

AXIS CAPITAL HOLDINGS LTD
Form 10-Q
November 03, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

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

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)

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 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

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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 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 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

As of October 30, 2009 there were 142,464,979 Common Shares, \$0.0125 par value per share, of the registrant outstanding.

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PART I FINANCIAL INFORMATION

Cautionary Statement Regarding Forward-looking Statements

This quarterly report 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 estimation 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 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 and coverage issues,

the failure of our cedants to adequately evaluate risks,

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,

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changes in accounting policies or practices,

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 Conditions and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

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ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****CONSOLIDATED BALANCE SHEETS****SEPTEMBER 30, 2009 (UNAUDITED) AND DECEMBER 31, 2008**

| | 2009 | 2008 |
|--------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| | (in thousands) | |
| Assets | | |
| Investments: | | |
| Fixed maturities, available for sale, at fair value (Amortized cost 2009: \$9,588,460; 2008: \$8,404,994) | \$ 9,682,932 | \$ 7,750,654 |
| Equity securities, available for sale, at fair value (Cost 2009: \$129,055; 2008: \$164,330) | 137,544 | 107,283 |
| Other investments, at fair value | 541,447 | 492,082 |
| Short-term investments | 282,737 | 261,879 |
| Total investments | 10,644,660 | 8,611,898 |
| Cash and cash equivalents | 1,108,954 | 1,697,581 |
| Restricted cash and cash equivalents | 130,517 | 123,092 |
| Accrued interest receivable | 82,169 | 79,232 |
| Insurance and reinsurance premium balances receivable | 1,497,639 | 1,185,785 |
| Reinsurance recoverable balances | 1,369,824 | 1,304,551 |
| Reinsurance recoverable balances on paid losses | 36,625 | 74,079 |
| Deferred acquisition costs | 363,739 | 273,096 |
| Prepaid reinsurance premiums | 284,922 | 279,553 |
| Securities lending collateral | 135,122 | 412,823 |
| Goodwill and intangible assets | 93,049 | 60,417 |
| Other assets | 172,248 | 180,727 |
| Total assets | \$ 15,919,468 | \$ 14,282,834 |
| Liabilities | | |
| Reserve for losses and loss expenses | \$ 6,579,914 | \$ 6,244,783 |
| Unearned premiums | 2,548,072 | 2,162,401 |
| Insurance and reinsurance balances payable | 170,664 | 202,145 |
| Securities lending payable | 138,092 | 415,197 |
| Senior notes | 499,449 | 499,368 |
| Other liabilities | 426,068 | 233,082 |
| Net payable for investments purchased | 159,102 | 64,817 |
| Total liabilities | 10,521,361 | 9,821,793 |
| Commitments and Contingencies | | |
| Shareholders equity | | |
| Preferred shares - Series A and B | 500,000 | 500,000 |
| Common shares (2009: 137,835; 2008: 136,212 shares issued and outstanding) | 1,901 | 1,878 |
| Additional paid-in capital | 2,003,417 | 1,962,779 |
| Accumulated other comprehensive income (loss) | 74,974 | (706,499) |
| Retained earnings | 3,319,467 | 3,198,492 |

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|--------------------------------------------------------------|----------------------|---------------|
| Treasury shares, at cost (2009: 14,472; 2008: 14,243 shares) | (501,652) | (495,609) |
| Total shareholders equity | 5,398,107 | 4,461,041 |
| Total liabilities and shareholders equity | \$ 15,919,468 | \$ 14,282,834 |

See accompanying notes to Consolidated Financial Statements

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

| | Three months ended | | Nine months ended | |
|------------------------------------------------------------------------|----------------------------------------------|---------------------|-------------------|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (in thousands, except for per share amounts) | | | |
| Revenues | | | | |
| Net premiums earned | \$ 706,025 | \$ 689,970 | \$ 2,078,154 | \$ 2,028,895 |
| Net investment income | 134,788 | 50,583 | 346,300 | 273,249 |
| Other insurance related loss | (135,738) | (13,806) | (159,394) | (19,073) |
| Net realized investment losses: | | | | |
| Other-than-temporary impairment losses | (283,418) | (49,663) | (336,214) | (65,804) |
| Portion of impairment losses transferred to other comprehensive income | 4,080 | | 5,523 | |
| Other realized investment losses | 25,973 | (39,416) | 13,051 | 13,962 |
| Total net realized investment losses | (253,365) | (89,079) | (317,640) | (51,842) |
| Total revenues | 451,710 | 637,668 | 1,947,420 | 2,231,229 |
| Expenses | | | | |
| Net losses and loss expenses | 311,109 | 705,531 | 1,077,360 | 1,438,929 |
| Acquisition costs | 113,423 | 90,333 | 318,708 | 282,593 |
| General and administrative expenses | 92,009 | 86,722 | 265,515 | 248,425 |
| Foreign exchange losses (gains) | 6,784 | (7,627) | 30,579 | (21,360) |
| Interest expense and financing costs | 7,977 | 7,941 | 23,869 | 23,789 |
| Total expenses | 531,302 | 882,900 | 1,716,031 | 1,972,376 |
| Income (loss) before income taxes | (79,592) | (245,232) | 231,389 | 258,853 |
| Income tax expense (benefit) | 7,082 | (5,104) | 24,785 | 11,554 |
| Net income (loss) | (86,674) | (240,128) | 206,604 | 247,299 |
| Preferred share dividends | 9,218 | 9,218 | 27,656 | 27,656 |
| Net income (loss) available to common shareholders | \$ (95,892) | \$ (249,346) | \$ 178,948 | \$ 219,643 |
| Weighted average common shares and common share equivalents: | | | | |
| Basic | 137,904 | 139,335 | 137,693 | 141,628 |
| Diluted | 137,904 | 139,335 | 150,258 | 157,315 |
| Earnings per common share: | | | | |
| Basic | \$ (0.70) | \$ (1.79) | \$ 1.30 | \$ 1.55 |
| Diluted | \$ (0.70) | \$ (1.79) | \$ 1.19 | \$ 1.40 |

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|-------------------------------------------------|----------------|----------|----------------|----------|
| Cash dividends declared per common share | \$ 0.20 | \$ 0.185 | \$ 0.60 | \$ 0.555 |
|-------------------------------------------------|----------------|----------|----------------|----------|

See accompanying notes to Consolidated Financial Statements.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**

| | Three months ended | | Nine months ended | |
|-------------------------------------------------------------------------------------------------------------------|---------------------------|---------------------|--------------------------|---------------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (in thousands) | | | |
| Net income (loss) | \$ (86,674) | \$ (240,128) | \$ 206,604 | \$ 247,299 |
| Other comprehensive income, net of tax: | | | | |
| Available for sale investments: | | | | |
| Unrealized gains (losses) arising during the period | 357,290 | (434,834) | 512,336 | (573,831) |
| Portion of other-than-temporary impairment losses recognized in other comprehensive income | (3,393) | | (4,836) | |
| Adjustment for re-classification of realized investment losses and net impairment losses recognized in net income | 247,428 | 89,296 | 312,064 | 53,779 |
| Foreign currency translation adjustment | 1,910 | | 243 | |
| Change in the unrecognized prior service cost for SERPs | | 562 | | 1,687 |
| Comprehensive income (loss) | \$ 516,561 | \$ (585,104) | \$ 1,026,411 | \$ (271,066) |

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

| | 2009 | 2008 |
|--------------------------------------------------------------------------------------------------------|------------------|------------------|
| | (in thousands) | |
| Common shares (shares outstanding) | | |
| Balance at beginning of period | 136,212 | 142,520 |
| Shares issued | 1,852 | 2,456 |
| Shares repurchased for treasury | (229) | (6,985) |
| Balance at end of period | 137,835 | 137,991 |
| Preferred shares - Series A and B | | |
| Balance at beginning and end of period | \$ 500,000 | \$ 500,000 |
| Common shares (par value) | | |
| Balance at beginning of period | 1,878 | 1,850 |
| Shares issued | 23 | 28 |
| Balance at end of period | 1,901 | 1,878 |
| Additional paid-in capital | | |
| Balance at beginning of period | 1,962,779 | 1,869,810 |
| Shares issued | 509 | 2,623 |
| Stock options exercised | 2,475 | 23,655 |
| Share-based compensation expense | 37,654 | 47,037 |
| Balance at end of period | 2,003,417 | 1,943,125 |
| Accumulated other comprehensive income (loss) | | |
| Balance at beginning of period | (706,499) | 22,668 |
| Cumulative effect of change in accounting principle at April 1 st , net of tax (see Note 1) | (38,334) | |
| Unrealized appreciation (depreciation) on available for sale investments, net of tax | 824,400 | (520,052) |
| Portion of other-than-temporary impairment losses, net of tax | (4,836) | |
| Amortization of prior service cost on the SERPs | | 1,687 |
| Foreign currency translation adjustment | 243 | |
| Balance at end of period | 74,974 | (495,697) |
| Retained earnings | | |
| Balance at beginning of period | 3,198,492 | 2,968,900 |
| Cumulative effect of change in accounting principle at April 1 st , net of tax (see Note 1) | 38,334 | |
| Net income | 206,604 | 247,299 |
| Series A and B preferred share dividends | (27,656) | (27,656) |
| Common share dividends | (96,307) | (91,056) |
| Balance at end of period | 3,319,467 | 3,097,487 |

| | | |
|----------------------------------|---------------------|---------------------|
| Treasury shares, at cost | | |
| Balance at beginning of period | (495,609) | (204,606) |
| Shares repurchased for treasury | (6,043) | (240,997) |
| Balance at end of period | (501,652) | (445,603) |
| Total shareholders equity | \$ 5,398,107 | \$ 4,601,190 |

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

| | 2009 | 2008 |
|------------------------------------------------------------------------------------------|--------------------|------------------|
| | (in thousands) | |
| Cash flows from operating activities: | | |
| Net income | \$ 206,604 | \$ 247,299 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Net realized investment losses | 317,640 | 51,842 |
| Unrealized loss on insurance derivative contract | 161,000 | 21,444 |
| Net realized and unrealized (gains) losses of other investments | (63,322) | 97,586 |
| Amortization/accretion of fixed maturities | 11,018 | 10,516 |
| Other amortization and depreciation | 11,650 | 8,263 |
| Share-based compensation expense | 37,654 | 47,037 |
| <i>Changes in:</i> | | |
| Accrued interest receivable | (2,937) | 12,645 |
| Reinsurance recoverable balances | (27,819) | (116,278) |
| Deferred acquisition costs | (90,643) | (56,201) |
| Prepaid reinsurance premiums | (5,369) | (22,020) |
| Reserve for loss and loss expenses | 335,131 | 818,893 |
| Unearned premiums | 385,671 | 320,535 |
| Insurance and reinsurance balances, net | (343,335) | (201,976) |
| Other items | (39,237) | (11,329) |
| Net cash provided by operating activities | 893,706 | 1,228,256 |
| Cash flows from investing activities: | | |
| Purchases of: | | |
| Fixed maturities | (8,260,119) | (6,868,348) |
| Equity securities | (33,995) | (289,966) |
| Other investments | (91,800) | (141,000) |
| Proceeds from the sale of: | | |
| Fixed maturities | 6,174,388 | 5,789,503 |
| Equity securities | 55,703 | 64,835 |
| Other investments | 86,190 | 69,521 |
| Proceeds from the redemption of fixed maturities | 726,060 | 721,178 |
| Net sales of short-term investments | (13,552) | (118,372) |
| Purchase of other assets | (43,398) | (8,640) |
| Change in restricted cash and cash equivalents | (7,425) | (38,982) |
| Net cash used in investing activities | (1,407,948) | (820,271) |
| Cash flows from financing activities: | | |
| Repurchase of shares | (6,043) | (240,997) |
| Dividends paid - common shares | (85,218) | (80,653) |
| Dividends paid - preferred shares | (27,656) | (27,656) |
| Proceeds from issuance of common shares | 3,007 | 26,306 |
| Net cash used in financing activities | (115,910) | (323,000) |

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|----------------------------------------------------------|---------------------|--------------|
| Effect of exchange rate changes on foreign currency cash | 41,525 | (37,279) |
| Increase (decrease) in cash and cash equivalents | (588,627) | 47,706 |
| Cash and cash equivalents - beginning of period | 1,697,581 | 1,273,117 |
| Cash and cash equivalents - end of period | \$ 1,108,954 | \$ 1,320,823 |

See accompanying notes to Consolidated Financial Statements

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

Basis of Presentation

The interim consolidated financial statements include the accounts of AXIS Capital Holdings Limited and its subsidiaries (herein referred to as we, us, our, or the Company).

The consolidated balance sheet at September 30, 2009 and the consolidated statements of operations, comprehensive income, shareholders equity and cash flows for the periods ended September 30, 2009 and 2008 have not been audited. The balance sheet at December 31, 2008 is derived from the audited financial statements.

These statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP) for interim financial information and with the Securities and Exchange Commission 's instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, these financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of our financial position and results of operations for the periods presented. The results of operations for any interim period are not necessarily indicative of the results for a full year. All significant inter-company accounts and transactions have been eliminated.

The following information should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2008. Certain reclassifications have been made to prior period amounts to conform to the current period presentation. Tabular dollars and share amounts are in thousands, except per share amounts.

Significant Accounting Policies

There were no changes to the significant accounting policies with the exception of changes to the accounting policy related to the valuation and recognition of losses related to investments, as required by new accounting guidance. Further, the following also includes an updated accounting policy for our foreign currency translation for the recently established Canadian branch and adoption of new accounting standards.

Investments

Investments available for sale

Fixed maturities and equities classified as available for sale are reported at fair value at the balance sheet date. See Note 4 Fair Value Measurements for additional information regarding the determination of fair value.

Purchases and sales of investments are recorded on a trade date basis. Realized gains or losses on sales of investments are determined based on the specific identification method. Net investment income is recognized when earned and includes interest and dividend income together with amortization of market premiums and discounts using the effective yield method and is net of investment management fees and other expenses. For mortgage-backed securities and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any adjustments that are required due to the change in effective yields and maturities are recognized on a prospective basis through yield adjustments.

The net unrealized gain or loss on available for sale investments, net of tax, is included as accumulated other comprehensive income (loss) in shareholders equity.

We assess quarterly whether available-for-sale investments with unrealized losses represent impairments that are other than temporary. There are several factors that are considered in the assessment of a security 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), (iii) the historical and implied future volatility of the fair value, (iv) the financial condition of, and near-term prospects of, the issuer and (v) the collateral structure and credit support of the security, if applicable.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Investments available for sale (continued)

On April 1, 2009, we adopted a new guidance issued by the Financial Accounting Standard Board (FASB) on recognition and presentation of other than temporary impairments (OTTI) for fixed maturities. Accordingly, we recognize an other-than-temporary impairment in earnings for a fixed maturity security in an unrealized loss position when we either (a) have the intent to sell the security, (b) more likely than not will be required to sell the security before its anticipated recovery, or (c) do not anticipate to fully recover the amortized cost based on projected cash flows to be collected. Prior to the adoption of this new guidance, we recorded an OTTI charge for a fixed maturity security in an unrealized position when we could not assert that we had both the intent and ability to hold the security for a period of time sufficient to allow for a recovery in its fair value to its amortized cost.

Under the new guidance, if the impaired fixed maturity security meets one of the first two criteria above, the entire difference between the security's fair value and its amortized cost is recorded as an OTTI charge in the Consolidated Statements of Operations. However, if the impairment arises due to an anticipated credit loss on the security (third criterion above), we recognize only the credit 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 accumulated other comprehensive income (AOCI) in shareholders' equity. The new amortized cost is accreted into net investment income.

For equity securities we continue to 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. When it is determined that the decline in value of an equity security is other-than-temporary, we adjust the carrying value of the equity security to its fair value, with a corresponding charge to earnings.

In periods subsequent to the recognition of an OTTI for either a fixed maturity or equity security, the new cost basis is not adjusted for subsequent increases in estimated fair value.

Other investments

We record other investments at fair value (see Note 4 – Fair Value Measurements), with the change in fair value and realized gains and losses reported in net investment income.

Short-term investments

Short-term investments primarily comprise highly liquid debt securities with maturity greater than three months but less than one year from the date of purchase. Short-term investments, which have been previously included in fixed maturities, are now reported separately in the Consolidated Balance Sheets at September 30, 2009 and December 31, 2008, the Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and 2008, and in the related disclosures. These investments are carried at amortized cost, which fairly approximates fair value.

Foreign Currency Translation

Our functional currency is the U.S. dollar, except for our recently established Canadian branch, for which the functional currency is the Canadian dollar. The assets and liabilities of the Canadian branch are translated using period-end exchange rates, and revenues and expenses are translated using average exchange rates during each period. Translation gains and losses are reported in accumulated other comprehensive income (loss) as a component of shareholders' equity.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Adoption of New Accounting Standards

Fair Value Measurements

Effective January 1, 2009, we adopted new guidance issued by FASB for non-financial assets and non-financial liabilities measured at fair value on a non-recurring basis. The adoption of this guidance did not impact our results of operations or financial position.

Effective April 1, 2009, we adopted the following issued by FASB:

New guidance on determining fair value when the volume and level of activity for an asset or liability have significantly decreased and identifying transactions that are not orderly. In these circumstances, the use of alternative valuation models may be appropriate to determine fair value. The new accounting standard also expands disclosure requirements to include disaggregation of the fair value disclosures by defining major categories, and must be applied prospectively. The adoption of this standard did not materially impact our results of operations or financial position. Refer to Note 4 – Fair Value Measurements for required disclosures.

New guidance amending the previous recognition and presentation of OTTI for debt securities, as disclosed above. It requires new interim and annual disclosure of both fixed maturities and equities, including more disaggregated information (refer to Note 4 – Fair Value Measurements). As of April 1, 2009, the adoption of this standard resulted in \$38 million net after-tax increase to retained earnings with a corresponding increase to accumulated other comprehensive income (loss), resulting in no change to our total shareholders' equity. This adjustment reflects the non-credit portion of the total OTTI of \$86 million previously recognized in retained earnings for fixed maturity securities still outstanding at March 31, 2009. As part of the cumulative effect adjustment, we also recorded a corresponding adjustment to the amortized cost of our fixed maturities.

New guidance requiring disclosure about fair value of financial instruments for interim reporting periods as well as in annual financial statements. Refer to Note 4 – Fair Value Measurements.

Business Combinations

In April 2009, we adopted revised guidance issued by FASB on the accounting for assets and liabilities assumed in a business combination that arise from contingencies, resulting in no impact to our results of operations or financial position. This guidance amends the previously issued standard on business combinations, by requiring that assets acquired or liabilities assumed in a business combination that arise from contingencies be recognized at fair value only if fair value can be reasonably estimated; otherwise the asset or liability should generally be recognized in accordance with guidance on accounting for contingencies, and removes the requirement to disclose an estimate of the range of outcomes of recognized contingencies at the acquisition date.

Determination of the Useful Life of Intangible Assets

Effective January 1, 2009, we adopted new guidance issued by FASB for determination of the useful life of intangible assets, resulting in no significant impact on our results of operations or financial position. The guidance amends the factors considered in developing assumptions used to determine the useful life of an intangible asset, and its intent is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Financial Guarantee Insurance Contracts

Effective January 1, 2009, we adopted new guidance issued by FASB for financial guarantee insurance contracts issued by insurance enterprises, resulting in no significant impact on our results of operations or financial position. This guidance amends the previous recognition and measurement of premium revenue and claim liabilities. A claim liability is recognized prior to an event of default when there is evidence that credit deterioration has occurred in an insured financial obligation. The new guidance also requires expanded disclosures about financial guarantee insurance contracts. The determination of the applicability of this new guidance to certain of our insurance contracts required significant management judgment due to the interpretation of the scope exemption for insurance contracts that are similar to financial guarantee insurance contracts.

Earnings per Share

Effective January 1, 2009, we adopted new guidance issued by FASB for the calculation of earnings per share, and the requirement that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) to be included in the computation of earnings per share pursuant to the two-class method. As the dividends on all outstanding unvested stock awards are restricted and forfeitable, the adoption of this guidance did not impact the calculation of our earnings per share.

Subsequent Events

Effective April 1, 2009, we adopted new accounting and disclosure guidance issued by FASB on management's assessment of subsequent events. This new guidance clarifies that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued or available to be issued. The adoption of this standard did not have an impact on our results of operations or financial position. In preparing our Consolidated Financial Statements, we have evaluated subsequent events through November 3, 2009, which is the date that these financial statements were issued.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Recently Issued Accounting Standards Not Yet Adopted

Transfers and Servicing of Financial Assets

In June 2009, the FASB issued new guidance for accounting for transfers of financial assets, which amends the derecognition guidance and eliminates the exemption from consolidation for qualifying special-purpose entities (QSPEs). Consequently, a transferor will need to evaluate all existing QSPEs to determine whether they must now be consolidated in accordance with the new guidance on consolidations (see below). This new guidance is effective for financial asset transfers occurring after January 1, 2010 and early adoption is prohibited. We do not anticipate the adoption of this guidance will impact our results of operations, financial condition and liquidity.

Consolidations

In June 2009, the FASB amended the consolidation guidance applicable to variable interest entities (VIEs). The amendments will significantly affect the overall consolidation analysis, in particular it modifies the approach for determining the primary beneficiary of a VIE. The primary beneficiary is the party that has: (1) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance, and (2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. The amended guidance is effective as of January 1, 2010, and early adoption is prohibited. We are currently evaluating the impact of the adoption of this accounting guidance on our financial condition and results of operations.

Fair Value Measurement of Liabilities

In August 2009, the FASB issued new guidance on measuring the fair value of liabilities. The fair value should be measured based on the price that would be paid to transfer the liability in an orderly transaction between market participants, including the company's own non-performance risk. In the absence of a quoted price in an active market for an identical liability at the measurement date, an entity should use a valuation technique that is consistent with the fair value measurement principles (see Note 4 Fair Value Measurements). This new guidance is effective for the interim period beginning after August 27, 2009. As the loss reserves relating to our insurance and reinsurance contracts are not measured at fair value, we do not anticipate the adoption of this guidance will materially impact our results of operations, financial condition and liquidity.

Fair Value Measurement of Certain Alternative Investments

In September 2009, the FASB issued new guidance for measuring the fair value of certain alternative investments. As a practical expedient for measuring fair value, an entity may use the net asset value per share (NAV) if the NAV is calculated in accordance with AICPA Audit and Accounting Guide for investment companies. This new guidance is effective for the first reporting period ending after December 15, 2009; however, early adoption is permitted. We do not anticipate the adoption of this guidance will impact our results of operations, financial condition and liquidity.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****2. SEGMENT INFORMATION**

Our underwriting operations are organized around two global underwriting platforms, AXIS Insurance and AXIS Re and therefore we have two reportable segments, insurance and reinsurance. Except for goodwill and intangible assets, we do not allocate assets by segment as we evaluate the underwriting results of each segment separately from the results of our investment portfolio.

The following tables summarize the underwriting results of operating segments for the periods indicated and the carrying values of goodwill and intangible assets as of September 30, 2009 and 2008:

| Three months ended September 30, | 2009 | | | 2008 | | |
|------------------------------------------|--------------------|-------------------|--------------------|--------------------|---------------------|---------------------|
| | Insurance | Reinsurance | Total | Insurance | Reinsurance | Total |
| Gross premiums written | \$ 413,922 | \$ 361,392 | \$ 775,314 | \$ 402,672 | \$ 322,611 | \$ 725,283 |
| Net premiums written | 239,781 | 355,363 | 595,144 | 235,666 | 315,750 | 551,416 |
| Net premiums earned | 278,637 | 427,388 | 706,025 | 293,572 | 396,398 | 689,970 |
| Other insurance related income (loss) | (135,898) | 160 | (135,738) | (13,751) | (55) | (13,806) |
| Net losses and loss expenses | (111,228) | (199,881) | (311,109) | (230,577) | (474,954) | (705,531) |
| Acquisition costs | (29,613) | (83,810) | (113,423) | (21,964) | (68,369) | (90,333) |
| General and administrative expenses | (55,685) | (18,719) | (74,404) | (49,361) | (17,366) | (66,727) |
| Underwriting income (loss) | \$ (53,787) | \$ 125,138 | 71,351 | \$ (22,081) | \$ (164,346) | (186,427) |
| Corporate expenses | | | (17,605) | | | (19,995) |
| Net investment income | | | 134,788 | | | 50,583 |
| Net realized investment losses | | | (253,365) | | | (89,079) |
| Foreign exchange gains (losses) | | | (6,784) | | | 7,627 |
| Interest expense and financing costs | | | (7,977) | | | (7,941) |
| Loss before income taxes | | | \$ (79,592) | | | \$ (245,232) |
| Net loss and loss expense ratio | 39.9% | 46.8% | 44.1% | 78.5% | 119.8% | 102.3% |
| Acquisition cost ratio | 10.6% | 19.6% | 16.1% | 7.5% | 17.2% | 13.1% |
| General and administrative expense ratio | 20.0% | 4.4% | 13.0% | 16.8% | 4.4% | 12.6% |
| Combined ratio | 70.5% | 70.8% | 73.2% | 102.8% | 141.4% | 128.0% |
| Goodwill and intangible assets | \$ 93,049 | \$ - | \$ 93,049 | \$ 60,726 | \$ - | \$ 60,726 |

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****2. SEGMENT INFORMATION (CONTINUED)**

| Nine months ended September 30, | 2009 | | | 2008 | | |
|------------------------------------------|-------------------|-------------------|-------------------|------------------|---------------|-------------------|
| | Insurance | Reinsurance | Total | Insurance | Reinsurance | Total |
| Gross premiums written | \$ 1,304,844 | \$ 1,708,606 | \$ 3,013,450 | \$ 1,392,993 | \$ 1,470,640 | \$ 2,863,633 |
| Net premiums written | 764,932 | 1,693,526 | 2,458,458 | 872,909 | 1,454,498 | 2,327,407 |
| Net premiums earned | 853,235 | 1,224,919 | 2,078,154 | 890,558 | 1,138,337 | 2,028,895 |
| Other insurance related (loss) income | (160,659) | 1,265 | (159,394) | (20,073) | 1,000 | (19,073) |
| Net losses and loss expenses | (451,143) | (626,217) | (1,077,360) | (549,723) | (889,206) | (1,438,929) |
| Acquisition costs | (84,122) | (234,586) | (318,708) | (84,798) | (197,795) | (282,593) |
| General and administrative expenses | (159,059) | (54,515) | (213,574) | (145,321) | (51,813) | (197,134) |
| Underwriting income (loss) | \$ (1,748) | \$ 310,866 | 309,118 | \$ 90,643 | \$ 523 | 91,166 |
| Corporate expenses | | | (51,941) | | | (51,291) |
| Net investment income | | | 346,300 | | | 273,249 |
| Net realized investment losses | | | (317,640) | | | (51,842) |
| Foreign exchange (losses) gains | | | (30,579) | | | 21,360 |
| Interest expense and financing costs | | | (23,869) | | | (23,789) |
| Income before income taxes | | | \$ 231,389 | | | \$ 258,853 |
| Net loss and loss expense ratio | 52.9% | 51.1% | 51.8% | 61.7% | 78.1% | 70.9% |
| Acquisition cost ratio | 9.9% | 19.2% | 15.4% | 9.6% | 17.4% | 13.9% |
| General and administrative expense ratio | 18.6% | 4.4% | 12.8% | 16.3% | 4.5% | 12.2% |
| Combined ratio | 81.4% | 74.7% | 80.0% | 87.6% | 100.0% | 97.0% |
| Goodwill and intangible assets | \$ 93,049 | \$ - | \$ 93,049 | \$ 60,726 | \$ - | \$ 60,726 |

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****3. 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 ⁽³⁾ |
|--------------------------------|------------------------------|------------------------------|-------------------------------|---------------------|----------------------------------------------|
| At September 30, 2009 | | | | | |
| Fixed maturities: | | | | | |
| U.S. government and agency | \$ 1,917,915 | \$ 22,324 | \$ (3,773) | \$ 1,936,466 | \$ - |
| Non-U.S. government | 516,781 | 18,078 | (648) | 534,211 | - |
| Corporate debt | 3,358,709 | 118,787 | (35,571) | 3,441,925 | 5,786 |
| Residential MBS ⁽¹⁾ | 1,964,280 | 50,909 | (39,880) | 1,975,309 | 10,131 |
| Commercial MBS | 788,288 | 10,510 | (52,254) | 746,544 | 957 |
| ABS ⁽²⁾ | 407,005 | 7,253 | (28,741) | 385,517 | 11,748 |
| Municipals | 635,482 | 30,691 | (3,213) | 662,960 | 394 |
| Total fixed maturities | \$ 9,588,460 | \$ 258,552 | \$ (164,080) | \$ 9,682,932 | \$ 29,016 |
| Equities: | | | | | |
| Common stock | \$ 129,055 | \$ 16,522 | \$ (8,033) | 137,544 | |
| Preferred stock | - | - | - | - | |
| Total equities | \$ 129,055 | \$ 16,522 | \$ (8,033) | \$ 137,544 | |

| | Amortized Cost or Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------------|------------------------------|------------------------------|-------------------------------|---------------------|
| At December 31, 2008 | | | | |
| Fixed maturities: | | | | |
| U.S. government and agency | \$ 1,148,767 | \$ 39,474 | \$ (908) | \$ 1,187,333 |
| Non-U.S. government | 272,006 | 19,915 | (12,696) | 279,225 |
| Corporate debt | 2,517,059 | 19,640 | (475,382) | 2,061,317 |
| Residential MBS ⁽¹⁾ | 2,736,811 | 71,523 | (96,336) | 2,711,998 |
| Commercial MBS | 933,315 | 90 | (170,307) | 763,098 |
| ABS ⁽²⁾ | 433,266 | 390 | (52,650) | 381,006 |
| Municipals | 363,770 | 6,479 | (3,572) | 366,677 |
| Total fixed maturities | \$ 8,404,994 | \$ 157,511 | \$ (811,851) | \$ 7,750,654 |

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Equities:

| | | | | |
|-----------------------|-------------------|-----------------|--------------------|-------------------|
| Common stock | \$ 132,935 | \$ 1,522 | \$ (48,620) | \$ 85,837 |
| Preferred stock | 31,395 | - | (9,949) | 21,446 |
| Total equities | \$ 164,330 | \$ 1,522 | \$ (58,569) | \$ 107,283 |

- (1) Residential mortgage-backed securities (MBS) include agency pass-through securities and collateralized mortgage obligations.
- (2) Asset-backed securities (ABS) include debt tranching securities collateralized by sub-prime mortgages, auto 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).
- (3) Represents the non-credit component of OTTI losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****3. INVESTMENTS (CONTINUED)****Contractual Maturities**

The contractual maturities of fixed maturities are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations.

| | Amortized Cost | Fair Value | % of Total Fair Value |
|----------------------------------------|---------------------------|-----------------------|----------------------------------|
| As at September 30, 2009 | | | |
| <u>Maturity</u> | | | |
| Due in one year or less | \$ 453,996 | \$ 562,213 | 5.8% |
| Due after one year through five years | 4,083,217 | 4,056,136 | 41.9% |
| Due after five years through ten years | 1,572,934 | 1,635,635 | 16.9% |
| Due after ten years | 318,740 | 321,578 | 3.3% |
| | 6,428,887 | 6,575,562 | 67.9% |
| Residential MBS | 1,964,280 | 1,975,309 | 20.4% |
| Commercial MBS | 788,288 | 746,544 | 7.7% |
| ABS | 407,005 | 385,517 | 4.0% |
| Total | \$ 9,588,460 | \$ 9,682,932 | 100.0% |

| | Amortized Cost | Fair Value | % of Total Fair Value |
|----------------------------------------|---------------------------|-----------------------|----------------------------------|
| As at December 31, 2008 | | | |
| <u>Maturity</u> | | | |
| Due in one year or less | \$ 416,178 | \$ 343,570 | 4.4% |
| Due after one year through five years | 2,798,157 | 2,512,428 | 32.4% |
| Due after five years through ten years | 814,175 | 803,331 | 10.4% |
| Due after ten years | 273,092 | 235,223 | 3.0% |
| | 4,301,602 | 3,894,552 | 50.2% |
| Residential MBS | 2,736,811 | 2,711,998 | 35.0% |
| Commercial MBS | 933,315 | 763,098 | 9.9% |
| ABS | 433,266 | 381,006 | 4.9% |
| Total | \$ 8,404,994 | \$ 7,750,654 | 100.0% |

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****3. INVESTMENTS (CONTINUED)****Gross Unrealized Losses**

The following tables summarize 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:

| At September 30, 2009 | 12 months or greater | | Less than 12 months | | Total | |
|-------------------------------|----------------------|---------------------|---------------------|--------------------|---------------------|---------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Fixed maturities: | | | | | | |
| U.S. government and agency | \$ - | \$ - | \$ 274,502 | \$ (3,773) | \$ 274,502 | \$ (3,773) |
| Non-U.S. government | 47,755 | (546) | 26,660 | (102) | 74,415 | (648) |
| Corporate debt | 219,591 | (32,069) | 250,946 | (3,502) | 470,537 | (35,571) |
| Residential MBS | 204,830 | (36,145) | 102,841 | (3,735) | 307,671 | (39,880) |
| Commercial MBS | 414,039 | (51,595) | 30,325 | (659) | 444,364 | (52,254) |
| ABS | 68,950 | (26,104) | 33,195 | (2,637) | 102,145 | (28,741) |
| Municipals | 5,199 | (869) | 37,782 | (2,344) | 42,981 | (3,213) |
| Total fixed maturities | \$ 960,364 | \$ (147,328) | \$ 756,251 | \$ (16,752) | \$ 1,716,615 | \$ (164,080) |
| Equities: | | | | | | |
| Common stock | \$ 42,137 | \$ (6,414) | \$ 25,166 | \$ (1,619) | 67,303 | (8,033) |
| Preferred stock | - | - | - | - | - | - |
| Total equities | \$ 42,137 | \$ (6,414) | \$ 25,166 | \$ (1,619) | \$ 67,303 | \$ (8,033) |

At December 31, 2008

| | | | | | | |
|-------------------------------|-------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Fixed maturities: | | | | | | |
| U.S. government and agency | \$ - | \$ - | \$ 84,208 | \$ (908) | \$ 84,208 | \$ (908) |
| Non-U.S. government | - | - | 162,203 | (12,696) | 162,203 | (12,696) |
| Corporate debt | 428,311 | (329,445) | 1,057,684 | (145,937) | 1,485,995 | (475,382) |
| Residential MBS | 75,916 | (16,266) | 385,527 | (80,070) | 461,443 | (96,336) |
| Commercial MBS | 138,132 | (49,091) | 611,631 | (121,216) | 749,763 | (170,307) |
| ABS | 59,597 | (18,878) | 300,585 | (33,772) | 360,182 | (52,650) |
| Municipals | - | - | 71,510 | (3,572) | 71,510 | (3,572) |
| Total fixed maturities | \$ 701,956 | \$ (413,680) | \$ 2,673,348 | \$ (398,171) | \$ 3,375,304 | \$ (811,851) |
| Equities: | | | | | | |
| Common stock | \$ 2,286 | \$ (3,083) | \$ 71,071 | \$ (45,537) | \$ 73,357 | \$ (48,620) |
| Preferred stock | - | - | 21,446 | (9,949) | 21,446 | (9,949) |

| | | | | | | | | | | | | |
|-----------------------|----|-------|----|---------|----|--------|----|----------|----|--------|----|----------|
| Total equities | \$ | 2,286 | \$ | (3,083) | \$ | 92,517 | \$ | (55,486) | \$ | 94,803 | \$ | (58,569) |
|-----------------------|----|-------|----|---------|----|--------|----|----------|----|--------|----|----------|

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****3. INVESTMENTS (CONTINUED)**Fixed Maturities

Of the total gross unrealized loss position at September 30, 2009, 11% (2008: 17%) was related to securities below investment grade or not rated. The gross unrealized losses on our fixed maturity portfolio at September 30, 2009, are primarily attributable to the historic wide credit spreads experienced during the credit crisis of 2008. During the first nine months of 2009, the gross unrealized losses have declined by \$648 million, of which \$311 million was due to impairments and the remaining \$337 million was due to price appreciation caused by significant credit spread tightening.

We concluded that the above securities in an unrealized loss position were temporarily impaired based on a detailed analysis of the underlying credit, projected cash flows to be collected, and other qualitative factors. Further, at September 30, 2009, we did not intend to sell the above 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 September 30, 2009, 50 securities (2008: 149) were in an unrealized loss position and six of these securities (2008: nil) have been in a continuous unrealized loss position for 12 months or greater. Based on our OTTI quarterly review process and our ability and intent to hold these securities for a reasonable period of time sufficient for a recovery of fair value, we concluded that the above equities in an unrealized loss position were temporarily impaired.

Credit Ratings

The following summarizes the credit ratings of fixed maturities as assigned by S&P:

| | Amortized Cost | Fair Value | % of Total Fair Value |
|--------------------------------|---------------------|---------------------|--------------------------|
| At September 30, 2009 | | | |
| Investment grade: | | | |
| AAA | \$ 5,945,477 | \$ 5,995,458 | 61.9% |
| AA | 858,536 | 865,282 | 9.0% |
| A | 1,744,729 | 1,679,600 | 17.3% |
| BBB | 875,666 | 1,012,366 | 10.5% |
| | 9,424,408 | 9,552,706 | 98.7% |
| Non-investment grade: | | | |
| Below BBB | 164,052 | 130,226 | 1.3% |
| Total | \$ 9,588,460 | \$ 9,682,932 | 100.0% |
| As at December 31, 2008 | | | |
| Investment grade: | | | |
| AAA | \$ 5,857,026 | \$ 5,692,296 | 73.3% |

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| | | | |
|-----------------------|---------------------|---------------------|---------------|
| AA | 521,697 | 491,185 | 6.3% |
| A | 1,076,980 | 944,841 | 12.3% |
| BBB | 912,340 | 601,196 | 7.8% |
| | 8,368,043 | 7,729,518 | 99.7% |
| Non-investment grade: | | | |
| Below BBB | 36,951 | 21,136 | 0.3% |
| Total | \$ 8,404,994 | \$ 7,750,654 | 100.0% |

Note: In the absence of an S&P rating, we used the lower rating established by Moody's or Fitch.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

b) Other Investments

The table below shows our portfolio of other investments reported at fair value:

| | September 30, 2009 | | December 31, 2008 | |
|--------------------------------|--------------------|---------------|-------------------|---------------|
| Hedge funds | \$ 321,820 | 59.4% | \$ 251,787 | 51.2% |
| Credit funds | 104,029 | 19.2% | 101,094 | 21.0% |
| CLO - equity tranches | 66,953 | 12.4% | 97,661 | 19.8% |
| Short duration high yield fund | 48,645 | 9.0% | 41,540 | 8.0% |
| Total other investments | \$ 541,447 | 100.0% | \$ 492,082 | 100.0% |

c) Net Investment Income

Net investment income was derived from the following sources:

| | Three months ended September 30, | | Nine months ended September 30, | |
|--------------------------------|-------------------------------------|------------------|------------------------------------|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Fixed maturities | \$ 98,337 | \$ 107,853 | \$ 290,935 | \$ 319,050 |
| Other investments | 38,646 | (66,395) | 57,384 | (82,925) |
| Cash and cash equivalents | 1,052 | 11,713 | 5,940 | 37,138 |
| Equities | 689 | 1,201 | 2,452 | 6,420 |
| Short-term investments | 81 | 424 | 524 | 3,118 |
| Gross investment income | 138,805 | 54,796 | 357,235 | 282,801 |
| Investment expenses | (4,017) | (4,213) | (10,935) | (9,552) |
| Net investment income | \$ 134,788 | \$ 50,583 | \$ 346,300 | \$ 273,249 |

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

d) Net Realized Investment Gains (Losses)

The following table provides an analysis of net realized investment losses:

| | Three months ended September 30, | | Nine months ended September 30, | |
|------------------------------------------------------|-------------------------------------|--------------------|------------------------------------|--------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Gross realized gains | \$ 51,610 | \$ 36,897 | \$ 136,191 | \$ 111,833 |
| Gross realized losses | (23,880) | (77,001) | (122,487) | (98,208) |
| Net OTTI recognized in earnings | (279,338) | (49,663) | (330,691) | (65,804) |
| Net realized losses on fixed maturities and equities | (251,608) | (89,767) | (316,987) | (52,179) |
| Change in fair value of: | | | | |
| Derivative instruments ⁽¹⁾ | (21,495) | 4,679 | (27,133) | 4,328 |
| Hedged investments ⁽¹⁾ | 19,738 | (3,991) | 26,480 | (3,991) |
| Net realized investment losses | \$ (253,365) | \$ (89,079) | \$ (317,640) | \$ (51,842) |

(1) Refer to Note 6 Derivative Instruments

The following table summarizes the net OTTI recognized in earnings by asset class:

| | Three months ended September 30, | | Nine months ended September 30, | |
|------------------------------------------|-------------------------------------|------------------|------------------------------------|------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Fixed maturities: | | | | |
| Corporate debt | \$ 263,496 | \$ 40,239 | \$ 276,522 | \$ 52,676 |
| Residential MBS | 4,733 | - | 12,679 | - |
| Commercial MBS | - | - | 10,843 | - |
| ABS | 675 | 3,943 | 10,658 | 7,647 |
| | 268,904 | 44,182 | 310,702 | 60,323 |
| Equities | 10,434 | 5,481 | 19,989 | 5,481 |
| Total OTTI recognized in earnings | \$ 279,338 | \$ 49,663 | \$ 330,691 | \$ 65,804 |

Fixed maturities

As disclosed in Note 2, on April 1, 2009, we adopted a new accounting standard which amended the previous OTTI recognition model for fixed maturities. For securities we intended to sell in the near term, we impaired \$3 million of residential MBS during the three months ended September 30, 2009. For the nine months ended September 30, 2009, we impaired \$2 million of corporate debt, \$7 million of residential MBS

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and \$11 million of commercial MBS that we intended to sell.

For the remaining impaired fixed maturities, we have recorded only their credit losses in earnings rather than the entire difference between the fair value and the amortized cost of fixed maturities. Because the new accounting standard does not allow for retrospective application, the OTTI amounts reported in the above table for the three and nine months ended September 30, 2009, are not measured on the same basis as prior period amounts and accordingly these amounts are not comparable. Furthermore, the net OTTI recognized in earnings for the first quarter of 2009 includes \$26 million of OTTI charges calculated prior to adoption of the new standard.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****3. INVESTMENTS (CONTINUED)**

The following table provides a roll forward of the credit losses, before income taxes, for which a portion of the OTTI was recognized in AOCI:

Three months ended September 30, 2009

| | |
|-------------------------------------------------------------------------------------------------------|-------------------|
| Beginning balance at June 30, 2009 | \$ 37,229 |
| Credit losses remaining in retained earnings related to adoption of accounting standard (see Note 1) | - |
| Credit loss impairments previously recognized in AOCI on securities which were sold during the period | (10,585) |
| Credit loss impairment recognized on securities not previously impaired | 265,257 |
| Additional credit loss impairments recognized on securities previously impaired | 677 |
| Increases due to passage of time on previously recorded credit losses | 670 |
| Ending balance at September 30, 2009 | \$ 293,248 |

Nine months ended September 30, 2009

| | |
|-------------------------------------------------------------------------------------------------------|-------------------|
| Beginning balance at April 1, 2009 | \$ - |
| Credit losses remaining in retained earnings related to adoption of accounting standard (see Note 1) | 45,347 |
| Credit loss impairments previously recognized in AOCI on securities which were sold during the period | (21,403) |
| Credit loss impairment recognized on securities not previously impaired | 267,770 |
| Additional credit loss impairments recognized on securities previously impaired | 864 |
| Increases due to passage of time on previously recorded credit losses | 670 |
| Ending balance at September 30, 2009 | \$ 293,248 |

The credit losses remaining in retained earnings upon adoption of the new accounting standard were \$33 million of corporate debt securities, \$7 million of ABS, \$4 million of residential MBS and \$1 million of commercial MBS. Corporate debts included \$20 million of credit losses related to the bankruptcy of Lehman Brothers.

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 significant inputs and the methodology used to estimate the credit losses for which a portion of the OTTI was recognized in AOCI were as follows:

Corporate Debt:

Our projected cash flows for corporate debt securities are primarily driven by our assumptions regarding the probability of default and the timing and amount of recoveries associated with defaults. Our default and recovery rate assumptions 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. Additionally, for medium-term notes (MTNs), our projected cash flows include significant inputs such as future credit spreads and use of leverage over the expected duration of each MTN.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

During the three months ended September 30, 2009, we recognized \$263 million of credit losses on the MTNs as there was considerable uncertainty regarding full recoverability. In response to the credit crisis, the MTNs managers reduced their leverage levels which in turn lowered the credit duration of the MTNs. As credit markets recovered and credit spreads tightened in recent months, price appreciation was not as pronounced as the depreciation during 2008 due to the lower credit duration of the MTNs. In recent months, credit spreads have tightened much quicker than anticipated which has hindered the ability of the MTN managers to reinvest the underlying cash flows at wider credit spreads. Consequently, based on updated cash flow projections, we do not believe that we will fully recover par on these MTNs and therefore we have recorded credit losses on these securities. The recognition of such losses does not necessarily indicate that sales will occur or that sales are imminent or planned.

During the three and nine months ended September 30, 2009, we sold corporate debt securities that were previously impaired, resulting in a decrease in credit loss impairments of \$9 million and \$19 million, respectively, in the above table.

Residential MBS and Commercial MBS:

We utilized models to determine the estimated credit losses for structured debt securities. To project expected cash flows to be collected, we utilized underlying data from widely accepted third-party data sources as well as the following significant assumptions: expected defaults, delinquencies, recoveries, foreclosure costs, and prepayments. These assumptions require significant management judgment and vary for each structured security based on the underlying property type, vintage, loan to collateral value ratio, geographic concentration, and current level of subordination. For each structured debt security with a significant unrealized loss position we have also corroborated our principal loss estimate with the independent investment manager's principal loss estimate.

During the three and nine months ended September 30, 2009, we have recorded credit losses of \$2 million and \$6 million respectively, on residential MBS. Based on our projected cash flows, we do not anticipate credit losses for our commercial MBS.

ABS:

The majority of the unrealized losses on ABS at September 30, 2009 were related to CLO debt tranching securities. We utilized the same internal model as for CLO equity tranching securities (see Note 4 Fair Value Measurements) to project estimated cash flows to be collected on the various CLO debt tranching securities. The significant inputs used in the model include default and recovery rates and collateral spreads. Our assumptions on default and recovery rates are established based on an assessment of actual experience to date for each CLO debt tranche and review of recent credit rating agencies' default and recovery forecasts. Based on projected cash flows at September 30, 2009, we do not anticipate credit losses on the CLO debt tranching securities.

Equities

During the three and nine months ended September 30, 2009, we recorded an OTTI charge of \$10 million (2008: \$5 million) and \$20 million (2008: \$5 million), respectively, on equities primarily due to the severity and duration of their impairments. The recognition of such losses does not necessarily indicate that sales will occur or that sales are imminent or planned.

e) Securities Lending

At September 30, 2009, we had \$135 million (2008: \$406 million) in securities on loan and we continue to wind down this lending program to reduce our counterparty credit risk.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. 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. 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.

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 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.

We used the following methods 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

Our U.S. Treasury securities are classified within Level 1 as the fair values are based on unadjusted market prices. For the remaining fixed maturities, substantially all are classified within Level 2.

The valuations for fixed maturity securities are generally obtained from third party pricing services for identical or comparable securities or through 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 are sourced from multiple vendors, and we maintain a vendor hierarchy by asset type based on historical pricing experience and vendor expertise.

Where pricing is unavailable from pricing services, we obtain unbinding quotes from broker-dealers or use an internal 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 classified within Level 3 and consisted primarily of CLO debt tranching securities, private corporate debt securities and certain residential MBS at September 30, 2009.

Equity Securities

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Our equity securities are classified within Level 1 as the fair values are based on quoted market prices in active markets.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

Other Investments

The short-duration high yield fund is classified within Level 2 as its fair value is estimated using the net asset value reported by Bloomberg and it has daily liquidity.

The hedge and credit funds are classified within Level 3 as we estimate their respective fair values using net asset values as advised by external fund manager or third party administrators. Certain of these funds have lock-up and other redemption provisions which limit our ability to liquidate these funds in the short term. However, we believe a market participant would not adjust the reported net asset value for these contractual provisions, and accordingly, we do not apply a discount factor to the reported net asset value. This position is consistent with the recently issued guidance to be adopted next quarter (see Note 1- Basis of Presentation and Accounting Policies).

We estimate the fair value for our CLO equity tranch securities (CLO Equities) based on an internal valuation model due to the lack of observable, relevant trade in the secondary markets. The model includes the following significant unobservable inputs: default and recovery rates and collateral spreads. Accordingly, we classified CLO Equities within Level 3. During the three month ended September 30, 2009, we have not adjusted the revised assumptions made during the second quarter of 2009 as there was no significant new trend in the underlying cash flows of the CLO- Equities. During the second quarter of 2009, we increased the default rate assumptions and decreased the related recovery rate assumptions for certain CLO Equities due to an increase in actual defaults and lower recoveries in the first six months of 2009. The adjustment to these significant assumptions was based on our assessment of actual experience on the underlying collateral for our CLO Equities as well as a review of recent credit rating agencies forecasted default and recovery rates for U.S. corporate speculative-grade securities. The valuation of these CLO Equities requires significant management judgment.

Derivative Instruments

a) Forward Contracts and Options

Our foreign currency forward contracts and options are customized to our hedging strategies and trade in the over-the-counter derivative market. We estimate the fair value for these derivatives using models 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.

b) Insurance Derivative Contract

The fair value for an indemnity contract with longevity risk exposure is based on an internal valuation model, which includes the following significant unobservable inputs:

The timing of the receipt of death benefits as well as the amount of premiums to be paid to maintain the policies in force, both of which are directly correlated to life expectancy assumptions for a portfolio of 188 lives;

The proceeds of selling the unmatured life settlement contracts in 2017; and

The risk margin that a market participant would require for providing this indemnity.

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The estimated indemnity payment, net of our contractual premium for providing the indemnity, is discounted using the risk free yield curve, adjusted for counterparties' credit risk.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****4. FAIR VALUE MEASUREMENTS (CONTINUED)**

During the current quarter, we have observed that the actual mortality experience for the above life settlements portfolio continued to lag from our expectations. Because of the persistency of this lag over two years, we now believe there is statistical credibility that should be attached to the actual experience thusfar in the portfolio. The combination of this lag in mortality experience and life settlements market data indicating increased life expectancy in a much larger sample of lives led us to reflect an increase in life expectancy throughout the underlying pool of lives in our valuation model. Accordingly, this resulted in an increase of \$136 million in the fair value liability with a corresponding charge to earnings during the third quarter of 2009. The projected indemnity payment in 2017 reflects nearly a full loss under this contract. Due to the use of significant unobservable inputs based on management judgment, we classified this contract within Level 3.

The tables below present the financial instruments measured at fair value on a recurring basis.

| At September 30, 2009 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
|--------------------------------|-------------------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|----------------------|
| Assets | | | | |
| Fixed maturities | | | | |
| U.S. government and agency | \$ 1,002,752 | \$ 933,714 | \$ - | \$ 1,936,466 |
| Non-U.S. government | - | \$ 534,211 | - | 534,211 |
| Corporate debt | - | 3,425,663 | 16,262 | 3,441,925 |
| Residential MBS | - | 1,960,864 | 14,445 | 1,975,309 |
| Commercial MBS | - | 737,037 | 9,507 | 746,544 |
| ABS | - | 306,822 | 78,695 | 385,517 |
| Municipals | - | 658,492 | 4,468 | 662,960 |
| | 1,002,752 | 8,556,803 | 123,377 | 9,682,932 |
| Equity securities | 137,544 | - | - | 137,544 |
| Other investments | - | 48,645 | 492,802 | 541,447 |
| Other assets (see Note 6) | - | 4,728 | - | 4,728 |
| Total | \$ 1,140,296 | \$ 8,610,176 | \$ 616,179 | \$ 10,366,651 |
| Liabilities | | | | |
| Other liabilities (see Note 6) | \$ - | \$ 220 | \$ 228,405 | \$ 228,625 |

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****4. FAIR VALUE MEASUREMENTS (CONTINUED)**

| At December 31, 2008 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
|--------------------------------|---------------------------------------------------------------------------------------|------------------------------------------------------------------|--------------------------------------------------------------|-----------------------------|
| <u>Assets</u> | | | | |
| Fixed maturities | | | | |
| U.S. government and agency | \$ 647,139 | \$ 540,194 | \$ - | \$ 1,187,333 |
| Non-U.S. government | - | 279,225 | - | 279,225 |
| Corporate debt | - | 2,061,317 | - | 2,061,317 |
| Residential MBS | - | 2,711,998 | - | 2,711,998 |
| Commercial MBS | - | 763,098 | - | 763,098 |
| ABS | - | 381,006 | - | 381,006 |
| Municipals | - | 366,677 | - | 366,677 |
| | 647,139 | 7,103,515 | - | 7,750,654 |
| Equity securities | 107,283 | - | - | 107,283 |
| Other investments | - | 41,540 | 450,542 | 492,082 |
| Other assets (see Note 6) | - | 5,005 | - | 5,005 |
| Total | \$ 754,422 | \$ 7,150,060 | \$ 450,542 | \$ 8,355,024 |
| <u>Liabilities</u> | | | | |
| Other liabilities (see Note 6) | \$ - | \$ 29,044 | \$ 62,597 | \$ 91,641 |

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****4. FAIR VALUE MEASUREMENTS (CONTINUED)**

The following tables present changes in Level 3 for financial instruments measured at fair value on a recurring basis for the periods indicated:

| Three months ended September 30, 2009 | Balance at beginning of period | Total net realized and unrealized gains / losses included in net income (1) | Change in net unrealized gains / losses included in other comprehensive income | Net purchases, sales, and distributions | Net transfers in (out) of Level 3 | Balance at end of period | Unrealized gains / losses for Level 3 Assets/ Liabilities held at the reporting date |
|------------------------------------------|-----------------------------------------|-----------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------------|--------------------------------|--------------------------------------------------------------------------------------------------------------|
| Assets | | | | | | | |
| Fixed maturities | | | | | | | |
| U.S. government and agency | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Non-U.S. government | - | - | - | - | - | - | - |
| Corporate debt | 16,923 | - | (986) | (111) | 436 | 16,262 | (5,689) |
| Residential MBS | 20,692 | - | 502 | 808 | (7,557) | 14,445 | (940) |
| Commercial MBS | - | - | (83) | - | 9,590 | 9,507 | (363) |
| ABS | 48,343 | - | 717 | 5,013 | 24,622 | 78,695 | (21,491) |
| Municipals | - | - | 21 | - | 4,447 | 4,468 | 259 |
| | 85,958 | - | 171 | 5,710 | 31,538 | 123,377 | (28,224) |
| Other investments | 493,767 | 34,345 | - | (35,310) | - | 492,802 | (152,316) |
| Liabilities | | | | | | | |
| Other liabilities | \$ 87,597 | \$ 136,000 | \$ - | \$ 4,808 | \$ - | \$ 228,405 | \$ (202,444) |

(1) Losses on fixed maturities are included in net realized investment (losses) gains. Gains and (losses) on other investments are included in net investment income. Losses on other liabilities are included in other insurance related (loss) income.

| Three months ended September 30, 2008 | Balance at beginning of period | Total net realized and unrealized gains / losses included in net income | Change in net unrealized gains / losses included in other comprehensive income | Net purchases, sales, and distributions | Net transfers in (out) of Level 3 | Balance at end of period | Unrealized gains / losses for Level 3 Assets/ Liabilities held at the reporting date |
|------------------------------------------|-----------------------------------------|-------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------------|--------------------------------|--------------------------------------------------------------------------------------------------------------|
|------------------------------------------|-----------------------------------------|-------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------------|--------------------------------|--------------------------------------------------------------------------------------------------------------|

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| | income (1) | | comprehensive income | | | | reporting date |
|---------------------------|------------|-------------|-------------------------|-------------|------|------------|-------------------|
| <u>Assets</u> | | | | | | | |
| Other investments | \$ 677,689 | \$ (68,011) | \$ - | \$ (19,211) | \$ - | \$ 590,467 | \$ (58,417) |
| <u>Liabilities</u> | | | | | | | |
| Other liabilities | \$ 23,790 | \$ 14,000 | \$ - | \$ 4,807 | \$ - | \$ 42,597 | \$ (21,444) |

(1) Losses on fixed maturities are included in net realized investment (losses) gains. Gains and (losses) on other investments are included in net investment income. Losses on other liabilities are included in other insurance related (loss) income.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

The following tables present changes in Level 3 for financial instruments measured at fair value on a recurring basis for the periods indicated:

| Nine months ended September 30, 2009 | Balance at beginning of period | Total net realized and unrealized gains / losses included in net income (1) | Change in net unrealized gains / losses included in other comprehensive income | Net purchases, sales, and distributions | Net transfers in (out) of Level 3 | Balance at end of period | Unrealized gains / losses for Level 3 Assets/ Liabilities held at the reporting date |
|-----------------------------------------|-----------------------------------------|-----------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------------|--------------------------------|--------------------------------------------------------------------------------------------------------------|
| Assets | | | | | | | |
| Fixed maturities | | | | | | | |
| U.S. government and agency | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Non-U.S. government | - | - | - | - | - | - | - |
| Corporate debt | - | - | (3,077) | (140) | 19,479 | 16,262 | (5,689) |
| Residential MBS | - | - | 6,422 | (7,918) | 15,941 | 14,445 | (940) |
| Commercial MBS | - | - | (7) | - | 9,514 | 9,507 | (363) |
| ABS | - | (373) | 4,956 | 4,616 | 69,496 | 78,695 | (21,491) |
| Municipals | - | - | 21 | - | 4,447 | 4,468 | 259 |
| | - | (373) | 8,315 | (3,442) | 118,877 | 123,377 | (28,224) |
| Other investments | 450,542 | 56,217 | - | (13,957) | - | 492,802 | (152,316) |
| Liabilities | | | | | | | |
| Other liabilities | \$ 62,597 | \$ 161,000 | \$ - | \$ 4,808 | \$ - | 228,405 | \$ (202,444) |

(1) Losses on fixed maturities are included in net realized investment (losses) gains. Gains and (losses) on other investments are included in net investment income. Losses on other liabilities are included in other insurance related (loss) income.

| Nine months ended September 30, 2008 | Balance at beginning of period | Total net realized and unrealized gains / losses included in net income (1) | Change in net unrealized gains / losses included in other comprehensive income | Net purchases, sales, and distributions | Net transfers in (out) of Level 3 | Balance at end of period | Unrealized gains / losses for Level 3 Assets/ Liabilities held at the reporting date |
|-----------------------------------------|-----------------------------------------|-----------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------------|--------------------------------|--------------------------------------------------------------------------------------------------------------|
|-----------------------------------------|-----------------------------------------|-----------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|--------------------------------------------------|-----------------------------------------------|--------------------------------|--------------------------------------------------------------------------------------------------------------|

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Assets

| | | | | | | | |
|-------------------|------------|-------------|------|-----------|------|------------|-------------|
| Other investments | \$ 592,593 | \$ (97,775) | \$ - | \$ 95,649 | \$ - | \$ 590,467 | \$ (58,417) |
|-------------------|------------|-------------|------|-----------|------|------------|-------------|

Liabilities

| | | | | | | | |
|-------------------|-----------|-----------|------|----------|------|-----------|-------------|
| Other liabilities | \$ 16,346 | \$ 21,444 | \$ - | \$ 4,807 | \$ - | \$ 42,597 | \$ (21,444) |
|-------------------|-----------|-----------|------|----------|------|-----------|-------------|

(1) Losses on fixed maturities are included in net realized investment (losses) gains. Gains and (losses) on other investments are included in net investment income. Losses on other liabilities are included in other insurance related (loss) income.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****4. FAIR VALUE MEASUREMENTS (CONTINUED)****Net Transfers in (out) of Level 3 Securities**

During the three and nine months ended September 30, 2009, we reclassified \$32 million and \$119 million, respectively, of fixed maturities from Level 2 to Level 3. The reclassifications were primarily related to residential mortgage-backed securities, private corporate debt securities and debt tranches of collateralized loan obligations. The reclassifications were due to a reduction in the volume of recently executed transactions and market quotations for these securities, or a lack of available broker quotes such that unobservable inputs had to be utilized for the valuation of these securities. Transfers into the Level 3 balance reflect the fair value of the securities at the beginning of the period and the transfers out of Level 3 reflect the fair value at the end of the period.

Fair Values of Financial Instruments

The carrying amount of financial assets and liabilities presented on the Consolidated Balance Sheets as at September 30, 2009, and December 31, 2008, are equal to fair value with the exception of senior notes. Senior notes are recorded at amortized cost with a carrying value of \$499 million (2008: \$499 million) and a fair value of \$504 million (2008: \$415 million) at September 30, 2009.

5. RESERVE FOR LOSSES AND LOSS EXPENSES

The following table shows a reconciliation of our beginning and ending gross unpaid losses and loss expenses for the periods indicated:

| Nine months ended September 30, | 2009 | 2008 |
|--------------------------------------------------------------------|------------------|------------------|
| Gross unpaid losses and loss expenses at beginning of period | \$ 6,244,783 | \$ 5,587,311 |
| Less reinsurance recoverable balances at beginning of period | (1,378,630) | (1,356,893) |
| Net losses and loss expense reserves at beginning of period | 4,866,153 | 4,230,418 |
| Net incurred losses related to: | | |
| Current year | 1,380,535 | 1,690,055 |
| Prior years | (303,175) | (251,126) |
| | 1,077,360 | 1,438,929 |
| Net paid losses related to: | | |
| Current year | (151,568) | (176,793) |
| Prior years | (706,295) | (482,469) |
| | (857,863) | (659,262) |
| Foreign exchange loss (gain) | 87,815 | (77,052) |

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| | | |
|---------------------------------------------------------------|---------------------|---------------------|
| Net losses and loss expense reserves at end of period | 5,173,465 | 4,933,033 |
| Reinsurance recoverable balances at end of period | 1,406,449 | 1,473,171 |
| Gross unpaid losses and loss expenses at end of period | \$ 6,579,914 | \$ 6,406,204 |

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

5. RESERVE FOR LOSSES AND LOSS EXPENSES (CONTINUED)

Net losses and loss expenses incurred include net favorable prior period reserve development of \$303 million and \$251 million for the nine months ended September 30, 2009 and 2008, respectively. Prior period reserve development arises from changes to loss estimates recognized in the current year that relate to losses incurred in previous calendar years. The following table summarizes net favorable reserve development by segment:

| Nine months ended September 30, | 2009 | 2008 |
|---------------------------------|-------------------|-------------------|
| Insurance | \$ 138,167 | \$ 142,294 |
| Reinsurance | 165,008 | 108,832 |
| Total | \$ 303,175 | \$ 251,126 |

Insurance Segment:

For the first nine months of 2009, we experienced \$138 million of net favorable reserve development, the principal components of which were as follows:

\$76 million of net favorable prior period reserve development on property (\$44 million), marine (\$28 million) and aviation (\$4 million) lines of business. This development was generated from accident years 2008 (\$49 million), 2007 (\$10 million) and 2006 (\$17 million), and reflects the recognition of better than expected loss emergence.

\$15 million of net favorable reserve development on liability lines of business generated across accident years 2004-2008 and driven primarily by the incorporation of more of our own actual experience with respect to reinsurance recoveries on our Excess & Surplus (E&S) umbrella lines.

\$42 million of net favorable prior period reserve development on professional lines business. This was driven by net favorable development on accident year 2007 and prior, reflecting the incorporation of more of our own claims experience into our loss ratios, with less weighting on our initial expected loss ratios derived from industry benchmarks. This was partially offset by net adverse development on accident year 2008 professional lines business (\$44 million), primarily reflecting higher than expected loss activity on our financial institutions business as a result of the economic downturn and credit crisis.

For the first nine months of 2008 we experienced net favorable prior period reserve development of \$142 million. This included \$65 million of favorable development from credit and political risk line of business, with the balance predominately from our accident years 2006 and 2007 property, marine and aviation lines of business.

Reinsurance Segment:

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For the first nine months of 2009, we experienced \$165 million of net favorable reserve development, the principal components of which were as follows:

\$112 million of net favorable prior period reserve development on property (\$57 million) and catastrophe (\$55 million) lines of business. This development was generated from accident years 2008 (\$69 million), 2007 (\$32 million) and prior (\$11 million), and reflects the recognition of better than expected loss emergence.

\$13 million of net favorable development on accident year 2008 crop reserves reflecting limited reported losses relative to our expectations.

\$51 million of net favorable prior period reserve development on professional lines reinsurance business, predominately generated from accident year 2005 and 2004, reflecting the incorporation of more of our own claims experience into our loss ratios, with less weighting on our initial expected loss ratios derived from industry benchmarks.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****5. RESERVE FOR LOSSES AND LOSS EXPENSES (CONTINUED)**

\$22 million of net adverse development on trade credit and bond reinsurance lines of business. This was driven by adverse development of \$43 million on accident year 2008, reflecting updated loss information received from our cedants this year, partially offset by favorable development on earlier accident years.

\$4 million of net favorable development on motor non-proportional business, primarily relating to better than expected loss experience on our accident year 2007 U.K. business.

For the first nine months of 2008 we experienced net favorable reserve development of \$109 million, the majority of which was generated from accident year 2006 and 2007 property and catastrophe lines of business in recognition of lower than expected claims experience. Favorable development in this period also included reserve reductions of approximately \$21 million on certain specific accident year 2005 property and catastrophe claims.

6. DERIVATIVE INSTRUMENTS

The following table summarizes information on the location and amounts of derivative fair values on the consolidated balance sheet as at September 30, 2009:

| | Notional Amount | Asset Derivatives | | Liability Derivatives | |
|------------------------------------------------------------------------|--------------------|---------------------------|-----------------|---------------------------|-------------------|
| | | Balance Sheet Location | Fair value | Balance Sheet Location | Fair Value |
| Derivatives designated as hedging instruments under FAS 133 | | | | | |
| Foreign exchange contracts | \$ 680,614 | Other assets | \$ 4,728 | Other liabilities | \$ - |
| Derivatives not designated as hedging instruments under FAS 133 | | | | | |
| <i>Relating to investment portfolio:</i> | | | | | |
| Foreign exchange contracts | \$ 8,061 | | \$ - | | \$ 220 |
| <i>Relating to underwriting portfolio:</i> | | | | | |
| Longevity risk derivative | \$ 400,000 | | - | | 228,405 |
| | | Other assets | \$ - | Other liabilities | \$ 228,625 |
| Total derivatives | | | \$ 4,728 | | \$ 228,625 |

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****6. DERIVATIVE INSTRUMENTS (CONTINUED)**

The following table summarizes information on the location and amounts of derivative fair values on the consolidated balance sheet as at December 31, 2008:

| | Notional Amount | Asset Derivatives | | Liability Derivatives | |
|------------------------------------------------------------------------|-----------------|------------------------|------------|------------------------|------------|
| | | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Derivatives designated as hedging instruments under FAS 133 | | | | | |
| Foreign exchange contracts | \$ 469,515 | Other assets | \$ - | Other liabilities | \$ 25,843 |
| Derivatives not designated as hedging instruments under FAS 133 | | | | | |
| <i>Relating to investment portfolio:</i> | | | | | |
| Foreign exchange contracts | \$ 27,293 | | \$ 262 | | \$ - |
| <i>Relating to underwriting portfolio:</i> | | | | | |
| Longevity risk derivative | \$ 400,000 | | - | | 62,597 |
| Currency collar options | | | | | |
| Put options - Long | \$ 83,832 | | 4,841 | | - |
| Call options - Short | \$ 41,916 | | (98) | | - |
| Foreign exchange contracts | \$ 41,916 | | - | | 3,156 |
| Catastrophe-related risk | \$ 50,000 | | - | | 45 |
| | | Other assets | \$ 5,005 | Other liabilities | \$ 65,798 |
| Total derivatives | | | \$ 5,005 | | \$ 91,641 |

For the fair value hierarchy level, refer to Note 4 Fair Value Measurements.

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The following table provides the total unrealized and realized losses recorded in earnings for the three and nine months ended September 30, 2009 and 2008.

| | Location of Gain (Loss) Recognized in Income on Derivative | Amount of Gain (Loss) Recognized in Income on Derivative | | | |
|----------------------------------------------------------------------------|---------------------------------------------------------------|-------------------------------------------------------------|-------------------|---------------------------|--------------------|
| | | Three months ended 2009 | 2008 | Nine months ended 2009 | 2008 |
| Derivatives in FAS 133 Fair Value Hedging Relationships | | | | | |
| Foreign exchange contracts | Net realized investment gains (losses) | \$ (21,154) | \$ 2,803 | \$ (27,801) | \$ 2,803 |
| Derivatives Not Designated as Hedging Instruments under FAS 133 | | | | | |
| <i>Relating to investment portfolio:</i> | | | | | |
| Foreign exchange contracts | Net realized investment gains (losses) | \$ (341) | \$ 1,540 | \$ 668 | \$ 1,112 |
| Mortgage derivatives | Net realized investment gains | - | 336 | - | 413 |
| <i>Relating to underwriting portfolio:</i> | | | | | |
| Longevity risk derivative | Other insurance related losses | (136,000) | (14,000) | (161,000) | (21,444) |
| <i>Currency collar options:</i> | | | | | |
| Put options - Long | Foreign exchange gains (losses) | - | 5,593 | 2,331 | 637 |
| Call options - Short | Foreign exchange gains (losses) | - | 1,714 | 97 | 2,387 |
| Foreign exchange contracts | Foreign exchange gains (losses) | (6,538) | - | (10,429) | - |
| Catastrophe-related risk | Other insurance related income (loss) | - | (345) | 45 | (210) |
| Total | | \$ (142,879) | \$ (5,162) | \$ (168,288) | \$ (17,105) |

Derivative Instruments Designated as a Fair Value Hedge

The hedging relationship foreign currency contracts were entered into to mitigate the foreign currency exposure of two available for sale (AFS) fixed maturity portfolios and short term investments denominated in Euros. The hedges were designated and qualified as a fair value hedge. The net impact of the hedges is recognized in net realized investment losses.

The following table provides the net earnings impact of the fair value hedges:

| | Three months ended | | Nine months ended | |
|-----------------------------|--------------------|----------|-------------------|----------|
| | 2009 | 2008 | 2009 | 2008 |
| Foreign exchange contracts | \$ (21,154) | \$ 2,803 | \$ (27,801) | \$ 2,803 |
| Hedged investment portfolio | 19,738 | (3,991) | \$ 26,480 | (3,991) |

| | | | | |
|-----------------------------------------------------|-------------------|-------------------|-------------------|-------------------|
| Hedge ineffectiveness recognized in earnings | \$ (1,416) | \$ (1,188) | \$ (1,321) | \$ (1,188) |
|-----------------------------------------------------|-------------------|-------------------|-------------------|-------------------|

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

6. DERIVATIVE INSTRUMENTS (CONTINUED)

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. Through our external investment managers, we entered into foreign currency forward contracts to manage the effect of this foreign currency risk. These foreign currency hedging activities by our investment managers have not been designated as specific hedges for financial reporting purposes.

Mortgage derivatives are commonly referred as to-be-announced mortgage-backed securities and are accounted for as derivatives. As part of our investment strategy, we may from time to time invest in mortgage derivatives.

b) Relating to underwriting portfolio

Longevity risk

In September 2007, we issued a policy which indemnifies a third party in the event of a non-payment of a \$400 million asset-backed note (Note). This security has a 10 year term with the full principal amount due at maturity and is collateralized by a portfolio of life settlement contracts and cash held by a special purpose entity (SPE). We have concluded that the indemnity contract was a derivative instrument and accordingly we have recorded it at its fair value (see Note 4 Derivative Instruments).

Through the issuance of our indemnity contract, we hold a significant implicit variable interest in the SPE and have concluded that the Company is not its primary beneficiary. To make this determination, we identified all significant creators of volatility generated from the SPE, which are longevity and interest rate risks, and the variable interests of the SPE. We absorbed the downside longevity risk up to an aggregate limit of \$400 million; whereas, the insured party absorbed the tail end of the longevity downside risk and the upside risk as well as the majority of the downside and upside of the interest rate risk. In accordance with accounting standards for the consolidation of variable interest entities, we calculated the expected losses and expected residual returns using cash flow scenario modeling to determine which party absorbed the majority of the expected losses. Based on these quantitative analyses and other qualitative factors, we concluded that the insured party was the primary beneficiary. The determination of the primary beneficiary required significant management judgment.

Foreign currency risk

Our insurance and reinsurance subsidiaries and branches operate in various foreign countries and consequently our underwriting portfolio is exposed to significant foreign currency risk. We manage foreign currency risk by seeking to match our liabilities under insurance and reinsurance policies that are payable in foreign currencies with cash and investments that are denominated in such currencies. When necessary, we may also use derivatives to economically hedge un-matched foreign currency exposures, specifically forward contracts and currency options.

Catastrophe-related risk

During 2006, we entered into a \$100 million Total Return Swap Facility (the Facility) with a financial institution for the purpose of accessing and isolating natural peril exposures embedded in capital market instruments. We utilized half of the Facility to enter into a \$50 million catastrophe-related total return swap transaction to assume losses from qualifying earthquake events. As a result of this swap, the Facility was collateralized by a lien over a portfolio of the Company s investment grade securities. During 2009, we earned payments on the swap, net of the Facility fee, which are included in other insurance related income. The catastrophe-related total return swap expired with no loss and the Facility terminated during the quarter.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****7. STOCK-BASED COMPENSATION**

Prior to 2009, restricted stock or restricted stock units (RSUs) awards were generally subject to a three year cliff vesting period after the date of grant or upon the employee's retirement eligibility, death, permanent disability or a qualifying change in control of the Company, if earlier. The restricted stock and RSUs granted in 2009 are subject to a vesting period of four years with 25% of the award to be vested annually and has the same accelerated vesting provisions as noted above, excluding the vesting on the employee's retirement eligibility.

The following table provides a reconciliation of the beginning and ending balance of nonvested restricted stock and RSUs for the nine months ended September 30, 2009:

| | Number of Shares | Weighted Average Grant Date Fair Value |
|--------------------------------------------------------|-----------------------------|-----------------------------------------------------------|
| Nonvested restricted stock - January 1, 2009 | 5,163 | \$ 34.66 |
| Granted | 1,267 | 26.36 |
| Vested | (1,595) | 32.35 |
| Forfeited | (80) | 35.27 |
| Nonvested restricted stock - September 30, 2009 | 4,755 | \$ 33.27 |

At September 30, 2009, we had 4,755 nonvested restricted stock outstanding, including 167 RSUs. For the three months ended September 30, 2009 and 2008, we incurred share-based compensation costs of \$12 million and \$18 million, respectively, and recorded tax benefits thereon of \$1 million and \$2 million. For the nine months ended September 30, 2009 and 2008, we incurred share-based compensation costs of \$38 million and \$47 million, respectively, and recorded tax benefits thereon of \$5 million and \$6 million. The total grant-date fair value of shares vested during the three months ended September 30, 2009 and 2008 were negligible. The total grant-date fair value of shares vested during the nine months ended September 30, 2009 and 2008 were \$52 million and \$23 million, respectively.

At September 30, 2009 and December 31, 2008, there was \$76 million and \$84 million, respectively, of unrecognized share-based compensation costs, which are expected to be recognized over the weighted average period of 2.5 years and 2.4 years, respectively.

Table of Contents**AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****8. EARNINGS PER COMMON SHARE**

The following table sets forth the comparison of basic and diluted earnings per common share:

| | At and for the three months ended September 30, | | At and for the nine months ended September 30, | |
|------------------------------------------------------|----------------------------------------------------|--------------|---------------------------------------------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| Basic earnings per common share | | | | |
| Net income (loss) available to common shareholders | \$ (95,892) | \$ (249,346) | \$ 178,948 | \$ 219,643 |
| Weighted average common shares outstanding | 137,904 | 139,335 | 137,693 | 141,628 |
| Basic earnings per common share | \$ (0.70) | \$ (1.79) | \$ 1.30 | \$ 1.55 |
| Diluted earnings per common share | | | | |
| Net income (loss) available to common shareholders | \$ (95,892) | \$ (249,346) | \$ 178,948 | \$ 219,643 |
| Weighted average common shares outstanding | 137,904 | 139,335 | 137,693 | 141,628 |
| Share equivalents: | | | | |
| Warrants | - | - | 10,328 | 12,600 |
| Restricted stock | - | - | 1,529 | 1,591 |
| Options | - | - | 695 | 1,496 |
| Restricted stock units | - | - | 13 | - |
| Weighted average common shares outstanding - diluted | 137,904 | 139,335 | 150,258 | 157,315 |
| Diluted earnings per common share | \$ (0.70) | \$ (1.79) | \$ 1.19 | \$ 1.40 |

For the nine months ended September 30, 2009, there were 1,008,487 (2008: 818,711) restricted shares, 1,262,945 (2008: nil) options and 54,667 (2008: nil) restricted stock units, which would have resulted in the issuance of common shares that were excluded in the computation of diluted earnings per share because the effect would be anti-dilutive.

Due to the net loss incurred in the three months ended September 30, 2009 and 2008, all the share equivalents were anti-dilutive.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

9. COMMITMENTS AND CONTINGENCIES

a) Legal Proceedings

Except as noted below, we are not a party to any material 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. In our opinion, the eventual outcome of these legal proceedings is not expected to have a material adverse effect on our financial condition or results of operations.

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. We believe that the lawsuit is completely without merit and we continue to vigorously defend the filed action.

b) Dividends for Common Shares and Preferred Shares

On September 18, 2009 the Board of Directors declared a dividend of \$0.20 per common share to shareholders of record at September 30, 2009, which was payable on October 15, 2009. The Board of Directors also declared a dividend of \$0.453125 per Series A 7.25% Preferred Share and a dividend of \$1.875 per Series B 7.5% Preferred Share. The Series A Preferred Share dividend was payable on October 15, 2009, to shareholders of record at the close of business on September 30, 2009 and the Series B Preferred Share dividend is payable on December 1, 2009, to shareholders of record at the close of business on November 13, 2009.

c) Reinsurance Purchase Commitment

We purchased reinsurance coverage for our insurance lines of business. The minimum reinsurance premiums are contractually due on a quarterly basis in advance. Accordingly at September 30, 2009, we have an outstanding reinsurance purchase commitment of \$94 million.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of our financial condition and results of operations. This should be read in conjunction with the Consolidated Financial Statements and related notes included in Item 1 of this report and also our Management's Discussion and Analysis of Results of Operations and Financial Condition contained in our Annual Report on Form 10-K for the year ended December 31, 2008. Tabular dollars are in thousands, except per share amounts. Amounts in tables may not reconcile due to rounding differences.

FINANCIAL MEASURES

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

Return on average common equity (ROACE): ROACE represents the level of net income available to common shareholders generated from the average of the opening and closing common shareholders' equity during the period. Our objective is to generate superior returns on capital that appropriately reward common shareholders for the risks we assume and to grow revenue only when we deem the returns meet or exceed our requirements. Although we recognize that the underwriting cycle is such that short-term excess profitability may be difficult to achieve, our current objective is to achieve an average ROACE of 15% or greater over the underwriting cycles.

ROACE was (8.2%) and 5.4% for the three and nine months ended September 30, 2009, respectively, compared to (22.5%) and 6.7% for the same periods in 2008. The return for the current quarter was impacted by net realized investment losses of \$253 million and an increase in the fair value liability of an insurance derivative contract of \$136 million. The results otherwise benefited from low catastrophe activity and higher net investment income relative to the prior year quarter. The return in the third quarter of 2008 was impacted by, among other things, losses incurred on Hurricanes Ike and Gustav of \$386 million (net of related earned reinstatement premium) and net realized investment losses of \$89 million. For further analysis, refer to the *Results of Operations Overview*, below.

Diluted book value per common share: Diluted book value per common share represents total common shareholders' equity divided by the number of common shares and diluted common share equivalents outstanding, using the treasury stock method. We consider diluted book value per common share an appropriate measure of the return to common shareholders, as we believe growth in book value on a diluted basis ultimately translates into growth in stock price.

Diluted book value per common share increased 22.5% from \$25.79 at December 31, 2008 to \$31.58 at September 30, 2009. The increase was primarily due to a decrease in unrealized losses on our investment portfolio of \$793 million together with net income available to common shareholders in the first nine months of 2009 of \$179 million. During the year we recorded other than temporary impairments (OTTI) charges on our investment portfolio of \$331 million, which reduced net income available to common shareholders but also contributed to the above reduction in the net unrealized loss position.

Cash dividends per common share: Dividend policy is an integral part of the value we create for shareholders. The quarterly cash dividend was \$0.20 per common share in the first three quarters of 2009 compared to \$0.185 in the first three quarters of 2008. The Board of Directors reviews

dividend policy on a regular basis and in December 2008, they authorized an 8% increase in quarterly dividend.

Table of Contents**RESULTS OF OPERATIONS OVERVIEW**

The table below breaks net income into three components: underwriting income, investment income and net realized gains/losses, and other revenues and expenses. Underwriting income on a segment basis is a measure of underwriting profitability that takes into account net premiums earned and other insurance related income as revenue and net losses and loss expenses, acquisition costs and underwriting related general and administrative costs as expenses.

Underwriting income is the difference between these revenue and expense items. Our investment portfolio is managed on a total return basis and we have therefore reviewed investment income and net realized gains/losses together. Other revenues and expenses represent corporate expenses, foreign exchange gains/losses, interest expense and income tax expense.

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|-----------------------------------------------------------|----------------------------------|--------------|---------------------|---------------------------------|--------------|-------------------|
| | 2009 | Change % | 2008 | 2009 | Change % | 2008 |
| Underwriting income (loss): | | | | | | |
| Insurance | \$ (53,787) | (144%) | \$ (22,081) | \$ (1,748) | nm | \$ 90,643 |
| Reinsurance | 125,138 | nm | (164,346) | 310,866 | nm | 523 |
| Net investment income and net realized gains/losses | (118,577) | (208%) | (38,496) | 28,660 | (87%) | 221,407 |
| Other revenues and expenses | (39,448) | (159%) | (15,205) | (131,174) | (101%) | (65,274) |
| Net income (loss) | (86,674) | 64% | (240,128) | 206,604 | (16%) | 247,299 |
| Preferred share dividends | (9,218) | - | (9,218) | (27,656) | - | (27,656) |
| Net income (loss) available to common shareholders | \$ (95,892) | (62%) | \$ (249,346) | \$ 178,948 | (19%) | \$ 219,643 |

nm not meaningful

Underwriting Results

Total underwriting income for the three and nine months ended September 30, 2009 was \$71 million and \$309 million, respectively, compared to an underwriting loss of \$186 million and underwriting income of \$91 million in the respective periods of 2008.

Underwriting income in our insurance segment for the three and nine months ended September 30, 2009 decreased \$32 million and \$92 million, respectively over the same periods of 2008. These decreases were driven by an increase in the fair value liability of an insurance derivative contract of \$136 million for the quarter and \$161 million for the year to date. In addition, our insurance segment was impacted by higher current accident year loss activity on its credit and political risk business this year. Underwriting results for the quarter did however benefit from a lower level of catastrophe activity relative to the prior year quarter, which included losses incurred on Hurricanes Ike and Gustav of \$115 million. Our insurance segment also experienced a lower frequency and severity of property losses over the year to date.

Underwriting income in our reinsurance segment for the three and nine months ended September 30, 2009 increased \$289 million and \$310 million, respectively over the same periods of 2008. These increases were driven by a lower level of catastrophe losses relative to the prior year, which included losses incurred on Hurricanes Ike and Gustav of \$271 million, net of related earned reinstatement premium. The increase in underwriting income for the quarter and year to date also reflects additional net favorable prior period reserve development versus the prior year periods of \$32 million and \$56 million, respectively. These factors were partially offset by increased loss activity on trade credit and bond

reinsurance business this year.

For further discussion of underwriting results refer to the *Underwriting Results* sections below.

Table of Contents**Investment Results**

Total net investment income and net realized investment gains/losses for the three and nine months ended September 30, 2009, decreased \$80 million and \$193 million, respectively, compared to the same periods in 2008. The reduction in the quarter was driven by an increase in net realized investment losses (\$164 million) and lower investment income on fixed maturities and cash and cash equivalents (\$20 million), partially offset by higher income from other investments (\$105 million). The increase in net realized investment losses this quarter was driven by OTTI charges from medium-term notes (MTNs) in the fixed maturity portfolio.

For the nine months ended September 30, 2009, the reduction in income primarily reflects an increase in net realized investment losses (\$266 million), lower investment income on fixed maturities and cash and cash equivalents (\$59 million), partially offset by increased income from other investments (\$140 million).

For further discussion and analysis of investment results, refer to the *Investment Income* section below.

Other Revenues and Expenses

Other revenues and expenses were as follows:

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---------------------------------|----------------------------------|---------------|------------------|---------------------------------|---------------|------------------|
| | | % | | | % | |
| | 2009 | Change | 2008 | 2009 | Change | 2008 |
| Corporate expenses | \$ 17,605 | 12% | \$ 19,995 | \$ 51,941 | (1%) | \$ 51,291 |
| Foreign exchange losses (gains) | 6,784 | nm | (7,627) | 30,579 | nm | (21,360) |
| Interest expense | 7,977 | - | 7,941 | 23,869 | - | 23,789 |
| Income tax expense (benefit) | 7,082 | nm | (5,104) | 24,785 | (115%) | 11,554 |
| Total | \$ 39,448 | (159%) | \$ 15,205 | \$ 131,174 | (101%) | \$ 65,274 |

nm not meaningful

Corporate expenses: 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 2.5% for the three and nine months ended September 30, 2009, compared to 2.9% and 2.5% for the same periods in 2008.

Foreign exchange gains/losses: Some of our business is written in currencies other than U.S. dollars. The foreign exchange loss for the third quarter of 2009 was principally due to the remeasurement of net liability balances denominated in Euro, following its appreciation against the U.S. dollar during the period. In comparison, the Euro depreciated against the U.S. dollar during the third quarter of 2008 driving the foreign exchange gain in this period.

Income tax expense: Income tax is generated primarily through our operations in the U.S. and Europe. The effective tax rate, which is calculated as income tax expense/benefit divided by income (loss) before income tax, was (8.9%) and 10.7% for the three and nine months ended September 30, 2009, compared to 2.1% and 4.5% in the same periods of 2008. The effective tax rate may vary between periods depending on the distribution of net income or losses among our various taxable jurisdictions.

In the current quarter, our U.S. subsidiaries generated net income, while our Bermuda and European subsidiaries recorded net losses, which resulted in an overall tax expense for the quarter. Significant to the third quarter of 2008 was the establishment of a full valuation allowance against net deferred tax assets arising from U.S. realized capital losses and investment impairments arising during the quarter. Apart from this specific item, both our U.S. and European subsidiaries reported taxable losses as a result of large loss activity in the third quarter of 2008. The increase in our effective tax rate over the year to date was primarily due to an increase in the portion of total income generated by our U.S. subsidiaries in 2009 versus 2008.

Table of Contents**UNDERWRITING RESULTS GROUP**

The following table provides group underwriting results for the periods indicated:

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|--------------------------------------------------|----------------------------------|-----------|---------------------|---------------------------------|-------------|------------------|
| | 2009 | Change % | 2008 | 2009 | Change % | 2008 |
| Revenues: | | | | | | |
| Gross premiums written | \$ 775,314 | 7% | \$ 725,283 | \$ 3,013,450 | 5% | \$ 2,863,633 |
| Net premiums written | 595,144 | 8% | 551,416 | 2,458,458 | 6% | 2,327,407 |
| Net premiums earned | 706,025 | 2% | 689,970 | 2,078,154 | 2% | 2,028,895 |
| Other insurance related loss | (135,738) | nm | (13,806) | (159,394) | nm | (19,073) |
| Expenses: | | | | | | |
| Current year net losses and loss expenses | (433,208) | | (781,802) | (1,380,535) | | (1,690,055) |
| Prior period reserve development | 122,099 | | 76,271 | 303,175 | | 251,126 |
| Acquisition costs | (113,423) | | (90,333) | (318,708) | | (282,593) |
| General and administrative expenses | (74,404) | | (66,727) | (213,574) | | (197,134) |
| Underwriting income (loss) ⁽¹⁾ | \$ 71,351 | nm | \$ (186,427) | \$ 309,118 | 239% | \$ 91,166 |

nm not meaningful

(1) Refer to Item 1, Note 2 - Segment Information to the Consolidated Financial Statements, for a reconciliation of underwriting income to net income available to common shareholders for the periods indicated above.

UNDERWRITING REVENUES

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

| | Gross Premiums Written | | | | | |
|--------------|----------------------------------|-----------|-------------------|---------------------------------|-----------|---------------------|
| | Three months ended September 30, | | | Nine months ended September 30, | | |
| | 2009 | Change % | 2008 | 2009 | Change % | 2008 |
| Insurance | \$ 413,922 | 3% | \$ 402,672 | \$ 1,304,844 | (6%) | \$ 1,392,993 |
| Reinsurance | 361,392 | 12% | 322,611 | 1,708,606 | 16% | 1,470,640 |
| Total | \$ 775,314 | 7% | \$ 725,283 | \$ 3,013,450 | 5% | \$ 2,863,633 |

% ceded

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| | | | | | | |
|--------------|------------|-------------|------------|------------|-------------|------------|
| Insurance | 42% | - | 42% | 41% | 4% | 37% |
| Reinsurance | 2% | - | 2% | 1% | - | 1% |
| Total | 23% | (1%) | 24% | 18% | (1%) | 19% |

Net Premiums Written

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|--------------|----------------------------------|-----------|-------------------|---------------------------------|-----------|---------------------|
| | 2009 | Change | 2008 | 2009 | Change | 2008 |
| Insurance | \$ 239,781 | 2% | \$ 235,666 | \$ 764,932 | (12%) | \$ 872,909 |
| Reinsurance | 355,363 | 13% | 315,750 | 1,693,526 | 16% | 1,454,498 |
| Total | \$ 595,144 | 8% | \$ 551,416 | \$ 2,458,458 | 6% | \$ 2,327,407 |

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The growth in consolidated gross premium written in the quarter and year to date was primarily driven by rate increases and growth opportunities within several reinsurance lines of business. In our insurance segment, market conditions have generally improved this year and the segment also benefited from growth opportunities within professional lines business. However, gross premiums written in 2009 were reduced by limited underwriting opportunities for credit and political risk business, as well as our decision to reduce peak zone catastrophe exposures, which particularly impacted our property related lines in the first half of this year.

Premiums Earned: Net premiums earned by segment were as follows:

| | Three months ended September 30, | | | Nine months ended September 30, | | | | | | |
|--------------|----------------------------------|-------------|-------------------|---------------------------------|-----------|---------------------|-------------|---------------------|-------------|-----------|
| | % | | | % | | | | | | |
| | 2009 | 2008 | Change | 2009 | 2008 | Change | | | | |
| Insurance | \$ 278,637 | 39% | \$ 293,572 | 43% | (5%) | \$ 853,235 | 41% | \$ 890,558 | 44% | (4%) |
| Reinsurance | 427,388 | 61% | 396,398 | 57% | 8% | 1,224,919 | 59% | 1,138,337 | 56% | 8% |
| Total | \$ 706,025 | 100% | \$ 689,970 | 100% | 2% | \$ 2,078,154 | 100% | \$ 2,028,895 | 100% | 2% |

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. Overall, consolidated net premiums earned in 2009 benefited from growth of the reinsurance segment this year, as discussed above. Net premiums earned in the insurance segment decreased during 2009, driven by exposure reductions over the last year.

UNDERWRITING EXPENSES

The following table provides a breakdown of our combined ratio:

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---------------------------------------------------------|----------------------------------|----------------|---------------|---------------------------------|----------------|--------------|
| | Point | | | Point | | |
| | 2009 | Change | 2008 | 2009 | Change | 2008 |
| Current year | 61.4% | (51.9%) | 113.3% | 66.4% | (16.9%) | 83.3% |
| Prior period reserve development | (17.3%) | (6.3%) | (11.0%) | (14.6%) | (2.2%) | (12.4%) |
| Acquisition cost ratio | 16.1% | 3.0% | 13.1% | 15.4% | 1.5% | 13.9% |
| General and administrative expense ratio ⁽¹⁾ | 13.0% | 0.4% | 12.6% | 12.8% | 0.6% | 12.2% |
| Combined ratio | 73.2% | (54.8%) | 128.0% | 80.0% | (17.0%) | 97.0% |

(1) The general and administration expense ratio includes corporate expenses not allocated to underwriting segments of 2.5% for the three and nine months ended September 30, 2009, and 2.9% and 2.5% for the three and nine months ended September 30, 2008, respectively. These costs are discussed further in the *Other Revenue and Expenses* section, above.

Table of Contents***Loss ratio:*****Current Year Loss Ratio:**

The 51.9 point reduction in our current year loss ratio was driven by lower catastrophe activity relative to the third quarter of 2008 which included net losses incurred on Hurricanes Gustav and Ike of \$407 million, or 59.0 points. This was partially offset by higher claims activity on crop and trade credit and bond reinsurance business and credit and political risk insurance business.

For the year to date, our consolidated current year loss ratio primarily benefited from lower catastrophe related losses. In particular Hurricanes Gustav and Ike contributed 20.1 points to the 2008 accident year loss ratio. We also experienced a lower frequency and severity of property related losses impacting our insurance segment relative to the prior year. These factors were partially offset by additional loss activity on credit related insurance and reinsurance lines of business.

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

Prior Period Reserve Development:

The following tables provide a breakdown of prior period reserve development for the periods indicated:

| | Three months ended September 30, | | Nine months ended September 30, | |
|--------------|----------------------------------|------------------|---------------------------------|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Insurance | \$ 55,401 | \$ 41,608 | \$ 138,167 | \$ 142,294 |
| Reinsurance | 66,698 | 34,663 | 165,008 | 108,832 |
| Total | \$ 122,099 | \$ 76,271 | \$ 303,175 | \$ 251,126 |

Insurance Segment:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---------------------------------------|----------------------------------|------------------|---------------------------------|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Property and all other ⁽¹⁾ | \$ 16,434 | \$ 41,340 | \$ 81,695 | \$ 153,315 |
| Liability | 284 | 868 | 14,628 | (668) |
| Professional lines | 38,683 | (600) | 41,844 | (10,353) |
| Total | \$ 55,401 | \$ 41,608 | \$ 138,167 | \$ 142,294 |

(1) All other includes marine, terrorism, aviation, and credit and political risk lines of business.

We experienced \$55 million of net favorable prior period reserve development in the third quarter of 2009, the principal components of which were as follows:

\$9 million of net favorable prior period reserve development on property lines of business. This development was primarily generated from accident year 2008 and reflects the recognition of better than expected loss emergence.

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\$39 million of net favorable prior period reserve development on professional lines business. This was driven by net favorable development on accident year 2005, and to a lesser extent accident years 2004 and 2006, reflecting the incorporation of more of our own claims experience into our loss ratios, with less weighting on our initial expected loss ratios derived from industry benchmarks. This was partially offset by net adverse development on accident year 2008 professional lines business (\$8 million), primarily reflecting higher than expected loss activity on our financial institutions business as a result of the economic downturn and credit crisis.

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We experienced \$42 million of net favorable prior period reserve development in the third quarter of 2008, the principal components of which were as follows:

\$14 million of favorable development from accident year 2005 energy offshore line of business. This included the favorable settlement of a large hurricane related claim against our original case reserve estimate.

\$10 million of favorable development from our aviation lines of business, predominately from accident year 2005. The favorable development was partially due to a reduction in our aerospace reserves following an assessment of our remaining exposures. In addition, claims experience on other aviation lines has been better than expected, particularly on pro-rata business.

\$5 million of favorable development from the accident year 2006 sovereign and corporate credit portion of our credit and political risk line of business. This was partially in recognition of lower than expected incurred loss activity on this accident year and also due to a change in development profile. Following an actuarial review earlier this year, we began to use a more accelerated development profile.

Net adverse development of \$1 million from professional lines business. This included adverse development of \$22 million from accident year 2007 IBNR reserves offset by favorable reserve development of \$21 million from accident years 2004 and prior.

The balance of favorable reserve development in the third quarter of 2008 was predominately derived from property lines of business, largely generated from our accident year 2007 (\$10 million) and 2006 accident year (\$5 million) reserves. This was in recognition of limited late reporting of losses as well as minimal deterioration on previously reported claims on these lines.

For the first nine months of 2009, we experienced \$138 million of net favorable reserve development, the principal components of which were as follows:

\$76 million of net favorable prior period reserve development on property (\$44 million), marine (\$28 million) and aviation (\$4 million) lines of business. This development was generated from accident years 2008 (\$49 million), 2007 (\$10 million) and 2006 (\$17 million).

\$15 million of net favorable reserve development on liability lines of business generated across accident years 2004-2008 and driven primarily by the incorporation of more of our own actual experience with respect to reinsurance recoveries on our Excess & Surplus (E&S) umbrella lines.

\$42 million of net favorable reserve development on professional lines business, which included \$86 million of net favorable reserve development on accident years 2007 and prior, offset by net adverse development of \$44 million on accident year 2008.

For the first nine months of 2008 we experienced net favorable prior period reserve development of \$142 million. This included \$65 million of favorable development from credit and political risk line of business, with the balance predominately from accident years 2006 and 2007 property, marine and aviation lines of business.

Table of ContentsReinsurance Segment:

| | Three months ended September 30, | | Nine months ended September 30, | |
|-----------------------------------|----------------------------------|------------------|---------------------------------|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Catastrophe, property and other | \$ 42,522 | \$ 42,412 | \$ 129,874 | \$ 117,694 |
| Credit and bond, motor, liability | (6,244) | (3,716) | (15,942) | (4,383) |
| Professional lines | 30,420 | (4,033) | 51,076 | (4,479) |
| Total | \$ 66,698 | \$ 34,663 | \$ 165,008 | \$ 108,832 |

We experienced \$67 million of net favorable prior period reserve development in the third quarter of 2009, the principal components of which were as follows:

\$30 million of net favorable prior period reserve development on property (\$21 million) and catastrophe (\$9 million) lines of business, the majority of which have short tail exposures. This development was generated from accident years 2008 (\$17 million), 2007 (\$8 million) and prior (\$5 million). The favorable development on these lines reflects the recognition of better than expected loss emergence.

\$11 million of net favorable development on accident year 2008 crop reserves reflecting limited reported losses relative to our expectations.

\$30 million of net favorable prior period reserve development on professional lines reinsurance business, predominately generated from accident year 2005 and 2004. The favorable development reflects the incorporation of more of our own claims experience into our loss ratios, with less weighting on our initial expected loss ratios derived from industry benchmarks.

\$8 million of net adverse development on accident year 2008 credit and bond business, primarily reflecting updated loss information from our large credit insureds.

We experienced \$35 million of net favorable prior period reserve development in the third quarter of 2008, the principal components of which were as follows:

\$42 million of net favorable prior period reserve development on property (\$31 million) and catastrophe (\$11 million) lines of business. This development was generated from accident years 2007 (\$23 million), 2006 (\$8 million), 2005 (\$10 million) and prior (\$1 million). The favorable development on these lines primarily reflected the recognition of better than expected loss emergence. In addition, accident year 2005 included \$9 million of favorable development in connection with the reduction of a specific hurricane related claim.

Net adverse development of \$4 million from professional lines business. This included adverse development of \$11 million from accident year 2007 reserves partially offset by favorable development of \$8 million from our accident year 2003 and 2004 reserves.

Adverse development of \$4 million on credit and bond lines of business, predominately from accident year 2007.

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For the first nine months of 2009, we experienced \$165 million of net favorable reserve development, the principal components of which were as follows:

\$112 million of net favorable prior period reserve development on property (\$57 million) and catastrophe (\$55 million) lines of business. This development was generated from accident years 2008 (\$69 million), 2007 (\$32 million) and prior (\$11 million).

\$13 million of net favorable development on crop reserves, predominately from accident year 2008.

\$51 million of net favorable prior period reserve development on professional lines reinsurance business, predominately generated from accident year 2005 and 2004.

\$22 million of net adverse development on credit and bond reinsurance lines of business. This was driven by adverse development of \$43 million on accident year 2008, reflecting updated loss information received from our cedants this year, partially offset by favorable development on earlier accident years.

\$4 million of net favorable development on motor non-proportional business, primarily relating to better than expected loss experience on our accident year 2007 U.K. business.

For the first nine months of 2008 we experienced net favorable reserve development of \$109 million, the majority of which was generated from accident year 2006 and 2007 property and catastrophe lines of business in recognition of lower than expected claims experience. Favorable development in this period also included reserve reductions of approximately \$21 million on certain specific accident year 2005 property and catastrophe claims.

Acquisition cost ratio: The 3.0 ratio point increase in our acquisition cost ratio reflects increased costs in both our segments this quarter. In the insurance segment, this was primarily due to lower ceding commissions relative to the prior year quarter, which had the non recurring benefit of adjustments to sliding scale commissions. In the reinsurance segment, the increase in acquisition costs this quarter reflects both changes in business mix and growth in lines with higher acquisition costs.

Table of Contents**UNDERWRITING RESULTS BY SEGMENT****INSURANCE SEGMENT**

Results from the insurance segment were as follows:

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|-------------------------------------------|----------------------------------|---------------|--------------------|---------------------------------|-------------|------------------|
| | 2009 | % Change | 2008 | 2009 | % Change | 2008 |
| Revenues: | | | | | | |
| Gross premiums written | \$ 413,922 | 3% | \$ 402,672 | \$ 1,304,844 | (6%) | \$ 1,392,993 |
| Net premiums written | 239,781 | 2% | 235,666 | 764,932 | (12%) | 872,909 |
| Net premiums earned | 278,637 | (5%) | 293,572 | 853,235 | (4%) | 890,558 |
| Other insurance related loss | (135,898) | nm | (13,751) | (160,659) | nm | (20,073) |
| Expenses: | | | | | | |
| Current year net losses and loss expenses | (166,629) | | (272,185) | (589,310) | | (692,017) |
| Prior period reserve development | 55,401 | | 41,608 | 138,167 | | 142,294 |
| Acquisition costs | (29,613) | | (21,964) | (84,122) | | (84,798) |
| General and administrative expenses | (55,685) | | (49,361) | (159,059) | | (145,321) |
| Underwriting income (loss) | \$ (53,787) | (144%) | \$ (22,081) | \$ (1,748) | nm | \$ 90,643 |

| | Point | | | Point | | |
|----------------------------------|--------------|----------------|---------------|--------------|---------------|--------------|
| | Change | | | Change | | |
| Ratios: | | | | | | |
| Current year loss ratio | 59.8% | (32.9%) | 92.7% | 69.1% | (8.6%) | 77.7% |
| Prior period reserve development | (19.9%) | (5.7%) | (14.2%) | (16.2%) | (0.2%) | (16.0%) |
| Acquisition cost ratio | 10.6% | 3.1% | 7.5% | 9.9% | 0.3% | 9.6% |
| General and administrative ratio | 20.0% | 3.2% | 16.8% | 18.6% | 2.3% | 16.3% |
| Combined ratio | 70.5% | (32.3%) | 102.8% | 81.4% | (6.2%) | 87.6% |

nm not meaningful

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

| | Three months ended September 30, | | | | | Nine months ended September 30, | | | | |
|-----------|----------------------------------|-----|------------|-----|-------------|---------------------------------|-----|------------|-----|-------------|
| | 2009 | | 2008 | | % Change | 2009 | | 2008 | | % Change |
| Property | \$ 147,117 | 35% | \$ 137,417 | 34% | 7% | \$ 429,676 | 33% | \$ 439,725 | 32% | (2%) |
| Marine | 45,765 | 11% | 41,121 | 10% | 11% | 168,249 | 13% | 170,609 | 12% | (1%) |
| Terrorism | 7,861 | 2% | 7,112 | 2% | 11% | 23,693 | 2% | 30,073 | 2% | (21%) |
| Aviation | 11,098 | 3% | 11,735 | 3% | (5%) | 35,341 | 3% | 37,936 | 3% | (7%) |

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| | | | | | | | | | | |
|---------------------------|-------------------|-------------|------------|------|--------|---------------------|-------------|--------------|------|--------------|
| Credit and political risk | (3,902) | (1%) | 24,817 | 6% | (116%) | 2,811 | - | 145,029 | 11% | (98%) |
| Professional lines | 155,382 | 38% | 137,553 | 34% | 13% | 487,127 | 37% | 420,929 | 30% | 16% |
| Liability | 50,601 | 12% | 42,833 | 11% | 18% | 157,918 | 12% | 145,162 | 10% | 9% |
| Other | - | - | 84 | - | nm | 29 | - | 3,530 | - | nm |
| Total | \$ 413,922 | 100% | \$ 402,672 | 100% | 3% | \$ 1,304,844 | 100% | \$ 1,392,993 | 100% | (6%) |

nm not meaningful

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The increase in gross premiums written this quarter was primarily driven by growth opportunities in professional lines business, most of which related to coverage for directors and officers liability in the U.S. Gross premiums written this quarter also benefited from the maturing of certain property and liability programs, having established this business with managing general agents and other producers in prior periods. This growth was partially offset by a reduction in credit and political risk business this quarter, reflecting limited underwriting opportunities within the weakened global economy.

For the year to date, the decrease in gross premiums written primarily reflects the reduction in credit and political risk business, as discussed above. Gross premiums were also impacted by our decision to reduce peak zone catastrophe exposures in property and marine lines of business this year as part of our ongoing diversification strategy within these lines. These factors were partially offset by a general improvement in rates this year, particularly for more volatile, loss-affected lines such as those with catastrophe exposure, energy and financial institutions business. In addition, we have also benefited from significant opportunities within professional lines business this year.

Premiums Ceded: Premiums ceded in the third quarter of 2009 were \$174 million, or 42% of gross premiums written, compared with \$167 million, or 42%, in the same period of 2008. For the first nine months of 2009, premiums ceded were \$540 million, or 41% of gross premiums written, compared to \$520 million, or 37%, in the same period of 2008. The increase in ceded premium ratios this year primarily reflects a combination of business mix changes and rate increases on our property reinsurance program.

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

| | Three months ended September 30, | | | | | | Nine months ended September 30, | | | | | |
|---------------------------|----------------------------------|-------------|-------------------|-------------|-------------|-------------------|---------------------------------|-------------------|-------------|-------------|--|--|
| | 2009 | | 2008 | | % Change | 2009 | | 2008 | | % Change | | |
| Property | \$ 64,624 | 23% | \$ 83,841 | 29% | (23%) | \$ 200,109 | 24% | \$ 247,589 | 28% | (19%) | | |
| Marine | 33,776 | 12% | 33,480 | 11% | 1% | 102,307 | 12% | 113,645 | 13% | (10%) | | |
| Terrorism | 7,705 | 3% | 10,407 | 3% | (26%) | 26,179 | 3% | 32,940 | 4% | (21%) | | |
| Aviation | 15,599 | 6% | 16,945 | 6% | (8%) | 46,436 | 5% | 49,672 | 5% | (7%) | | |
| Credit and political risk | 33,739 | 12% | 41,784 | 14% | (19%) | 133,434 | 16% | 108,846 | 12% | 23% | | |
| Professional lines | 101,314 | 36% | 83,851 | 29% | 21% | 283,440 | 33% | 250,587 | 28% | 13% | | |
| Liability | 21,881 | 8% | 21,517 | 7% | 2% | 61,237 | 7% | 77,139 | 9% | (21%) | | |
| Other | (1) | - | 1,747 | 1% | nm | 93 | - | 10,140 | 1% | nm | | |
| Total | \$ 278,637 | 100% | \$ 293,572 | 100% | (5%) | \$ 853,235 | 100% | \$ 890,558 | 100% | (4%) | | |

nm not meaningful

The decrease in net premiums earned in the quarter and year to date follows a reduction of 14% in net premiums written in the rolling twelve months ending September 30, 2009 versus the twelve months ending September 30, 2008. However, the reduction in net premiums earned during 2009 has been less than the aforementioned reduction in net premiums written. This is partially due to the earning of credit and political risk business written in prior years, which typically provides multi-year coverage, and therefore earns over a greater number of periods. The average duration of the unearned premium on credit and political risk line of business at September 30, 2009 was 5.0 years. Net premiums earned on credit and political risk business for the first nine months of 2009 also includes the accelerated recognition of \$25 million of premium due to the exhaustion of exposure on certain loss impacted policies.

Table of Contents**Insurance Losses**

Loss Ratio: The table below shows the components of our loss ratio:

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|----------------------------------|----------------------------------|----------------|--------------|---------------------------------|---------------|--------------|
| | 2009 | Point Change | 2008 | 2009 | Point Change | 2008 |
| Current year | 59.8% | (32.9%) | 92.7% | 69.1% | (8.6%) | 77.7% |
| Prior period reserve development | (19.9%) | (5.7%) | (14.2%) | (16.2%) | (0.2%) | (16.0%) |
| Loss ratio | 39.9% | (38.6%) | 78.5% | 52.9% | (8.8%) | 61.7% |

The third quarter of 2009 benefited from a lower level of catastrophe activity relative to the prior year quarter, which included \$115 million, or 39.2 points, of losses from Hurricanes Ike and Gustav. This was partially offset by higher claims activity on the credit component of our credit and political risk line of business relative to the prior year quarter.

The reduction in our current year loss over the year to date was driven by lower catastrophe losses and a lower frequency and severity of property per risk losses. In particular, Hurricanes Ike and Gustav contributed 12.9 points to the 2008 accident year loss ratio. This was partially offset by increased claims activity on the credit component of our credit and political risk line of business. The current year loss ratio on credit and political risk business for the first nine months of 2009 was 110% compared to 37% for the same period of 2008. These loss ratios are net of estimated recoveries entitled to us through insurance contracts. On the payment of a claim, we generally receive subrogation rights to all the insured's rights of recovery. These rights entitle us to recovery of either the collateral pledged under the insured agreement and/or the residual underlying value of a financial instrument or some other form of security. The estimate of such recoveries requires significant management judgment.

Refer to the *Prior Period Reserve Development* section on page 45, for a discussion of movements in our prior period loss reserves.

General and Administrative Ratio: The increase in our general and administrative ratio in the quarter and year to date primarily reflects additional headcount and IT costs in 2009.

Other Insurance Related Income / Loss: We recorded an increase in the fair value liability of an insurance derivative contract in the three and nine months ended September 30, 2009 of \$136 million and \$161 million, respectively, compared to \$14 million and \$21 million for the three and nine months ended September 30, 2008, respectively. Refer to the *Critical Accounting Estimate Fair Value Measurements* section for further details.

Insurance Outlook

In the insurance marketplace, we continue to observe a general improvement in rates, particularly for more volatile, loss-affected lines such as those with catastrophe exposure, energy and financial institutions business. We are also observing a general stabilization in terms and conditions. Large accounts generally remain the most competitive across all lines of business.

For aviation business, we observed some positive rate improvement in third quarter renewals, although generally not as high as we require, and we expect this trend to continue through the fourth quarter. On our credit and political risk line of business, as has been the case throughout this year, global lending and trading activity remains weak and, therefore, opportunities in this line are expected to remain limited.

In our professional lines business, although we continue to see new opportunities, the market for non-financial institutions commercial business remains competitive and grows more competitive as security concerns around certain market participants abate. For liability business, we are observing fewer new business opportunities and less available renewal premium as a result of exposure reduction by insureds amidst the current economic environment. This affect is compounded by the competitive pressures around this lower premium base. As a result, we continue to maintain a defensive posture in these lines.

Table of Contents**REINSURANCE SEGMENT****Overview**

Results in the reinsurance segment were as follows:

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|-------------------------------------------|----------------------------------|----------------|---------------------|---------------------------------|----------------|---------------|
| | 2009 | % Change | 2008 | 2009 | % Change | 2008 |
| Revenues: | | | | | | |
| Gross premiums written | \$ 361,392 | 12% | \$ 322,611 | \$ 1,708,606 | 16% | \$ 1,470,640 |
| Net premiums written | 355,363 | 13% | 315,750 | 1,693,526 | 16% | 1,454,498 |
| Net premiums earned | 427,388 | 8% | 396,398 | 1,224,919 | 8% | 1,138,337 |
| Other insurance related income (loss) | 160 | nm | (55) | 1,265 | 27% | 1,000 |
| Expenses: | | | | | | |
| Current year net losses and loss expenses | (266,579) | | (509,617) | (791,225) | | (998,038) |
| Prior period reserve development | 66,698 | | 34,663 | 165,008 | | 108,832 |
| Acquisition costs | (83,810) | | (68,369) | (234,586) | | (197,795) |
| General and administrative expenses | (18,719) | | (17,366) | (54,515) | | (51,813) |
| Underwriting income (loss) | \$ 125,138 | nm | \$ (164,346) | \$ 310,866 | nm | \$ 523 |
| | | Point | | | Point | |
| Ratios: | | | | | | |
| | | Change | | | Change | |
| Current year loss ratio | 62.4% | (66.1%) | 128.5% | 64.6% | (23.1%) | 87.7% |
| Prior period reserve development | (15.6%) | (6.9%) | (8.7%) | (13.5%) | (3.9%) | (9.6%) |
| Acquisition cost ratio | 19.6% | 2.4% | 17.2% | 19.2% | 1.8% | 17.4% |
| General and administrative ratio | 4.4% | - | 4.4% | 4.4% | (0.1%) | 4.5% |
| Combined ratio | 70.8% | (70.6%) | 141.4% | 74.7% | (25.3%) | 100.0% |

Gross Premiums Written: The following tables provide gross premiums written by line of business for the periods indicated:

| Three months ended September 30, | 2009 | | 2008 | | % Change |
|----------------------------------|-------------------|-------------|-------------------|-------------|-------------|
| | \$ | % | \$ | % | |
| Catastrophe | \$ 87,700 | 24% | \$ 115,216 | 36% | (24%) |
| Property | 78,196 | 22% | 64,683 | 20% | 21% |
| Professional Lines | 84,903 | 23% | 55,378 | 17% | 53% |
| Credit and bond | 18,369 | 5% | 5,083 | 2% | 261% |
| Motor | 7,655 | 2% | 7,202 | 2% | 6% |
| Liability | 78,896 | 22% | 54,659 | 17% | 44% |
| Engineering | 5,979 | 2% | 17,381 | 5% | (66%) |
| Other | (306) | - | 3,009 | 1% | (110%) |
| Total | \$ 361,392 | 100% | \$ 322,611 | 100% | 12% |

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The 12% increase in gross premiums written this quarter reflects both improving market conditions and the select expansion of business. We were able to grow property, credit and bond, professional lines and liability business this quarter primarily through new business opportunities. Professional lines business also benefited from an increase in our participation on certain renewals. The growth in liability premiums this quarter included an opportunistic capped proportional contract for \$25 million. Partially offsetting this growth, catastrophe premiums were lower this quarter, primarily due to the fact that the prior year period included \$29 million of reinstatement premiums in connection with Hurricanes Ike and Gustav.

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| Nine months ended September 30, | 2009 | | 2008 | | % Change | Excluding FX Impact |
|---------------------------------|---------------------|-------------|---------------------|-------------|-------------|------------------------|
| | \$ | % | \$ | % | | |
| Catastrophe | 457,118 | 27% | 445,470 | 30% | 3% | 4% |
| Property | 314,736 | 18% | 292,507 | 20% | 8% | 10% |
| Professional Lines | 268,963 | 16% | 174,560 | 12% | 54% | 55% |
| Credit and bond | 214,008 | 13% | 148,887 | 10% | 44% | 48% |
| Motor | 109,130 | 6% | 99,559 | 7% | 10% | 19% |
| Liability ⁽¹⁾ | 262,611 | 15% | 185,333 | 13% | 42% | 44% |
| Engineering | 56,084 | 3% | 78,500 | 5% | (29%) | (26%) |
| Other ⁽¹⁾ | 25,956 | 2% | 45,824 | 3% | (43%) | (41%) |
| Total | \$ 1,708,606 | 100% | \$ 1,470,640 | 100% | 16% | 19% |

(1) Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

Gross premiums written in the first nine months of 2009 were negatively impacted by a stronger U.S. dollar, most significantly against the Euro and Sterling, relative to the same period in 2008. The impact of foreign exchange rate movements is highlighted in the table above. Gross premiums written otherwise increased 19%, driven by improved market conditions and growth opportunities across several lines of business.

Net Premiums Earned: The following table shows net premiums earned by line of business:

| | Three months ended September 30, | | | | | Nine months ended September 30, | | | | |
|--------------------------|----------------------------------|-------------|-------------------|-------------|-------------|---------------------------------|-------------|---------------------|-------------|-------------|
| | 2009 | | 2008 | | % Change | 2009 | | 2008 | | % Change |
| Catastrophe | \$ 115,930 | 27% | \$ 129,969 | 33% | (11%) | \$ 337,770 | 28% | \$ 344,127 | 30% | (2%) |
| Property | 82,187 | 19% | 77,318 | 19% | 6% | 236,661 | 19% | 230,018 | 20% | 3% |
| Professional Lines | 70,336 | 17% | 54,973 | 14% | 28% | 199,831 | 16% | 164,073 | 15% | 22% |
| Credit and bond | 47,004 | 11% | 35,441 | 9% | 33% | 132,530 | 11% | 103,345 | 9% | 28% |
| Motor | 27,152 | 6% | 24,089 | 6% | 13% | 77,094 | 6% | 76,738 | 7% | - |
| Liability ⁽¹⁾ | 60,459 | 14% | 47,439 | 12% | 27% | 169,397 | 14% | 144,009 | 13% | 18% |
| Engineering | 16,539 | 4% | 14,124 | 4% | 17% | 48,074 | 4% | 38,478 | 3% | 25% |
| Other ⁽¹⁾ | 7,781 | 2% | 13,045 | 3% | (40%) | 23,562 | 2% | 37,549 | 3% | (37%) |
| Total | \$ 427,388 | 100% | \$ 396,398 | 100% | 8% | \$ 1,224,919 | 100% | \$ 1,138,337 | 100% | 8% |

(1) Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

The increase in net premiums earned in the quarter and year to date reflects growth in several lines of business this year, as discussed above. Partially offsetting this growth, the third quarter of 2008 included an additional \$21 million of catastrophe earned premiums in connection with Hurricanes Ike and Gustav losses.

Table of Contents**Reinsurance Losses**

Loss Ratio: The following table shows the components of our loss ratio:

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|----------------------------------|----------------------------------|-----------------|---------------|---------------------------------|-----------------|--------------|
| | 2009 | Point Change | 2008 | 2009 | Point Change | 2008 |
| Current year | 62.4% | (66.1%) | 128.5% | 64.6% | (23.1%) | 87.7% |
| Prior period reserve development | (15.6%) | (6.9%) | (8.7%) | (13.5%) | (3.9%) | (9.6%) |
| Loss ratio | 46.8% | (73.0%) | 119.8% | 51.1% | (27.0%) | 78.1% |

Current Year Quarter

The third quarter of 2009 benefited from lower catastrophe activity relative to the prior year quarter, which included \$292 million, or 73.7 points, of losses from Hurricanes Ike and Gustav. This was partially offset by an increase in European windstorm activity together with additional Canadian crop losses this quarter. In addition, we also increased the expected the current year loss ratio on credit and bond business this quarter to reflect additional reported losses on certain quota share treaties.

The reduction in our current year loss over the year to date was driven by lower catastrophe losses in 2009. In particular, Hurricanes Ike and Gustav contributed 25.7 points to the 2008 accident year loss ratio. This was partially offset by increased loss activity on credit and bond business. The current year loss ratio on our credit and bond business for the first nine months of 2009 was 92% compared to 65% for the same period of 2008.

Refer to the *Prior Period Reserve Development* section on page 45, for a discussion of movements in our prior period loss reserves.

Reinsurance Outlook

Overall, rates in our reinsurance lines of business are, at a minimum, stable and, in the best cases, increasing meaningfully. We continue to benefit due to concerns over the financial strength of distressed reinsurers or due to competitors' de-risking activities.

We expect the reinsurance market to remain positive as we enter 2010. Some of the stronger areas in the reinsurance market will be those affected by dislocation or loss activity, including trade credit reinsurance business and financial-institutions exposed professional liability reinsurance, and catastrophe-exposed business.

For catastrophe-exposed business, rate reductions for North American earthquake exposure should be in line with exposure reductions indicated by changes in two major catastrophe models. These should result in expected margins in line with expectations before the model changes. The market dynamics around U.S. Wind support stable margins going into 2010. These factors include, stable to increasing demand for wind coverage, the de-population of larger Florida insurance companies, increased fragility of Florida wind-exposed companies due to inadequate premium for attritional losses, and the Florida Hurricane Catastrophe Fund pushing limit into the private reinsurance market. In Europe, a few cat-exposed placements have been biased downward, but wind margin has remained stable.

While proportional property business is suffering from rate decline in underlying business, our business has a catastrophe bias and is generally holding up well. For property risk business, we expect higher attachment points and pricing as the reinsurance market has been exposed to significant frequency experience for commercial writers in U.S. and Europe in the recent past.

The general trend across the U.S. liability reinsurance lines continues to be small but steady rate increases with no slippage in terms and conditions. We continue to identify attractive opportunities to increase our market share in these lines, either through new or renewal business. Similarly, in our professional lines business, market conditions are favorable, particularly for financial institutions-exposed components.

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NET INVESTMENT INCOME AND NET REALIZED INVESTMENT GAINS/LOSSES

Investment Results

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

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---------------------------------------------------|----------------------------------|-------------|---------------|---------------------------------|------------|----------------|
| | 2009 | % Change | 2008 | 2009 | % Change | 2008 |
| Fixed maturities | \$ 98,337 | (9%) | \$ 107,853 | \$ 290,935 | (9%) | \$ 319,050 |
| Cash and cash equivalents | 1,052 | (91%) | 11,713 | 5,940 | (84%) | 37,138 |
| Short-term investments | 81 | (81%) | 424 | 524 | (83%) | 3,118 |
| Other investments | 38,646 | nm | (66,395) | 57,384 | nm | (82,925) |
| Equities | 689 | (43%) | 1,201 | 2,452 | (62%) | 6,420 |
| Gross investment income | 138,805 | 153% | 54,796 | 357,235 | 26% | 282,801 |
| Investment expense | (4,017) | 5% | (4,213) | (10,935) | (14%) | (9,552) |
| Net investment income | 134,788 | 166% | 50,583 | 346,300 | 27% | 273,249 |
| Net realized investment losses | (253,365) | nm | (89,079) | (317,640) | nm | (51,842) |
| | \$ (118,577) | 208% | \$ (38,496) | \$ 28,660 | (87%) | \$ 221,407 |
| Average investment balances ⁽¹⁾ | | | | | | |
| Fixed maturities | \$ 9,513,659 | 9% | \$ 8,717,450 | \$ 9,133,096 | 8% | \$ 8,491,400 |
| Cash and cash equivalents ⁽²⁾ | 1,345,883 | 1% | 1,329,524 | 1,492,869 | 5% | 1,420,702 |

(1) The average investment balances are calculated by taking the average of the month-end amortized cost balances held for the periods indicated.

(2) Includes restricted cash and cash equivalent balances.

nm not meaningful

Net Investment Income

Fixed Maturities: The reduction in investment income from fixed maturities reflects lower short-term and intermediate interest rates and the tightening of credit spreads during the first nine months of 2009, partially offset by growth in our average fixed maturity balances during the year. The annualized pre-tax yield on fixed maturities, calculated as net investment income divided by the average amortized cost balances for the period, was 4.1% and 4.2% for the three and nine months ended September 30, 2009, respectively, compared with 4.9% and 5.0% for the three and nine months ended September 30, 2008, respectively.

Cash and Cash Equivalents: The reduction in net investment income from cash and cash equivalents is driven by a significant decline in global short-term interest rates this year. The average pre-tax yield on our operating cash was 0.3% and 0.5% for the three and nine months ended September 30, 2009, respectively, compared to 3.5% for the comparative periods of 2008.

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|-----------------------------------------------------------|----------------------------------|--------------------|---------------------------------|--------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Credit funds | \$ 14,435 | \$ (31,320) | \$ 39,670 | \$ (56,616) |
| Hedge funds | 17,821 | (36,691) | 33,445 | (41,159) |
| Short duration high yield fund | 2,867 | (713) | 7,105 | 189 |
| CLO- equity tranches | 3,523 | 2,329 | (22,836) | 14,661 |
| Total | \$ 38,646 | \$ (66,395) | \$ 57,384 | \$ (82,925) |
| Return on other investments, pre-tax⁽¹⁾ | 7.1% | (9.7%) | 11.3% | (12.5%) |

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

The increase in investment income on other investments in the quarter and year to date was driven by a strong recovery in hedge funds and credit funds. The hedge fund investments have exposures to net long equity positions, and these funds tracked the strong performance of global equity indices during the quarter. Credit funds also advanced on the recovery of market pricing for the underlying debt securities that form the collateral of these funds during 2009. In 2008, credit funds were negatively impacted by illiquidity proliferating throughout the credit markets rather than a fundamental deterioration of the underlying collateral.

For the year to date, investment income from other investment was impacted by a reduction in the fair value of the CLO equity tranching securities associated with an increase in defaults on the underlying collateral. Refer to the *Critical Accounting Estimate Fair Value Measurements* section for further details.

Net Realized Investment Losses

The following table provides a breakdown of net realized investment losses for the periods indicated:

| | Three months ended September 30, | | Nine months ended September 30, | |
|------------------------------------------------|----------------------------------|--------------------|---------------------------------|--------------------|
| | 2009 | 2008 | 2009 | 2008 |
| On sale of: | | | | |
| Fixed maturities and short-term investments | \$ 26,136 | \$ 21,782 | \$ 27,035 | \$ 75,318 |
| Equities | 1,594 | (61,886) | (13,331) | (61,693) |
| Net OTTI recognized in earnings | (279,338) | (49,663) | (330,691) | (65,804) |
| Change in fair value of derivative instruments | (21,495) | 4,679 | (27,133) | 4,328 |
| Change in fair value of hedged investments | 19,738 | (3,991) | 26,480 | (3,991) |
| Net realized investment losses | \$ (253,365) | \$ (89,079) | \$ (317,640) | \$ (51,842) |

On sale of investments:

The net realized investment gains on sale of fixed maturities and short-term investments in the first nine months of 2009 primarily included gains on U.S. agency pass-throughs (residential MBS) as these securities were sold to reduce duration risk (refer to *Cash and Investments* section for further details).

Net realized investment losses on the sale of equities in the first nine months of 2009 were driven by the sale of preferred shares in the financial sector in the first quarter of the year. For the comparative period, net realized investment losses on the sale of equities include losses of \$60 million in connection with the sale of the Fannie Mae and Freddie Mac non-redeemable preferred equity in the third quarter of the year.

Table of ContentsOTTI charges:

We review our available-for-sale investment portfolio each quarter to determine if the unrealized loss position of a security is other-than-temporary. Refer to the *Critical Accounting Estimates OTTI* section for further details on our impairment review process.

Effective April 1, 2009, the OTTI charge to earnings reflects only credit impairments, where projected cash flows are less than the amortized cost of a security, or the full unrealized loss position if we intend to sell a fixed maturity security or it is more likely than not that we will need to sell it to meet our liabilities. The new guidance does not allow for retrospective application, therefore the OTTI charge for the first quarter of 2009 as well as for prior year periods are based on previous OTTI requirements (i.e. the difference between the fair value and amortized cost of a debt security in an unrealized loss position).

The following table summarizes our OTTI recognized in earnings by asset class:

| | Three months ended September 30, | | Nine months ended September 30, | |
|------------------------------------------|----------------------------------|-----------|---------------------------------|-----------|
| | 2009 | 2008 | 2009 | 2008 |
| Fixed maturities: | | | | |
| Corporate debt | \$ 263,496 | \$ 40,239 | \$ 276,522 | \$ 52,676 |
| Residential MBS | 4,733 | - | 12,679 | - |
| Commercial MBS | - | - | 10,843 | - |
| ABS | 675 | 3,943 | 10,658 | 7,647 |
| | 268,904 | 44,182 | 310,702 | 60,323 |
| Equities | 10,434 | 5,481 | 19,989 | 5,481 |
| Total OTTI recognized in earnings | \$ 279,338 | \$ 49,663 | \$ 330,691 | \$ 65,804 |

Corporate debt:

The OTTI charges on corporate debt during 2009 primarily related to an impairment charge of \$263 million on a portfolio of MTNs, which we no longer expect to fully recover to amortized cost. In response to the credit crisis, the MTNs managers reduced their leverage levels which in turn lowered the credit duration of the MTNs. As credit markets recovered and credit spreads tightened in recent months, price appreciation was not as pronounced as the depreciation during 2008 due to the lower credit duration of the MTNs. In recent months, credit spreads have tightened much quicker than anticipated which has hindered the ability of the MTN managers to reinvest the underlying cash flows at wider credit spreads. Consequently, based on updated cash flow projections, we do not believe that we will fully recover par on these MTNs and therefore we have recorded credit losses on these securities. The recognition of these OTTI losses does not indicate that sales will occur or that sales are imminent or are planned.

During the three and nine months ended September 30, 2008, we impaired \$29 million of corporate securities held in Lehman Brothers following its bankruptcy and sale in September 2008.

Residential MBS:

The impairment charges on the residential MBS during 2009 for the quarter and year to date were primarily related to our intent to sell certain securities at the reporting date.

Commercial MBS:

The OTTI charge on the commercial MBS for the year to date was related to our intent to sell certain commercial MBS to take advantage of the favorable market conditions and to reduce our exposure on this asset class.

ABS:

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The OTTI losses on ABS in 2009 and 2008 relate primarily to certain ABS with subprime and alternative A collateral that were downgraded to speculative grade by rating agencies.

Table of Contents*Equities:*

The OTTI losses on equities in 2009 and 2008 are due to the severity and duration of the unrealized loss positions, for which we concluded the forecasted recovery period was too uncertain. The recognition of such losses does not necessarily indicate that sales will occur or that sales are imminent or planned.

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, designed to manage risk. 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 for the period indicated:

| | Three months ended September 30, | | Nine months ended September 30, | |
|-----------------------------------------------------------------------------|----------------------------------|---------------|---------------------------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| Net investment income | \$ 134,788 | \$ 50,583 | \$ 346,300 | \$ 273,249 |
| Net realized investments losses | (253,365) | (89,079) | (317,640) | (51,842) |
| Change in net unrealized losses, net of currency hedges | 613,154 | (346,479) | 792,630 | (525,905) |
| Total | \$ 494,577 | \$ (384,975) | \$ 821,290 | \$ (304,498) |
| Average cash and investments ⁽¹⁾ | \$ 11,456,801 | \$ 10,792,555 | \$ 10,956,831 | \$ 10,732,793 |
| Total return on average cash and investments, pre-tax ⁽²⁾ | 4.3% | (3.6%) | 7.5% | (2.8%) |

(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) Non-annualized.

For further information on the movements in net unrealized losses, net of currency hedges, refer to the *Cash and Investments* section below.

Table of Contents**CASH AND INVESTMENTS**

At September 30, 2009 and December 31, 2008, the fair value of total cash and investments, including accrued interest receivable (at cost) and net receivable/payable for investments sold/purchased was \$11.8 billion and \$10.4 billion, respectively, as summarized below:

| | September 30, 2009 | | December 31, 2008 | |
|------------------------------------------------------|----------------------|-------------|----------------------|-------------|
| U.S. government and agency | \$ 1,936,466 | 16% | \$ 1,187,333 | 12% |
| Non U.S. government | 534,211 | 5% | 279,225 | 2% |
| Corporate debt | 3,441,925 | 29% | 2,061,317 | 20% |
| Residential MBS | 1,975,309 | 17% | 2,711,998 | 26% |
| Commercial MBS | 746,544 | 6% | 763,098 | 7% |
| ABS | 385,517 | 3% | 381,006 | 4% |
| Municipals | 662,960 | 6% | 366,677 | 3% |
| Total Fixed Maturities | 9,682,932 | 82% | 7,750,654 | 74% |
| Total Equities | 137,544 | 1% | 107,283 | 1% |
| Total Short-term investments | 282,737 | 2% | 261,879 | 3% |
| Cash at investment managers, net of unsettled trades | 218,979 | 2% | 663,192 | 6% |
| Total Invested Assets | 10,322,192 | 87% | 8,783,008 | 84% |
| Other cash and cash equivalents ⁽¹⁾ | 861,390 | 7% | 1,092,664 | 10% |
| Other investments | 541,447 | 5% | 492,082 | 5% |
| Accrued interest receivable | 82,169 | 1% | 79,232 | 1% |
| Total Cash and Investments | \$ 11,807,198 | 100% | \$ 10,446,986 | 100% |

(1) Include restricted cash and cash equivalents.

Fixed Maturity Investments

In the first nine months of 2009 we reduced holdings in U.S. agency pass-throughs (residential MBS) in favor of U.S. Treasury and Agency debt securities to reduce the potential added duration risk on MBS due to the anticipated rising interest rates while maintaining similar exposure to this high quality sector. During 2009 the majority of new investments were made in high-grade corporate debt securities to take advantage of higher yields while maintaining the same overall credit quality profile for the investment portfolio. At September 30, 2009 and December 31, 2008, fixed maturities had an approximate average duration of 2.8 and 2.5 years, respectively. When incorporating cash and cash equivalents into this calculation, the average duration at September 30, 2009 and December 31, 2008 is reduced to 2.6 and 2.1 years, respectively.

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The following table summarizes the credit ratings for fixed maturities as assigned by S&P:

| | Amortized Cost | Fair Value | % of Total Fair Value |
|---------------------------------------|---------------------|---------------------|--------------------------|
| <u>At September 30, 2009</u> | | | |
| Investment grade: | | | |
| AAA | \$ 5,945,477 | \$ 5,995,458 | 61.9% |
| AA | 858,536 | 865,282 | 9.0% |
| A | 1,744,729 | 1,679,600 | 17.3% |
| BBB | 875,666 | 1,012,366 | 10.5% |
| | 9,424,408 | 9,552,706 | 98.7% |
| Non-investment grade: | | | |
| Below BBB | 164,052 | 130,226 | 1.3% |
| Total | \$ 9,588,460 | \$ 9,682,932 | 100.0% |
| <u>As at December 31, 2008</u> | | | |
| Investment grade: | | | |
| AAA | \$ 5,857,026 | \$ 5,692,296 | 73.3% |
| AA | 521,697 | 491,185 | 6.3% |
| A | 1,076,980 | 944,841 | 12.3% |
| BBB | 912,340 | 601,196 | 7.8% |
| | 8,368,043 | 7,729,518 | 99.7% |
| Non-investment grade: | | | |
| Below BBB | 36,951 | 21,136 | 0.3% |
| Total | \$ 8,404,994 | \$ 7,750,654 | 100.0% |

Note: In the absence of an S&P rating, we used the lower rating established by Moody's or Fitch.

The shift in credit ratings since December 31, 2008, is primarily attributable to a shift away from non-agency MBS to investment grade corporate debt securities, coupled with a higher price appreciation in the lower credit ratings.

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The net unrealized losses on available for sale securities decreased \$793 million during the first nine months of 2009, comprising the following movements:

| | Net Unrealized Gains (Losses) at September 30, 2009 | Net Unrealized Gains (Losses) at December 31, 2008 | Change |
|--------------------------------------|-----------------------------------------------------------|----------------------------------------------------------|-------------------|
| Fixed maturities: | | | |
| U.S. government and agency | \$ 18,551 | \$ 38,566 | \$ (20,015) |
| Non-U.S. government | 17,430 | 7,219 | 10,211 |
| Corporate debt | 83,216 | (455,742) | 538,958 |
| Residential MBS | 11,029 | (24,813) | 35,842 |
| Commercial MBS | (41,744) | (170,217) | 128,473 |
| ABS | (21,488) | (52,260) | 30,772 |
| Municipals | 27,478 | 2,907 | 24,571 |
| Total fixed maturities | 94,472 | (654,340) | 748,812 |
| Equities: | | | |
| Common stock | 8,489 | (47,098) | 55,587 |
| Preferred stock | - | (9,949) | 9,949 |
| Total equities | 8,489 | (57,047) | 65,536 |
| Short-term investments | - | (4,762) | 4,762 |
| Total before fair value hedge | 102,961 | (716,149) | 819,110 |
| Fair value hedge adjustment | (18,372) | 8,108 | (26,480) |
| Total | \$ 84,589 | \$ (708,041) | \$ 792,630 |

The movement from net unrealized losses to net unrealized gains during 2009 is primarily due to a tightening of credit spreads and a downward shift in the yield curve which has resulted in a significant recovery in fair value for our corporate debt and structured credit securities. Further, we have recorded \$331 million in OTTI charges during the first nine months of 2009 which resulted in an equal decrease in our net unrealized loss position. The following provides a further analysis by major security type.

Corporate Debt:

At September 30, 2009, our corporate debt portfolio had an average credit rating of A (December 31, 2008: A), a duration of 3.1 years (December 31, 2008: 3.1 years) and a weighted average life of 4.3 years (December 31, 2008: 4.5 years). The composition of our corporate debt securities at September 30, 2009 was as follows:

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| | Fair Value | % of Fair Value of Total Fixed Maturities | Net Unrealized Gains at September 30, 2009 | Change in Net Unrealized Gains (Losses) since December 31, 2008 |
|-----------------------|---------------------|-------------------------------------------------|--------------------------------------------------|--------------------------------------------------------------------------|
| Direct Financials | \$ 1,773,814 | 18.3% | \$ 20,773 | \$ 117,935 |
| Direct Non Financials | 1,307,415 | 13.5% | 62,443 | 90,094 |
| Medium-term notes | 360,696 | 3.7% | - | 330,929 |
| Total | \$ 3,441,925 | 35.5% | \$ 83,216 | \$ 538,958 |

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The direct financials exposures are primarily related to U.S. banks (35%), foreign banks (24%), and brokerage (15%), with the remainder diversified across several other sub-sectors. Included in direct financials debt is \$311 million of FDIC guaranteed bonds. At September 30, 2009, and December 31, 2008, the weighted average credit rating of financials debt was A by S&P.

Non-financial exposures are primarily related to communications (27%), electric (17%) and consumer non-cyclicals (16%), with the remainder diversified across several other sub-sectors. The weighted average credit rating of non-financials debt at September 30, 2009 and December 31, 2008 was A- by S&P.

The MTNs portfolio is collateralized by a pool of European fixed maturity securities diversified by country and asset sector with the majority of the exposure consisting of investment-grade corporate and sovereign debt. The MTNs portfolio provides exposure to floating rate notes which allows us to diversify from our fixed interest rate exposure of other fixed maturity securities we hold in our investment portfolio. The fair value of MTNs is driven by the return of the underlying pool of fixed maturities and the level of leverage. As previously noted, we have impaired all the MTNs at September 30, 2009, resulting in decreasing their amortized costs basis to fair value with no remaining unrealized losses. We intend to continue holding the MTNs in the near term as we believe there is good short-term total return prospect for these investments.

Residential MBS:

Residential MBS portfolio investments are supported by loans that are diversified across economic sectors and geographical areas. During the current quarter, we have further reduced holdings in agency residential MBS due to the strong rally since late 2008 which gave us an opportunity to reduce our duration extension risk. We have reallocated the proceeds to U.S. treasury and agency debt securities. We also reduced holdings in non-agency residential MBS and reallocated the proceeds to investment grade corporate debt securities to take advantage of higher yields. At September 30, 2009, 89% of our total residential MBS was backed by U.S. government-sponsored agencies. For the remaining holdings of \$226 million, the weighted average credit rating was A by S&P. At September 30, 2009, the average duration and weighted average life was 0.03 years and 5.1 years, respectively, for our non-agency residential MBS portfolio, compared with 0.3 years and 3.1 years at December 31, 2008. The vintage years for these securities have not changed significantly since December 31, 2008.

Our total exposure to subprime and Alt-A collateral has reduced to \$88 million at September 30, 2009 from \$131 million at December 31, 2008, primarily due to sales. Our holdings in these securities continue to be highly rated with 50% rated AAA by S&P.

Commercial MBS:

During the third quarter of 2009, we continued to see an improvement in the fair value for the commercial MBS. This was the primary contributor to the significant reduction in the unrealized loss position for this asset class. During the current quarter, we reduced commercial MBS holdings by \$50 million, for a total net reduction of \$145 million in 2009. The commercial MBS portfolio continues to be rated highly, with approximately 86% rated AAA by S&P. Additionally, the weighted average estimated subordination percentage for the portfolio was 28% at September 30, 2009, 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 this time, based on fundamental analysis, we do not expect a principal loss on commercial MBS. At September 30, 2009, the average duration, weighted average life, and vintage years for the commercial MBS portfolio have not changed significantly since December 31, 2008.

Asset- Backed Securities:

Our total exposure to ABS has not changed significantly since December 31, 2008 but the mix of underlying loan types has shifted. We have increased our exposure to the auto sector while our holdings in credit card related ABS has decreased since December 31, 2008. Over 85% of our ABS is rated AAA by S&P. The remaining 15% of the ABS consists primarily \$43 million of CLO debt tranching securities. The average duration, weighted average life and vintage years for our ABS portfolio at September 30, 2009 has not changed significantly since December 31, 2008.

Table of Contents*Equity Securities*

The increase in fair value of common stock holdings to \$138 million at September 30, 2009 from December 31, 2008, was primarily due to an improved valuation due to the recovery in the global equity markets in 2009.

Securities Lending

We continue to wind down our security lending program. As of September 30, 2009, we had outstanding securities lending agreements of \$135 million, a reduction from \$406 million at December 31, 2008.

LIQUIDITY AND CAPITAL RESOURCES

There has been no material change in our liquidity or capital resource requirements since December 31, 2008. For more information refer to the *Liquidity and Capital Resources* section included under Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2008.

At September 30, 2009, common equity was \$4.9 billion compared to \$4.0 billion at December 31, 2008. The following table reconciles opening and closing common equity positions:

| | |
|-----------------------------------------------------------------------|---------------------|
| Common equity - December 31, 2008 | \$ 3,961,041 |
| Net income | 206,604 |
| Unrealized appreciation on available for sale investments, net of tax | 819,564 |
| Common share dividends | (96,307) |
| Preferred share dividends | (27,656) |
| Share-based compensation and other | 34,861 |
| Common equity - September 30, 2009 | \$ 4,898,107 |

COMMITMENTS AND CONTINGENCIES

There have been no other material changes in our commitments or contingencies since December 31, 2008. Refer to Item 7 included in our Annual Report on Form 10-K for the year ended December 31, 2008.

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CRITICAL ACCOUNTING ESTIMATES

Our Consolidated Financial Statements have been prepared in conformity with U.S. GAAP, which include certain accounting policies that we consider to be critical due to the amount of judgment and uncertainty inherent in the application of those policies. While we believe that the amounts included in our Consolidated Financial Statements reflect our best judgment, the use of different assumptions could produce materially different accounting estimates. As disclosed in our 2008 Annual Report on Form 10-K, we believe the following accounting estimates are critical to our operations and require the most subjective and complex judgment:

Reserve for Losses and Loss Expenses

Reinsurance Recoverable Balances

Premiums

Fair Value Measurements

Other-Than-Temporary Impairments (OTTI)

See below for an updated discussion of the application of estimates and assumptions around Fair Value Measurements and OTTI. For the remaining critical accounting estimates, there was no material change since December 31, 2008. Refer to Item 7 included in our Annual Report on Form 10-K for the year ended December 31, 2008.

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.

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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. This may lead us to change the selection of our valuation technique (from market to cash flow 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.

The following section is a summary of the valuation methodologies we used to measure our financial instruments.

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Fixed Maturities

We use quoted market values and other relevant observable market data provided by independent pricing sources as inputs into our process for estimating the fair values of fixed maturities. The pricing sources are primarily nationally recognized pricing services and broker-dealers.

Pricing Services

At September 30, 2009, pricing for approximately 86% (December 31, 2008: 87%) of our total fixed maturities was based on prices provided by nationally recognized independent pricing services (74% index providers and 12% pricing vendors). Prices are sourced from multiple pricing services, and a vendor hierarchy is maintained by asset type based on historical pricing experience and vendor expertise. Generally, we receive prices from multiple pricing services for each security and select the pricing from the pricing service highest in our vendor hierarchy. Generally, pricing services provide pricing for less-complex, liquid securities based on market quotations in active markets when available. For fixed maturities that do not trade on a listed exchange, the pricing service will use its proprietary pricing matrix models and use observable market inputs to estimate the fair value of a security. These observable market inputs include: reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-side markets, benchmark securities, bids, offers, reference data, and industry and economic factors. Additionally, pricing vendors may use an Option Adjusted Spread model commonly used to develop prepayment and interest rate scenarios for the purpose of estimating fair values of mortgage-backed and asset-backed securities.

At September 30, 2009 and December 31, 2008, we have not adjusted any pricing provided by independent pricing services (see *Management Pricing Validation* below). Accordingly, except for U.S. Treasury securities, we have classified all the remaining fixed maturities priced by pricing services as Level 2. As U.S. Treasury securities are liquid and trade in an active market; we have classified these securities as Level 1.

Broker-Dealers

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 these 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.

If we conclude the quote from a broker does not reflect an orderly transaction, we will place little weight on the non-binding broker quote and a greater weight on the use of an internal model to estimate fair value of illiquid securities. The evaluation of whether or not actual transactions in the current financial markets represent distressed sales requires significant management judgment. At September 30, 2009, the use of an internal model for fixed maturities was limited to CLO debt tranche securities, given the lack of relevant observable trades.

At September 30, 2009, approximately 9% (December 31, 2008: 8%) of fixed maturities were priced by non-binding quotes from broker-dealers. Where we have the ability to corroborate the non-binding broker quote with either a quote from a pricing vendor or another independent broker, and the price quotations do not vary significantly, we classify these securities as Level 2 within our fair value hierarchy. We classify securities priced by a single non-binding broker quote and/or use of internal model as Level 3 in our fair value hierarchy. At September 30, 2009, these securities consisted primarily of some Residential MBS and CLO debt tranche securities for a total estimated fair value of \$123 million or approximately 1% of the total fixed maturity portfolio.

Other Pricing Sources

For certain securities within the corporate bond portfolio such as medium-term notes, we use prices provided by independent administrators which are marked to market daily. Pricing is based on the mid point of the bid-ask quotes, where available; otherwise it is obtained from a sample of non-binding quotes from broker-dealers in active markets. For medium-term notes, we have full transparency with respect to their underlying securities, and therefore we can corroborate the pricing received with relevant observable market data. Accordingly, these securities were also classified as Level 2.

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Management Pricing Validation

As management is ultimately responsible for determining the fair value measurements for all securities, we validate prices received by comparing the fair value estimates to our knowledge of the current markets. We 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) a review of the pricing methodologies and valuation models used by outside parties to measure fair value; (ii) quantitative analysis and attribution analysis; and (iii) selecting randomly purchased or sold securities and comparing the executed prices to the fair value estimates provided by the independent pricing sources and broker-dealers.

Equity Securities

The fair values for equity securities are based on closing exchange prices provided by independent pricing sources and, accordingly, we have classified all our equity securities within Level 1.

Other Investments

Alternative Investment Funds:

We have one open-end short-duration high yield fund with daily liquidity that is measured using the net asset value as reported by Bloomberg. We have classified this fund as Level 2.

For hedge and credit funds, we measure fair value by obtaining the net asset value as advised by our external fund manager or third party administrator, which involves limited management judgment. For any funds for which we did not receive a September 30, 2009 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 did not have a reporting lag in our fair value measurements for these funds. The financial statements of each fund in our portfolio are generally prepared using fair value measurements for the underlying investments and generally are audited annually. In addition to reviewing these audited financial statements, we regularly review fund performance directly with the fund managers and perform qualitative analysis to corroborate the reasonableness of the reported net asset values. Certain of these funds have lock-up and other redemption provisions which limit our ability to liquidate these funds in the short term. As these provisions are common in the investment industry, we do not believe a market participant would apply a significant discount, if any, to the reported net asset value; accordingly, we have not reflected such adjustment in the fair value of these funds. We have classified the hedge and credit funds as Level 3 within the fair value hierarchy as we do not have full access to the underlying investment holdings for most of the funds to enable us to corroborate the fair value measurement used by the fund managers.

CLO Equity Securities:

We have also invested in equity tranche CLO securities (also known as cash flow CLOs in the industry). For these securities, we estimate fair value based on observable relevant trades in active secondary markets where available or the use of our internal valuation model where the market is inactive. Following the credit market dislocation in 2008, the CLO Equity market continues to be depressed. At or near September 30, 2009, we have not observed any relevant market trades for CLO Equity securities. Accordingly, we continue to rely on the use of our internal models to estimate the fair value of cash flow CLOs. The key assumptions used in our models are: default and recovery rates, collateral spreads, and prepayments. Of these assumptions, the default and recovery rates are the most judgmental inputs to which the valuation of CLO Equities is most sensitive. The projected cash flows for CLO Equities are also discounted using the current risk free interest rate.

Each CLO structure must maintain certain over-collateralization ratios (OC ratios) in order to make distributions to the equity tranche holders. Generally, the OC ratio is calculated as: a) the remaining collateral adjusted for marked-to-market defaulted loans, net of estimated recoveries, and certain credit downgrades, divided by b) the total remaining debt obligations. During the second quarter of 2009, we noted an acceleration in defaults on the underlying collateral for certain CLO Equities we continue to hold. However, the rate of defaults has stabilized for most CLO Equities and for some the default rates have slightly decreased during the third quarter of 2009.

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The cumulative actual default rate up to August 31, 2009, for CLO Equities varied from 0.7% to 6.4%. Consequently, for certain CLO Equities the defaults have significantly eroded the value of the collateral to the extent that some OC ratios are currently out-of-compliance. As a result, for these CLO Equities, the income distributions that would normally flow to us as an equity tranche holder are now diverted to the debt tranche holders to pay down on the debt principal until the OC ratio is back in compliance. In light of this emerging data, we have revised our default rates as well as recovery rates for all of our CLO Equities that are not performing as previously anticipated during the second quarter of 2009. To establish new default rates for our valuation models, we have considered the above noted actual defaults for CLO Equities as well as S&P's revised forecasts made during the second quarter to its baseline projected default rate of 14.3% by March 2010 for U.S. corporate speculative-grade securities from 7.6% by October 2009, as previously reported in December 2008. We increased our default rate assumptions between 2.4% to 6.4% for the remainder of 2009 for CLO Equities that are not performing to our previous expectations. For these securities, we have also reduced the recovery rate assumptions by 5% based on observations of actual recoveries in 2009 and credit rating agencies' forecasted recovery rate. These revised default and recovery rates were the principal drivers of the \$26 million decrease in fair value of CLO Equities for the second quarter. We made no adjustment to our default and recovery rates assumptions during the current quarter and accordingly, there was no significant change to our estimated fair value of the CLO Equities.

As a sensitivity analysis of our estimated fair value, we believe it is reasonably likely that our estimated fair value of the CLO Equities could further deteriorate from a range of \$7 million to \$23 million within the next 12 months based on some stress test scenarios, which included (but were not limited to):

An increase in default rate assumptions to 14% for all CLO Equities for the remainder of 2009, with a decrease to 8% for 2010 and 4% for 2011 and thereafter; assuming no change to our revised recovery rate assumptions.

A further reduction in recovery rate assumptions to 45% for all CLO Equities, with no adjustment to our revised default rate assumptions.

Derivative Instruments

There has been no significant change to the application of estimates and assumptions relating to derivative instruments except for the insurance derivative contract since December 31, 2008.

Until this quarter, our valuation model maintained the longevity expectancy assumptions in place at inception of the insurance derivative contract. These assumptions were a function of data and information accumulated by certain life settlement industry service providers. Because of the high value death benefits for the lives in the underlying portfolio of the insurance indemnity contract and the small population (initially 188 lives), the early lag in mortality experience was not believed to be indicative of experience that should be expected for the broader portfolio of lives. However, due to the persistency of this lag over two years, we now believe there is statistical credibility that should be attached to the actual mortality experience thus far in the portfolio. The combination of this lag in mortality experience and life settlements market data indicating increased life expectancy in a much larger sample of lives led us to reflect an increase in life expectancy throughout the underlying pool of lives in our valuation model.

As a result, we have adjusted the life expectancy upward for the remaining 184 lives by approximately 17 months, resulting in an increase of \$136 million in the fair value liability with a corresponding charge to earnings during the third quarter of 2009. No other change in assumptions was made to our internal model for estimating the fair value of this contract except for market inputs such as credit spreads and risk free rates. The projected indemnity payment in 2017 reflects nearly a full loss under this contract. Accordingly, we do not anticipate further material change to our fair value liability estimate assuming no significant changes to our current market inputs.

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OTHER-THAN-TEMPORARY IMPAIRMENTS (OTTI)

We review quarterly whether a decline in the fair values of available-for-sale (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 a rigorous 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 the qualitative 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 fixed maturities and equity securities.

Fixed Maturities

In accordance with the adoption of the recently issued accounting standard, we recognize an OTTI in earnings for a fixed maturity security in an unrealized loss position when we either:

- 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 fully recover the amortized cost based on projected cash flows to be collected.

This new guidance overrides the previous requirement to assert both the intent and ability to hold the security for a period of time sufficient to allow for a recovery in its fair value to its amortized cost for not impairing a fixed maturity in an unrealized loss position.

A security is impaired when the fair value is below its amortized costs. If the impaired fixed maturity security meets either of the first two criteria above, the entire difference between the security's fair value and its amortized cost is recorded as an OTTI charge in the Consolidated Statements of Operations. However, if the impairment arises due to an anticipated credit loss on the security (third criterion above), we recognize only the credit 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. The new amortized cost is accreted into net investment income.

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.

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For impaired securities that we do not intend to sell and it is more likely that we will not be required to sell, we have established some parameters for identifying securities in an unrealized loss position 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.

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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 generally 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 for which a portion of the OTTI was recognized in other comprehensive income (loss) were as follows:

Corporate Debt:

Our projected cash flows for corporate debt securities are primarily driven by our assumptions regarding the probability of default and the timing and amount of recoveries associated with defaults. Our default and recovery rate assumptions 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. Additionally, for medium-term notes, our projected cash flows include significant inputs such as future credit spreads and use of leverage over the expected duration of each medium-term notes.

Residential MBS, Commercial MBS:

We use models to determine the estimated credit losses for structured securities, such as MBS and ABS. We project expected cash flows to be collected, by utilizing underlying data from widely accepted third-party data sources as well as the following significant assumptions: expected defaults, delinquencies, recoveries, foreclosure costs, and prepayments. These assumptions require significant management judgment and vary for each structured security based on the underlying property type, vintage, loan to collateral value ratio, geographic concentration, and current level of subordination. We also corroborate our principal loss estimate with the independent investment manager's principal loss estimate for each structured debt security with a significant unrealized loss position.

ABS:

The majority of the unrealized losses on ABS at September 30, 2009 were related to CLO debt tranching securities. We use the same internal model as for CLO Equities (see discussion above) to project estimated cash flows to be collected on the various CLO debt tranching securities. The significant inputs used in the model include default and recovery rates and collateral spreads. Our assumptions on default and recovery rates are established based on an assessment of actual experience to date for each CLO debt tranche and review of recent credit rating agencies' default and recovery forecasts.

Equities

Because equity securities were specifically excluded from the above new OTTI recognition model, we continue to consider our ability and intent to hold an equity security in an unrealized 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 the past twelve months, 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 50% for nine consecutive months.

We have also established parameters for identifying potential impaired equity securities for fundamental analysis based on the severity and the duration of the unrealized loss position. One parameter we use is when an equity security's fair value is 50% less than its cost for six consecutive months.

From time to time, we may sell our available-for-sale 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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OTTI Charge

During the three and nine months ended September 30, 2009 we recorded a total OTTI charge in earnings of \$279 million and \$331 million, respectively. Refer to the *Net Investment Income and Net Realized Investment Gains/Losses* section of the MD&A for further details.

NEW ACCOUNTING STANDARDS

See Item 1, Note 1 Basis of Presentation and Accounting Policies to the Consolidated Financial Statements for a discussion of new accounting standards we have recently adopted and recently issued accounting pronouncements we have not yet adopted.

OFF-BALANCE SHEET AND SPECIAL PURPOSE ENTITY ARRANGEMENTS

As of September 30, 2009, we have not entered into any off-balance sheet arrangements, as defined by Item 303 (a) (4) of Regulation S-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

See below for an updated discussion of the interest rate and credit spread risks. For the remaining market related risks, there have been no material changes since December 31, 2008. Refer to Item 7A included in our Annual Report on Form 10-K for the year ended December 31, 2008 for a discussion of the Company's market risk components.

INTEREST RATE RISK

Fluctuations in interest rates have a direct impact on the market valuation of fixed maturities. As interest rates rise, the fair value of fixed maturities falls, and the converse is also true. We have calculated the effect that an immediate parallel shift in the U.S. interest rate yield curve would have on our fixed maturities at September 30, 2009. The modeling of this effect was performed on each security individually using the security's effective duration and changes in prepayment expectations for MBS and ABS securities. Prepayment risk results from potential

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accelerated principal payments that shorten the average life, and therefore, the expected yield of the security. The results of this analysis are summarized in the table below.

| As at September 31, 2009 | Interest Rate Shift in Basis Points | | | | |
|---------------------------------|--------------------------------------------|---------------|--------------|--------------|--------------|
| | -100 | -50 | 0 | +50 | +100 |
| Total Fair Value | \$ 10,252,951 | \$ 10,112,182 | \$ 9,965,669 | \$ 9,814,089 | \$ 9,657,748 |
| Fair Value Change from Base | 2.9% | 1.5% | 0.0% | (1.5%) | (3.1%) |
| Change in Unrealized Value | \$ 287,282 | \$ 146,513 | \$ - | \$ (151,580) | \$ (307,921) |

| As at December 31, 2008 | Interest Rate Shift in Basis Points | | | | |
|--------------------------------|--------------------------------------------|--------------|--------------|--------------|--------------|
| | -100 | -50 | 0 | +50 | +100 |
| Total Fair Value | \$ 8,263,301 | \$ 8,169,548 | \$ 8,012,533 | \$ 7,946,561 | \$ 7,825,040 |
| Fair Value Change from Base | 3.1% | 2.0% | 0.0% | (0.8%) | (2.3%) |
| Change in Unrealized Value | \$ 250,768 | \$ 157,015 | \$ - | \$ (65,972) | \$ (187,493) |

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We manage interest rate risk by selecting fixed maturities with durations, yields, currency and liquidity tailored to the anticipated cash outflow characteristics of our insurance and reinsurance liabilities. Refer to the *Cash and Investments* section above, for a discussion of target and actual durations on our investment portfolios and a discussion on risk management techniques, respectively.

CREDIT SPREAD RISK

Fluctuations in credit spreads have a direct impact on the market valuation of fixed maturities. A credit spread is the difference between the yield on the fixed maturity security of a particular borrower (or a class of borrowers with a specified credit rating) and the yield of similar maturity U.S. Treasury fixed maturity. As credit spreads widen, the fair value of fixed maturities falls, and the converse is also true.

The following tables summarize the effect of an immediate, parallel shift in credit spreads in a static interest rate environment at September 30, 2009 and December 31, 2008:

| As at September 30, 2009 | Credit Spread Shift in Basis Points | | | | |
|-----------------------------|-------------------------------------|---------------|--------------|--------------|--------------|
| | -200 | -100 | 0 | +100 | +200 |
| Total Fair Value | \$ 10,559,059 | \$ 10,262,364 | \$ 9,965,669 | \$ 9,668,975 | \$ 9,372,280 |
| Fair Value Change from Base | 6.0% | 3.0% | 0.0% | (3.0%) | (6.0%) |
| Change in Unrealized Value | \$ 593,390 | \$ 296,695 | \$ - | \$ (296,695) | \$ (593,389) |

| As at December 31, 2008 | Credit Spread Shift in Basis Points | | | | |
|-----------------------------|-------------------------------------|--------------|--------------|--------------|--------------|
| | -200 | -100 | 0 | +100 | +200 |
| Total Fair Value | \$ 8,424,377 | \$ 8,218,455 | \$ 8,012,533 | \$ 7,806,611 | \$ 7,600,689 |
| Fair Value Change from Base | 5.1% | 2.6% | 0.0% | (2.6%) | (5.1%) |
| Change in Unrealized Value | \$ 411,844 | \$ 205,922 | \$ - | \$ (205,922) | \$ (411,844) |

As the performance of credit funds are driven by the valuation of the underlying bank loans, these funds are also exposed to credit spreads movement. The impact of a 15% decline in the fair value of our credit funds at September 30, 2009 is \$16 million, on a pre-tax basis.

ITEM 4. 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 the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)) as of September 30, 2009. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2009, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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The Company's management has performed an evaluation, with the participation of the Company's Chief Executive Officer and Chief Financial Officer of changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2009. Based upon that evaluation, there have been no changes to the Company's internal control over financial reporting during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Except as noted below, we are not a party to any material 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. In our opinion, the eventual outcome of these legal proceedings is not expected to have a material adverse effect on our financial condition or results of operations.

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. We believe that the lawsuit is completely without merit and we continue to vigorously defend the filed action.

ITEM 1A. RISK FACTORS

There were no material changes from the risk factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008.

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The following table sets forth information regarding the number of shares we repurchased during the third quarter of 2009.

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ^(a) | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Announced Plans or Programs ^(b) |
|----------------------|-------------------------------------------|------------------------------------|-------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------|
| | | | | |
| July 1-31, 2009 | - | - | - | \$211.6 million |
| August 1-31, 2009 | 4,114 | \$28.46 | - | \$211.6 million |
| September 1-30, 2009 | - | - | - | \$211.6 million |
| Total | 4,114 | | - | \$211.6 million |

(a) Share repurchases relating to withhold to cover tax liabilities upon vesting of restricted stock awards are excluded from our share repurchase plan.

(b) On December 6, 2007, our Board of Directors approved a new share repurchase plan with the authorization to repurchase up to an additional \$400 million of our common shares. This repurchase plan is authorized to continue until December 31, 2009.

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ITEM 6. EXHIBITS

- (a) Exhibits
 - 3.1 Certificate of Incorporation and Memorandum of Association (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1/A (Registration No. 333-103620) filed on April 16, 2003).
 - 3.2 Amended and Restated Bye-Laws (incorporated by reference to Appendix B to the Definitive Proxy Statement for the 2009 Annual General Meeting of Shareholders filed on March 27, 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 Certificate of Designations setting from 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).
 - 4.3 Certificate of Designations setting from 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).
 - 10.1 2010 Directors Annual Compensation Program.
 - 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.

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SIGNATURES

Pursuant to the requirements 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.

Dated: November 3, 2009

AXIS CAPITAL HOLDINGS LIMITED

By:

/s/ JOHN R. CHARMAN
John R. Charman
President and Chief Executive Officer

/s/ DAVID B. GREENFIELD
David B. Greenfield
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)