

XL GROUP PLC
Form 10-Q
November 03, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from _____ to _____

Commission file number 1-10804

XL GROUP

Public Limited Company

(Exact name of registrant as specified in its charter)

Ireland

(State or other jurisdiction of
incorporation or organization)

XL House, 8 St. Stephen's Green, Dublin 2, Ireland
(Address of principal executive offices and zip code)

+353 (1) 400-5500

(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 for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No "

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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. (Check one):

Large accelerated filer x 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 x

As of October 30, 2014, there were 258,053,681 outstanding Ordinary Shares, \$0.01 par value per share, of the registrant.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

XL GROUP PLC

UNAUDITED CONSOLIDATED BALANCE SHEETS

(U.S. dollars in thousands, except share data)

	September 30, 2014	December 31, 2013
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost: 2014, \$28,418,355; 2013, \$27,111,874)	\$29,806,144	\$27,500,136
Equity securities, at fair value (cost: 2014, \$848,171; 2013, \$903,201)	960,368	1,040,237
Short-term investments, at fair value (amortized cost: 2014, \$284,898; 2013, \$455,470)	281,887	456,288
Total investments available for sale	\$31,048,399	\$28,996,661
Fixed maturities, held to maturity at amortized cost (fair value: 2014, nil; 2013, \$3,131,235)	—	2,858,695
Investments in affiliates	1,599,586	1,370,943
Other investments	1,277,442	1,164,630
Total investments	\$33,925,427	\$34,390,929
Cash and cash equivalents	2,353,734	1,800,832
Accrued investment income	330,149	346,809
Deferred acquisition costs	420,953	670,659
Ceded unearned premiums	1,025,054	788,871
Premiums receivable	2,801,683	2,612,602
Reinsurance balances receivable	166,280	118,885
Unpaid losses and loss expenses recoverable	3,431,137	3,435,230
Receivable from investments sold	26,846	144,765
Goodwill and other intangible assets	450,411	411,611
Deferred tax asset	209,334	237,884
Other assets	768,748	693,810
Total assets	\$45,909,756	\$45,652,887
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Unpaid losses and loss expenses	\$19,936,982	\$20,481,065
Deposit liabilities	1,242,696	1,509,243
Future policy benefit reserves	4,965,907	4,803,816
Funds withheld on life retrocession arrangements (net of future policy benefit reserves recoverable: 2014, \$4,560,388; 2013, nil)	914,773	—
Unearned premiums	4,301,271	3,846,526
Notes payable and debt	1,662,206	2,263,203
Reinsurance balances payable	608,188	302,399
Payable for investments purchased	85,312	60,162
Deferred tax liability	65,320	86,330
Other liabilities	906,327	950,845
Total liabilities	\$34,688,982	\$34,303,589
Commitments and Contingencies		
Shareholders' Equity:	\$2,602	\$2,783

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Ordinary shares, 999,990,000 authorized, par value \$0.01; issued and outstanding (2014, 260,249,801; 2013, 278,253,308)

Additional paid in capital	7,490,875	7,994,100
Accumulated other comprehensive income	1,231,929	736,657
Retained earnings	1,115,648	1,264,093
Shareholders' equity attributable to XL Group plc	\$9,841,054	\$9,997,633
Non-controlling interest in equity of consolidated subsidiaries	1,379,720	1,351,665
Total shareholders' equity	\$11,220,774	\$11,349,298
Total liabilities and shareholders' equity	\$45,909,756	\$45,652,887
See accompanying Notes to Unaudited Consolidated Financial Statements		

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
(U.S. dollars in thousands, except per share data)	2014	2013	2014	2013
Revenues:				
Net premiums earned	\$1,473,412	\$1,625,312	\$4,458,845	\$4,717,396
Net investment income:				
Net investment income - excluding Life Funds Withheld Assets	169,956	237,921	616,753	716,935
Net investment income - Life Funds Withheld Assets	56,474	—	75,639	—
Total net investment income	\$226,430	\$237,921	\$692,392	\$716,935
Realized investment gains (losses):				
Net realized gains (losses) on investments sold - excluding Life Funds Withheld Assets	10,957	1,229	139,373	85,733
Other-than-temporary impairments ("OTTI") on investments - excluding Life Funds Withheld Assets	(752)	) (2,388	) (27,390	) (7,676
OTTI on investments transferred to (from) other comprehensive income - excluding Life Funds Withheld Assets	(392)	) (799	) (2,097	) (2,538
Net realized gains (losses) on investments sold - Life Funds Withheld Assets	2,022	—	2,646	—
OTTI on investments - Life Funds Withheld Assets	(7,494)	) —	(16,265) —
Total net realized gains (losses) on investments	\$4,341	\$(1,958)	\$96,267	\$75,519
Net realized and unrealized gains (losses) on derivative instruments	5,131	880	18,540	3,660
Net realized and unrealized gains (losses) on life retrocession embedded derivative and derivative instruments - Life Funds Withheld Assets	(201,264)	) —	(218,810)) —
Income (loss) from investment fund affiliates	24,500	5,079	75,486	83,843
Fee income and other	10,782	10,875	31,942	31,378
Total revenues	\$1,543,332	\$1,878,109	\$5,154,662	\$5,628,731
Expenses:				
Net losses and loss expenses incurred	\$859,588	\$1,006,520	\$2,518,973	\$2,787,210
Claims and policy benefits	20,101	116,549	218,987	344,269
Acquisition costs	182,882	238,328	566,915	690,473
Operating expenses	341,255	311,506	984,709	898,497
Exchange (gains) losses	(23,348)	) 20,303	8,234	(24,463)
Loss on sale of life reinsurance subsidiary	—	—	666,423	—
Interest expense	42,851	37,926	99,877	114,830
Total expenses	\$1,423,329	\$1,731,132	\$5,064,118	\$4,810,816
Income (loss) before income tax and income (loss) from operating affiliates	\$120,003	\$146,977	\$90,544	\$817,915
Income (loss) from operating affiliates	20,021	24,590	94,044	88,413
Provision (benefit) for income tax	30,057	897	58,724	73,248
Net income (loss)	\$109,967	\$170,670	\$125,864	\$833,080
Non-controlling interests	37,583	35,022	77,024	73,944
Net income (loss) attributable to ordinary shareholders	\$72,384	\$135,648	\$48,840	\$759,136
Weighted average ordinary shares and ordinary share equivalents outstanding, in thousands – basic	264,353	285,393	270,494	289,957

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Weighted average ordinary shares and ordinary share equivalents outstanding, in thousands – diluted	269,140	290,490	274,912	294,828
Earnings (loss) per ordinary share and ordinary share equivalent – basic	\$0.27	\$0.48	\$0.18	\$2.62
Earnings (loss) per ordinary share and ordinary share equivalent – diluted	\$0.27	\$0.47	\$0.18	\$2.57

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
(U.S. dollars in thousands)	2014	2013	2014	2013
Net income (loss) attributable to ordinary shareholders	\$72,384	\$135,648	\$48,840	\$759,136
Change in net unrealized gains (losses) on investments - excluding Life Funds Withheld Assets, net of tax	(130,135)	104,198	371,945	(690,401)
Unrealized gains on held to maturity investment portfolio at time of transfer to available for sale, net of tax	—	—	424,861	—
Change in adjustments related to future policy benefit reserves, net of tax	51,286	(37,503)	(423,179)	(70,305)
Change in net unrealized gains (losses) on investments - Life Funds Withheld Assets, net of tax	93,921	—	106,218	—
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	15,172	(27,831)	29,145	(2,189)
Change in OTTI losses recognized in other comprehensive income, net of tax	5,963	7,469	10,895	27,089
Change in underfunded pension liability, net of tax	418	1,093	379	1,388
Change in value of cash flow hedge	83	110	303	330
Foreign currency translation adjustments, net of tax	(11,814)	4,020	(25,295)	(23,616)
Comprehensive income (loss)	\$97,278	\$187,204	\$544,112	\$1,432

See accompanying Notes to Unaudited Consolidated Financial Statements

XL GROUP PLC

UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Nine Months Ended September 30,	
(U.S. dollars in thousands)	2014	2013
Ordinary Shares:		
Balance - beginning of year	\$2,783	\$2,987
Issuance of ordinary shares	11	11
Buybacks of ordinary shares	(196)	(177)
Exercise of stock options	4	7
Balance - end of period	\$2,602	\$2,828
Additional Paid in Capital:		
Balance - beginning of year	\$7,994,100	\$8,584,752
Issuance of ordinary shares	20	22
Buybacks of ordinary shares	(560,007)	(499,229)
Exercise of stock options	5,408	9,711
Share-based compensation expense	51,354	34,667
Balance - end of period	\$7,490,875	\$8,129,923
Accumulated Other Comprehensive Income (Loss):		
Balance - beginning of year	\$736,657	\$1,520,020
Change in net unrealized gains (losses) on investments - excluding Life Funds Withheld Assets, net of tax	371,945	(690,401)
Unrealized gains on held to maturity investment portfolio at time of transfer to available for sale, net of tax	424,861	—
Change in adjustments related to future policy benefit reserves, net of tax	(423,179)	(70,305)
Change in net unrealized gains (losses) on investments - Life Funds Withheld Assets, net of tax	106,218	—
Change in net unrealized gains (losses) on affiliate and other investments, net of tax	29,145	(2,189)
Change in OTTI losses recognized in other comprehensive income, net of tax	10,895	27,089
Change in underfunded pension liability, net of tax	379	1,388
Change in value of cash flow hedge	303	330
Foreign currency translation adjustments, net of tax	(25,295)	(23,616)
Balance - end of period	\$1,231,929	\$762,316
Retained Earnings (Deficit):		
Balance - beginning of year	\$1,264,093	\$402,318
Net income (loss) attributable to ordinary shareholders	48,840	759,136
Dividends on ordinary shares	(130,713)	(122,513)
Buybacks of ordinary shares	(66,572)	(26,112)
Balance - end of period	\$1,115,648	\$1,012,829
Non-controlling Interest in Equity of Consolidated Subsidiaries:		
Balance - beginning of year	\$1,351,665	\$1,346,325
Non-controlling interests - contributions	24,839	500
Non-controlling interests - distributions	—	(37)
Non-controlling interests	3,216	(300)
Non-controlling interest share in change in accumulated other comprehensive income (loss)	—	(29)
Non-controlling interests - deconsolidation	—	(1,841)
Balance - end of period	\$1,379,720	\$1,344,618
Total Shareholders' Equity	\$11,220,774	\$11,252,514
See accompanying Notes to Unaudited Consolidated Financial Statements		

XL GROUP PLC
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
(U.S. dollars in thousands)	2014	2013
Cash flows provided by (used in) operating activities:		
Net income (loss)	\$ 125,864	\$ 833,080
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Net realized (gains) losses on investments	(96,267)	(75,519)
Net realized and unrealized (gains) losses on derivative instruments	(18,540)	(3,660)
Net realized and unrealized gains (losses) on life retrocession embedded derivative and derivative instruments - Life Funds Withheld Assets	218,810	—
Amortization of premiums (discounts) on fixed maturities	118,021	127,524
(Income) loss from investment and operating affiliates	(107,659)	(172,256)
Loss on sale of life reinsurance subsidiary	666,423	—
Share-based compensation	65,304	45,447
Depreciation	43,511	44,147
Accretion of deposit liabilities	3,136	36,779
Changes in:		
Unpaid losses and loss expenses	(128,919)	(85,471)
Future policy benefit reserves	(172,234)	(128,281)
Funds withheld on life retrocession arrangements, net	2,968	—
Unearned premiums	524,393	486,249
Premiums receivable	(262,435)	(341,520)
Unpaid losses and loss expenses recoverable	(230,870)	28,566
Ceded unearned premiums	(251,985)	(183,198)
Reinsurance balances receivable	(49,462)	(38,612)
Deferred acquisition costs	243,391	(47,859)
Reinsurance balances payable	264,994	338,769
Deferred tax asset - net	(42,142)	(3,693)
Derivatives	(6,262)	14,563
Other assets	(44,467)	(81,148)
Other liabilities	(154,501)	39,645
Other	16,953	19,337
Total adjustments	\$ 602,161	\$ 19,809
Net cash provided by (used in) operating activities	\$ 728,025	\$ 852,889
Cash flows provided by (used in) investing activities:		
Proceeds from sale of fixed maturities and short-term investments	\$ 4,048,233	\$ 3,042,348
Proceeds from redemption of fixed maturities and short-term investments	2,681,001	3,142,738
Proceeds from sale of equity securities	370,189	95,083
Purchases of fixed maturities and short-term investments	(5,616,992)	(6,480,368)
Purchases of equity securities	(326,319)	(358,484)
Proceeds from sale of affiliates	231,902	194,956
Purchases of affiliates	(293,974)	(289,716)
Proceeds from sale of life reinsurance subsidiary	570,000	—
Other, net	(158,250)	83,575
Net cash provided by (used in) investing activities	\$ 1,505,790	\$ (569,868)
Cash flows provided by (used in) financing activities:		
Proceeds from issuance of ordinary shares and exercise of stock options	\$ 5,411	\$ 9,718

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Buybacks of ordinary shares	(626,774)	(525,520)
Dividends paid on ordinary shares	(129,490)	(121,131)
Distributions to non-controlling interests	(41,463	)	(42,026)
Contributions from non-controlling interests	24,839		500	
Repayment of debt	(600,000)	—	
Deposit liabilities	(266,542	)	(87,788)
Net cash provided by (used in) financing activities	\$(1,634,019	)	\$(766,247)
Effects of exchange rate changes on foreign currency cash	(46,894	)	(4,259)
Increase (decrease) in cash and cash equivalents	\$552,902		\$(487,485)
Cash and cash equivalents - beginning of period	1,800,832		2,618,378	
Cash and cash equivalents - end of period	\$2,353,734		\$2,130,893	
See accompanying Notes to Unaudited Consolidated Financial Statements				

XL GROUP PLC

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation and Consolidation

Unless the context otherwise indicates, references herein to the “Company” include XL Group plc, an Irish public limited company (“XL-Ireland”), and its consolidated subsidiaries.

These unaudited consolidated financial statements include the accounts of the Company and all of its subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but do not include all disclosures required by GAAP. In the opinion of management, these unaudited financial statements reflect all adjustments considered necessary for a fair statement of financial position and results of operations at the end of and for the periods presented. The results of operations for any interim period are not necessarily indicative of the results for a full year. All inter-company accounts and transactions have been eliminated. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure about contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates. For further information, see Item 8, Note 2(a), “Significant Accounting Policies – Basis of Preparation and Consolidation,” to the Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. On October 31, 2014, the Company filed a current report on Form 8-K that included recasted financial statements to reflect changes in the Company’s reportable segments (the “Recast Financials”). Other than the changes to Notes 1, “General,” and 4, “Segment Information,” to describe the changes in the segments, the Recast Financials are identical to the Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

To facilitate period-to-period comparisons, certain reclassifications have been made to prior period consolidated financial statement amounts to conform to current period presentation.

2. Significant Accounting Policies

(a) Investments Related to Life Retrocession Arrangements written on a Funds Withheld Basis

The designated investments that support the life retrocession arrangements written on a funds withheld basis (“Life Funds Withheld Assets”) entered into in connection with the sale of our life reinsurance subsidiary are included within “Total investments available for sale”. Investment results for these assets - including interest income, unrealized gains and losses, and gains and losses from sales - are passed directly to the reinsurer pursuant to a contractual arrangement which is accounted for as a derivative. See Note 3, “Sale of Life Reinsurance Subsidiary,” for information regarding the reinsurance arrangement.

Changes in the fair value of the embedded derivative associated with these life retrocession arrangements are recorded in “Net realized and unrealized gains (losses) on life retrocession embedded derivative and derivative instruments - Life Funds Withheld Assets” on the consolidated statements of income. The fair value of the embedded derivative is included within “Funds withheld on life retrocession arrangements, net of future policy benefit reserves recoverable” on the consolidated balance sheets.

(b) Reinsurance

The Company enters into reinsurance agreements with other companies in the normal course of business. All premium and loss-related balances related to reinsurance agreements are reported on a gross basis within our consolidated balance sheets, with the exception of the life retrocession arrangements written on a funds withheld basis. The future policy benefit reserves recoverable related to these retrocession arrangements are netted against the funds withheld liability owing to the counterparty on the consolidated balance sheets due to the contractual right of offset.

During the three months ended September 30, 2014, the Company recorded \$20 million, net of tax, to premiums earned and associated tax accruals, related to reinstatement premiums due under assumed reinsurance contracts arising from unpaid losses and loss expenses reported in a prior period. We evaluated the quantitative and qualitative aspects of this correction and concluded that the impact of recognizing it during this quarter is not material to the consolidated

financial statements, nor is it material to previously issued consolidated financial statements in prior periods.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(c) Recent Accounting Pronouncements

In July 2013, the FASB issued an accounting standards update concerning the presentation of unrecognized tax benefits. The objective of the guidance is to improve the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The guidance seeks to reduce the diversity in practice by providing guidance on the presentation of unrecognized tax benefits to better reflect the manner in which an entity would settle, at the reporting date, any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The guidance was effective for annual and interim reporting periods beginning after December 15, 2013, with both early adoption and retrospective application permitted. This guidance did not have a significant impact on the Company's financial condition, results of operations or cash flows.

In April 2014, the FASB issued an accounting standards update intended to improve financial reporting by changing key criteria used to evaluate whether disposal transactions meet the definition of discontinued operations. Under the guidance only those disposals of components of an entity - either by sale or otherwise - which represent strategic shifts that have, or will have, a major effect on an entity's operations and financial results would qualify for reporting as discontinued operations. Disposals that are considered to be routine in nature can no longer be reported as discontinued operations. However, a disposal may now qualify for discontinued operations reporting even if the disposed component's operations and cash flows are not eliminated from on-going operations of the disposing entity, or if post-disposal, the disposing entity still has significant continuing involvement in the component's operations. The standard also establishes both additional disclosure requirements and expanded disclosures regarding on-going involvement an entity may have with a discontinued operation after its disposal. The guidance is effective prospectively for all public company disposals (or component reclassifications to held-for-sale) that occur within annual periods beginning on or after December 15, 2014. Early adoption is permitted, but only for disposals (or component reclassifications to held-for-sale) that have not been reported in financial statements issued or available for issuance prior to the effective date. This guidance is not expected to have a significant impact on the Company's financial condition, results of operations or cash flows.

3. Sale of Life Reinsurance Subsidiary

On May 1, 2014, XL Insurance (Bermuda) Ltd ("XLIB") entered into a sale and purchase agreement with GreyCastle Holdings Ltd. ("GreyCastle") providing for the sale of 100% of the common shares of XL Life Reinsurance (SAC) Ltd ("XLLR") (subsequent to the transaction XLLR changed its name to GreyCastle Life Reinsurance (SAC) Ltd), a wholly-owned subsidiary of XLIB, to GreyCastle for \$570 million in cash. This transaction was completed on May 30, 2014. As a result of the transaction, XLLR reinsures the majority of the Company's life reinsurance business via 100% quota share reinsurance (the "Life Retro Arrangements"). This transaction covers a substantial portion of the Company's life reinsurance reserves. The Company announced the run-off of its life reinsurance business in 2009. The run-off life reinsurance business, including the business subject to the transaction, was previously reported within the Company's Life operations segment. Subsequent to the transaction, the Company no longer considers the Life operations to be a separate operating segment and the results of the life run-off business are reported within "Corporate and Other." See Note 5, "Segment Information" for further information. In addition, certain securities within fixed maturities were reclassified from held to maturity to available for sale in conjunction with this transaction. See Note 6, "Investments," for further information.

All of the reclassified securities are included within Life Funds Withheld Assets, along with certain other available for sale securities as defined in the sale and purchase agreement. The Life Funds Withheld Assets are managed pursuant to agreed investment guidelines that meet the contractual commitments of the XL ceding companies and applicable laws and regulations. All of the investment results associated with the Life Funds Withheld Assets ultimately accrue to GreyCastle. Because the Company no longer shares in the risks and rewards of the underlying performance of the supporting invested assets, disclosures within the financial statement notes included herein separate the Life Funds Withheld Assets from the rest of the Company's investments.

At May 30, 2014, gross future policy benefit reserves relating to the Life operations were approximately \$5.2 billion. Subsequent to the completion of this transaction the Company retained approximately \$0.4 billion of these reserves, and recorded a reinsurance recoverable from XLLR of \$4.8 billion. Under the terms of the transaction, the Company continues to own, on a funds withheld basis, assets supporting the Life Retro Arrangements consisting of cash, fixed maturity securities and accrued interest. Based upon the right of offset, the funds withheld liability owing to GreyCastle is recorded net of future policy benefit reserves recoverable, and is included within "Funds withheld on life retrocession arrangements, net of future policy benefit reserves recoverable" on the unaudited consolidated balance sheets. The transaction resulted in an overall after-tax U.S. GAAP net loss of \$621.3 million recorded in the three months ended June 30, 2014.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

At September 30, 2014, gross future policy benefit reserves relating to the run-off life operations were approximately \$5.0 billion, of which the Company retained approximately \$0.4 billion, after consideration of its future policy benefit reserves recoverable from XLLR of \$4.6 billion. The net funds withheld liability included within "Funds withheld on life retrocession arrangements, net of future policy benefit reserves recoverable" was \$0.9 billion. The Company continued to own \$5.5 billion of assets supporting the Life Retro Arrangements.

The impact of the Life Retro Arrangements on the Company's results since the completion of the transaction on May 30, 2014 were as follows:

Impact of Life Retro Arrangements	Three months ended September 30, 2014	May 30 to September 30, 2014
(U.S. dollars in thousands)		
Underwriting profit (loss) (1)	\$3,711	\$3,711
Net investment income - Life Funds Withheld Assets	56,474	75,639
Net realized gains (losses) on investments sold - Life Funds Withheld Assets	2,022	2,646
OTTI on investments - Life Funds Withheld Assets	(7,494)	(16,265)
Exchange (gains) losses	2,062	2,062
Other income and expenses	124	105
Net realized and unrealized gains (losses) on life retrocession embedded derivative and derivative instruments - Life Funds Withheld Assets	(201,264)	(218,810)
Net income (loss)	\$(144,365)	\$(150,912)
Change in net unrealized gains (losses) on investments - Life Funds Withheld Assets, net of tax	93,921	106,218
Change in adjustments related to future policy benefit reserves, net of tax	51,286	51,286
Change in cumulative translation adjustment - Life Funds Withheld Assets, net of tax	2,869	(2,881)
Comprehensive income (loss)	\$3,711	\$3,711

(1) The underwriting profit of \$3.7 million relates to a premium adjustment during the three months ended September 30, 2014 relating to the Life Retro Arrangements transaction which was completed on May 30, 2014. Excluding this transaction related impact the changes to other comprehensive income relating to the Life Retro Arrangements was \$148.1 million and \$154.6 million for the three and nine months ended September 30, 2014, respectively.

As shown in the table above, although the Company's net income (loss) is subject to variability related to the Life Retro Arrangements, there is minimal impact on the company's comprehensive income in any period. The life retrocession embedded derivative value includes the interest income, unrealized gains and losses, and realized gains and losses from sales on the Life Funds Withheld Assets subsequent to May 30, 2014.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. Fair Value Measurements

Fair value is defined as the amount that would be received for the sale of an asset or paid to transfer a liability (an exit price), in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants as of the measurement date. Applicable accounting guidance provides an established hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors that market participants would use in valuing the asset or liability. Assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurements. The Company reviews the fair value hierarchy classification on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification of levels for certain securities within the fair value hierarchy.

The fair values for available for sale investments are generally sourced from third parties. The fair value of fixed income securities is based upon quoted market values where available, "evaluated bid" prices provided by third party pricing services ("pricing services") where quoted market values are not available, or by reference to broker quotes where pricing services do not provide coverage for a particular security. While the Company receives values for the majority of the investment securities it holds from pricing services, it is ultimately management's responsibility to determine whether the values received and recorded in the financial statements are representative of appropriate fair value measurements.

The Company performs regular reviews of the prices received from its third party valuation sources to assess if the prices represent a reasonable estimate of the fair value. This process is completed by investment and accounting personnel who are independent of those responsible for obtaining the valuations. The approaches taken by the Company include, but are not limited to, annual reviews of the controls of the external parties responsible for sourcing valuations, which are subjected to automated tolerance checks, quarterly reviews of the valuation sources and dates, and monthly reconciliations between the valuations provided by our external parties and valuations provided by our third party investment managers at a portfolio level.

Where broker quotes are the primary source of the valuations, sufficient information regarding the specific inputs utilized by the brokers is generally not available to support a Level 2 classification. The Company obtains the majority of broker quoted values from third party investment managers who perform independent verifications of these valuations using pricing matrices based upon information gathered by market traders. In addition, for the majority of these securities, the Company compares the broker quotes to independent valuations obtained from third party pricing vendors, which may also consist of broker quotes, to assess if the prices received represent a reasonable estimate of the fair value.

As discussed in Note 2(a), "Significant Accounting Policies - Investments Related to Life Retrocession Arrangements written on a Funds Withheld Basis," under the Life Retro Arrangements, all of the investment results associated with the Life Funds Withheld Assets ultimately accrue to GreyCastle. Because the Company no longer shares in the risks and rewards of the underlying performance of the Life Funds Withheld Assets, the financial statements and accompanying notes included herein separately report the Life Funds Withheld Assets from the rest of the Company's investments.

For further information, see Item 8, Note 2(b), "Significant Accounting Policies - Fair Value Measurements," to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

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(a) Fair Value Summary

The following tables set forth the Company's assets and liabilities that were accounted for at fair value at September 30, 2014 and December 31, 2013 by level within the fair value hierarchy:

September 30, 2014 (U.S. dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Collateral and Counterparty Netting	Balance at September 30, 2014
Assets					
Fixed maturities - Available for Sale ("AFS") - Excluding Life Funds					
Withheld Assets					
U.S. Government and Government-Related/Supported	\$—	\$2,127,508	\$—	\$—	\$2,127,508
Corporate (1)	—	9,419,983	7,042	—	9,427,025
Residential mortgage-backed securities – Agency ("RMBS - Agency")	—	3,328,400	6,482	—	3,334,882
Residential mortgage-backed securities – Non-Agency ("RMBS - Non-Agency")	—	435,644	10	—	435,654
Commercial mortgage-backed securities ("CMBS")	—	1,099,253	—	—	1,099,253
Collateralized debt obligations ("CDO")	—	4,152	742,483	—	746,635
Other asset-backed securities	—	1,145,415	12,050	—	1,157,465
U.S. States and political subdivisions of the States	—	1,981,459	—	—	1,981,459
Non-U.S. Sovereign Government, Provincial, Supranational and Government-Related/Supported	—	4,233,178	—	—	4,233,178
Total fixed maturities - AFS - Excluding Funds Withheld Assets, at fair value	\$—	\$23,774,992	\$768,067	\$—	\$24,543,059
Equity securities, at fair value	589,321	371,047	—	—	960,368
Short-term investments, at fair value (1)(2)	—	281,887	—	—	281,887
Total investments AFS - Excluding Funds Withheld Assets	\$589,321	\$24,427,926	\$768,067	\$—	\$25,785,314
Fixed maturities - Life Funds Withheld Assets					
U.S. Government and Government-Related/Supported	\$—	\$18,326	\$—	\$—	\$18,326
Corporate	—	2,898,684	—	—	2,898,684
RMBS – Agency	—	3,896	—	—	3,896
RMBS – Non-Agency	—	86,542	—	—	86,542
CMBS	—	200,348	—	—	200,348