood and controlled. We have claims teams located throughout our main business units. Our claim teams include a diverse group of experienced professionals, including claims adjusters and attorneys. We also use approved external service providers, such as independent adjusters and appraisers, surveyors, accountants, investigators and specialist attorneys, as appropriate.

We maintain claims handling guidelines and claims reporting control and escalation procedures in all our claims units. Large claims matters are reviewed during weekly claims meetings. The minutes from each meeting are circulated to our underwriters, senior management and others involved in the reserving process. To maintain communication between underwriting and claims teams, claims personnel regularly report at underwriting meetings and frequently attend client meetings.

AXIS fosters a strong culture of review among its claims teams. This includes MIAs, whereby senior claims handlers audit a sample of claim files. The process is designed to ensure consistency between the claims units and to develop group wide best practices.

When we receive notice of a claim, regardless of size, it is recorded within our underwriting and claims system. To assist with the reporting of significant claims, we have also developed a standard format and procedure to produce “flash reports” for significant events and potential losses, regardless of whether we have exposure. Our process for flash reporting allows a direct notification to be communicated to underwriters and senior management worldwide. Similarly, for natural peril catastrophes, we have developed a catastrophe database, along with catastrophe coding in certain systems, that allows for the gathering, blending and reporting of loss information as it develops from early modeled results to fully adjusted and paid losses.

### **Credit Risk**

Credit risk represents the risk of incurring financial loss due to the diminished creditworthiness (eroding credit rating and, ultimately, default) of our third party counterparties. We distinguish between various forms of credit exposure; the risk of issuer default from instruments in which we invest or trade, such as corporate bonds; counterparty exposure in a direct contractual relationship, such as retrocession; the credit risk related to our receivables, including those from brokers and other intermediaries; and the risk we assume through our (re)insurance contracts, such as our credit and political risk and trade credit and bond lines of business.

### ***Credit risk aggregation***

We monitor and control the aggregation of credit risk on a group-wide basis by assigning limits on the maximum credit exposure we are willing to assume by single obligors and groups, industry sector, country, region or other inter-dependencies. Our credit exposures are aggregated based on the origin of risk. Limits are based and adjusted on a variety of factors including the prevailing economic environment and the nature of the underlying credit exposures.

Our credit aggregation measurement and reporting process is facilitated by our credit risk exposure database, which contains relevant information on counterparty details and credit risk exposures. The database is accessible by management throughout the Group, thus providing transparency to allow for the implementation of active exposure management strategies. We also license third party databases to provide credit risk assessments. The global sovereign debt crisis has resulted in heightened concerns about the creditworthiness of certain countries (e.g. Greece, Ireland, Italy, Spain and Portugal), sectors (e.g. banking) and individual entities. We are monitoring all our credit aggregations and, where appropriate, we have adjusted our internal risk limits and/or taken specific actions to reduce our risk exposures. Refer to ‘*Cash and Investments*’ in Item 7 for a tabular disclosure of eurozone exposure for our fixed maturity portfolio.

Credit risk aggregation is also managed through minimizing overlaps in underwriting, financing and investing activities.



### ***Credit risk relating to investing activities***

With our fixed maturity investment portfolio, which represents approximately \$12 billion or 63% of our total assets, we are exposed to potential losses arising from the diminished creditworthiness of issuers of bonds as well as third party counterparties such as custodians. We limit such credit risk through diversification, issuer exposure limitation graded by ratings and, with respect to custodians, through contractual and other legal remedies. Excluding U.S. Treasury and Agency securities, we limit our concentration of credit risk to any single corporate issuer to 2% or less of our fixed maturities portfolio for securities rated A- or above and 1% or less of our fixed maturities portfolio for securities rated below A-.

We also have credit risk relating to our cash and cash equivalents. In order to mitigate concentration and operational risks related to cash and cash equivalents, we limit the maximum amount of cash that can be deposited with a single counterparty and additionally limit acceptable counterparties based on current rating, outlook and other relevant factors.

### ***Credit risk relating to reinsurance recoverable assets***

Within our reinsurance purchasing activities, we are exposed to the credit risk of a reinsurer failing to meet its obligations under our reinsurance contracts. To help mitigate this, all of our reinsurance purchasing is subject to financial security requirements specified by our RSC. The RSC maintains a list of approved reinsurers, performs credit risk assessments for potential new reinsurers, regularly monitors approved reinsurers with consideration for events which may have a material impact on their creditworthiness, recommends counterparty tolerance levels for different types of ceded business and monitors concentrations of credit risk. This assessment considers a wide range of individual attributes, including a review of the counterparty's financial strength, industry position and other qualitative factors.

We monitor counterparty credit quality and exposures, with special monitoring of those cases that merit close attention.

### ***Credit risk relating to receivables***

Our largest credit risk exposure to receivables is from brokers and other intermediaries; the risk arises where they collect premiums from customers to be paid to us or pay claims to customers on our behalf. We have policies and standards in place to manage and monitor credit risk from intermediaries with a focus on day-to-day monitoring of the largest positions.

### ***Credit risk relating to our underwriting portfolio***

In our insurance segment, we provide credit insurance primarily for lenders (financial institutions) seeking to mitigate the risk of non-payment from their borrowers primarily in emerging markets. This product has complemented our more traditional political risk insurance business in recent years. For the credit insurance contracts, it is necessary for the buyer of the insurance, most often a bank, to hold an insured asset, most often an underlying loan, in order to claim compensation under the insurance contract. The vast majority of the credit insurance provided is for single-name illiquid risks, primarily in the form of senior secured bank loans that can be individually analyzed and underwritten. As part of this underwriting process, an evaluation of credit-worthiness and reputation of the obligor is critical and forms the cornerstone of the underwriting process. We generally require that our clients retain a share of each transaction that we insure. A key element to our underwriting analysis is the assessment of recovery in the event of default and, accordingly, the strength of the collateral and the enforceability of rights to the collateral are paramount. We avoid insurance for structured finance products defined by pools of risks and insurance for synthetic products that would expose us to mark-to-market losses. We also seek to avoid terms in our credit insurance contracts which introduce liquidity risk, most notably, in the form of a collateralization requirement upon a ratings downgrade. We also provide protection against sovereign default or sovereign actions that result in impairment of cross-border investments for banks and corporations. Of note, we do not have any direct sovereign credit insurance exposure to any of the eurozone countries. Our contracts generally include conditions precedent to our liability relating to the enforceability of the insured transaction and restricting amendments to the transaction documentation, obligations on the insured to prevent and minimize losses, subrogation rights (including rights to have the insured asset transferred to us) and waiting periods. Under most of our policies, a loss payment is made in the event the debtor failed to pay our client when payment is due subject to a waiting period of up to 180 days.

In our reinsurance segment, we provide reinsurance of credit and bond insurers exposed to the risks of financial loss arising from non-payment of trade receivables covered by a policy (credit insurance) or non-performance (bonding). Our credit insurance exposures are concentrated primarily within Western European economies, while our surety bond exposures are concentrated primarily within Latin American and Western European economies.

## **Market Risk**

Market risk is the risk that our financial instruments may be negatively impacted by movements in financial market prices or rates such as equity prices, interest rates, credit spreads and foreign exchange rates. Fluctuations in market rates primarily affect our investment portfolio.

Through asset and liability management, we aim to ensure that economic factors influence the value of our investments and that of our loss reserves and other liabilities in the same way; thus mitigating the effect of market fluctuations. For example, we reflect important features of our liabilities, such as maturity patterns and currency structures, on the assets side of the balance sheet by acquiring investments with similar characteristics.

We supplement our asset-liability management with various internal policies and limits. As part of our strategic asset allocation process, different asset strategies are simulated and stressed in order to evaluate the ‘best’ portfolio (given return objectives and risk constraints) at both the group and operating entity level. We centralize the management of asset classes to control aggregation of risk, and provide a consistent approach to constructing portfolios as well as the selection process of external asset managers. We have limits on the concentration of investments by single issuers and certain asset classes, and we limit the level of illiquid investments (see '*Liquidity Risk*' below). Further, our investment guidelines do not permit the use of leverage in any of our fixed maturity portfolios.

We stress test our investment portfolios using historical and hypothetical scenarios to analyze the impact of unusual market conditions and to ensure potential investment losses remain within our risk appetite. At an annual aggregated level, we manage the total risk exposure to our investment portfolio so that the ‘total return’ investment loss in any one year is unlikely to exceed a defined percentage of our common equity at a defined return period.

We manage foreign currency risk by seeking to match our estimated (re)insurance liabilities payable in foreign currencies with assets, including cash and investments that are also denominated in such currencies. Where necessary, we use derivative financial instruments for economic hedging purposes. For example, in certain circumstances, we use forward contracts and currency options, to economically hedge portions of our un-matched foreign currency exposures.

## **Operational Risk**

Operational risk represents the risk of financial loss as a result of inadequate processes, system failures, human error or external events. We have a dedicated team within Group Risk responsible for overseeing the management of operational risks, applying a centrally coordinated methodology to identify and assess risks. We have developed a group-wide operational risk framework that focuses on early recognition of operational risks. As part of this, we maintain an operational loss-event database which helps us better monitor and analyze potential operational risk, identify any trends, and, where necessary, put in place improvement actions to avoid occurrence or recurrence of operational loss events.

We manage transaction type operational risks through the application of process controls throughout our business. In testing these controls, we supplement the work of our internal audit team, with regular underwriting and claim MIAs (as discussed above).

We have specific processes and systems in place to focus on high priority operational matters such as information security, managing business continuity, and third party vendor risk:

- Major failures and disasters which could cause a severe disruption to working environments, facilities and personnel, represent a significant operational risk to us. Our Business Continuity Management framework strives to protect critical business functions from these effects to enable us to carry out our core tasks in time and at the quality required. During 2012, we continued to review our Business Continuity Planning procedures through cyclical planned tests.
- We have developed a number of IT platforms, applications and security controls to support our business activities worldwide. Dedicated security standards are in place for our IT systems to ensure the proper use, availability and protection of our information assets.
- Our use of third party vendors exposes us to a number of increased operational risks, including the risk of security breaches, fraud, non-compliance with laws and regulations or internal guidelines and inadequate service. We manage material third party vendor risk, by, among other things, performing a thorough risk assessment on potential large vendors, reviewing a vendor’s financial stability, ability to provide ongoing service and business continuity planning.

## **Liquidity Risk**

Liquidity risk is the risk that we may not have sufficient liquid financial resources to meet our obligations when they fall due, or would have to incur excessive costs to do so. As a (re)insurer, our core business generates liquidity primarily through premium and investment income. Our exposure to liquidity risk stems mainly from the need to cover potential extreme loss events and regulatory constraints that limit the flow of funds within the Group. To manage these risks, we have a range of liquidity policies and measures in place:

- We maintain cash and cash equivalents and high quality, liquid investment portfolios to meet expected outflows, as well as those that could result from a range of potential stress events. We place internal limits on the maximum percentage of cash and investments which may be in a restricted form as well as a minimum percentage of our investment portfolio to mature within a defined timeframe.
- We maintain committed borrowing facilities, as well as access to diverse funding sources to cover contingencies. Funding sources include asset sales, external debt issuances and lines of credit.

## **Capital Management**

Our capital management strategy is to maximize long-term shareholder value by, among other things, optimizing capital allocation and minimizing our cost of capital. We also manage our capital in accordance with our desired financial strength rating, as well as regulatory and solvency requirements.

We monitor the capital positions of the Group and operating entity level and apply regular stress tests based on adverse scenarios. This allows us to take appropriate measures to ensure the continued strength of capital and solvency positions, and also enables us to take advantage of growth opportunities as they arise. Such measures are performed as and when required and include traditional capital management tools (e.g. dividends, share buy-backs, issuances of shares or debt) or through changes to our risk exposure (e.g. recalibration of our investment portfolio or changes to our reinsurance purchasing strategy).

### ***Internal capital adequacy***

Our internal capital model plays an important role in the management and allocation of internal capital. Our internal capital requirement captures the potential for severe, but rare, aggregate losses over a one-year time horizon, which we also measure, monitor and report at more extreme return periods. Our internal capital model is also used to manage risks resulting from reasonably possible smaller adverse events that could occur in the near-term, because the results allow us to analyze our exposure to each source of risk both separately and in aggregate.

### ***Regulatory capital requirements***

In each country in which we operate, the local regulator specifies the minimum amount and type of capital that each of the regulated entities must hold in support of their liabilities. We target to hold, in addition to the minimum capital required to comply with the solvency requirements, an adequate buffer to ensure that each of our operating entities meets its local capital requirements. Refer to Note 18 of the Consolidated Financial Statements, under Item 8 for further information.

### ***Rating agency capital requirements***

Rating agencies apply their own models to evaluate the relationship between the required risk capital of a company and its available capital resources. The assessment of capital adequacy is usually an integral part of the rating agency process. Meeting rating agency capital requirements and maintaining strong credit ratings are strategic business objectives of the AXIS Group. For further information on our financial strength refer to the '*Liquidity and Capital Resources*' section in Item 7 of this report.

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## REGULATION

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### *General*

The business of (re)insurance is regulated in most countries, although the degree and type of regulation varies significantly from one jurisdiction to another. In addition, many jurisdictions are currently evaluating changes to their regulation and AXIS is monitoring these potential developments. To the extent AXIS is aware of impending changes in regulation, we designate project teams to prepare the organization to comply on a timely basis with such anticipated changes. The following describes the current material regulations under which the Company operates.

### *Bermuda*

Our Bermuda insurance operating subsidiary, AXIS Specialty Bermuda, is a Class 4 general business insurer subject to the Insurance Act 1978 of Bermuda and related regulations, as amended (the "Insurance Act"). The Insurance Act provides that no person may carry on any insurance or reinsurance business in or from within Bermuda unless registered as an insurer by the BMA under the Insurance Act. The Insurance Act imposes on Bermuda insurance companies solvency and liquidity standards and auditing and reporting requirements, and grants the BMA powers to supervise, investigate, require information and demand the production of documents and intervene in the affairs of insurance companies. Significant requirements pertaining to Class 4 insurers include the appointment of an independent auditor, the appointment of a loss reserve specialist, the appointment of a principal representative in Bermuda, the filing of annual and quarterly Statutory Financial Returns, the filing of annual GAAP financial statements, the filing of an annual capital and solvency return, compliance with minimum and enhanced capital requirements, compliance with certain restrictions on reductions of capital and the payment of dividends and distributions, compliance with group solvency and supervision rules, if applicable, and compliance with the Insurance Code of Conduct.

In 2011, the BMA notified AXIS Specialty Bermuda that it intended to act as group supervisor and that it had designated AXIS Specialty Bermuda as the 'designated insurer' of the AXIS group of insurance companies. In accordance with the group supervision and insurance group solvency rules, the AXIS insurance group is required to prepare and submit annual audited group GAAP financial statements, annual group statutory financial statements, an annual group statutory financial return, an annual group capital and solvency return and quarterly group unaudited financial returns. Enhanced group capital requirements ("ECR") will be phased in beginning with the financial year ending December 31, 2013, when the applicable ECR will be 50% of the amount prescribed by the BMA, with an additional 10% applicable each subsequent year through 2018, when the full ECR will be required.

AXIS Capital, AXIS Specialty Bermuda and AXIS Specialty Holdings Bermuda Limited must also comply with provisions of the Bermuda Companies Act 1981, as amended (the "Companies Act"), regulating the payment of dividends and distributions. A Bermuda company may not declare or pay a dividend or make a distribution out of contributed surplus if there are reasonable grounds for believing that: (a) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of the company's assets would thereby be less than its liabilities.

The Singapore branch of AXIS Specialty Bermuda (established in 2008) is also regulated by the Monetary Authority of Singapore pursuant to The Insurance Act of Singapore, and is registered by the Accounting and Corporate Regulatory Authority ("ACRA") as a foreign company in Singapore and regulated by ACRA pursuant to the Singapore Companies Act. Prior to establishing its Singapore branch, AXIS Specialty Bermuda had maintained a representative office in Singapore since 2004.

### *United States*

#### *U.S. Insurance Holding Company Regulation of AXIS Capital's Insurance Subsidiaries*

As members of an insurance holding company system, each of AXIS Capital's U.S. insurer subsidiaries are subject to the insurance holding company system laws and regulations of the states in which they do business. These laws generally require each of the U.S. subsidiaries to register with its respective domestic state insurance department and to furnish financial and other information which may materially affect the operations, management or financial condition within the holding company system. All transactions within a holding company system that involve an insurance company must be fair and equitable. Notice to the insurance departments is required prior to the consummation of transactions affecting the ownership or control

of an insurer and of certain material transactions between an insurer and an entity in its holding company system, and certain transactions may not be consummated without the department's prior approval.

### *State Insurance Regulation*

Our U.S. insurance subsidiaries also are subject to regulation and supervision by their respective states of domicile and by other jurisdictions in which they do business. The regulations generally are derived from statutes that delegate regulatory and supervisory powers to an insurance official. The regulatory framework varies from state to state, but generally relates to approval of policy forms and rates, the standards of solvency that must be met and maintained, including risk-based capital standards, material transactions between an insurer and its affiliates, the licensing of insurers, agents and brokers, restrictions on insurance policy terminations, the nature of and limitations on the amount of certain investments, limitations on the net amount of insurance of a single risk compared to the insurer's surplus, deposits of securities for the benefit of policyholders, methods of accounting, periodic examinations of the financial condition and market conduct of insurance companies, the form and content of reports of financial condition required to be filed, and reserves for unearned premiums, losses, expenses and other obligations.

Our U.S. insurance subsidiaries are required to file detailed quarterly statutory financial statements with state insurance regulators in each of the states in which they conduct business. In addition, the U.S. insurance subsidiaries' operations and accounts are subject to financial condition and market conduct examination at regular intervals by state regulators.

Regulators and rating agencies use statutory surplus as a measure to assess our U.S. subsidiaries' ability to support business operations and pay dividends. Our U.S. insurance subsidiaries are subject to various state statutory and regulatory restrictions that limit the amount of dividends that may be paid from earned surplus without prior approval from regulatory authorities. These restrictions differ by state, but generally are based on calculations using statutory surplus, statutory net income and investment income. In addition, many state regulators use the National Association of Insurance Commissioners promulgated risk-based capital requirements as a means of identifying insurance companies which may be undercapitalized.

Although the insurance industry generally is not directly regulated by the federal government, federal legislation and initiatives can affect the industry and our business. On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") was signed into law. Certain sections of that act pertain to the regulation and business of insurance. Specifically, the Federal Insurance Office was created ("FIO"). Initially the FIO will have limited authority and mainly collect information and report on the business of insurance to Congress. In addition, Dodd-Frank contained the Nonadmitted and Reinsurance Reform Act of 2010 ("NRRRA"). NRRRA attempts to coordinate the payment of surplus lines taxes, simplify the granting of alien insurers to become surplus lines authorized and coordinates the credit for certain reinsurance. Various sections of Dodd-Frank become effective over time and regulations have yet to be drafted for certain provisions. AXIS does not anticipate that Dodd-Frank will have any material effect on its operations or finances this year, but will continue to monitor its implementation.

### *Operations of AXIS Specialty Bermuda, AXIS Re SE, AXIS Re Europe, AXIS Specialty Europe, AXIS Specialty London and AXIS Specialty Australia*

The insurance laws of each state of the United States and of many other countries regulate or prohibit the sale of (re) insurance within their jurisdictions by (re)insurers that are not admitted to do business within such jurisdictions, or conduct business pursuant to exemptions. AXIS Specialty Europe is eligible to write surplus lines business in all 50 of the United States, the District of Columbia, Puerto Rico and all other U.S. territories. AXIS Specialty Bermuda and AXIS Re SE (including its branch AXIS Re Europe) are not licensed or eligible to write business in the United States. AXIS Specialty Bermuda, AXIS Specialty Europe and AXIS Re SE do not maintain offices, solicit, advertise, underwrite, settle claims or conduct any insurance activities in any jurisdiction in the United States where the conduct of such activities would require these companies to be admitted or authorized.

In addition to the regulatory requirements imposed by the jurisdictions in which they are licensed, reinsurers' business operations are affected by regulatory requirements in various states of the U.S. governing "credit for reinsurance" that are imposed on their ceding companies. In general, a ceding company obtaining reinsurance from a reinsurer that is licensed, accredited or approved by the jurisdiction or state in which the ceding company files statutory financial statements is permitted to reflect in its statutory financial statements a credit in an aggregate amount equal to the ceding company's liability for unearned premiums (which are that portion of premiums written which applies to the unexpired portion of the policy period), loss reserves and loss expense reserves ceded to the reinsurer. Neither AXIS Specialty Bermuda, AXIS Specialty Europe nor AXIS Re SE are licensed, accredited or approved in any state in the U.S. The great majority of states,

however, permit a credit to statutory surplus resulting from reinsurance obtained from a non-licensed or non-accredited reinsurer to be recognized to the extent that the reinsurer provides a letter of credit, trust fund or other acceptable security arrangement. A few states do not allow credit for reinsurance ceded to non-licensed reinsurers except in certain limited circumstances and others impose additional requirements that make it difficult to become accredited.

Our European legal entities will be subject to Solvency II regulation once Omnibus II, which will include a commencement date, is approved by the European Parliament. Solvency II is a risk based capital regime that consolidates and modernizes European (re)insurance regulation and supervision. Under Solvency II, European (re)insurers will calculate capital in accordance with a new standard formula, once finalized, or an internal model provided it has been approved by the Central Bank of Ireland ("CBI") as lead regulator of our European legal entities, implement a risk management framework and governance measures and fulfill enhanced disclosure requirements.

## ***Ireland***

### *AXIS Specialty Europe*

AXIS Specialty Europe is a European public limited liability company incorporated as a non-life insurer under the laws of Ireland and is authorized and regulated by the CBI pursuant to the Insurance Acts 1909 to 2000, as amended, statutory instruments and the Central Bank Acts 1942 – 2010, as well as regulations relating to general insurance. AXIS Specialty Europe is authorized to conduct business in 16 non-life insurance classes of business. AXIS Specialty Europe may also write reinsurance business up to certain limitations within the classes of insurance business for which it is authorised. Significant additional regulation that applies to AXIS Specialty Europe includes the CBI's 2010 Corporate Governance Code for Credit Institutions and Insurance Undertakings and the CBI's 2011 Fit and Proper requirements.

Ireland is a member of the European Economic Area, ("EEA"), which comprises each of the countries of the European Union, ("EU"), and Iceland, Lichtenstein and Norway. Ireland transposed the EU's Third Non-Life Insurance Directive into Irish law. This directive introduced a single system for the authorization and financial supervision of non-life insurance companies by their home state. Under this system, AXIS Specialty Europe is permitted to provide insurance services to clients located in any other EEA member state ("Freedom of Services"), provided it has notified the CBI and subject to compliance with any "general good requirements" as may be established by the applicable EEA member state regulators. AXIS Specialty Europe has notified the CBI of its intention to provide insurance services from Ireland and the United Kingdom on a Freedom of Services basis in all 30 EEA countries.

The Third Non-Life Directive also permits AXIS Specialty Europe to carry on insurance business in any other EEA member state under the principle of "Freedom of Establishment." In May 2003, AXIS Specialty Europe established a UK branch known as AXIS Specialty London. The CBI remains responsible for the prudential supervision of the UK branch, however, AXIS Specialty London must also comply with the "general good" requirements of the Financial Services Authority of the United Kingdom.

In July 2008, AXIS Specialty Europe established AXIS Specialty Australia, a branch office in Australia to transact general insurance business. While the CBI continues to be the responsible supervisory authority, the Australia Prudential Regulation Authority ("APRA") is also responsible for the authorization of and the ongoing prudential supervision of the branch in accordance with the Insurance Act 1973 as amended as well as regulations applicable to general insurers. AXIS Specialty Europe is also registered as a foreign company with the Australia Securities Investment Commission in accordance with Australia's Corporations Act 2001, as amended.

AXIS Specialty Europe has obtained local regulatory permission to carry on insurance business in Jersey and to write cross-border reinsurance business into India.

### *AXIS Re SE*

AXIS Re SE is a European public limited liability company incorporated as a reinsurer under the laws of Ireland. AXIS Re SE is authorized by the CBI as a composite reinsurer (non-life and life) in accordance with the European Communities (Reinsurance) Regulations 2006 (the "Regulations"). The Regulations, as amended, which gave effect to the EU Reinsurance Directive, provide a comprehensive framework for the authorization and supervision of reinsurers in Ireland. Significant additional regulation that applies to AXIS Re SE includes the CBI's 2010 Corporate Governance Code for Credit Institutions and Insurance Undertakings and the CBI's 2011 Fit and Proper requirements.

The EU Reinsurance Directive provides that the authorization and supervision of European reinsurers is the responsibility of the EU member state where the head office of the relevant reinsurer is located. Once authorized in its home state, a reinsurer is automatically entitled to conduct reinsurance business in all EEA member states under the principles of Freedom of Establishment and Freedom of Services, similar to the system that applies to EU based insurers. The Reinsurance Directive provides that the home state regulator is fully responsible for the financial and prudential supervision of a reinsurer, including business it carries on in other countries, either through branches or Freedom of Services.

In September 2003, AXIS Re SE established a branch in Zurich, Switzerland, known as AXIS Re Europe. The Swiss Financial Market Supervisory Authority (FINMA) does not impose additional regulation upon a Swiss branch of an EEA reinsurer.

AXIS Re SE has obtained local regulatory permissions to reinsure companies in Bolivia, Brazil, Chile, Columbia, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, India, Mexico, Paraguay, Peru and Venezuela.

AXIS Re SE has marketing offices in Brazil, France and Spain. These offices are representative offices only and no business may be written or any regulated activity conducted from these offices. AXIS Re Limited Escritório de Representação No Brasil Ltda. was established in Brazil as a subsidiary of AXIS Re SE to facilitate the Brazilian regulatory requirements for approval of a representative office of AXIS Re SE.

#### *AXIS Specialty Holdings Ireland Ltd.*

AXIS Specialty Holdings Ireland Ltd. is the limited liability holding company for AXIS Specialty Europe and AXIS Re SE, incorporated under the laws of Ireland. In its capacity as a holding company of EU regulated (re)insurance companies, AXIS Specialty Holdings Ireland Ltd. is subject to certain of the CBI's consolidated solvency requirements.

#### ***United Kingdom***

Under the law of England and Wales, a company may only conduct insurance and/or reinsurance business in the United Kingdom upon authorization. AXIS Specialty Bermuda and the U.S. (re)insurance subsidiaries are not authorized to conduct insurance and/or reinsurance business in the United Kingdom. AXIS Re SE is authorized to transact business in the United Kingdom on a freedom of services basis pursuant to the reinsurance directive, and AXIS Specialty Europe is authorized to transact business in the U.K. on a freedom of services basis pursuant to the Third Non-Life Insurance Directive and to conduct business in the U.K. on a freedom of establishment basis through its branch, AXIS Specialty London.

#### ***Switzerland***

AXIS Re SE conducts reinsurance business from its branch in Zurich, Switzerland, subject to the supervision of the CBI. AXIS Specialty Europe, AXIS Specialty Bermuda and the U.S. (re)insurance subsidiaries are not authorized to conduct insurance or reinsurance business in Switzerland.

#### ***Singapore***

AXIS Specialty Bermuda conducts (re)insurance business from its branch in Singapore, subject to the supervision of the BMA and the Monetary Authority of Singapore. AXIS Specialty Europe, AXIS Re SE, and the U.S. (re)insurance subsidiaries are not authorized to conduct insurance or reinsurance business in Singapore.

#### ***Canada***

AXIS Reinsurance Company conducts (re)insurance business from its branch in Canada, subject to the supervision of the New York Department of Insurance and the Office of the Superintendent of Financial Institutions Canada ("OSFI"), the federal regulatory authority that supervises federal Canadian and non-Canadian insurance companies operating in Canada pursuant to the Insurance Companies Act (Canada). The branch is authorized by OSFI to transact insurance and reinsurance. In addition, the branch is subject to the laws and regulations of each of the provinces and territories in which it is licensed.

AXIS Specialty Europe, AXIS Re SE, AXIS Specialty Bermuda and the U.S. other insurance subsidiaries are not otherwise authorized to conduct insurance or reinsurance business in Canada.

### ***Australia***

AXIS Specialty Europe conducts (re)insurance business from its branch in Australia, subject to the supervision of the CBI and the Australian Prudential Regulatory Authority (APRA). Significant additional regulation that applies to AXIS Specialty Australia includes branch capital adequacy, assets in Australia, risk management, reinsurance management, governance, audit and actuarial requirements.

AXIS Specialty Bermuda, AXIS Re SE and the U.S. (re)insurance subsidiaries are not authorized to conduct insurance or reinsurance business in Australia.

### ***Other Countries***

The AXIS (re)insurance companies also (re)insure risks in many countries pursuant to regulatory permissions and exemptions available to non-admitted (re)insurers.

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## **EMPLOYEES**

As of February 21, 2013 we had approximately 1,100 employees. We believe that our employee relations are excellent.

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## **AVAILABLE INFORMATION**

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and therefore file periodic reports, proxy statements and other information, including reports filed by officers and directors under Section 16(a) of the Exchange Act, with the Securities and Exchange Commission (“SEC”). The public may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC (such as us) and the address of that site is <http://www.sec.gov>. Our common shares are traded on the NYSE with the symbol “AXS” and you can review similar information concerning us at the office of the NYSE at 20 Broad Street, New York, New York, 10005. Our Internet website address is <http://www.axiscapital.com>. Information contained in our website is not part of this report.

We make available free of charge, including through our internet website, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. Current copies of the charter for each of our Audit Committee, Corporate Governance and Nominating Committee, Compensation Committee, Finance Committee, Executive Committee and Risk Committee, as well as our Corporate Governance Guidelines and Code of Business Conduct, are available on our internet website at <http://www.axiscapital.com>.



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## ITEM 1A. RISK FACTORS

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You should carefully consider the following risks and all of the other information set forth in this report, including our consolidated financial statements and the notes thereto:

**Our results of operations and financial condition could be materially adversely affected by the occurrence of natural and man-made disasters.**

We have substantial exposure to unexpected losses resulting from natural disasters, man-made catastrophes and other catastrophe events. Catastrophes can be caused by various events, including hurricanes, typhoons, earthquakes, hailstorms, floods, explosions, severe winter weather, fires, and other natural or man-made disasters. The incidence and severity of catastrophes are inherently unpredictable and our losses from catastrophes could be substantial.

Increases in the values and concentrations of insured property may increase the severity of these occurrences in the future. Also, changes in global climate conditions may further increase the frequency and severity of catastrophe activity and losses in the future. Examples of the impact of catastrophe events include our recognition of the net losses and loss expenses of:

- \$331 million in relation to Storm Sandy in 2012;
- \$789 million, in aggregate, in relation to the February and June earthquakes near Christchurch, New Zealand, the Japanese earthquake and tsunami, first quarter Australian weather events and the Thai floods in 2011;
- \$256 million, in aggregate, in relation to the Chilean and September New Zealand earthquakes in 2010; and
- \$408 million, in aggregate, in relation to Hurricanes Ike and Gustav in 2008.

These events materially reduced our net income in the years noted above. Although we attempt to manage our exposure to such events through the use of underwriting controls and the purchase of third-party reinsurance, catastrophe events are inherently unpredictable and the actual nature of such events when they occur could be more frequent or severe than contemplated in our pricing and risk management expectations. As a result, the occurrence of one or more catastrophe events could have a material adverse effect on our results of operations or financial condition.

**The (re)insurance business is historically cyclical, and we expect to experience periods with excess underwriting capacity and unfavorable premium rates.**

The (re)insurance business historically has been a cyclical industry characterized by periods of intense price competition due to excessive underwriting capacity as well as periods when shortages of capacity permitted favorable premium levels. An increase in premium levels is often offset by an increasing supply of (re)insurance capacity, via capital provided by new entrants, new capital market instruments and structures and/or the commitment of additional capital by existing (re)insurers, which may cause prices to decrease. Any of these factors could lead to a significant reduction in premium rates, less favorable policy terms and fewer submissions for our underwriting services. In addition to these considerations, changes in the frequency and severity of losses suffered by insureds and insurers may affect the cycles of the (re)insurance business significantly.

In recent years, we experienced a softening market cycle throughout many of our property and liability lines of business, with increased competition, surplus underwriting capacity and deteriorating rates, terms and conditions all having an impact on our ability to write business. While a number of factors, including but not limited to the frequency and severity of recent global catastrophe activity and the current interest rate environment, appear to be contributing to rate hardening in certain business lines, there can be no assurance of a broad cycle turn in the near future.

**Our investment and derivative instrument portfolios are exposed to significant capital markets risk related to changes in interest rates, credit spreads and equity prices as well as other risks, which may adversely affect our results of operations, financial condition or cash flows.**

The performance of our cash and investments portfolio has a significant impact on our financial results. A failure to successfully execute our investment strategy could have a significant impact on our results of operations or financial condition.

Our investment portfolio is subject to a variety of market risks, including risks relating to general economic conditions, interest rate fluctuations, equity price risk, foreign currency movements, pre-payment or reinvestment risk, liquidity risk and credit risk. Although we attempt to manage market risks through, among other things, stressing diversification and conservation of principal and liquidity in our investment guidelines, it is possible that, in periods of economic weakness or periods of turmoil in capital markets, we may experience significant losses in our portfolio.

Our fixed maturities, which represent 88% of our total investments at December 31, 2012, may be adversely impacted by changes in interest rates. Increases in interest rates could cause the fair value of our investment portfolio to decrease, resulting in a lower book value (refer to Item 7A *'Quantitative and Qualitative Disclosure About Market Risk'* for a related sensitivity analysis).

In addition, a low interest rate environment, such as the current environment, can result in reductions in our investment yield as new funds and proceeds from sales and maturities of fixed income securities are invested at lower rates. This reduces our overall profitability. Interest rates are highly sensitive to many factors, including governmental monetary policies, inflation, domestic and international economic and political conditions and other factors beyond our control.

Our portfolios of "other investments" and equity securities expose us to market price variability, driven by a number of factors outside our control including, but not limited to, global equity market performance.

Given our reliance on external investment managers, we are also exposed to operational risks, which may include, but are not limited to, a failure to follow our investment guidelines, technological and staffing deficiencies and inadequate disaster recovery plans.

Our derivative instrument counterparties may default on amounts owed to us due to bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Even if we are entitled to collateral in circumstances of default, such collateral may be illiquid or proceeds from such collateral when liquidate may not be sufficient to recover the full amount of the obligation.

**Global economic conditions could materially and adversely affect our business, results of operations and financial condition.**

In recent years, worldwide financial markets experienced unprecedented volatility and disruption including, among other things, dislocation in the mortgage and asset-backed securities markets, deleveraging and decreased liquidity generally, widening of credit spreads, bankruptcies and government intervention in a number of large financial institutions. These events resulted in extraordinary responses by governments worldwide, including the enactment of the Emergency Economic Stabilization Act of 2008 and the U.S. Recovery and Reinvestment Act in 2009 and Dodd-Frank in 2010. This market turmoil affected (among other aspects of our business) the demand for and claims made under our products, the ability of customers, counterparties and others to establish or maintain their relationships with us, our ability to access and efficiently use internal and external capital resources and our investment performance. Although there were some indications of stability in the financial markets in 2010, the downgrade in the S&P credit rating for U.S. government securities and eurozone economic instability during 2011 and 2012 resulted in additional global financial market turmoil and economic instability. There continues to be significant uncertainty regarding the timeline for a full global economic recovery. As such, evolving market conditions may continue to affect our results of operations, financial position and capital resources. In the event that there is additional deterioration or volatility in financial markets or general economic conditions, our results of operations, financial position and/or liquidity, and competitive landscape could be materially and adversely affected.

**We could face unanticipated losses from war, terrorism and political unrest, and these or other unanticipated losses could have a material adverse effect on our financial condition, results of operations and/or liquidity.**

We have substantial exposure to unexpected losses resulting from war, acts of terrorism and political instability. In certain instances, we specifically (re)insure risks resulting from acts of terrorism. Even in cases where we attempt to exclude losses from terrorism and certain other similar risks from some coverages written by us, there can be no assurance that a court or arbitration panel will interpret policy language or otherwise issue a ruling favorable to us. Accordingly, we can offer no assurance that our reserves will be adequate to cover losses should they materialize.

We have limited terrorism coverage in our own reinsurance program for our exposure to catastrophe losses related to acts of terrorism. Furthermore, although the Terrorism Risk Insurance Extension Act of 2005 ("TRIEA") provides benefits in the event of certain acts of terrorism, those benefits are subject to a deductible and to other limitations. Under TRIEA, once our

losses attributable to certain acts of terrorism exceed 20% of our direct commercial property and liability insurance premiums for the preceding calendar year, the federal government will reimburse us for 85% of such losses in excess of this deductible. Notably, TRIEA does not provide coverage for reinsurance losses. Given the unpredictable frequency and severity of terrorism losses, as well as the limited terrorism coverage in our own reinsurance program, future losses from acts of terrorism could materially and adversely affect our results of operations, financial condition and/or liquidity in future periods. TRIEA may not be extended beyond 2014.

Our credit and political risk insurance line of business protects insureds with interests in foreign jurisdictions in the event governmental action prevents them from exercising their contractual rights and may also protect their assets against physical damage perils. This may include risks arising from expropriation, forced abandonment, license cancellation, trade embargo, contract frustration, non-payment, war on land or political violence (including terrorism, revolution, insurrection and civil unrest). Political risk insurance is typically provided to financial institutions, equity investors, exporters, importers, export credit agencies and multilateral agencies in an array of industries, in connection with investments and contracts in both emerging markets and developed countries.

Our credit and political risk line of business also protects insureds in foreign jurisdictions against non-payment coverage on specific loan obligations as a result of commercial as well as political risk events. The vast majority of the credit insurance provided is for single-named illiquid risks, primarily in the form of secured bank loans that can be individually analyzed and written. We avoid insurance for structured finance products defined by pools of risks and insurance for synthetic products that would expose us to mark-to-market losses. We also avoid terms in our credit insurance contracts which introduce liquidity risk, most notably, in the form of a collateralization requirement upon a ratings downgrade. Although we also attempt to manage our exposure, by among other things, setting credit limits by country, region, industry and individual counterparty and regularly reviewing our aggregate exposures, the occurrence of one or more large losses on our credit insurance portfolio could have a material adverse effect on our results of operations or financial condition.

**If actual claims exceed our loss reserves, our financial results could be adversely affected.**

While we believe that our loss reserves at December 31, 2012 are adequate, new information, events or circumstances, unknown at the original valuation date, may lead to future developments in our ultimate losses being significantly greater or less than the reserves currently provided. The actual final cost of settling claims outstanding at December 31, 2012 as well as claims expected to arise from the unexpired period of risk is uncertain. There are many other factors that would cause our reserves to increase or decrease, which include, but are not limited to, changes in claim severity, changes in the expected level of reported claims, judicial action changing the scope and/or liability of coverage, changes in the legislative, regulatory, social and economic environment and unexpected changes in loss inflation.

Our eleven-year operating history, which includes periods of rapid growth, means that our loss reserve estimate places more reliance on industry benchmarks than may be the case for companies with longer operating histories; as a result, the potential for volatility in our estimated loss reserves may be more pronounced. When establishing our single point best estimate of loss reserves at December 31, 2012, our management considered actuarial estimates and applied informed judgment regarding qualitative factors that may not be fully captured in actuarial estimates. Such factors included, but were not limited to: the timing of the emergence of claims, volume and complexity of claims, social and judicial trends, potential severity of individual claims and the extent of internal historical loss data versus industry information.

Changes to our previous estimate of prior year loss reserves can adversely impact the reported calendar year underwriting results if reserves prove to be deficient or favorably impact our reported results if reserves prove to be redundant. If our net income is insufficient to absorb a required increase in our loss reserves, we would incur an operating loss and could incur a reduction of our capital.

**The effects of emerging claim and coverage issues on our business are uncertain.**

As industry practices and legal, judicial, social, political and other environmental conditions change, unexpected issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the frequency and/or severity of claims. For example, the global financial crisis resulted in a higher level of claim activity on professional lines (re)insurance business. In some instances, these changes may not become apparent until some time after we have issued the insurance or reinsurance contracts that are affected by the changes. In addition, our actual losses may vary materially from our current estimate of the loss based on a number of factors (see '*If actual claims exceed our loss reserves, our financial results could be adversely affected*' above). As

a result, the full extent of liability under an insurance or reinsurance contract may not be known for many years after such contract is issued and a loss occurs.

**The failure of any of the loss limitation methods we employ could have a material adverse effect on our results of operations or financial condition.**

We seek to mitigate our loss exposure by writing a number of our (re)insurance contracts on an excess of loss basis. Excess of loss (re)insurance indemnifies the insured against losses in excess of a specified amount. We generally limit the program size for each client on our insurance business and purchase reinsurance for many of our lines of business. In the case of proportional reinsurance treaties, we seek per occurrence limitations or loss and loss expense ratio caps to limit the impact of losses from any one event. In proportional reinsurance, the reinsurer shares a proportional part of the premiums and losses of the reinsured. We also seek to limit our loss exposure through geographic diversification. Geographic zone limitations involve significant underwriting judgments, including the determination of the area of the zones and the inclusion of a particular policy within a particular zone's limits. In addition, various provisions of our policies, such as limitations or exclusions from coverage or choice of forum negotiated to limit our risks may not be enforceable in the manner we intend. We cannot be sure that any of these loss limitation methods will be effective and mitigate our loss exposure. As a result of these risks, one or more catastrophe or other events could result in claims that substantially exceed our expectations, which could have a material adverse effect on our results of operations or financial condition.

**We utilize models to assist our decision making in key areas such as underwriting, reserving, reinsurance purchasing and the evaluation of our catastrophe risk but actual results could differ materially from model output.**

We employ various modeling techniques (e.g. scenarios, predictive, stochastic and/or forecasting) to analyze and estimate exposures, loss trends and other risks associated with our assets and liabilities. We utilize modeled outputs and related analyses to assist us in decision-making, for example related to underwriting and pricing, reserving, reinsurance purchasing and the evaluation of our catastrophe risk through estimates of probable maximum losses, or "PMLs". The modeled outputs and related analyses are subject to various assumptions, uncertainties and the inherent limitations of any statistical analysis, including the use of historical internal and industry data. Consequently, our actual losses from natural catastrophes, whether from individual components (e.g. wind, flood, earthquake, etc.) or in the the aggregate, may differ materially from our modeled results. If, based upon these models or other factors, we misprice our products or underestimate the frequency and/or severity of loss events, our results of operations or financial condition may be adversely affected.

With respect to the evaluation of our catastrophe risk, our modeling utilizes a mix of historical data, scientific theory and mathematical methods. Output from multiple commercially available vendor models serves as a key input in our PML estimation process. We believe that there is considerable uncertainty in the data and parameter inputs for these vendor models. In that regard, there is no universal standard in the preparation of insured data for use in the models and the running of modeling software. In our view, the accuracy of the models depends heavily on the availability of detailed insured loss data from actual recent large catastrophes. Due to the limited number of events, there is significant potential for substantial differences between the modeled loss estimate and actual company experience for a single large catastrophe event. This potential difference could be even greater for perils with limited or no modeled annual frequency. We perform our own vendor model validation (including sensitivity analysis and backtesting, where possible) and supplement model output with historical loss information and analysis and management judgment. In addition, we derive our own estimates for non-modeled perils. Despite this, our PML estimates are subject to a high degree of uncertainty and our actual losses from catastrophe events may differ materially.

**The risk associated with reinsurance underwriting could adversely affect us.**

We do not always separately evaluate each of the individual risks assumed under reinsurance treaties, which is common amongst reinsurers. Therefore, we are largely dependent on the original underwriting decisions made by ceding companies. We are subject to the risk that the ceding companies may not have adequately evaluated the risks to be reinsured and that the premiums ceded may not adequately compensate us for the risks we assume.

**We could be materially adversely affected if managing general agents, general agents and other producers in our program business exceed their underwriting authorities or otherwise breach obligations owed to us.**

In program business conducted by our insurance segment, following our underwriting, financial, claims and information technology due diligence reviews, we authorize managing general agents, general agents and other producers to write business on our behalf within underwriting authorities prescribed by us. Once a program commences, we must rely on the

underwriting controls of these agents to write business within the underwriting authorities provided by us. Although we monitor our programs on an ongoing basis, our monitoring efforts may not be adequate or our agents may exceed their underwriting authorities or otherwise breach obligations owed to us. To the extent that our agents exceed their authorities or otherwise breach obligations owed to us in the future, our results of operations and financial condition could be materially adversely affected.

**If we choose to purchase reinsurance, we may be unable to do so, and if we successfully purchase reinsurance, we may be unable to collect amounts due to us.**

We purchase reinsurance for our (re)insurance operations in order to mitigate the volatility of losses upon our financial results.

From time to time, market conditions have limited, and in some cases have prevented, (re)insurers from obtaining the types and amounts of reinsurance that they consider adequate for their business needs. There is no guarantee that our desired amounts of reinsurance or retrocessional reinsurance will be available in the marketplace in the future. In addition to capacity risk, the remaining capacity may not be on terms we deem appropriate or acceptable or with companies with whom we want to do business.

A reinsurer's insolvency, or inability or refusal to make payments under the terms of its reinsurance agreement with us, could have a material adverse effect on our business because we remain liable to the insured. We face counterparty risk whenever we purchase reinsurance or retrocessional reinsurance. Consequently, the insolvency, inability or unwillingness of any of our present or future reinsurers to make timely payments to us under the terms of our reinsurance or retrocessional agreements could have an adverse effect on us.

**If we experience difficulties with technology and/or data security, our ability to conduct our business might be negatively impacted.**

While technology can streamline many business processes and ultimately reduce the cost of operations, technology initiatives present certain risks. Our business is dependent upon our employees' and outsourcers' ability to perform, in an efficient and uninterrupted fashion, necessary business functions such as processing policies and paying claims. A shutdown or inability to access one or more of our facilities, a power outage, or a failure of one or more of our information technology, telecommunications or other systems could significantly impair our ability to perform such functions on a timely basis. If sustained or repeated, such a business interruption, system failure or service denial could result in a deterioration of our ability to write and process business, provide customer service, pay claims in a timely manner or perform other necessary business functions. Computer viruses, hackers and other external hazards including catastrophe events could expose our data systems to security breaches. These risks could expose us to data loss and damages. As a result, our ability to conduct our business might be adversely affected. To date, we have not experienced a material breach of cybersecurity. While administrative and technical controls, along with other preventative actions, reduce the risk of cyber incidents and protect our information technology, they may be insufficient to prevent cyber attacks and/or other security breaches to our computer systems.

We outsource certain technology and business process functions to third parties and may do so increasingly in the future. If we do not effectively develop and implement our outsourcing strategy, third party providers do not perform as anticipated or we experience technological or other problems with a transition, we may not realize productivity improvements or cost efficiencies and may experience operational difficulties, increased costs and a loss of business. Our outsourcing of certain technology and business process functions to third parties may expose us to enhanced risk related to data security, which could result in monetary and reputational damages. In addition, our ability to receive services from third party providers might be impacted by cultural differences, political instability, unanticipated regulatory requirements or policies. As a result, our ability to conduct our business might be adversely affected.

**Our operating results may be adversely affected by currency fluctuations.**

Our reporting currency is the U.S. dollar. However, a portion of our gross premiums are written in currencies other than the U.S. dollar and a portion of our loss reserves are in non-U.S. currencies. In addition, a portion of our investment portfolio is denominated in currencies other than the U.S. dollar. From time to time, we may experience losses resulting from fluctuations in the values of these non-U.S. currencies, which could adversely affect our operating results. Although we attempt to manage our foreign currency exposure through matching of our major foreign-denominated assets and liabilities, as well as

through use of currency derivatives, there is no guarantee that we will successfully mitigate our exposure to foreign exchange losses.

**We may require additional capital in the future, which may not be available or may only be available on unfavorable terms.**

Our future capital requirements depend on many factors, including regulatory requirements, our ability to write new business successfully, the frequency and severity of catastrophe events and our ability to establish premium rates and reserves at levels sufficient to cover losses. We may need to raise additional funds through financings. If we are unable to do so, it may curtail our growth and reduce our assets. Any equity or debt financing, if available at all, may be on terms that are not favorable to us. Equity financings could be dilutive to our existing shareholders and could result in the issuance of securities that have rights, preferences and privileges that are senior to those of our other securities. If we cannot obtain adequate capital on favorable terms or at all, our business, operating results and financial condition could be adversely affected.

**Our inability to obtain the necessary credit could affect our ability to offer reinsurance in certain markets.**

Neither AXIS Specialty Bermuda nor AXIS Re SE is licensed or admitted as a (re)insurer in any jurisdiction other than Bermuda, Ireland and Singapore. Because the U.S. and some other jurisdictions do not permit insurance companies to take credit on their statutory financial statements for reinsurance obtained from unlicensed or non-admitted insurers unless appropriate security mechanisms are in place, our reinsurance clients in these jurisdictions typically require AXIS Specialty Bermuda and AXIS Re SE to provide letters of credit or other collateral. Our credit facilities are used to post letters of credit. However, if our credit facilities are not sufficient or if we are unable to renew our credit facilities or arrange for other types of security on commercially affordable terms, AXIS Specialty Bermuda and AXIS Re SE could be limited in their ability to write business for some of our clients.

**A downgrade in our financial strength or credit ratings by one or more rating agencies could materially and negatively impact our business, financial condition, results of operations and/or liquidity.**

As our ability to underwrite business is dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. A downgrade, withdrawal or negative watch/outlook by any of these institutions could cause our competitive position in the (re)insurance industry to suffer and make it more difficult for us to market our products. If we experience a credit rating downgrade, withdrawal or negative watch/outlook in the future, we could incur higher borrowing costs and may have more limited means to access capital. A downgrade, withdrawal or negative watch/outlook could also result in a substantial loss of business for us, as ceding companies and brokers that place such business may move to other (re)insurers with higher ratings.

**The regulatory system under which we operate, and potential changes thereto, could have a material adverse effect on our business.**

In a time of financial uncertainty or a prolonged economic downturn or recession, regulators may choose to adopt more restrictive insurance laws and regulations, which may result in lower revenues and/or higher costs and thus could materially and adversely affect our results of operations.

Our (re)insurance subsidiaries conduct business globally and our businesses in each of these jurisdictions are subject to varying degrees of regulation and supervision. The laws and regulations of the jurisdictions in which our (re)insurance subsidiaries are domiciled require, among other things, that our subsidiaries maintain minimum levels of statutory capital and liquidity, meet solvency standards, participate in guaranty funds and submit to periodic examinations of their financial condition and compliance with underwriting regulations. These laws and regulations also limit or restrict payments of dividends and reductions in capital. Statutes, regulations and policies may also restrict the ability of these subsidiaries to write (re)insurance contracts, to make certain investments and to distribute funds. The purpose of insurance laws and regulations generally is to protect insureds and ceding insurance companies, not our shareholders. We may not be able to comply fully with, or obtain appropriate exemptions from, these statutes and regulations. Failure to comply with or to obtain appropriate authorizations and/or exemptions under any applicable laws could result in restrictions on our ability to do business or undertake activities that are regulated in one or more of the jurisdictions in which we conduct business and could subject us to fines and other sanctions. In addition, changes in the laws or regulations to which our (re)insurance subsidiaries are subject or in the interpretation thereof by enforcement or regulatory agencies could have an adverse effect on our business.

**Potential government intervention in our industry as a result of recent events and instability in the marketplace for insurance products could hinder our flexibility and negatively affect the business opportunities that may be available to us in the market.**

Government intervention and the possibility of future government intervention have created uncertainty in the (re)insurance markets. Government regulators are generally concerned with the protection of policyholders to the exclusion of other constituents, including shareholders of (re)insurers. An example of such intervention was the expansion of the Florida Hurricane Catastrophe Fund in 2007, which increased the capacity of the Fund to compete against commercial providers of catastrophe reinsurance. In addition, in December 2007, the TRIEA of 2007 extended the material provisions of TRIA for an additional seven years to December 31, 2014 and expanded coverage to include domestic acts of terrorism.

In recent years certain U.S. and non-U.S. judicial and regulatory authorities, including U.S. Attorney's Offices and certain state attorneys general, have commenced investigations into other business practices in the insurance industry. In addition, although the U.S. federal government has not historically regulated insurance, there have been proposals from time to time, and especially after the recent global financial crisis, to impose federal regulation on the insurance industry. For example, in 2010, Dodd-Frank established a FIO within the U.S. Treasury. This FIO initially has limited regulatory authority and is empowered to gather data and information regarding the insurance industry, including conducting a study for submission to the U.S. Congress on how to modernize and improve insurance regulation in the U.S. Further, Dodd-Frank gives the Federal Reserve supervisory authority over a number of financial services companies, including insurance companies, if they are designated by a two-thirds vote of a Financial Stability Oversight Council as 'systemically important'. While we do not believe that we are systemically important, as defined in Dodd-Frank, Dodd-Frank or additional federal regulation that is adopted in the future could impose significant burdens on us, impact the ways in which we conduct our business, increase compliance costs, duplicate state regulation and/or could result in a competitive disadvantage.

Further, once the European Parliament approves Omnibus II, which will include a commencement date, our European legal entities will be subject to Solvency II regulations. Solvency II will replace the existing European Commission ("E.C.") (re)insurance legislation and has three pillars: (i) a risk based capital assessment, including the approval of internal capital models, (ii) a principles-based risk governance framework, and (iii) external regulatory disclosure obligations. Our European subsidiaries AXIS Specialty Europe and AXIS Re SE are working towards becoming Solvency II compliant. The Bermuda Monetary Authority ("BMA") is seeking "equivalence" under the Solvency II directive and the E.C. has completed a preliminary equivalence assessment, identifying certain areas for improvement prior to granting full equivalence. AXIS Specialty Limited is working towards meeting the new BMA requirements. Many of the detailed requirements are still being finalized by the E.C. The final implementation of the Solvency II directive may require us to incur considerable expense in order to comply with the requirements and the adoption of new capital modeling rules could impact the levels of capital required to operate our Bermuda and European subsidiaries. Solvency II could also increase our compliance costs and impact the way in which we conduct our business and govern our subsidiaries.

While we cannot predict the exact nature, timing or scope of possible governmental initiatives, such proposals could adversely affect our business by, among other things:

- Providing reinsurance capacity in markets and to consumers that we target;
- Requiring our further participation in industry pools and guaranty associations;
- Expanding the scope of coverage under existing policies; e.g., following large disasters;
- Further regulating the terms of (re)insurance contracts; or
- Disproportionately benefiting the companies of one country over those of another.

**Since we depend on a few brokers for a large portion of our revenues, loss of business provided by any one of them could adversely affect us.**

We market our (re)insurance worldwide primarily through (re)insurance brokers and derive a significant portion of our business from a limited number of brokers. Marsh & McLennan Companies, Inc., including its subsidiary Guy Carpenter & Company, Inc., Aon Corporation and Willis Group Holdings Ltd., provided a total of 61% of our gross premiums written during 2012. Our relationships with these brokers are based on the quality of our underwriting and claim services, as well as our financial strength ratings. Any deterioration in these factors could result in the brokers advising our clients to place their business with other (re)insurers. In addition, these brokers also have, or may in the future acquire, ownership interests in insurance and reinsurance companies that may compete with us and these brokers may favor their own (re)insurers over other companies. Loss of all or a substantial portion of the business provided by one or more of these brokers could have a material adverse effect on our business.

**Our reliance on brokers subjects us to credit risk.**

In accordance with industry practice, we pay amounts owed on claims under our (re)insurance contracts to brokers, and these brokers pay these amounts over to the clients that have purchased (re)insurance from us. Although the law is unsettled and depends upon the facts and circumstances of the particular case, in some jurisdictions, if a broker fails to make such a payment, we might remain liable to the insured or ceding insurer for the deficiency.

Conversely, in certain jurisdictions, when the insured or ceding insurer pays premiums for these policies to brokers for payment over to us, these premiums might be considered to have been paid and the insured or ceding insurer will no longer be liable to us for those amounts, whether or not we have actually received the premiums from the broker. Consequently, we assume a degree of credit risk associated with brokers with whom we transact business. These risks are heightened during periods characterized by financial market instability and/or an economic downturn or recession.

**Certain of our policyholders and intermediaries may not pay premiums owed to us due to bankruptcy or other reasons.**

Bankruptcy, liquidity problems, distressed financial condition or the general effects of economic recession may increase the risk that policyholders or intermediaries, such as insurance brokers, may not pay a part of or the full amount of premiums owed to us, despite an obligation to do so. The terms of our contracts may not permit us to cancel our insurance even though we have not received payment. If non-payment becomes widespread, whether as a result of bankruptcy, lack of liquidity, adverse economic conditions, operational failure or otherwise, it could have a material adverse impact on our revenues and results of operations.

**Changes in current accounting practices and future pronouncements may materially impact our reported financial results.**

Developments in accounting practices may require us to incur considerable additional expenses to comply with such developments, particularly if we are required to prepare information relating to prior periods for comparative purposes or to apply the new requirements retroactively. The impact of changes in current accounting practices and future pronouncements cannot be predicted but may affect the calculation of net income, net equity and other relevant financial statement line items. In particular, the U.S. Financial Accounting Standards Board (“FASB”) and the International Accounting Standards Board (“IASB”, and together with the FASB, the “Boards”) continue to work jointly on an insurance contract project, although the Boards acknowledge that the resulting standards will not converge. Continued deliberations are expected in 2013, with each Board expected to issue Exposure Drafts. The accounting and reporting guidance for insurance contracts proposed by both Boards would result in a material change from the current insurance accounting models toward more fair value-based models. Additionally, the Boards continue to develop a comprehensive model for accounting for and reporting of financial instruments, which may lead to further recognition of fair value changes through net income and changes in the way impairments are measured. Changes resulting from these two projects could introduce significant volatility in the earnings of insurance industry participants. There remains considerable uncertainty with respect to the final outcome of these two projects.



**We could be adversely affected by the loss of one or more key executives or by an inability to attract and retain qualified personnel.**

Our success depends on our ability to retain the services of our existing key executives and to attract and retain additional qualified personnel in the future. The loss of the services of any of our key executives or the inability to hire and retain other highly qualified personnel in the future could adversely affect our ability to conduct our business. There can be no assurance that we will be successful in identifying, hiring or retaining successors on terms acceptable to us or on any terms.

Under Bermuda law, non-Bermudians, with some limited exceptions, may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government only upon showing that, after proper public advertisement in most cases, no Bermudian or spouse of a Bermudian, holder of a permanent resident certificate or holder of a working resident certificate has applied who meets the minimum standard requirements for the advertised position. In 2001, the Bermuda government announced a new immigration policy limiting the duration of work permits to between six and nine years, with specified exemptions for “key” employees. In March 2004, the Bermuda government announced an amendment to the immigration policy which expanded the categories of occupations recognized by the government as “key” and for which businesses are eligible to apply for holders of jobs in those categories to be exempt from the six to nine year term limits. The categories include senior executives (chief executive officers, presidents through vice presidents), managers with global responsibility, senior financial posts (treasurers, chief financial officers through controllers, specialized qualified accountants, quantitative modeling analysts), certain legal professionals (general counsel, specialist attorneys, qualified legal librarians and knowledge managers), senior insurance professionals (senior underwriters, senior claims adjustors), experienced/specialized brokers, actuaries, specialist investment traders/analysts and senior information technology engineers/managers. All executive officers who work in our Bermuda office that require work permits have obtained them.

**Competition in the insurance industry could reduce our growth and profitability.**

The (re)insurance industry is highly competitive. We compete on an international and regional basis with major U.S., Bermuda, European and other international (re)insurers and with Lloyd's underwriting syndicates, some of which have greater financial, marketing and management resources than we do. We also compete with new companies that continue to be formed to enter the (re)insurance markets. In addition, capital market participants have recently created alternative products that are intended to compete with reinsurance products. Increased competition could result in fewer submissions, lower premium rates, less favorable policy terms and conditions and greater costs of customer acquisition and retention. In addition, if industry pricing does not meet our hurdle rate, we may reduce our future underwriting activities. These factors could have a material adverse effect on our growth and profitability.

**Our ability to pay dividends and to make payments on indebtedness may be constrained by our holding company structure.**

AXIS Capital is a holding company and has no direct operations of its own. AXIS Capital has no significant operations or assets other than its ownership of the shares of its operating (re)insurance subsidiaries, AXIS Specialty Bermuda, AXIS Re SE, AXIS Specialty Europe, AXIS Re U.S., AXIS Specialty U.S., AXIS Surplus and AXIS Insurance Co. (collectively, our “Insurance Subsidiaries”). Dividends and other permitted distributions from our Insurance Subsidiaries (in some cases through our subsidiary holding companies), are our primary source of funds to meet ongoing cash requirements, including debt service payments and other expenses, and to pay dividends to our shareholders. Our Insurance Subsidiaries are subject to significant regulatory restrictions limiting their ability to declare and pay dividends and make distributions. The inability of our Insurance Subsidiaries to pay dividends in an amount sufficient to enable us to meet our cash requirements at the holding company level could have a material adverse effect on our business and our ability to pay dividends and make payments on our indebtedness.

**Global climate change may have a material adverse effect on our results of operation and financial condition if we are not able to adequately assess and reserve for the increased frequency and severity of catastrophes resulting from these environmental factors.**

The frequency and severity of natural catastrophe activity, including hurricanes, tornadoes, floods and droughts, has been greater in recent years. Atmospheric concentrations of carbon dioxide and other greenhouse gases have increased dramatically since the industrial revolution and there is debate as to whether this has caused a gradual increase in global average temperatures. Increasing global average temperatures may continue in the future and could impact our business in the long-term. However, there is no clear consensus in the scientific community regarding the effect of global environmental

factors on the frequency and severity of catastrophes. Climatologists concur that heat from the ocean drives hurricanes, but they cannot agree on how much ocean temperature changes alter the annual outlook. In addition, it is unclear whether rising sea temperatures are part of a longer cycle.

We attempt to mitigate the risk of financial exposure from climate change through our underwriting risk management practices. This includes sensitivity to geographic concentrations of risks, the purchase of protective reinsurance and selective underwriting criteria which can include, but is not limited to, higher premiums and deductibles and more specifically excluded policy risks. However, given the scientific uncertainty about the causes of increased frequency and severity of catastrophes and the lack of adequate predictive tools, a continuation and worsening of recent trends may have a material impact on our results of operation or financial condition.

**AXIS Capital is a Bermuda company and it may be difficult for you to enforce judgments against it or its directors and executive officers.**

AXIS Capital is incorporated pursuant to the laws of Bermuda and our business is based in Bermuda. In addition, some of our directors and officers reside outside the United States, and all or a substantial portion of our assets and the assets of such persons are located in jurisdictions outside the United States. As a result, it may be difficult or impossible to effect service of process within the United States upon those persons or to recover against us or them on judgments of U.S. courts, including judgments predicated upon civil liability provisions of the U.S. federal securities laws. Further, it may not be possible to bring a claim in Bermuda against us or our directors and officers for violation of U.S. federal securities laws because these laws may have no extraterritorial application under Bermuda law and do not have force of law in Bermuda. A Bermuda court may, however, impose civil liability, including the possibility of monetary damages, on us or our directors and officers if the facts alleged in a complaint constitute or give rise to a cause of action under Bermuda law.

**There are provisions in our organizational documents that may reduce or increase the voting rights of our shares.**

Our bye-laws generally provide that shareholders have one vote for each common share held by them and are entitled to vote, on a non-cumulative basis, at all meetings of shareholders. However, the voting rights exercisable by a shareholder may be limited so that certain persons or groups are not deemed to hold 9.5% or more of the voting power conferred by our shares. Under these provisions, some shareholders may have the right to exercise their voting rights limited to less than one vote per share. Moreover, these provisions could have the effect of reducing the voting power of some shareholders who would not otherwise be subject to the limitation by virtue of their direct share ownership. In addition, our board of directors may limit a shareholder's exercise of voting rights where it deems it necessary to do so to avoid adverse tax, legal or regulatory consequences.

We also have the authority under our bye-laws to request information from any shareholder for the purpose of determining whether a shareholder's voting rights are to be limited pursuant to the bye-laws. If a shareholder fails to respond to our request for information or submits incomplete or inaccurate information in response to a request by us, we may, in our sole discretion, eliminate the shareholder's voting rights.

**There are provisions in our bye-laws that may restrict the ability to transfer common shares and which may require shareholders to sell their common shares.**

Our board of directors may decline to register a transfer of any common shares under some circumstances, including if they have reason to believe that any non-de minimis adverse tax, regulatory or legal consequences to us, any of our subsidiaries or any of our shareholders may occur as a result of such transfer. Our bye-laws also provide that if our board of directors determines that share ownership by a person may result in non-de minimis adverse tax, legal or regulatory consequences to us, any of our subsidiaries or any of our shareholders, then we have the option, but not the obligation, to require that shareholder to sell to us or to third parties to whom we assign the repurchase right for fair value the minimum number of common shares held by such person which is necessary to eliminate the non-de minimis adverse tax, legal or regulatory consequences.

**Applicable insurance laws may make it difficult to effect a change of control of our company.**

Before a person can acquire control of a U.S. insurance company, prior written approval must be obtained from the insurance commissioner of the state where the domestic insurer is domiciled. Prior to granting approval of an application to acquire control of a domestic insurer, the state insurance commissioner will consider such factors as the financial strength of the acquiror, the integrity and management of the acquiror's board of directors and executive officers, the acquiror's plans for the

future operations of the domestic insurer and any anti-competitive results that may arise from the consummation of the acquisition of control. Generally, state statutes provide that control over a domestic insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, 10% or more of the voting securities of the domestic insurer. Because a person acquiring 10% or more of our common shares would indirectly control the same percentage of the stock of the AXIS U.S. Subsidiaries, the insurance change of control laws of Connecticut, Illinois and New York would likely apply to such a transaction.

In addition, the Insurance Acts and Regulations in Ireland require that anyone acquiring or disposing of a direct or indirect holding in an Irish authorized insurance company (such as AXIS Specialty Europe) that represents 10% or more of the capital or of the voting rights of such company or that makes it possible to exercise a significant influence over the management of such company, or anyone who proposes to decrease or increase that holding to specified levels, must first notify the CBI of their intention to do so. They also require any Irish authorized insurance company that becomes aware of any acquisitions or disposals of its capital involving the specified levels to notify the CBI. The specified levels are 20%, 33% and 50% or such other level of ownership that results in the company becoming the acquiror's subsidiary within the meaning of article 20 of the European Communities (non-Life Insurance) Framework Regulations 1994.

The CBI has three months from the date of submission of a notification within which to oppose the proposed transaction if the CBI is not satisfied as to the suitability of the acquiror in view of the necessity "to ensure prudent and sound management of the insurance undertaking concerned." Any person owning 10% or more of the capital or voting rights or an amount that makes it possible to exercise a significant influence over the management of AXIS Capital would be considered to have a "qualifying holding" in AXIS Specialty Europe.

While our bye-laws limit the voting power of any shareholder to less than 9.5%, there can be no assurance that the applicable regulatory body would agree that a shareholder who owned 10% or more of our shares did not, because of the limitation on the voting power of such shares, control the applicable Insurance Subsidiary. These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control of the Company, including transactions that some or all of our shareholders might consider to be desirable.

**Anti-takeover provisions in our bye-laws could impede an attempt to replace our directors or to effect a change in control, which could diminish the value of our common shares.**

Our bye-laws contain provisions that may make it more difficult for shareholders to replace directors and could delay or prevent a change of control that a shareholder might consider favorable. These provisions include a staggered board of directors, limitations on the ability of shareholders to remove directors other than for cause, limitations on voting rights and restrictions on transfer of our common shares. These provisions may prevent a shareholder from receiving the benefit from any premium over the market price of our shares offered by a bidder in a potential takeover. Even in the absence of an attempt to effect a change in management or a takeover attempt, these provisions may adversely affect the prevailing market price of our shares if they are viewed as discouraging takeover attempts in the future.

**We may become subject to taxes in Bermuda after March 31, 2035, which may have a material adverse effect on our results of operations.**

The Bermuda Minister of Finance, under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, as amended, has given each of AXIS Capital, AXIS Specialty Holdings Bermuda Limited and AXIS Specialty Bermuda an assurance that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax will not be applicable to AXIS Capital, AXIS Specialty Bermuda or any of their respective operations, shares, debentures or other obligations until March 31, 2035. Given the limited duration of the Minister of Finance's assurance, we cannot be certain that we will not be subject to any Bermuda tax after March 31, 2035.

**Our non-U.S. companies may be subject to U.S. tax that may have a material adverse effect on our results of operations.**

AXIS Capital, AXIS Specialty Holdings Bermuda Limited and AXIS Specialty Bermuda are Bermuda companies, AXIS Specialty Holdings Ireland Limited ("AXIS Ireland Holdings"), AXIS Re SE, AXIS Specialty Europe, and AXIS Specialty Global Holdings Limited are Irish companies and AXIS Specialty U.K. Holdings Limited ("AXIS U.K. Holdings") is a U.K. company. We intend to manage our business so that each of these companies will operate in such a manner that none of these companies should be subject to U.S. tax (other than U.S. excise tax on (re)insurance premium income attributable to insuring

or reinsuring U.S. risks and U.S. withholding tax on some types of U.S. source investment income), because none of these companies should be treated as engaged in a trade or business within the United States. However, because there is considerable uncertainty as to the activities that constitute being engaged in a trade or business within the United States, we cannot be certain that the U.S. Internal Revenue Service will not contend successfully that any of AXIS Capital or its non-U.S. subsidiaries is/are engaged in a trade or business in the United States. If AXIS Capital or any of its non-U.S. subsidiaries were considered to be engaged in a trade or business in the United States, it could be subject to U.S. corporate income and additional branch profits taxes on the portion of its earnings effectively connected to such U.S. business. If this were to be the case, our results of operations could be materially adversely affected.

**Our non-U.K. companies may be subject to U.K. tax that may have a material adverse effect on our results of operations.**

We intend to operate in such a manner so that none of our companies, other than AXIS U.K. Holdings, should be resident in the United Kingdom for tax purposes and that none of our companies, other than AXIS Specialty Europe, should have a permanent establishment in the United Kingdom. Accordingly, we expect that none of our companies other than, AXIS U.K. Holdings and AXIS Specialty Europe should be subject to U.K. tax. Nevertheless, because neither case law nor U.K. statutes conclusively define the activities that constitute trading in the United Kingdom through a permanent establishment, the U.K. Inland Revenue might contend successfully that any of our companies, in addition to AXIS U.K. Holdings and AXIS Specialty Europe, is/are trading in the United Kingdom through a permanent establishment in the United Kingdom and therefore subject to U.K. tax.

In addition, there are circumstances in which companies that are neither resident in the United Kingdom, nor entitled to the protection afforded by a double tax treaty between the United Kingdom and the jurisdiction in which they are resident, may be exposed to income tax in the United Kingdom (other than by deduction or withholding) on the profits of a trade carried on there even if that trade is not carried on through a permanent establishment. We intend to operate in such a manner that none of our companies will fall within the charge to United Kingdom income tax in this respect.

If any of our companies, other than AXIS U.K. Holdings, were treated as being resident in the United Kingdom for U.K. corporation tax purposes, or if any of our companies other than AXIS U.K. Holdings, and AXIS Specialty Europe were to be treated as carrying on a trade in the United Kingdom, whether or not through a permanent establishment, our results of operations could be materially adversely affected.

**Our U.K. operations may be affected by future changes in U.K. tax law.**

AXIS U.K. Holdings should be treated as resident in the United Kingdom (by virtue of its being incorporated and managed there) and accordingly be subject to U.K. tax in respect of its worldwide income and gains. AXIS Specialty Europe is subject to U.K. corporation tax as a result of its having a permanent establishment in the United Kingdom, however the charge to U.K. corporation tax is limited to profits (including revenue profits and capital gains) attributable directly or indirectly to such permanent establishment. Any change in the basis or rate of U.K. corporation tax could materially adversely affect the operations of these companies.

**Our non-Irish companies may be subject to Irish tax that may have a material adverse effect on our results of operations.**

We intend to operate in such a manner so that none of our companies, other than AXIS Ireland Holdings, AXIS Re SE, AXIS Specialty Europe, and AXIS Specialty Global Holdings Limited should be resident in Ireland for tax purposes and that none of our companies, other than AXIS Ireland Holdings, AXIS Re SE, AXIS Specialty Europe, and AXIS Specialty Global Holdings Limited should be treated as carrying on a trade through a branch or agency in Ireland.

Accordingly, we expect that none of our companies other than AXIS Ireland Holdings, AXIS Re SE, AXIS Specialty Europe and AXIS Specialty Global Holdings Limited should be subject to Irish corporation tax. Nevertheless, since the determination as to whether a company is resident in Ireland is a question of fact to be determined based on a number of different factors and since neither case law nor Irish legislation conclusively defines the activities that constitute trading in Ireland through a branch or agency, the Irish Revenue Commissioners might contend successfully that any of our companies, in addition to AXIS Ireland Holdings, AXIS Re SE, AXIS Specialty Europe and AXIS Specialty Global Holdings Limited, is resident in or otherwise trading through a branch or agency in Ireland and therefore subject to Irish corporation tax. If this were the case, our results of operations could be materially adversely affected.

**If corporate tax rates in Ireland increase, our results of operations could be materially adversely affected.**

Trading income derived from the (re)insurance businesses carried on in Ireland by AXIS Specialty Europe and AXIS Re SE is generally taxed in Ireland at a rate of 12.5%. Over the past number of years, various EU member states have, from time to time, called for harmonization of the corporate tax base within the EU. Ireland, along with other member states, has consistently resisted any movement towards standardized corporate tax rates or tax base in the EU. The Government of Ireland has also made clear its commitment to retain the 12.5% rate of corporation tax. If, however, tax laws in Ireland change so as to increase the general corporation tax rate in Ireland, our results of operations could be materially adversely affected.

**If investments held by AXIS Specialty Europe or AXIS Re SE are determined not to be integral to the (re)insurance businesses carried on by those companies, additional Irish tax could be imposed and our business and financial results could be materially adversely affected.**

Based on administrative practice, taxable income derived from investments made by AXIS Specialty Europe and AXIS Re SE is generally taxed in Ireland at the rate of 12.5% on the grounds that such investments either form part of the permanent capital required by regulatory authorities, or are otherwise integral to the (re)insurance businesses carried on by those companies. AXIS Specialty Europe and AXIS Re SE intend to operate in such a manner so that the level of investments held by such companies does not exceed the amount that is integral to the (re)insurance businesses carried on by AXIS Specialty Europe and AXIS Re SE. If, however, investment income earned by AXIS Specialty Europe or AXIS Re SE exceeds these thresholds, or if the administrative practice of the Irish Revenue Commissioners changes, Irish corporation tax could apply to such investment income at a higher rate (currently 25%) instead of the general 12.5% rate, and our results of operations could be materially adversely affected.

**Changes in U.S. federal income tax law or the manner in which it is interpreted could materially adversely affect us.**

Legislation has been introduced in the U.S. Congress intended to eliminate some perceived tax advantages of companies (including insurance companies) that have legal domiciles outside the United States, but have certain U.S. connections. Previously, legislation had been introduced in Congress to limit the deductibility of reinsurance premiums paid by U.S. companies to non-U.S. affiliates. A similar provision was included as part of President Obama's proposed budget for fiscal year 2013. It is possible that this or similar legislation could be introduced in and enacted by the current Congress or future Congresses that could have an adverse impact on us. In addition, existing interpretations of U.S. federal income tax laws could change, also resulting in an adverse impact on us.

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**ITEM 1B. UNRESOLVED STAFF COMMENTS**

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We have no outstanding, unresolved comments from the SEC staff at December 31, 2012.

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**ITEM 2. PROPERTIES**

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We maintain office facilities in the United States, Bermuda, Europe, Canada, Australia, Singapore and Latin America. We own the property in which our offices are located in Dublin, Ireland, and we lease office space in the other countries. We renew and enter into new leases in the ordinary course of business as required. Our global headquarters is located at 92 Pitts Bay Road, Pembroke, Bermuda. We believe that our office space is sufficient for us to conduct our operations for the foreseeable future.

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**ITEM 3. LEGAL PROCEEDINGS**

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From time to time, we are subject to routine legal proceedings, including arbitrations, arising in the ordinary course of business. These legal proceedings generally relate to claims asserted by or against us in the ordinary course of insurance or reinsurance operations; estimated amounts payable under such proceedings are included in the reserve for losses and loss expenses in our Consolidated Balance Sheets.

Except as noted below, we are not a party to any material legal proceedings arising outside the ordinary course of business.

In 2005, a putative class action lawsuit was filed against our U.S. insurance subsidiaries. In re Insurance Brokerage Antitrust Litigation was filed on August 15, 2005 in the United States District Court for the District of New Jersey and includes as defendants numerous insurance brokers and insurance companies. The lawsuit alleges antitrust and Racketeer Influenced and Corrupt Organizations Act (“RICO”) violations in connection with the payment of contingent commissions and manipulation of insurance bids and seeks damages in an unspecified amount. On October 3, 2006, the District Court granted, in part, motions to dismiss filed by the defendants, and ordered plaintiffs to file supplemental pleadings setting forth sufficient facts to allege their antitrust and RICO claims. After plaintiffs filed their supplemental pleadings, defendants renewed their motions to dismiss. On April 15, 2007, the District Court dismissed without prejudice plaintiffs' complaint, as amended, and granted plaintiffs thirty (30) days to file another amended complaint and/or revised RICO Statement and Statements of Particularity. In May 2007, plaintiffs filed (i) a Second Consolidated Amended Commercial Class Action complaint, (ii) a Revised Particularized Statement Describing the Horizontal Conspiracies Alleged in the Second Consolidated Amended Commercial Class Action Complaint, and (iii) a Third Amended Commercial Insurance Plaintiffs' RICO Case Statement Pursuant to Local Rule 16.1(B)(4). On June 21, 2007, the defendants filed renewed motions to dismiss. On September 28, 2007, the District Court dismissed with prejudice plaintiffs' antitrust and RICO claims and declined to exercise supplemental jurisdiction over plaintiffs' remaining state law claims. On October 10, 2007, plaintiffs filed a notice of appeal of all adverse orders and decisions to the United States Court of Appeals for the Third Circuit, and a hearing was held in April 2009. On August 16, 2010, the Third Circuit Court of Appeals affirmed the District Court's dismissal of the antitrust and RICO claims arising from the contingent commission arrangements and remanded the case to the District Court with respect to the manipulation of insurance bids allegations. We continued to believe that the lawsuit was completely without merit and on that basis vigorously defended the filed action. However, for the sole purpose of avoiding additional litigation costs, we reached an agreement in principle with plaintiffs during the first quarter of 2011 to settle all claims and causes of action in this matter for an immaterial amount. On March 30, 2012, the District Court issued the final settlement order, and this matter is now closed.

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**ITEM 4. MINE SAFETY DISCLOSURES**

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Not Applicable.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common shares are listed on the New York Stock Exchange under the symbol "AXS". The following table provides the high and low sales prices per share of our common shares for each of the fiscal quarters in the last two fiscal years as reported on the New York Stock Exchange Composite Tape:

	2012			2011		
	High	Low	Dividends Declared	High	Low	Dividends Declared
1st Quarter	\$ 33.52	\$ 30.35	\$ 0.24	\$ 37.81	\$ 32.07	\$ 0.23
2nd Quarter	\$ 35.12	\$ 30.60	\$ 0.24	\$ 36.63	\$ 30.23	\$ 0.23
3rd Quarter	\$ 36.45	\$ 32.03	\$ 0.24	\$ 32.40	\$ 24.80	\$ 0.23
4th Quarter	\$ 38.80	\$ 33.65	\$ 0.25	\$ 32.99	\$ 25.03	\$ 0.24

On February 4, 2013, the number of holders of record of our common shares was 33. This figure does not represent the actual number of beneficial owners of our common shares because shares are frequently held in "street name" by securities dealers and others for the benefit of beneficial owners who may vote the shares.

While we expect to continue paying cash dividends in the foreseeable future, the declaration and payment of future dividends will be at the discretion of our Board of Directors and will depend upon many factors, including our earnings, financial condition, business needs, capital and surplus requirements of our operating subsidiaries and regulatory and contractual restrictions, including those set forth in our credit facilities. See Item 7 'Liquidity and Capital Resources' for further information.

#### ISSUER PURCHASES OF EQUITY SECURITIES

The following table provides information regarding the number of common shares we repurchased in the quarter ended December 31, 2012:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(a)</sup>	Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Announced Plans or Programs <sup>(b)</sup>
October 1-31, 2012	890	\$36.45	—	\$236.3 million
November 1-30, 2012	2,125	\$35.26	—	\$236.3 million
December 1-31, 2012	21,892	\$35.96	—	\$750.0 million
<b>Total</b>	<b>24,907</b>		<b>—</b>	<b>\$750.0 million</b>

- (a) From time to time, we purchase shares in connection with the vesting of restricted stock awards granted to our employees under our 2007 Long-Term Equity Compensation Plan. The purchase of these shares is separately authorized and is not part of our Board-authorized share repurchase program, described below.
- (b) On September 24, 2010, our Board of Directors approved a share repurchase plan to repurchase up to \$750 million of our common shares until December 31, 2012. On December 17, 2012, our Board of Directors authorized a new share repurchase plan to repurchase \$750 million of our common shares through to December 31, 2014. The new share repurchase authorization, effective January 1, 2013, replaced the previous plan which had \$236.3 million available until the end of 2012. Share repurchases may be effected from time to time in open market or privately negotiated transactions, depending on market conditions.

## ITEM 6. SELECTED FINANCIAL DATA

The following tables set forth our selected historical consolidated financial information for the last five years. This data should also be read in conjunction with the Consolidated Financial Statements and the accompanying notes presented under Item 8 and with 'Management's Discussion and Analysis of Financial Condition and Results of Operations' under Item 7.

	At and For the year Ended December 31,				
	2012	2011	2010	2009	2008
(in thousands, except per share amounts)					
<b>Selected Statement of Operations Data:</b>					
Gross premiums written	\$ 4,139,643	\$ 4,096,153	\$ 3,750,536	\$ 3,587,295	\$ 3,390,388
Net premiums earned	3,415,463	3,314,961	2,947,410	2,791,764	2,687,181
Net investment income	380,957	362,430	406,892	464,478	247,237
Net realized investment gains (losses) <sup>(1)</sup>	127,469	121,439	195,098	(311,584)	(85,267)
Net losses and loss expenses	2,096,028	2,675,052	1,677,132	1,423,872	1,712,766
Acquisition costs	627,653	587,469	488,712	420,495	366,509
General and administrative expenses	560,981	459,151	449,885	370,157	335,758
Interest expense and financing costs	61,863	62,598	55,876	32,031	31,673
Preferred share dividends	38,228	36,875	36,875	36,875	36,875
Net income available to common shareholders	\$ 495,004	\$ 9,430	\$ 819,848	\$ 461,011	\$ 350,501
<b>Per Common Share Data:</b>					
Basic earnings per common share	\$ 4.05	\$ 0.08	\$ 6.74	\$ 3.36	\$ 2.50
Diluted earnings per common share	\$ 4.00	\$ 0.07	\$ 6.02	\$ 3.07	\$ 2.26
Cash dividends declared per common share	\$ 0.97	\$ 0.93	\$ 0.86	\$ 0.81	\$ 0.755
Basic weighted average common shares outstanding	122,148	122,499	121,728	137,279	140,322
Diluted weighted average common shares outstanding	123,654	128,122	136,199	150,371	155,320
<b>Operating Ratios:<sup>(2)</sup></b>					
Net loss and loss expense ratio	61.4%	80.7%	56.9%	51.0%	63.7%
Acquisition cost ratio	18.4%	17.7%	16.6%	15.1%	13.6%
General and administrative expense ratio	16.4%	13.9%	15.2%	13.2%	12.5%
Combined ratio	96.2%	112.3%	88.7%	79.3%	89.8%
<b>Selected Balance Sheet Data:</b>					
Investments	\$ 13,546,894	\$ 12,466,889	\$ 11,524,166	\$ 10,622,104	\$ 8,611,898
Cash and cash equivalents	850,550	1,082,838	1,045,355	864,054	1,820,673
Reinsurance recoverable on unpaid and paid losses	1,863,819	1,770,329	1,577,547	1,424,172	1,378,630
Total assets	18,852,344	17,806,059	16,445,731	15,306,524	14,282,834
Reserve for losses and loss expenses	9,058,731	8,425,045	7,032,375	6,564,133	6,244,783
Unearned premiums	2,454,692	2,454,462	2,333,676	2,209,397	2,162,401
Senior notes	995,245	994,664	994,110	499,476	499,368
Total shareholders' equity	5,779,761	5,444,079	5,624,970	5,500,244	4,461,041
Book value per common share <sup>(3)</sup>	\$ 44.75	\$ 39.37	\$ 45.60	\$ 37.84	\$ 29.08
Diluted book value per common share <sup>(3)</sup>	\$ 42.97	\$ 38.08	\$ 39.37	\$ 33.65	\$ 25.79
Common shares outstanding	117,920	125,588	112,393	132,140	136,212
Common shares outstanding - diluted	122,793	129,818	130,189	148,596	153,588

(1) Effective April 1, 2009, we adopted new Financial Accounting Standards Board guidance for the recognition and presentation of other-than-temporary impairments for fixed maturities.

(2) Operating ratios are calculated by dividing the respective operating expenses by net premiums earned.

(3) Book value per common share and diluted book value per common share are based on total common shareholders' equity divided by common shares and diluted common share equivalents outstanding, respectively.



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**ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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The following is a discussion and analysis of our results of operations for the years ended December 31, 2012, 2011 and 2010 and our financial condition at December 31, 2012 and 2011. This should be read in conjunction with the Consolidated Financial Statements and related notes included in Item 8 of this report. Tabular dollars are in thousands, except per share amounts. Amounts in tables may not reconcile due to rounding differences.

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## 2012 FINANCIAL HIGHLIGHTS

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### 2012 Consolidated Results of Operations

- Net income available to common shareholders of \$495 million, or \$4.05 per share basic and \$4.00 per diluted share
- Operating income of \$422 million, or \$3.41 per diluted share<sup>(1)</sup>
- Gross premiums written of \$4.1 billion
- Net premiums written of \$3.3 billion
- Net premiums earned of \$3.4 billion
- Net favorable prior year reserve development of \$245 million
- Significant catastrophe and weather-related losses included:
  - Pre-tax net losses (net of related reinstatement premiums) of \$331 million in relation to Storm Sandy
  - Aggregate pre-tax net losses (net of related reinstatement premiums) of \$105 million for other notable events of 2012 (including the impact of severe drought conditions on U.S. crops, Hurricane Isaac and first and second quarter U.S. weather events)
- Net financial impact of Storm Sandy of \$301 million, after consideration of reinstatement premiums, ceding commissions and the associated income tax benefit
- No material change in our aggregate estimate for losses related to 2011 and 2010 calendar year natural catastrophe and weather-related events
- Underwriting income of \$263 million and combined ratio of 96.2%
- Net investment income of \$381 million
- Net realized investment gains of \$127 million
- Senior leadership transition in the second quarter resulted in separation payments and accelerated and incremental share-based compensation expenses totaling \$34 million

### 2012 Consolidated Financial Condition

- Total cash and investments of \$14.4 billion; fixed maturities, cash and short-term securities comprise 90% of total cash and investments and have an average credit rating of AA-
- Total assets of \$18.9 billion
- Reserve for losses and loss expenses of \$9.1 billion and reinsurance recoverable of \$1.9 billion
- Total debt of \$995 million and a debt to total capital ratio of 14.7%
- Repurchased 9.4 million common shares for total cost of \$318 million; remaining authorization under the repurchase program approved by our Board of Directors of \$634 million at February 21, 2013
- Common shareholders' equity of \$5.3 billion; diluted book value per common share of \$42.97

(1) Operating income (loss) is a non-GAAP financial measure as defined in SEC Regulation G. See 'Non-GAAP Financial Measures' for reconciliation to nearest GAAP financial measure (net income available to common shareholders).

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## EXECUTIVE SUMMARY

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### Business Overview

We are a Bermuda-based global provider of specialty lines insurance and treaty reinsurance products with operations in Bermuda, the United States, Europe, Singapore, Canada, Australia and Latin America. Our underwriting operations are organized around our two global underwriting platforms, AXIS Insurance and AXIS Reinsurance.

Our mission is to provide our clients and distribution partners with a broad range of risk transfer products and services and meaningful capacity, backed by significant financial strength. We manage our portfolio holistically, aiming to construct the optimum consolidated portfolio of funded and unfunded risks, consistent with our risk appetite and development of our franchise. We nurture an ethical, entrepreneurial and disciplined culture that promotes outstanding client service, intelligent risk taking and the achievement of superior risk-adjusted returns for our shareholders. We believe that the achievement of our objectives will position us as a leading global, diversified specialty insurance and reinsurance company, as measured by quality, sustainability and profitability. Our execution on this mission in 2012 included:

- the continuing growth of our new accident & health line, focused on specialty accident and health products; and
- the focus on lines of business with attractive rates, generating premium growth in our insurance segment.

In addition, we effectively lowered the weighted average annual dividend rate on our preferred equity capital base by 42 basis points, to 6.953%, at a book value cost of \$7 million. This was achieved via the issuance of \$400 million of 6.875% Series C shares, in conjunction with the redemption of \$150 million of our 7.25% Series A preferred shares and the repurchase of \$247 million of our 7.50% Series B preferred shares via tender offer.

### Results of Operations

Year ended December 31,	2012	% Change	2011	% Change	2010
Underwriting income (loss):					
Insurance	\$ 65,477	87%	\$ 35,034	(83%)	\$ 210,039
Reinsurance	197,660	nm	(362,260)	nm	199,164
Net investment income	380,957	5%	362,430	(11%)	406,892
Net realized investment gains	127,469	5%	121,439	(38%)	195,098
Other expenses, net	(224,322)	103%	(110,338)	(29%)	(154,470)
Net income	547,241	nm	46,305	(95%)	856,723
Preferred share dividends	(38,228)	4%	(36,875)	—%	(36,875)
Loss on repurchase of preferred shares	(14,009)	—%	—	—%	—
<b>Net income available to common shareholders</b>	<b>\$ 495,004</b>	nm	<b>\$ 9,430</b>	<b>(99%)</b>	<b>\$ 819,848</b>
<b>Operating income (loss)</b>	<b>\$ 421,523</b>	nm	<b>\$ (153,912)</b>	nm	<b>\$ 611,342</b>

nm – not meaningful

### Underwriting Results

**2012 versus 2011:** The \$590 million improvement in our underwriting result during 2012 was largely due to a reduction in the frequency and severity of natural catastrophe and weather-related losses. During 2011, we recognized aggregate pre-tax net losses (net of related reinstatement premiums) of \$931 million for numerous catastrophe and weather events, including: the February Christchurch, New Zealand earthquake ("New Zealand II"), the Japanese earthquake and tsunami, the series of severe U.S. storms and tornadoes in April/May, first quarter Australian weather events (January floods and Cyclone Yasi), the Thai floods, the June Christchurch aftershock ("New Zealand III"), the Danish floods, Hurricane Irene and Tropical Storm Lee; these events impacted our reinsurance segment to a greater extent. Comparatively, in 2012, we recognized pre-tax net losses (net of related reinstatement premiums) of \$331 million for Storm Sandy and an aggregate \$105 million for the impact

of severe drought conditions on U.S. crops, Hurricane Isaac and first and second quarter U.S. weather events. Growth in net premiums earned in our insurance segment and improvements in the current accident year loss ratios exclusive of the catastrophe and weather-related losses for both segments further contributed to the improvement in 2012; this was partially offset by a \$13 million reduction in net favorable prior year reserve development and growth in general and administrative expenses.

Our insurance segment's underwriting income for 2011 included aggregate pre-tax net losses (inclusive of premiums to reinstate reinsurance protection) of \$157 million related to the 2011 events noted above. Comparatively, underwriting income for 2012 included pre-tax net losses (inclusive of related premiums to reinstate reinsurance protection) of \$178 million for Storm Sandy and an aggregate \$44 million for Hurricane Isaac and first and second quarter 2012 U.S. weather events. Despite increased catastrophe and weather-related losses in 2012, underwriting income for the segment improved due to growth in net premiums earned (driven by the expansion of our business over the past year), an improvement in the current accident year loss ratio exclusive of catastrophe and weather activity and a \$19 million increase in net favorable prior year reserve development. This was partially offset by commensurate growth in acquisition costs and general and administrative expenses.

The \$560 million improvement in the reinsurance segment's underwriting result was primarily attributable to the significantly lower level of natural catastrophe and weather-related losses; the majority of our 2011 natural catastrophe and weather-related losses emanated from our reinsurance segment and drove the underwriting loss for that year. The segment's underwriting loss for 2011 included aggregate pre-tax net losses (net of related reinstatement premiums) of \$774 million for the events noted above, with the most significant amounts being for New Zealand II, the Japanese earthquake and tsunami and the first quarter Australian weather events. Comparatively, in 2012, we recognized pre-tax net losses (net of related reinstatement premiums) of \$153 million for Storm Sandy and an aggregate \$60 million for the impact of severe drought conditions on U.S. crops, Hurricane Isaac and first and second quarter 2012 U.S. weather events. An improvement in the current accident year loss ratio, exclusive of these catastrophe and weather-related losses, further contributed to the improvement in 2012. Partially offsetting these improvements was a \$32 million reduction in net favorable prior year reserve development, a reduction in net premiums earned and increases in acquisition costs and general and administrative expenses.

**2011 versus 2010:** The significantly high frequency and severity of natural catastrophe activity in 2011, described above, was the primary driver of the deterioration in underwriting results in that year. However, natural catastrophe activity also impacted underwriting results for 2010. In comparison to the \$931 million for 2011 noted above, during 2010 we recognized aggregate pre-tax net losses (net of related reinstatement premiums) of \$248 million for the September New Zealand earthquake ("New Zealand I") and the Chilean earthquake, with substantially all of this emanating from our reinsurance segment. Further contributing to the reduction in underwriting income was a \$56 million decrease in net favorable prior year reserve development.

Our insurance segment's 2011 underwriting income included \$157 million in pre-tax net losses (inclusive of related premiums to reinstate reinsurance protection) related to the events of 2011 noted above, while catastrophe losses in 2010 were insignificant. A \$15 million reduction in net favorable prior year reserve development and an increase in acquisition costs also contributed to the reduction in underwriting income; reductions in ceded reinsurance costs and increases in gross premiums written contributed to higher net premiums earned and partially offset these reductions.

Our reinsurance segment's 2011 underwriting loss included aggregate pre-tax net losses (net of related reinstatement premiums) of \$774 million for the events of 2011 noted above. Substantially all of our natural catastrophe-related pre-tax net losses in 2010 emanated from the reinsurance segment. A \$40 million reduction in net favorable prior period reserve development also contributed to the variance in the underwriting result between periods.

### ***Net Investment Income***

The variability in our net investment income for 2010 through 2012 was largely attributable to our alternative investment portfolio ("other investments"). Income from this portfolio increased by \$56 million in 2012, driven by improved performance for our hedge funds (reflective of global equity market performance) and credit funds (driven by pricing improvement in underlying bank loans). Comparatively, income from these investments decreased \$33 million in 2011, reflective of the underperformance of both global equities and bank loans during in that year.

Excluding income from our other investments, net investment income decreased by \$12 million and \$37 million, respectively, in 2011 and 2012. These decreases were primarily attributable our fixed maturity portfolio, where lower reinvestment yields drove reductions in income despite higher investment balances.

### ***Net Realized Investment Gains***

During each period presented, we realized net investment gains largely due to the sale of fixed maturities. Other-than-temporary impairment ("OTTI") charges were \$24 million, \$16 million and \$18 million in 2012, 2011 and 2010, respectively.

### ***Other (Expenses) Revenues, Net***

Appreciation in the Sterling and euro against the U.S. dollar drove foreign exchange losses of \$30 million in 2012, related to the remeasurement of our foreign-denominated net insurance-related liabilities. In 2011 and 2010, depreciation in these currencies resulted in foreign exchange gains of \$45 million and \$16 million, respectively. Excluding these foreign exchange-related amounts, other expenses were \$170 million, \$155 million and \$195 million, respectively in 2010, 2011 and 2012.

The \$15 million decrease in 2011 was driven by a \$23 million reduction in income tax expense, as taxable income declined due to the significant catastrophe activity previously noted. This was partially offset by an increase in interest expense following our March 2010 senior note issuance.

A \$53 million increase in corporate expenses drove the increase in other expenses in 2012. Separation payments and accelerated and incremental share-based compensation costs related to our second quarter 2012 senior leadership transition totaled \$34 million and were the primary driver of this increase. Partially offsetting the increase in corporate expenses was a \$12 million reduction in tax expense, as the impact of Storm Sandy led to minimal taxable income in the U.S. for 2012.

### ***Loss on Repurchase of Preferred Shares***

In conjunction with the effective reduction of the dividend rate on our preferred equity base previously discussed, we repurchased \$150 million of our 7.25% Series A preferred shares and \$247 million of our 7.50% Series B preferred shares during the first half of 2012. While the Series A shares were redeemed at liquidation value, we paid a \$7 million premium to repurchase the Series B shares in advance of the first eligible redemption date. This premium, combined with the recognition of the proportionate share of issue costs for both series as an expense, resulted in a \$14 million loss. As the issue costs for these shares were recognized in shareholders' equity in the period the shares were originally issued, the only impact on book value related to the \$7 million premium on the Series B repurchase. Refer to Item 8, Note 13 to the Consolidated Financial Statements for further details.

### **Outlook**

Management expects gross premiums written to increase across both of our segments in 2013. The primary insurance market continues to see favorable pricing momentum. We see ongoing improvement across most classes and geographies within our insurance segment and will pursue opportunities to expand our reach in areas where we believe returns are most attractive.

We believe that the global reinsurance market is generally at equilibrium with acceptable levels of profitability. There is some pressure in lines that have shown strong profitability and have attracted new capacity in recent years. On the other hand, there is some upside pressure on pricing for loss-affected property treaties and lines with recent major loss activity, including Sandy-affected treaties, agriculture and marine, and Management expects that these areas will contribute to growth in reinsurance premiums.

## Financial Measures

We believe that the following financial indicators are important in evaluating our performance and measuring the overall growth in value generated for our common shareholders:

Year ended and at December 31,	2012	2011	2010
ROACE <sup>(1)</sup>	9.7%	0.2%	16.2%
Operating ROACE <sup>(2)</sup>	8.2%	(3.1%)	12.1%
Diluted book value per common share <sup>(3)</sup>	\$ 42.97	\$ 38.08	\$ 39.37
Cash dividends declared per common share	0.97	0.93	0.86
Value creation <sup>(4)</sup>	\$ 5.86	\$ (0.36)	\$ 6.58

- (1) Return on average common equity ("ROACE") is calculated by dividing net income available to common shareholders for the period by the average shareholders' equity determined by using the common shareholders' equity balances at the beginning and end of the period.
- (2) Operating ROACE is calculated by dividing operating income (loss) for the period by the average common shareholders' equity determined by using the common shareholders' equity balances at the beginning and end of the period. Operating ROACE is a non-GAAP financial measure, as defined in SEC Regulation G. See 'Non-GAAP Financial Measures' for additional information and a reconciliation to the nearest GAAP financial measure (ROACE).
- (3) Diluted book value per common share represents total common shareholders' equity divided by the number of common shares and diluted common share equivalents outstanding, determined using the treasury stock method.
- (4) Value creation represents the change in diluted book value per common share and dividends declared during the period.

### **Return on equity**

Our objective is to generate superior returns on capital that appropriately reward our common shareholders for the risks we assume and to grow revenue only when we expect the returns will meet or exceed our requirements. We recognize that the nature of underwriting cycles and the frequency or severity of large loss events in any one year may make it difficult to achieve a profitability target in any specific period and, therefore, established a ROACE target of 15% over the full underwriting cycle. Our average annual ROACE since inception is approximately 14%, tracking closely to our long-term goal.

**2012 versus 2011:** The improvement in our underwriting result, driven by the lower level of catastrophe and weather-related losses previously discussed, was the primary contributor to the improved operating ROACE; the increase in net investment income also contributed. These favorable variances were partially offset by the increase in corporate expenses previously discussed.

In addition to the items noted above for operating ROACE, ROACE is also impacted by net realized investment gains, foreign exchange losses (gains) and the loss on repurchase of preferred shares. The magnitude of our net realized investment gains resulted in these amounts contributing favorably, in aggregate, to our results for both periods; thus ROACE exceeded operating ROACE.

**2011 versus 2010:** Our underwriting loss, driven by catastrophe and weather-related losses, was the primary driver of the negative operating ROACE for 2011; reductions in net favorable prior year reserve development and net investment income also contributed to a lower return when compared to 2010.

Our combined net realized investment gains and foreign exchange gains for 2011 were sufficient for us to recognize net income for the period; as such, our ROACE for the year was marginally positive. Net realized investment gains and foreign exchange gains in 2010 also contributed to a higher ROACE, in comparison to operating ROACE.

### **Diluted book value per common share**

We consider diluted book value per common share to be an appropriate measure of our returns to common shareholders, as we believe growth in our book value on a diluted basis will ultimately translate into appreciation of our stock price.

The previously described impact of catastrophe and weather-related losses on our 2011 net income available to common shareholders was the primary driver of the 3% reduction in our diluted book value per common share for the 2011 fiscal year. During 2012, our diluted book value per common share appreciated by 13%, driven by \$495 million in net income available

to common shareholders, an overall improvement in valuations for our available-for-sale securities and, to a lesser extent, the execution of common share repurchases at a discount to book value.

### **Cash dividends per common share**

We believe in returning excess capital to our shareholders by way of dividends (as well as share repurchases) and, accordingly, our dividend policy is an integral part of the value we create for our shareholders. Our cumulatively strong earnings have permitted our Board of Directors to approve nine successive annual increases in quarterly common share dividends.

### **Value creation**

Taken together, we believe that growth in diluted book value per common share and common share dividends declared represent the total value created for our common shareholders. Despite the impact of catastrophe events, our net income combined with valuation improvements on our available-for-sale securities and common share repurchases executed at a discount to book value led to an increases in diluted book value per common share during 2010 and 2012; dividends declared provided additional value for our shareholders. The global frequency and severity of catastrophe activity in 2011 drove a small reduction in shareholder value for that year.

## UNDERWRITING RESULTS – GROUP

The following table provides our group underwriting results for the periods indicated. Underwriting income (loss) is a pre-tax measure of underwriting profitability that takes into account net premiums earned and other insurance related income as revenues and net losses and loss expenses, acquisition costs and underwriting-related general and administrative costs as expenses.

Year ended December 31,	2012	% Change	2011	% Change	2010
<b>Revenues:</b>					
Gross premiums written	\$ 4,139,643	1%	\$ 4,096,153	9%	\$ 3,750,536
Net premiums written	3,337,456	(2%)	3,419,434	9%	3,147,540
Net premiums earned	3,415,463	3%	3,314,961	12%	2,947,410
Other insurance related income	2,676		2,396		2,073
<b>Expenses:</b>					
Current year net losses and loss expenses	(2,340,868)		(2,932,513)		(1,990,187)
Prior year reserve development	244,840		257,461		313,055
Acquisition costs	(627,653)		(587,469)		(488,712)
Underwriting-related general and administrative expenses <sup>(1)</sup>	(431,321)		(382,062)		(374,436)
<b>Underwriting income (loss)<sup>(2)</sup></b>	<b>\$ 263,137</b>	nm	<b>\$ (327,226)</b>	nm	<b>\$ 409,203</b>
<b>General and administrative expenses<sup>(1)</sup></b>	<b>\$ 560,981</b>		<b>\$ 459,151</b>		<b>\$ 449,885</b>
<b>Income before income taxes<sup>(2)</sup></b>	<b>\$ 550,528</b>		<b>\$ 61,538</b>		<b>\$ 895,403</b>

nm - not meaningful

- (1) Underwriting-related general and administrative expenses is a non-GAAP measure as defined in SEC Regulation G. Our total general and administrative expenses also included \$129,660, \$77,089 and \$75,449 of corporate expenses for 2012, 2011 and 2010, respectively; refer to 'Other Expenses (Revenues), Net' for additional information related to these corporate expenses. Also, refer to 'Non-GAAP Financial Measures' for further information.
- (2) Group (or consolidated) underwriting income (loss) is a non-GAAP financial measure as defined in SEC Regulation G. Refer to Item 8, Note 3 to the Consolidated Financial Statements, for a reconciliation of consolidated underwriting income (loss) to the nearest GAAP financial measures (income before income taxes) for the periods indicated above. Also, refer to 'Non-GAAP Financial Measures' for additional information related to the presentation of consolidated underwriting income (loss).



## UNDERWRITING REVENUES

### *Premiums Written:*

Gross and net premiums written, by segment, were as follows:

Year ended December 31,	Gross Premiums Written				
	2012	% Change	2011	% Change	2010
Insurance	\$ 2,309,481	9%	\$ 2,121,829	11%	\$ 1,916,116
Reinsurance	1,830,162	(7%)	1,974,324	8%	1,834,420
<b>Total</b>	<b>\$ 4,139,643</b>	<b>1%</b>	<b>\$ 4,096,153</b>	<b>9%</b>	<b>\$ 3,750,536</b>
<b>% ceded</b>					
Insurance	<b>34%</b>	3 pts	31%	1 pts	30%
Reinsurance	<b>1%</b>	— pts	1%	— pts	1%
<b>Total</b>	<b>19%</b>	<b>2 pts</b>	<b>17%</b>	<b>1 pts</b>	<b>16%</b>
	Net Premiums Written				
	2012	% Change	2011	% Change	2010
Insurance	\$ 1,522,245	4%	\$ 1,466,134	10%	\$ 1,332,220
Reinsurance	1,815,211	(7%)	1,953,300	8%	1,815,320
<b>Total</b>	<b>\$ 3,337,456</b>	<b>(2%)</b>	<b>\$ 3,419,434</b>	<b>9%</b>	<b>\$ 3,147,540</b>

**2012 versus 2011:** Gross premiums written growth was driven by a \$188 million increase in our insurance segment, attributable to a number of lines of business, with the most significant increases emanating from professional lines, liability and accident & health. Growth in professional lines was driven by geographic expansion (including our European operations) and newer initiatives, with an improving rate environment also contributing. Select new business opportunities, primarily in our U.S. excess and surplus lines umbrella business, drove the increase in liability business; rate increases also contributed. Finally, our recently established accident & health line continued to generate new business.

Partially offsetting this growth was a reduction in gross premiums written in our reinsurance segment, primarily related to the repositioning of our catastrophe reinsurance portfolio throughout 2012. We reduced catastrophe exposure in certain zones, including the Northeast and Mid-Atlantic regions of the U.S.; this was partially offset by exposure increases in other areas, where we believe risk and return characteristics are more attractive. Property business also contributed to the overall reduction in gross premiums written for the reinsurance segment, with the drivers being reduced purchasing by certain of our clients and our evaluation of risk/return characteristics. In addition, our trade credit and bond reinsurance premiums also decreased, as we managed our European exposure base in light of current economic conditions and changes in contract terms.

The three point increase in the ceded premium ratio for our insurance segment was driven by changes in our reinsurance purchasing, primarily higher cession rates on our professional lines quota share reinsurance program on renewal during the second quarter. Business mix changes, driven by growth in our liability business, also contributed.

**2011 versus 2010:** Our new accident & health line was the primary driver of the 11% increase in gross premiums written in our insurance segment. Geographic expansion and new business initiatives also contributed to the increase. Gross premiums written growth for our reinsurance segment was primarily driven by proportional motor reinsurance business, with the primary contributing factors being increases on renewal and new business. Gross premiums written for trade credit and bond reinsurance business also increased.

### Net Premiums Earned:

Net premiums earned by segment were as follows:

Year ended December 31,	2012		2011		2010		% Change	
							11 to 12	10 to 11
Insurance	\$ 1,558,058	46%	\$ 1,429,687	43%	\$ 1,206,493	41%	9%	18%
Reinsurance	1,857,405	54%	1,885,274	57%	1,740,917	59%	(1%)	8%
<b>Total</b>	<b>\$ 3,415,463</b>	<b>100%</b>	<b>\$ 3,314,961</b>	<b>100%</b>	<b>\$ 2,947,410</b>	<b>100%</b>	<b>3%</b>	<b>12%</b>

Changes in net premiums earned reflect period to period changes in net premiums written and business mix, together with normal variability in premium earning patterns.

**2012 versus 2011:** Growth in net premiums earned for our insurance segment was primarily driven by recent growth in gross premiums written in our accident & health line; net premiums earned also increased due to growth in our professional lines business in recent quarters, though this was tempered by the previously mentioned increase in quota share cessions. The reduction in catastrophe gross premiums written during 2012, described above, was the primary driver of the decline in net premiums earned for our reinsurance segment.

**2011 versus 2010:** Eleven percent growth in gross premiums written and changes in our reinsurance purchasing effected during the second quarter of 2010 drove the 18% growth in net premiums earned for our insurance segment. The 8% increase in our reinsurance segment is consistent with gross premiums written growth.

### UNDERWRITING EXPENSES

The following table provides a breakdown of our combined ratio:

Year ended December 31,	2012	% Point Change	2011	% Point Change	2010
Current accident year loss ratio	68.5%	(20.0)	88.5%	21.0	67.5%
Prior year reserve development	(7.1%)	0.7	(7.8%)	2.8	(10.6%)
Acquisition cost ratio	18.4%	0.7	17.7%	1.1	16.6%
General and administrative expense ratio <sup>(1)</sup>	16.4%	2.5	13.9%	(1.3)	15.2%
<b>Combined ratio</b>	<b>96.2%</b>	<b>(16.1)</b>	<b>112.3%</b>	<b>23.6</b>	<b>88.7%</b>

(1) The general and administration expense ratio includes corporate expenses not allocated to underwriting segments of 3.8%, 2.4% and 2.5% for 2012, 2011 and 2010, respectively. These costs are further discussed in the 'Other Expenses (Revenues), Net' section.

### Current Accident Year Loss Ratio:

**2012 versus 2011:** A lower level of natural catastrophe and weather-related losses in 2012 was the primary driver of the 20.0 point reduction in our current accident year loss ratio, though the ratios for both years were significantly impacted by natural catastrophe events.

The most significant catastrophe event of 2012 was Storm Sandy, which made landfall as a post-tropical cyclone with hurricane-force winds near Atlantic City, New Jersey on October 29<sup>th</sup>. Storm Sandy impacted numerous U.S. states, with particularly severe wind, flooding and storm surge damage in New Jersey and New York. We recognized estimated pre-tax net losses (net of related reinstatement premiums) of \$331 million in relation to this event, with approximately half of this amount recognized in each of our insurance and reinsurance segments. In addition, during 2012 we recognized pre-tax net losses of \$37 million in relation to the impact of severe drought conditions on U.S. crops and an aggregate \$68 million (net of related reinstatement premiums) for first and second quarter U.S. weather events and Hurricane Isaac. While the crop-related losses were exclusive to our reinsurance segment, the other events impacted both of our segments.

Comparatively, numerous notable natural catastrophe and significant weather events impacted our results in 2011, namely: New Zealand II, the Japanese earthquake and tsunami, the series of severe U.S. storms and tornadoes in April and May, first quarter Australian weather events, the Thai floods, New Zealand III, the Danish floods, Hurricane Irene and Tropical Storm Lee. In aggregate, we recognized pre-tax net losses (net of related reinstatement premiums) of of \$931 million in relation to

these events during 2011. Of this amount, \$774 million and \$157 million, respectively, emanated from our reinsurance and insurance segments.

Exclusive of the impact of the catastrophe and weather-related losses noted above, the current accident year loss ratio for each of our segments improved in 2012:

- Reduced exposure and loss experience related to aggregate property reinsurance of regional insurance companies in the U.S. drove an improvement in our reinsurance segment, though this was partially offset by a higher ratio for our trade credit and bond reinsurance business and business mix changes; and
- A lower level of loss activity in our property and marine lines of business and a reduction in the ratio for our credit and political risk business (given a notable improvement in loss experience during the year) were the primary drivers of the improvement in our insurance segment.

**2011 versus 2010:** The level of natural catastrophe and weather-related losses was also the primary driver of the variance in the current accident year loss ratios for these years. In comparison to the 2011 catastrophe and weather-related losses noted above, we recognized pre-tax net losses (net of related reinstatement premiums) of \$138 million for New Zealand I and \$110 million for the February earthquake in Chile during 2010. In addition, there were a number of other weather-related loss events during 2010, including Australian and U.S. storms and European Windstorm Xynthia in the first quarter and further Australian storms and flooding and U.S. storms in the fourth quarter. The 2010 events principally impacted our reinsurance segment.

Exclusive of the impact of the catastrophe and weather-related losses noted above, the current accident year loss ratio increased in each of our segments during 2011:

- Rate reductions, changes in business mix and an increased level of property and marine loss activity contributed to an increase in our insurance segment; and
- Business mix changes and rate reductions contributed to an increase in our reinsurance segment, though partially offset by a reduction in the ratio for our trade credit and bond reinsurance business, as global economic conditions improved.

For further discussion on current accident year loss ratios, refer to the insurance and reinsurance segment discussions below.

### **Estimates for Significant Catastrophe Events**

Our estimated net losses in relation to the catastrophe events described above were derived from ground-up assessments of our in-force contracts and treaties providing coverage in the affected regions. These assessments take into account the latest information available from clients, brokers and loss adjusters. In addition, we consider industry insured loss estimates, market share analyses and catastrophe modeling analyses, when appropriate. Our estimates remain subject to change as additional loss data becomes available.

We continue to monitor paid and incurred loss development for catastrophe events of prior years and update our estimates of ultimate losses accordingly. While there was no material change in our aggregate estimate for the events of 2011 and 2010 during 2012, updated information received during the year resulted in revisions to our estimated ultimate losses for each of the three New Zealand earthquakes; our estimate for the 2010 accident year event (New Zealand I) decreased and our combined estimate for the 2011 accident year events (New Zealand II/III) increased.

The frequency and/or severity of natural catastrophe activity in each of 2010 through 2012 was high and our December 31, 2012 net reserve for losses and loss expenses continues to include estimated amounts for numerous natural catastrophe events that occurred during this period. We caution that the magnitude and/or complexity of losses arising from certain of these events, in particular Storm Sandy, the Japanese earthquake and tsunami, the three New Zealand earthquakes and the Thai floods, inherently increases the level of uncertainty and, therefore, the level of management judgment involved in arriving at our estimated net reserves for losses and loss expenses. As a result, our actual losses for these events may ultimately differ materially from our current estimates.

### Prior Year Reserve Development:

Our favorable prior year reserve development was the net result of several underlying developments on prior accident years, identified during our quarterly reserve review process. The following table provides a breakdown of net prior year reserve development by segment:

<b>Year ended December 31,</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Insurance	\$ 122,209	\$ 103,014	\$ 118,336
Reinsurance	122,631	154,447	194,719
<b>Total</b>	<b>\$ 244,840</b>	<b>\$ 257,461</b>	<b>\$ 313,055</b>

### Overview

The majority of the net favorable prior year reserve development related to short-tail lines of business, with our professional lines business also contributing notably.

The underlying exposures in the property, marine and aviation reserving classes within our insurance segment and the property reserving class within our reinsurance segment largely relate to short-tail business. Development from these classes contributed \$186 million, \$178 million and \$181 million of the total net favorable prior year reserve development in 2012, 2011 and 2010, respectively, and primarily reflected the recognition of better than expected loss emergence.

Our professional lines insurance and reinsurance business contributed further net favorable prior year reserve development of \$54 million, \$105 million and \$117 million, respectively in 2012, 2011 and 2010. This prior year reserve development was driven by increased weight being given to experience-based actuarial methods in selecting our ultimate loss estimates for accident years 2009 and prior. As our loss experience has generally been better than expected, this resulted in the recognition of favorable prior year reserve development. Given the significance of the global financial crisis, we expect that loss development patterns for the 2007 through 2009 accident years may ultimately differ from other years; as a result, we are exercising a greater degree of caution in recognizing potential favorable loss emergence for these years.

Refer to the 'Critical Accounting Estimate – Reserve for Losses and Loss Expenses' section for further details. We caution that conditions and trends that impacted the development of our reserve for losses and loss expenses in the past may not recur in the future.

The following sections provide further details on prior year reserve development by segment, reserving class and accident year.

### Insurance Segment:

<b>Year ended December 31,</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Property and other	\$ 63,919	\$ 55,779	\$ 51,740
Marine	37,322	21,910	23,338
Aviation	5,017	9,842	11,995
Credit and political risk	(143)	(13,764)	(18,414)
Professional lines	19,458	49,868	56,993
Liability	(3,364)	(20,621)	(7,316)
<b>Total</b>	<b>\$ 122,209</b>	<b>\$ 103,014</b>	<b>\$ 118,336</b>

In 2012, we recognized \$122 million of net favorable prior year reserve development, the principal components of which were:

- \$64 million of net favorable prior year reserve development on our property and other business, the majority of which related to the 2009 through 2011 accident years (\$42 million) and the 2008 accident year (\$17 million). While development was primarily driven by better than expected loss emergence, \$7 million of the 2008 accident year amount was due to the final settlement of two Hurricane Ike claims.

- \$37 million of net favorable prior year reserve development on marine business, spanning a number of accident years and largely related to better than expected loss emergence. The majority of this, \$21 million, related to offshore energy business.
- \$19 million of net favorable prior year reserve development on professional lines business, primarily related to the 2006 through 2008 accident years and for the reasons discussed in the overview.

During the fourth quarter of 2012, we began to give weight to actuarial methods that incorporate our own favorable historical claims experience for our oldest accident year liability business. Refer to the '*Critical Accounting Estimate - Reserve for Losses and Loss Expenses*' section for further details.

In 2011, we recognized \$103 million of net favorable prior year reserve development, the principal components of which were:

- \$56 million of net favorable prior year reserve development on our property and other business, the majority of which related to the 2010 (\$27 million), 2009 (\$9 million) and 2008 (\$10 million) accident years. While the 2010 and 2009 amounts primarily related to better than expected loss emergence, the 2008 amount largely related to updated information from our client with respect to one large loss event.
- \$22 million of net favorable prior year reserve development on marine business, spanning a number of accident years and related to better than expected loss emergence. The majority of this, \$21 million, related to offshore energy business.
- \$10 million of net favorable prior year reserve development on aviation business, spanning a number of accident years and driven by better than expected loss emergence.
- \$14 million of net adverse prior year reserve development on credit and political risk business, primarily driven by \$21 million in adverse development on the 2009 accident year as we reduced our recovery estimates based on the latest available information. Partially offsetting this amount was \$8 million in net favorable development on the 2007 and 2008 accident years.
- \$50 million of net favorable prior year reserve development on professional lines business. We recognized a total of \$60 million of net favorable development for 2004 through 2007 accident years, largely due to the reasons discussed in the overview. This amount included \$19 million reallocated from the 2007 accident year to the 2008 accident year, recognized after consideration of our claims history and other available information and data for accident years impacted by the global financial crisis; in the aggregate, our estimate for global financial crisis remained unchanged. Partially offsetting this was the recognition of \$8 million of net adverse development on the 2010 accident year.
- \$21 million of net adverse prior year reserve development on liability business, primarily emanating from the 2010 accident year and related to the receipt of two notable claims.

In 2010, we recognized \$118 million of net favorable prior year reserve development, the principal components of which were:

- \$52 million of net favorable prior year reserve development on our property and other business, the majority of which emanated from the 2005 through 2009 accident years and related to better than expected loss emergence.
- \$23 million of net favorable prior year reserve development on marine business, largely related to the 2007 through 2009 accident years and driven by better than expected loss emergence. The majority of this, \$20 million, related to offshore energy business.
- \$12 million of net favorable prior year reserve development on aviation business, spanning several accident years and largely related to better than expected loss emergence.
- \$18 million of net adverse prior year reserve development on credit and political risk business. This balance consisted of net adverse development of \$54 million on the 2009 accident year, as we finalized settlements for certain loss events and reduced our recovery estimates for the latest available information. Partially offsetting this amount was \$36 million in net favorable prior year reserve development on the 2006 through 2008 accident years, in recognition of better than anticipated loss emergence on our CEND and credit business.

- \$57 million of net favorable prior year reserve development on professional lines business, primarily generated from the 2004 through 2006 accident years, for the reasons discussed in the overview.
- \$7 million of net adverse development on liability business, primarily related to the 2007 through 2009 accident years and reflecting earlier than expected loss emergence on our U.S. excess and surplus lines umbrella business for those accident years during 2010.

**Reinsurance Segment:**

<b>Year ended December 31,</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Property and other	\$ 79,802	\$ 90,437	\$ 93,534
Credit and bond	12,254	39,806	37,793
Professional lines	34,291	55,628	60,067
Motor	(4,328)	(31,802)	1,225
Liability	612	378	2,100
<b>Total</b>	<b>\$ 122,631</b>	<b>\$ 154,447</b>	<b>\$ 194,719</b>

In 2012, we recognized \$123 million of net favorable prior year reserve development, the principal components of which were:

- \$80 million of net favorable prior year reserve development on property and other business, consisting largely of:
  - \$63 million of net favorable prior year reserve development on catastrophe and property business. Net favorable development was evident across all accident years, with the exception of 2011, and was largely due to better than expected loss emergence. We recognized net adverse development of \$18 million on the 2011 accident year, driven by the revision in our estimates for New Zealand II/III as noted under '*Estimates for Significant Catastrophe Events*' above.
  - \$16 million of net favorable prior year reserve development on crop business, largely related to the 2011 accident year and due to better than expected loss emergence. Of this amount, \$6 million related to updated information for one particular claim; the remainder was due to better than expected loss emergence.
- \$12 million of net favorable prior year reserve development on trade credit and bond reinsurance business, primarily related to the 2010 and 2011 accident years, in recognition of better than expected loss emergence and updated information from our cedants.
- \$34 million of net favorable prior year reserve development on professional lines reinsurance business, primarily related to the 2007, and to a lesser extent 2006, accident years for the reasons discussed in the overview.

Aggregate net prior year reserve development for our liability reserving class was insignificant during 2012; however, there were underlying favorable and adverse movements by accident year, driven by an underwriting to accident year reallocation for claims associated with a particular group of treaties.

In 2011, we recognized \$154 million of net favorable prior year reserve development, the principal components of which were:

- \$90 million of net favorable prior year reserve development on property and other business largely consisting of:
  - \$71 million of net favorable prior year reserve development on catastrophe and property business. This development primarily related to the 2007 through 2009 accident years and reflected better than expected loss emergence.
  - \$11 million of net favorable prior year reserve development on crop business, largely related to the 2010 accident year and due to better than expected loss emergence.
  - \$8 million in net favorable prior year reserve development on engineering business, primarily related to the 2007 through 2009 accident years and due to better than expected loss emergence.
- \$40 million of net favorable prior year reserve development on trade credit and bond reinsurance business, largely related to the 2009 and 2010 accident years, in recognition of better than expected loss emergence and updated information from our cedants.

- \$56 million of net favorable prior year reserve development on professional lines reinsurance business, primarily related to the 2005 through 2007 accident years for the reasons discussed in the overview.
- \$32 million of net adverse prior year reserve development on motor reinsurance business, primarily related to 2008 through 2010 accident year non-proportional business and due to changes in assumptions relating to settlement practices in the U.K. motor market (namely, Periodic Payment Orders, or “PPOs”).

In 2010, we recognized \$195 million of net favorable prior year reserve development, the principal components of which were:

- \$94 million of net favorable prior year reserve development on property and other business largely consisting of:
  - \$75 million of net favorable prior year reserve development on property and catastrophe business, largely consisting of net favorable development on the 2009 (\$39 million), 2007 (\$14 million) and 2005 (\$28 million) accident years and partially offset by net adverse development of \$17 million on the 2008 accident year. Development on the 2009 and 2007 accident years was driven by better than expected loss emergence, while development on the 2005 accident year was driven by a favorable court judgment associated with one claim and a reduction in our reserve for another claim following the receipt of updated information. The net adverse development on the 2008 accident year largely related to updated information with respect to Hurricane Ike losses.
  - \$21 million of net favorable prior year reserve development on crop reserves, principally related to the 2009 accident year and largely resulting from the reduction in reserves for Canadian crop losses following updated information from the cedant.
- \$38 million of net favorable prior year reserve development on trade credit and bond reinsurance lines of business, largely related to the 2009 accident year and, to a lesser extent the 2007 and 2008 accident years, in recognition of better than expected loss emergence and updated information from our cedants.
- \$60 million of net favorable prior year reserve development on professional lines reinsurance business, primarily on the 2006 accident year and, to a lesser extent the 2007, 2005 and 2004 accident years, for the reasons discussed in the overview.

## RESULTS BY SEGMENT

### INSURANCE SEGMENT

Results from our insurance segment were as follows:

Year ended December 31,	2012	% Change	2011	% Change	2010
<b>Revenues:</b>					
Gross premiums written	\$ 2,309,481	9%	\$ 2,121,829	11%	\$ 1,916,116
Net premiums written	1,522,245	4%	1,466,134	10%	1,332,220
Net premiums earned	1,558,058	9%	1,429,687	18%	1,206,493
Other insurance related income	2,676		2,396		2,073
<b>Expenses:</b>					
Current year net losses and loss expenses	(1,075,773)		(1,022,333)		(688,205)
Prior year reserve development	122,209		103,014		118,336
Acquisition costs	(226,859)		(199,583)		(152,223)
General and administrative expenses	(314,834)		(278,147)		(276,435)
<b>Underwriting income</b>	<u>\$ 65,477</u>	87%	<u>\$ 35,034</u>	(83%)	<u>\$ 210,039</u>
		<u>% Point Change</u>		<u>% Point Change</u>	
<b>Ratios:</b>					
Current year loss ratio	69.0%	(2.5)	71.5%	14.5	57.0%
Prior year reserve development	(7.8%)	(0.6)	(7.2%)	2.6	(9.8%)
Acquisition cost ratio	14.6%	0.6	14.0%	1.4	12.6%
General and administrative ratio	20.2%	0.8	19.4%	(3.6)	23.0%
<b>Combined ratio</b>	<u>96.0%</u>	<u>(1.7)</u>	<u>97.7%</u>	<u>14.9</u>	<u>82.8%</u>

### Gross Premiums Written:

The following table provides gross premiums written by line of business:

Year ended December 31,	2012		2011		2010		% Change	
							11 to 12	10 to 11
Property	\$ 651,188	27%	\$ 635,278	30%	\$ 600,806	31%	3%	6%
Marine	252,434	11%	240,481	11%	224,814	12%	5%	7%
Terrorism	37,186	2%	34,313	2%	37,246	2%	8%	(8%)
Aviation	65,143	3%	70,792	3%	75,794	4%	(8%)	(7%)
Credit and political risk	39,405	2%	35,734	2%	30,669	2%	10%	17%
Professional lines	836,634	36%	764,205	36%	712,053	37%	9%	7%
Liability	266,696	12%	213,256	10%	228,247	12%	25%	(7%)
Accident & health	160,795	7%	127,770	6%	6,487	—%	26%	nm
<b>Total</b>	<u>\$ 2,309,481</u>	<u>100%</u>	<u>\$ 2,121,829</u>	<u>100%</u>	<u>\$ 1,916,116</u>	<u>100%</u>	<u>9%</u>	<u>11%</u>

nm – not meaningful



**2012 versus 2011:** Growth in gross premiums written was evident in the majority of our lines of business, with professional lines, liability and accident & health contributing most significantly. Geographic expansion (including our European operations) and newer initiatives were the primary drivers of the growth in professional lines; an improving rate environment also contributed. Liability growth was attributable to select new business opportunities and, to a lesser extent, rate increases in our U.S. excess and surplus lines umbrella business. Our recently established accident & health line continued to generate new business. Property premiums were also up, as growth driven by rate increases and new business opportunities more than offset a reduction due to the non-renewal of certain catastrophe-exposed business written through MGAs.

**2011 versus 2010:** Our accident & health line, launched in 2010, led the 11% growth in gross premiums written. A large portion of this growth was due to accident & health reinsurance business assumed.

Excluding accident & health, gross premiums written growth was 4% and was largely attributable to geographic expansion and certain newer business lines, including renewable energy and design professionals & environmental liability. Geographic expansion (including our Australian and Canadian operations) contributed to the increases in property and professional lines, with the design professionals & environmental liability initiative also contributing to growth in professional lines. Our renewable energy business relates to both onshore and offshore exposures, with growth thus pertaining to the property and marine lines, respectively.

**Premiums Ceded:**

**2012 versus 2011:** Premiums ceded in 2012 were \$787 million, or 34%, of gross premiums written, compared to \$656 million, or 31%, in 2011. The increase in the ceded premium ratio was largely due to changes in our reinsurance purchasing, most notably a higher cession rate on our professional lines quota share reinsurance program on renewal during the second quarter. Business mix changes also contributed to the increase, most notably in relation to the growth in our liability business, for which we purchase significant reinsurance.

**2011 versus 2010:** Our ceded premium ratios for 2011 and 2010 were comparable at 31% and 30% of gross premiums written, respectively.

**Net Premiums Earned:**

The following table provides net premiums earned by line of business:

Year ended December 31,	2012		2011		2010		% Change	
							11 to 12	10 to 11
Property	\$ 408,943	26%	\$ 385,291	27%	\$ 337,525	28%	6%	14%
Marine	171,165	11%	152,123	11%	145,356	12%	13%	5%
Terrorism	38,605	2%	35,213	2%	32,486	3%	10%	8%
Aviation	60,363	4%	70,681	5%	66,636	6%	(15%)	6%
Credit and political risk	87,103	6%	97,680	7%	89,773	7%	(11%)	9%
Professional lines	563,500	36%	536,238	38%	444,663	37%	5%	21%
Liability	86,873	6%	89,555	6%	87,481	7%	(3%)	2%
Accident & health	141,506	9%	62,906	4%	2,573	—%	125%	nm
<b>Total</b>	<b>\$ 1,558,058</b>	<b>100%</b>	<b>\$ 1,429,687</b>	<b>100%</b>	<b>\$ 1,206,493</b>	<b>100%</b>	<b>9%</b>	<b>18%</b>

nm – not meaningful

**2012 versus 2011:** Growth in our accident & health line, commensurate with gross premiums written growth since the launch of this product offering, accounted for 61% of the overall growth in net premiums earned. Growth in professional lines business in recent quarters, arising from geographic expansion (including our European, Australian and Canadian operations) and targeted initiatives, also contributed to the increases; however, the impact of this growth was tempered in the second half of 2012 by the aforementioned increase in quota share cessions.

**2011 versus 2010:** The 18% growth in net premiums earned was primarily reflective of the 11% growth in gross premiums written discussed above. Further contributing were reinsurance purchasing changes effected during the second quarter of 2010.

**Loss Ratio:**

The table below shows the components of our loss ratio:

Year ended December 31,	2012	% Point Change	2011	% Point Change	2010
Current accident year	69.0%	(2.5)	71.5%	14.5	57.0%
Prior year reserve development	(7.8%)	(0.6)	(7.2%)	2.6	(9.8%)
<b>Loss ratio</b>	<b>61.2%</b>	<b>(3.1)</b>	<b>64.3%</b>	<b>17.1</b>	<b>47.2%</b>

**Current Accident Year Loss Ratio**

**2012 versus 2011:**

Natural catastrophe and weather-related losses impacted the current accident year loss ratios for both periods.

During 2012, we recognized estimated pre-tax net losses (inclusive of related premiums to reinstate our reinsurance protection) of \$178 million for Storm Sandy. In addition, we recognized aggregate pre-tax net losses of \$44 million for Hurricane Isaac and first and second quarter 2012 U.S. weather events.

Comparatively, during 2011, we recognized estimated pre-tax net losses (inclusive of related premiums to reinstate our reinsurance protection) for the following natural catastrophe and weather related events:

- \$40 million in relation to the series of severe U.S. storms in April and May;
- \$32 million in relation to the Thai floods;
- \$29 million in relation to the Japanese earthquake and tsunami;
- \$20 million in relation to New Zealand II; and
- an aggregate \$35 million in relation to Hurricane Irene and Tropical Storm Lee.

Exclusive of these catastrophe and weather-related losses, our 2012 current accident year loss ratio improved relative to 2011 primarily due to:

- a lower level of loss activity in our property and marine lines of business; and
- a reduction in the ratio for our credit & political risk line of business (loss experience on this business was notably less in 2012, driving a 22 percentage point reduction in the ratio from 60% to 38%).

**2011 versus 2010:**

Natural catastrophe and weather-related losses were the primary driver of the 14.5 point increase. While the 2011 current accident year loss ratio was impacted by the events noted above, catastrophe-related pre-tax net losses were insignificant in 2010. Exclusive of these items, rate reductions, changes in business mix and a higher level of loss activity in our property and marine lines of business also contributed to a higher ratio in 2011.

Refer to the ‘*Prior Year Reserve Development*’ section for further details.

**Acquisition Cost Ratio:** Growth in accident & health gross premiums written introduced some upward movement in the acquisition cost ratio for the segment starting in 2011; excluding this business, the 2012 and 2011 acquisition cost ratios were 13.0% and 13.2%, respectively.

**General and Administrative Expense Ratio:** General and administrative expenses increased in 2012, driven by performance-based compensation expenses and staff increases. From a general and administrative expense ratio perspective, commensurate growth in net premiums earned muted the impact on the 2012 ratio.

## REINSURANCE SEGMENT

Results from our reinsurance segment were as follows:

Year ended December 31,	2012	% Change	2011	% Change	2010
<b>Revenues:</b>					
Gross premiums written	\$ 1,830,162	(7%)	\$ 1,974,324	8%	\$ 1,834,420
Net premiums written	1,815,211	(7%)	1,953,300	8%	1,815,320
Net premiums earned	1,857,405	(1%)	1,885,274	8%	1,740,917
<b>Expenses:</b>					
Current year net losses and loss expenses	(1,265,095)		(1,910,180)		(1,301,982)
Prior year reserve development	122,631		154,447		194,719
Acquisition costs	(400,794)		(387,886)		(336,489)
General and administrative expenses	(116,487)		(103,915)		(98,001)
<b>Underwriting income (loss)</b>	<u>\$ 197,660</u>	nm	<u>\$ (362,260)</u>	nm	<u>\$ 199,164</u>
<b>Ratios:</b>					
		<u>% Point Change</u>		<u>% Point Change</u>	
Current year loss ratio	68.1%	(33.2)	101.3%	26.5	74.8%
Prior year reserve development	(6.6%)	1.6	(8.2%)	3.0	(11.2%)
Acquisition cost ratio	21.6%	1.0	20.6%	1.3	19.3%
General and administrative ratio	6.3%	0.8	5.5%	(0.2)	5.7%
<b>Combined ratio</b>	<u>89.4%</u>	<u>(29.8)</u>	<u>119.2%</u>	<u>30.6</u>	<u>88.6%</u>

nm – not meaningful

### **Gross Premiums Written:**

The following table provides gross premiums written by line of business for the periods indicated:

Year ended December 31,	2012		2011		2010		<u>% Change</u>	
							11 to 12	10 to 11
Catastrophe	\$ 368,314	21%	\$ 471,822	24%	\$ 453,059	25%	(22%)	4%
Property	315,758	17%	359,987	18%	354,528	19%	(12%)	2%
Professional lines	301,863	16%	281,394	14%	288,236	16%	7%	(2%)
Credit and bond	264,572	14%	299,923	15%	254,130	14%	(12%)	18%
Motor	235,648	13%	238,365	12%	148,683	8%	(1%)	60%
Liability	242,817	13%	229,728	12%	238,062	13%	6%	(4%)
Engineering	70,597	4%	65,219	3%	68,215	4%	8%	(4%)
Other	30,593	2%	27,886	2%	29,507	1%	10%	(5%)
<b>Total</b>	<u>\$ 1,830,162</u>	<u>100%</u>	<u>\$ 1,974,324</u>	<u>100%</u>	<u>\$ 1,834,420</u>	<u>100%</u>	<u>(7%)</u>	<u>8%</u>

**2012 versus 2011:** Gross premiums written decreased by \$144 million, primarily driven by the \$104 million reduction in catastrophe business. We repositioned our catastrophe portfolio throughout 2012, reducing exposure in certain zones (including the Northeast and Mid-Atlantic regions of the U.S.); this was partially offset by exposure increases in other areas, including Florida and Japan, where we believe risk and return characteristics are more attractive. The decline in property premiums was driven by reductions in reinsurance purchasing by certain of our clients, as well as our evaluation of risk/return characteristics. Our trade credit and bond reinsurance premiums also decreased, driven by management of our

European exposure base in light of current economic conditions and changes in contract terms. While motor premiums were down slightly for the year, there was an underlying shift in business mix; we reduced our participation in uncapitalized U.K. excess of loss business in light of recent settlement trends, which was partially offset by an increase in proportional business.

**2011 versus 2010:** The 8% growth in gross premiums written was primarily driven by our motor reinsurance line of business, driven by a higher volume of European proportional business; both increases on renewal and new business contributed. Gross premiums written for our trade credit and bond reinsurance business also increased, with both premium adjustments on prior year treaties and an increase in Latin American surety business contributing.

Refer to the 'Critical Accounting Estimates – Premiums' section for a further discussion of related estimates.

**Net Premiums Earned:**

The following table provides net premiums earned by line of business:

Year ended December 31,	2012		2011		2010		% Change	
							11 to 12	10 to 11
Catastrophe	\$ 375,088	19%	\$ 456,858	24%	\$ 454,954	26%	(18%)	—%
Property	351,470	19%	356,022	19%	323,201	19%	(1%)	10%
Professional lines	297,726	16%	281,025	15%	285,224	16%	6%	(1%)
Credit and bond	277,185	15%	263,912	14%	217,809	13%	5%	21%
Motor	237,006	13%	202,830	11%	127,404	7%	17%	59%
Liability	220,874	12%	230,872	12%	232,014	13%	(4%)	—%
Engineering	68,402	4%	65,727	4%	71,229	4%	4%	(8%)
Other	29,654	2%	28,028	1%	29,082	2%	6%	(4%)
<b>Total</b>	<b>\$ 1,857,405</b>	<b>100%</b>	<b>\$ 1,885,274</b>	<b>100%</b>	<b>\$ 1,740,917</b>	<b>100%</b>	<b>(1%)</b>	<b>8%</b>

**2012 versus 2011:** The reduction in catastrophe business written during 2012, described above, drove the decrease in net premiums earned. Partially offsetting this was an increase for motor reinsurance, driven by the recent increases in proportional writings previously noted.

**2011 versus 2010:** Growth was primarily driven by the increased motor and trade credit and bond writings during 2011, outlined above.

**Loss Ratio:**

The table below shows the components of our loss ratio:

Year ended December 31,	2012	% Point Change	2011	% Point Change	2010
Current accident year	68.1%	(33.2)	101.3%	26.5	74.8%
Prior year reserve development	(6.6%)	1.6	(8.2%)	3.0	(11.2%)
<b>Loss ratio</b>	<b>61.5%</b>	<b>(31.6)</b>	<b>93.1%</b>	<b>29.5</b>	<b>63.6%</b>

**Current Accident Year Loss Ratio**

**2012 versus 2011:**

While natural catastrophe and weather-related losses contributed to the current accident year loss ratios for both periods, the impact was less significant in 2012.

During 2012, we recognized estimated pre-tax net losses (net of related reinstatement premiums) of \$153 million for Storm Sandy. In addition, we recognized aggregate pre-tax net losses (net of related reinstatement premiums) of \$60 million for the impact of severe drought conditions on U.S. crops, Hurricane Isaac and first and second quarter 2012 U.S. weather events.

Comparatively, during 2011, we recognized estimated pre-tax net losses (net of related reinstatement premiums) for the following natural catastrophe and weather-related events:

- \$370 million in relation to New Zealand II;
- \$192 million in relation to the Japanese earthquake and tsunami;
- \$74 million in relation to the first quarter Australian weather events;
- \$44 million in relation to the series of U.S. storms and tornadoes in April and May;
- \$32 million in relation to the Thai floods; and
- an aggregate \$63 million in relation to New Zealand III, the Danish floods and Hurricane Irene.

Exclusive of these catastrophe and weather-related losses, our 2012 current accident year loss ratio improved relative to 2011 largely due to reduced exposure and loss experience related to aggregate property reinsurance of regional insurance companies in the U.S. This was partially offset by a higher ratio for our trade credit and bond reinsurance business (up 12 percentage points to 62% in 2012, reflecting uncertainty around the economic environment in Europe) and business mix changes (including growth in motor reinsurance).

**2011 versus 2010:**

Natural catastrophe and weather-related losses were the primary driver of the increase in the 2011 current accident year loss ratio, in comparison to 2010. While the 2011 current accident year loss ratio was impacted by the events noted above, during 2010 we recognized pre-tax net losses (net of related reinstatement premiums) of \$136 million for New Zealand I and \$110 million for the Chilean earthquake. In addition, there were a number of other weather-related loss events of note in 2010, including Australian and U.S. storms and European Windstorm Xynthia in the first quarter and further Australian storms and flooding and U.S. storms in the fourth quarter.

Changes in business mix and rate reductions also contributed to the increase in 2011; however, these increases were partially offset by a reduction in our current accident year loss ratio for trade credit and bond business, as updated information from our cedants suggested loss activity would continue to decrease from levels experienced during the global financial crisis. Our current accident year loss ratio for this business was 50% in 2011, compared to 61% in 2010.

Refer to the ‘*Prior Year Reserve Development*’ section for further details.

**Acquisition Cost Ratio:** The increases in the reinsurance segment’s acquisition cost ratios were driven by changes in business mix.

**General and Administrative Expense Ratio:** General and administrative expense increased in 2012, driven by performance-based compensation expenses and staffing increases.

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**OTHER EXPENSES (REVENUES), NET**

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The following table provides a breakdown of our other expenses (revenues), net:

Year ended December 31,	2012	% Change	2011	% Change	2010
Corporate expenses	\$ 129,660	68%	\$ 77,089	2%	\$ 75,449
Foreign exchange losses (gains)	29,512	nm	(44,582)	187%	(15,535)
Interest expense and financing costs	61,863	(1%)	62,598	12%	55,876
Income tax expense	3,287	(78%)	15,233	(61%)	38,680
<b>Total</b>	<b>\$ 224,322</b>	<b>103%</b>	<b>\$ 110,338</b>	<b>(29%)</b>	<b>\$ 154,470</b>

nm – not meaningful

**Corporate Expenses:** Our corporate expenses include holding company costs necessary to support our worldwide insurance and reinsurance operations and costs associated with operating as a publicly-traded company. As a percentage of net premiums earned, corporate expenses were 3.8%, 2.4% and 2.5% for 2012, 2011 and 2010, respectively. The increase in corporate expenses during 2012 was reflective of costs associated with our second quarter 2012 senior leadership transition; these costs included accelerated and incremental share-based compensation expenses of \$20 million and separation payments of \$14 million. Excluding these senior leadership transition amounts, corporate expenses were 2.8% of net premiums earned for 2012.

**Foreign Exchange Losses (Gains):** Some of our business is written in currencies other than the U.S. dollar. Movements in the rates of exchange for the euro and Sterling against the U.S. dollar were the primary drivers of the amounts in each period presented. Appreciation in these currencies against the U.S. dollar resulted in foreign exchange losses on the remeasurement of our net insurance-related liabilities during 2012, whereas depreciation had the opposite effect in 2011 and 2010.

**Interest Expense and Financing Costs:** Interest expense primarily relates to interest due on our senior notes. The increase in 2011 noted above was driven by our issuance of senior notes on March 23, 2010. See Item 8, Note 10(a) to the Consolidated Financial Statements for further details.

**Income Tax Expense:** Income tax expense primarily results from income generated by our foreign operations in the United States and Europe. Our effective tax rate, which is calculated as income tax expense divided by income before tax, was 0.6%, 24.8% and 4.3% in 2012, 2011 and 2010, respectively. This effective rate can vary between periods depending on the distribution of net income (loss) amongst tax jurisdictions, as well as other factors.

A significant portion of our losses and loss expenses for Storm Sandy related to insurance risks written by our U.S. subsidiaries, driving a low effective tax rate for 2012. Comparatively, a large proportion of the 2011 catastrophe and weather-related losses previously described arose from reinsurance risks written in Bermuda; these losses reduced income before tax without a corresponding tax benefit. Our U.S. and European operations generated taxable income in 2011, thus resulting in a notably higher effective tax rate for the year in comparison to 2010.

Further increasing income tax expense for 2011 was the establishment of a \$13 million valuation allowance related to 2011 operating loss tax-carryforwards generated from branch operations in Singapore and Australia. Partially offsetting these increases was a further \$10 million reduction in income tax expense due to the elimination of the remaining valuation allowance associated with our U.S. capital loss carryforwards. During 2011, we concluded an allowance was no longer required, as there were sufficient net unrealized gains that could be realized in order to generate capital gains in the remaining carryforward period.

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## NET INVESTMENT INCOME AND NET REALIZED INVESTMENT GAINS/LOSSES

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### Net Investment Income

The following table provides a breakdown of income earned from our cash and investment portfolio by major asset class:

Year ended December 31,	2012	% Change	2011	% Change	2010
Fixed maturities	\$ 304,400	(10%)	\$ 337,616	(4%)	\$ 352,357
Other investments	87,660	175%	31,856	(51%)	64,765
Equities	11,904	6%	11,186	286%	2,900
Cash and cash equivalents	4,528	(21%)	5,697	(2%)	5,836
Short-term investments	596	(63%)	1,592	10%	1,441
<b>Gross investment income</b>	<b>409,088</b>	5%	<b>387,947</b>	(9%)	<b>427,299</b>
Investment expense	(28,131)	10%	(25,517)	25%	(20,407)
<b>Net investment income</b>	<b>\$ 380,957</b>	5%	<b>\$ 362,430</b>	(11%)	<b>\$ 406,892</b>
<b>Pre-tax yield:<sup>(1)</sup></b>					
Fixed maturities	<u>2.7%</u>		<u>3.2%</u>		<u>3.6%</u>

(1) Pre-tax yield is annualized and calculated as net investment income divided by the average month-end amortized cost balances for the periods indicated.

### **Fixed Maturities:**

**2012 versus 2011:** The 10% reduction in investment income from fixed maturities reflected lower reinvestment yields throughout much of 2012 due to downward shifts in U.S. and European risk-free yield curves. Spread tightening, primarily on investment-grade and high yield corporate debt, also contributed to lower reinvestment yields. These declines were partially offset by growth of 6% on our average fixed maturities balances during 2012 as additional investments in fixed maturities were funded primarily by reinvestment of net investment income.

**2011 versus 2010:** The 4% reduction in investment income from fixed maturities reflected lower reinvestment yields primarily due to a downward shift in U.S. and European risk-free yield curves. The reduction was partially offset by widening credit spreads and growth of 7% on our average fixed maturities balances during 2011 as additional cash provided by operations was allocated partially to fixed maturities.

### **Other Investments:**

Other investments include hedge funds, fund of hedge funds, credit funds and CLO equity tranch securities (“CLO Equities”). These investments are recorded at fair value, with the change in fair value reported in net investment income. Consequently, the pre-tax return on other investments may vary materially period over period, particularly during volatile credit and equity markets.

The following table provides a breakdown of net investment income (loss) from other investments:

Year ended December 31,	2012	2011	2010
Hedge funds	\$ 29,673	\$ (7,329)	\$ 8,799
Fund of hedge funds	15,279	(1,561)	16,864
Credit funds	11,599	(4,125)	14,474
CLO - equity tranching securities	31,109	44,871	21,970
Short duration high yield fund	—	—	2,658
<b>Total net investment income from other investments</b>	<b>\$ 87,660</b>	<b>\$ 31,856</b>	<b>\$ 64,765</b>
<b>Pre-tax return on other investments<sup>(1)</sup></b>	<b>11.1%</b>	<b>5.3%</b>	<b>12.1%</b>

(1) The pre-tax return on other investments is calculated by dividing total income from other investments by the average month-end fair value balances held for the periods indicated.

**2012 versus 2011:** The improvement in the pre-tax return on our other investments portfolio was primarily driven by the strong rally in global equity markets and its impact on our hedge funds and funds of hedge funds. Performance of our credit funds also improved in 2012 due to modest improvements in the pricing of the underlying bank loans. Although CLO Equities provided less income in 2012, their continued strong performance is still a significant positive contributor to current year performance. The increase in fair value of our CLO Equities was driven primarily by lower than anticipated default rates and higher than anticipated recovery rates for the underlying collateral. Refer to the 'Critical Accounting Estimates – Fair Value Measurements' for further details on the fair value measurement.

**2011 versus 2010:** The lower pre-tax return on other investments in 2011 was primarily due to modest negative returns from our investments in hedge and credit funds, compared to positive returns provided by these holdings in 2010. The negative returns of these funds were reflective of the underperformance of both global equities and bank loans during 2011. Partially offsetting the decline in the pre-tax return was the increase in the fair value for our investment in CLO Equities which was driven primarily by higher cash distributions than previously expected.

***Investment Expenses:***

**2012 versus 2011:** The increase was primarily due to increased third party investment manager fees relating to higher investment balances created by improved valuations and additional allocations to emerging market debt, short duration high yield debt and common stocks, which have higher management fees than core fixed income.

**2011 versus 2010:** The increase was due to asset class changes. Additionally, third party investment manager fees increased due to higher investment balances as a result of improved valuations and additional allocations.

**Net Realized Investment Gains/Losses**

Our fixed maturities and equities are classified as available for sale and reported at fair value. The effect of market movements on our available for sale investment portfolio impacts net income (through net realized investment gains/losses) only when securities are sold, hedged, or impaired. Additionally, changes in the fair value of investment derivatives, mainly foreign exchange forward contracts, are recorded in net realized investment gains/losses.



The following table provides a breakdown of net realized investment gains:

Year ended December 31,	2012	2011	2010
<i>On sale of investments:</i>			
Fixed maturities and short-term investments	\$ 140,238	\$ 134,804	\$ 200,048
Equities	12,881	2,468	10,800
	<u>153,119</u>	<u>137,272</u>	<u>210,848</u>
OTTI charges recognized in earnings	(24,234)	(15,861)	(17,932)
Change in fair value of investment derivatives	(9,170)	4,431	(3,641)
Fair value hedges	7,754	(4,403)	5,823
<b>Net realized investment gains</b>	<u>\$ 127,469</u>	<u>\$ 121,439</u>	<u>\$ 195,098</u>

***On sale of investments:***

Generally, sales of individual securities occur when there are changes in the relative value, credit quality, or duration of a particular issuer. We may also sell to rebalance our investment portfolio in order to change exposure to particular sectors or asset classes.

**2012 versus 2011:** Improvements in global equity markets throughout 2012 also enabled us to realize gains on our equity holdings during 2012. The primary sources of the net realized gains on fixed maturities in 2012 were investment-grade corporate debt, agency MBS and non-U.S. governments compared to the primary sources of investment-grade corporate debt, agency MBS and U.S. government and agencies in 2011.

**2011 versus 2010:** The decrease in net realized gains was largely due to significant gains realized in 2010 as a result of significant credit spread tightening. In 2011, we realized net gains primarily on fixed maturities as a result of the lower U.S. and European risk-free rates. The primary sources of the net realized gains on fixed maturities in 2011 were investment-grade corporate debt, U.S. government and agency securities and agency MBS which is consistent with the sources of the 2010 net realized gains.

***OTTI charges:***

Refer to the ‘*Critical Accounting Estimates – OTTP*’ section for details on our impairment review process.

The following table provides a summary of the OTTI recognized in earnings by asset class:

Year ended December 31,	2012	2011	2010
Fixed maturities:			
Non-U.S. government	\$ 3,281	\$ —	\$ —
Corporate debt	1,821	1,954	3,156
CMBS	—	—	413
Non-Agency RMBS	2,016	717	4,715
ABS	795	61	1,126
Municipals	—	483	19
	<u>7,913</u>	<u>3,215</u>	<u>9,429</u>
Equities:			
Common stocks	7,318	12,646	8,503
Exchange traded funds	9,003	—	—
	<u>16,321</u>	<u>12,646</u>	<u>8,503</u>
<b>Total OTTI recognized in earnings</b>	<u>\$ 24,234</u>	<u>\$ 15,861</u>	<u>\$ 17,932</u>

The level of OTTI losses increased in 2012 compared to 2011 and 2010 due mainly to losses recorded on equity exchange traded funds ("ETFs") where we no longer have the intent to hold the securities until full recovery of cost as it is likely that these investments will be reallocated to other asset classes.

***Change in Fair Value of Investment Derivatives:***

From time to time, we may economically hedge the foreign exchange exposure of non-U.S. denominated securities by entering into foreign exchange contracts. During 2012, our economic hedges related to Canadian dollar, Sterling, euro and Australian dollar denominated securities. The net realized and unrealized loss for the year was primarily driven by our exposure to the euro, which gained 2% against the U.S. dollar during the year. These hedges did not qualify for fair value hedge accounting and accordingly, the corresponding net unrealized gains on the economically hedged securities are recorded as part of accumulated other comprehensive income in shareholders' equity.

***Fair Value Hedges:***

We entered into foreign exchange forward contracts to hedge the foreign currency exposure of certain available for sale fixed maturity portfolios denominated in euros. The hedges were designated and qualified as fair value hedges, resulting in the net impact of the hedges recognized in net realized investment gains (losses). During 2012, we sold all available for sale fixed maturities in the portfolios that qualified for hedge accounting and settled all of the associated foreign exchange forward contracts.

Foreign denominated assets and liabilities will continue to be substantially matched, in order to minimize any foreign exchange impact on book value.

***Total Return***

Our investment strategy is to take a long-term view by actively managing our investment portfolio to maximize total return within certain guidelines and constraints. In assessing returns under this approach, we include net investment income, net realized investment gains and losses and the change in unrealized gains and losses generated by our investment portfolio. The following table provides a breakdown of the total return on cash and investments, inclusive of foreign exchange impact, for the periods indicated:

<b>Year ended December 31,</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Net investment income	\$ 380,957	\$ 362,430	\$ 406,892
Net realized investments gains	127,469	121,439	195,098
Change in net unrealized gains/losses, net of currency hedges	250,212	(34,320)	74,175
<b>Total</b>	<b>\$ 758,638</b>	<b>\$ 449,549</b>	<b>\$ 676,165</b>
<b>Average cash and investments<sup>(1)</sup></b>	<b>\$ 14,098,888</b>	<b>\$ 13,309,143</b>	<b>\$ 12,285,244</b>
<b>Total return on average cash and investments, pre-tax<sup>(2)</sup></b>	<b>5.4%</b>	<b>3.4%</b>	<b>5.5%</b>

(1) The average cash and investments balance is calculated by taking the average of the month-end fair value balances held for the periods indicated.

(2) Excluding the impact of foreign currencies due to matching with foreign denominated insurance liabilities, the total return would be 4.9% for 2012 (2011: 3.7%, 2010: 5.3%).

## CASH AND INVESTMENTS

The table below provides a breakdown of our cash and investments:

	December 31, 2012		December 31, 2011	
	Amortized Cost or Cost	Fair Value	Amortized Cost or Cost	Fair Value
Fixed maturities	\$ 11,605,672	\$ 11,928,049	\$ 10,821,338	\$ 10,940,100
Equities	608,306	666,548	699,566	677,560
Other investments	730,101	843,437	650,955	699,320
Short-term investments	108,860	108,860	149,909	149,909
<b>Total investments</b>	<b>\$ 13,052,939</b>	<b>\$ 13,546,894</b>	<b>\$ 12,321,768</b>	<b>\$ 12,466,889</b>
Cash and cash equivalents <sup>(1)</sup>	\$ 850,550	\$ 850,550	\$ 1,082,838	\$ 1,082,838

(1) Includes restricted cash and cash equivalents of \$91 million and \$101 million for 2012 and 2011, respectively.

### Overview

The cost of our total investments increased by \$731 million from December 31, 2011, primarily due to investing a portion of our operating cash flows generated in 2012, investing cash on hand and reinvesting net investment income and proceeds from sales in 2012. In addition to these cash contributions, significant contributors to the increase in the fair value of our total investments from December 31, 2011 include improved valuations for our fixed maturities and equities and, to a lesser degree, movements in foreign exchange rates, mainly the euro strengthening against the U.S. dollar. The strong rally in global equity markets during 2012 combined with new and incremental hedge fund investments contributed to the increase in fair value of our other investments.

The following provides a further analysis on our investment portfolio.

### **Fixed Maturities**

The following provides a breakdown of our investment in fixed maturities:

	December 31, 2012		December 31, 2011	
	Fair Value	% of Total	Fair Value	% of Total
<b>Fixed maturities:</b>				
U.S. government and agency	\$ 1,422,885	13%	\$ 1,148,267	10%
Non-U.S. government	1,104,576	9%	1,212,451	11%
Corporate debt	3,876,382	32%	3,609,591	33%
Agency RMBS	2,659,908	22%	2,636,634	24%
CMBS	840,084	7%	312,691	3%
Non-Agency RMBS	95,199	1%	165,713	2%
ABS	643,206	5%	632,042	6%
Municipals <sup>(1)</sup>	1,285,809	11%	1,222,711	11%
<b>Total</b>	<b>\$ 11,928,049</b>	<b>100%</b>	<b>\$ 10,940,100</b>	<b>100%</b>
<b>Credit ratings:</b>				
U.S. government and agency	\$ 1,422,885	13%	\$ 1,148,267	10%
AAA <sup>(2)</sup>	4,791,455	39%	4,783,578	44%
AA	1,175,205	10%	1,345,583	12%
A	2,215,326	19%	1,949,612	18%
BBB	1,473,388	12%	1,181,156	11%
Below BBB <sup>(3)</sup>	849,790	7%	531,904	5%
<b>Total</b>	<b>\$ 11,928,049</b>	<b>100%</b>	<b>\$ 10,940,100</b>	<b>100%</b>

(1) Includes bonds issued by states, municipalities, and political subdivisions.

(2) Includes U.S. government-sponsored agency RMBS and CMBS.

(3) Non-investment grade and non-rated securities.

At December 31, 2012, fixed maturities had a weighted average credit rating of AA- (2011: AA-) with a book yield of 2.6% (2011: 2.9%) and an average duration of 3.0 years (2011: 2.8 years). When incorporating short-term investments and cash and cash equivalents into this calculation (bringing the total to \$12.9 billion), the average rating would be AA- (2011: AA-) and the average duration would be 2.8 years (2011: 2.5 years).

Our methodology for assigning credit ratings to our fixed maturities is in line with the methodology used for the Barclay's U.S. Aggregate Bond index. This methodology uses the middle of Standard & Poor's (S&P), Moody's and Fitch ratings. When ratings from only two of these agencies are available, the lower rating is used. When a rating from only one agency is available, it is used. Previously, we used S&P's ratings; in the absence of a rating from S&P, we used the lower of the ratings established by Moody's and Fitch.

To calculate the weighted average credit rating for fixed maturities, we assign points to each rating with 29 points for the highest rating (AAA) and 2 points for the lowest rating (D) and then calculate the weighted average based on the fair values of the individual securities. Securities that are not rated by S&P, Moody's or Fitch are excluded from the weighted average calculation. At December 31, 2012, the fair value of fixed maturities not rated was \$7 million (2011: \$2 million).

As part of our ongoing risk management process, in addition to managing our credit risk exposure within our fixed maturity portfolio we also monitor the aggregation of country risk exposure on a group-wide basis (refer to Item 1 'Risk and Capital Management' for further details). Country risk exposure is the risk that events within a country, such as currency crises, regulatory changes and other political events, will adversely affect the ability of obligors within the country to honor their obligations to us. For foreign corporate debt securities and structured securities, we measure the country risk exposure based

on the country of the obligor's domicile. For debt securities issued by a foreign subsidiary with an implicit or explicit parental guarantee, the country of risk would be that of the parent.

In light of global concerns over the creditworthiness of certain countries within the eurozone, we have actively managed our exposure to sovereign debt issued by these countries. During 2012, we sold all remaining sovereign debt holdings in France, Spain and Belgium. Our current non-U.S. government holdings include exposure to only three countries within the eurozone - Germany, Netherlands and Austria, all of which are rated AAA. At December 31, 2012, we held no sovereign debt issued by the peripheral European countries of Greece, Ireland, Italy, Portugal and Spain.

The following table provides a breakdown of the fair value of our eurozone exposure within our fixed maturity portfolio:

	Non-U.S. Government	Corporate	Non-Agency RMBS	ABS	Total	% of Total
<b><u>At December 31, 2012</u></b>						
<i>Eurozone countries:</i>						
Germany	\$ 107,291	\$ 105,712	\$ —	\$ 11,585	\$ 224,588	42%
Netherlands	23,988	62,170	1,866	22,497	110,521	20%
Supranationals <sup>(1)</sup>	79,534	—	—	—	79,534	15%
France	—	40,693	—	8,567	49,260	9%
Luxembourg	—	30,352	—	—	30,352	6%
Belgium	—	24,950	—	—	24,950	5%
Ireland	—	7,989	—	—	7,989	1%
Spain	—	7,627	—	—	7,627	1%
Austria	6,108	—	—	—	6,108	1%
Italy	—	—	—	—	—	—%
<b>Total eurozone</b>	<b>\$ 216,921</b>	<b>\$ 279,493</b>	<b>\$ 1,866</b>	<b>\$ 42,649</b>	<b>\$ 540,929</b>	<b>100%</b>
<b><u>At December 31, 2011</u></b>						
<i>Eurozone countries:</i>						
Germany	\$ 247,741	\$ 133,990	\$ —	\$ 23,990	\$ 405,721	42%
France	119,820	78,241	—	—	198,061	20%
Netherlands	63,264	23,208	7,247	23,505	117,224	12%
Spain	80,010	21,563	—	—	101,573	10%
Supranationals <sup>(1)</sup>	58,350	—	—	—	58,350	6%
Belgium	48,560	5,537	—	—	54,097	6%
Luxembourg	—	19,836	—	—	19,836	2%
Austria	16,266	—	—	—	16,266	2%
Italy	—	3,977	—	—	3,977	—%
Ireland	—	390	—	—	390	—%
<b>Total eurozone</b>	<b>\$ 634,011</b>	<b>\$ 286,742</b>	<b>\$ 7,247</b>	<b>\$ 47,495</b>	<b>\$ 975,495</b>	<b>100%</b>

(1) Includes supranationals only within the eurozone.

We also have an indirect eurozone exposure through our investment of \$104 million in non-U.S. bond mutual funds.

The following is an analysis of our fixed maturity portfolio by major asset classes.

U.S. Government and Agency:

The increase was mainly due to an allocation to Treasury Inflation-Protected Securities ("TIPS") which are expected to reduce the impact of rising rates on the portfolio caused by higher than expected inflation.

Non-U.S. Government:

Our holdings in non-U.S. government securities consisted of fixed income obligations of non-U.S. sovereigns, including government agencies, local governments and supranationals. The table below summarizes our aggregate fixed maturity exposures to governments in the eurozone and other non-U.S. government concentrations by fair value at December 31, 2012 and 2011:

Country	December 31, 2012			December 31, 2011		
	Fair Value	% of Total	Weighted Average Credit Rating	Fair Value	% of Total	Weighted Average Credit Rating
<i>Eurozone countries:</i>						
Germany	\$ 107,291	10%	AAA	\$ 247,741	20%	AAA
Supranationals <sup>(1)</sup>	79,534	7%	AAA	58,350	5%	AAA
Netherlands	23,988	2%	AAA	63,264	5%	AAA
Austria	6,108	1%	AAA	16,266	1%	AAA
France	—	—%	—	119,820	10%	AAA
Spain	—	—%	—	80,010	7%	AA-
Belgium	—	—%	—	48,560	4%	AA
<b>Total eurozone</b>	<b>\$ 216,921</b>	<b>20%</b>	<b>AAA</b>	<b>\$ 634,011</b>	<b>52%</b>	<b>AA+</b>
<i>Other concentrations:</i>						
United Kingdom	\$ 201,658	18%	AAA	\$ 245,098	20%	AAA
Australia	193,259	17%	AAA	108,923	9%	AAA
Canada	132,938	12%	AA+	129,583	11%	AAA
Russian Federation	58,218	5%	BBB	23,203	2%	BBB
Brazil	49,987	5%	BBB	5,613	—%	BBB
Other	251,595	23%	A	66,020	6%	AA-
<b>Total other concentrations</b>	<b>\$ 887,655</b>	<b>80%</b>	<b>AA-</b>	<b>\$ 578,440</b>	<b>48%</b>	<b>AA+</b>
<b>Total non-U.S. government</b>	<b>\$ 1,104,576</b>	<b>100%</b>	<b>AA</b>	<b>\$ 1,212,451</b>	<b>100%</b>	<b>AA+</b>

(1) Includes supranationals only within the eurozone.

During 2012, we decreased our allocation in non-U.S. government debt securities as we actively reduced our exposure to eurozone sovereign debt. The primary driver of the growth in "other concentrations" is the \$133 million funding of a portfolio of emerging market debt securities. At December 31, 2012, this portfolio had a weighted average credit rating of BBB+, a duration of 3.9 years and a yield-to-worst of 5.2%. The top four country exposures are Mexico, Russia, South Africa and Brazil. The securities in this portfolio are held in local currency and not currently hedged back to U.S. dollars.

At December 31, 2012, our non-U.S. sovereign debt portfolio had net unrealized gains of \$28 million (2011: \$29 million net unrealized losses) which included gross unrealized foreign exchange losses of \$3 million (2011: \$50 million), mainly on euro-denominated securities.

Corporate Debt:

The composition of our corporate debt securities by sector was as follows:

	December 31, 2012			December 31, 2011		
	Fair Value	% of Total	Weighted Average Credit Rating	Fair Value	% of Total	Weighted Average Credit Rating
Financial institutions:						
U.S. banking	\$ 986,723	25%	A-	\$ 698,864	19%	A
Corporate/commercial finance	247,633	6%	BBB+	206,404	6%	A-
Insurance	208,149	5%	A	64,973	2%	A-
Foreign banking	31,924	1%	A-	31,814	1%	A+
Consumer finance	25,522	1%	BBB-	60,541	2%	A
Investment brokerage	10,110	—%	BB+	23,814	1%	A-
<b>Total financial institutions</b>	<b>1,510,061</b>	<b>38%</b>	<b>A-</b>	<b>1,086,410</b>	<b>31%</b>	<b>A</b>
Communications	470,013	12%	BBB-	446,932	12%	BBB
Consumer cyclical	414,058	11%	BBB-	245,834	7%	BBB-
Consumer non-cyclicals	355,117	9%	BBB-	446,478	12%	BBB+
Industrials	335,017	9%	BB+	341,936	9%	BBB
Utilities	287,693	7%	BBB	400,687	7%	BBB+
Energy	207,881	6%	BBB-	214,564	11%	BBB+
Non-U.S. government guaranteed	94,987	2%	AAA	224,803	6%	AA-
Other	201,555	6%	BBB-	201,947	5%	BBB+
<b>Total</b>	<b>\$ 3,876,382</b>	<b>100%</b>	<b>BBB</b>	<b>\$ 3,609,591</b>	<b>100%</b>	<b>BBB+</b>
<i>Credit quality summary:</i>						
Investment grade	\$ 3,094,744	80%	A-	\$ 3,148,337	87%	A-
Non-investment grade	781,638	20%	B+	461,254	13%	B+
<b>Total</b>	<b>\$ 3,876,382</b>	<b>100%</b>	<b>BBB</b>	<b>\$ 3,609,591</b>	<b>100%</b>	<b>BBB+</b>

The increase in corporate debt holdings during 2012 was mainly due to the increase in our allocation to short duration high yield corporate debt securities. At December 31, 2012, our short duration high yield portfolio had a fair value of \$793 million (2011: \$499 million), a weighted-average credit rating of B+ (2011: BB-) and duration of 1.7 years (2011: 1.3 years). The primary sector exposures for this high yield portfolio are consumer cyclical, communications, industrials, consumer non-cyclicals and energy. These five sectors comprise 75% (2011: 76%) of the total fair value of this portfolio.

During 2012, we added to our U.S. banking holdings as, despite the significant rally in investment-grade corporates, spreads in this sector remained attractive relative to historical averages. At December 31, 2012 and 2011, all of our holdings in this sector are investment-grade. Our holdings of non-U.S. government guaranteed corporates declined during 2012 due to the lack of new supply to replace securities that matured during the year.

At December 31, 2012, our corporate debt portfolio, including short duration high yield securities, had a weighted average credit rating of BBB (2011: BBB+) and a duration of 2.9 years (2011: 3.1 years). The decline in the weighted average credit rating for the portfolio in 2012 was largely due to the increase in our allocation to short duration high yield corporate debt securities.

Mortgage-Backed Securities:

The following table provides a breakdown of the fair value of our RMBS and CMBS portfolios by credit rating:

	December 31, 2012		December 31, 2011	
	RMBS	CMBS	RMBS	CMBS
Government agency	\$ 2,659,908	\$ —	\$ 2,636,634	\$ —
AAA	27,266	603,001	92,851	260,443
AA	5,631	150,508	5,398	40,776
A	6,687	65,520	5,155	11,472
BBB	7,638	21,055	8,517	—
Below BBB <sup>(1)</sup>	47,977	—	53,792	—
<b>Total</b>	<b>\$ 2,755,107</b>	<b>\$ 840,084</b>	<b>\$ 2,802,347</b>	<b>\$ 312,691</b>

(1) Non-investment grade securities

*Residential MBS:*

Our RMBS portfolio consists primarily of AAA-rated U.S. agency issues and is supported by loans that are diversified across geographical areas. Due to a change in prepayment speed assumptions, the duration of our agency MBS holdings expanded from 1.8 years at December 31, 2011 to 2.6 years at December 31, 2012.

During 2012, our holdings of non-agency RMBS declined mainly due to paydowns. At December 31, 2012, the average duration and weighted average life was 0.3 years (2011: 0.1 years) and 3.5 years (2011: 5.8 years), respectively, for non-agency RMBS.

*Commercial MBS:*

We increased our allocation to commercial MBS in 2012, primarily due to attractive valuations relative to other structured products. Our non-agency CMBS portfolio continues to be rated highly, with approximately 90% rated AA or better (2011: 96%). Additionally, the weighted average estimated subordination percentage for the portfolio was 30% at December 31, 2012 (2011: 25%), which represents the current weighted average estimated percentage of the capital structure subordinated to the investment holding that is available to absorb losses before the security incurs the first dollar loss of principal. At December 31, 2012, the average duration and weighted average life was 2.8 years (2011: 2.9 years) and 3.1 years (2011: 4.2 years), respectively.



Asset-Backed Securities:

The following table provides a breakdown of the fair value of our ABS by underlying collateral and credit rating:

	Asset-backed securities					Total
	AAA	AA	A	BBB	Below BBB <sup>(3)</sup>	
<b><u>At December 31, 2012</u></b>						
Auto	\$ 157,932	\$ 5,221	\$ 30,743	\$ 28,402	\$ —	\$ 222,298
Student loan	152,653	6,862	—	—	—	159,515
Credit card	52,984	—	—	—	—	52,984
CLO - debt tranches	—	17,222	8,853	14,749	11,750	52,574
Other	137,650	4,237	5,487	4,860	3,601	155,835
<b>Total</b>	<b>\$ 501,219</b>	<b>\$ 33,542</b>	<b>\$ 45,083</b>	<b>\$ 48,011</b>	<b>\$ 15,351</b>	<b>\$ 643,206</b>
<b>% of total</b>	<b>78%</b>	<b>5%</b>	<b>7%</b>	<b>8%</b>	<b>2%</b>	<b>100%</b>
<b><u>At December 31, 2011</u></b>						
Auto	\$ 265,652	\$ —	\$ —	\$ —	\$ —	\$ 265,652
Student loan	152,100	7,893	—	—	—	159,993
Credit card	91,461	—	—	—	—	91,461
CLO - debt tranches	—	—	24,775	13,101	9,643	47,519
Other	65,392	371	160	227	1,267	67,417
<b>Total</b>	<b>\$ 574,605</b>	<b>\$ 8,264</b>	<b>\$ 24,935</b>	<b>\$ 13,328</b>	<b>\$ 10,910</b>	<b>\$ 632,042</b>
<b>% of total</b>	<b>91%</b>	<b>1%</b>	<b>4%</b>	<b>2%</b>	<b>2%</b>	<b>100%</b>

The average duration and weighted average life of our ABS portfolio at December 31, 2012 was 0.9 years (2011: 0.7 years) and 3.6 years (2011: 3.1 years), respectively.

Municipals:

Our holdings in municipal debt are primarily held within the taxable portfolios of our U.S. subsidiaries and include debt issuance from states, municipalities and political subdivisions. The following table provides a breakdown of the fair value of our municipal debt portfolio by state and between Revenue and General Obligation (“G.O.”) bonds:

	G.O.	Revenue	Total	% of Total Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Weighted Average Credit Rating
<b><u>At December 31, 2012</u></b>							
New York	\$ 46,597	\$ 163,859	\$ 210,456	16%	\$ 10,644	\$ (301)	AA
California	65,477	139,239	204,716	16%	11,929	(250)	A+
Texas	37,576	86,795	124,371	10%	5,584	(8)	AA
Florida	7,797	70,000	77,797	6%	4,444	—	AA-
Illinois	19,572	55,116	74,688	6%	3,267	(33)	A+
Other	154,958	438,823	593,781	46%	22,902	(133)	AA
	<u>\$ 331,977</u>	<u>\$ 953,832</u>	<u>\$ 1,285,809</u>	<u>100%</u>	<u>\$ 58,770</u>	<u>\$ (725)</u>	<u>AA-</u>
<b><u>At December 31, 2011</u></b>							
New York	\$ 47,856	\$ 153,068	\$ 200,924	16%	\$ 9,020	\$ (6)	AA
California	66,113	132,870	198,983	16%	9,874	(162)	A+
Texas	46,446	91,235	137,681	11%	5,355	(5)	AA
Florida	10,344	57,825	68,169	6%	3,297	—	AA-
Washington	27,515	30,177	57,692	5%	2,184	(9)	AA
Other	117,217	442,045	559,262	46%	22,708	(1,498)	AA-
	<u>\$ 315,491</u>	<u>\$ 907,220</u>	<u>\$ 1,222,711</u>	<u>100%</u>	<u>\$ 52,438</u>	<u>\$ (1,680)</u>	<u>AA-</u>

During 2012, we continued to add municipal debt securities primarily to our taxable U.S. portfolios due to the attractive relative value of this asset class.

G.O. bonds are backed by the full faith and credit of the authority that issued the debt and are secured by the taxing powers of those authorities. Revenue bonds are backed by the revenue stream generated by the services provided by the issuer (e.g. sewer, water or utility projects). As issuers of revenue bonds do not have the ability to draw from tax revenues or levy taxes to fund obligations, revenue bonds may carry a greater risk of default than G.O. bonds. At December 31, 2012, the top three revenue streams related to transportation (22%), school (12%) and power (11%) (2011: transportation (20%), power (15%) and school (14%)).

Additionally, certain of our holdings in municipal debt are insured by financial guarantee companies. At December 31, 2012, we held insurance enhanced municipal bonds in the amount of \$202 million (2011: \$231 million), with a weighted average credit rating of AA- (2011: AA-). In the event the financial guarantors are unable to make good on their guarantee on a defaulted security, we would then be exposed to the credit loss. Excluding the insurance benefit from the financial guarantee companies, the weighted average credit quality of our insured bond holdings would be AA- (2011: AA-). At December 31, 2012, our largest exposures to financial guarantors were Assured Guaranty Corp. for \$90 million (2011: \$92 million), National Public Finance Guarantee Corporation for \$58 million (2011: \$63 million) and Ambac Financial Group, Inc. for \$31 million (2011: \$38 million). We had no direct investments in these companies at December 31, 2012 and 2011.

### Gross Unrealized Losses:

At December 31, 2012, the gross unrealized losses on our fixed maturities portfolio were \$18 million (2011: \$125 million).

The following table provides information on the severity of the unrealized loss position as a percentage of amortized cost for all investment grade fixed maturities in an unrealized loss position and includes any impact of foreign exchange:

Severity of Unrealized Loss	December 31, 2012			December 31, 2011		
	Fair Value	Gross Unrealized Losses	% of Total Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	% of Total Gross Unrealized Losses
0-10%	\$ 1,547,790	\$ (13,192)	92%	\$ 2,461,280	\$ (78,634)	74%
10-20%	9,533	(1,171)	8%	174,001	(24,829)	23%
20-30%	—	—	—%	9,853	(3,110)	3%
30-40%	—	—	—%	—	—	—%
40-50%	—	—	—%	—	—	—%
> 50%	—	—	—%	—	—	—%
<b>Total</b>	<b>\$ 1,557,323</b>	<b>\$ (14,363)</b>	<b>100%</b>	<b>\$ 2,645,134</b>	<b>\$ (106,573)</b>	<b>100%</b>

The improvement in investment-grade pricing is primarily due to significant credit spread tightening. Lower risk-free rates on European issues also had a meaningful impact on the reduction in total gross unrealized losses compared to 2011.

The following table provides information on the severity of the unrealized loss position as a percentage of amortized cost for all non-investment grade fixed maturities in an unrealized loss position at December 31, 2012 and 2011:

Severity of Unrealized Loss	December 31, 2012			December 31, 2011		
	Fair Value	Gross Unrealized Losses	% of Total Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	% of Total Gross Unrealized Losses
0-10%	\$ 143,396	\$ (3,223)	79%	\$ 170,244	\$ (4,965)	27%
10-20%	4,302	(714)	17%	29,538	(4,733)	26%
20-30%	583	(185)	4%	17,647	(6,532)	36%
30-40%	—	—	—%	4,172	(2,081)	11%
40-50%	—	—	—%	—	—	—%
> 50%	—	—	—%	—	—	—%
<b>Total</b>	<b>\$ 148,281</b>	<b>\$ (4,122)</b>	<b>100%</b>	<b>\$ 221,601</b>	<b>\$ (18,311)</b>	<b>100%</b>

Despite significantly increasing our allocation to high yield corporate debt during 2012, both the amount and severity of gross unrealized losses on our non-investment grade fixed maturities declined, primarily due to significant tightening of high yield credit spreads.

### **Equities**

During 2012, we decreased our allocation to global equities, mainly due to sales of exchange traded funds (“ETFs”) which were originally introduced to our portfolio in 2011 to provide highly liquid and cost efficient exposure to the global equity markets. The proceeds from these sales were reinvested in high yield corporate debt and hedge funds.

At December 31, 2012, our equities portfolio had net unrealized gains of \$58 million (2011: \$22 million net unrealized losses) of which most relate to our managed portfolios. The \$80 million change in net unrealized gains/losses was caused primarily by the strong rally in the equity markets during 2012.

### ***Other Investments***

The composition of our other investment portfolio is summarized as follows:

	December 31, 2012		December 31, 2011	
<u>Hedge funds</u>				
Long/short equity funds	\$ 302,680	36%	\$ 214,498	31%
Multi-strategy funds	244,075	29%	230,750	33%
Event-driven funds	149,670	17%	99,061	14%
Total hedge funds	<u>696,425</u>	<u>82%</u>	<u>544,309</u>	<u>78%</u>
<u>Credit funds</u>				
Leveraged bank loan funds	62,768	8%	69,132	10%
Event-driven funds	21,809	3%	19,319	3%
Total credit funds	<u>84,577</u>	<u>11%</u>	<u>88,451</u>	<u>13%</u>
Total hedge and credit funds	<u>781,002</u>	<u>93%</u>	<u>632,760</u>	<u>91%</u>
CLO - Equities	62,435	7%	66,560	9%
<b>Total other investments</b>	<u>\$ 843,437</u>	<u>100%</u>	<u>\$ 699,320</u>	<u>100%</u>

The \$148 million increase in the fair value of our total hedge and credit funds in 2012 was driven by \$92 million of net subscriptions as well as \$56 million of increased valuations during the year as our hedge and credit funds tracked the rally in the global equity and credit markets. Certain of these funds may be subject to restrictions on redemptions which may limit our ability to liquidate these investments in the short term. Refer to Item 8, Note 5(b) of our Consolidated Financial Statements for further details.

The \$4 million decrease in the fair value of the CLO – Equities since December 31, 2011, was due to \$31 million of improved valuations, offset by \$35 million in cash distributions received during 2012.

### ***Restricted Investments***

In order to support our obligations in regulatory jurisdictions where we operate as a non-admitted carrier, we provide collateral in the form of assets held in trust and, to a lesser extent, letters of credit. Refer to Item 8, Note 10(b) to our Consolidated Financial Statements for further information on our collateral requirements upon issuance of certain letters of credit. The fair value of our restricted investments primarily relates to these items, as noted in the table below. Our restricted investments primarily consist of high-quality fixed maturity and short-term investment securities.

At December 31,	2012	2011
Collateral in Trust for inter-company agreements	\$ 2,134,931	\$ 1,921,586
Collateral for secured letter of credit facility	470,062	441,229
Collateral in Trust for third party agreements	245,539	238,395
Securities on deposit with regulatory authorities	59,456	49,543
<b>Total restricted investments</b>	<u>\$ 2,909,988</u>	<u>\$ 2,650,753</u>

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## LIQUIDITY AND CAPITAL RESOURCES

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### LIQUIDITY

Liquidity is a measure of a company's ability to generate cash flows sufficient to meet the short-term and long-term cash requirements of its business operations. We manage our liquidity at both the holding company and operating subsidiary level.

#### *Holding Company*

As a holding company, AXIS Capital has no operations of its own and its assets consist primarily of investments in its subsidiaries. Accordingly, AXIS Capital's future cash flows depend on the availability of dividends or other statutorily permissible distributions, such as returns of capital, from its subsidiaries. The ability to pay such dividends and/or distributions is limited by the applicable laws and regulations of the various countries and states in which AXIS Capital's subsidiaries operate (refer to Item 8, Note 18, to the Consolidated Financial Statements for further information), as well as the need to maintain capital levels to adequately support (re)insurance operations and to preserve financial strength ratings issued by independent rating agencies. During 2012, AXIS Capital received \$525 million (2011: \$385 million; 2010: \$698 million) of distributions from its subsidiaries. AXIS Capital's primary uses of funds are dividend payments to both common and preferred shareholders, share repurchases, interest and principal payments on debt, capital investments in subsidiaries and payment of corporate operating expenses. We believe the dividend/distribution capacity of AXIS Capital's subsidiaries, which was over \$1 billion at December 31, 2012, will provide AXIS Capital with sufficient liquidity for the foreseeable future.

#### *Operating Subsidiaries*

AXIS Capital's operating subsidiaries primarily derive cash from the net inflow of premiums less claim payments related to underwriting activities and from net investment income. Historically, these cash receipts have been sufficient to fund the operating expenses of these subsidiaries, as well as to fund dividend payments to AXIS Capital. The subsidiaries' remaining cash flows are generally reinvested in our investment portfolio, although they have also been used to fund common share repurchases in recent periods.

The (re)insurance business of our operating subsidiaries inherently provides liquidity, as premiums are received in advance (sometimes substantially in advance) of the time claims are paid. However, the amount of cash required to fund claim payments can fluctuate significantly from period to period, due to the low frequency/high severity nature of certain types business we write.

The following table summarizes our consolidated cash flows from operating, investing and financing activities in the last three years:

Total cash provided by (used in) <sup>(1)</sup>	2012	2011	2010
Operating activities	\$ 1,120,617	\$ 1,190,142	\$ 1,187,777
Investing activities	(862,381)	(832,718)	(687,790)
Financing activities	(481,811)	(302,480)	(351,661)
Effect of exchange rate changes on cash	1,543	(2,610)	(7,425)
<b>Increase (decrease) in cash and cash equivalents</b>	<b>\$ (222,032)</b>	<b>\$ 52,334</b>	<b>\$ 140,901</b>

(1) See Consolidated Statements of Cash Flows included in Item 8, 'Financial Statements and Supplementary Data', of this report for additional information.

- While our 2011 cash flows from operating activities were comparable to 2010, there were certain notable underlying movements; net premium-related cash receipts increased but were partially offset by an increase in net paid losses. Premium receipts increased due to growth in gross premiums written, as well as changes in reinsurance purchasing effected in the second quarter of 2010. The high frequency and severity of natural catastrophe and weather-related events in 2010 and 2011 drove an increase in net paid losses, though this was partially offset by a continued reduction in payments related to lines of business impacted by the global financial crisis. The slight reduction in operating cash flows in 2012 was driven by an increase in net paid losses, as we continued to pay claims related to 2010 and 2011

events. Partially offsetting this was an increase in net premium receipts, driven by growth in gross premiums written; this growth was partially muted in the second half of 2012 due to the previously discussed changes in reinsurance purchasing in the second quarter.

- During 2011, we increased our allocation to global equities and hedge funds, driving combined net purchases of equities and other investments of \$0.5 billion. Our remaining cash outflows for 2011, and the majority for 2012 and 2010, largely related to the net purchase of fixed maturities (2012: \$0.9 billion, 2011: \$0.3 billion, 2010: \$0.6 billion). Fixed income purchases for 2012 included the previously discussed increased allocations to TIPS, short duration high yield corporate debt and CMBS, a portion of which was funded from cash on hand at the end of 2011. Refer to the '*Cash and Investments*' section for further details.
- Dividends paid to common and preferred shareholders are the primary source of recurring cash flows used in financial activities and totaled \$159 million in 2012 (2011: \$243 million, 2010: \$145 million); this amount was higher for 2011 relative to the preceding and succeeding years largely due to the payment of deferred dividends to certain warrant holders upon exercise (refer to Item 8, Note 13 to our Consolidated Financial Statements). Financing cash outflows also included common share repurchases totaling \$318 million, \$66 million and \$710 million, respectively in 2012, 2011 and 2010. We note that market share repurchases are completely discretionary (see '*Capital Resources – Share Repurchases*' below). During 2012, financing cash flows also included a net \$11 million outflow related to the three preferred share transactions discussed under '*Capital Resources - Preferred Shares*' below. During 2010, cash outflows were partially offset by the \$495 million net proceeds received from our senior notes issuance (discussed in Item 8, Note 10(a) of our Consolidated Financial Statements).

Our diversified underwriting portfolio has demonstrated an ability to withstand catastrophic losses. Since 2003, with the only exception being 2009, our annual cash flows from operations were in excess of \$1 billion; operating cash flows of \$850 billion for 2009 were adversely impacted by claims arising amidst the global financial crisis and a non-recurring payment of \$200 million to settle our insurance derivative contract. These positive cash flows were generated notwithstanding the impacts of the global financial crisis and the recognition of significant natural catastrophe-related losses during the period: our net losses and loss expenses included \$266 million for Hurricanes Charley, Frances, Ivan and Jeanne in 2004; \$1,019 million for Hurricanes Katrina, Rita and Wilma in 2005; \$408 million for Hurricanes Gustav and Ike in 2008; \$256 million for the Chilean earthquake and New Zealand I in 2010; \$944 million for numerous natural catastrophe and weather events in 2011; and \$331 million for Storm Sandy in 2012. There remains significant uncertainty associated with our estimates of net losses for certain of these events (see '*Underwriting Results – Group – Underwriting Expenses*' for further details), as well as the timing of the associated cash outflows.

Should claim payment obligations accelerate beyond our ability to fund payments from operating cash flows, we would utilize our cash and cash equivalent balances and/or liquidate a portion of our investment portfolio. Our investment portfolio is heavily weighted towards conservative, high quality and highly liquid securities. We expect that, if necessary, approximately \$13.4 billion of cash and invested assets at December 31, 2012 could be available in one to three business days under normal market conditions; of this amount, \$2.9 billion relates to restricted assets, which primarily support our obligations in regulatory jurisdictions where we operate as a non-admitted carrier (see Item 8, Note 5(e) to the Consolidated Financial Statements for further details). For context, our largest 1-in-250 year return period, single occurrence, single-zone modeled probable maximum loss (Southeast U.S. Hurricane) is approximately \$1 billion, net of reinsurance; our claim payments pertaining to such an event would be paid out over a period spanning many months. Our internal risk tolerance framework aims to limit both the loss of capital due to a single event, and the loss of capital that would occur from multiple but perhaps smaller events, in any year. Refer to the '*Risk and Capital Management*' section of Item 1 for further information.

Our net paid losses may continue to increase in the short-term, due to the recent significant level of natural catastrophe activity. However, we continue to expect that cash flows generated from our operations, combined with the liquidity provided by our investment portfolio, will be sufficient to cover our required cash outflows and other contractual commitments through the foreseeable future. Refer to the '*Contractual Obligations and Commitments*' section below for further information about the anticipated amounts and timing of our contractual obligations and commitments.

## CAPITAL RESOURCES

In addition to common equity, we have utilized other external sources of financing, including debt, preferred shares and letters of credit to support our business operations. We believe that we hold sufficient capital to allow us to take advantage of market opportunities and to maintain our financial strength ratings, as well as to comply with various local statutory regulations. We monitor our capital adequacy on a regular basis and will seek to adjust our capital base (up or down) according to the needs of our business (see *'Risk and Capital Management'* in Item 1).

The following table summarizes our consolidated capital position for the periods indicated:

<b>At December 31,</b>	<b>2012</b>	<b>2011</b>
Long-term debt	\$ 995,245	\$ 994,664
Preferred shares	502,843	500,000
Common equity	5,276,918	4,944,079
Shareholders' equity	5,779,761	5,444,079
<b>Total capital</b>	<b>\$ 6,775,006</b>	<b>\$ 6,438,743</b>
<b>Ratio of debt to total capital</b>	<b>14.7%</b>	15.4%
<b>Ratio of debt and preferred equity to total capital</b>	<b>22.1%</b>	23.2%

We finance our operations with a combination of debt and equity capital. Our debt to total capital and debt and preferred equity to total capital ratios provide an indication of our capital structure, along with some insight into our financial strength. A company with higher ratios in comparison to industry average may show weak financial strength because the cost of its debts may adversely affect results of operations and/or increase its default risk. We believe that our financial flexibility remains strong.

**Long-term Debt:** Long-term debt represents the senior notes we issued during 2004 and 2010, which mature in 2014 and 2020, respectively. For further information, refer to Item 8, Note 10(a) of the Consolidated Financial Statements.

### **Preferred Shares:**

During 2005, we issued \$250 million of 7.25% Series A and \$250 million of 7.50% Series B non-cumulative preferred shares.

During March 2012, we issued 16 million newly designated 6.875% Series C preferred shares with a liquidation preference of \$25.00 per share for gross proceeds of \$400 million. Dividends on the Series C preferred shares are non-cumulative; to the extent declared, dividends will accumulate, with respect to each dividend period, in an amount per share equal to 6.875% of the liquidation preference per annum. We may redeem the shares on or after April 15, 2017 at a redemption price of \$25.00 per share.

Concurrent with the closing of the Series C preferred share issuance, we redeemed six million of our previously outstanding Series A preferred shares at the \$25.00 per share redemption price, for a total redemption of \$150 million. Following this redemption, four million Series A preferred shares, representing \$100 million in aggregate liquidation preference, remain outstanding.

During April 2012, we closed a cash tender offer for any and all of our outstanding Series B preferred shares at a price of \$102.81 per share. As a result, we repurchased 2,471,570 Series B Preferred shares, for \$254 million. At December 31, 2012, 28,430 Series B preferred shares, representing \$3 million in aggregate liquidation preference, remain outstanding. We may redeem these shares on or after December 1, 2015, at a redemption price of \$100.00 per share.

On a combined basis, these three transactions resulted in a \$7 million decrease in book value and a 42 basis point reduction in the weighted average annual dividend rate on our preferred equity.

**Common Equity:** Underlying movements in the value of our common equity over the past two years are outlined in the following table:

Year ended December 31,	2012	2011
<b>Common equity - opening</b>	<b>\$ 4,944,079</b>	<b>\$ 5,124,970</b>
Net income	547,241	46,305
Change in unrealized appreciation on available for sale investments, net of tax	232,232	(45,706)
Share repurchases	(317,687)	(65,885)
Common share dividends <sup>(1)</sup>	(152,607)	(121,646)
Preferred share dividends	(38,228)	(36,875)
Share-based compensation	67,912	39,134
Premium on repurchase of Series B preferred shares	(6,916)	—
Series C preferred share issue costs (included in additional paid-in capital)	(6,456)	—
Other	7,348	3,782
<b>Common equity - closing</b>	<b>\$ 5,276,918</b>	<b>\$ 4,944,079</b>

(1) Common share dividends were historically recognized as a reduction of retained earnings when paid. During the fourth quarter of 2012, we recognized a \$31 million adjustment in order to recognize dividends when declared. See Item 8, Note 13(c) of the Consolidated Financial Statements for further details.

### ***Credit and Letter of Credit Facilities***

We routinely enter into agreements with financial institutions to obtain secured and unsecured credit facilities. These facilities are primarily used for the issuance of letters of credit, in the normal course of operations, to certain (re)insurance operations that purchase reinsurance protection from us. These letters of credit allow those operations to take credit, under local insurance regulations, for reinsurance obtained in jurisdictions where AXIS Capital's subsidiaries are not licensed or otherwise admitted as an insurer. The value of our letters of credit outstanding is driven by, amongst other factors, loss development on existing reserves, the payment patterns of such reserves, the expansion of our business and the loss experience of such business. A portion of these facilities may also be used for liquidity purposes.

Each of our existing facilities is described further below; refer to Item 8, Note 10(b) to our Consolidated Financial Statements for additional information.

#### ***Secured Letter of Credit Facility***

We maintain a secured \$750 million letter of credit facility (the "LOC Facility"). This facility is subject to certain covenants, including the requirement to maintain sufficient collateral to cover all of our obligations under the facility. Such obligations include contingent reimbursement obligations for outstanding letters of credit and fees payable to the lender. In the event of default, the lender may exercise certain remedies, including the exercise of control over pledged collateral and the termination of the availability of the facility to any or all of the participating operating subsidiaries.

#### ***Credit Facility***

We also have a revolving \$500 million credit facility (the "Credit Facility"), which provides us with combined borrowing and letter of credit issuance capacity up to the aggregate amount of the facility. At our request, and subject to certain conditions, the aggregate commitment of this facility may be increased by up to \$250 million. Interest on loans issued under this facility is payable based on underlying market rates at the time of loan issuance. While any loans are unsecured, we have the option to issue letters of credit on a secured basis in order to reduce associated fees. This facility is subject to certain non-financial covenants that we believe are customary for facilities of this type, including limitations on fundamental changes, the incurrence of additional indebtedness and liens and certain transactions with affiliates and investments, as defined in the facility documents.



Compliance with certain financial covenants that we believe are customary for (re)insurance companies in credit facilities of this type is also required. These covenants include:

- (i) Maintenance of a minimum consolidated net worth, with the minimum being equal to the sum of \$3.689 billion plus 25% of consolidated net income (if positive) for each semi-annual fiscal period ending on or after December 31, 2010 plus 25% of the net cash proceeds received by AXIS Capital from the issuance of its capital stock during each such semi-annual fiscal period. For the purposes of this covenant, consolidated net worth excludes unrealized appreciation (depreciation) on our available for sale investments.
- (ii) Maintenance of a maximum debt to total capital ratio of 0.35 to 1. For the purposes of this covenant, unrealized appreciation (depreciation) on our available for sale investments is excluded from total capital.
- (iii) Maintenance of an A.M. Best Company, Inc. (“A.M. Best”) financial strength rating of at least B++ for each of AXIS Capital’s material insurance/reinsurance subsidiaries that are party to the Credit Facility.

At December 31, 2012, this facility required a minimum consolidated net worth of \$4.038 billion and our actual consolidated net worth, as calculated under the provisions of the Credit Facility, was \$5.431 billion. We had a consolidated debt to total capital ratio, calculated in accordance with the Credit Facility provisions, of 0.15 to 1 and each of our material insurance/reinsurance subsidiaries party to the agreement had an A.M. Best financial strength rating of A.

In the event of default, including a breach of the covenants outlined above, the lenders may exercise certain remedies including the termination of the facility, the declaration of all principal and interest amounts related to facility loans to be immediately due and the requirement that any outstanding letters of credit that we opted to obtain on an unsecured basis be collateralized.

Additionally, the facility allows for an adjustment to the level of pricing should AXIS Capital experience a change in its senior unsecured debt ratings.

#### *Available Capacity*

At December 31, 2012, we had \$423 million of letters of credit outstanding under the LOC Facility. There were no letters of credit or borrowings outstanding under the Credit Facility. Thus, remaining available capacity under these two facilities was \$827 million, not taking into consideration the \$250 million potential increase in the amount available under the Credit Facility. We were in compliance with all covenants of both facilities at December 31, 2012. We are currently evaluating alternatives in advance of the scheduled expirations of the LOC Facility and the Credit Facility and believe that we will be able to continue to meet the collateral requirements of our clients and adequately preserve our liquidity.

#### **Share Repurchases**

As part of our capital management strategy, our Board of Directors authorizes common share repurchase programs. On December 17, 2012, our Board of Directors authorized a new \$750 million share common share repurchase plan, which replaced the existing plan set to expire at the end of 2012. At February 21, 2013, the remaining authorization under the program was \$634 million (refer to Item 5 ‘*Market for Registrant’s Common Equity, Related Stockholder Matters and Issue Purchases of Equity Securities*’ and Item 8, Note 20 to the Consolidated Financial Statements for additional information). As noted above, repurchases under this program are entirely discretionary; the timing and amount of the additional repurchase transactions will depend on a variety of factors including, but not limited to, global (re)insurance and financial market conditions and opportunities, capital management and regulatory considerations.

#### **Shelf Registrations**

On March 18, 2010, we filed an unallocated universal shelf registration statement with the SEC, which became effective upon filing. Pursuant to the shelf registration, we may issue an unlimited amount of equity, debt, trust preferred securities, warrants, purchase contracts or a combination of those securities. Our intent and ability to issue securities pursuant to this registration statement will depend on market conditions at the time of any proposed offering. We expect to renew this filing prior to its expiration.

### **Financial Strength Ratings**

Our principal (re)insurance operating subsidiaries are assigned financial strength ratings from internationally recognized rating agencies, including Standard & Poor’s, A.M. Best and Moody’s Investors Service. These ratings are publicly announced and are available directly from the agencies, as well as on our website.

Such financial strength ratings represent the opinions of the rating agencies on the overall financial strength of a company and its capacity to meet the obligations of its (re)insurance contracts. Independent ratings are one of the important factors that establish our competitive position in (re)insurance markets. The rating agencies consider many factors in determining the financial strength rating of an insurance company, including the relative level of statutory surplus necessary to support the business operations of the company. These ratings are based upon factors considered by the rating agencies to be relevant to policyholders, agents and intermediaries and are not directed toward the protection of investors. Such ratings are not recommendations to buy, sell or hold securities.

The following are the most recent financial strength ratings from internationally recognized agencies in relation to our principal (re)insurance operating subsidiaries:

<b>Rating agency</b>	<b>Agency’s description of rating</b>	<b>Rating</b>	<b>Agency’s rating definition</b>	<b>Ranking of rating</b>
Standard & Poor’s	An “opinion about the financial security characteristics of an insurance organization, with respect to its ability to pay under its insurance policies and contracts, in accordance with their terms”.	A+ (Stable)	“Strong financial security characteristics”	The ‘A’ grouping is the third highest out of nine major rating categories. The first seven major rating categories may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.
A.M. Best	An “opinion of an insurer’s financial strength and ability to meet its ongoing insurance policy and contract obligations”.	A (Positive)	“Excellent ability to meet ongoing insurance obligations”	The ‘A’ grouping is the third highest ratings category out of fifteen. Ratings outlooks (‘Positive’, ‘Negative’ and ‘Stable’) are assigned to indicate a rating’s potential direction over an intermediate term, generally defined as 12 - 36 months.
Moody’s Investors Service	“Opinions of the ability of insurance companies to pay punctually senior policyholder claims and obligations.”	A2 (Stable)	“Upper-medium grade and subject to low credit risk”	The ‘A’ grouping is the third highest out of nine rating categories. Each of the second through seventh categories are subdivided into three subcategories, as indicated by an appended numerical modifier of ‘1’, ‘2’ and ‘3’. The ‘1’ modifier indicates that the obligation ranks in the higher end of the rating category, the ‘2’ modifier indicates a mid-category ranking and the ‘3’ modifier indicates a ranking in the lower end of the rating category.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The following table provides a breakdown of our contractual obligations and commitments at December 31, 2012 by period due:

Contractual Obligations and Commitments	Payment Due By Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
<b>Operating activities</b>					
Estimated gross loss and loss expense payments <sup>(1)</sup>	\$ 9,058,731	\$ 2,626,119	\$ 2,894,122	\$ 1,420,002	\$ 2,118,488
Operating lease obligations <sup>(2)</sup>	186,741	26,904	54,225	38,793	66,819
Reinsurance purchase commitments <sup>(3)</sup>	53,751	53,751	—	—	—
<b>Investing activities</b>					
Unfunded investment commitments <sup>(4)</sup>	40,000	40,000	—	—	—
<b>Financing activities</b>					
Senior notes (including interest payments) <sup>(5)</sup>	1,277,813	58,125	587,500	58,750	573,438
<b>Total</b>	<u>\$ 10,617,036</u>	<u>\$ 2,804,899</u>	<u>\$ 3,535,847</u>	<u>\$ 1,517,545</u>	<u>\$ 2,758,745</u>

- (1) We are obligated to pay claims for specified loss events covered by the (re)insurance contracts we write. Such loss payments represent our most significant future payment obligation. In contrast to our other contractual obligations, our cash payments are not determinable from the terms specified within the underlying contracts. The total amount in the table above reflects our best estimate of our reserve for losses and loss expenses. However, the actual amounts and timing may differ materially; refer to the 'Critical Accounting Estimates – Reserve for Losses and Loss Expenses' for further information. We have not taken into account corresponding reinsurance recoverable amounts that would be due to us. Given the limited loss development pattern information specific to our experience, we have generally estimated the timing of payment by applying industry benchmark payout patterns to each underlying reserving class.
- (2) We lease office space under operating leases which expire at various dates. We renew and enter into new leases in the ordinary course of business, as required.
- (3) We purchase reinsurance protection for our insurance lines of business. The minimum premiums are contractually due in advance on a quarterly basis.
- (4) We have unfunded investment commitments related to our investments in hedge and credit funds, which are callable by our investment managers. We have assumed that such investments will be called in the next year but such funding may occur over a longer period of time, due to market conditions and other factors. For further details, refer to Item 8, Note 5(b) to the Consolidated Financial Statements.
- (5) For further details on the terms of our senior unsecured debt, refer to Item 8, Note 10(a) to the Consolidated Financial Statements.

## CRITICAL ACCOUNTING ESTIMATES

Our Consolidated Financial Statements include certain amounts that are inherently uncertain and judgmental in nature. As a result, we are required to make assumptions and best estimates in order to determine the reported values. We consider an accounting estimate to be critical if: (1) it requires that significant assumptions be made in order to deal with uncertainties and (2) changes in the estimate could have a material impact on our results of operations, financial condition or liquidity.

We believe that the material items requiring such subjective and complex estimates are our:

- reserves for losses and loss expenses;
- reinsurance recoverable balances;
- premiums;
- fair value measurements for our financial assets and liabilities; and
- assessments of other-than-temporary impairments.

Nevertheless, other significant accounting policies are important to understanding our Consolidated Financial Statements. See Item 8, Note 2 'Significant Accounting Policies' to the Consolidated Financial Statements for further information.

We believe that the amounts included in our Consolidated Financial Statements reflect our best judgment. However, factors such as those described in Item 1A 'Risk Factors' could cause actual events or results to differ materially from our underlying assumptions and estimates; this could lead to a material adverse impact on our results of operations, financial condition and/or liquidity.

## **RESERVE FOR LOSSES AND LOSS EXPENSES**

### **Overview**

We believe the most significant accounting judgment we make is the estimate of our reserve for losses and loss expenses (“loss reserves”). Our loss reserves represent management’s estimate of the unpaid portion of our ultimate liability for losses and loss expenses (“ultimate losses”) for (re)insured events that have occurred at or before the balance sheet date. Our loss reserves reflect both claims that have been reported to us (“case reserves”) and claims that have been incurred but not yet reported to us (“IBNR”). Our loss reserves represent our best estimate of what the ultimate settlement and administration of claims will cost, based on our assessment of facts and circumstances known at that particular point in time.

Loss reserves are not an exact calculation of liability but instead are complex estimates. The process of estimating loss reserves involves a number of variables (see ‘*Selection of Reported Reserves (Management’s Best Estimate)*’) below for further details). We review our estimate of loss reserves each reporting period and consider all significant facts and circumstances then known. As additional experience and other data become available and/or laws and legal interpretations change, we may adjust our previous estimates of loss reserves; these adjustments are recognized in the period they are determined and, therefore, can impact that period’s underwriting results either favorably (when reserves established in prior years prove to be redundant) or adversely (when reserves established in prior years prove to be deficient).

### **Case Reserves**

With respect to our insurance operations, we are generally notified of insured losses by our insureds and/or their brokers. Based on this information, our claims personnel estimate our ultimate losses arising from the claim, including the cost of administering the claims settlement process. These estimates reflect the judgment of our claims personnel based on general reserving practices, the experience and knowledge of such personnel regarding the nature of the specific claim and, where appropriate, the advice of legal counsel, loss adjusters and other relevant consultants.

For our reinsurance business, case reserves for reported claims are generally established based on reports received from ceding companies and/or their brokers. For excess of loss contracts, we are typically notified of insured losses on specific contracts and record a case reserve for the estimated ultimate liability arising from the claim. With respect to contracts written on a proportional basis, we typically receive aggregated claims information and record a case reserve based on that information. However, our proportional reinsurance contracts typically require that losses in excess of pre-defined amounts be separately notified so that we can adequately evaluate them. Our claims department evaluates each specific loss notification we receive and records additional case reserves when a ceding company’s reserve for a claim is not considered adequate.

In deciding whether to provide treaty reinsurance, we carefully review and analyze a cedant’s underwriting and risk management practices to ensure appropriate underwriting, data capture and reporting procedures. We also undertake an extensive program of cedant audits, using outsourced legal and industry experience where necessary. This allows us to review cedants’ claims administration practices to ensure that reserves are consistent with exposures, adequately established and properly reported in a timely manner and also allows us to verify that claims are appropriately handled.

### **IBNR**

The estimation of IBNR is necessary due to the time lags between when a loss event occurs and when it is actually reported to us, referred to as the reporting lag. Reporting lags may arise from a number of factors, including but not limited to the nature of the loss, the use of intermediaries and complexities in the claims adjusting process. By definition, we do not have specific information on IBNR so it must be estimated. IBNR is calculated by deducting incurred losses (i.e. paid losses and case reserves) from management’s best estimate of ultimate losses. In contrast to case reserves, which are established at the contract level, IBNR reserves are generally estimated at an aggregate level and cannot be identified as reserves for a particular loss event or contract. Refer to the ‘*Reserving For Significant Catastrophic Events*’ section below for additional information on reserving for such events.

## Reserving Process

### *Sources of Information*

Our quarterly reserving process begins with the collection and analysis of paid and incurred claim data for each of our segments. The segmental data is disaggregated by reserving class and further disaggregated by accident year (i.e. the year in which the loss event occurred). We use underwriting year information (i.e. the year in which the contract inception) to analyze some of our proportional reinsurance business and subsequently allocate reserves to the respective accident years. Our reserving classes are selected to ensure that the underlying contracts have homogeneous loss development characteristics, while remaining large enough to make the estimation of trends credible. We review our reserving classes on a regular basis and adjust them over time as our business evolves. This data, in addition to industry benchmarks, serves as a key input to many of the methods employed by our actuaries. The relative weights assigned to our own historical loss data versus industry data vary according to the length of the development profile for the reserving class being evaluated. At present, we generally give more weight to our own experience (and, correspondingly, less weight to industry data) for reserving classes with short and medium claim tails; the converse is true for reserving classes with longer claim tails. (See 'Claim Tail Analysis' below for more detailed information by claim tail class.)

### *Actuarial Analysis*

Multiple actuarial methods are available to estimate ultimate losses. Each method has its own assumptions and its own advantages and disadvantages, with no single estimation method being better than the others in all situations and no one set of assumption variables being meaningful for all reserving classes. The relative strengths and weaknesses of the particular estimation methods when applied to a particular group of claims can also change over time.

The following is a brief description of the reserve estimation methods commonly employed by our actuaries and a discussion of their particular strengths and weaknesses:

- Expected Loss Ratio Method ("ELR"): This method estimates ultimate losses for an accident year by applying an expected loss ratio to the earned premium for that accident year. Generally, expected loss ratios are based on one or more of (a) an analysis of historical loss experience to date, (b) pricing information and (c) industry data, adjusted as appropriate, to reflect changes in rates and terms and conditions. This method is insensitive to actual incurred losses for the accident year in question and is, therefore, often useful in the early stages of development when very few losses have been incurred. Conversely, the lack of sensitivity to incurred/paid losses for the accident year in question means that this method is usually inappropriate in later stages of an accident year's development.
- Loss Development Method (also referred to as the Chain Ladder Method or Link Ratio Method): This method assumes that the losses incurred/paid for each accident year at a particular development stage follow a relatively similar pattern. It assumes that on average, every accident year will display the same percentage of ultimate losses incurred/paid at the same point in time after the inception of the accident year. The percentages incurred/paid are established for each development stage (e.g. 12 months, 24 months, etc.) after examining historical averages from historical loss development data and/or external industry benchmark information. Ultimate losses are then estimated by multiplying the actual incurred/paid losses by the reciprocal of the established incurred/paid percentage. The strengths of this method are that it reacts to loss emergence/payments and that it makes full use of historical claim emergence/payment experience. However, this method has weaknesses when the underlying assumption of stable loss development/payment patterns is not valid. This could be the consequence of changes in business mix, claim inflation trends or claim reporting practices and/or the presence of large claims, amongst other things. Furthermore, this method tends to produce volatile estimates of ultimate losses where there is volatility in the underlying incurred/paid patterns. In particular, where the expected percentage of incurred/paid losses is low, small deviations between actual and expected claims can lead to very volatile estimates of ultimate losses. As a result, this method is often unsuitable at early development stages for an accident year.
- Bornhuetter-Ferguson Method ("BF"): This method can be seen as a combination of the ELR and Loss Development Methods, under which the Loss Development Method is given progressively more weight as an accident year matures. The main advantage of the BF Method is that it provides a more stable estimate of ultimate losses than the Loss Development Method at earlier stages of development, while remaining more sensitive to emerging loss development than the ELR Method. In addition, the BF Method allows for the incorporation of external market information through the use of expected loss ratios, whereas the Loss Development Method does not incorporate such information.

As part of our quarterly loss reserve review process, our actuaries employ the estimation method(s) that they believe will produce the most reliable estimate of ultimate losses, at that particular evaluation date, for each reserving class and accident year combination. Often, this is a blend (i.e. weighted average) of the results of two or more appropriate actuarial methods. These ultimate loss estimates are generally utilized to evaluate the adequacy of our ultimate loss estimates for previous accident years, as established in the prior reporting period. For the initial estimate of the current accident year, the available claim data is typically insufficient to produce a reliable estimate of ultimate losses. As a result, our initial estimate for an accident year is generally based on the ELR Method. The initial ELR for each reserving class is established collaboratively by our actuaries, underwriters and management at the start of the accident year as part of the planning process, taking into consideration prior accident years' experience and industry benchmarks, adjusted after considering factors such as exposure trends, rate differences, changes in contract terms and conditions, business mix changes and other known differences between the current accident year and prior accident years. The initial expected loss ratios for a given accident year may be modified over time if the underlying assumptions, such as loss development or premium rate changes, differ from the original assumptions.

#### *Reserving for Credit and Political Risk Business*

Our credit and political risk insurance business consists primarily of credit insurance and confiscation, expropriation, nationalization and deprivation coverages ("CEND"). Claims for this business tend to be characterized by their severity risk, as opposed to their frequency risk. Therefore, claim payment and reporting patterns are anticipated to be volatile. Under the notification provisions of our credit insurance, we anticipate being advised of an insured event within a relatively short time period. As a result, we generally estimate ultimate losses based on a contract-by-contract analysis which considers the contracts' terms, the facts and circumstances of underlying loss events and qualitative input from claims managers.

An important and distinguishing feature of many of these contracts, though, is our contractual right, subsequent to payment of a claim to our insured, to be subrogated to, or otherwise have an interest in, the insured's rights of recovery under an insured loan or facility agreement. These estimated recoveries are recorded as an offset to our credit and political risk loss reserves. The lag between the date of a claim payment and our ultimate recovery from the corresponding security can result in negative case reserves at a point in time (as was the case at December 31, 2012 and 2011). The nature of the underlying collateral is specific to each transaction and we also estimate the value of this collateral on a contract-by-contract basis. This valuation process is inherently subjective and involves the application of management's judgment because active markets for the collateral often do not exist. Our estimates of value are based on numerous inputs, including information provided by our insureds, as well as third party sources including rating agencies, asset valuation specialists and other publicly available information. We also assess any post-event circumstances, including restructurings, liquidations and possession of asset proposals/agreements.

In some instances, upon becoming aware of a loss event related to our credit and political risk business, we negotiate a final settlement of all of our policy liabilities for a fixed amount. In most circumstances, this occurs when the insured moves to realize the benefit of the collateral that underlies the insured loan or facility and presents us with a net settlement proposal that represents a full and final payment by us under the terms of the policy. In consideration for this payment, we secure a cancellation of the policy, or a release of all claims, and waive our right to pursue a recovery of these settlement payments against the security that may have been available to us under the insured loan or facility agreement. In certain circumstances, cancellation by way of net settlement or full payment can result in an adjustment of the net premium to be received and earned on the policy.

#### *Reserving For Significant Catastrophic Events*

We cannot estimate losses from widespread catastrophic events, such as hurricanes and earthquakes, using the traditional actuarial methods described above. Rather, loss reserves for such events are estimated by management after a catastrophe occurs by completing an in-depth analysis of individual contracts which may potentially be impacted by the catastrophic event. This in-depth analysis may rely on several sources of information, including: (1) estimates of the size of insured industry losses from the catastrophic event and our corresponding market share; (2) a review of our portfolio of contracts performed to identify those contracts which may be exposed to the catastrophic event; (3) a review of modeled loss estimates based on information previously reported by customers and brokers, including exposure data obtained during the underwriting process; (4) discussions of the impact of the event with our customers and brokers and (5) catastrophe bulletins published by various independent statistical reporting agencies. We generally use a blend of these information sources to arrive at our aggregate estimate of the ultimate losses arising from the catastrophic event. In subsequent reporting periods, we review changes in paid and incurred losses in relation to each significant catastrophe and adjust our estimates of ultimate

losses for each event if there are developments that are different from our previous expectations; such adjustments are recorded in the period in which they are identified.

There are additional risks affecting our ability to accurately estimate ultimate losses for catastrophic events. For example, the estimation of loss reserves related to hurricanes and earthquakes can be affected by factors including, but not limited to: the inability to access portions of impacted areas, infrastructure disruptions, the complexity of factors contributing to losses, legal and regulatory uncertainties, complexities involved in estimating business interruption losses and additional living expenses, the impact of demand surge, fraud and the limited nature of information available. For hurricanes, additional complex coverage factors may include determining whether damage was caused by flooding versus wind, evaluating general liability and pollution exposures, and mold damage. The timing of a catastrophe, for example near the end of a reporting period, can also affect the level of information available to us to estimate reserves for that reporting period.

Our results of operations for each of 2012, 2011 and 2010 were significantly impacted by natural catastrophe activity. See Item 7 'Underwriting Results – Group, Underwriting Expenses' for a discussion of these events and the remaining associated uncertainties.

#### *Key Actuarial Assumptions*

The use of the above actuarial methods requires us to make certain explicit assumptions, the most significant of which are: (1) expected loss ratios and (2) loss development patterns.

We began operations in late 2001. In our earlier years, we placed significant reliance on industry benchmarks in establishing our expected loss ratios. Over time, we have placed more reliance on our historical loss experience in establishing these ratios where we believe the weight of our own actual experience has become sufficiently credible for consideration. The weight given to our experience differs for each of our three claim tail classes and is discussed further in the 'Claim Tail Analysis' section below. In establishing expected loss ratios for our insurance segment, we give consideration to a number of other factors, including exposure trends, rate adequacy on new and renewal business, ceded reinsurance costs, changes in claims emergence and our underwriters' view of terms and conditions in the market environment. For our reinsurance segment, expected loss ratios are based on a contract-by-contract review, which considers information provided by clients together with estimates provided by our underwriters and actuaries about the impact of changes in pricing, terms and conditions and coverage. We also consider the market experience of an independent actuarial firm, as appropriate.

Similarly, we also placed significant reliance on industry benchmarks in selecting our loss development patterns in earlier years. Over time, we have given varying degrees of weight to our own historical loss experience, as further discussed in the 'Claim Tail Analysis' section.

#### *Selection of Reported Reserves (Management's Best Estimate)*

Our quarterly reserving process involves the collaboration of our underwriting, claims, actuarial, legal and finance departments, includes various segmental committee meetings and culminates with the approval of a single point best estimate by our Group Reserving Committee, which comprises senior management. In selecting this best estimate, management considers actuarial estimates and applies informed judgment regarding qualitative factors that may not be fully captured in these actuarial estimates. Such factors include, but are not limited to: the timing of the emergence of claims, volume and complexity of claims, social and judicial trends, potential severity of individual claims and the extent of internal historical loss data versus industry information. While these qualitative factors are considered in arriving at the point estimate, no specific provisions for qualitative factors are established.

The quarterly evaluation process also includes consultation with an independent actuarial firm. The work performed by the actuarial firm is an important part of the reserving process. We compare our recorded loss reserves to those estimated by the actuarial firm to determine whether our single point best estimate is reasonable. On an annual basis, the independent actuarial firm provides an actuarial opinion on the reasonableness of our loss reserves for each of our operating subsidiaries; such actuarial opinions are required to meet various insurance regulatory requirements. The actuarial firm discusses its conclusions with management and presents its findings to our Board of Directors.

## Claim Tail Analysis

The following table shows our total loss reserves for each of our reportable segments, segregated between case reserves and IBNR and by significant reserving class. This table is presented on a gross basis and, therefore, does not include the benefit of reinsurance recoveries.

At December 31,	2012			2011		
	Case Reserves	IBNR	Total	Case Reserves	IBNR	Total
Insurance segment:						
Property and other	\$ 551,831	\$ 297,389	\$ 849,220	\$ 435,887	\$ 304,098	\$ 739,985
Marine	218,523	174,780	393,303	176,111	195,422	371,533
Aviation	18,511	40,775	59,286	25,972	39,952	65,924
Credit and political risk	(82,006)	84,811	2,805	(110,961)	90,143	(20,818)
Professional lines	489,662	1,641,635	2,131,297	446,155	1,451,820	1,897,975
Liability	190,464	866,178	1,056,642	217,052	810,090	1,027,142
Total Insurance	<u>1,386,985</u>	<u>3,105,568</u>	<u>4,492,553</u>	<u>1,190,216</u>	<u>2,891,525</u>	<u>4,081,741</u>
Reinsurance segment:						
Property and other	917,614	449,056	1,366,670	1,026,134	506,855	1,532,989
Credit and bond	104,537	173,259	277,796	81,357	145,694	227,051
Professional lines	280,386	802,605	1,082,991	239,986	763,693	1,003,679
Motor	386,528	407,610	794,138	313,518	323,871	637,389
Liability	196,632	847,951	1,044,583	168,161	774,035	942,196
Total Reinsurance	<u>1,885,697</u>	<u>2,680,481</u>	<u>4,566,178</u>	<u>1,829,156</u>	<u>2,514,148</u>	<u>4,343,304</u>
<b>Total</b>	<u>\$ 3,272,682</u>	<u>\$ 5,786,049</u>	<u>\$ 9,058,731</u>	<u>\$ 3,019,372</u>	<u>\$ 5,405,673</u>	<u>\$ 8,425,045</u>

The overall increase in our gross loss reserves during 2012 was driven by the impact of Storm Sandy, growth in our business and the continued accumulation of reserves for longer-tailed lines.

In order to capture the key dynamics of our loss reserve development and potential volatility, our reserving classes should be considered according to their potential expected length of loss emergence and settlement, generally referred to as the “tail”. We consider our business to consist of three claim tail classes: short-tail, medium-tail and long-tail. Below is a discussion of the specifics of our loss reserve process as they apply to each claim tail class, as well as commentary on the factors contributing to our historical loss reserve development for each class. Favorable development on prior accident year reserves indicates that our current estimates are lower than our previous estimates, while adverse development indicates that our current estimates are higher than our previous estimates.

### *Short-Tail Business*

Our short-tail business generally includes exposures for which losses are usually known and paid within a relatively short period of time after the underlying loss event has occurred. Our short-tail business primarily relates to property coverages and includes the majority of our property, terrorism and marine business and certain aviation business within our insurance segment, together with the property, catastrophe and crop business within our reinsurance segment.

The key actuarial assumptions for our short-tail business in our early accident years were primarily developed with reference to industry benchmarks for both expected loss ratios and loss development patterns. As our own historical loss experience amassed, it gained credibility and became relevant for consideration in establishing these key actuarial assumptions. As a result, we gradually increased the weighting assigned to our own historical experience in selecting the expected loss ratios and loss development patterns utilized to establish our estimates of ultimate losses for an accident year.

Due to the relatively short reporting and settlement patterns for our short-tail business, we generally place more weight upon experience-based methods and other qualitative considerations in establishing reserves for our most recent accident years. Our estimates for more mature accident years are generally based on actuarial methods that are more responsive to actual



experience, such as the Loss Development Method. As our experience developed more favorably than our initial expectations, we recognized favorable prior year development on short-tail business in recent years. See 'Underwriting Results - Group - Prior Year Reserve Development' for a discussion of the net favorable reserve development recognized when re-estimating our ultimate losses for short-tail business during the past three years.

Although our estimates of ultimate losses for our short-tail business are inherently less uncertain than for our medium and long-tail business, significant judgment is still required. For example, because much of our excess insurance and excess of loss reinsurance business has high attachment points, it is often difficult to estimate whether claims will exceed those attachment points. Also, the inherent uncertainties relating to catastrophe events previously discussed, together with our typically large line sizes, further add to the complexity of estimating our potential exposure. In addition, we use MGAs and other producers for certain business within our insurance segment; this can delay the reporting of loss information to us. We expect that the majority of development for an accident year will be recognized in the subsequent one to three years.

#### *Medium-Tail Business*

Our medium-tail business primarily consists of professional lines (re)insurance and trade credit and bond reinsurance business. Certain other classes of business, including aviation hull and offshore energy insurance and engineering reinsurance, are also considered to have a medium-tail. Claim reporting and settlement periods on these classes are generally longer than those of our short-tail reserving classes. We also consider our credit and political risk insurance business to have a medium tail, due to the complex nature of claims and the potential additional time that may be required to realize our subrogation assets.

For our earliest accident years, our initial key actuarial expected loss ratio and loss development assumptions were established utilizing industry benchmarks. Due to the longer claim tail, the length of time required to develop our own credible loss history for use in the reserving process is greater for our medium-tail business than for our short-tail business. As a result, the number of accident years where we relied heavily on industry benchmarks to establish our key actuarial assumptions is greater for our medium-tail business. Our reserving approach for medium-tail business is tailored by line of business, with our significant lines being specifically addressed below.

#### Professional Lines (Re)insurance

For our professional lines business, claim payment and reporting patterns are typically medium to long-tail in nature. The underlying business is predominantly written on a claims-made basis, with the majority of reinsurance treaties being written on a risks attaching basis. With respect to our key actuarial assumptions, we are progressively giving more weight to our own experience when establishing our expected loss ratios; our assumed loss development patterns continue to be based primarily on industry benchmarks.

Loss reporting patterns for professional lines business tend to be volatile, causing instability in actuarial indications based on incurred loss data until an accident year matures for a number of years. Consequently, our initial loss reserves for an accident year are generally based upon an ELR method and the consideration of relevant qualitative factors. As accident years mature, we increasingly give more weight to methods that reflect our actual experience until our selections are based almost exclusively on experience-based methods. We evaluate the appropriateness of the transition to experience-based methods at the reserving class level, commencing this transition when we believe that our incurred loss development is sufficient to produce meaningful actuarial indications. The rate at which we transition fully to sole reliance on experience-based methods can vary by reserving class and by accident year, depending on our assessment of the stability and relevance of such indications.

Our transition from the ELR method to experience-based methods began during 2008, when we commenced gradual transition for the 2004 and prior accident years. As our loss history continued to develop, the transition was expanded to include additional accident years. At the end of 2012, the transition had begun for the 2009 and prior accident years for certain underlying reserve classes. As our actual loss experience has generally been more favorable than initial expectations, this transition led to the recognition of net favorable prior year reserve development in recent years; see '*Underwriting Results - Group - Prior Year Development*' for a discussion of the development recognized during the last three years.

We believe that there continues to be relatively high uncertainty around ultimate losses for the 2007 through 2009 accident years, resulting from the global financial crisis. This is attributable to both a higher than average volume of reported claims for these years and a higher proportion of open claims, relative to earlier accident years at the same stage of development. Given the significance of the global financial crisis, we believe that development patterns for the 2007 through 2009 accident

years may ultimately differ from other years. In light of this, we separately evaluate the latest available claims information for each reserving class impacted by this 'event' when establishing loss reserves, in addition to considering actuarial indications. Given our expectation of longer development patterns for these accident years, we are exercising a greater degree of caution in recognizing potential favorable loss emergence.

#### Trade Credit and Bond Reinsurance

For our trade credit and bond reinsurance business, our initial and most recent accident year loss reserves are generally based on the ELR method, with consideration given to qualitative factors. Given that there is a more stable reporting pattern for trade credit business, we generally commence the transition to experience-based methods sooner than for bond business.

#### Credit and Political Risk Insurance

Refer to the previous discussions of this business under '*Reserving Process – Actuarial Analysis*' and '*Reserving Process – Reserving for Credit and Political Risk Business*' above for a discussion of specific loss reserve issues related to this business. When considering prior accident year reserve development for this line of business, it is important to note that the multi-year nature of the credit business distorts loss ratios when a single accident year is considered in isolation. In recent years, the average term of these contracts has been four to five years. The premiums we receive are generally earned evenly over the contract term, thus spanning multiple accident years. In contrast, losses incurred on these contracts, which can be characterized as low in frequency and high in severity, are reflected in a single accident year.

As previously described, the estimation of the value of our recoveries on credit and political risk business requires significant management judgment. At December 31, 2012, our total estimated recoveries on credit insurance business were \$106 million, of which \$82 million related to contracts where we had already paid losses and \$24 million related to contracts where case reserves were recognized. Comparatively, at December 31, 2011, our estimated recoveries were \$158 million, with \$109 million and \$49 million, respectively, relating to paid losses and case reserves. The reduction in 2012 largely reflected the reduction in recovery estimates for two claims based on updated information and the settlement of one claim.

#### *Long-Tail Business*

In contrast to our short and medium-tail business, the claim tail for our long-tail business is expected to be notably longer, as claims are often reported and ultimately paid or settled years, or even decades, after the related loss events occur. Our long-tail business primarily relates to liability business written in our insurance and reinsurance segments, as well as our motor reinsurance business.

As a general rule, our estimates of accident year ultimate losses for our long-tail business are notably more uncertain than those for our short and medium-tail business. Factors that contribute additional uncertainty to estimates for our long-tail business include, but are not limited to:

- The more significant weight given to industry benchmarks in forming our key actuarial assumptions;
- The potential volatility of actuarial estimates, given the number of years of development it takes to produce a meaningful incurred loss as a percentage of ultimate losses;
- Inherent uncertainties about loss trends, claims inflation (e.g. medical, judicial, social) and general economic conditions; and
- The possibility of future litigation, legislative or judicial change that may impact future loss experience relative to the prior industry loss experience relied upon in reserve estimation.

To date, our key actuarial assumptions for our long-tail business have been derived almost exclusively from industry benchmarks, rather than our own historical experience. Given our relatively short operating history in comparison to the development tail for this business, we do not believe that our own historical loss development for our long-tail business has amassed an appropriate volume to serve as a credible input into the key actuarial assumptions previously outlined. While we utilize industry benchmarks that we believe reflect the nature and coverage of our business, our actual loss experience may differ from the benchmarks based on industry averages.

Due to the length of the development tail for this business, our reserve estimates for all accident years are predominantly based on the ELR method and the consideration of qualitative factors. As part of our quarterly reserving process, we monitor actual paid and incurred loss emergence relative to expected loss emergence based on industry-benchmark loss development patterns. The drivers of any unfavorable loss emergence are investigated and, as a result, have led to an immediate

recognition of adverse development in some instances. Prior to the fourth quarter of 2012 (see additional details below), we did not recognize any favorable loss emergence. As a result, during each of the past three years, we recognized net adverse development for our liability insurance business in light of unfavorable loss emergence for certain reserving class and accident year combinations.

In addition, during 2011, we recognized net adverse development on our motor reinsurance business, mainly as a result of a change in our assumptions surrounding U.K. settlement practices. Specifically, we increased our assumptions relating to the frequency and cost of claims that are expected to settle using Periodic Payment Orders ("PPOs"), which are annuities designed to cover items such as the ongoing cost of care and loss of earnings for injured claimants. We do not discount our loss reserves in order to adjust for the time value of money associated with such annuity awards.

See '*Underwriting Results Group - Prior Year Reserve Development*' for further details on the recognition of adverse development for our long-tail business during the last three years.

Commencing with our fourth quarter 2012 reserving process, we began to give weight to actuarial methods that reflect our actual experience for liability business as we believe that our oldest accident years are now at a stage of expected development where such methods will produce meaningful actuarial indications. As a result, we commenced a transition from the ELR method to the BF method for the oldest accident years for certain reserving classes within our insurance liability line of business and recognized corresponding net favorable prior year reserve development totaling \$6 million for the 2003, and to a lesser extent the 2002, accident years during the quarter. We will continue to analyze our incurred loss emergence relative to expected emergence for all of our long-tail reserving classes and expect to commence transition to experience-based methods for those accident years where we believe the stage of expected development will produce meaningful actuarial indications.

### **Sensitivity Analysis**

While we believe that our loss reserves at December 31, 2012 are adequate, new information, events or circumstances may result in ultimate losses that are materially greater or less than provided for in our loss reserves. As previously noted, there are many factors that may cause our reserves to increase or decrease, particularly those related to catastrophe losses and long-tail lines of business.

Our expected loss ratios are a key assumption in our estimate of ultimate losses for business at an early stage of development. All else remaining equal, a higher expected loss ratio would result in a higher ultimate loss estimate, and vice versa. Our assumed loss development patterns are another significant assumption in estimating our loss reserves. All else remaining equal, accelerating a loss reporting pattern (i.e. shortening the claim tail) would result in lower ultimate losses, as the estimated proportion of losses already incurred would be higher. The uncertainty in the timing of the emergence of claims (i.e. the length of the development pattern) is generally greater for a company like ours with a limited operating history which, therefore, must rely on industry benchmarks to a certain extent when establishing loss reserve estimates.

The following tables show the effect on our estimate of gross loss reserves of reasonably likely changes in the two key assumptions used to estimate our gross loss reserves at December 31, 2012.

The results show the cumulative increase (decrease) in our loss reserves across all accident years. For example, if our assumed loss development pattern for our property and other insurance business was three months shorter with no accompanying change in our ELR assumption, our loss reserves may decrease by approximately \$22 million. Each of the impacts set forth in the tables is estimated individually, without consideration for any correlation among key assumptions or among reserving classes. Therefore, it would be inappropriate to take each of the amounts and add them together in an attempt to estimate total volatility. While we believe the variations in the expected loss ratios and loss development patterns presented could be reasonably expected, our own historical data regarding variability is generally limited and actual variations may be greater or less than these amounts. It is also important to note that the variations are not meant to be a "best-case" or "worst-case" series of scenarios and, therefore, it is possible that future variations in our loss reserves may be more or less than the amounts presented. While we believe that these are reasonably likely scenarios, we do not believe this sensitivity analysis should be considered an actual reserve range.

<b>INSURANCE</b>				
<b>Development Pattern</b>	<b>Expected Loss Ratio</b>			
<b><i>Property and Other</i></b>	<b>5% lower</b>	<b>Unchanged</b>	<b>5% higher</b>	
3 months shorter	\$ (43,974)	\$ (21,986)	\$	3
Unchanged	(23,088)	—		23,088
3 months longer	13,032	38,021		63,010
<b><i>Marine</i></b>	<b>5% lower</b>	<b>Unchanged</b>	<b>5% higher</b>	
3 months shorter	\$ (25,502)	\$ (17,612)	\$	(9,722)
Unchanged	(8,771)	—		8,771
3 months longer	14,628	24,630		34,632
<b><i>Aviation</i></b>	<b>5% lower</b>	<b>Unchanged</b>	<b>5% higher</b>	
3 months shorter	\$ (5,086)	\$ (3,239)	\$	(1,391)
Unchanged	(2,009)	—		2,009
3 months longer	2,230	4,462		6,695
<b><i>Credit and Political Risk</i></b>	<b>10% lower</b>	<b>Unchanged</b>	<b>10% higher</b>	
3 months shorter	\$ (14,418)	\$ —	\$	14,418
Unchanged	(14,418)	—		14,418
3 months longer	(14,418)	—		14,418
<b><i>Professional Lines</i></b>	<b>10% lower</b>	<b>Unchanged</b>	<b>10% higher</b>	
6 months shorter	\$ (258,715)	\$ (50,543)	\$	158,666
Unchanged	(211,132)	—		217,687
6 months longer	(127,922)	85,010		302,168
<b><i>Liability</i></b>	<b>10% lower</b>	<b>Unchanged</b>	<b>10% higher</b>	
6 months shorter	\$ (123,444)	\$ (18,031)	\$	87,382
Unchanged	(107,216)	—		107,216
6 months longer	(86,693)	22,803		132,300

<b>REINSURANCE</b>				
<b>Development Pattern</b>	<b>Expected Loss Ratio</b>			
<b><i>Property and Other</i></b>	<b>5% lower</b>	<b>Unchanged</b>	<b>5% higher</b>	
3 months shorter	\$ (96,027)	\$ (31,218)	\$ 33,591	
Unchanged	(66,370)	—	66,370	
3 months longer	(28,444)	39,923	108,289	
<b><i>Credit and Bond</i></b>	<b>10% lower</b>	<b>Unchanged</b>	<b>10% higher</b>	
6 months shorter	\$ (61,495)	\$ (18,606)	\$ 24,283	
Unchanged	(43,895)	—	43,895	
6 months longer	(17,584)	30,184	77,951	
<b><i>Professional Lines</i></b>	<b>10% lower</b>	<b>Unchanged</b>	<b>10% higher</b>	
6 months shorter	\$ (107,362)	\$ (22,297)	\$ 62,768	
Unchanged	(89,898)	—	89,898	
6 months longer	(66,142)	29,579	125,300	
<b><i>Motor</i></b>	<b>10% lower</b>	<b>Unchanged</b>	<b>10% higher</b>	
6 months shorter	\$ (98,128)	\$ (2,010)	\$ 94,108	
Unchanged	(96,178)	—	96,178	
6 months longer	(93,360)	2,904	99,168	
<b><i>Liability</i></b>	<b>10% lower</b>	<b>Unchanged</b>	<b>10% higher</b>	
6 months shorter	\$ (131,961)	\$ (3,106)	\$ 125,749	
Unchanged	(129,166)	—	129,166	
6 months longer	(126,220)	3,273	132,766	

## REINSURANCE RECOVERABLE

In the normal course of business, we purchase reinsurance to protect our business from losses due to exposure aggregation and to limit ultimate losses from catastrophic events. The purchase of reinsurance does not discharge our liabilities under contracts written by us. Consequently, an exposure exists with respect to reinsurance recoverable to the extent that any of our reinsurers are unwilling or unable to pay our claims.

The following table shows the composition of our reinsurance recoverable on unpaid losses for each of our reportable segments, segregated between those related to case reserves and those related to IBNR and by significant line of business:

At December 31,	2012			2011		
	Case Reserves	IBNR	Total	Case Reserves	IBNR	Total
Insurance segment:						
Property and other	\$ 146,478	\$ 77,535	\$ 224,013	\$ 135,836	\$ 96,207	\$ 232,043
Marine	116,806	49,535	166,341	84,935	66,740	151,675
Aviation	243	861	1,104	740	1,211	1,951
Credit and political risk	—	—	—	—	—	—
Professional lines	197,308	534,332	731,640	200,380	485,908	686,288
Liability	100,708	537,231	637,939	119,200	489,855	609,055
Total Insurance	<u>561,543</u>	<u>1,199,494</u>	<u>1,761,037</u>	<u>541,091</u>	<u>1,139,921</u>	<u>1,681,012</u>
Reinsurance segment:						
Property and other	—	—	—	—	—	—
Credit and bond	—	—	—	—	—	—
Professional lines	—	329	329	—	433	433
Motor	—	—	—	—	—	—
Liability	—	64,251	64,251	—	55,378	55,378
Total Reinsurance	<u>—</u>	<u>64,580</u>	<u>64,580</u>	<u>—</u>	<u>55,811</u>	<u>55,811</u>
<b>Total</b>	<u>\$ 561,543</u>	<u>\$ 1,264,074</u>	<u>\$ 1,825,617</u>	<u>\$ 541,091</u>	<u>\$ 1,195,732</u>	<u>\$ 1,736,823</u>

Reinsurance recoverable on unpaid losses as a percentage of gross loss reserves was comparable, at 20% and 21% for December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, respectively, 98.8% and 98.6% of our gross reinsurance recoverable (i.e. excluding the provision for uncollectible amounts) were collectible from reinsurers rated A- or better by A.M. Best. For an analysis of the credit risk associated with our reinsurance recoverable balances at December 31, 2012, refer to Item 8, Note 11 to the Consolidated Financial Statements.

The recognition of reinsurance recoverable on unpaid losses and loss expenses requires two key estimates. The first estimate is the amount of loss reserves to be ceded to our reinsurers. This amount consists of two elements, those related to our gross case reserves and those related to our gross IBNR. Reinsurance recoveries related to our gross case reserves are estimated on a case-by-case basis by applying the terms of any applicable reinsurance coverage to our individual case reserve estimates. Our estimate of ceded IBNR is generally developed as part of our loss reserving process and, consequently, its estimation is subject to similar risks and uncertainties as the estimation of gross IBNR. Estimates of amounts to be ceded under non-proportional reinsurance contracts also take into account pricing information for those contracts and require greater judgment than estimates for proportional contracts.

The second estimate is the amount of reinsurance recoverable on unpaid and paid losses that we will ultimately be unable to recover from reinsurers. The majority of our reinsurance recoverable on unpaid losses will not be due for collection until some point in the future. As a result, the amount we ultimately collect may differ from our estimate due to the ability and willingness of reinsurers to pay our claims, which may be negatively impacted by factors such as insolvency, contractual disputes over contract language or coverage and/or other reasons. Additionally, over the period of time before the amounts become due to us, economic conditions and/or operational performance of a particular reinsurer may deteriorate and this

could also affect the willingness and ability of a reinsurer to meet their contractual obligations to us. Accordingly, we review our reinsurance recoverable on a quarterly basis and estimate and record an offsetting provision for uncollectible amounts. Any changes in this provision are reflected in net income. We are selective in choosing our reinsurers, placing reinsurance principally with reinsurers with a strong financial condition and industry ratings.

We apply case-specific provisions against certain recoveries that we deem unlikely to be collected in full. In addition, we use a default analysis to estimate our provision for uncollectible amounts on the remainder of the balance. The principal components of the default analysis are reinsurance recoverable by reinsurer and default factors applied to estimate uncollectible amounts based on our reinsurers' credit ratings. The default factors are based on a model developed by a major rating agency. The provision recorded against reinsurance recoverable was \$16 million and \$18 million at December 31, 2012 and 2011, respectively. We have not written off any significant reinsurance recoverable balances in the last three years. At December 31, 2012, the use of different assumptions within our approach could have a material effect on our provision for uncollectible reinsurance recoverable. To the extent the creditworthiness of our reinsurers was to deteriorate due to an adverse event affecting the reinsurance industry, such as a large number of major catastrophes, actual uncollectible amounts could be significantly greater than our provision. Given the various considerations used to estimate our uncollectible provision, we cannot precisely quantify the effect a specific industry event may have on our provision.

## **PREMIUMS**

Our revenues are primarily generated from gross premiums written originating from our underwriting operations. The basis for our recognized gross premiums written varies by contract type.

### **Insurance Segment**

For the majority of our insurance business, we receive a fixed premium which is identified in the policy and recorded as unearned premium on the inception date of the contract. This premium will be adjusted only if the underlying insured values ultimately differ. Accordingly, we actively monitor underlying insured values and record adjustment premiums in the period in which amounts are reasonably determinable. Gross premiums written on a fixed premium basis accounted for approximately 93%, 92% and 97% of the segment's total for the years ended December 31, 2012, 2011 and 2010, respectively. A portion of this business is written through MGAs, third parties granted authority to bind risks on our behalf in accordance with our underwriting guidelines. For this business, we record premiums based on monthly statements received from the MGAs. Due to inherent reporting delays, we generally record premiums written via MGAs one month in arrears. In the event that a significant individual statement is not received, we record our best estimate based upon our historical experience.

A limited portion of our insurance business is written on a line slip or proportional basis, under which we assume a fixed percentage of the premiums and losses on a particular risk or group of risks along with numerous other unrelated insurers. Although premiums on this business are not contractually stated, we recognize gross premiums written based on an estimate provided by the client via the broker. For further details on the estimation process, see the discussion provided for the reinsurance segment below. We review these estimates on a quarterly basis and record significant adjustments in premium estimates when identified. Gross premiums written on a line slip/proportional basis comprised 7%, 8% and 3% of the segment's total for the years ended December 31, 2012, 2011 and 2010, respectively, and therefore the associated impact of these estimates on our pre-tax net income was immaterial. The proportionate increase in 2012 and 2011, when compared to 2010, was driven by growth in our accident & health line, a large portion of which related to proportional reinsurance business.

In our credit and political risk line of business, we write certain policies on a multi-year basis with premiums generally payable in installments. We record premiums at the inception of the policy based on our best estimate of total premiums, including assumptions relating to prepayments/refinancings. Furthermore, certain contracts within this line of business meet the U.S. GAAP definition of a financial guarantee insurance contract. Premiums for such contracts are recognized as the present value of the contractual premiums due or expected to be collected using a discount rate that reflects the risk-free rate at the inception of contract. Due to the scope exemption for insurance contracts that are similar to financial guarantee insurance contracts, the determination of whether certain of our credit and political risk contracts fall within the scope of the U.S. GAAP definition for financial guarantee contracts requires significant management judgment. For the years ended December 31, 2012 and 2011, our total premiums from financial guarantee insurance contracts were immaterial in the context of total gross premiums written for the segment. At December 31, 2012, the average duration of the outstanding unearned premiums written for our credit and political line of business was 4.0 years (2011: 4.4 years).

## Reinsurance Segment

We provide excess of loss and proportional coverage to cedants (i.e. insurance companies). In most cases, cedants seek protection from us for business that they have not yet written at the time they enter into agreements with us. As a result, cedants must estimate their underlying premiums when purchasing reinsurance coverage from us.

Our excess of loss reinsurance contracts with cedants generally include provisions for a deposit or minimum premium payable to us. The minimum/deposit premium is generally adjusted at the end of the contract period to reflect changes in the underlying risks in force during the contract period. Minimum/deposit premiums generally cover the majority of premiums due under excess of loss contracts, with the adjustable portion typically comprising an insignificant portion of the total premium paid to us. Therefore, the deposit/minimum premiums are generally considered to be the best estimate of the excess of loss reinsurance written premiums at inception. We record adjustments to the deposit/minimum premiums in the period during which they become determinable. Excess of loss contracts accounted for 47%, 53% and 55% of our reinsurance segment's total gross premiums written for the years ended December 31, 2012, 2011 and 2010, respectively. The decrease during 2012 was primarily driven by the repositioning of our catastrophe portfolio throughout the year.

Many of our excess of loss contracts also include provisions that require an automatic reinstatement of coverage in the event of a loss. In a year of large loss events, reinstatement premiums will be higher than in a year in which there are no such events. Reinstatement premiums are recognized when a triggering loss event occurs and losses are recorded by us. While the reinstatement premium amount is defined by contract terms, our recognition of reinstatement premiums is dependent on our estimate of losses and loss expenses, which reflect management's best judgment as described above in '*Critical Accounting Estimates – Reserves for Losses and Loss Expenses*'.

For business written under proportional contracts, our initial recognition of gross premiums written is based on estimates of premiums written provided by the cedant (via a broker) at contract inception. We may exercise judgment to modify the initial premium estimates provided by the cedants based on our prior experience with the cedant. We review these premium estimates on a quarterly basis and evaluate their reasonability in light of actual premiums reported to date by cedants, communications between us and the cedants/brokers and our view of changes in the marketplace and the cedants' competitive positions therein. Factors contributing to changes from the initial premium estimates may include:

- changes in renewal rates or rates of new business accepted by cedants (such changes could result from changes in the relevant insurance market that could affect more than one of our cedants or could be a consequence of changes in the marketing strategy or risk appetite of an individual cedant);
- changes in underlying exposure values; and/or
- changes in rates being charged by cedants.

As a result of this review process, any adjustments to estimates are recognized in gross premiums written during the period they are determined. Such changes in premium estimates could be material to gross premiums written and the resulting adjustments may directly and significantly impact net premiums earned favorably or unfavorably in the period they are determined because the adjustment may be substantially or fully earned. Gross premiums written for proportional contracts, including amounts related to the adjustment of premium estimates established in prior years, accounted for 53%, 47% and 45% of our reinsurance segment's gross premiums written for the years ended December 31, 2012, 2011 and 2010, respectively.



We made estimates on proportional treaties incepting during the year as follows:

<b>Year ended December 31,</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Catastrophe	\$ 2,264	\$ 4,595	\$ 5,187
Property	169,214	200,823	206,269
Professional lines	199,732	165,297	168,897
Credit and bond	232,998	254,548	226,858
Motor	158,230	128,164	64,893
Liability	116,208	111,454	121,004
Engineering	55,846	60,576	54,505
Other	10,918	8,405	8,617
<b>Total estimated premiums</b>	<b>\$ 945,410</b>	<b>\$ 933,862</b>	<b>\$ 856,230</b>
<b>Gross premiums written (reinsurance segment)</b>	<b>1,830,162</b>	<b>1,974,324</b>	<b>1,834,420</b>
<b>As a % of total gross premiums written</b>	<b>52%</b>	<b>47%</b>	<b>47%</b>

Since inception, our historical experience has shown that cumulative adjustments to our annual initial premium estimates on proportional reinsurance contracts have ranged from a negative revision of 3% to a favorable revision of 9%. Giving more weight to recent years where premium volume was comparable to current levels, we believe that a reasonably likely change in our 2012 proportional reinsurance gross premiums written estimate would be 5% in either direction. Such a change would result in a variance in our gross premiums written of approximately \$47 million and an immaterial impact on our pre-tax net income. However, larger variations, both positive and negative, are possible.

### **Earning Basis**

Our premiums are earned over the period during which we are exposed to the underlying risk. Changes in circumstance subsequent to contract inception can impact the earning period. For example, when our exposure limit for a contract is reached, we fully earn any associated unearned premium. This can have a significant impact on net premiums earned, particularly for multi-year contracts such as those in our credit and political risk line of business.

Our fixed premium insurance and excess of loss reinsurance contracts are generally written on a “losses occurring” or “claims made” basis over the term of the contract. Accordingly, we earn the premium evenly over the contract term, which is generally 12 months.

Line slip and proportional (re)insurance contracts are generally written on a “risks attaching” basis, covering claims that relate to the underlying policies written during the terms of such contracts. As the underlying business incepts throughout the contract term (typically one year) and typically has a one-year coverage period, we generally earn these premiums evenly over a 24-month period.

### **FAIR VALUE MEASUREMENTS**

Our estimates of fair value for financial assets and financial liabilities are based on the framework established in U.S. GAAP. This framework is based on the inputs used in valuation and gives the highest priority to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect our significant market assumptions. The three levels of the hierarchy are as follows:

- Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments.
- Level 2 – Valuations based on quoted prices in active markets for similar assets or liabilities, quoted prices for identical assets or liabilities in inactive markets, or for which significant inputs are observable (e.g. interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect our own assumptions about assumptions that market participants might use.

Refer to Item 8, Note 6 of the Consolidated Financial Statements for further details on the valuation techniques and assumptions used in estimating the fair value of our financial instruments.

Our estimated fair value of a financial instrument may differ from the amount that could be realized if the security was sold in an immediate sale, e.g., a forced transaction. Additionally, the valuation of fixed maturities is more subjective when markets are less liquid due to the lack of market based inputs, as was the case during the global financial market crisis in late 2008 and early 2009. This may lead us to change the selection of our valuation technique (from market to income approach) or may cause us to use multiple valuation techniques to estimate the fair value of a financial instrument. This circumstance may require significant management judgment and could cause an instrument to be reclassified between levels of the fair value hierarchy.

### **Fixed Maturities and Equities**

Since 2009, significant liquidity has returned to the financial markets, resulting in an increase in observable market prices for our financial instruments. At December 31, 2012, the fair value for 96% (2011: 95%) of our total fixed maturities and equities was based on prices provided by globally recognized independent pricing services where we have a current and detailed understanding of how their prices were derived. The remaining securities were priced by either non-binding broker quotes or internal valuation models.

Generally, we obtain quotes directly from broker-dealers who are active in the corresponding markets when prices are unavailable from independent pricing services. This may also be the case if the pricing from pricing services is not reflective of current market levels, as detected by our pricing control tolerance procedures. Generally, broker-dealers value securities through their trading desks based on observable market inputs. Their pricing methodologies include mapping securities based on trade data, bids or offers, observed spreads and performance on newly issued securities. They may also establish pricing through observing secondary trading of similar securities.

At December 31, 2012 and 2011, we have not adjusted any pricing provided by independent pricing services (see 'Management Pricing Validation' below). Additionally, our total Level 3 fixed maturities and equities amounted to \$71 million (2011: \$51 million), less than 1% of total fixed maturities and equities. Refer to Item 8, Note 6 to our Consolidated Financial Statements for further information.

#### *Management Pricing Validation*

While we obtain pricing from pricing services and/or broker-dealers, management is ultimately responsible for determining the fair value measurements for all securities. To ensure fair value measurement is applied consistently and in accordance with U.S. GAAP, we periodically update our understanding of the pricing methodologies used by the pricing services and broker-dealers.

We also challenge any prices we believe may not be representative of fair value under current market conditions. Our review process includes, but is not limited to: (i) initial and ongoing evaluation of the pricing methodologies and valuation models used by outside parties to calculate fair value; (ii) quantitative analysis; (iii) a review of multiple quotes obtained in the pricing process and the range of resulting fair values for each security, if available, and (iv) randomly selecting purchased or sold securities and comparing the executed prices to the fair value estimates provided by the independent pricing sources and broker-dealers.

### **Other Investments**

#### *Hedge Funds and Credit Funds*

We measure the fair value for hedge and credit funds by obtaining the net asset value (NAV) as advised by our external fund manager or third party administrator. For any funds for which we did not receive a December 31, 2012 net asset value, we have recorded an estimate of the change in fair value for the latest period based on return estimates obtained from the fund managers. Accordingly, we do not have a reporting lag in our fair value measurements for these funds. Historically, our estimated NAVs have not significantly diverged from the subsequent final audited NAVs. Where we have the ability to liquidate our holdings at the reported NAV in the near term, these hedge and credit funds are classified as Level 2 within the fair value hierarchy while the remaining funds are classified as Level 3.

### *CLO – Equity Securities*

We have also invested in CLO Equities, also known as “cash flow CLOs” in the industry. In 2012, the CLO – Equity market continues to be mostly inactive with only a small number of transactions being observed in the market and even fewer still involving deals we hold. Accordingly, we continue to rely on the use of our internal discounted cash flow model (income approach) to estimate the fair value of CLO – Equities. At December 31, 2012, the estimated fair value for CLO – Equities was \$62 million (2011: \$67 million), based on the following significant inputs used in our valuation model.

<b>At December 31,</b>	<b>2012</b>	<b>2011</b>
Default rates	<b>4.0% - 5.0%</b>	4.0% - 5.0%
Loss severity rate	<b>53.5%</b>	53.5%
Collateral spreads	<b>2.6% - 4.2%</b>	2.6% - 4.2%
Estimated maturity dates	<b>1.8 - 5.7 years</b>	1.9 - 6.1 years

Of these significant inputs, the default and loss severity rates are the most judgmental unobservable market inputs to which the valuation of CLO – Equities is most sensitive.

Actual default rates at November 30, 2012 for our CLO – Equities varied from 0.2% to 4.5% (November 30, 2011: 0.2% to 1.8%) on the remaining underlying collateral. While, on average, these default rates are much lower than our default rate assumptions noted above, we remain cautious on this favorable development given the continuing global economic uncertainty. Due to the use of significant unobservable inputs in our discounted cash flow model, we continue to classify the CLO – Equities as Level 3.

### **OTHER-THAN-TEMPORARY IMPAIRMENTS (“OTTI”)**

Because our available-for-sale (“AFS”) investment portfolio is the largest component of our consolidated assets and a multiple of shareholders’ equity, OTTI could be material to our financial condition and operating results particularly during periods of dislocation in the financial markets. During 2012, we recorded a total OTTI charge in earnings of \$24 million (2011: \$16 million; 2010: \$18 million). Refer to the ‘*Net Investment Income and Net Realized Investment Gains/Losses*’ section above for further details.

We review quarterly whether a decline in the fair values of AFS securities below their amortized costs is other-than-temporarily impaired. The OTTI assessment is inherently judgmental, especially where securities have experienced severe declines in fair value in a short period. Our OTTI review process is based on both quantitative and qualitative approach. We identify securities for review based on credit quality, relative health of industry sector, yield analysis, security performance and topical issues. For identified securities, we prepare a fundamental analysis at the security level and consider the following factors:

- The length of time and extent to which the fair value has been less than the amortized cost for fixed maturities or cost for equity securities.
- The financial condition, near-term and long-term prospects for the issuer of the security, including the relevant industry conditions and trends, and implications of rating agency actions and offering prices.
- The historical and implied volatility of the fair value.
- The collateral structure and credit support.

The following provides further details regarding our OTTI recognition and processes for AFS fixed maturities and equity securities.

### **Fixed Maturities**

A security is “impaired” when the fair value is below its amortized cost. For an impaired fixed maturity, we recognize an OTTI in earnings when we:

- 1) have the intent to sell the security,
- 2) more likely than not will be required to sell the security before its anticipated recovery, or
- 3) do not anticipate to recover fully the amortized cost based on projected cash flows to be collected (i.e. a credit loss exists).

For the first two criteria above, the OTTI charge is the entire difference between the security’s fair value and its amortized cost. However, if the impairment arises due to an anticipated credit loss on the security (third criterion above), we recognize only the credit loss component of the OTTI amount in earnings with a corresponding adjustment to amortized cost (new cost basis). The non-credit component (e.g. interest rates, market conditions, etc.) of the OTTI amount is recognized in other comprehensive income in our shareholders’ equity.

From time to time, we may sell fixed maturities subsequent to the balance sheet date that we did not intend to sell at the balance sheet date. Conversely, we may not sell fixed maturities that we previously asserted that we intended to sell at the balance sheet date. Such changes in intent may arise due to events occurring subsequent to the balance sheet date. The types of events that may result in a change in intent include, but are not limited to, significant changes in the economic facts and circumstances related to the specific issuer, changes in liquidity needs, or changes in tax laws or the regulatory environment.

For impaired investment-grade securities (i.e. rated BBB or above) that we do not intend to sell and it is more likely than not that we will not be required to sell, we have established some parameters for identifying securities with potential credit impairments. Our parameters focus primarily on the extent and duration of the decline, including but not limited to:

- declines in value greater than 20% for nine consecutive months,
- declines in value greater than 10% for twelve consecutive months, and
- declines in value greater than 5% and rated less than BBB (i.e. downgraded to non-investment grade since its original purchase).

For impaired securities held within our high yield portfolios (i.e. managed under a mandate to invest exclusively in non-investment grade securities), we have established separate parameters for our credit loss assessment. Due to the additional volatility inherent in high yield securities relative to investment-grade securities, we focus on the severity of the impairment and work closely with our external high yield investment managers to identify securities with significant potential credit impairments.

If a security meets one of the above criteria, we then perform a fundamental analysis by considering the qualitative factors noted above. Our OTTI review process for credit impairment excludes all fixed maturities guaranteed by the U.S. government and its agencies because we anticipate these securities will not be settled below amortized costs.

The credit loss component of OTTI recognized in earnings is calculated based on the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to the impairment. The significant inputs and the methodology used to estimate the credit losses are disclosed in Item 8, Note 5(d) to the Consolidated Financial Statements.

### **Equities**

We consider our ability and intent to hold an equity security in an unrealized loss position for a reasonable period of time to allow for a full recovery. As an equity security does not have a maturity date, the forecasted recovery for an equity security is inherently more judgmental than for a fixed maturity security.

In light of the volatile global equity markets we have experienced in recent years, we generally impair any equities for which we do not forecast a recovery to cost within three years. Further, we generally impair an equity security if its value has declined by more than 30% for nine consecutive months or by more than 20% for twelve consecutive months. We have also established parameters for identifying potential impaired equity securities for fundamental analysis based on the severity, in either percentage or absolute dollar terms, of the unrealized loss position.

From time to time, we may sell our AFS equities subsequent to the balance sheet date that were considered temporarily impaired at the balance sheet date. This may occur due to events occurring subsequent to the balance sheet date that result in a change in our intent or ability to hold an equity security. Such subsequent events that may result in a sale include significant deterioration in the financial condition of the issuer, significant unforeseen changes in our liquidity needs, or changes in tax laws or the regulatory environment.

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## **RECENT ACCOUNTING PRONOUNCEMENTS**

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See Item 8, Note 2(m) to the Consolidated Financial Statements for a discussion of recently issued accounting pronouncements that we have not yet adopted.

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## **OFF-BALANCE SHEET AND SPECIAL PURPOSE ENTITY ARRANGEMENTS**

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At December 31, 2012, we have not entered into any off-balance sheet arrangements, as defined by Item 303(a)(4) of Regulation S-K.

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## **NON-GAAP FINANCIAL MEASURES**

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In this report, we present operating income (loss), consolidated underwriting income (loss) and underwriting-related general and administrative expenses, which are “non-GAAP financial measures” as defined in Regulation G.

Operating income (loss) represents after-tax operational results without consideration of after-tax net realized investment gains (losses), foreign exchange losses (gains) and losses on repurchase of preferred shares. We also present diluted operating income (loss) per common share and operating return on average common equity (“operating ROACE”), which are derived from the non-GAAP operating income (loss) measure.

Consolidated underwriting income (loss) is a pre-tax measure of underwriting profitability that takes into account net premiums earned and other insurance related income as revenues and net losses and loss expenses, acquisition costs and underwriting-related general and administrative costs as expenses. Underwriting-related general and administrative expenses include those general and administrative expenses that are incremental and/or directly attributable to our individual underwriting operations. While these measures are presented in Item 8, Note 3 to our Consolidated Financial Statements, they are considered non-GAAP financial measures when presented elsewhere on a consolidated basis.

Operating income (loss), diluted operating income (loss) per common share and operating ROACE can be reconciled to the nearest GAAP financial measures as follows:

<b>Year ended December 31,</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Net income available to common shareholders	\$ 495,004	\$ 9,430	\$ 819,848
Net realized investment gains, net of tax <sup>(1)</sup>	(115,854)	(119,736)	(193,124)
Foreign exchange losses (gains), net of tax <sup>(2)</sup>	28,364	(43,606)	(15,382)
Loss on repurchase of preferred shares, net of tax <sup>(3)</sup>	14,009	—	—
Operating income (loss)	<u>\$ 421,523</u>	<u>\$ (153,912)</u>	<u>\$ 611,342</u>
Earnings per common share - diluted	\$ 4.00	\$ 0.07	\$ 6.02
Net realized investment gains, net of tax	(0.94)	(0.93)	(1.42)
Foreign exchange losses (gains), net of tax	0.24	(0.34)	(0.11)
Loss on repurchase of preferred shares, net of tax	0.11	—	—
Adjustment for anti-dilutive securities <sup>(4)</sup>	—	(0.06)	—
Operating income (loss) per common share - diluted	<u>\$ 3.41</u>	<u>\$ (1.26)</u>	<u>\$ 4.49</u>
Weighted average common shares and common share equivalents - diluted, for net income <sup>(5)</sup>	123,654	128,122	136,199
Weighted average common shares and common share equivalents - diluted, for operating income (loss)	123,654	122,499	136,199
Average common shareholders' equity	\$ 5,110,499	\$ 5,034,525	\$ 5,062,607
ROACE	9.7%	0.2%	16.2%
Operating ROACE	8.2%	(3.1%)	12.1%

(1) Tax cost of \$11,615, \$1,703 and \$1,974 for 2012, 2011 and 2010, respectively. Tax impact is estimated by applying the statutory rates of applicable jurisdictions, after consideration of other relevant factors including the ability to utilize capital losses.

(2) Tax benefit (cost) of \$1,148, (\$976) and (\$153) for 2012, 2011 and 2010, respectively. Tax impact is estimated by applying the statutory rates of applicable jurisdictions, after consideration of other relevant factors including the tax status of specific foreign exchange transactions.

(3) Tax impact is nil.

(4) For operating loss per share purposes, we have excluded the impact of otherwise anti-dilutive securities.

(5) Refer to Note 12 to the Consolidated Financial Statements for further details on the dilution calculation.

A reconciliation of consolidated underwriting income (loss) to income before income taxes (the nearest GAAP financial measure) can be found in Item 8, Note 3 to the Consolidated Financial Statements. Underwriting-related general and administrative are reconciled to general and administrative expenses (the nearest GAAP financial measure) within 'Underwriting Results - Group'.

We present our results of operations in the way we believe will be most meaningful and useful to investors, analysts, rating agencies and others who use our financial information to evaluate our performance. This includes the presentation of "operating income (loss)" (in total and on a per share basis), "annualized operating return on average common equity" (which is based on the "operating income (loss)" measure) and "consolidated underwriting income (loss)", which incorporates "underwriting-related general and administrative expenses".

#### Operating Income (Loss)

Although the investment of premiums to generate income and realized investment gains (or losses) is an integral part of our operations, the determination to realize investment gains (or losses) is independent of the underwriting process and is heavily influenced by the availability of market opportunities. Furthermore, many users believe that the timing of the realization of investment gains (or losses) is somewhat opportunistic for many companies.

Foreign exchange losses (gains) in our Consolidated Statements of Operations are primarily driven by the impact of foreign exchange rate movements on net insurance related-liabilities. However, this movement is only one element of the overall impact of foreign exchange rate fluctuations on our financial position. In addition, we recognize unrealized foreign exchange losses (gains) on our available-for-sale investments in other comprehensive income and foreign exchange losses (gains) realized upon the sale of these investments in net realized investments gain (losses). These unrealized and realized foreign exchange rate movements generally offset a large portion of the foreign exchange losses (gains) reported separately in earnings, thereby minimizing the impact of foreign exchange rate movements on total shareholders' equity. As such, the Statement of Operations foreign exchange losses (gains) in isolation are not a fair representation of the performance of our business.

Losses on repurchase of preferred shares arise from capital transactions and, therefore, are not reflective of underlying business performance.

In this regard, certain users of our financial statements evaluate earnings excluding after-tax net realized investment gains (losses), foreign exchange losses (gains) and losses on repurchase of preferred shares to understand the profitability of recurring sources of income.

We believe that showing net income available to common shareholders exclusive of net realized gains (losses), foreign exchange losses (gains) and losses on repurchase of preferred shares reflects the underlying fundamentals of our business. In addition, we believe that this presentation enables investors and other users of our financial information to analyze performance in a manner similar to how our management analyzes the underlying business performance. We also believe this measure follows industry practice and, therefore, facilitates comparison of our performance with our peer group. We believe that equity analysts and certain rating agencies that follow us, and the insurance industry as a whole, generally exclude these items from their analyses for the same reasons.

#### Consolidated Underwriting Income (Loss)/Underwriting-Related General and Administrative Expenses

Corporate expenses include holding company costs necessary to support our worldwide (re)insurance operations and costs associated with operating as a publicly-traded company. As these costs are not incremental and/or directly attributable to our individual underwriting operations, we exclude them from underwriting-related general and administrative expenses and, therefore, consolidated underwriting income (loss). Interest expense and financing costs primarily relate to interest payable on our senior notes and are excluded from consolidated underwriting income (loss) for the same reason.

We evaluate our underwriting results separately from the performance of our investment portfolio. As such, we believe it appropriate to exclude net investment income and net realized investment gains (losses) from our underwriting profitability measure.

As noted above, foreign exchange losses (gains) in our Consolidated Statement of Operations primarily relate to our net insurance-related liabilities. However, we manage our investment portfolio in such a way that unrealized and realized foreign exchange rate gains (losses) on our investment portfolio generally offset a large portion of the foreign exchange losses (gains) arising from our underwriting portfolio. As a result, we believe that foreign exchange losses (gains) are not a meaningful contributor to our underwriting performance and, therefore, exclude them from consolidated underwriting income (loss).

We believe that presentation of underwriting-related general and administrative expenses and consolidated underwriting income (loss) provides investors with an enhanced understanding of our results of operations, by highlighting the underlying pre-tax profitability of our underwriting activities.

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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

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Market risk represents the potential for an economic loss due to adverse changes in the fair value of financial instruments. Refer to '*Risk and Capital Management*' section under Item 1 for further details on how we manage market risk relating to our financial instruments.

Our Balance Sheets include a substantial amount of assets whose fair values are subject to market risks. Our fixed income and equity securities are classified as available-for-sale and, as such, changes in fair value caused by changes in interest rates, equity prices and foreign currency exchange rates will have an immediate impact on our comprehensive income, shareholders' equity and book value but may not have an immediate impact on consolidated net income. Changes in these market risks will only impact our consolidated net income when, and if, securities are sold or an OTTI charge is recorded. Further, we have alternative investments including hedge funds, credit funds, and CLO – Equities at December 31, 2012 and 2011. These investments are also exposed to market risks, with the change in fair value reported immediately in earnings.

The following is a sensitivity analysis of our primary market risk exposures at December 31, 2012 and 2011. Our policies to address these risks in 2012 were not materially different from 2011. We do not currently anticipate significant changes in our primary market risk exposures or in how those exposures are managed in future reporting periods based upon what is known or expected to be in effect in future reporting periods.

**SENSITIVITY ANALYSIS****Interest Rate and Credit Spread Risk**

Interest rate risk includes fluctuations in interest rates and credit spreads that have a direct impact on the fair value of our fixed maturities. As interest rates rise and credit spreads widen, the fair value of fixed maturities falls, and the converse is also true.

We monitor our sensitivity to interest rate changes and credit spread changes by revaluing our fixed maturities using a variety of different interest rates (inclusive of credit spreads). We use duration and convexity at the security level to estimate the change in fair value that would result from a change in each security's yield. Duration measures the price sensitivity of an asset to changes in yield rates. Convexity measures how the duration of the security changes with interest rates. The duration and convexity analysis takes into account changes in prepayment expectations for MBS and ABS securities. The analysis is performed at the security level and aggregated up to the asset category levels for reporting in the tables below.



The following table presents the estimated pre-tax impact on the fair value of our fixed maturities at December 31, 2012 and 2011 due to an instantaneous increase in the U.S. yield curve of 100 basis points and an additional 100 basis point credit spread widening for corporate debt, non-agency residential and commercial MBS, ABS and municipal bond securities.

	Fair Value	Potential Adverse Change in Fair Value		
		Increase in interest rate by 100 basis points	Widening of credit spreads by 100 basis points	Total
<b><u>At December 31, 2012</u></b>				
U.S. government and agency	\$ 1,422,885	\$ (55,856)	\$ —	\$ (55,856)
Non-U.S. government	1,104,576	(34,088)	—	(34,088)
Agency MBS	2,659,908	(68,821)	—	(68,821)
<i>Securities exposed to credit spreads:</i>				
Corporate debt	3,876,382	(111,035)	(116,763)	(227,798)
CMBS	840,084	(23,773)	(24,037)	(47,810)
Non agency RMBS	95,199	(1,897)	(2,959)	(4,856)
ABS	643,206	(5,525)	(14,331)	(19,856)
Municipals	1,285,809	(54,567)	(55,134)	(109,701)
	<u>\$ 11,928,049</u>	<u>\$ (355,562)</u>	<u>\$ (213,224)</u>	<u>\$ (568,786)</u>
<b><u>At December 31, 2011</u></b>				
U.S. government and agency	\$ 1,148,267	\$ (30,557)	\$ —	\$ (30,557)
Non-U.S. government	1,212,451	(37,172)	—	(37,172)
Agency MBS	2,636,634	(50,924)	—	(50,924)
<i>Securities exposed to credit spreads:</i>				
Corporate debt	3,609,591	(113,228)	(123,567)	(236,795)
CMBS	312,691	(9,145)	(9,227)	(18,372)
Non agency RMBS	165,713	(217)	(3,659)	(3,876)
ABS	632,042	(4,411)	(12,699)	(17,110)
Municipals	1,222,711	(57,416)	(57,844)	(115,260)
	<u>\$ 10,940,100</u>	<u>\$ (303,070)</u>	<u>\$ (206,996)</u>	<u>\$ (510,066)</u>

U.S. government agencies have a limited range of spread widening, therefore, 100 basis points of spread widening for these securities is highly improbable in normal market conditions. As previously noted, our non-U.S. government debt obligations are highly-rated, with no remaining exposure to the European peripheral countries. Accordingly, we believe the potential for future widening of credit spreads would also be limited for these securities. Further, certain of our holdings in non-agency RMBS and ABS have floating interest rates, which mitigate our interest rate risk exposure.

The above sensitivity analysis reflects our view of changes that are reasonably possible over a one-year period. Note this should not be construed as our prediction of future market events, but rather an illustration of the impact of such events.

As the performance of our investment in credit funds are driven by the valuation of the underlying bank loans, these funds are also exposed to credit spreads movement. At December 31, 2012, the impact of an instantaneous 15% decline in the fair value of our investment in credit funds would be \$13 million (2011: \$13 million), on a pre-tax basis. Our investment in CLO – Equities is also exposed to interest rate risk, but it would have an insignificant impact to its fair value in the event the risk free yield curve increase by 100 basis points.

Additionally, our investment in foreign bond mutual funds is exposed to interest rate risk; however, this exposure is largely mitigated by the short duration of the underlying securities.

### Equity Price Risk

Our portfolio of equity securities, excluding the foreign bond mutual funds, has exposure to equity price risk. This risk is defined as the potential loss in fair value resulting from adverse changes in stock prices. Our global equity portfolio is correlated with a blend of the S&P 500 and MSCI World indices and changes in this blend of indices would approximate the impact on our portfolio. The fair value of our equity securities at December 31, 2012 was \$563 million (2011: \$561 million). At December 31, 2012, the impact of a 20% decline in the overall market prices of our equity exposures would be \$113 million (2011: \$112 million), on a pre-tax basis.

Our investment in hedge funds has significant exposure to equity strategies with net long positions. At December 31, 2012, the impact of an instantaneous 15% decline in the fair value of our investment in hedge funds would be \$104 million (2011: \$82 million), on a pre-tax basis.

### Foreign Currency Risk

The table below provides a sensitivity analysis of our total net foreign currency exposures.

	AUD	NZD	CAD	EUR	GBP	JPY	Other	Total
<b>At December 31, 2012</b>								
Net managed assets (liabilities), excluding derivatives	\$ (51,247)	\$ (278,388)	\$ 78,242	\$ (25,315)	\$ (21,525)	\$ (8,387)	\$ (15,020)	\$ (321,640)
Foreign currency derivatives, net	25,961	245,801	(58,297)	39,588	—	15,329	—	268,382
Net managed foreign currency exposure	(25,286)	(32,587)	19,945	14,273	(21,525)	6,942	(15,020)	(53,258)
Other net foreign currency exposure	5,454	—	211	22,257	15,199	14,224	201,062	258,407
<b>Total net foreign currency exposure</b>	<b>\$ (19,832)</b>	<b>\$ (32,587)</b>	<b>\$ 20,156</b>	<b>\$ 36,530</b>	<b>\$ (6,326)</b>	<b>\$ 21,166</b>	<b>\$ 186,042</b>	<b>\$ 205,149</b>
Net foreign currency exposure as a percentage of total shareholders' equity	(0.3%)	(0.6%)	0.3%	0.6%	(0.1%)	0.4%	3.2%	3.5%
Pre-tax impact of net foreign currency exposure on shareholders' equity given a hypothetical 10% rate movement <sup>(1)</sup>	\$ (1,983)	\$ (3,259)	\$ 2,016	\$ 3,653	\$ (633)	\$ 2,117	\$ 18,604	\$ 20,515
<b>At December 31, 2011</b>								
Net managed assets (liabilities), excluding derivatives	\$ (108,549)	\$ (327,165)	\$ 53,336	\$ 552,421	\$ (16,960)	\$ (73,888)	\$ (1,047)	\$ 78,148
Foreign currency derivatives, net	72,093	314,890	(39,348)	(637,822)	(62,036)	44,666	8,225	(299,332)
Net managed foreign currency exposure	(36,456)	(12,275)	13,988	(85,401)	(78,996)	(29,222)	7,178	(221,184)
Other net foreign currency exposure	(945)	—	1,209	26,748	22,581	33,580	30,052	113,225
<b>Total net foreign currency exposure</b>	<b>\$ (37,401)</b>	<b>\$ (12,275)</b>	<b>\$ 15,197</b>	<b>\$ (58,653)</b>	<b>\$ (56,415)</b>	<b>\$ 4,358</b>	<b>\$ 37,230</b>	<b>\$ (107,959)</b>
Net foreign currency exposure as a percentage of total shareholders' equity	(0.7%)	(0.2%)	0.3%	(1.1%)	(1.1%)	0.1%	0.7%	(2.0%)
Pre-tax impact of net foreign currency exposure on shareholders' equity given a hypothetical 10% rate movement <sup>(1)</sup>	\$ (3,740)	\$ (1,228)	\$ 1,520	\$ (5,865)	\$ (5,642)	\$ 436	\$ 3,723	\$ (10,796)

(1) Assumes 10% change in underlying currencies relative to the U.S. dollar.

### Net Managed Foreign Currency Exposure

Our net managed foreign currency exposure is subject to our internal risk tolerance standards. For significant foreign currency exposures, defined as those where our net asset/liability position exceeds the greater of 1% of our shareholders' equity or \$50 million, the value of assets denominated in those currencies should fall within a range of 90 - 110% of liabilities denominated in the same currency. In addition, our aggregate foreign currency exposure is subject to the same tolerance range. We use derivative instruments to maintain net managed foreign currency exposures within our risk tolerance levels.

During 2012, our euro-denominated net assets, excluding derivatives, and the derivatives used to hedge these net assets decreased, as we actively reduced our eurozone sovereign debt exposure. Refer to Item 7 '*Cash and Investments - Fixed Maturities - Non-U.S. Government*' for further details.

Business written as part of the January 2013 renewal season is expected to offset a large portion of the \$53 million net short managed foreign currency exposure at December 31, 2012. Remaining un-matched foreign currency exposure will be economically hedged with foreign currency derivatives to ensure our net exposure remains within our risk tolerances.

### Other Net Foreign Currency Exposure

Other net foreign currency exposure includes those assets managed by specific investment managers who have the discretion to hold foreign currency exposures as part of their total return strategy. The funding of an emerging market debt securities portfolio was the primary driver for the increase in other net foreign currency exposures during 2012. Refer to Item 7 '*Cash and Investments - Fixed Maturities - Non-U.S. Government*' for further details on this portfolio.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of  
AXIS Capital Holdings Limited

We have audited the accompanying consolidated balance sheets of AXIS Capital Holdings Limited and subsidiaries (the “Company”) as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of AXIS Capital Holdings Limited and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2012, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 2013 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

/s/ Deloitte & Touche Ltd.

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Hamilton, Bermuda  
February 22, 2013

**AXIS CAPITAL HOLDINGS LIMITED**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2012 AND 2011**

	2012	2011
	(in thousands)	
<b>Assets</b>		
Investments:		
Fixed maturities, available for sale, at fair value <i>(Amortized cost 2012: \$11,605,672; 2011: \$10,821,338)</i>	\$ 11,928,049	\$ 10,940,100
Equity securities, available for sale, at fair value <i>(Cost 2012: \$608,306; 2011: \$699,566)</i>	666,548	677,560
Other investments, at fair value	843,437	699,320
Short-term investments, at fair value and amortized cost	108,860	149,909
Total investments	13,546,894	12,466,889
Cash and cash equivalents	759,817	981,849
Restricted cash and cash equivalents	90,733	100,989
Accrued interest receivable	97,220	98,346
Insurance and reinsurance premium balances receivable	1,474,821	1,413,839
Reinsurance recoverable on unpaid and paid losses	1,863,819	1,770,329
Deferred acquisition costs	389,248	407,527
Prepaid reinsurance premiums	315,676	238,623
Receivable for investments sold	1,254	3,006
Goodwill and intangible assets	97,493	99,590
Other assets	215,369	225,072
<b>Total assets</b>	<b>\$ 18,852,344</b>	<b>\$ 17,806,059</b>
<b>Liabilities</b>		
Reserve for losses and loss expenses	\$ 9,058,731	\$ 8,425,045
Unearned premiums	2,454,692	2,454,462
Insurance and reinsurance balances payable	270,739	206,539
Senior notes	995,245	994,664
Payable for investments purchased	64,553	151,941
Other liabilities	228,623	129,329
<b>Total liabilities</b>	<b>13,072,583</b>	<b>12,361,980</b>
<b>Commitments and Contingencies</b>		
<b>Shareholders' equity</b>		
Preferred shares - Series A, B and C	502,843	500,000
Common shares <i>(2012: 171,867; 2011: 170,159 shares issued and 2012: 117,920; 2011: 125,588 shares outstanding)</i>	2,146	2,125
Additional paid-in capital	2,179,034	2,105,386
Accumulated other comprehensive income	362,622	128,162
Retained earnings	4,497,789	4,155,392
Treasury shares, at cost <i>(2012: 53,947; 2011: 44,571 shares)</i>	(1,764,673)	(1,446,986)
<b>Total shareholders' equity</b>	<b>5,779,761</b>	<b>5,444,079</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 18,852,344</b>	<b>\$ 17,806,059</b>

See accompanying notes to Consolidated Financial Statements.

**AXIS CAPITAL HOLDINGS LIMITED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<small>(in thousands, except for per share data)</small>		
<b>Revenues</b>			
Net premiums earned	\$ 3,415,463	\$ 3,314,961	\$ 2,947,410
Net investment income	380,957	362,430	406,892
Other insurance related income	2,676	2,396	2,073
Net realized investment gains			
Other-than-temporary impairment (OTTI) losses	(24,234)	(16,446)	(19,216)
Non-credit portion of OTTI losses recognized in other comprehensive income	—	585	1,284
Other net realized investment gains	151,703	137,300	213,030
Total net realized investment gains	127,469	121,439	195,098
<b>Total revenues</b>	<b>3,926,565</b>	<b>3,801,226</b>	<b>3,551,473</b>
<b>Expenses</b>			
Net losses and loss expenses	2,096,028	2,675,052	1,677,132
Acquisition costs	627,653	587,469	488,712
General and administrative expenses	560,981	459,151	449,885
Foreign exchange losses (gains)	29,512	(44,582)	(15,535)
Interest expense and financing costs	61,863	62,598	55,876
<b>Total expenses</b>	<b>3,376,037</b>	<b>3,739,688</b>	<b>2,656,070</b>
<b>Income before income taxes</b>	<b>550,528</b>	<b>61,538</b>	<b>895,403</b>
Income tax expense	3,287	15,233	38,680
<b>Net income</b>	<b>547,241</b>	<b>46,305</b>	<b>856,723</b>
Preferred share dividends	38,228	36,875	36,875
Loss on repurchase of preferred shares	14,009	—	—
<b>Net income available to common shareholders</b>	<b>\$ 495,004</b>	<b>\$ 9,430</b>	<b>\$ 819,848</b>
<b>Per share data</b>			
Net income per common share			
Basic net income	\$ 4.05	\$ 0.08	\$ 6.74
Diluted net income	\$ 4.00	\$ 0.07	\$ 6.02
Weighted average number of common shares outstanding - basic	122,148	122,499	121,728
Weighted average number of common shares outstanding - diluted	123,654	128,122	136,199
Cash dividends declared per common share	\$ 0.97	\$ 0.93	\$ 0.86

See accompanying notes to Consolidated Financial Statements.

**AXIS CAPITAL HOLDINGS LIMITED**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**FOR THE YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<b>(in thousands)</b>		
<b>Net income</b>	<b>\$ 547,241</b>	<b>\$ 46,305</b>	<b>\$ 856,723</b>
<b>Other comprehensive income (loss), net of tax;</b>			
Available for sale investments:			
Unrealized gains arising during the period	<b>348,510</b>	74,297	266,294
Adjustment for re-classification of realized investment gains and OTTI losses recognized in net income	<b>(116,278)</b>	(119,548)	(190,646)
Unrealized gains (losses) arising during the period, net of reclassification adjustment	<b>232,232</b>	(45,251)	75,648
Non-credit portion of OTTI losses	—	(455)	(1,284)
Foreign currency translation adjustment	<b>510</b>	(3,045)	16,026
Net change in benefit plan assets and obligations recognized in equity and reclassification adjustment	<b>1,718</b>	92	798
<b>Total other comprehensive income (loss), net of tax</b>	<b>234,460</b>	(48,659)	91,188
<b>Comprehensive income (loss)</b>	<b>\$ 781,701</b>	<b>\$ (2,354)</b>	<b>\$ 947,911</b>

See accompanying notes to Consolidated Financial Statements.



**AXIS CAPITAL HOLDINGS LIMITED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
		(in thousands)	
<b>Preferred shares - Series A, B and C</b>			
Balance at beginning of period	\$ 500,000	\$ 500,000	\$ 500,000
Shares issued - Series C	400,000	—	—
Shares repurchased - Series A and B	(397,157)	—	—
<b>Balance at end of period</b>	<b>502,843</b>	<b>500,000</b>	<b>500,000</b>
<b>Common shares (par value)</b>			
Balance at beginning of period	2,125	1,934	1,903
Shares issued	21	191	31
<b>Balance at end of period</b>	<b>2,146</b>	<b>2,125</b>	<b>1,934</b>
<b>Additional paid-in capital</b>			
Balance at beginning of period	2,105,386	2,059,708	2,014,815
Shares issued - common shares	2,582	1,769	635
Issue costs on newly issued preferred shares	(6,456)	—	—
Reversal of issue costs on repurchase of preferred shares	7,093	—	—
Stock options exercised	2,517	4,775	7,563
Share-based compensation expense	67,912	39,134	36,695
<b>Balance at end of period</b>	<b>2,179,034</b>	<b>2,105,386</b>	<b>2,059,708</b>
<b>Accumulated other comprehensive income</b>			
Balance at beginning of period	128,162	176,821	85,633
Unrealized appreciation on available for sale investments, net of tax:			
Balance at beginning of period	116,096	161,802	87,438
Unrealized gains (losses) arising during the period, net of reclassification adjustment	232,232	(45,251)	75,648
Non-credit portion of OTTI losses	—	(455)	(1,284)
Balance at end of period	348,328	116,096	161,802
Cumulative foreign currency translation adjustments, net of tax:			
Balance at beginning of period	13,784	16,829	803
Foreign currency translation adjustment	510	(3,045)	16,026
Balance at end of period	14,294	13,784	16,829
Supplemental Executive Retirement Plans (SERPs):			
Balance at beginning of period	(1,718)	(1,810)	(2,608)
Net change in benefit plan assets and obligations recognized in equity and reclassification adjustment	1,718	92	798
Balance at end of period	—	(1,718)	(1,810)
<b>Balance at end of period</b>	<b>362,622</b>	<b>128,162</b>	<b>176,821</b>
<b>Retained earnings</b>			
Balance at beginning of period	4,155,392	4,267,608	3,569,411
Net income	547,241	46,305	856,723
Series A, B and C preferred share dividends	(38,228)	(36,875)	(36,875)
Loss on repurchase of preferred shares	(14,009)	—	—
Common share dividends	(152,607)	(121,646)	(121,651)
<b>Balance at end of period</b>	<b>4,497,789</b>	<b>4,155,392</b>	<b>4,267,608</b>
<b>Treasury shares, at cost</b>			
Balance at beginning of period	(1,446,986)	(1,381,101)	(671,518)
Shares repurchased for treasury	(317,687)	(65,885)	(709,583)
<b>Balance at end of period</b>	<b>(1,764,673)</b>	<b>(1,446,986)</b>	<b>(1,381,101)</b>
<b>Total shareholders' equity</b>	<b>\$ 5,779,761</b>	<b>\$ 5,444,079</b>	<b>\$ 5,624,970</b>

See accompanying notes to Consolidated Financial Statements.

**AXIS CAPITAL HOLDINGS LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	(in thousands)		
<b>Cash flows from operating activities:</b>			
Net income	\$ 547,241	\$ 46,305	\$ 856,723
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Net realized investment gains	(127,469)	(121,439)	(195,098)
Net realized and unrealized gains of other investments	(87,623)	(31,013)	(63,627)
Amortization of fixed maturities	135,297	93,356	61,122
Other amortization and depreciation	13,821	16,905	14,104
Share-based compensation expense	67,912	39,134	36,695
<i>Changes in:</i>			
Accrued interest receivable	1,126	(1,982)	(6,805)
Reinsurance recoverable balances	(93,490)	(192,782)	(153,375)
Deferred acquisition costs	18,279	(48,227)	(56,980)
Prepaid reinsurance premiums	(77,053)	(17,227)	80,489
Reserve for loss and loss expenses	633,686	1,392,670	468,242
Unearned premiums	230	120,786	124,279
Insurance and reinsurance balances, net	3,218	(28,562)	(59,017)
Other items	85,442	(77,782)	81,025
<b>Net cash provided by operating activities</b>	<u>1,120,617</u>	<u>1,190,142</u>	<u>1,187,777</u>
<b>Cash flows from investing activities:</b>			
Purchases of:			
Fixed maturities	(13,513,143)	(15,472,001)	(12,429,332)
Equity securities	(377,749)	(603,746)	(257,674)
Other investments	(110,084)	(220,000)	(65,000)
Short-term investments	(383,981)	(841,124)	(578,762)
Proceeds from the sale of:			
Fixed maturities	11,144,351	13,754,436	10,622,948
Equity securities	468,473	222,506	126,076
Other investments	53,590	70,988	179,607
Short-term investments	354,924	710,178	423,451
Proceeds from redemption of fixed maturities	1,456,553	1,422,171	1,236,076
Proceeds from redemption of short-term investments	69,751	151,216	113,074
Purchase of other assets	(35,322)	(42,193)	(17,854)
Change in restricted cash and cash equivalents	10,256	14,851	(40,400)
<b>Net cash used in investing activities</b>	<u>(862,381)</u>	<u>(832,718)</u>	<u>(687,790)</u>
<b>Cash flows from financing activities:</b>			
Net proceeds from issuance of senior notes	—	—	494,870
Net proceeds from issuance of preferred shares	393,544	—	—
Repurchase of preferred shares	(404,073)	—	—
Repurchase of common shares	(317,687)	(65,885)	(709,583)
Dividends paid - common shares	(120,487)	(206,455)	(108,302)
Dividends paid - preferred shares	(38,228)	(36,875)	(36,875)
Proceeds from issuance of common shares	5,120	6,735	8,229
<b>Net cash used in financing activities</b>	<u>(481,811)</u>	<u>(302,480)</u>	<u>(351,661)</u>
Effect of exchange rate changes on foreign currency cash	1,543	(2,610)	(7,425)
Increase (decrease) in cash and cash equivalents	(222,032)	52,334	140,901
Cash and cash equivalents - beginning of period	981,849	929,515	788,614
<b>Cash and cash equivalents - end of period</b>	<u>\$ 759,817</u>	<u>\$ 981,849</u>	<u>\$ 929,515</u>
<b>Supplemental disclosures of cash flow information:</b>			
Income taxes paid	\$ 10,897	\$ 23,853	\$ 37,688
Interest paid	\$ 58,125	\$ 58,125	\$ 48,986

See accompanying notes to Consolidated Financial Statements.

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012, 2011 AND 2010**

**1. HISTORY**

AXIS Capital Holdings Limited (“AXIS Capital”) is the Bermuda-based holding company for the AXIS group of companies, collectively the “Company”. AXIS Capital was incorporated on December 9, 2002, under the laws of Bermuda. Through its subsidiaries and branches organized in Bermuda, the United States, Europe, Singapore, Canada, Australia and Latin America, AXIS Capital provides a broad range of (re)insurance products on a worldwide basis under two distinct global underwriting platforms, AXIS Insurance and AXIS Reinsurance. In these notes, the terms “we,” “us,” “our,” or the “Company” refer to AXIS Capital and its direct and indirect subsidiaries.

**2. SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) and include the accounts of AXIS Capital, its wholly-owned subsidiaries, and variable interest entities (“VIEs”) in which the Company is considered the primary beneficiary. All inter-company accounts and transactions have been eliminated.

A VIE is an entity that either: (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. We are the primary beneficiary of a VIE if we have a controlling financial interest in the VIE, based on the following two characteristics: a) the power to direct the activities of the VIE that most significantly impact the economic performance of the VIE, and b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

Tabular dollar and share amounts are in thousands, with the exception of per share amounts. All amounts are reported in U.S. dollars.

**Use of Estimates**

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes that the amounts included in the consolidated financial statements reflect its best estimates and assumptions, actual results could differ from those estimates. The Company’s principal estimates include:

- reserve for losses and loss expenses;
- reinsurance recoverable on unpaid losses, including the provision for uncollectible amounts;
- gross and net premiums written and net premiums earned;
- other-than-temporary impairments (“OTTI”) in the carrying value of available-for-sale investment securities; and
- fair value measurements for our financial assets.

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012, 2011 AND 2010**

**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Our significant accounting policies are:

**a) Investments**

***Investments available for sale***

Our fixed maturities and equities classified as “available for sale” are reported at fair value at the balance sheet date. See Note 6 – Fair Value Measurements for additional information regarding the determination of fair value. The change in fair value (net unrealized gain or loss) on our available for sale investments, net of tax, is included as a separate component of accumulated other comprehensive income (loss) (“AOCI”) in shareholders’ equity.

Net investment income includes interest and dividend income and the amortization of market premiums and discounts and is presented net of investment expenses. Investment income is recognized when earned. Purchases and sales of investments are recorded on a trade-date basis and realized gains/losses on sales of investments are determined based on the specific identification method.

We recognize investment income from fixed maturities based on the constant effective yield method, which includes an adjustment for estimated principal repayments, if any. The effective yield used to determine the amortization for fixed maturities subject to prepayment risk (e.g. asset-backed, loan-backed and other structured securities) is recalculated and adjusted periodically based upon actual historical and/or projected future cash flows. The adjustments to the yield for highly-rated prepayable fixed maturities are accounted for using the retrospective method. The adjustments to the yield for other prepayable fixed maturities are accounted for using the prospective method.

On a quarterly basis, we assess whether unrealized losses on available for sale investments represent impairments that are other than temporary. Several factors are considered in this assessment including, but not limited to: (i) the extent and duration of the decline, (ii) the reason for the decline (e.g. credit spread widening, credit event, foreign exchange rate movements), (iii) the historical and implied future volatility of the fair value, (iv) the financial condition and near-term prospects of the issuer and (v) the collateral structure and credit support of the security, if applicable.

A fixed maturity is impaired when the fair value is below its amortized cost. For an impaired fixed maturity where we intend to sell the security or it is more likely than not that we will be required to sell the security before its anticipated recovery, the full amount of the impairment is charged to earnings and is included in net realized investment gains (losses). Where we intend to hold the impaired fixed maturity, we estimate the anticipated credit loss of the security and recognize only this portion of the impairment in earnings, with the remaining non-credit related balance of the impairment (i.e. related to interest rates, market conditions, etc.) recognized in AOCI.

We impair an equity security in an unrealized loss position when we do not have the ability and intent to hold the security for a reasonable period of time to allow for a full recovery. The full impairment is charged to earnings and is included in net realized investment gains (losses).

Upon recognition of an OTTI, the new cost basis for the security is the previous amortized cost for a fixed maturity or cost for an equity security less the OTTI recognized in earnings. The new cost basis is not adjusted for subsequent recoveries in fair value; except for fixed maturities whereby the difference between the new cost basis and the expected cash flows is accreted on a quarterly basis to net investment income over the remaining life of the fixed maturity.

***Other investments***

We record other investments at fair value (see Note 6 – Fair Value Measurements), with both changes in fair value and realized gains/losses reported in net investment income.

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012, 2011 AND 2010**

**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Short-term investments***

Short-term investments primarily comprise highly-liquid debt securities with maturities greater than three months but less than one year from the date of purchase. These investments are carried at amortized cost, which approximates fair value.

**b) Cash and cash equivalents**

Cash equivalents include money-market funds and fixed interest deposits placed with a maturity of under 90 days when purchased. Cash and cash equivalents are recorded at amortized cost, which approximates fair value due to the short-term, liquid nature of these securities. Our restricted cash balance primarily relates to funds held in trust in support of our obligations in regulatory jurisdictions where we operate as a non-admitted carrier.

**c) Premiums and Acquisition Costs**

***Premiums***

Insurance premiums written are recorded in accordance with the terms of the underlying policies. For multi-year policies where premiums are payable in annual installments, premiums are recorded at the inception of the policy based on management's best estimate of total premiums to be received. However, this excludes premiums for the period during which the client has the ability to unilaterally commute or cancel coverage. Reinsurance premiums are recorded at the inception of the policy and are estimated based upon information received from ceding companies. Any subsequent differences arising on insurance and reinsurance premium estimates are recorded in the period they are determined.

(Re)insurance premiums are earned over the period during which we are exposed to the underlying risk, which is generally one to two years with the exception of multi-year contracts. Unearned premiums represent the portion of premiums written which is applicable to the unexpired risks under contracts in force.

Reinstatement premiums are recognized at the time a loss event occurs and coverage limits for the remaining life of the contract are reinstated under pre-defined contract terms; such premiums are earned over the remaining risk period. The accrual of reinstatement premiums is based on our estimate of losses and loss adjustment expenses, which reflects management's judgment, as described in Note 2(d) – Losses and Loss Expenses below.

Premiums receivable balances in excess of 90 days past due are reviewed for impairment at least quarterly and an allowance is established for amounts considered uncollectible. The need for charge-off of any amounts previously reserved as uncollectible is assessed on a quarterly basis.

***Acquisition Costs***

Acquisition costs vary with and are directly related to the acquisition of (re)insurance contracts and consist primarily of fees and commissions paid to brokers and premium taxes. Premiums receivable are presented net of applicable acquisition costs when contract terms provide for the right of offset. Acquisition costs are shown net of commissions earned on ceded reinsurance. Our net acquisition costs are deferred and charged to expense as the related premium is earned.

Anticipated losses and loss expenses, other costs and investment income related to these premiums are considered in assessing the recoverability of our deferred acquisition costs. If deferred amounts are estimated to be unrecoverable, they are expensed. Compensation expenses for personnel involved in contract acquisition, as well as advertising costs, are expensed as incurred.

**d) Losses and Loss Expenses**

Our reserve for losses and loss expenses represents an estimate of the unpaid portion of our ultimate liability for losses and loss expenses for (re)insured events that have occurred at or before the balance sheet date. The balance reflects both claims

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012, 2011 AND 2010**

**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

that have been reported to us (“case reserves”) and claims that have been incurred but not yet reported to us (“IBNR”). These amounts are reduced for estimated amounts of salvage and subrogation recoveries.

We review our reserve for losses and loss expenses on a quarterly basis. Case reserves are primarily established based on amounts reported from insureds and/or their brokers. Management estimates IBNR after reviewing detailed actuarial analyses and applying informed judgment regarding qualitative factors that may not be fully captured in the actuarial estimates. A variety of actuarial methods are utilized in this process, including the Expected Loss Ratio, Bornhuetter-Ferguson and Chain Ladder methods. Our estimate is highly dependent on management’s judgment as to which method(s) are most appropriate for a particular accident year and class of business. Our historical claims data is often supplemented with industry benchmarks when applying these methodologies.

Any adjustments to our previous reserve for losses and loss expenses estimates are recognized in the period they are determined. While we believe that our reserves for losses and loss expenses are adequate, this estimate requires significant judgment and new information, events or circumstances may result in ultimate losses that are materially greater or less than provided for in the Consolidated Balance Sheets.

**e) Reinsurance**

In the normal course of business, we purchase reinsurance protection to limit our ultimate losses from catastrophic events and to reduce our loss aggregation risk. The premiums paid to our reinsurers (i.e. premiums ceded) are expensed over the coverage period. Prepaid reinsurance premiums represent the portion of premiums ceded applicable to the unexpired term of the contracts in force. Reinstatement-related premiums ceded are recorded at the time a loss event occurs and our coverage limits for the remaining life of a contract are reinstated under pre-defined contract terms; such premiums are expensed over the remaining risk period.

Reinsurance recoverable related to our case reserves is estimated on a case-by-case basis by applying the terms of any applicable reinsurance coverage to our individual case reserve estimates. Our estimate of reinsurance recoverable related to our IBNR reserves is generally developed as part of our loss reserving process.

Our reinsurance recoverable is presented net of a provision for uncollectible amounts, reflecting the amount we believe will ultimately not be recovered due to reinsurer insolvency, contractual disputes and/or some other reason. We apply case-specific provisions against certain recoveries that we deem unlikely to be collected in full. In addition, we use a default analysis to estimate our provision for uncollectible amounts on the remainder of the balance.

The estimates of our reinsurance recoverable and the associated provision require management’s judgment and are reviewed in detail on a quarterly basis. Any adjustments to amounts recognized in prior periods are reported in our net losses and loss expenses in the Consolidated Statement of Operations for the period when the adjustments were identified. The charge-off of amounts previously reserved as uncollectible is also considered on a case-by-case basis as part of this quarterly process.

**f) Foreign Exchange**

The Company’s reporting currency is the U.S. dollar. In translating the financial statements of our subsidiaries or branches where the functional currency is other than the U.S. dollar, assets and liabilities are converted into U.S. dollars using the rates of exchange in effect at the balance sheet dates and revenues and expenses are converted using the weighted average foreign exchange rates for the period. The effect of translation adjustments is reported as a separate component of AOCI in shareholders’ equity.

In recording foreign currency transactions, revenue and expense items are converted to the relevant functional currency at the exchange rate prevailing at the transaction date. Assets and liabilities originating in currencies other than the functional currency are translated into the functional currency at the rates of exchange in effect at the balance sheet date. The resulting foreign currency gains or losses are recognized in the Consolidated Statements of Operations, with the exception of those

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012, 2011 AND 2010**

**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

related to foreign-denominated available for sale investments. For these investments, exchange rate fluctuations represent an unrealized appreciation/depreciation in the value of the securities and are included in the related component of AOCI.

**g) Share-Based Compensation**

The Company is authorized to issue restricted stock awards and units, stock options and other equity-based awards to its employees and directors. The fair value of service-based awards is measured at the grant date, with the associated expense recognized on a straight-line basis over the service period. The fair value of performance-based awards is measured at the grant date, with the associated expense recognized on a straight-line basis over the applicable performance and vesting period, provided that the outcome of the underlying performance condition is considered probable. Forfeiture benefits are estimated at the time of grant and incorporated in the determination of share-based compensation expense.

**h) Derivative Instruments**

*Derivative Instruments not Designated as Hedging Instruments*

We may enter into derivative instruments such as futures, options, interest rate swaps and foreign currency forward contracts as part of our overall foreign currency risk management strategy, to obtain exposure to a particular financial market or for yield enhancement. From time to time we may also enter into (re)insurance contracts that meet the FASB's definition of a derivative contract.

We measure all derivative instruments at fair value (see Note 6 – Fair Value Measurements) and recognize them as either assets or liabilities in the Consolidated Balance Sheets. Subsequent changes in fair value and any realized gains or losses are recognized in the Consolidated Statements of Operations.

*Derivative Instruments Designated as Hedging Instruments*

We may designate a currency derivative as a hedge of foreign exchange rate-related movements in the fair value of certain investment portfolios. This is referred to as a fair value hedge. Changes in the fair value of the designated fair value hedge, along with the changes in the fair value of the hedged asset attributable to the hedged risk, are recorded in net realized investment gains (losses) in the Consolidated Statements of Operations, along with any hedge ineffectiveness.

To qualify for hedge accounting treatment, a derivative must be highly effective in mitigating the designated changes in value of the hedged item. Further, the hedge relationship must be designated and formally documented at the inception, detailing the particular risk management objective and strategy for the hedge, including the item and risk that is being hedged, the derivative that is being used, and how effectiveness will be assessed. We formally measure the hedge effectiveness at inception and on an ongoing basis. We evaluate the effectiveness on a retrospective and prospective basis, using the period-to-period dollar offset method. Using this method, if the hedge correlation is within the range of 80% to 125%, we consider the hedge effective and apply hedge accounting. Cash flows from derivative instruments designated as hedging instruments are presented as operating activities in the Consolidated Statements of Cash Flows.

**i) Goodwill and Intangible Assets**

We classify intangible assets into three categories: (1) intangible assets with finite lives subject to amortization, (2) intangible assets with indefinite lives not subject to amortization, and (3) goodwill.

We amortize intangible assets with finite lives over their estimated useful lives in proportion to the estimated economic benefits of the intangible assets. We also test these assets for impairment if circumstances indicate that the carrying value may not be fully recoverable. Such circumstances may include an economic downturn in a geographic market or a change in the assessment of future operations. If, as a result of such an evaluation, we determine that the carrying value of the finite-lived intangible assets is not recoverable, the value of the assets will be reduced to fair value with the difference being expensed in the Consolidated Statement of Operations.

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Our intangible assets with indefinite lives include licenses held by certain subsidiaries in various jurisdictions that allow such subsidiaries to write insurance and/or reinsurance business. These intangible assets are carried at or below estimated fair value and are tested annually for impairment, either qualitatively or quantitatively, and between annual tests if events or changes in circumstances indicate that it is more likely than not that the asset is impaired.

We have recorded goodwill in connection with certain acquisitions. Goodwill represents the excess of the cost of acquisitions over the fair value of the net assets acquired and is assigned to applicable reporting unit(s) on the acquisition date, based upon the expected benefit to be received by the reporting unit. We determine the expected benefit based on several factors, including the purpose of the business combination, our strategy subsequent to the business combination and the structure of the acquired company subsequent to the business combination. Goodwill is not subject to amortization. We test goodwill for potential impairment during the fourth quarter each year and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit to a level below its carrying amount. We have the option to first make this assessment on a qualitative basis. Should we choose to forgo this option, or if our qualitative assessment indicates that fair value is more likely than not below carrying value, we conduct a quantitative two-step impairment evaluation at the reporting unit level. First, we identify potential impairment by comparing the estimated fair values of the reporting units to estimated book values, including goodwill. The fair value of each reporting unit is derived based upon valuation techniques and assumptions that we believe market participants would use to value our business. The estimated fair values are generally determined utilizing methodologies that incorporate discounted cash flow analyses. The values derived from the analyses are then compared to recent market transactions for reasonableness. We derive the net book value of our reporting units by estimating the amount of shareholders' equity required to support the activities of each reporting unit. If the estimated fair value of a reporting unit exceeds the estimated book value, goodwill is not considered impaired. If the book value exceeds the estimated fair value, the second step compares the implied fair value of the reporting unit's goodwill with the carrying amount of the goodwill in order to determine the magnitude of impairment to be recognized. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit's identifiable assets and liabilities from the fair value of the reporting unit as a whole. The excess of the carrying value of goodwill above the implied goodwill, if any, would be recognized as an impairment charge in the Consolidated Statement of Operations.

**j) Income Taxes**

Certain subsidiaries and branches of the Company operate in jurisdictions where they are subject to taxation. Current and deferred income taxes are charged or credited to net income, or in certain cases to AOCI, based upon enacted tax laws and rates applicable in the relevant jurisdiction in the period in which the tax becomes accruable or realizable. Deferred income taxes are provided for all temporary differences between the bases of assets and liabilities used in the Consolidated Balance Sheets and those used in the various jurisdictional tax returns. When our assessment indicates that it is more likely than not that a portion of a deferred tax asset will not be realized in the foreseeable future, a valuation allowance against deferred tax assets is recorded. We recognize the tax benefits of uncertain tax positions only when the position is more-likely-than-not to be sustained upon audit by the relevant taxing authorities.

**k) Treasury Shares**

Common shares repurchased by the Company and not subsequently cancelled are classified as treasury shares and are recorded at cost. This results in a reduction of shareholders' equity in the Consolidated Balance Sheets. When shares are reissued from treasury, we use the average cost method to determine the cost of the reissued shares. Gains on sales/reissuances of treasury shares are credited to additional paid-in capital, while losses are charged to additional paid-in capital to the extent that previous net gains from reissued treasury shares were included therein; otherwise losses are charged to retained earnings.



**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012, 2011 AND 2010**

**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**l) New Accounting Standards Adopted in 2012**

Goodwill

Effective January 1, 2012, we prospectively adopted FASB guidance providing entities with the option to perform a qualitative assessment prior to calculating the estimated fair value of a reporting unit, the first step of the required annual goodwill impairment test. Entities able to qualitatively conclude that the fair value of a reporting unit more likely than not (a likelihood of more than 50%) exceeds its carrying amount can bypass the existing requirement to perform the quantitative annual impairment test. The adoption of this guidance did not impact our results of operations, financial condition or liquidity.

Fair Value Measurement and Disclosures

Effective January 1, 2012, we prospectively adopted FASB guidance amending existing fair value measurement guidance to:

- clarify principal market determination,
- address the fair value measurement of instruments with offsetting market or counterparty credit risks,
- clarify that the “valuation premise” and “highest and best use” concepts are not relevant to financial instruments,
- limit the application of premiums and discounts,
- prohibit the use of blockage factors to all three levels of the fair value hierarchy, and
- expand disclosure requirements.

The adoption of this amended guidance did not impact our results of operations, financial condition or liquidity. The additional disclosures are provided in Note 6 - Fair Value Measurements.

Indefinite-Lived Intangible Assets (Other Than Goodwill)

During 2012, we adopted new guidance issued by the FASB providing entities with the option to perform a qualitative assessment prior to calculating the estimated fair value of indefinite-lived intangible assets (other than goodwill), as required for annual impairment tests. Entities able to qualitatively conclude that the fair value of an indefinite-lived intangible asset (other than goodwill) more likely than not (a likelihood of more than 50%) exceeds its carrying amount can bypass the existing requirement to perform the quantitative annual impairment test. The adoption of this guidance did not impact our results of operations, financial condition or liquidity.

**m) Recently Issued Accounting Standard Not Yet Adopted**

Balance Sheet Offsetting

In December 2011, the FASB issued new guidance requiring additional disclosures about financial instruments and derivative instruments that are either: (1) offset for balance sheet presentation purposes or (2) subject to an enforceable master netting arrangement or similar arrangement, regardless of whether they are offset for balance sheet presentation purposes. This guidance will be effective at January 1, 2013, with retrospective presentation of the new disclosures required. In January 2013, the FASB issued a related scope clarification, limiting the applicability of the requirements to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing/lending transactions. As this new guidance is disclosure-related only and does not amend existing balance sheet offsetting guidance, adoption will not impact our results of operations, financial condition or liquidity.

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Reporting Amounts Reclassified Out of AOCI*

In February 2013, the FASB issued new guidance requiring additional disclosures about reclassification adjustments from AOCI. This guidance will be effective prospectively at January 1, 2013. As this new guidance is disclosure-related only and does not amend existing guidance on the reporting net income available to common shareholders or other comprehensive income, adoption will not impact our results of operations, financial condition or liquidity.

**3. SEGMENT INFORMATION**

Our underwriting operations are organized around our global underwriting platforms, AXIS Insurance and AXIS Reinsurance. Therefore we have determined that we have two reportable segments, insurance and reinsurance. We do not allocate our assets by segment, with the exception of goodwill and intangible assets, as we evaluate the underwriting results of each segment separately from the results of our investment portfolio.

**Insurance**

Our insurance segment provides insurance coverage on a worldwide basis. The product lines in this segment are property, marine, terrorism, aviation, credit and political risk, professional lines, liability and accident & health.

**Reinsurance**

Our reinsurance segment provides non-life treaty reinsurance to insurance companies on a worldwide basis. The product lines in this segment are catastrophe, property, professional lines, credit and bond, motor, liability, engineering and other.

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**3. SEGMENT INFORMATION (CONTINUED)**

The following tables summarize the underwriting results of our reportable segments, as well as the carrying values of allocated goodwill and intangible assets:

At and year ended December 31, 2012	Insurance	Reinsurance	Total
Gross premiums written	\$ 2,309,481	\$ 1,830,162	\$ 4,139,643
Net premiums written	1,522,245	1,815,211	3,337,456
Net premiums earned	1,558,058	1,857,405	3,415,463
Other insurance related income	2,676	—	2,676
Net losses and loss expenses	(953,564)	(1,142,464)	(2,096,028)
Acquisition costs	(226,859)	(400,794)	(627,653)
General and administrative expenses	(314,834)	(116,487)	(431,321)
<b>Underwriting income</b>	<u>\$ 65,477</u>	<u>\$ 197,660</u>	<u>263,137</u>
Corporate expenses			(129,660)
Net investment income			380,957
Net realized investment gains			127,469
Foreign exchange losses			(29,512)
Interest expense and financing costs			(61,863)
<b>Income before income taxes</b>			<u>\$ 550,528</u>
Net loss and loss expense ratio	61.2%	61.5%	61.4%
Acquisition cost ratio	14.6%	21.6%	18.4%
General and administrative expense ratio	20.2%	6.3%	16.4%
<b>Combined ratio</b>	<u>96.0%</u>	<u>89.4%</u>	<u>96.2%</u>
<b>Goodwill and intangible assets</b>	<u>\$ 97,493</u>	<u>\$ —</u>	<u>\$ 97,493</u>

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**3. SEGMENT INFORMATION (CONTINUED)**

At and year ended December 31, 2011	Insurance	Reinsurance	Total
Gross premiums written	\$ 2,121,829	\$ 1,974,324	\$ 4,096,153
Net premiums written	1,466,134	1,953,300	3,419,434
Net premiums earned	1,429,687	1,885,274	3,314,961
Other insurance related income	2,396	—	2,396
Net losses and loss expenses	(919,319)	(1,755,733)	(2,675,052)
Acquisition costs	(199,583)	(387,886)	(587,469)
General and administrative expenses	(278,147)	(103,915)	(382,062)
<b>Underwriting income (loss)</b>	<u>\$ 35,034</u>	<u>\$ (362,260)</u>	<u>(327,226)</u>
Corporate expenses			(77,089)
Net investment income			362,430
Net realized investment gains			121,439
Foreign exchange gains			44,582
Interest expense and financing costs			(62,598)
<b>Income before income taxes</b>			<u>\$ 61,538</u>
Net loss and loss expense ratio	64.3%	93.1%	80.7%
Acquisition cost ratio	14.0%	20.6%	17.7%
General and administrative expense ratio	19.4%	5.5%	13.9%
<b>Combined ratio</b>	<u>97.7%</u>	<u>119.2%</u>	<u>112.3%</u>
<b>Goodwill and intangible assets</b>	<u>\$ 99,590</u>	<u>\$ —</u>	<u>\$ 99,590</u>

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**3. SEGMENT INFORMATION (CONTINUED)**

At and year ended December 31, 2010	Insurance	Reinsurance	Total
Gross premiums written	\$ 1,916,116	\$ 1,834,420	\$ 3,750,536
Net premiums written	1,332,220	1,815,320	3,147,540
Net premiums earned	1,206,493	1,740,917	2,947,410
Other insurance related income	2,073	—	2,073
Net losses and loss expenses	(569,869)	(1,107,263)	(1,677,132)
Acquisition costs	(152,223)	(336,489)	(488,712)
General and administrative expenses	(276,435)	(98,001)	(374,436)
<b>Underwriting income</b>	<u>\$ 210,039</u>	<u>\$ 199,164</u>	409,203
Corporate expenses			(75,449)
Net investment income			406,892
Net realized investment gains			195,098
Foreign exchange gains			15,535
Interest expense and financing costs			(55,876)
<b>Income before income taxes</b>			<u>\$ 895,403</u>
Net loss and loss expense ratio	47.2%	63.6%	56.9%
Acquisition cost ratio	12.6%	19.3%	16.6%
General and administrative expense ratio	23.0%	5.7%	15.2%
<b>Combined ratio</b>	<u>82.8%</u>	<u>88.6%</u>	<u>88.7%</u>
<b>Goodwill and intangible assets</b>	<u>\$ 103,231</u>	<u>\$ —</u>	<u>\$ 103,231</u>

**AXIS CAPITAL HOLDINGS LIMITED**  
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**3. SEGMENT INFORMATION (CONTINUED)**

The following table presents our gross premiums written by the geographical location of our subsidiaries:

Year ended December 31,	2012	2011	2010
Bermuda	\$ 684,588	\$ 822,237	\$ 822,530
Europe	1,561,701	1,493,692	1,203,091
United States	1,893,354	1,780,224	1,724,915
<b>Total gross premium written</b>	<b>\$ 4,139,643</b>	<b>\$ 4,096,153</b>	<b>\$ 3,750,536</b>

The following table presents our net premiums earned by segment and line of business:

Year ended December 31,	2012	2011	2010
<u>Insurance</u>			
Property	\$ 408,943	\$ 385,291	\$ 337,525
Marine	171,165	152,123	145,356
Terrorism	38,605	35,213	32,486
Aviation	60,363	70,681	66,636
Credit and political risk	87,103	97,680	89,773
Professional lines	563,500	536,238	444,663
Liability	86,873	89,555	87,481
Accident & health	141,506	62,906	2,573
Total Insurance	<u>1,558,058</u>	<u>1,429,687</u>	<u>1,206,493</u>
<u>Reinsurance</u>			
Catastrophe	375,088	456,858	454,954
Property	351,470	356,022	323,201
Professional lines	297,726	281,025	285,224
Credit and bond	277,185	263,912	217,809
Motor	237,006	202,830	127,404
Liability	220,874	230,872	232,014
Engineering	68,402	65,727	71,229
Other	29,654	28,028	29,082
Total Reinsurance	<u>1,857,405</u>	<u>1,885,274</u>	<u>1,740,917</u>
<b>Total</b>	<b>\$ 3,415,463</b>	<b>\$ 3,314,961</b>	<b>\$ 2,947,410</b>

**AXIS CAPITAL HOLDINGS LIMITED**  
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**4. GOODWILL AND INTANGIBLE ASSETS**

The following table shows an analysis of goodwill and intangible assets:

	Goodwill	Intangible assets with an indefinite life	Intangible assets with a finite life	Total
<b>Net balance at December 31, 2010</b>	\$ 49,297	\$ 26,036	\$ 27,898	\$ 103,231
Amortization	—	—	(3,717)	(3,717)
Foreign currency translation adjustment	53	—	23	76
<b>Net balance at December 31, 2011</b>	<u>49,350</u>	<u>26,036</u>	<u>24,204</u>	<u>99,590</u>
Amortization	—	—	(2,618)	(2,618)
Foreign currency translation adjustment	285	—	236	521
<b>Net balance at December 31, 2012</b>	<u>\$ 49,635</u>	<u>\$ 26,036</u>	<u>\$ 21,822</u>	<u>\$ 97,493</u>
<b>Gross balance at December 31, 2012</b>	<b>\$ 42,237</b>	<b>\$ 26,036</b>	<b>\$ 35,596</b>	<b>\$ 103,869</b>
Accumulated amortization	—	—	<b>(21,369)</b>	<b>(21,369)</b>
Foreign currency translation adjustment	<b>7,398</b>	—	<b>7,595</b>	<b>14,993</b>
Accumulated impairment charges	—	—	—	—
<b>Net balance at December 31, 2012</b>	<u>\$ 49,635</u>	<u>\$ 26,036</u>	<u>\$ 21,822</u>	<u>\$ 97,493</u>

We estimate that the annual amortization expense for our total intangible assets with a finite life will be approximately \$2 million from 2013 to 2017. The estimated remaining useful lives of these assets range from seven to twenty-six years.

Intangible assets with an indefinite life consist primarily of U.S. state licenses that provide a legal right to transact business indefinitely. Our impairment reviews for goodwill and indefinite lived intangibles did not result in the recognition of impairment losses for the years ended December 31, 2012, 2011 and 2010.

**AXIS CAPITAL HOLDINGS LIMITED**  
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**5. INVESTMENTS**

**a) Fixed Maturities and Equities**

The amortized cost or cost and fair values of our fixed maturities and equities were as follows:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Non-credit OTTI in AOCI <sup>(5)</sup>
<b><u>At December 31, 2012</u></b>					
<b>Fixed maturities</b>					
U.S. government and agency	\$ 1,413,520	\$ 9,484	\$ (119)	\$ 1,422,885	\$ —
Non-U.S. government	1,076,501	30,276	(2,201)	1,104,576	—
Corporate debt	3,746,616	135,658	(5,892)	3,876,382	—
Agency RMBS <sup>(1)</sup>	2,594,180	67,398	(1,670)	2,659,908	—
CMBS <sup>(2)</sup>	814,211	25,999	(126)	840,084	—
Non-Agency RMBS	93,266	2,503	(570)	95,199	(884)
ABS <sup>(3)</sup>	639,614	10,774	(7,182)	643,206	—
Municipals <sup>(4)</sup>	1,227,764	58,770	(725)	1,285,809	—
<b>Total fixed maturities</b>	<b>\$ 11,605,672</b>	<b>\$ 340,862</b>	<b>\$ (18,485)</b>	<b>\$ 11,928,049</b>	<b>\$ (884)</b>
<b>Equity securities</b>					
Common stocks	398,975	51,821	(7,398)	443,398	
Exchange-traded funds	109,434	9,727	—	119,161	
Non-U.S. bond mutual funds	99,897	4,092	—	103,989	
<b>Total equity securities</b>	<b>\$ 608,306</b>	<b>\$ 65,640</b>	<b>\$ (7,398)</b>	<b>\$ 666,548</b>	
<b><u>At December 31, 2011</u></b>					
<b>Fixed maturities</b>					
U.S. government and agency	\$ 1,142,732	\$ 5,669	\$ (134)	\$ 1,148,267	\$ —
Non-U.S. government	1,241,664	7,359	(36,572)	1,212,451	—
Corporate debt	3,581,320	85,766	(57,495)	3,609,591	—
Agency RMBS <sup>(1)</sup>	2,568,053	69,073	(492)	2,636,634	—
CMBS <sup>(2)</sup>	298,138	14,816	(263)	312,691	—
Non-Agency RMBS	177,529	1,431	(13,247)	165,713	(1,120)
ABS <sup>(3)</sup>	639,949	7,094	(15,001)	632,042	—
Municipals <sup>(4)</sup>	1,171,953	52,438	(1,680)	1,222,711	—
<b>Total fixed maturities</b>	<b>\$ 10,821,338</b>	<b>\$ 243,646</b>	<b>\$ (124,884)</b>	<b>\$ 10,940,100</b>	<b>\$ (1,120)</b>
<b>Equity securities</b>					
Common stocks	341,603	25,143	(19,291)	347,455	
Exchange-traded funds	239,411	77	(25,507)	213,981	
Non-U.S. bond mutual funds	118,552	—	(2,428)	116,124	
<b>Total equity securities</b>	<b>\$ 699,566</b>	<b>\$ 25,220</b>	<b>\$ (47,226)</b>	<b>\$ 677,560</b>	

(1) Residential mortgage-backed securities (RMBS) originated by U.S. agencies.

(2) Commercial mortgage-backed securities (CMBS).

(3) Asset-backed securities (ABS) include debt tranching securities collateralized primarily by auto loans, student loans, credit cards, and other asset types. This asset class also includes an insignificant position in collateralized loan obligations (CLOs) and collateralized debt obligations (CDOs).

(4) Municipals include bonds issued by states, municipalities and political subdivisions.

(5) Represents the non-credit component of the other-than-temporary impairment (OTTI) losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.



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**5. INVESTMENTS (CONTINUED)**

In the normal course of investing activities, we actively manage allocations to non-controlling tranches of structured securities (variable interests) issued by VIEs. These structured securities include RMBS, CMBS and ABS and are included in the above table. Additionally, within our other investments portfolio, we also invest in limited partnerships (hedge and credit funds) and CLO equity tranching securities, which are all variable interests issued by VIEs (see Note 5(b)). For these variable interests, we do not have the power to direct the activities that are most significant to the economic performance of the VIEs and accordingly we are not the primary beneficiary for any of these VIEs. Our maximum exposure to loss on these interests is limited to the amount of our investment. We have not provided financial or other support with respect to these structured securities other than our original investment.

**Contractual Maturities**

The contractual maturities of fixed maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value	% of Total Fair Value
<b><u>At December 31, 2012</u></b>			
<b>Maturity</b>			
Due in one year or less	\$ 651,111	\$ 657,045	5.5%
Due after one year through five years	4,880,039	4,989,151	41.8%
Due after five years through ten years	1,847,295	1,951,569	16.4%
Due after ten years	85,956	91,887	0.8%
	<u>7,464,401</u>	<u>7,689,652</u>	<u>64.5%</u>
Agency RMBS	2,594,180	2,659,908	22.3%
CMBS	814,211	840,084	7.0%
Non-Agency RMBS	93,266	95,199	0.8%
ABS	639,614	643,206	5.4%
<b>Total</b>	<u><u>\$ 11,605,672</u></u>	<u><u>\$ 11,928,049</u></u>	<u><u>100.0%</u></u>
<b><u>At December 31, 2011</u></b>			
<b>Maturity</b>			
Due in one year or less	\$ 543,100	\$ 539,009	4.9%
Due after one year through five years	4,694,832	4,685,866	42.8%
Due after five years through ten years	1,779,811	1,845,054	16.9%
Due after ten years	119,926	123,091	1.1%
	<u>7,137,669</u>	<u>7,193,020</u>	<u>65.7%</u>
Agency RMBS	2,568,053	2,636,634	24.1%
CMBS	298,138	312,691	2.9%
Non-Agency RMBS	177,529	165,713	1.5%
ABS	639,949	632,042	5.8%
<b>Total</b>	<u><u>\$ 10,821,338</u></u>	<u><u>\$ 10,940,100</u></u>	<u><u>100.0%</u></u>

**AXIS CAPITAL HOLDINGS LIMITED**  
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**5. INVESTMENTS (CONTINUED)**

**Gross Unrealized Losses**

The following table summarizes fixed maturities and equities in an unrealized loss position and the aggregate fair value and gross unrealized loss by length of time the security has continuously been in an unrealized loss position:

	12 months or greater		Less than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b><u>At December 31, 2012</u></b>						
<b>Fixed maturities</b>						
U.S. government and agency	\$ —	\$ —	\$ 119,730	\$ (119)	\$ 119,730	\$ (119)
Non-U.S. government	44,568	(1,453)	153,134	(748)	197,702	(2,201)
Corporate debt	95,511	(2,947)	451,651	(2,945)	547,162	(5,892)
Agency RMBS	9,557	(148)	521,400	(1,522)	530,957	(1,670)
CMBS	1,749	(16)	69,615	(110)	71,364	(126)
Non-Agency RMBS	11,026	(537)	115	(33)	11,141	(570)
ABS	99,514	(7,034)	39,296	(148)	138,810	(7,182)
Municipals	6,386	(270)	77,766	(455)	84,152	(725)
<b>Total fixed maturities</b>	<b>\$ 268,311</b>	<b>\$ (12,405)</b>	<b>\$ 1,432,707</b>	<b>\$ (6,080)</b>	<b>\$ 1,701,018</b>	<b>\$ (18,485)</b>
<b>Equity securities</b>						
Common stocks	\$ 11,554	\$ (1,793)	\$ 95,697	\$ (5,605)	\$ 107,251	\$ (7,398)
Exchange-traded funds	—	—	—	—	—	—
Non-U.S. bond mutual funds	—	—	—	—	—	—
<b>Total equity securities</b>	<b>\$ 11,554</b>	<b>\$ (1,793)</b>	<b>\$ 95,697</b>	<b>\$ (5,605)</b>	<b>\$ 107,251</b>	<b>\$ (7,398)</b>
<b><u>At December 31, 2011</u></b>						
<b>Fixed maturities</b>						
U.S. government and agency	\$ —	\$ —	\$ 233,816	\$ (134)	\$ 233,816	\$ (134)
Non-U.S. government	—	—	786,034	(36,572)	786,034	(36,572)
Corporate debt	54,843	(2,437)	1,228,479	(55,058)	1,283,322	(57,495)
Agency RMBS	—	—	105,059	(492)	105,059	(492)
CMBS	5,155	(17)	11,243	(246)	16,398	(263)
Non-Agency RMBS	43,348	(8,127)	85,053	(5,120)	128,401	(13,247)
ABS	65,096	(9,497)	201,569	(5,504)	266,665	(15,001)
Municipals	8,450	(1,467)	38,590	(213)	47,040	(1,680)
<b>Total fixed maturities</b>	<b>\$ 176,892</b>	<b>\$ (21,545)</b>	<b>\$ 2,689,843</b>	<b>\$ (103,339)</b>	<b>\$ 2,866,735</b>	<b>\$ (124,884)</b>
<b>Equity securities</b>						
Common stocks	\$ 4,445	\$ (2,105)	\$ 124,481	\$ (17,186)	\$ 128,926	\$ (19,291)
Exchange-traded funds	—	—	212,050	(25,507)	212,050	(25,507)
Non-U.S. bond mutual funds	—	—	116,124	(2,428)	116,124	(2,428)
<b>Total equity securities</b>	<b>\$ 4,445</b>	<b>\$ (2,105)</b>	<b>\$ 452,655</b>	<b>\$ (45,121)</b>	<b>\$ 457,100</b>	<b>\$ (47,226)</b>

**AXIS CAPITAL HOLDINGS LIMITED**  
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**5. INVESTMENTS (CONTINUED)**

Fixed Maturities

At December 31, 2012, 478 fixed maturities (2011: 791) were in an unrealized loss position of \$18 million (2011: \$125 million) of which \$3 million (2011: \$18 million) was related to securities below investment grade or not rated.

At December 31, 2012, 146 securities (2011: 138) have been in a continuous unrealized loss position for 12 months or greater and have a fair value of \$268 million (2011: \$177 million). Following our credit impairment review, we concluded that these securities as well as the remaining securities in an unrealized loss position in the above table were temporarily depressed at December 31, 2012, and are expected to recover in value as the securities approach maturity. Further, at December 31, 2012, we did not intend to sell these securities in an unrealized loss position and it is more likely than not that we will not be required to sell these securities before the anticipated recovery of their amortized costs.

Equity Securities

At December 31, 2012, 106 securities (2011: 128) were in an unrealized loss position of \$7 million (2011: \$47 million).

At December 31, 2012, 17 (2011: 10) securities have been in a continuous unrealized loss position for 12 months or greater and have a fair value of \$12 million (2011: \$4 million). Based on our impairment review process and our ability and intent to hold these securities for a reasonable period of time sufficient for a full recovery, we concluded that the above equities in an unrealized loss position were temporarily impaired at December 31, 2012 and 2011.

**b) Other Investments**

The following tables provide a breakdown of our investments in hedge and credit funds and CLO equity tranching securities (CLO Equities), together with additional information relating to the liquidity of each category:

	Fair Value		Redemption Frequency (if currently eligible)	Redemption Notice Period
<b><u>At December 31, 2012</u></b>				
Long/short equity funds	\$	302,680 36%	Monthly, Quarterly, Semi-annually	30-60 days
Multi-strategy funds		244,075 29%	Quarterly, Semi-annually	60-95 days
Event-driven funds		171,479 20%	Quarterly, Annually	45-95 days
Leveraged bank loan funds		62,768 8%	Quarterly	65 days
CLO - Equities		62,435 7%	n/a	n/a
<b>Total other investments</b>	<b>\$</b>	<b>843,437 100%</b>		
<b><u>At December 31, 2011</u></b>				
Long/short equity funds	\$	214,498 31 %	Quarterly, Semi-annually	30-60 days
Multi-strategy funds		230,750 33 %	Quarterly, Semi-annually	60-95 days
Event-driven funds		118,380 17 %	Quarterly, Annually	45-95 days
Leveraged bank loan funds		69,132 10 %	Quarterly	65 days
CLO - Equities		66,560 9 %	n/a	n/a
<b>Total other investments</b>	<b>\$</b>	<b>699,320 100 %</b>		

n/a – not applicable

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**5. INVESTMENTS (CONTINUED)**

The investment strategies for the above funds are as follows:

- *Long/short equity funds*: Seek to achieve attractive returns by executing an equity trading strategy involving both long and short investments in publicly-traded equities.
- *Multi-strategy funds*: Seek to achieve above-market returns by pursuing multiple investment strategies to diversify risks and reduce volatility. This category includes funds of hedge funds which invest in a large pool of hedge funds across a diversified range of hedge fund strategies.
- *Event-driven funds*: Seek to achieve attractive returns by exploiting situations where announced or anticipated events create opportunities.
- *Leveraged bank loan funds*: Seek to achieve attractive returns by investing primarily in bank loan collateral that has limited duration exposure.

Two common redemption restrictions which may impact our ability to redeem our hedge and credit funds are gates and lockups. A gate is a suspension of redemptions which may be implemented by the general partner or investment manager of the fund in order to defer, in whole or in part, the redemption request in the event the aggregate amount of redemption requests exceeds a predetermined percentage of the fund's net assets which may otherwise hinder the general partner or investment manager's ability to liquidate holdings in an orderly fashion in order to generate the cash necessary to fund extraordinarily large redemption payouts. A lockup period is the initial amount of time an investor is contractually required to hold the security before having the ability to redeem. During 2012 and 2011, neither of these restrictions impacted our redemption requests.

At December 31, 2012, \$38 million (2011: \$90 million) of our long/short equity funds, representing 4% (2011: 13%) of our total other investments, relate to a holding where we are still within the lockup period. The expiry of this lockup period is September, 2014. No other category contains investments currently subject to lockup.

At December 31, 2012, \$29 million (2011: \$45 million) of our hedge and credit fund investments were invested in funds that are not accepting redemption requests. Of this amount, 92% relates to a leveraged bank loan fund in a period of planned principal distributions which has a target completion date in late 2013 and, based on current market conditions and payments made to date, management expects this target date to be met. The remainder primarily relates to funds that entered liquidation or had their assets side pocketed as a result of the global financial crisis which began in late 2008. For these funds, management is currently unable to estimate when those funds will be distributed.

At December 31, 2012, we have \$40 million (2011: nil) of unfunded commitments relating to our investments in hedge and credit funds.

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**5. INVESTMENTS (CONTINUED)**

**c) Net Investment Income**

Net investment income was derived from the following sources:

Year ended December 31,	2012	2011	2010
Fixed maturities	\$ 304,400	\$ 337,616	\$ 352,357
Other investments	87,660	31,856	64,765
Equity securities	11,904	11,186	2,900
Cash and cash equivalents	4,528	5,697	5,836
Short-term investments	596	1,592	1,441
<b>Gross investment income</b>	<b>409,088</b>	<b>387,947</b>	<b>427,299</b>
Investment expenses	(28,131)	(25,517)	(20,407)
<b>Net investment income</b>	<b>\$ 380,957</b>	<b>\$ 362,430</b>	<b>\$ 406,892</b>

**d) Net Realized Investment Gains**

The following table provides an analysis of net realized investment gains:

Year ended December 31,	2012	2011	2010
Gross realized gains <sup>(1)</sup>	\$ 278,493	\$ 260,288	\$ 326,930
Gross realized losses <sup>(1)</sup>	(125,374)	(123,016)	(116,082)
Net OTTI recognized in earnings	(24,234)	(15,861)	(17,932)
Net realized gains on fixed maturities and equity securities	128,885	121,411	192,916
Change in fair value of investment derivatives <sup>(1)</sup>	(9,170)	4,431	(3,641)
Fair value hedges <sup>(2)</sup>	7,754	(4,403)	5,823
<b>Net realized investment gains</b>	<b>\$ 127,469</b>	<b>\$ 121,439</b>	<b>\$ 195,098</b>

(1) Includes \$37 million of gains (2011: \$11 million of losses, 2010: \$15 million of gains) related to previously unrealized foreign exchange currency amounts on the hedged investment portfolio.

(2) Refer to Note 7 – Derivative Instruments

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**5. INVESTMENTS (CONTINUED)**

The following table summarizes the OTTI recognized in earnings by asset class:

Year ended December 31,	2012	2011	2010
<b>Fixed maturities:</b>			
Non-U.S. government	\$ 3,281	\$ —	\$ —
Corporate debt	1,821	1,954	3,156
CMBS	—	—	413
Non-Agency RMBS	2,016	717	4,715
ABS	795	61	1,126
Municipals	—	483	19
	<u>7,913</u>	<u>3,215</u>	<u>9,429</u>
<b>Equity Securities</b>			
Common stocks	7,318	12,646	8,503
Exchange-traded funds	9,003	—	—
	<u>16,321</u>	<u>12,646</u>	<u>8,503</u>
<b>Total OTTI recognized in earnings</b>	<b>\$ 24,234</b>	<b>\$ 15,861</b>	<b>\$ 17,932</b>

Fixed Maturities

The following table provides a roll forward of the credit losses (“credit loss table”), before income taxes, for which a portion of the OTTI was recognized in AOCI:

Year ended December 31,	2012	2011
Balance at beginning of period	\$ 2,061	\$ 57,498
Credit impairments recognized on securities not previously impaired	—	448
Additional credit impairments recognized on securities previously impaired	—	—
Change in timing of future cash flows on securities previously impaired	—	(101)
Intent to sell of securities previously impaired	—	—
Securities sold/redeemed/matured	(252)	(55,784)
<b>Balance at end of period</b>	<b>\$ 1,809</b>	<b>\$ 2,061</b>

Credit losses are calculated based on the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to the impairment. The following provides a summary of the credit loss activities by asset class for the above table as well as the significant inputs and the methodology used to estimate these credit losses.

*Non-U.S. Government:*

Non-U.S. government obligations are evaluated for credit loss primarily through qualitative assessments of the likelihood of credit loss using information such as credit ratings and yield. At December 31, 2012, our holdings in sovereign debt, including \$217 million (2011: \$634 million) relating to the eurozone countries, were all highly rated securities. The gross unrealized losses of \$2 million at December 31, 2012 were due to foreign exchange losses, mainly on euro-denominated securities. We have concluded there were no credit losses anticipated for these securities at December 31, 2012.

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**5. INVESTMENTS (CONTINUED)**

*Corporate Debt:*

Certain previously impaired medium-term notes (MTNs) held matured during 2011, resulting in a \$52 million decrease in the accumulated credit loss impairments in the above credit loss table. These maturities also resulted in \$15 million of realized gains. All previously impaired MTNs were sold or matured by December 31, 2011.

To estimate credit losses for corporate debt securities, our projected cash flows are primarily driven by our assumptions regarding the probability of default and the severity associated with those defaults. Our default and loss severity rates are based on credit rating, credit analysis, industry analyst reports and forecasts, Moody's historical default data and any other data relevant to the recoverability of the security. In 2012, the OTTI charges on corporate debt securities were related to our intent to sell, as well as unrealized foreign exchange losses on certain securities where forecasted recovery was uncertain.

*CMBS:*

Our investments in CMBS are diversified and highly rated, with a weighted average estimated subordination percentage of 30% at December 31, 2012 (2011: 25%). Based on discounted cash flows at December 31, 2012, the current level of subordination is sufficient to cover the estimated loan losses on the underlying collateral of the CMBS.

*Non-agency RMBS:*

For non-agency RMBS, our projected cash flows incorporated underlying data from widely accepted third-party data sources along with certain internal assumptions and judgments regarding the future performance of the security. These assumptions included the following: default, delinquency, loss severity and prepayment rates. The assumptions used to calculate the credit losses in 2012 have not changed significantly since December 31, 2011. At December 31, 2012, the fair value of our non-agency RMBS was \$95 million (2011: \$166 million), consisting primarily of \$65 million (2011: \$128 million) of Prime and \$22 million (2011: \$23 million) of Alt-A MBS. At December 31, 2012, we had gross unrealized losses of \$1 million (2011: \$13 million) on these securities. We have concluded there are no credit losses anticipated for these securities at December 31, 2012, other than those already recorded.

*ABS:*

The majority of the unrealized losses on ABS at December 31, 2012, and 2011, were related to CLO debt tranching securities ("CLO Debt") with a carrying value of \$53 million (2011: \$48 million). We used the following significant inputs to estimate the credit loss for these securities:

At December 31,	2012	2011
Default rate	4.0%	4.0%
Loss severity rate	53.5%	53.5%
Collateral spreads	2.5% - 3.7%	2.6% - 3.8%

Our assumptions on default and loss severity rates are established based on an assessment of actual experience to date for each CLO Debt and review of recent credit rating agencies' default and loss severity forecasts. Based on the underlying collateral values and our projected cash flows at December 31, 2012, our CLO Debt had sufficient credit protection levels to receive all contractually obligated principal and interest payments.

Equity Securities

The OTTI losses on common stocks in 2012 and 2011 are primarily due to the severity and duration of their unrealized loss positions, for which we concluded the forecasted recovery period was uncertain. The recognition of such losses does not necessarily indicate that sales will occur or that sales are imminent or planned. During 2012, we recorded \$9 million of OTTI

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**5. INVESTMENTS (CONTINUED)**

losses on our exchange-traded funds as we no longer had the intent to hold these underwater securities through full recovery of cost. At December 31, 2012, the fair value of our equities was \$667 million (2011: \$678 million), which included \$7 million (2011: \$47 million) of gross unrealized losses.

**e) Restricted Investments**

In order to support our obligations in regulatory jurisdictions where we operate as a non-admitted carrier, we provide collateral in the form of assets held in trust and, to a lesser extent, letters of credit. Refer to Note 10(b) for further information on our collateral requirements upon issuance of certain letters of credit. The fair value of our restricted investments primarily relates to these items, as noted in the table below. Our restricted investments primarily consist of high-quality fixed maturity and short-term investment securities.

At December 31,	2012	2011
Collateral in Trust for inter-company agreements	\$ 2,134,931	\$ 1,921,586
Collateral for secured letter of credit facility	470,062	441,229
Collateral in Trust for third party agreements	245,539	238,395
Securities on deposit with regulatory authorities	59,456	49,543
<b>Total restricted investments</b>	<b>\$ 2,909,988</b>	<b>\$ 2,650,753</b>

**6. FAIR VALUE MEASUREMENTS**

**Fair Value Hierarchy**

Fair value is defined as the price to sell an asset or transfer a liability (i.e. the “exit price”) in an orderly transaction between market participants. We use a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. The hierarchy is broken down into three levels as follows:

- Level 1 - Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access.
- Level 2 - Valuations based on quoted prices in active markets for similar assets or liabilities, quoted prices for identical assets or liabilities in inactive markets, or for which significant inputs are observable (e.g. interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.
- Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect our own judgments about assumptions that market participants might use.

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment.

Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This may lead us to change the selection of our valuation technique (from market to cash flow approach) or may



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**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

cause us to use multiple valuation techniques to estimate the fair value of a financial instrument. This circumstance could cause an instrument to be reclassified between levels within the fair value hierarchy.

We used the following valuation techniques and assumptions in estimating the fair value of our financial instruments as well as the general classification of such financial instruments pursuant to the above fair value hierarchy.

**Fixed Maturities**

At each valuation date, we use the market approach valuation technique to estimate the fair value of our fixed maturities portfolio, when possible. This market approach includes, but is not limited to, prices obtained from third party pricing services for identical or comparable securities and the use of “pricing matrix models” using observable market inputs such as yield curves, credit risks and spreads, measures of volatility, and prepayment speeds. Pricing from third party pricing services is sourced from multiple vendors, when available, and we maintain a vendor hierarchy by asset type based on historical pricing experience and vendor expertise. When prices are unavailable from pricing services, we obtain non-binding quotes from broker-dealers who are active in the corresponding markets.

The following describes the significant inputs generally used to determine the fair value of our fixed maturities by asset class.

*U.S. government and agency*

U.S. government and agency securities consist primarily of debt securities issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association. As the fair values of our U.S. Treasury securities are based on unadjusted market prices in active markets, they are classified within Level 1. The fair values of U.S. government agency securities are priced using the spread above the risk-free yield curve. As the yields for the risk-free yield curve and the spreads for these securities are observable market inputs, the fair values of U.S. government agency securities are classified within Level 2.

*Non-U.S. government*

Non-U.S. government securities comprise debt securities issued by non-U.S. governments and their agencies along with supranational organizations (also known as sovereign debt securities). The fair value of these securities is based on prices obtained from international indices or a valuation model that includes the following inputs: interest rate yield curves, cross-currency basis index spreads, and country credit spreads for structures similar to the sovereign debt security we hold in terms of issuer, maturity and seniority. As the significant inputs are observable market inputs, the fair value of non-U.S. government securities are classified within Level 2.

*Corporate debt*

Corporate debt securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair values of these securities are generally determined using the spread above the risk-free yield curve. These spreads are generally obtained from the new issue market, secondary trading and broker-dealer quotes. As these spreads and the yields for the risk-free yield curve are observable market inputs, the fair values of our corporate debt securities are classified within Level 2. Where pricing is unavailable from pricing services, we obtain non-binding quotes from broker-dealers to estimate fair value. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. In this event, securities are classified within Level 3.

*MBS*

Our portfolio of RMBS and CMBS are originated by both agencies and non-agencies. The fair values of these securities are determined through the use of a pricing model (including Option Adjusted Spread) which uses prepayment speeds and

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**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

spreads to determine the appropriate average life of the MBS. These spreads are generally obtained from the new issue market, secondary trading and broker-dealer quotes. As the significant inputs used to price MBS are observable market inputs, the fair values of the MBS are classified within Level 2. Where pricing is unavailable from pricing services, we obtain non-binding quotes from broker-dealers to estimate fair value. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. These securities are classified within Level 3.

*ABS*

ABS include mostly investment-grade debt securities backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, student loans, credit card receivables, and CLO Debt originated by a variety of financial institutions. The fair values of ABS are priced through the use of a model which uses prepayment speeds and spreads sourced primarily from the new issue market. As the significant inputs used to price ABS are observable market inputs, the fair values of ABS are classified within Level 2. Where pricing is unavailable from pricing services, we obtain non-binding quotes from broker-dealers or use a discounted cash flow model to estimate fair value. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. These securities are priced within Level 3.

*Municipals*

Our municipal portfolio comprises debt securities issued by U.S. domiciled state and municipal entities. The fair value of these securities is determined using spreads obtained from broker-dealers, trade prices and the new issue market. As the significant inputs used to price the municipals are observable market inputs, municipals are classified within Level 2.

**Equity Securities**

Equity securities include U.S. and non-U.S. common stocks, exchange-traded funds, and non-U.S. bond mutual funds. For common stocks and exchange-traded funds, we classified these within Level 1 as their fair values are based on unadjusted market prices in active markets. Our investments in non-U.S. bond mutual funds have daily liquidity, with redemption based on the net asset value (NAV) of the funds. Accordingly, we have classified these investments as Level 2.

**Other Investments**

As a practical expedient, we estimate fair values for hedge and credit funds using NAVs as advised by external fund managers or third party administrators. For each of our hedge and credit funds, the NAV is based on the manager's or administrator's valuation of the underlying holdings in accordance with U.S. GAAP. For any funds for which we have not yet received a NAV concurrent with our period end date, we record an estimate of the change in fair value for the period subsequent to the most recent NAV. Such estimates are based on return estimates for the period between the most recently issued NAV and the period end date; these estimates are obtained from the relevant fund managers. Accordingly, we do not have a reporting lag in our fair value measurements for these funds. Historically, our valuation estimates incorporating these return estimates have not significantly diverged from the subsequent NAVs.

Within the hedge and credit fund industries, there is a general lack of transparency necessary to facilitate a detailed independent assessment of the values placed on the securities underlying the NAV provided by the fund manager or fund administrator. To address this, on a quarterly basis, we perform a number of monitoring procedures designed to assist us in the assessment of the quality of the information provided by managers and administrators. These procedures include, but are not limited to, regular review and discussion of each fund's performance with its manager, regular evaluation of fund performance against applicable benchmarks and the backtesting of our fair value estimates against subsequently received NAVs. Backtesting involves comparing our previously reported values for each individual fund against NAVs per audited financial statements (for year-end values) and final NAVs from fund managers and fund administrators (for interim values).

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**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

For our hedge and credit fund investments with liquidity terms allowing us to fully redeem our holdings at the applicable NAV in the near term, we have classified these investments as Level 2. Certain investments in hedge and credit funds have redemption restrictions (see Note 3 for further details) that prevent us from redeeming in the near term and therefore we have classified these investments as Level 3.

At December 31, 2012, the CLO - Equities were classified within Level 3 as we estimated the fair value for these securities using an income approach valuation technique (discounted cash flow model) due to the lack of observable and relevant trades in the secondary markets.

**Short-Term Investments**

Short-term investments primarily comprise highly liquid securities with maturities greater than three months but less than one year from the date of purchase. These securities are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their amortized cost approximates fair value.

**Derivative Instruments**

Our foreign currency forward contracts and options are customized to our hedging strategies and trade in the over-the-counter derivative market. We use the market approach valuation technique to estimate the fair value for these derivatives based on significant observable market inputs from third party pricing vendors, non-binding broker-dealer quotes and/or recent trading activity. Accordingly, we classified these derivatives within Level 2.

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**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

The table below presents the financial instruments measured at fair value on a recurring basis:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
<b><u>At December 31, 2012</u></b>				
<b><u>Assets</u></b>				
Fixed maturities				
U.S. government and agency	\$ 1,094,220	\$ 328,665	\$ —	\$ 1,422,885
Non-U.S. government	—	1,104,576	—	1,104,576
Corporate debt	—	3,874,832	1,550	3,876,382
Agency RMBS	—	2,659,908	—	2,659,908
CMBS	—	835,788	4,296	840,084
Non-Agency RMBS	—	94,089	1,110	95,199
ABS	—	579,231	63,975	643,206
Municipals	—	1,285,809	—	1,285,809
	<u>1,094,220</u>	<u>10,762,898</u>	<u>70,931</u>	<u>11,928,049</u>
Equity securities				
Common stocks	443,398	—	—	443,398
Exchange-traded funds	119,161	—	—	119,161
Non-U.S. bond mutual funds	—	103,989	—	103,989
	<u>562,559</u>	<u>103,989</u>	<u>—</u>	<u>666,548</u>
Other investments				
Hedge funds	—	385,241	311,184	696,425
Credit funds	—	35,765	48,812	84,577
CLO-Equities	—	—	62,435	62,435
	<u>—</u>	<u>421,006</u>	<u>422,431</u>	<u>843,437</u>
Short-term investments	—	108,860	—	108,860
Other assets (see Note 7)	—	5,838	—	5,838
<b>Total</b>	<b><u>\$ 1,656,779</u></b>	<b><u>\$ 11,402,591</u></b>	<b><u>\$ 493,362</u></b>	<b><u>\$ 13,552,732</u></b>
<b><u>Liabilities</u></b>				
Other liabilities (see Note 7)	\$ —	\$ 3,737	\$ —	\$ 3,737
<b><u>At December 31, 2011</u></b>				
<b><u>Assets</u></b>				
Fixed maturities				
U.S. government and agency	\$ 765,519	\$ 382,748	\$ —	\$ 1,148,267
Non-U.S. government	—	1,212,451	—	1,212,451
Corporate debt	—	3,608,041	1,550	3,609,591
Agency RMBS	—	2,636,634	—	2,636,634
CMBS	—	312,691	—	312,691
Non-Agency RMBS	—	165,713	—	165,713
ABS	—	582,714	49,328	632,042
Municipals	—	1,222,711	—	1,222,711
	<u>765,519</u>	<u>10,123,703</u>	<u>50,878</u>	<u>10,940,100</u>
Equity securities				
Common stocks	347,455	—	—	347,455
Exchange-traded funds	213,981	—	—	213,981
Non-U.S. bond mutual funds	—	116,124	—	116,124
	<u>561,436</u>	<u>116,124</u>	<u>—</u>	<u>677,560</u>
Other investments				
Hedge funds	—	248,208	296,101	544,309
Credit funds	—	38,308	50,143	88,451
CLO-Equities	—	—	66,560	66,560
	<u>—</u>	<u>286,516</u>	<u>412,804</u>	<u>699,320</u>
Short-term investments	—	149,909	—	149,909
Other assets (see Note 7)	—	38,175	—	38,175
<b>Total</b>	<b><u>\$ 1,326,955</u></b>	<b><u>\$ 10,714,427</u></b>	<b><u>\$ 463,682</u></b>	<b><u>\$ 12,505,064</u></b>
<b><u>Liabilities</u></b>				
Other liabilities (see Note 7)	\$ —	\$ 2,035	\$ —	\$ 2,035

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**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

During 2012 and 2011, we had no transfers between Levels 1 and 2.

**Level 3 Fair Value Measurements**

Except for hedge funds and credit funds priced using NAV as a practical expedient and certain fixed maturities priced using broker-dealer quotes (underlying inputs are not available), the following table quantifies the significant unobservable inputs we have used in estimating fair value at December 31, 2012 for our investments classified as Level 3 in the fair value hierarchy:

	Fair Value	Valuation Technique	Unobservable Input	Range	Weighted Average
ABS - CLO Debt	\$ 52,574	Discounted cash flow	Credit spreads	3.9% - 5.5%	4.5%
			Illiquidity discount <sup>(1)</sup>	5%	5%
Other investments - CLO - Equities	\$ 62,435	Discounted cash flow	Default rates	4.0% - 5.0%	4.4%
			Loss severity rate	53.5%	53.5%
			Collateral spreads	2.6% - 4.2%	3.3%
			Estimated maturity dates	1.8 - 5.7 years	4.5 years

(1) Judgmentally determined based on limited trades of similar securities observed in the secondary markets.

ABS where fair value is estimated through the use of a discounted cash flow model (income approach) is limited to our holdings of CLO Debt. These securities represent primarily holdings of investment-grade debt tranches within collateralized loan obligations with underlying collateral of loans originated primarily by U.S. corporations. For estimating the fair values of the CLO Debt securities, in the absence of actively trading secondary markets for these securities, we discount the estimated cash flows based on current credit spreads for similar securities, derived from observable offer prices. As these securities are thinly traded in the secondary markets, we apply an illiquidity discount to these discounted cash flows in developing our estimate of fair value. Significant increases (decreases) in either of the significant unobservable inputs (credit spread, illiquidity discount) in isolation would result in lower (higher) fair value estimates for our CLO Debt. The interrelationship between these inputs is insignificant. These inputs are updated on a quarterly basis and the reasonableness of the resulting prices is assessed through a comparison to observable offer prices for similar securities.

The CLO - Equities market continues to be mostly inactive with only a small number of transactions being observed in the market and fewer still involving transactions in our CLO - Equities. Accordingly, we continue to rely on the use of our internal discounted cash flow model (income approach) to estimate fair value of CLO - Equities. Of the significant inputs into this model, the default and loss severity rates are the most judgmental unobservable market inputs to which the valuation of CLO - Equities is most sensitive. A significant increase (decrease) in either of these significant inputs in isolation would result in lower (higher) fair value estimates for our CLO - Equities and, in general, a change in default rate assumptions will be accompanied by a directionally similar change in loss severity rate assumptions. Collateral spreads and estimated maturity dates are less judgmental inputs as they are based on the historical average of actual spreads and the weighted average life of the current underlying portfolios, respectively. A significant increase (decrease) in either of these significant inputs in isolation would result in higher (lower) fair value estimates for our CLO - Equities. In general, these inputs have no significant interrelationship with each other or with default and loss severity rates.

On a quarterly basis, our valuation processes for both CLO Debt and CLO - Equities include a review of the underlying cash flows and key assumptions used in the discounted cash flow models. We review and update the above significant unobservable inputs based on information obtained from secondary markets, including from the managers of the CLOs we hold. These inputs are the responsibility of management and, in order to ensure fair value measurement is applied consistently and in accordance with U.S. GAAP, we update our assumptions through regular communication with industry participants and ongoing monitoring of the deals in which we participate (e.g. default and loss severity rate trends), we

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**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

maintain a current understanding of the market conditions, historical results, as well as emerging trends that may impact future cash flows. By maintaining this current understanding, we are able to assess the reasonableness of the inputs we ultimately use in our models.

The following tables present changes in Level 3 for financial instruments measured at fair value on a recurring basis for the periods indicated:

	Opening Balance	Transfers into Level 3	Transfers out of Level 3	Included in earnings <sup>(1)</sup>	Included in OCI <sup>(2)</sup>	Purchases	Sales	Settlements/Distributions	Closing Balance	Change in unrealized investment gain/loss <sup>(3)</sup>
<b>Year ended December 31, 2012</b>										
<b>Fixed maturities</b>										
Corporate debt	\$ 1,550	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,550	\$ —
Non-Agency RMBS	—	1,110	—	—	—	—	—	—	1,110	—
CMBS	—	4,296	—	—	—	—	—	—	4,296	—
ABS	49,328	10,539	—	—	5,112	—	—	(1,004)	63,975	—
	<u>50,878</u>	<u>15,945</u>	<u>—</u>	<u>—</u>	<u>5,112</u>	<u>—</u>	<u>—</u>	<u>(1,004)</u>	<u>70,931</u>	<u>—</u>
<b>Other investments</b>										
Hedge funds	296,101	—	(9,435)	27,353	—	—	(2,835)	—	311,184	27,353
Credit funds	50,143	—	—	5,948	—	—	—	(7,279)	48,812	5,948
CLO-Equities	66,560	—	—	31,108	—	—	—	(35,233)	62,435	31,108
	<u>412,804</u>	<u>—</u>	<u>(9,435)</u>	<u>64,409</u>	<u>—</u>	<u>—</u>	<u>(2,835)</u>	<u>(42,512)</u>	<u>422,431</u>	<u>64,409</u>
<b>Total assets</b>	<u>\$ 463,682</u>	<u>\$ 15,945</u>	<u>\$ (9,435)</u>	<u>\$ 64,409</u>	<u>\$ 5,112</u>	<u>\$ —</u>	<u>\$ (2,835)</u>	<u>\$ (43,516)</u>	<u>\$ 493,362</u>	<u>\$ 64,409</u>
<b>Year ended December 31, 2011</b>										
<b>Fixed maturities</b>										
Corporate debt	\$ 1,550	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,550	\$ —
Non-Agency RMBS	19,678	—	(17,695)	—	63	—	—	(2,046)	—	—
CMBS	—	—	—	—	—	—	—	—	—	—
ABS	43,178	1,891	—	—	4,352	—	—	(93)	49,328	—
	<u>64,406</u>	<u>1,891</u>	<u>(17,695)</u>	<u>—</u>	<u>4,415</u>	<u>—</u>	<u>—</u>	<u>(2,139)</u>	<u>50,878</u>	<u>—</u>
<b>Other investments</b>										
Hedge funds	358,277	—	(223,194)	(8,906)	—	195,000	(25,076)	—	296,101	(8,906)
Credit funds	104,756	—	(38,309)	(4,968)	—	—	(192)	(11,144)	50,143	(4,112)
CLO-Equities	56,263	—	—	44,873	—	—	—	(34,576)	66,560	44,873
	<u>519,296</u>	<u>—</u>	<u>(261,503)</u>	<u>30,999</u>	<u>—</u>	<u>195,000</u>	<u>(25,268)</u>	<u>(45,720)</u>	<u>412,804</u>	<u>31,855</u>
<b>Total assets</b>	<u>\$ 583,702</u>	<u>\$ 1,891</u>	<u>\$ (279,198)</u>	<u>\$ 30,999</u>	<u>\$ 4,415</u>	<u>\$ 195,000</u>	<u>\$ (25,268)</u>	<u>\$ (47,859)</u>	<u>\$ 463,682</u>	<u>\$ 31,855</u>

(1) Gains and losses included in earnings on fixed maturities are included in net realized investment gains (losses). Gains and (losses) included in earnings on other investments are included in net investment income.

(2) Gains and losses included in other comprehensive income (“OCI”) on fixed maturities are included in unrealized gains (losses) arising during the period.

(3) Change in unrealized investment gain/(loss) relating to assets held at the reporting date.

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**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

The transfers into and out of fair value hierarchy levels reflect the fair value of the securities at the end of the reporting period.

Transfers into Level 3 from Level 2

The transfers to Level 3 from Level 2 made in 2012 and 2011 were due to a reduction in the availability of observable market inputs or a lack of sufficient quotes available from pricing vendors and broker-dealers. None of the transfers were as a result of changes in valuation methodology that we made.

Transfers out of Level 3 into Level 2

During 2011, the transfer of fixed maturities from Level 3 to Level 2 relates to non-agency RMBS for which observable market inputs and multiple quotes from pricing vendors and broker-dealers became available during the year as a result of the return of liquidity in this asset class. We also transferred certain hedge and credit funds (included in “other investments”) from Level 3 to Level 2 during 2012 and 2011 as we have the ability to liquidate these holdings at the reported NAV in the near term.

**Financial Instruments Not Carried at Fair Value**

U.S. GAAP guidance over disclosures about the fair value of financial instruments are also applicable to financial instruments not carried at fair value, except for certain financial instruments, including insurance contracts.

The carrying values of cash equivalents (including restricted amounts), accrued investment income, receivable for investments sold, certain other assets, payable for investments purchased and certain other liabilities approximated their fair values at December 31, 2012, due to their respective short maturities. As these financial instruments are not actively traded, their respective fair values are classified within Level 2.

At December 31, 2012, our senior notes are recorded at amortized cost with a carrying value of \$995 million (2011: \$995 million) and have a fair value of \$1,091 million (2011: \$1,039 million). The fair values of these securities were obtained from a third party pricing service and pricing was based on the spread above the risk-free yield curve. These spreads are generally obtained from the new issue market, secondary trading and broker-dealer quotes. As these spreads and the yields for the risk-free yield curve are observable market inputs, the fair values of our senior notes are classified within Level 2.

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**7. DERIVATIVE INSTRUMENTS**

The following table summarizes the balance sheet classification of derivatives recorded at fair value. The notional amounts represent the basis upon which payments or receipts are calculated and are presented in the table in order to quantify the magnitude of our derivative activities. Notional amounts are not reflective of credit risk.

	At December 31, 2012			At December 31, 2011		
	Derivative Notional Amount	Asset Derivative Fair Value <sup>(1)</sup>	Liability Derivative Fair Value <sup>(1)</sup>	Derivative Notional Amount	Asset Derivative Fair Value <sup>(1)</sup>	Liability Derivative Fair Value <sup>(1)</sup>
<b>Derivatives designated as hedging instruments</b>						
Foreign exchange forward contracts	\$ —	\$ —	\$ —	\$ 540,176	\$ 16,519	\$ —
<b>Derivatives not designated as hedging instruments</b>						
<i>Relating to investment portfolio:</i>						
Foreign exchange forward contracts	287,819	1,067	2,733	287,711	7,012	1,783
<i>Relating to underwriting portfolio:</i>						
Foreign exchange forward contracts	476,191	4,771	1,004	955,728	14,644	252
<b>Total derivatives</b>		<u>\$ 5,838</u>	<u>\$ 3,737</u>		<u>\$ 38,175</u>	<u>\$ 2,035</u>

(1) Asset and liability derivatives are classified within other assets and other liabilities on the Consolidated Balance Sheets.

**Fair Value Hedges**

We entered into foreign exchange forward contracts to hedge the foreign currency exposure of certain available for sale fixed maturity portfolios denominated in euros. The hedges were designated and qualified as fair value hedges, resulting in the net impact of the hedges recognized in net realized investment gains (losses). During 2012, we sold all available for sale fixed maturities in the portfolios that qualified for hedge accounting and settled all of the associated foreign exchange forward contracts.

The following table provides the total impact on earnings relating to foreign exchange contracts designated as fair value hedges along with the impact of the related hedged investment portfolio for the periods indicated:

Year ended December 31,	2012	2011	2010
Foreign exchange forward contracts	\$ 10,853	\$ 11,682	\$ 35,886
Hedged investment portfolio	(3,099)	(16,085)	(30,063)
<b>Hedge ineffectiveness recognized in earnings</b>	<u>\$ 7,754</u>	<u>\$ (4,403)</u>	<u>\$ 5,823</u>

**Derivative Instruments not Designated as Hedging Instruments**

*a) Relating to Investment Portfolio*

Within our investment portfolio we are exposed to foreign currency risk. Accordingly, the fair values for our investment portfolio are partially influenced by the change in foreign exchange rates. We may enter into foreign currency forward contracts to manage the effect of this foreign currency risk. These foreign currency hedging activities are not designated as specific hedges for financial reporting purposes.



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**7. DERIVATIVE INSTRUMENTS (CONTINUED)**

In addition, our external equity investment managers have the discretion to hold foreign currency exposures as part of their total return strategy.

*b) Relating to Underwriting Portfolio*

Foreign Currency Risk

Our (re)insurance subsidiaries and branches operate in various foreign countries. Consequently, some of our business is written in currencies other than the U.S. dollar and, therefore, our underwriting portfolio is exposed to significant foreign currency risk. We manage foreign currency risk by seeking to match our foreign-denominated net liabilities under (re) insurance contracts with cash and investments denominated in such currencies. We may also use derivative instruments, specifically forward contracts and currency options, to economically hedge foreign currency exposures.

The decrease in the notional amount of underwriting related derivatives since 2011 was primarily due to settlement of certain foreign denominated liabilities relating to the catastrophe losses incurred from the New Zealand and Japanese earthquakes.

The total unrealized and realized gains (losses) recognized in earnings for derivatives not designated as hedges were as follows:

		<b>Amount of Gain (Loss) Recognized in</b>		
		<b>Income on Derivative</b>		
<b>Location of Gain (Loss) Recognized in Income on Derivative</b>		<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Derivatives not designated as hedging instruments</b>				
<i>Relating to investment portfolio:</i>				
Foreign exchange forward contracts	Net realized investment gains (losses)	\$ (9,170)	\$ 4,431	\$ (3,641)
<i>Relating to underwriting portfolio:</i>				
Foreign exchange forward contracts	Foreign exchange gains (losses)	26,612	33,893	9,596
Currency collar options	Foreign exchange gains (losses)	—	267	—
<b>Total</b>		<b>\$ 17,442</b>	<b>\$ 38,591</b>	<b>\$ 5,955</b>

**8. RESERVE FOR LOSSES AND LOSS EXPENSES**

Our reserve for losses and loss expenses comprise the following:

<b>As of December 31,</b>	<b>2012</b>	<b>2011</b>
Reserve for reported losses and loss expenses	\$ 3,272,682	\$ 3,019,372
Reserve for losses incurred but not reported	5,786,049	5,405,673
<b>Reserve for losses and loss expenses</b>	<b>\$ 9,058,731</b>	<b>\$ 8,425,045</b>

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**8. RESERVE FOR LOSSES AND LOSS EXPENSES (CONTINUED)**

The following table presents a reconciliation of our beginning and ending gross reserve for losses and loss expenses and net reserve for unpaid losses and loss expenses for the periods indicated:

Year ended December 31,	2012	2011	2010
Gross reserve for losses and loss expenses, beginning of period	\$ 8,425,045	\$ 7,032,375	\$ 6,564,133
Less reinsurance recoverable on unpaid losses, beginning of period	(1,736,823)	(1,540,633)	(1,381,058)
Net reserve for unpaid losses and loss expenses, beginning of period	<u>6,688,222</u>	<u>5,491,742</u>	<u>5,183,075</u>
Net incurred losses and loss expenses related to:			
Current year	2,340,868	2,932,513	1,990,187
Prior years	(244,840)	(257,461)	(313,055)
	<u>2,096,028</u>	<u>2,675,052</u>	<u>1,677,132</u>
Net paid losses and loss expenses related to:			
Current year	(322,836)	(509,075)	(300,293)
Prior years	(1,299,384)	(953,035)	(1,042,890)
	<u>(1,622,220)</u>	<u>(1,462,110)</u>	<u>(1,343,183)</u>
Foreign exchange and other	<u>71,084</u>	<u>(16,462)</u>	<u>(25,282)</u>
Net reserve for unpaid losses and loss expenses, end of period	7,233,114	6,688,222	5,491,742
Reinsurance recoverable on unpaid losses, end of period	1,825,617	1,736,823	1,540,633
<b>Gross reserve for losses and loss expenses, end of period</b>	<u>\$ 9,058,731</u>	<u>\$ 8,425,045</u>	<u>\$ 7,032,375</u>

We write business with loss experience generally characterized as low frequency and high severity in nature, which can result in volatility in our financial results. During 2012, 2011 and 2010, respectively, we recognized aggregate net losses and loss expenses of \$331 million, \$789 million and \$256 million in relation to significant natural catastrophe events. These amounts related to Storm Sandy for 2012, the Japanese earthquake and tsunami, the February and June earthquakes in New Zealand, first quarter Australian weather events and the Thai floods for 2011 and the September New Zealand earthquake and the Chilean earthquake for 2010.

Prior year reserve development arises from changes to loss and loss expense estimates related to loss events that occurred in previous calendar years. Such development is summarized by segment in the following table:

	Insurance	Reinsurance	Total
<b>Year ended December 31, 2012</b>	<b>\$ 122,209</b>	<b>\$ 122,631</b>	<b>\$ 244,840</b>
Year ended December 31, 2011	103,014	154,447	257,461
Year ended December 31, 2010	118,336	194,719	313,055

Overall, the majority of the net favorable prior year reserve development related to short-tail lines of business, with our professional lines business also contributing notably.

The underlying exposures in our property, marine and aviation reserving classes within our insurance segment and the property reserving class within our reinsurance segment largely relate to short-tail business. Development from these classes contributed \$186 million, \$178 million and \$181 million of the total net favorable prior year reserve development in 2012, 2011 and 2010, respectively, and primarily reflected the recognition of better than expected loss emergence.

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**8. RESERVE FOR LOSSES AND LOSS EXPENSES (CONTINUED)**

Our professional lines insurance and reinsurance business contributed further net favorable prior year reserve development of \$54 million, \$105 million and \$117 million, respectively, in 2012, 2011 and 2010. This prior year reserve development was driven by increased weight being given to experience-based actuarial methods in selecting our ultimate loss estimates for accident years 2009 and prior. As our loss experience has generally been better than expected, this resulted in the recognition of favorable prior year reserve development. Given the significance of the global financial crisis, we expect that loss development patterns for the 2007 through 2009 accident years may ultimately differ from other years; as a result, we are exercising a greater degree of caution in recognizing potential favorable loss emergence for these years.

The frequency and/or severity of natural catastrophe activity in each of 2010 through 2012 was high and our December 31, 2012 net reserve for losses and loss expenses continues to include estimated amounts for numerous natural catastrophe events that occurred during this period. We caution that the magnitude and/or complexity of losses arising from certain of these events, in particular Storm Sandy, the Japanese earthquake and tsunami, the three New Zealand earthquakes and the Thai floods, inherently increases the level of uncertainty and, therefore, the level of management judgment involved in arriving at our estimated net reserves for losses and loss expenses. As a result, our actual losses for these events may ultimately differ materially from our current estimates.

**9. REINSURANCE**

We purchase treaty and facultative reinsurance to reduce exposure to significant losses. Facultative reinsurance provides coverage for all or a portion of the losses incurred for a single policy and we separately negotiate each facultative contract. Treaty reinsurance provides coverage for a specified type or category of risks. Our treaty reinsurance agreements provide this coverage on either an excess of loss or a proportional basis. Excess of loss covers provide a contractually set amount of coverage after a specified loss amount has been reached. These covers can be purchased on a package policy basis, which provide us with coverage for a number of lines of business within one contract. In contrast, proportional covers provide us with a specified percentage of coverage from the first dollar of loss.

All of these reinsurance covers provide us the right to recover of a portion of specified losses and loss expenses from reinsurers. However, to the extent that our reinsurers do not meet their obligations under these agreements due to solvency issues, contractual disputes or other reasons, we remain liable. We predominantly cede our business to reinsurers rated A- or better by A.M. Best.

Gross and net premiums written and earned were as follows:

Year ended December 31,	2012		2011		2010	
	Premiums written	Premiums earned	Premiums written	Premiums earned	Premiums written	Premiums earned
Gross	\$ 4,139,643	\$ 4,141,037	\$ 4,096,153	\$ 3,973,956	\$ 3,750,536	\$ 3,632,177
Ceded	(802,187)	(725,574)	(676,719)	(658,995)	(602,996)	(684,767)
Net	<u>\$ 3,337,456</u>	<u>\$ 3,415,463</u>	<u>\$ 3,419,434</u>	<u>\$ 3,314,961</u>	<u>\$ 3,147,540</u>	<u>\$ 2,947,410</u>

During the year ended December 31, 2012, we recognized ceded losses and loss expenses of \$396 million (2011: \$450 million; 2010: \$425 million).

Our provision for unrecoverable reinsurance was \$16 million at December 31, 2012 (2011: \$18 million). At December 31, 2012, 98.8% (2011: 98.6%) of our gross reinsurance recoverables were collectible from reinsurers rated A- or better by A.M. Best.

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**10. DEBT AND FINANCING ARRANGEMENTS**

**a) Senior Notes**

On November 15, 2004, AXIS Capital issued \$500 million aggregate principal amount of 5.75% senior unsecured debt (the “5.75% Senior Notes”) at an issue price of 99.785%, generating net proceeds of \$496 million. Interest on the 5.75% Senior Notes is payable semi-annually in arrears on June 1 and December 1 of each year, beginning on June 1, 2005. Unless previously redeemed, the 5.75% Senior Notes will mature on December 1, 2014.

On March 23, 2010, AXIS Specialty Finance LLC (“AXIS Specialty Finance”), a 100% owned finance subsidiary, issued \$500 million aggregate principal amount of 5.875% senior unsecured debt (the “5.875% Senior Notes” and, together with the 5.75% Senior Notes, the “Senior Notes”) at an issue price of 99.624%. The net proceeds of the issuance, after consideration of the offering discount and underwriting expenses and commissions, totaled approximately \$495 million. Interest on the 5.875% Senior Notes is payable semi-annually in arrears on June 1 and December 1 of each year, beginning on June 1, 2010. Unless previously redeemed, the 5.875% Senior Notes will mature on June 1, 2020. The 5.875% Senior Notes are ranked as unsecured senior obligations of AXIS Specialty Finance. AXIS Capital has fully and unconditionally guaranteed all obligations of AXIS Specialty Finance under the 5.875% Senior Notes. AXIS Capital’s obligations under this guarantee are unsecured and senior and rank equally with all other senior obligations of AXIS Capital.

We have the option to redeem the Senior Notes at any time and from time to time, in whole or in part, at a “make-whole” redemption price, which is equal to the greater of the aggregate principal amount or the sum of the present values of the remaining scheduled payments of principal and interest. The related indentures contain various covenants, including limitations on liens on the stock of restricted subsidiaries, restrictions as to the disposition of the stock of restricted subsidiaries and limitations on mergers and consolidations. We were in compliance with all the covenants contained in the indentures at December 31, 2012.

Interest expense recognized in relation to our Senior Notes includes interest payable, amortization of the offering discounts and amortization of debt offering expenses. The offering discounts and debt offering expenses are amortized over the period of time during which the Senior Notes are outstanding. During 2012, we incurred interest expense of \$59 million (2011: \$59 million, 2010: \$52 million).

**b) Credit Facilities**

On May 14, 2010, certain of AXIS Capital’s operating subsidiaries entered into a secured \$750 million letter of credit facility (the “LOC Facility”) with Citibank Europe plc (“Citibank”) pursuant to a Master Reimbursement Agreement and other ancillary documents (together, the “LOC Facility Documents”). The LOC Facility may be terminated by Citibank on December 31, 2013 upon thirty days prior notice. Under the terms of the LOC Facility, letters of credit to a maximum aggregate amount of \$750 million are available for issuance on behalf of the operating subsidiaries. These letters of credit will principally be used to support the reinsurance obligations of the operating subsidiaries. The LOC Facility is subject to certain covenants, including the requirement to maintain sufficient collateral, as defined in the LOC Facility Documents, to cover all of the obligations under the LOC Facility. Such obligations include contingent reimbursement obligations for outstanding letters of credit and fees payable to Citibank. In the event of default, Citibank may exercise certain remedies, including the exercise of control over pledged collateral and the termination of the availability of the LOC Facility to any or all of the operating subsidiaries party to the LOC Facility Documents.

On August 24, 2010, AXIS Capital and certain of its operating subsidiaries entered into a three-year revolving \$500 million credit facility (the “Credit Facility”) with a syndication of lenders pursuant to a Credit Agreement and other ancillary documents (together, the “Credit Facility Documents”). Subject to certain conditions and at the request of AXIS Capital, the aggregate commitment under the Credit Facility may be increased by up to \$250 million. Under the terms of the Credit Facility, loans are available for general corporate purposes and letters of credit may be issued in the ordinary course of business, with total usage not to exceed the aggregate amount of the Credit Facility. Interest on loans issued under the Credit Facility is payable based on underlying market rates at the time of loan issuance. While loans under the Credit Facility are unsecured, we have the option to issue letters of credit on a secured basis in order to reduce associated fees. The letters of

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**10. DEBT AND FINANCING ARRANGEMENTS (CONTINUED)**

credit will principally be used to support the reinsurance obligations of the operating subsidiaries. Under the Credit Facility, AXIS Capital guarantees the obligations of the operating subsidiaries and each of AXIS Specialty Finance and AXIS Specialty Holdings Bermuda Limited guarantees the obligations of AXIS Capital and the operating subsidiaries. The Credit Facility is subject to certain non-financial covenants, including limitations on fundamental changes, the incurrence of additional indebtedness and liens and certain transactions with affiliates and investments, as defined in the Credit Facility Documents. The Credit Facility also requires compliance with certain financial covenants, including a maximum debt to capital ratio and a minimum consolidated net worth requirement. In addition, each of AXIS Capital's material (re)insurance subsidiaries party to the Credit Facility must maintain a minimum A.M. Best Company, Inc. financial strength rating. In the event of default, including a breach of these covenants, the lenders may exercise certain remedies including the termination of the Credit Facility, the declaration of all principal and interest amounts related to Credit Facility loans to be immediately due and the requirement that all outstanding letters of credit be collateralized.

At December 31, 2012, we had \$423 million and nil letters of credit outstanding under the LOC Facility and the Credit Facility, respectively. There was no debt outstanding under the Credit Facility. We were in compliance with all LOC Facility and Credit Facility covenants at December 31, 2012.

**11. COMMITMENTS AND CONTINGENCIES**

**a) Concentrations of Credit Risk**

***Credit Risk Aggregation***

We monitor and control the aggregation of credit risk on a consolidated basis by assigning limits on the maximum credit exposure we are willing to assume by single obligors and groups, industry sector, country, region or other inter-dependencies. Our credit exposures are aggregated based on the origin of risk. Limits are based and adjusted on a variety of factors, including the prevailing economic environment and the nature of the underlying credit exposures. Our credit aggregation measurement and reporting process is facilitated by an exposure database, which contains relevant information on counterparties and credit risk; we also license third party databases to provide credit risk assessments.

Credit risk aggregation is also managed through minimizing overlaps in underwriting, financing and investing activities.

The assets that potentially subject us to concentrations of credit risk consist principally of cash and investments, reinsurance recoverable and (re)insurance premiums receivable balances, as described below:

***Cash and Investments***

In order to mitigate concentration and operational risks related to cash and cash equivalents, we limit the maximum amount of cash that can be deposited with a single counterparty and additionally limit acceptable counterparties based on current rating, outlook and other relevant factors.

Our investment portfolio is managed by external investment managers in accordance with our investment guidelines. We limit credit risk through diversification, issuer exposure limitation graded by ratings and, with respect to custodians, through contractual and other legal remedies. Excluding U.S. government and agency securities, we limit our concentration of credit risk to any single corporate issuer to 2% or less of our fixed maturities portfolio for securities rated A- or above and 1% or less of our fixed maturities portfolio for securities rated below A-. At December 31, 2012, we were in compliance with these limits.

***Reinsurance Recoverable Balances***

With respect to our reinsurance recoverable balances, we are exposed to the risk of a reinsurer failing to meet its obligations under coverage we have purchased. To mitigate this risk, all reinsurance coverage we purchase is subject to requirements established by our Reinsurance Security Committee. This Committee maintains a list of approved reinsurers, performs credit

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**11. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

risk assessments for potential new reinsurers, regularly monitors approved reinsurers with consideration for events which may have a material impact on their creditworthiness, recommends counterparty tolerance levels for different types of ceded business and monitors concentrations of credit risk. The assessment of each reinsurer considers a range of attributes, including a review of financial strength, industry position and other qualitative factors. Generally, the Committee requires that reinsurers who do not meet specified requirements provide collateral.

The three largest balances by reinsurer accounted for 13%, 10% and 10% of total reinsurance recoverable on unpaid and paid losses at December 31, 2012 (2011: 13%, 10% and 10%). Amounts related to our reinsurers with the ten largest balances comprised 72% of December 31, 2012 balance (2011: 70%) and had a weighted average A.M. Best rating of A+ (2011: A+).

***Premiums Receivable Balances***

The diversity of our client base limits the credit risk associated with our premiums receivable. In addition, for insurance contracts we have contractual rights to cancel coverage for non-payment of premiums and for reinsurance contracts we have contractual rights to offset premiums receivable with corresponding payments for losses and loss expenses.

Brokers and other intermediaries collect premiums from customers to be paid to us. We have policies and standards in place to manage and monitor credit risk from intermediaries with a focus on day-to-day monitoring of the largest positions.

These contractual rights contribute to the mitigation of credit risk, as does our monitoring of aged receivable balances. In light of these mitigating factors, and considering that a significant portion of our premiums receivable are not currently due based on the terms of the underlying contracts, we do not utilize specific credit quality indicators to monitor our premiums receivable balance. At December 31, 2012, we recorded an allowance for estimated uncollectible premiums receivable of \$2 million (2011: \$4 million). The corresponding bad debts expense charges for 2012, 2011 and 2010 were insignificant.

**b) Brokers**

We produce our business through brokers and direct relationships with insurance companies. During 2012, three brokers accounted for 61% (2011: 63%; 2010: 62%) of our total gross premiums written. Aon Corporation accounted for 27% (2011: 27%; 2010: 25%), Marsh, Inc. (including its subsidiary Guy Carpenter and Company) for 22% (2011: 23%; 2010: 24%), and Willis Group Holdings Ltd. for 12% (2011: 13%; 2010: 13%). No other broker and no one insured or reinsured accounted for more than 10% of our gross premiums written in any of the last three years.

**c) Lease Commitments**

We lease office space under operating leases which expire at various dates. We renew and enter into new leases in the ordinary course of business, as required. During 2012, total rent expense with respect to these operating leases was \$29 million (2011: \$24 million; 2010: \$19 million).

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Future minimum lease payments under our leases are expected to be as follows:

<b>Year ended December 31,</b>	
2013	\$ 26,904
2014	29,839
2015	24,386
2016	20,881
2017	17,912
Later years	66,819
<b>Total future minimum lease payments</b>	<b>\$ 186,741</b>

**d) Reinsurance Purchase Commitment**

We purchase reinsurance coverage for our insurance lines of business. The minimum reinsurance premiums are contractually due in advance on a quarterly basis. Accordingly at December 31, 2012, we have an outstanding reinsurance purchase commitment of \$54 million. Actual payments under the reinsurance contracts will depend on the underlying subject premium and may exceed the minimum premium.

**e) Legal Proceedings**

From time to time, we are subject to routine legal proceedings, including arbitrations, arising in the ordinary course of business. These legal proceedings generally relate to claims asserted by or against us in the ordinary course of insurance or reinsurance operations; estimated amounts payable under such proceedings are included in the reserve for losses and loss expenses in our Consolidated Balance Sheets.

Except as noted below, we are not a party to any material legal proceedings arising outside the ordinary course of business.

In 2005, a putative class action lawsuit was filed against our U.S. insurance subsidiaries. In re Insurance Brokerage Antitrust Litigation was filed on August 15, 2005 in the United States District Court for the District of New Jersey and includes as defendants numerous insurance brokers and insurance companies. The lawsuit alleges antitrust and Racketeer Influenced and Corrupt Organizations Act (“RICO”) violations in connection with the payment of contingent commissions and manipulation of insurance bids and seeks damages in an unspecified amount. On October 3, 2006, the District Court granted, in part, motions to dismiss filed by the defendants, and ordered plaintiffs to file supplemental pleadings setting forth sufficient facts to allege their antitrust and RICO claims. After plaintiffs filed their supplemental pleadings, defendants renewed their motions to dismiss. On April 15, 2007, the District Court dismissed without prejudice plaintiffs' complaint, as amended, and granted plaintiffs thirty (30) days to file another amended complaint and/or revised RICO Statement and Statements of Particularity. In May 2007, plaintiffs filed (i) a Second Consolidated Amended Commercial Class Action complaint, (ii) a Revised Particularized Statement Describing the Horizontal Conspiracies Alleged in the Second Consolidated Amended Commercial Class Action Complaint, and (iii) a Third Amended Commercial Insurance Plaintiffs' RICO Case Statement Pursuant to Local Rule 16.1(B)(4). On June 21, 2007, the defendants filed renewed motions to dismiss. On September 28, 2007, the District Court dismissed with prejudice plaintiffs' antitrust and RICO claims and declined to exercise supplemental jurisdiction over plaintiffs' remaining state law claims. On October 10, 2007, plaintiffs filed a notice of appeal of all adverse orders and decisions to the United States Court of Appeals for the Third Circuit, and a hearing was held in April 2009. On August 16, 2010, the Third Circuit Court of Appeals affirmed the District Court's dismissal of the antitrust and RICO claims arising from the contingent commission arrangements and remanded the case to the District Court with respect to the manipulation of insurance bids allegations. We continued to believe that the lawsuit was completely without merit and on that basis vigorously defended the filed action. However, for the sole purpose of avoiding additional litigation costs, we reached

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**11. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

an agreement in principle with plaintiffs during the first quarter of 2011 to settle all claims and causes of action in this matter for an immaterial amount. On March 30, 2012, the District Court issued the final settlement order, and this matter is now closed.

**12. EARNINGS PER COMMON SHARE**

The following table provides a computation of basic and diluted earnings per common share:

At and year ended December 31,	2012	2011	2010
<b>Basic earnings per common share</b>			
Net income	\$ 547,241	\$ 46,305	\$ 856,723
Less: preferred share dividends	38,228	36,875	36,875
Less: loss on repurchase of preferred shares	14,009	—	—
Net income available to common shareholders	<u>495,004</u>	<u>9,430</u>	<u>819,848</u>
Weighted average common shares outstanding - basic	<u>122,148</u>	<u>122,499</u>	<u>121,728</u>
<b>Basic earnings per common share</b>	<u>\$ 4.05</u>	<u>\$ 0.08</u>	<u>\$ 6.74</u>
<b>Diluted earnings per common share</b>			
Net income available to common shareholders	<u>\$ 495,004</u>	<u>\$ 9,430</u>	<u>\$ 819,848</u>
Weighted average common shares outstanding - basic	122,148	122,499	121,728
Warrants	—	4,292	12,106
Stock compensation plans	1,506	1,331	2,365
Weighted average common shares outstanding - diluted	<u>123,654</u>	<u>128,122</u>	<u>136,199</u>
<b>Diluted earnings per common share</b>	<u>\$ 4.00</u>	<u>\$ 0.07</u>	<u>\$ 6.02</u>
Anti-dilutive shares excluded from the dilutive computation	<u>614</u>	<u>1,134</u>	<u>187</u>



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**13. SHAREHOLDERS' EQUITY**

**a) Common Shares**

At December 31, 2012, and 2011, our authorized share capital was 800,000,000 common shares, par value of \$0.0125 per share.

The following table presents our common shares issued and outstanding, excluding restricted shares under our stock compensation plans (see Note 15 – Share-based Compensation):

Year ended December 31,	2012	2011	2010
Shares issued, balance at beginning of period	170,159	154,912	152,465
Shares issued	1,708	15,247	2,447
<b>Total shares issued at end of period</b>	<b>171,867</b>	170,159	154,912
Treasury shares, balance at beginning of period	(44,571)	(42,519)	(20,325)
Shares repurchased	(9,376)	(2,052)	(22,194)
<b>Total treasury shares at end of period</b>	<b>(53,947)</b>	(44,571)	(42,519)
<b>Total shares outstanding</b>	<b>117,920</b>	125,588	112,393

Warrants

During 2011, our founding shareholders exercised all remaining warrants. These warrants were exercised on a cashless basis pursuant to the terms of the applicable warrant agreements, resulting in a lower number of shares being issued than the number of warrants exercised. Accordingly, we issued 12,893,483 common shares upon the exercise of 19,827,760 warrants. In connection with the warrant exercise, we paid deferred dividends of \$93 million to those warrant holders who chose the deferred cash option for dividends declared.

Treasury shares

On December 17, 2012, our Board of Directors authorized a new share repurchase plan for up to \$750 million of our common shares through December 31, 2014. The new plan is effective January 1, 2013.

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**13. SHAREHOLDERS' EQUITY (CONTINUED)**

The following table presents our common share repurchase activities, which are held in treasury:

Year ended December 31,	2012	2011	2010
<b>In the open market:</b>			
Total shares	6,057	1,609	18,750
Total cost	\$ 203,704	\$ 49,974	\$ 590,694
Average price per share <sup>(2)</sup>	\$ 33.63	\$ 31.07	\$ 31.50
<b>From employees:<sup>(1)</sup></b>			
Total shares	319	443	381
Total cost	\$ 10,483	\$ 15,911	\$ 11,062
Average price per share <sup>(2)</sup>	\$ 32.85	\$ 35.92	\$ 29.04
<b>From founding shareholder:<sup>(3)</sup></b>			
Total shares	3,000	—	3,063
Total cost	\$ 103,500	\$ —	\$ 107,827
Average price per share <sup>(2)</sup>	\$ 34.50	\$ —	\$ 35.21
<b>Total</b>			
Total shares	9,376	2,052	22,194
Total cost	\$ 317,687	\$ 65,885	\$ 709,583
Average price per share <sup>(2)</sup>	\$ 33.88	\$ 32.11	\$ 31.97

(1) To satisfy withholding tax liabilities upon vesting of restricted stock, restricted stock units, and exercise of stock options. Share repurchases from employees are excluded from the authorized share repurchase plans noted above.

(2) Calculated using whole figures.

(3) We privately negotiated with Trident II, L.P. and affiliated entities to repurchase 3,000,000 (2011: none; 2010: 3,062,824) of our common shares.

**b) Series A, B and C Preferred Shares**

Series A Preferred Shares

During October 2005, we issued \$250 million of 7.25% Series A preferred shares, par value \$0.0125 per share, with a liquidation preference of \$25.00 per share. We may redeem the shares at a redemption price of \$25.00 per share. Dividends on the Series A preferred shares are non-cumulative. Consequently, if the board of directors does not authorize and declare a dividend for any dividend period, holders of the Series A preferred shares will not be entitled to receive a dividend for such period, and such undeclared dividend will not accumulate and be payable. Holders of Series A preferred shares will be entitled to receive, only when, as and if declared by the board of directors, non-cumulative cash dividends from the original issue date, quarterly in arrears on the fifteenth day of January, April, July and October of each year, commencing on January 15, 2006, without accumulation of any undeclared dividends. To the extent declared, these dividends will accumulate, with respect to each dividend period, in an amount per share equal to 7.25% of the liquidation preference per annum. For 2012 and 2011, the total dividends declared and paid on Series A preferred shares was \$1.8125 per share.

Concurrent with the issuance of our Series C preferred shares (see below), we redeemed 6,000,000 of our 7.25% Series A preferred shares, representing \$150 million in aggregate liquidation preference, without accumulation of any undeclared dividends. In connection with this redemption, we recognized a \$5 million loss on redemption (calculated as the difference between the redemption price and the carrying value), which was recognized as a reduction in determining our net income

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**13. SHAREHOLDERS' EQUITY (CONTINUED)**

available to common shareholders. Following this redemption, 4,000,000 Series A preferred shares, representing \$100 million in aggregate liquidation preference, remain outstanding.

Series B Preferred Shares

During November 2005, we issued \$250 million of 7.50% Series B preferred shares, par value \$0.0125 per share, with a liquidation preference of \$100.00 per share. We may redeem the shares on or after December 1, 2015 at a redemption price of \$100 per share. Dividends on the Series B preferred shares if, as and when declared by our board of directors will be payable initially at a fixed rate per annum equal to 7.50% of the liquidation preference on the first day of March, June, September and December of each year, commencing on March 1, 2006, up to but not including December 1, 2015. Commencing on March 1, 2016, the dividend rate on the Series B preferred shares will be payable at a floating rate. During a floating rate period, the floating rate per annum will be reset quarterly at a rate equal to 3.4525% plus the 3 month LIBOR Rate. Dividends on the Series B preferred shares are non-cumulative. For 2012 and 2011, the total dividends declared and paid on Series B preferred shares was \$7.50 per share.

During April 2012, we closed a cash tender offer for any and all of our outstanding 7.50% Series B preferred shares at a purchase price of \$102.81 per share. As a result, we purchased 2,471,570 Series B preferred shares for \$254 million. In connection with this tender offer, we recognized a \$9 million loss on redemption (calculated as the difference between the redemption price and the carrying value), which was recognized as a reduction in determining our net income available to common shareholders. Following the completion of the tender offer, 28,430 Series B preferred shares, representing \$3 million in aggregate liquidation preference, remain outstanding.

Series C Preferred Shares

On March 19, 2012, we issued \$400 million of 6.875% Series C preferred shares, par value \$0.0125 per share, with a liquidation preference of \$25.00 per share. We may redeem the Series C preferred shares on or after April 15, 2017 at a redemption price of \$25.00 per share. Dividends on the Series C preferred shares are non-cumulative. Consequently, if the board of directors does not authorize and declare a dividend for any period, holders of the Series C preferred shares will not be entitled to receive a dividend for such period, and such undeclared dividend will not accumulate and be payable. Holders of the Series C preferred shares will be entitled to receive, only when, as and if declared by the board of directors, non-cumulative cash dividends from the original issue date, quarterly in arrears on the fifteenth day of January, April, July and October of each year, commencing on July 15, 2012, without accumulation of any undeclared dividends. To the extent declared, these dividends will accumulate, with respect to each dividend period, in an amount per share equal to 6.875% of the liquidation preference per annum. For 2012, the total dividends declared on Series C preferred shares was \$1.413196 per share. Of this amount, \$0.983508 was paid in 2012 and the remaining \$0.429688 was subsequently paid in 2013.

The holders of our Series A, B and C preferred shares have no voting rights other than the right to elect a specified number of directors if preferred share dividends are not declared and paid for a specified period.

**c) Out of Period Adjustment**

Common share dividends were historically recognized as a reduction of retained earnings when paid. During 2012, we recognized a \$31 million adjustment in our Consolidated Statement of Shareholders' Equity in order to reflect dividends within retained earnings when declared, with a corresponding increase in other liabilities in our Consolidated Balance Sheet. This adjustment did not impact net income or net income available to common shareholders.

We believe that this matter was quantitatively and qualitatively immaterial to our previously issued financial statements and that the recognition of the adjustment in 2012 was similarly immaterial.

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**14. RETIREMENT PLANS**

We provide defined contribution plans that are self directed to eligible employees through various plans sponsored by us. Generally, mutual funds are made available pursuant to which employees and we contribute a percentage of the employee's gross salary into the plan each month.

For eligible U.S. employees, we provide a non-qualified deferred compensation plan that enables them to make salary contributions in excess of those permitted under the AXIS 401(k) Plan, to make additional employee contributions from their bonus payments, and to receive discretionary employer contributions.

We also provided supplemental executive retirement plans ("SERP") to both the Chairman and the former CEO. We settled all obligations under our SERP during the third quarter of 2012, resulting in the recognition of an insignificant loss.

During 2012, our total pension expenses were \$20 million (2011: \$20 million and 2010: \$15 million) for the above retirement benefits.

**15. SHARE-BASED COMPENSATION**

In May 2007, our shareholders approved the establishment of the AXIS Capital Holdings Limited 2007 Long-Term Equity Compensation Plan ("2007 Plan"). The 2007 Plan provides for, among other things, the grant of restricted stock, restricted stock units, non-qualified and incentive stock options, and other equity-based awards to our employees and directors. The 2007 Plan authorized the issuance of a total of 5,000,000 shares. In May of 2009 and 2012, our shareholders approved amendments to the 2007 Plan to increase the number of common shares authorized for issuance by 4,000,000 and 6,000,000 respectively, to bring the total number of common shares authorized for issuance to 15,000,000. As a result of the adoption of the 2007 Plan, the 2003 Long-Term Equity Compensation and 2003 Directors Long-Term Equity Compensation Plan were terminated, except that all related outstanding awards will remain in effect.

We currently issue restricted stock and restricted stock units to our employees with service conditions, vesting generally over a period of 4 years with 25% of the award vesting annually. During 2012, we also granted a performance-based stock award to a key employee in order to promote long-term growth and profitability. The award represents the right to receive a specified number of common shares in the future, based upon the achievement of established performance criteria during the applicable performance period, which is the period ending on the third anniversary of the grant date. At December 31, 2012, we anticipate that the established performance based criterion for this award is likely to be achieved.

Grants provided under the 2007 Plan generally allow for accelerated vesting provisions upon the employee's death, permanent disability, or certain terminations following a change in control of the Company occurring within two years of the change in control event. Notwithstanding these vesting provisions, the Compensation Committee of our Board has broad authority to accelerate vesting at its own discretion.

In 2012, we issued common shares to non-management directors under the 2007 Plan with no restriction. At December 31, 2012, 6,633,981 equity-based awards remained available for grant under the 2007 Plan. Between January 1, 2013 and February 21, 2013, we granted a total of 1,656,500 restricted stock units to our employees. Included in the total restricted stock units granted subsequent to December 31, 2012 were 748,250 awards which will be settled in cash upon vesting.

We have granted stock options under the 2003 Plans; however, none have been issued since 2005. All outstanding stock options are fully vested and exercisable. These options expire ten years from the date of grant.

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**15. SHARE-BASED COMPENSATION (CONTINUED)**

**a) Restricted Stock**

The following table provides a reconciliation of the beginning and ending balance of nonvested restricted stock (including restricted stock units) for the year ended December 31, 2012:

	Performance-based Stock Awards		Service-based Stock Awards	
	Number of Restricted Stock	Weighted Average Grant Date Fair Value	Number of Restricted Stock	Weighted Average Grant Date Fair Value
Nonvested restricted stock - beginning of year	—	\$ —	3,816	\$ 32.69
Granted	250	34.42	2,198	31.95
Vested	—	—	(1,321)	31.93
Forfeited	—	—	(264)	32.69
<b>Nonvested restricted stock - end of year</b>	<b>250</b>	<b>\$ 34.42</b>	<b>4,429</b>	<b>\$ 32.48</b>

(1) Fair value is based on the closing price of our common shares on the New York Stock Exchange on the day of the grant.

During 2012, we granted 2,447,700 restricted stock awards (2011: 1,839,250; 2010: 1,496,550) to our employees with a weighted average grant-date fair value per share of \$32.20 (2011: \$36.12; 2010: \$28.91). At December 31, 2012, the total nonvested restricted stock in the above table included 401,438 of restricted stock units (2011: 378,937).

During 2012, we incurred a compensation cost of \$68 million (2011: \$39 million; 2010: \$37 million) in respect of all restricted stock and restricted stock units, and recorded tax benefits thereon of \$8 million (2011: \$7 million; 2010: \$6 million). Compensation costs incurred in 2012 includes \$20 million of accelerated and incremental expenses associated with the the transition in our senior leadership. The retirement of one senior leader resulted in the modification of that leader's outstanding restricted stock awards to eliminate the previously existing service condition. The unanticipated termination without cause of another senior officer lead to the early satisfaction of employment obligations and resulted in the service condition associated with that officer's outstanding restricted stock awards being fully satisfied.

The total fair value of shares vested during 2012 was \$43 million (2011: \$63 million; 2010: \$56 million). At December 31, 2012, we had unrecognized compensation costs of \$89 million (2011: \$86 million) which are expected to be recognized over the weighted average period of 2.5 years (2011: 2.6 years).

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**15. SHARE-BASED COMPENSATION (CONTINUED)**

**b) Stock options**

The following is a summary of stock options outstanding and exercisable at December 31, 2012 and related activity for the year ended:

	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value <sup>(1)</sup>
Outstanding and exercisable - beginning of year	1,668	\$ 24.71		
Granted	—	—		
Exercised	(749)	19.76		
Expired	—	—		
<b>Outstanding and exercisable - end of year</b>	<b>919</b>	<b>\$ 28.74</b>	<b>1.6</b>	<b>\$ 5,425</b>

(1) The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between our closing stock price at December 31, 2012 and the exercisable price, multiplied by the number of in-the-money-options) that would have been received by the stock option holder had all stock option holders exercised their stock options on December 31, 2012.

The total intrinsic value of stock options exercised during 2012 was \$11 million (2011: \$9 million) and we received proceeds of \$3 million (2011: \$5 million). For these exercised stock options, we issued new shares from the authorized share capital pool rather than from our treasury pool.

**16. RELATED PARTY TRANSACTIONS**

The transactions listed below are classified as related party transactions as each counterparty had or has had either a direct or indirect shareholding in us or has been a board member during any period covered by the financial statements.

The collateral manager of four of our CLOs is Blackstone Debt Advisors L.P., who is entitled to management fees payable by the collateralized obligations in the ordinary course of business. We also have investments in two hedge funds and one credit fund managed by Blackstone Alternative Asset Management, LP, who is entitled to management fees in the ordinary course of business. On June 30, 2012, Blackstone Group ceased to be a related party. In the six months ended June 30, 2012, total management fees to the Blackstone Group were \$1 million (full years 2011: \$2 million; 2010: \$2 million). Subsequent to June 30, 2012, Blackstone Group continues to provide the same services under the same terms.

In the ordinary course of business, we engage SKY Harbor Capital Management, LLC for asset management services for certain of our short duration high yield debt portfolios and StoneRiver RegEd for broker and adjuster licensing, appointment and compliance services. During 2012, total fees paid to these Stone Point Group companies were \$2 million (2011: nil, 2010: nil).

**17. INCOME TAXES**

Under current Bermuda law, we are not required to pay any taxes in Bermuda on income or capital gains. We have received an assurance from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, we will be exempt from taxation in Bermuda until March 2035. Our Bermuda subsidiary has an operating branch in Singapore, which is subject to the relevant taxes in that jurisdiction. The branch is not under examination in this tax jurisdiction, but remains subject to examination for tax years 2009 through 2012.

Our U.S. subsidiaries are subject to federal, state and local corporate income taxes and other taxes applicable to U.S. corporations. The provision for federal income taxes has been determined under the principles of the consolidated tax

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**17. INCOME TAXES (CONTINUED)**

provisions of the U.S. Internal Revenue Code and Regulations. Should the U.S. subsidiaries pay a dividend outside the U.S. group, withholding taxes will apply. Our U.S. subsidiaries are not under examination but remain subject to examination in the U.S. for tax years 2009 through 2012.

In Canada, our U.S. reinsurance company operates through a branch and our U.S. service company has an unlimited liability company subsidiary based in Canada. Prior to 2011, our U.S. service company operated in Canada via a Canadian branch. These Canadian operations are subject to the relevant taxes in that jurisdiction and generally remain subject to examination for tax years 2008 through 2012. Our Canadian reinsurance branch is currently under audit by the Canada Revenue Agency for income taxes for tax years 2009 and 2010.

We also have subsidiaries in Ireland, the United Kingdom (U.K.), Australia and Brazil. Our Ireland insurance subsidiary with branch operations in the U.K. and Australia was subject to a compliance review of the U.K. branch for 2009, by H.M. Revenue and Customs, which resulted in no significant adjustments. These subsidiaries and their branches, other than the U.K. branch, are not under examination, but generally remain subject to examination in all applicable jurisdictions for tax years 2008 through 2012.

The following table provides an analysis of our income tax expense and net tax assets:

Year ended December 31,	2012	2011	2010
Current income tax expense (benefit)			
United States	\$ 4,931	\$ 5,064	\$ 26,633
Europe	8,566	9,598	12,173
Other	(174)	188	120
Deferred income tax expense (benefit)			
United States	(10,749)	1,379	121
Europe	713	(996)	(173)
Other	—	—	(194)
<b>Total income tax expense</b>	<b>\$ 3,287</b>	<b>\$ 15,233</b>	<b>\$ 38,680</b>
Net current tax (liabilities) receivables	\$ 1,164	\$ 1,318	\$ (8,525)
Net deferred tax assets	52,794	60,836	72,606
<b>Net tax assets</b>	<b>\$ 53,958</b>	<b>\$ 62,154</b>	<b>\$ 64,081</b>

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**17. INCOME TAXES (CONTINUED)**

Deferred income taxes reflect the tax impact of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. The significant components of our deferred tax assets and liabilities were as follows:

At December 31,	2012	2011
<b>Deferred tax assets:</b>		
Discounting of loss reserves	\$ 61,534	\$ 65,271
Unearned premiums	32,355	31,640
Operating loss carryforwards	20,685	21,074
Accruals not currently deductible	23,266	14,187
Other investment adjustments and impairments	8,790	6,310
Tax credits	7,945	2,134
Depreciation	3,858	2,414
Capital loss carryforwards	—	4,245
Other deferred tax assets	7,915	2,809
<b>Deferred tax assets before valuation allowance</b>	<b>166,348</b>	150,084
Valuation allowance	(24,574)	(21,264)
<b>Deferred tax assets net of valuation allowance</b>	<b>141,774</b>	128,820
<b>Deferred tax liabilities:</b>		
Deferred acquisition costs	(27,211)	(29,195)
Net unrealized gains on investments	(44,137)	(25,925)
Amortization of intangible assets and goodwill	(8,258)	(6,999)
Accrued market discounts	(4,681)	(4,156)
Equalization reserves	(1,957)	(1,497)
Other deferred tax liabilities	(2,736)	(212)
<b>Deferred tax liabilities</b>	<b>(88,980)</b>	(67,984)
<b>Net deferred tax assets</b>	<b>\$ 52,794</b>	<b>\$ 60,836</b>

At December 31, 2012, the total operating loss carryforwards for our Singapore and Australian branches were \$117 million (2011: \$112 million) and \$51 million (2011: \$54 million), respectively. Such operating losses are currently available to offset future taxable income of the branches and may be carried forward indefinitely in each jurisdiction. At December 31, 2012, our European subsidiaries have a \$3 million (2011: nil) foreign tax credit which can be carried forward indefinitely. In addition, at December 31, 2012, our U.S. companies have a \$5 million (2011: \$2 million) alternative minimum tax credit that can be carried forward indefinitely.

Our remaining capital loss carryforwards, in the U.S., were utilized by realizing capital gains during 2012.



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**17. INCOME TAXES (CONTINUED)**

The following table provides an analysis of the movement in our valuation allowance:

At December 31,	2012	2011
<b>Income tax expense:</b>		
Valuation allowance - beginning of year	\$ 30,623	\$ 27,539
Operating loss carryforwards	635	12,287
Foreign tax credit	2,675	306
Capital loss carryforwards and impairments	—	(9,509)
<b>Valuation allowance - end of year</b>	<b>33,933</b>	<b>30,623</b>
<b>Accumulated other comprehensive income:</b>		
<b>Valuation allowance - beginning and end of year<sup>(1)</sup></b>	<b>(9,359)</b>	<b>(9,359)</b>
<b>Total valuation allowance - end of year</b>	<b>\$ 24,574</b>	<b>\$ 21,264</b>

(1) Remaining disproportionate tax effect credit balance relating to elimination of valuation allowance

At December 31, 2012 and 2011, we established a full valuation allowance on: (1) operating loss carryforwards relating to branch operations in Australia and Singapore due to cumulative losses in recent years and (2) unutilized foreign tax credits available in Ireland. Although realization is not assured, management believes it is more likely than not that the tax benefit of the recorded net deferred tax assets will be realized.

Outside of the items for which we have established a valuation allowance as described above, our gross deferred tax assets relate substantially to our U.S. operations. In evaluating our ability to recover these tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including historical results, operating loss carryback potential and scheduled reversals of deferred tax liabilities. Our U.S. operations have produced significant taxable income in prior periods and have deferred tax liabilities that will reverse in future periods such that we believe sufficient ordinary taxable income is available to utilize all remaining ordinary deferred tax assets. In 2012, there were sufficient net unrealized gains to offset remaining impairments, therefore a valuation allowance on such impairments in the U.S., was not considered necessary. In 2011, we concluded that a valuation allowance on U.S. capital loss carryforwards and impairments was not needed as there were sufficient net unrealized capital gains that would, if necessary, be recognized to generate sufficient capital gains within the carryforward period.

There were no unrecognized tax benefits at December 31, 2012 and 2011.

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**17. INCOME TAXES (CONTINUED)**

The following table presents the distribution of income before income taxes between domestic and foreign jurisdictions as well as a reconciliation of the actual income tax rate to the amount computed by applying the effective tax rate of 0% under Bermuda law to income before income taxes:

Year ended December 31,	2012	2011	2010
<b>Income before income taxes</b>			
Bermuda (domestic)	\$ 485,613	\$ 10,911	\$ 713,100
Foreign	64,915	50,627	182,303
<b>Total income before income taxes</b>	<u>\$ 550,528</u>	<u>\$ 61,538</u>	<u>\$ 895,403</u>
<b>Reconciliation of effective tax rate (% of income before income taxes)</b>			
Expected tax rate	0.0 %	0.0 %	0.0 %
Foreign taxes at local expected rates:			
United States	0.4 %	33.2 %	5.1 %
Europe	1.4 %	10.7 %	1.3 %
Other	— %	3.3 %	(0.2)%
Valuation allowance	0.6 %	(15.5)%	(1.0)%
Net tax exempt income	(1.5)%	(11.2)%	(0.6)%
Other	(0.3)%	4.3 %	(0.3)%
<b>Actual tax rate</b>	<u>0.6 %</u>	<u>24.8 %</u>	<u>4.3 %</u>

**18. STATUTORY FINANCIAL INFORMATION**

Our (re)insurance operations are subject to insurance and/or reinsurance laws and regulations in the jurisdictions in which they operate, the most significant of which include Bermuda, Ireland and the United States. These regulations include certain restrictions on the amount of dividends or other distributions, such as loans or cash advances, available to shareholders without prior approval of the insurance regulatory authorities.

The statutory capital and surplus in each of our most significant regulatory jurisdictions at December 31, 2012 and 2011 was as follows:

At December 31,	Bermuda		Ireland		United States	
	2012	2011	2012	2011	2012	2011
Required statutory capital and surplus	\$ 2,048,329	\$ 2,004,439	\$ 279,078	\$ 262,879	\$ 358,674	\$ 325,998
Actual statutory capital and surplus	\$ 4,091,437	\$ 3,887,670	\$ 904,237	\$ 820,891	\$ 1,295,679	\$ 1,237,046

Under the Insurance Act 1978, amendments thereto and Related Regulations of Bermuda, our Bermuda subsidiary, AXIS Specialty Bermuda is restricted as to the payment of dividends and/or distributions for amounts greater than 25% of the prior year's statutory capital and surplus whereby a signed affidavit by at least two members of the Board of Directors attesting that a dividend and/or distribution in excess of this amount would not cause the company to fail to meet its relevant margins is required. At December 31, 2012, the maximum dividend/distribution AXIS Specialty Bermuda could pay, without a signed affidavit, having met minimum levels of statutory capital and surplus requirements, was approximately \$1 billion.

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**18. STATUTORY FINANCIAL INFORMATION (CONTINUED)**

Our Irish subsidiaries, AXIS Specialty Europe SE and AXIS Re SE, are required to maintain minimum levels of statutory and capital surplus. At December 31, our subsidiaries were in compliance with these requirements. Our Irish subsidiaries may declare dividends out of retained earnings subject to meeting their solvency and capital requirements. At December 31, 2012, the maximum dividend our Irish subsidiaries could pay out of retained earnings, subject to regulatory approval, was approximately \$142 million.

Our U.S. operations required statutory capital and surplus is determined using risk based capital tests, which is the threshold that constitutes the authorized control level. If a company falls below the control level, the commissioner is authorized to take whatever regulatory actions may be considered necessary to protect policyholders and creditors. The maximum dividend that may be paid by our U.S. insurance subsidiaries is restricted by the regulatory requirements of the domiciliary states. Generally, the maximum dividend that may be paid by each of our U.S. insurance subsidiaries is limited to unassigned surplus (statutory equivalent of retained earnings) and may also be limited to statutory net income, net investment income or 10% of total statutory capital and surplus. At December 31, 2012, the maximum dividend that our U.S. insurance operations could pay without regulatory approval was approximately \$130 million.

Our operating subsidiaries in Bermuda and the United States maintain branch offices in Singapore and Canada, respectively. Our Irish operating subsidiaries maintain branch offices in Switzerland, Australia and the United Kingdom. As branch offices are not considered separate entities for regulatory purposes, the required and actual statutory capital and surplus amounts for each jurisdiction in the table above include amounts related to the applicable branch offices. Our Singaporean, Australian and Canadian branch offices are subject to additional minimum capital or asset requirements in their countries of domicile. At December 31, 2012 and 2011, the actual capital/assets for each of these branches exceeded the relevant local regulatory requirements.

Total statutory net income of our operating subsidiaries was \$697 million, \$99 million, \$921 million for 2012, 2011 and 2010, respectively. The difference between statutory financial statements and statements prepared in accordance with U.S. GAAP vary by jurisdiction; however, the primary difference is that statutory financial statements do not reflect deferred acquisition costs, certain net deferred tax assets, goodwill and intangible assets, unrealized appreciation on debt securities or certain unauthorized reinsurance recoverables.

**AXIS CAPITAL HOLDINGS LIMITED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012, 2011 AND 2010**

**19. UNAUDITED CONDENSED QUARTERLY FINANCIAL DATA**

The following is an unaudited summary of our quarterly financial results:

Quarters ended	Mar 31	Jun 30	Sep 30	Dec 31
<b><u>2012</u></b>				
Net premiums earned	\$ 846,362	\$ 850,603	\$ 862,447	\$ 856,049
Net investment income	116,023	74,449	103,638	86,847
Net realized investment gains	14,491	30,405	50,803	31,771
Underwriting income (loss)	62,689	119,739	154,999	(74,291)
Net income (loss) available to common shareholders	121,997	168,152	223,407	(18,551)
Earnings (loss) per common share - basic	\$ 0.97	\$ 1.36	\$ 1.84	\$ (0.16)
Earnings (loss) per common share - diluted	\$ 0.96	\$ 1.35	\$ 1.82	\$ (0.16)
<b><u>2011</u></b>				
Net premiums earned	\$ 788,201	\$ 840,014	\$ 839,992	\$ 846,753
Net investment income	110,655	100,018	49,396	102,362
Net realized investment gains (losses)	30,144	37,477	57,557	(3,738)
Underwriting income (loss)	(461,305)	28,974	90,029	15,076
Net income (loss) available to common shareholders	(383,760)	101,068	212,058	80,064
Earnings (loss) per common share - basic	\$ (3.39)	\$ 0.81	\$ 1.68	\$ 0.63
Earnings (loss) per common share - diluted	\$ (3.39)	\$ 0.79	\$ 1.66	\$ 0.63

**20. SUBSEQUENT EVENT**

Subsequent to December 31, 2012, we privately negotiated with Trident II, L.P. and affiliated entities to repurchase 3 million common shares at an average price of \$38.70 per share, for a total cost of \$116 million. At February 21, 2013 we have \$634 million of remaining authorization under the common share repurchase program approved by our Board of Directors, which will expire on December 31, 2014.

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**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

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None.

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**ITEM 9A. CONTROLS AND PROCEDURES**

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*Disclosure Controls and Procedures*

The Company's management has performed an evaluation, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) as of December 31, 2012. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2012, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and is accumulated and communicated to management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

*Management's Annual Report on Internal Control Over Financial Reporting*

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act). The Company's management has performed an assessment, with the participation of the Company's Chief Executive Officer and the Company's Chief Financial Officer, of our internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework. Based upon that assessment, the Company's management believes that, as of December 31, 2012, our internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Our independent registered public accounting firm has issued an audit report on our assessment of our internal control over financial reporting as of December 31, 2012. This report appears below.

All internal control systems, no matter how well designed, have inherent limitations. As a result, even those internal control systems determined to be effective can provide only reasonable assurance with respect to financial reporting and the preparation of financial statements.

*Changes in Internal Control Over Financial Reporting*

The Company's management has performed an evaluation, with the participation of the Company's Chief Executive Officer and the Company's Chief Financial Officer, of changes in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2012. Based upon that evaluation, there were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
AXIS Capital Holdings Limited

We have audited the internal control over financial reporting of AXIS Capital Holdings Limited and subsidiaries (the “Company”) as of December 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Controls Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2012 of the Company and our report dated February 22, 2013 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche Ltd.

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Hamilton, Bermuda  
February 22, 2013

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**ITEM 9B. OTHER INFORMATION**

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Not applicable.

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**PART III**

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**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

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The information required by this item is incorporated by reference from the sections captioned “Proposal No. 1 – Election of Directors”, “Corporate Governance”, “Section 16(a) Beneficial Ownership Reporting Compliance” and “Executive Officers” in the definitive proxy statement that will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year ended December 31, 2012 pursuant to Regulation 14A.

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**ITEM 11. EXECUTIVE COMPENSATION**

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The information required by this item is incorporated by reference from the sections captioned “Executive Compensation”, “Compensation Discussion and Analysis”, “Director Compensation”, “Compensation Committee Report” and “Compensation Committee Interlocks and Insider Participation” in the definitive proxy statement that will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year ended December 31, 2012 pursuant to Regulation 14A.

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**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

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The information required by this item is incorporated by reference from the sections captioned “Principal Shareholders” and “Equity Compensation Plan Information” in the definitive proxy statement that will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year ended December 31, 2012 pursuant to Regulation 14A.

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**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

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The information required by this item is incorporated by reference from the sections captioned “Certain Relationships and Related Transactions”, and “Corporate Governance” in the definitive proxy statement that will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year ended December 31, 2012 pursuant to Regulation 14A.

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**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

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The information required by this item is incorporated by reference from the section captioned “Principal Accounting Fees and Services” in the definitive proxy statement that will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year ended December 31, 2012 pursuant to Regulation 14A.

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**PART IV**

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**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

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**(a) Financial Statements, Financial Statement Schedules and Exhibits****1. Financial Statements**

Included in Part II – see Item 8 of this report.

**2. Financial Statement Schedules**

Report of Independent Registered Public Accounting Firm  
Schedule II – Condensed Financial Information of Registrant  
Schedule III – Supplementary Insurance Information  
Schedule IV – Supplementary Reinsurance Information

Schedules I, V and VI have been omitted as the information is provided in Item 8, Consolidated Financial Statements, or in the above schedules.

**3. Exhibits**

<b>Exhibit Number</b>	<b>Description of Document</b>
3.1	Certificate of Incorporation and Memorandum of Association of AXIS Capital Holdings Limited (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (Amendment No. 1) (No. 333-103620) filed on April 16, 2003).
3.2	Amended and Restated Bye-laws of AXIS Capital Holdings Limited (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 filed on May 15, 2009).
4.1	Specimen Common Share Certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (Amendment No. 3) (No. 333-103620) filed on June 10, 2003).
4.2	Amended and Restated Series A Warrant for the Purchase of Common Shares (incorporated by reference to Exhibit 4.2 to the Company's Annual Report on Form 10-K for the period ended December 31, 2003).
4.3	Senior Indenture between AXIS Capital Holdings Limited and The Bank of New York, as trustee, dated as of November 15, 2004 (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on November 15, 2004).
4.4	First Supplemental Indenture between AXIS Capital Holdings Limited and The Bank of New York, as trustee, dated as of November 15, 2004 (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on November 15, 2004).
4.5	Senior Indenture among AXIS Specialty Finance LLC, AXIS Capital Holdings Limited and The Bank of New York Mellon Trust Company, N.A., as trustee, dated as of March 23, 2010 (incorporated by reference to Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q filed on April 27, 2010).
4.6	Certificate of Designations setting forth the specific rights, preferences, limitations and other terms of the Series A Preferred Shares (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on October 4, 2005).
4.7	Certificate of Designations setting forth the specific rights, preferences, limitations and other terms of the Series B Preferred Shares (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on November 23, 2005).



- 4.8 Certificate of Designations setting from the specific rights, preferences, limitations and other terms of the Series C Preferred Shares (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on March 19, 2012).
- 10.1 Amended and Restated Shareholders Agreement dated December 31, 2002, among AXIS Capital Holdings Limited and each of the persons listed on Schedule A thereto (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 (Amendment No. 3) (No. 333-103620) filed on June 10, 2003).
- \*10.2 Employment Agreement between John R. Charman and AXIS Specialty Limited dated as of December 15, 2003 (incorporated by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003).
- \*10.3 Amendment No. 1 to Employment Agreement between John R. Charman and AXIS Specialty Limited dated October 23, 2007 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 24, 2007).
- \*10.4 Amendment No. 2 to Employment Agreement between John R. Charman and AXIS Specialty Limited dated February 19, 2008 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 19, 2008).
- \*10.5 Amendment No. 3 to Employment Agreement between John R. Charman and AXIS Specialty Limited dated May 20, 2008 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 20, 2008).
- \*10.6 Amendment No. 4 to Employment Agreement between John R. Charman and AXIS Specialty Limited dated December 31, 2010 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 4, 2011).
- \*10.7 Amendment No. 5 to Employment Agreement between John R. Charman and AXIS Specialty Limited dated May 3, 2012 (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K/A filed on May 9, 2012).
- \*10.8 Amended and Restated Supplemental Executive Retirement Agreement by and between AXIS Specialty Limited and John R. Charman dated May 8, 2008 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on August 5, 2008).
- \*10.9 Addendum to the Amended and Restated Supplemental Executive Retirement Agreement dated July 11, 2012 between AXIS Capital Holdings Limited, AXIS Specialty Limited, Codan Trust Company Limited and John R. Charman (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on July 16, 2012).
- \*10.10 Amended and Restated Service Agreement between Michael A. Butt and AXIS Specialty Limited dated as of December 15, 2003 (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003).
- \*10.11 Amendment No. 1 to Amended and Restated Service Agreement, effective as of May 12, 2006, between AXIS Specialty Limited and Michael A. Butt (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on May 18, 2006).
- \*10.12 Amendment No. 2 to Amended and Restated Service Agreement by and between AXIS Specialty Limited and Michael A. Butt dated September 19, 2008 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 23, 2008).
- \*10.13 Amendment No. 3 to Amended and Restated Service Agreement by and between Michael A. Butt and AXIS Specialty Limited dated May 6, 2009 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 7, 2009).
- \*10.14 Amendment No. 4 to Amended and Restated Service Agreement by and between Michael A. Butt and AXIS Specialty Limited dated December 31, 2010 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on January 4, 2011).
- \*10.15 Separation Agreement and Release between Michael A. Butt and AXIS Specialty Limited dated May 3, 2012 (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K/A filed on May 9, 2012).

- \*10.16 Consulting Agreement between Michael A. Butt and AXIS Specialty Limited dated May 3, 2012 (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K/A filed on May 9, 2012).
- \*10.17 Amended and Restated Supplemental Executive Retirement Agreement by and between AXIS Specialty Limited and Michael A. Butt dated May 8, 2008 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on August 5, 2008).
- \*10.18 Addendum to the Amended and Restated Supplemental Executive Retirement Agreement dated July 13, 2012 between AXIS Capital Holdings Limited, AXIS Specialty Limited, Codan Trust Company Limited and Michael A. Butt (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on July 16, 2012).
- \*10.19 Employment Agreement by and among AXIS Capital Holdings Limited, AXIS Specialty U.S. Services, Inc. and Albert Benchimol dated May 3, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed on May 9, 2012).
- \*10.20 Restricted Stock Agreement for Albert Benchimol pursuant to the AXIS Capital Holdings Limited 2007 Long-Term Equity Compensation Plan (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K/A filed on May 9, 2012).
- \*10.21 Employment Agreement between Dennis B. Reding and AXIS Specialty U.S. Services, Inc. dated as of December 31, 2010 (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on January 4, 2011).
- \*10.22 Amendment No. 1 to Employment Agreement by and between Dennis B. Reding and AXIS Specialty U.S. Services, Inc., dated December 27, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 28, 2012).
- \*10.23 Employment Agreement by and between John Gressier and AXIS Specialty Limited dated as of December 31, 2010 (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on January 4, 2011).
- \*10.24 Employment Agreement by and between John D. Nichols and AXIS Specialty U.S. Services, Inc. dated February 6, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 8, 2012).
- \*10.25 Employment Agreement by and between AXIS Specialty U.S. Services, Inc. and Joseph C. Henry dated May 16, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 18, 2012).
- \*10.26 2003 Long-Term Equity Compensation Plan (incorporated by reference to Exhibit 10.12 to the Company's Registration Statement on Form S-1 (Amendment No. 2) (No. 333-103620) filed on May 17, 2003).
- \*10.27 2007 Long-Term Equity Compensation Plan, as amended (incorporated by reference to Exhibit 4.4 to the Company's Registration Statement on Form S-8 filed on May 15, 2012).
- \*10.28 Form of Employee Restricted Stock Agreement (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 28, 2010).
- \*10.29 Form of Employee Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on September 28, 2010).
- †\*10.30 Form of Cash/Stock Settled Employee Restricted Stock Unit Agreement.
- \*10.31 Form of Employee Restricted Stock Unit Agreement (Canada) (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on February 8, 2012).
- \*10.32 2003 Directors Long-Term Equity Compensation Plan (incorporated by reference to Exhibit 4.5 to the Company's Registration Statement on Form S-8 (No. 333-110228) filed on November 4, 2003).
- \*10.33 2003 Directors Deferred Compensation Plan, as amended and restated (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on April 28, 2009).
- †\*10.34 2013 Directors Annual Compensation Program.
- \*10.35 AXIS Specialty U.S. Services, Inc. Supplemental Retirement Plan (incorporated by reference to Exhibit 10.23 to the Company's Annual Report on Form 10-K filed on February 26, 2008).

- \*10.36 2004 Annual Incentive Plan (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on December 15, 2004).
- \*10.37 Form of Grant Letter for certain employees of AXIS Specialty Europe Limited under the 2003 Long-Term Equity Compensation Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 23, 2006).
- 10.38 Master Reimbursement Agreement, dated as of May 14, 2010, by and among AXIS Specialty Limited, AXIS Re Limited, AXIS Specialty Europe Limited, AXIS Insurance Company, AXIS Surplus Insurance Company, AXIS Specialty Insurance Company, AXIS Reinsurance Company and Citibank Europe plc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 19, 2010).
- 10.39 Amendment to Master Reimbursement Agreement dated January 27, 2012 by and among AXIS Specialty Limited, AXIS Re Limited, AXIS Specialty Europe Limited, AXIS Insurance Company, AXIS Surplus Insurance Company, AXIS Specialty Insurance Company and AXIS Reinsurance Company and Citibank Europe plc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 30, 2012).
- 10.40 Credit Agreement, dated as of August 24, 2010, by and among AXIS Capital Holdings Limited, certain subsidiaries of AXIS Capital Holdings Limited party thereto, Bank of America, N.A., as Administrative Agent and the other lenders party thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 25, 2010).
- 10.41 First Amendment to Credit Agreement, dated as of November 21, 2011, among AXIS Capital Holdings Limited, certain subsidiaries of AXIS Capital Holdings Limited party thereto, designated Lenders thereto, and Bank of America, N.A., as Administrative Agent, Fronting Bank and LC Administrator (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 23, 2011).
- †12.1 Computation of Ratio of Earnings to Fixed Charges and Preferred Dividends.
- †21.1 Subsidiaries of the registrant.
- †23.1 Consent of Deloitte & Touche.
- †24.1 Power of Attorney (included as part of signature pages hereto).
- †31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- †31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- †32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- †32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- †101 The following financial information from AXIS Capital Holdings Limited's Annual Report on Form 10-K for the year ended December 31, 2012 formatted in XBRL: (i) Consolidated Balance Sheets at December 31, 2012 and 2011; (ii) Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010; (iii) Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2012, 2011 and 2010; (iv) Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2012, 2011 and 2010; (v) Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010; and (vi) Notes to Consolidated Financial Statements, tagged as blocks of text and in detail.

\* Exhibits 10.2 through 10.37 represent a management contract, compensatory plan or arrangement in which directors and/or executive officers are eligible to participate.

† Filed herewith.

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**SIGNATURES**

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Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on February 22, 2013.

**AXIS CAPITAL HOLDINGS LIMITED**

By: /s/ ALBERT BENCHIMOL  
Albert Benchimol  
President and Chief Executive Officer

**POWER OF ATTORNEY**

We, the undersigned directors and executive officers of AXIS Capital Holdings Limited, hereby appoint Joseph Henry and Richard T. Gieryn, Jr., and each of them singly, as our true and lawful attorneys with full power to them and each of them to sign for us, and in our names in the capacities indicated below, any and all amendments to the Annual Report on Form 10-K filed with the Securities and Exchange Commission, hereby ratifying and confirming our signatures as they may be signed by our said attorneys to any and all amendments to said Annual Report on Form 10-K.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 22, 2013.

<u>Signature</u>	<u>Title</u>
<u>/s/ ALBERT BENCHIMOL</u> Albert Benchimol	Chief Executive Officer, President and Director (Principal Executive Officer)
<u>/s/ JOSEPH HENRY</u> Joseph Henry	Chief Financial Officer (Principal Financial Officer)
<u>/s/ JAMES O'SHAUGHNESSY</u> James O'Shaughnessy	Controller (Principal Accounting Officer)
<u>/s/ GEOFFREY BELL</u> Geoffrey Bell	Director
<u>/s/ JANE BOISSEAU</u> Jane Boisseau	Director
<u>/s/ MICHAEL A. BUTT</u> Michael A. Butt	Director
<u>/s/ CHARLES A. DAVIS</u> Charles A. Davis	Director
<u>/s/ ROBERT L. FRIEDMAN</u> Robert L. Friedman	Director

<u>Signature</u>	<u>Title</u>
<u>/s/ DONALD J. GREENE</u> Donald J. Greene	Director
<u>/s/ CHRISTOPHER V. GREETHAM</u> Christopher V. Greetham	Director
<u>/s/ MAURICE A. KEANE</u> Maurice A. Keane	Director
<u>/s/ SIR ANDREW LARGE</u> Sir Andrew Large	Director
<u>/s/ CHERYL-ANN LISTER</u> Cheryl-Ann Lister	Director
<u>/s/ THOMAS C. RAMEY</u> Thomas C. Ramey	Director
<u>/s/ HENRY B. SMITH</u> Henry B. Smith	Director
<u>/s/ WILHELM ZELLER</u> Wilhelm Zeller	Director

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
AXIS Capital Holdings Limited

We have audited the consolidated financial statements of AXIS Capital Holdings Limited and subsidiaries (the “Company”) as of December 31, 2012, and 2011, and for each of the three years in the period ended December 31, 2012, and have issued our report thereon dated February 22, 2013 (which report expresses an unqualified opinion) and the Company’s internal control over financial reporting as of December 31, 2012, and have issued our report thereon dated February 22, 2013; such reports are included elsewhere in this Form 10-K. Our audits also included the consolidated financial statement schedules of the Company listed in Item 15. These consolidated financial statement schedules are the responsibility of the Company’s management. Our responsibility is to express an opinion based on our audits. In our opinion, such consolidated financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ Deloitte & Touche Ltd.

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Hamilton, Bermuda

February 22, 2013

SCHEDULE II

**AXIS CAPITAL HOLDINGS LIMITED**  
**CONDENSED BALANCE SHEETS – PARENT COMPANY**  
**DECEMBER 31, 2012 AND 2011**

	2012	2011
	(in thousands)	
<b>Assets</b>		
Investments in subsidiaries on equity basis	\$ 6,571,607	\$ 6,201,506
Cash and cash equivalents	2,841	2,363
Other assets	2,706	3,567
<b>Total assets</b>	<b>\$ 6,577,154</b>	<b>\$ 6,207,436</b>
<b>Liabilities</b>		
Intercompany payable	\$ 243,252	\$ 250,919
Senior notes	499,798	499,691
Dividends payable	37,370	5,250
Other liabilities	16,973	7,497
<b>Total liabilities</b>	<b>797,393</b>	<b>763,357</b>
<b>Shareholders' equity</b>		
Preferred shares - Series A, B and C	502,843	500,000
Common shares (2012: 171,867; 2011: 170,159 shares issued and 2012: 117,920; 2011: 125,588 shares outstanding)	2,146	2,125
Additional paid-in capital	2,179,034	2,105,386
Accumulated other comprehensive income	362,622	128,162
Retained earnings	4,497,789	4,155,392
Treasury shares, at cost (2012: 53,947; 2011: 44,571 shares)	(1,764,673)	(1,446,986)
<b>Total shareholders' equity</b>	<b>5,779,761</b>	<b>5,444,079</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 6,577,154</b>	<b>\$ 6,207,436</b>

- (1) On November 15, 2004, AXIS Capital issued \$500 million aggregate principal amount of 5.75% senior unsecured debt ("Senior Notes") at an issue price of 99.785%, generating net proceeds of \$496 million. Interest of the 5.75% Senior Notes is payable semi-annually in arrears on June 1 and December 1 of each year, beginning on June 1, 2005. Unless previously redeemed, the 5.75% Senior Notes will mature on December 1, 2014.
- (2) AXIS Capital has fully and unconditionally guaranteed all obligations of AXIS Specialty Finance, a 100% owned finance subsidiary, related to the issuance of \$500 million aggregate principal amount of 5.875% senior unsecured notes. AXIS Capital's obligations under this guarantee are unsecured and senior and rank equally with all other senior obligations of AXIS Capital.

**AXIS CAPITAL HOLDINGS LIMITED**  
**CONDENSED STATEMENTS OF OPERATIONS – PARENT COMPANY**  
**YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	(in thousands)		
<b>Revenues</b>			
Net investment income	\$ 25	\$ 1	\$ 74
<b>Total revenues</b>	<u>25</u>	<u>1</u>	<u>74</u>
<b>Expenses</b>			
General and administrative expenses	62,293	36,248	33,785
Interest expense and financing costs	29,201	29,201	29,201
<b>Total expenses</b>	<u>91,494</u>	<u>65,449</u>	<u>62,986</u>
<b>Loss before equity in net earnings of subsidiaries</b>	<b>(91,469)</b>	<b>(65,448)</b>	<b>(62,912)</b>
Equity in net earnings of subsidiaries	638,710	111,753	919,635
<b>Net income</b>	<u>547,241</u>	<u>46,305</u>	<u>856,723</u>
Preferred share dividends	38,228	36,875	36,875
Loss on repurchase of preferred shares	14,009	—	—
<b>Net income available to common shareholders</b>	<u>\$ 495,004</u>	<u>\$ 9,430</u>	<u>\$ 819,848</u>
<b>Comprehensive income (loss)</b>	<u>\$ 781,701</u>	<u>\$ (2,354)</u>	<u>\$ 947,911</u>



SCHEDULE II

**AXIS CAPITAL HOLDINGS LIMITED**  
**CONDENSED STATEMENTS OF CASH FLOWS – PARENT COMPANY**  
**YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010**

	2012	2011	2010
	(in thousands)		
<b>Cash flows from operating activities:</b>			
Net income	\$ 547,241	\$ 46,305	\$ 856,723
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Equity in net earnings of subsidiaries	(638,710)	(111,753)	(919,635)
Change in intercompany payable	(7,667)	(44,503)	103,544
Dividends received from subsidiaries	525,000	255,000	697,500
Other items	56,425	21,298	87,277
<b>Net cash provided by operating activities</b>	<b>482,289</b>	166,347	825,409
<b>Cash flows from investing activities:</b>			
Capital repaid from subsidiary	—	130,000	—
<b>Net cash from investing activities</b>	—	130,000	—
<b>Cash flows from financing activities:</b>			
Net proceeds from the issuance of preferred shares	393,544	—	—
Repurchase of preferred shares	(404,073)	—	—
Repurchase of common shares	(317,687)	(65,885)	(709,583)
Dividends paid - common shares	(120,487)	(206,455)	(108,302)
Dividends paid - preferred shares	(38,228)	(36,875)	(36,875)
Proceeds from issuance of common shares	5,120	6,735	8,229
<b>Net cash used in financing activities</b>	<b>(481,811)</b>	(302,480)	(846,531)
Increase (decrease) in cash and cash equivalents	478	(6,133)	(21,122)
Cash and cash equivalents - beginning of period	2,363	8,496	29,618
<b>Cash and cash equivalents - end of period</b>	<b>\$ 2,841</b>	\$ 2,363	\$ 8,496
<b>Supplemental disclosures of cash flow information:</b>			
Interest paid	\$ 28,750	\$ 28,750	\$ 28,750

**AXIS CAPITAL HOLDINGS LIMITED**  
**SUPPLEMENTARY INSURANCE INFORMATION**

**At and year ended December 31, 2012**

(in thousands)	Deferred Acquisition Costs	Reserve for Losses and Loss Expenses	Unearned Premiums	Net Premiums Earned	Net Investment Income <sup>(1)</sup>	Losses And Loss Expenses	Amortization of Deferred Acquisition Costs	Other Operating Expenses <sup>(2)</sup>	Net Premiums Written
Insurance	\$ 128,311	\$ 4,492,553	\$ 1,456,318	\$ 1,558,058	\$ —	\$ 953,564	\$ 226,859	\$ 314,834	\$ 1,522,245
Reinsurance	260,937	4,566,178	998,374	1,857,405	—	1,142,464	400,794	116,487	1,815,211
Corporate	—	—	—	—	380,957	—	—	129,660	—
<b>Total</b>	<b>\$ 389,248</b>	<b>\$ 9,058,731</b>	<b>\$ 2,454,692</b>	<b>\$ 3,415,463</b>	<b>\$ 380,957</b>	<b>\$ 2,096,028</b>	<b>\$ 627,653</b>	<b>\$ 560,981</b>	<b>\$ 3,337,456</b>

**At and year ended December 31, 2011**

(in thousands)	Deferred Acquisition Costs	Reserve for Losses and Loss Expenses	Unearned Premiums	Net Premiums Earned	Net Investment Income <sup>(1)</sup>	Losses And Loss Expenses	Amortization of Deferred Acquisition Costs	Other Operating Expenses <sup>(2)</sup>	Net Premiums Written
Insurance	\$ 142,743	\$ 4,081,741	\$ 1,412,699	\$ 1,429,687	\$ —	\$ 919,319	\$ 199,583	\$ 278,147	\$ 1,466,134
Reinsurance	264,784	4,343,304	1,041,763	1,885,274	—	1,755,733	387,886	103,915	1,953,300
Corporate	—	—	—	—	362,430	—	—	77,089	—
<b>Total</b>	<b>\$ 407,527</b>	<b>\$ 8,425,045</b>	<b>\$ 2,454,462</b>	<b>\$ 3,314,961</b>	<b>\$ 362,430</b>	<b>\$ 2,675,052</b>	<b>\$ 587,469</b>	<b>\$ 459,151</b>	<b>\$ 3,419,434</b>

**At and year ended December 31, 2010**

(in thousands)	Deferred Acquisition Costs	Reserve for Losses and Loss Expenses	Unearned Premiums	Net Premiums Earned	Net Investment Income <sup>(1)</sup>	Losses And Loss Expenses	Amortization of Deferred Acquisition Costs	Other Operating Expenses <sup>(2)</sup>	Net Premiums Written
Insurance	\$ 119,323	\$ 3,512,002	\$ 1,359,668	\$ 1,206,493	\$ —	\$ 569,869	\$ 152,223	\$ 276,435	\$ 1,332,220
Reinsurance	239,977	3,520,373	974,008	1,740,917	—	1,107,263	336,489	98,001	1,815,320
Corporate	—	—	—	—	406,892	—	—	75,449	—
<b>Total</b>	<b>\$ 359,300</b>	<b>\$ 7,032,375</b>	<b>\$ 2,333,676</b>	<b>\$ 2,947,410</b>	<b>\$ 406,892</b>	<b>\$ 1,677,132</b>	<b>\$ 488,712</b>	<b>\$ 449,885</b>	<b>\$ 3,147,540</b>

- (1) As we evaluate the underwriting results of each of our reportable segments separately from the results of our investment portfolio, we do not allocate net investment income to our reportable segments.
- (2) Amounts related to our reportable segments reflect underwriting-related general and administrative expenses, including those incurred directly by segment personnel and certain corporate overhead costs allocated based on estimated consumption, headcount and other variables deemed relevant. Other corporate overhead costs, which are not incremental and/or directly attributable to our individual underwriting operations, are not allocated to our reportable segments and are presented separately as corporate expenses.

**AXIS CAPITAL HOLDINGS LIMITED  
SUPPLEMENTARY REINSURANCE INFORMATION  
YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010**

<u>(in thousands)</u>	<u>DIRECT GROSS PREMIUM</u>	<u>CEDED TO OTHER COMPANIES</u>	<u>ASSUMED FROM OTHER COMPANIES</u>	<u>NET AMOUNT</u>	<u>PERCENTAGE OF AMOUNT ASSUMED TO NET</u>
2012	\$ 1,805,887	\$ 802,187	\$ 2,333,756	\$ 3,337,456	69.9%
2011	1,696,600	676,719	2,399,553	3,419,434	70.2%
2010	1,619,880	602,996	2,130,656	3,147,540	67.7%

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## Directors and Executive Officers

### DIRECTORS

#### **Geoffrey Bell**

President,  
Geoffrey Bell and Company  
–Corporate Governance and  
Nominating Committee  
–Finance Committee  
–Risk Committee

#### **Albert A. Benchimol**

Chief Executive Officer and President,  
AXIS Capital  
–Executive Committee  
–Risk Committee

#### **Jane Boisseau**

Former Partner and Co-Chair,  
Insurance Regulatory Department of  
Dewey & LeBoeuf LLP  
–Audit Committee  
–Corporate Governance and  
Nominating Committee

#### **Michael A. Butt**

Chairman of the Board,  
AXIS Capital  
–Executive Committee

#### **Charles A. Davis**

Chief Executive Officer,  
Stone Point Capital L.L.C.  
–Finance Committee, Chairperson  
–Executive Committee

#### **Robert L. Friedman**

Senior Advisor and Former  
Senior Managing Director,  
Blackstone Group L.P.  
–Compensation Committee  
–Finance Committee

#### **Donald J. Greene**

Former Named Partner,  
LeBoeuf, Lamb, Greene  
& MacRae, L.L.P.  
–Corporate Governance and  
Nominating Committee,  
Chairperson  
–Audit Committee  
–Compensation Committee  
–Risk Committee

#### **Christopher V. Greetham**

Former Chief Investment Officer,  
XL Capital Ltd.  
–Compensation Committee  
–Finance Committee

#### **Maurice A. Keane**

Former Group CEO,  
The Bank of Ireland  
–Audit Committee  
–Corporate Governance and  
Nominating Committee  
–Risk Committee

#### **Sir Andrew Large**

Former Deputy Governor  
for Financial Stability,  
Bank of England  
–Risk Committee,  
Chairperson  
–Corporate Governance and  
Nominating Committee

#### **Cheryl-Ann Lister**

Former Chairperson and CEO,  
Bermuda Monetary Authority  
–Audit Committee  
–Risk Committee

#### **Thomas C. Ramey**

Former Chairman and President,  
Liberty International,  
Liberty Mutual Group  
–Audit Committee, Chairperson  
–Compensation Committee

#### **Henry B. Smith**

Former CEO,  
W.P. Stewart & Co., Ltd. and  
Bank of Bermuda Limited  
–Lead Independent Director  
–Compensation Committee,  
Chairperson  
–Executive Committee,  
Chairperson  
–Audit Committee

#### **Alice Young**

Special Counsel and Chairperson  
of Asia Pacific Practice,  
Kaye Scholer LLP  
–Audit Committee

#### **Wilhelm Zeller**

Former Chairman  
of the Executive Board,  
Hannover Re  
–Audit Committee  
–Risk Committee

### EXECUTIVE OFFICERS

#### **Albert A. Benchimol**

Chief Executive Officer and President

#### **Christopher N. DiSipio**

Chief Executive Officer  
AXIS Accident & Health

#### **John W. Gressier**

Chief Executive Officer  
AXIS Insurance

#### **Joseph C. Henry**

Executive Vice President and  
Chief Financial Officer

#### **John D. Nichols**

Chief Executive Officer,  
AXIS Reinsurance

#### **Dennis B. Reding**

Executive Vice President and  
Chief Operating Officer



## Shareholder Information

### ANNUAL MEETING

The Annual General Meeting of AXIS Capital Holdings Limited shareholders will be held on May 3, 2013 at 8:30 a.m., AST at AXIS Overbay Cottage, 11 Waterloo Lane, Pembroke HM 08, Bermuda.

### INVESTOR RELATIONS

Visit the Investor Information section of [www.axiscapital.com](http://www.axiscapital.com), write to the Investor Relations Department of AXIS Capital or email [investorrelations@axiscapital.com](mailto:investorrelations@axiscapital.com) for copies of AXIS Capital's Annual Report, Forms 10-K and 10-Q or other reports filed with or furnished to the Securities and Exchange Commission.

### ADDRESS INVESTOR RELATIONS INQUIRIES TO:

Director, Investor Relations  
AXIS Capital Holdings Limited  
92 Pitts Bay Road  
Pembroke HM 08, Bermuda  
Tel: 441 405 2727  
Email: [investorrelations@axiscapital.com](mailto:investorrelations@axiscapital.com)

### TRANSFER AGENT AND REGISTRAR

The Transfer Agent for AXIS Capital is Computershare Trust Company N.A. For shareholder inquiries, please contact:

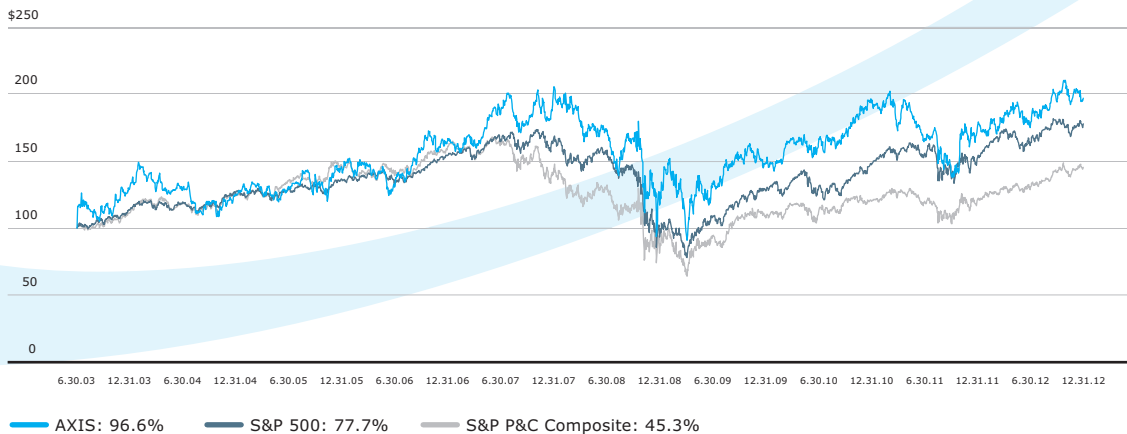
Computershare Trust Company N.A.  
480 Washington Boulevard  
Jersey City,  
New Jersey 07310-1900  
Tel: 866 230 9140  
(U.S. Shareholders)  
Tel: 201 680 6685  
(Non-U.S. Shareholders)  
Website:  
[cpushareownerservices.com](http://cpushareownerservices.com)

### INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Deloitte & Touche Ltd.  
Corner House  
Church & Parliament Streets  
Hamilton HM FX, Bermuda

### TOTAL SHAREHOLDER RETURN

AXIS Capital Holdings Limited



Set forth above is a graph comparing the yearly percentage change in the cumulative total shareholder return on our common shares (assuming reinvestment of dividends) from July 1, 2003, the date that our common shares began trading on the New York Stock Exchange, through December 31, 2012 as compared to the cumulative total return of the Standard & Poor's 500 Stock Index and the cumulative total return of the Standard & Poor's Property and Casualty Insurance Index. This graph assumes an investment of \$100 in July 2003.

AXIS Capital's total return is computed using the initial public offering price of \$22.00 per share.



[www.axiscapital.com](http://www.axiscapital.com)