

AXIS CAPITAL HOLDINGS LTD  
Form 10-Q  
April 27, 2012  
Table of Contents

**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 March 31, 2012

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 April 20, 2012, there were 129,403,012 Common Shares, \$0.0125 par value per share, of the registrant outstanding.

**Table of Contents**

**AXIS CAPITAL HOLDINGS LIMITED**

**INDEX TO FORM 10-Q**

|                       | <b>Page</b>   |
|-----------------------|---|
| <b><u>PART I</u></b>  |   |
|                       | <b><u>Financial Information</u></b>   |
| Item 1.               | <u>Consolidated Financial Statements</u> 4  |
| Item 2.               | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 31 |
| Item 3.               | <u>Quantitative and Qualitative Disclosures About Market Risk</u> 57                            |
| Item 4.               | <u>Controls and Procedures</u> 57   |
| <b><u>PART II</u></b> |   |
|                       | <b><u>Other Information</u></b>   |
| Item 1.               | <u>Legal Proceedings</u> 58   |
| Item 1A.              | <u>Risk Factors</u> 58  |
| Item 2.               | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 59                           |
| Item 6.               | <u>Exhibits</u> 60  |
|                       | <u>Signatures</u> 61  |

**Table of Contents**

**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 and magnitude of natural and man-made disasters,

actual claims exceeding our loss reserves,

general economic, capital and credit market conditions,

the failure of any of the loss limitation methods we employ,

the effects of emerging claims, coverage and regulatory issues,

the failure of our cedants to adequately evaluate risks,

inability to obtain additional capital on favorable terms, or at all,

the loss of one or more key executives,

a decline in our ratings with rating agencies,

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loss of business provided to us by our major brokers,

changes in accounting policies or practices,

the use of industry catastrophe models and changes to these models,

changes in governmental regulations,

increased competition,

changes in the political environment of certain countries in which we operate or underwrite business,

fluctuations in interest rates, credit spreads, equity prices and/or currency values, and

the other matters set forth under Item 1A, *Risk Factors* and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations* included in our Annual Report on Form 10-K for the year ended December 31, 2011.

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

**Table of Contents**

**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS**

|  | <b>Page</b> |
|--|-------------|
| <u>Consolidated Balance Sheets at March 31, 2012 (Unaudited) and December 31, 2011</u>   | 5           |
| <u>Consolidated Statements of Operations for the three months ended March 31, 2012 and 2011 (Unaudited)</u>                      | 6           |
| <u>Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2012 and 2011 (Unaudited)</u>     | 7           |
| <u>Consolidated Statements of Changes in Shareholders' Equity for the three months ended March 31, 2012 and 2011 (Unaudited)</u> | 8           |
| <u>Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011 (Unaudited)</u>                      | 9           |
| <u>Notes to the Consolidated Financial Statements (Unaudited)</u>  | 10          |

**Table of Contents****AXIS CAPITAL HOLDINGS LIMITED****CONSOLIDATED BALANCE SHEETS****MARCH 31, 2012 (UNAUDITED) AND DECEMBER 31, 2011**

|   | 2012                 | 2011                 |
|---|----------------------|----------------------|
|   | (in thousands)       |                      |
| <b>Assets</b>   |                      |                      |
| Investments:  |                      |                      |
| Fixed maturities, available for sale, at fair value<br>(Amortized cost 2012: \$11,214,712; 2011: \$10,821,338)    | \$ 11,440,643        | \$ 10,940,100        |
| Equity securities, available for sale, at fair value<br>(Cost 2012: \$703,938; 2011: \$699,566)                   | 757,038              | 677,560              |
| Other investments, at fair value  | 769,554              | 699,320              |
| Short-term investments, at fair value and amortized cost  | 50,264               | 149,909              |
| <b>Total investments</b>  | <b>13,017,499</b>    | <b>12,466,889</b>    |
| Cash and cash equivalents   | 1,021,839            | 981,849              |
| Restricted cash and cash equivalents  | 151,932              | 100,989              |
| Accrued interest receivable   | 93,860               | 98,346               |
| Insurance and reinsurance premium balances receivable   | 1,900,002            | 1,413,839            |
| Reinsurance recoverable on unpaid and paid losses   | 1,766,597            | 1,770,329            |
| Deferred acquisition costs  | 547,667              | 407,527              |
| Prepaid reinsurance premiums  | 227,935              | 238,623              |
| Receivable for investments sold   | 7,276                | 3,006                |
| Goodwill and intangible assets  | 99,439               | 99,590               |
| Other assets  | 191,554              | 225,072              |
| <b>Total assets</b>   | <b>\$ 19,025,600</b> | <b>\$ 17,806,059</b> |
| <b>Liabilities</b>  |                      |                      |
| Reserve for losses and loss expenses  | \$ 8,599,344         | \$ 8,425,045         |
| Unearned premiums   | 2,965,329            | 2,454,462            |
| Insurance and reinsurance balances payable  | 181,405              | 206,539              |
| Senior notes  | 994,806              | 994,664              |
| Other liabilities   | 270,627              | 129,329              |
| Payable for investments purchased   | 114,910              | 151,941              |
| <b>Total liabilities</b>  | <b>13,126,421</b>    | <b>12,361,980</b>    |
| <b>Commitments and Contingencies</b>  |                      |                      |
| <b>Shareholders equity</b>  |                      |                      |
| Preferred shares - Series A, B, and C   | 750,000              | 500,000              |
| Common shares (2012: 171,408; 2011: 170,159 shares issued<br>and 2012: 125,365; 2011: 125,588 shares outstanding) | 2,140                | 2,125                |
| Additional paid-in capital  | 2,117,208            | 2,105,386            |
| Accumulated other comprehensive income  | 278,174              | 128,162              |
| Retained earnings   | 4,246,354            | 4,155,392            |
| Treasury shares, at cost (2012: 46,043; 2011: 44,571 shares)  | (1,494,697)          | (1,446,986)          |

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|  |                      |               |
|--|----------------------|---------------|
| <b>Total shareholders equity</b>                 | <b>5,899,179</b>     | 5,444,079     |
| <b>Total liabilities and shareholders equity</b> | <b>\$ 19,025,600</b> | \$ 17,806,059 |

See accompanying notes to Consolidated Financial Statements.



**Table of Contents****AXIS CAPITAL HOLDINGS LIMITED****CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)****FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2011**

|  | 2012   | 2011                |
|--|--|---------------------|
|  | (in thousands, except for per share amounts) |                     |
| <b>Revenues</b>  |  |                     |
| Net premiums earned  | \$ 846,362                                   | \$ 788,201          |
| Net investment income  | 116,023                                      | 110,655             |
| Other insurance related income   | 631  | 763                 |
| Net realized investment gains:   |  |                     |
| Other-than-temporary impairment (OTTI) losses                              | (3,909)                                      | (2,155)             |
| Non-credit portion of OTTI losses recognized in other comprehensive income | -  | 215                 |
| Other realized investment gains  | 18,400                                       | 32,084              |
| <b>Total net realized investment gains</b>                                 | <b>14,491</b>                                | <b>30,144</b>       |
| <b>Total revenues</b>  | <b>977,507</b>                               | <b>929,763</b>      |
| <b>Expenses</b>  |  |                     |
| Net losses and loss expenses   | 510,690                                      | 1,019,801           |
| Acquisition costs  | 168,397                                      | 135,356             |
| General and administrative expenses  | 123,652                                      | 116,520             |
| Foreign exchange losses  | 20,447                                       | 15,058              |
| Interest expense and financing costs                                       | 15,636                                       | 15,860              |
| <b>Total expenses</b>  | <b>838,822</b>                               | <b>1,302,595</b>    |
| <b>Income (loss) before income taxes</b>                                   | <b>138,685</b>                               | <b>(372,832)</b>    |
| Income tax expense   | 2,848  | 1,709               |
| <b>Net income (loss)</b>   | <b>135,837</b>                               | <b>(374,541)</b>    |
| Preferred share dividends  | 9,219  | 9,219               |
| Loss on repurchase of preferred shares                                     | 4,621  | -                   |
| <b>Net income (loss) available to common shareholders</b>                  | <b>\$ 121,997</b>                            | <b>\$ (383,760)</b> |
| <b>Per share data</b>  |  |                     |
| Net income (loss) per common share:  |  |                     |
| Basic net income (loss)  | \$ 0.97                                      | \$ (3.39)           |
| Diluted net income (loss)  | \$ 0.96                                      | \$ (3.39)           |
| Weighted average number of common shares outstanding - basic               | 125,782                                      | 113,351             |
| Weighted average number of common shares outstanding - diluted             | 126,668                                      | 113,351             |
| Cash dividends declared per common share                                   | \$ 0.24                                      | \$ 0.23             |

See accompanying notes to Consolidated Financial Statements.



**Table of Contents****AXIS CAPITAL HOLDINGS LIMITED****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)****FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2011**

|  | <b>2012</b>           | <b>2011</b>         |
|--|-----------------------|---------------------|
|  | <b>(in thousands)</b> |                     |
| <b>Net income (loss)</b>   | <b>\$ 135,837</b>     | <b>\$ (374,541)</b> |
| <b>Other comprehensive income (loss), net of tax:</b>  |                       |                     |
| Available for sale investments:  |                       |                     |
| Unrealized gains arising during the period   | <b>164,413</b>        | 12,782              |
| Adjustment for re-classification of realized investment gains and OTTI losses recognized in net income | <b>(15,194)</b>       | (35,949)            |
| Unrealized gains (losses) arising during the period, net of reclassification adjustment                | <b>149,219</b>        | (23,167)            |
| Non-credit portion of OTTI losses  | -                     | (215)               |
| Foreign currency translation adjustment  | <b>793</b>            | 1,753               |
| <b>Total other comprehensive income (loss), net of tax</b>   | <b>150,012</b>        | <b>(21,629)</b>     |
| <b>Comprehensive income (loss)</b>   | <b>\$ 285,849</b>     | <b>\$ (396,170)</b> |

See accompanying notes to Consolidated Financial Statements.

**Table of Contents****AXIS CAPITAL HOLDINGS LIMITED****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)****FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2011**

|   | 2012             | 2011             |
|---|------------------|------------------|
|   | (in thousands)   |                  |
| <b>Preferred shares - Series A, B, and C</b>  |                  |                  |
| Balance at beginning of period  | \$ 500,000       | \$ 500,000       |
| Shares issued - Series C  | 400,000          | -                |
| Shares repurchased - Series A   | (150,000)        | -                |
| <b>Balance at end of period</b>   | <b>750,000</b>   | <b>500,000</b>   |
| <b>Common shares (par value)</b>  |                  |                  |
| Balance at beginning of period  | 2,125            | 1,934            |
| Shares issued   | 15               | 24               |
| <b>Balance at end of period</b>   | <b>2,140</b>     | <b>1,958</b>     |
| <b>Additional paid-in capital</b>   |                  |                  |
| Balance at beginning of period  | 2,105,386        | 2,059,708        |
| Shares issued - common shares   | 998              | 1,410            |
| Issue costs on newly issued preferred shares  | (6,032)          | -                |
| Reversal of issue costs on repurchase of preferred shares                               | 4,621            | -                |
| Stock options exercised   | 235              | 3,417            |
| Share-based compensation expense  | 12,000           | 10,447           |
| <b>Balance at end of period</b>   | <b>2,117,208</b> | <b>2,074,982</b> |
| <b>Accumulated other comprehensive income</b>   |                  |                  |
| Balance at beginning of period  | 128,162          | 176,821          |
| Unrealized appreciation on available for sale investments, net of tax:                  |                  |                  |
| Balance at beginning of period  | 116,096          | 161,802          |
| Unrealized gains (losses) arising during the period, net of reclassification adjustment | 149,219          | (23,167)         |
| Non-credit portion of OTTI losses   | -                | (215)            |
| Balance at end of period  | 265,315          | 138,420          |
| <b>Cumulative foreign currency translation adjustments, net of tax:</b>                 |                  |                  |
| Balance at beginning of period  | 13,784           | 16,829           |
| Foreign currency translation adjustments  | 793              | 1,753            |
| Balance at end of period  | 14,577           | 18,582           |
| <b>Supplemental Executive Retirement Plans (SERPs):</b>                                 |                  |                  |
| Balance at beginning of period  | (1,718)          | (1,810)          |
| Net change in benefit plan assets and obligations recognized in equity                  | -                | -                |
| Balance at end of period  | (1,718)          | (1,810)          |

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|  |                     |              |
|--|---------------------|--------------|
| <b>Balance at end of period</b>          | <b>278,174</b>      | 155,192      |
| <b>Retained earnings</b>                 |                     |              |
| Balance at beginning of period           | <b>4,155,392</b>    | 4,267,608    |
| Net income (loss)                        | <b>135,837</b>      | (374,541)    |
| Series A and B preferred share dividends | <b>(9,219)</b>      | (9,219)      |
| Loss on repurchase of preferred shares   | <b>(4,621)</b>      | -            |
| Common share dividends                   | <b>(31,035)</b>     | (30,772)     |
| <b>Balance at end of period</b>          | <b>4,246,354</b>    | 3,853,076    |
| <b>Treasury shares, at cost</b>          |                     |              |
| Balance at beginning of period           | <b>(1,446,986)</b>  | (1,381,101)  |
| Shares repurchased for treasury          | <b>(47,711)</b>     | (14,527)     |
| <b>Balance at end of period</b>          | <b>(1,494,697)</b>  | (1,395,628)  |
| <b>Total shareholders equity</b>         | <b>\$ 5,899,179</b> | \$ 5,189,580 |

See accompanying notes to Consolidated Financial Statements.

**Table of Contents**

## AXIS CAPITAL HOLDINGS LIMITED

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

## FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2011

|   | 2012             | 2011             |
|---|------------------|------------------|
|   | (in thousands)   |                  |
| <b>Cash flows from operating activities:</b>  |                  |                  |
| Net income (loss)   | \$ 135,837       | \$ (374,541)     |
| <b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b> |                  |                  |
| Net realized investment gains   | (14,491)         | (30,144)         |
| Net realized and unrealized gains of other investments  | (40,420)         | (25,031)         |
| Amortization of fixed maturities  | 29,749           | 20,134           |
| Other amortization and depreciation   | 3,009            | 3,435            |
| Share-based compensation expense  | 12,000           | 10,447           |
| <i>Changes in:</i>  |                  |                  |
| Accrued interest receivable   | 4,486            | 2,351            |
| Reinsurance recoverable balances  | 3,732            | (111,231)        |
| Deferred acquisition costs  | (140,140)        | (139,298)        |
| Prepaid reinsurance premiums  | 10,688           | 8,588            |
| Reserve for loss and loss expenses  | 174,299          | 981,486          |
| Unearned premiums   | 510,867          | 604,652          |
| Insurance and reinsurance balances, net   | (511,297)        | (560,084)        |
| Other items   | (2,778)          | (113,075)        |
| <b>Net cash provided by operating activities</b>  | <b>175,541</b>   | <b>277,689</b>   |
| <b>Cash flows from investing activities:</b>  |                  |                  |
| Purchases of:   |                  |                  |
| Fixed maturities  | (4,114,912)      | (3,794,801)      |
| Equity securities   | (108,848)        | (167,697)        |
| Other investments   | (50,084)         | (45,000)         |
| Short-term investments  | (79,398)         | (163,980)        |
| Proceeds from the sale of:  |                  |                  |
| Fixed maturities  | 3,311,446        | 3,237,485        |
| Equity securities   | 109,990          | 32,903           |
| Other investments   | 20,271           | 34,222           |
| Short-term investments  | 132,157          | 125,041          |
| Proceeds from redemption of fixed maturities  | 339,436          | 469,745          |
| Proceeds from redemption of short-term investments  | 46,970           | 78,649           |
| Purchase of other assets  | (5,491)          | (6,388)          |
| Change in restricted cash and cash equivalents  | (50,943)         | (7,083)          |
| <b>Net cash used in investing activities</b>  | <b>(449,406)</b> | <b>(206,904)</b> |
| <b>Cash flows from financing activities:</b>  |                  |                  |
| Net proceeds from issuance of preferred shares  | 393,968          | -                |
| Repurchase of common shares   | (47,711)         | (14,527)         |
| Dividends paid - common shares  | (32,398)         | (29,320)         |
| Dividends paid - preferred shares   | (9,219)          | (9,219)          |
| Proceeds from issuance of common shares   | 1,248            | 4,851            |

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|  |                     |                   |
|--|---------------------|-------------------|
| <b>Net cash (used in) provided by financing activities</b>           | <b>305,888</b>      | <b>(48,215)</b>   |
| Effect of exchange rate changes on foreign currency cash             | 7,967               | 11,181            |
| <b>Increase in cash and cash equivalents</b>                         | <b>39,990</b>       | <b>33,751</b>     |
| Cash and cash equivalents - beginning of period                      | 981,849             | 929,515           |
| <b>Cash and cash equivalents - end of period</b>                     | <b>\$ 1,021,839</b> | <b>\$ 963,266</b> |
| <b>Non-cash financing activities:</b>                                |                     |                   |
| Repurchase of Class A preferred shares included in other liabilities | \$ 150,000          | \$ -              |
| See accompanying notes to Consolidated Financial Statements.         |                     |                   |

**Table of Contents**

**AXIS CAPITAL HOLDINGS LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES**

**Basis of Presentation**

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

The consolidated balance sheet at March 31, 2012 and the consolidated statements of operations, comprehensive income (loss), shareholders equity and cash flows for the periods ended March 31, 2012 and 2011 have not been audited. The balance sheet at December 31, 2011 is derived from our audited financial statements.

These financial 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 ( *SEC* ) 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 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, 2011. Tabular dollar and share amounts are in thousands, except per share amounts.

**Significant Accounting Policies**

There have been no changes to our significant accounting policies as described in our Annual Report on Form 10-K for the year ended December 31, 2011.

**Adoption of New Accounting Standards**

**Goodwill**

Effective January 1, 2012, we prospectively adopted FASB guidance providing entities with the option to perform a qualitative assessment prior to calculating the estimated fair value of a reporting unit, the first step of the required annual goodwill impairment test. Entities able to qualitatively conclude that the fair value of a reporting unit more likely than not (a likelihood of more than 50%) exceeds its carrying amount can bypass the existing requirement to perform the quantitative annual impairment test. This new guidance does not change how the Company measures a goodwill impairment loss; thus, the adoption of this guidance did not impact our results of operations, financial condition or liquidity.

**Fair Value Measurement and Disclosures**

Effective January 1, 2012, we prospectively adopted FASB guidance amending existing fair value measurement guidance to:

clarify principal market determination,

address the fair value measurement of instruments with offsetting market or counterparty credit risks,



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clarify that the valuation premise and highest and best use concepts are not relevant to financial instruments,

limit the application of premiums and discounts,

prohibit the use of blockage factors to all three levels of the fair value hierarchy, and

expand disclosure requirements.

The adoption of this amended guidance did not impact our results of operations, financial condition or liquidity. The additional disclosures are provided in Note 4 Fair Value Measurements.

**Table of Contents****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***Balance Sheet Offsetting*

In December 2011, the FASB issued new guidance requiring additional disclosures about financial instruments and derivative instruments that are either: (1) offset for balance sheet presentation purposes or (2) subject to an enforceable master netting arrangement or similar arrangement, regardless of whether they are offset for balance sheet presentation purposes. This guidance will be effective at January 1, 2013, with retrospective presentation of the new disclosures required. As this new guidance is disclosure-related only and does not amend the existing balance sheet offsetting guidance, the adoption of this guidance will not impact our results of operations, financial condition or liquidity.

**2. SEGMENT INFORMATION**

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

The following table summarizes the underwriting results of our reportable segments, as well as and the carrying values of goodwill and intangible assets.

| Three months ended March 31,             | 2012             |                  |                   | 2011               |                     |                     |
|--|------------------|------------------|-------------------|--------------------|---------------------|---------------------|
|  | Insurance        | Reinsurance      | Total             | Insurance          | Reinsurance         | Total               |
| Gross premiums written                   | \$ 524,678       | \$ 1,000,490     | \$ 1,525,168      | \$ 424,991         | \$ 1,123,439        | \$ 1,548,430        |
| Net premiums written                     | 378,614          | 988,572          | 1,367,186         | 289,316            | 1,111,463           | 1,400,779           |
| Net premiums earned                      | 390,254          | 456,108          | 846,362           | 327,648            | 460,553             | 788,201             |
| Other insurance related income           | 631              | -                | 631               | 763                | -                   | 763                 |
| Net losses and loss expenses             | (241,724)        | (268,966)        | (510,690)         | (266,633)          | (753,168)           | (1,019,801)         |
| Acquisition costs                        | (61,155)         | (107,242)        | (168,397)         | (42,079)           | (93,277)            | (135,356)           |
| General and administrative expenses      | (77,444)         | (27,773)         | (105,217)         | (67,726)           | (27,386)            | (95,112)            |
| <b>Underwriting income (loss)</b>        | <b>\$ 10,562</b> | <b>\$ 52,127</b> | <b>62,689</b>     | <b>\$ (48,027)</b> | <b>\$ (413,278)</b> | <b>(461,305)</b>    |
| Corporate expenses                       |                  |                  | (18,435)          |                    |                     | (21,408)            |
| Net investment income                    |                  |                  | 116,023           |                    |                     | 110,655             |
| Net realized investment gains            |                  |                  | 14,491            |                    |                     | 30,144              |
| Foreign exchange losses                  |                  |                  | (20,447)          |                    |                     | (15,058)            |
| Interest expense and financing costs     |                  |                  | (15,636)          |                    |                     | (15,860)            |
| <b>Income (loss) before income taxes</b> |                  |                  | <b>\$ 138,685</b> |                    |                     | <b>\$ (372,832)</b> |

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|  |                  |              |                  |            |        |            |
|--|------------------|--------------|------------------|------------|--------|------------|
| Net loss and loss expense ratio          | <b>61.9%</b>     | <b>59.0%</b> | <b>60.3%</b>     | 81.4%      | 163.5% | 129.4%     |
| Acquisition cost ratio                   | <b>15.7%</b>     | <b>23.5%</b> | <b>19.9%</b>     | 12.8%      | 20.3%  | 17.1%      |
| General and administrative expense ratio | <b>19.9%</b>     | <b>6.1%</b>  | <b>14.6%</b>     | 20.7%      | 5.9%   | 14.8%      |
| <b>Combined ratio</b>                    | <b>97.5%</b>     | <b>88.6%</b> | <b>94.8%</b>     | 114.9%     | 189.7% | 161.3%     |
| <b>Goodwill and intangible assets</b>    | <b>\$ 99,439</b> | <b>\$ -</b>  | <b>\$ 99,439</b> | \$ 102,847 | \$ -   | \$ 102,847 |

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

The amortized cost or cost and fair values of our fixed maturities and equity securities were as follows:

|                                | Amortized<br>Cost or<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value        | Non-credit<br>OTTI<br>in AOCI <sup>(5)</sup> |
|--------------------------------|------------------------------|------------------------------|-------------------------------|----------------------|--|
| <b>At March 31, 2012</b>       |                              |                              |                               |                      |  |
| <b>Fixed maturities</b>        |                              |                              |                               |                      |  |
| U.S. government and agency     | \$ 1,236,263                 | \$ 3,116                     | \$ (2,748)                    | \$ 1,236,631         | \$ -   |
| Non-U.S. government            | 1,056,201                    | 15,065                       | (6,811)                       | 1,064,455            | -  |
| Corporate debt                 | 3,687,513                    | 114,270                      | (16,463)                      | 3,785,320            | -  |
| Agency RMBS <sup>(1)</sup>     | 2,750,017                    | 64,536                       | (2,455)                       | 2,812,098            | -  |
| CMBS <sup>(2)</sup>            | 423,012                      | 17,917                       | (242)                         | 440,687              | -  |
| Non-Agency RMBS                | 159,899                      | 1,827                        | (6,521)                       | 155,205              | (880)  |
| ABS <sup>(3)</sup>             | 804,490                      | 8,013                        | (10,463)                      | 802,040              | -  |
| Municipals <sup>(4)</sup>      | 1,097,317                    | 47,393                       | (503)                         | 1,144,207            | -  |
| <b>Total fixed maturities</b>  | <b>\$ 11,214,712</b>         | <b>\$ 272,137</b>            | <b>\$ (46,206)</b>            | <b>\$ 11,440,643</b> | <b>\$ (880)</b>                              |
| <b>Equity securities</b>       |                              |                              |                               |                      |  |
| Common stocks                  | \$ 381,596                   | \$ 57,744                    | \$ (6,528)                    | \$ 432,812           |  |
| Exchange-traded funds          | 226,902                      | 7,209                        | (7,824)                       | 226,287              |  |
| Foreign bond mutual funds      | 95,440                       | 2,499                        | -                             | 97,939               |  |
| <b>Total equity securities</b> | <b>\$ 703,938</b>            | <b>\$ 67,452</b>             | <b>\$ (14,352)</b>            | <b>\$ 757,038</b>    |  |
| <b>At December 31, 2011</b>    |                              |                              |                               |                      |  |
| <b>Fixed maturities</b>        |                              |                              |                               |                      |  |
| U.S. government and agency     | \$ 1,142,732                 | \$ 5,669                     | \$ (134)                      | \$ 1,148,267         | \$ -   |
| Non-U.S. government            | 1,241,664                    | 7,359                        | (36,572)                      | 1,212,451            | -  |
| Corporate debt                 | 3,581,320                    | 85,766                       | (57,495)                      | 3,609,591            | -  |
| Agency RMBS <sup>(1)</sup>     | 2,568,053                    | 69,073                       | (492)                         | 2,636,634            | -  |
| CMBS <sup>(2)</sup>            | 298,138                      | 14,816                       | (263)                         | 312,691              | -  |
| Non-Agency RMBS                | 177,529                      | 1,431                        | (13,247)                      | 165,713              | (1,120)                                      |
| ABS <sup>(3)</sup>             | 639,949                      | 7,094                        | (15,001)                      | 632,042              | -  |
| Municipals <sup>(4)</sup>      | 1,171,953                    | 52,438                       | (1,680)                       | 1,222,711            | -  |
| <b>Total fixed maturities</b>  | <b>\$ 10,821,338</b>         | <b>\$ 243,646</b>            | <b>\$ (124,884)</b>           | <b>\$ 10,940,100</b> | <b>\$ (1,120)</b>                            |

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### Equity securities

|                             |                |               |                 |                |
|-----------------------------|----------------|---------------|-----------------|----------------|
| Common stocks               | \$ 341,603     | \$ 25,143     | \$ (19,291)     | \$ 347,455     |
| Exchange-traded funds       | 239,411        | 77            | (25,507)        | 213,981        |
| Foreign bond mutual funds   | 118,552        | -             | (2,428)         | 116,124        |
| <br>Total equity securities | <br>\$ 699,566 | <br>\$ 25,220 | <br>\$ (47,226) | <br>\$ 677,560 |

(1) Residential mortgage-backed securities (RMBS) originated by U.S. agencies.

(2) Commercial mortgage-backed securities (CMBS).

(3) Asset-backed securities (ABS) include debt tranching securities collateralized primarily by auto loans, student loans, credit cards, and other asset types. This asset class also includes an insignificant position in collateralized loan obligations (CLOs) and collateralized debt obligations (CDOs).

(4) Municipals include bonds issued by states, municipalities and political subdivisions.

(5) Represents the non-credit component of the other-than-temporary impairment (OTTI) losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

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

In the normal course of investing activities, we actively manage allocations to non-controlling tranches of structured securities (variable interests) issued by VIEs. These structured securities include RMBS, CMBS and ABS and are included in the above table. Additionally, within our other investments portfolio, we also invest in limited partnerships (hedge and credit funds) and CLO equity tranch securities, which are all variable interests issued by VIEs (see Note 3(b)). For these variable interests, we do not have the power to direct the activities that are most significant to the economic performance of the VIEs and accordingly we are not the primary beneficiary for any of these VIEs. Our maximum exposure to loss on these interests is limited to the amount of our investment. We have not provided financial or other support with respect to these structured securities other than our original investment.

**Contractual Maturities**

The contractual maturities of fixed maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|  | Amortized<br>Cost    | Fair<br>Value        | % of Total<br>Fair Value |
|--|----------------------|----------------------|--------------------------|
| <b><u>At March 31, 2012</u></b>        |                      |                      |                          |
| <b><u>Maturity</u></b>                 |                      |                      |                          |
| Due in one year or less                | \$ 500,062           | \$ 501,131           | 4.4%                     |
| Due after one year through five years  | 4,681,361            | 4,749,326            | 41.4%                    |
| Due after five years through ten years | 1,762,801            | 1,842,509            | 16.1%                    |
| Due after ten years                    | 133,070              | 137,647              | 1.2%                     |
|  | <b>7,077,294</b>     | <b>7,230,613</b>     | <b>63.1%</b>             |
| Agency RMBS                            | 2,750,017            | 2,812,098            | 24.6%                    |
| CMBS                                   | 423,012              | 440,687              | 3.9%                     |
| Non-Agency RMBS                        | 159,899              | 155,205              | 1.4%                     |
| ABS                                    | 804,490              | 802,040              | 7.0%                     |
| <b>Total</b>                           | <b>\$ 11,214,712</b> | <b>\$ 11,440,643</b> | <b>100.0%</b>            |

**At December 31, 2011**

|  |                  |                  |              |
|--|------------------|------------------|--------------|
| <b><u>Maturity</u></b>                 |                  |                  |              |
| Due in one year or less                | \$ 543,100       | \$ 539,009       | 4.9%         |
| Due after one year through five years  | 4,694,832        | 4,685,866        | 42.8%        |
| Due after five years through ten years | 1,779,811        | 1,845,054        | 16.9%        |
| Due after ten years                    | 119,926          | 123,091          | 1.1%         |
|  | <b>7,137,669</b> | <b>7,193,020</b> | <b>65.7%</b> |
| Agency RMBS                            | 2,568,053        | 2,636,634        | 24.1%        |
| CMBS                                   | 298,138          | 312,691          | 2.9%         |
| Non-Agency RMBS                        | 177,529          | 165,713          | 1.5%         |
| ABS                                    | 639,949          | 632,042          | 5.8%         |

|              |               |               |        |
|--------------|---------------|---------------|--------|
| <b>Total</b> | \$ 10,821,338 | \$ 10,940,100 | 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:

|                                    | 12 months or greater |                    | Less than 12 months |                     | Total               |                     |
|------------------------------------|----------------------|--------------------|---------------------|---------------------|---------------------|---------------------|
|                                    | Fair Value           | Unrealized Losses  | Fair Value          | Unrealized Losses   | Fair Value          | Unrealized Losses   |
| <b><u>At March 31, 2012</u></b>    |                      |                    |                     |                     |                     |                     |
| <b>Fixed maturities</b>            |                      |                    |                     |                     |                     |                     |
| U.S. government and agency         | \$ -                 | \$ -               | \$ 797,097          | \$ (2,748)          | \$ 797,097          | \$ (2,748)          |
| Non-U.S. government                | -                    | -                  | 352,331             | (6,811)             | 352,331             | (6,811)             |
| Corporate debt                     | 30,461               | (911)              | 862,305             | (15,552)            | 892,766             | (16,463)            |
| Agency RMBS                        | -                    | -                  | 604,392             | (2,455)             | 604,392             | (2,455)             |
| CMBS                               | 1,956                | (52)               | 58,519              | (190)               | 60,475              | (242)               |
| Non-Agency RMBS                    | 40,847               | (4,323)            | 38,443              | (2,198)             | 79,290              | (6,521)             |
| ABS                                | 69,862               | (8,172)            | 181,695             | (2,291)             | 251,557             | (10,463)            |
| Municipals                         | 2,342                | (71)               | 49,626              | (432)               | 51,968              | (503)               |
| <b>Total fixed maturities</b>      | <b>\$ 145,468</b>    | <b>\$ (13,529)</b> | <b>\$ 2,944,408</b> | <b>\$ (32,677)</b>  | <b>\$ 3,089,876</b> | <b>\$ (46,206)</b>  |
| <b>Equity securities</b>           |                      |                    |                     |                     |                     |                     |
| Common stocks                      | \$ 6,027             | \$ (1,603)         | \$ 64,520           | \$ (4,925)          | \$ 70,547           | \$ (6,528)          |
| Exchange-traded funds              | -                    | -                  | 77,589              | (7,824)             | 77,589              | (7,824)             |
| Foreign bond mutual funds          | -                    | -                  | -                   | -                   | -                   | -                   |
| <b>Total equity securities</b>     | <b>\$ 6,027</b>      | <b>\$ (1,603)</b>  | <b>\$ 142,109</b>   | <b>\$ (12,749)</b>  | <b>\$ 148,136</b>   | <b>\$ (14,352)</b>  |
| <b><u>At December 31, 2011</u></b> |                      |                    |                     |                     |                     |                     |
| <b>Fixed maturities</b>            |                      |                    |                     |                     |                     |                     |
| U.S. government and agency         | \$ -                 | \$ -               | \$ 233,816          | \$ (134)            | \$ 233,816          | \$ (134)            |
| Non-U.S. government                | -                    | -                  | 786,034             | (36,572)            | 786,034             | (36,572)            |
| Corporate debt                     | 54,843               | (2,437)            | 1,228,479           | (55,058)            | 1,283,322           | (57,495)            |
| Agency RMBS                        | -                    | -                  | 105,059             | (492)               | 105,059             | (492)               |
| CMBS                               | 5,155                | (17)               | 11,243              | (246)               | 16,398              | (263)               |
| Non-Agency RMBS                    | 43,348               | (8,127)            | 85,053              | (5,120)             | 128,401             | (13,247)            |
| ABS                                | 65,096               | (9,497)            | 201,569             | (5,504)             | 266,665             | (15,001)            |
| Municipals                         | 8,450                | (1,467)            | 38,590              | (213)               | 47,040              | (1,680)             |
| <b>Total fixed maturities</b>      | <b>\$ 176,892</b>    | <b>\$ (21,545)</b> | <b>\$ 2,689,843</b> | <b>\$ (103,339)</b> | <b>\$ 2,866,735</b> | <b>\$ (124,884)</b> |



| <b>Equity securities</b>       |                 |                   |                   |                    |                   |                    |
|--------------------------------|-----------------|-------------------|-------------------|--------------------|-------------------|--------------------|
| Common stocks                  | \$ 4,445        | \$ (2,105)        | \$ 124,481        | \$ (17,186)        | \$ 128,926        | \$ (19,291)        |
| Exchange-traded funds          | -               | -                 | 212,050           | (25,507)           | 212,050           | (25,507)           |
| Foreign bond mutual funds      | -               | -                 | 116,124           | (2,428)            | 116,124           | (2,428)            |
| <b>Total equity securities</b> | <b>\$ 4,445</b> | <b>\$ (2,105)</b> | <b>\$ 452,655</b> | <b>\$ (45,121)</b> | <b>\$ 457,100</b> | <b>\$ (47,226)</b> |

Fixed Maturities

At March 31, 2012, 662 fixed maturities (2011: 791) were in an unrealized loss position of \$46 million (2011: \$125 million) of which \$8 million (2011: \$18 million) of this balance was related to securities below investment grade or not rated.

At March 31, 2012, 121 (2011: 138) securities have been in continuous unrealized loss position for 12 months or greater and have a fair value of \$145 million (2011: \$177 million). Following our credit impairment review, we concluded that these securities as well as the remaining securities in an unrealized loss position in the above table were temporarily depressed at March 31, 2012, and are expected to recover in value as the securities approach maturity. Further, at March 31, 2012, we did not intend to sell these securities in an unrealized

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

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 March 31, 2012, 109 securities (2011: 128) were in an unrealized loss position of \$14 million (2011: \$47 million).

At March 31, 2012, 17 (2011: 10) securities have been in a continuous unrealized loss position for 12 months or greater and have a fair value of \$6 million (2011: \$4 million). Based on our impairment review process and our ability and intent to hold these securities for a reasonable period of time sufficient for a full recovery, we concluded that the above equities in an unrealized loss position were temporarily impaired at March 31, 2012.

**b) Other Investments**

The following tables provide a breakdown of our investments in hedge and credit funds and CLO equity tranching securities (CLO Equities), together with additional information relating to the liquidity of each category:

|                                | Fair Value        |             | Redemption Frequency<br>(if currently eligible) | Redemption<br>Notice Period |
|--------------------------------|-------------------|-------------|---|-----------------------------|
| <b>At March 31, 2012</b>       |                   |             |   |                             |
| Long/short equity funds        | \$ 283,749        | 37%         | Monthly, Quarterly, Semi-annually               | 30-60 days                  |
| Multi-strategy funds           | 238,522           | 31%         | Quarterly, Semi-annually                        | 60-95 days                  |
| Event-driven funds             | 124,084           | 16%         | Quarterly, Annually                             | 45-95 days                  |
| Leveraged bank loan funds      | 62,290            | 8%          | Quarterly                                       | 65 days                     |
| CLO - Equities                 | 60,909            | 8%          | n/a   | n/a                         |
| <b>Total other investments</b> | <b>\$ 769,554</b> | <b>100%</b> |   |                             |
| <b>At December 31, 2011</b>    |                   |             |   |                             |
| Multi-strategy funds           | \$ 230,750        | 33%         | Quarterly, Semi-annually                        | 60-95 days                  |
| Long/short equity funds        | 214,498           | 31%         | Quarterly, Semi-annually                        | 30-60 days                  |
| Event-driven funds             | 118,380           | 17%         | Quarterly, Annually                             | 45-95 days                  |
| Leveraged bank loan funds      | 69,132            | 10%         | Quarterly                                       | 65 days                     |
| CLO - Equities                 | 66,560            | 9%          | n/a   | n/a                         |
| <b>Total other investments</b> | <b>\$ 699,320</b> | <b>100%</b> |   |                             |

n/a - not applicable

The investment strategies for the above funds are as follows:

*Long/short equity funds:* Seek to achieve attractive returns by executing an equity trading strategy involving both long and short investments in publicly-traded equities.

*Multi-strategy funds:* Seek to achieve above-market returns by pursuing multiple investment strategies to diversify risks and reduce volatility. This category includes funds of hedge funds which invest in a large pool of hedge funds across a diversified range of hedge fund strategies.

*Event-driven funds:* Seek to achieve attractive returns by exploiting situations where announced or anticipated events create opportunities.

*Leveraged bank loan funds:* Seek to achieve attractive returns by investing primarily in bank loan collateral that has limited interest rate risk exposure.

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

Two common redemption restrictions which may impact our ability to redeem our hedge and credit funds are gates and lockups. A gate is a suspension of redemptions which may be implemented by the general partner or investment manager of the fund in order to defer, in whole or in part, the redemption request in the event the aggregate amount of redemption requests exceeds a predetermined percentage of the fund's net assets which may otherwise hinder the general partner or investment manager's ability to liquidate holdings in an orderly fashion in order to generate the cash necessary to fund extraordinarily large redemption payouts. A lockup period is the initial amount of time an investor is contractually required to hold the security before having the ability to redeem. During 2012 and 2011, neither of these restrictions impacted our redemption requests. At March 31, 2012, \$101 million (2011: \$90 million) of our long/short equity funds, representing 13% (2011: 13%) of our total other investments, relate to holdings where we are still within the lockup period. The expiries of these lockup periods range from June, 2012 to September, 2014. No other category contains investments currently subject to lockup.

At March 31, 2012, \$37 million (2011: \$45 million) of our hedge and credit fund investments were invested in funds that are not accepting redemption requests. Of this amount, 82% relates to a leveraged bank loan fund in a period of planned principal distributions which has a target completion date in late 2013 and, based on current market conditions and payments made to date, management expects this target date to be met. The remainder primarily relates to funds that entered liquidation or had their assets side pocketed as a result of the credit crisis which began in late 2008. For these funds, management is currently unable to estimate when those funds will be distributed.

At March 31, 2012, and 2011, we have no unfunded commitments relating to our investments in hedge and credit funds.

**c) Net Investment Income**

Net investment income was derived from the following sources:

| <b>Three months ended March 31,</b> | <b>2012</b>       | <b>2011</b> |
|-------------------------------------|-------------------|-------------|
| Fixed maturities                    | \$ 79,637         | \$ 88,581   |
| Other investments                   | 40,420            | 25,311      |
| Cash and cash equivalents           | 1,608             | 2,153       |
| Equity securities                   | 1,110             | 824         |
| Short-term investments              | 154               | 387         |
| <b>Gross investment income</b>      | <b>122,929</b>    | 117,256     |
| Investment expenses                 | (6,906)           | (6,601)     |
| <b>Net investment income</b>        | <b>\$ 116,023</b> | \$ 110,655  |

**d) Net Realized Investment Gains (Losses)**

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

| <b>Three months ended March 31,</b>                           | <b>2012</b>      | <b>2011</b>      |
|---|------------------|------------------|
| Gross realized gains  | \$ 68,246        | \$ 76,332        |
| Gross realized losses   | (45,911)         | (38,413)         |
| Net OTTI recognized in earnings                               | (3,909)          | (1,940)          |
| Net realized gains on fixed maturities and equity securities  | 18,426           | 35,979           |
| Change in fair value of investment derivatives <sup>(1)</sup> | (5,882)          | (9,100)          |
| Fair value hedges <sup>(1)</sup>                              | 1,947            | 3,265            |
| <b>Net realized investment gains</b>                          | <b>\$ 14,491</b> | <b>\$ 30,144</b> |

(1) Refer to Note 5 Derivative Instruments

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

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

| <b>Three months ended March 31,</b>      | <b>2012</b>     | <b>2011</b>     |
|--|-----------------|-----------------|
| <b>Fixed maturities:</b>                 |                 |                 |
| Corporate debt                           | \$ 105          | \$ 1,026        |
| Non-Agency RMBS                          | 1,208           | 370             |
| ABS                                      | 180             | 61              |
| Municipals                               | -               | 483             |
|  | <b>1,493</b>    | <b>1,940</b>    |
| <b>Equity securities</b>                 | <b>2,416</b>    | <b>-</b>        |
| <b>Total OTTI recognized in earnings</b> | <b>\$ 3,909</b> | <b>\$ 1,940</b> |

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

| <b>Three months ended March 31,</b>  | <b>2012</b>     | <b>2011</b>     |
|--|-----------------|-----------------|
| Balance at beginning of period   | \$ 2,061        | \$ 57,498       |
| Credit impairments recognized on securities not previously impaired        | -               | -               |
| Additional credit impairments recognized on securities previously impaired | -               | -               |
| Change in timing of future cash flows on securities previously impaired    | -               | (101)           |
| Intent to sell of securities previously impaired                           | -               | -               |
| Securities sold/redeemed/matured   | (14)            | (48,022)        |
| <b>Balance at end of period</b>  | <b>\$ 2,047</b> | <b>\$ 9,375</b> |

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**Table of Contents**

**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.

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 within the fair value hierarchy.

We used the following valuation techniques and assumptions in estimating the fair value of our financial instruments as well as the general classification of such financial instruments pursuant to the above fair value hierarchy.

**Fixed Maturities**

At each valuation date, we use the market approach valuation technique to estimate the fair value of our fixed maturities portfolio, when possible. This market approach includes, but is not limited to, prices obtained from third party pricing services for identical or comparable securities and the use of pricing matrix models using observable market inputs such as yield curves, credit risks and spreads, measures of volatility, and prepayment speeds. Pricing from third party pricing services is sourced from multiple vendors, when available, and we maintain a vendor hierarchy by asset type based on historical pricing experience and vendor expertise. When prices are unavailable from pricing services, we obtain non-binding quotes from broker-dealers who are active in the corresponding markets.

The following describes the significant inputs generally used to determine the fair value of our fixed maturities by asset class.

*U.S. government and agency*

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U.S. government and agency securities consist primarily of bonds issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association. As the fair values of our U.S. Treasury securities are based on unadjusted market prices in active markets, they are classified within Level 1. The fair values of U.S. government agency securities are priced using the spread above the risk-free yield curve. As the yields for the risk-free yield curve and the spreads for these securities are observable market inputs, the fair values of U.S. government agency securities are classified within Level 2.



**Table of Contents**

**AXIS CAPITAL HOLDINGS LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**4. FAIR VALUE MEASUREMENTS (CONTINUED)**

*Non-U.S. government*

Non-U.S. government securities comprise bonds issued by non-U.S. governments and their agencies along with supranational organizations (also known as sovereign debt securities). The fair value of these securities is based on prices obtained from international indices or a valuation model that includes the following inputs: interest rate yield curves, cross-currency basis index spreads, and country credit spreads for structures similar to the sovereign bond in terms of issuer, maturity and seniority. As the significant inputs are observable market inputs, the fair value of non-U.S. government securities are classified within Level 2.

*Corporate debt*

Corporate debt securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair values of these securities are generally determined using the spread above the risk-free yield curve. These spreads are generally obtained from the new issue market, secondary trading and broker-dealer quotes. As these spreads and the yields for the risk-free yield curve are observable market inputs, the fair values of our corporate debt securities are classified within Level 2. Where pricing is unavailable from pricing services, we obtain non-binding quotes from broker-dealers to estimate fair value. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. In this event, securities are classified within Level 3 and consisted of private corporate debt securities at March 31, 2012.

*MBS*

Our portfolio of RMBS and CMBS are originated by both agencies and non-agencies. The fair values of these securities are determined through the use of a pricing model (including Option Adjusted Spread) which uses prepayment speeds and spreads to determine the appropriate average life of the MBS. These spreads are generally obtained from the new issue market, secondary trading and broker-dealer quotes. As the significant inputs used to price MBS are observable market inputs, the fair values of the MBS are classified within Level 2. Where pricing is unavailable from pricing services, we obtain non-binding quotes from broker-dealers to estimate fair value. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. These securities are classified within Level 3.

*ABS*

ABS include mostly investment-grade bonds backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, student loans, credit card receivables, and CLO Debt originated by a variety of financial institutions. Similarly to MBS, the fair values of ABS are priced through the use of a model which uses prepayment speeds and spreads sourced primarily from the new issue market. As the significant inputs used to price ABS are observable market inputs, the fair values of ABS are classified within Level 2. Where pricing is unavailable from pricing services, we obtain non-binding quotes from broker-dealers or use a discounted cash flow model to estimate fair value. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. These securities are priced within Level 3 at March 31, 2012.

*Municipals*

Our municipal portfolio comprises bonds issued by U.S. domiciled state and municipality entities. The fair value of these securities is determined using spreads obtained from broker-dealers, trade prices and the new issue market. As the significant inputs used to price the municipals are observable market inputs, municipals are classified within Level 2.

**Equity Securities**

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Equity securities include U.S. and foreign common stocks, exchange-traded funds, and foreign bond mutual funds. For common stocks and exchange-traded funds, we classified these within Level 1 as their fair values are based on quoted market prices in active markets. Our investments in foreign bond mutual funds have daily liquidity, with redemption based on the net asset value (NAV) of the funds. Accordingly, we have classified these investments as Level 2.

### **Other Investments**

As a practical expedient, we estimate fair values for hedge and credit funds using NAVs as advised by external fund managers or third party administrators. For our hedge and credit fund investments with liquidity terms allowing us to fully redeem our holdings at the applicable NAV in the near term, we have classified these investments as Level 2. Certain investments in hedge and credit funds have

**Table of Contents**

**AXIS CAPITAL HOLDINGS LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**4. FAIR VALUE MEASUREMENTS (CONTINUED)**

redemption restrictions (see Note 3 for further details) that prevent us from redeeming in the near term and therefore we have classified these investments as Level 3.

At March 31, 2012, the CLO Equities were classified within Level 3 as we estimated the fair value for these securities using an income approach valuation technique (internal discounted cash flow model) due to the lack of observable and relevant trades in the secondary markets.

**Short-Term Investments**

Short-term investments primarily comprise highly liquid securities with maturities greater than three months but less than one year from the date of purchase. These securities are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their amortized cost approximates fair value.

**Derivative Instruments**

Our foreign currency forward contracts and options are customized to our hedging strategies and trade in the over-the-counter derivative market. We use the market approach valuation technique to estimate the fair value for these derivatives based on significant observable market inputs from third party pricing vendors, non-binding broker-dealer quotes and/or recent trading activity. Accordingly, we classified these derivatives within Level 2.

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

The table below presents the financial instruments measured at fair value on a recurring basis.

|                                | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total Fair<br>Value  |
|--------------------------------|--|--|--|----------------------|
| <b>At March 31, 2012</b>       |  |  |  |                      |
| <b>Assets</b>                  |  |  |  |                      |
| Fixed maturities               |  |  |  |                      |
| U.S. government and agency     | \$ 823,424   | \$ 413,207   | \$ -   | \$ 1,236,631         |
| Non-U.S. government            | -  | 1,064,455  | -  | 1,064,455            |
| Corporate debt                 | -  | 3,783,770  | 1,550  | 3,785,320            |
| Agency RMBS                    | -  | 2,812,098  | -  | 2,812,098            |
| CMBS                           | -  | 440,687  | -  | 440,687              |
| Non-Agency RMBS                | -  | 155,205  | -  | 155,205              |
| ABS                            | -  | 751,625  | 50,415   | 802,040              |
| Municipals                     | -  | 1,144,207  | -  | 1,144,207            |
|                                | 823,424  | 10,565,254   | 51,965   | 11,440,643           |
| Equity securities              |  |  |  |                      |
| Common stocks                  | 432,812  | -  | -  | 432,812              |
| Exchange-traded funds          | 226,287  | -  | -  | 226,287              |
| Foreign bond mutual funds      | -  | 97,939   | -  | 97,939               |
|                                | 659,099  | 97,939   | -  | 757,038              |
| Other investments              |  |  |  |                      |
| Hedge funds                    | -  | 311,746  | 314,601  | 626,347              |
| Credit funds                   | -  | 32,114   | 50,184   | 82,298               |
| CLO-Equities                   | -  | -  | 60,909   | 60,909               |
|                                | -  | 343,860  | 425,694  | 769,554              |
| Short-term investments         | -  | 50,264   | -  | 50,264               |
| Other assets (see Note 5)      | -  | 6,961  | -  | 6,961                |
| <b>Total</b>                   | <b>\$ 1,482,523</b>  | <b>\$ 11,064,278</b>                                   | <b>\$ 477,659</b>                                  | <b>\$ 13,024,460</b> |
| <b>Liabilities</b>             |  |  |  |                      |
| Other liabilities (see Note 5) | \$ -   | \$ 7,525   | \$ -   | \$ 7,525             |
| <b>At December 31, 2011</b>    |  |  |  |                      |
| <b>Assets</b>                  |  |  |  |                      |
| Fixed maturities               |  |  |  |                      |
| U.S. government and agency     | \$ 765,519   | \$ 382,748   | \$ -   | \$ 1,148,267         |
| Non-U.S. government            | -  | 1,212,451  | -  | 1,212,451            |
| Corporate debt                 | -  | 3,608,041  | 1,550  | 3,609,591            |
| Agency RMBS                    | -  | 2,636,634  | -  | 2,636,634            |

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|                                |              |               |            |               |
|--------------------------------|--------------|---------------|------------|---------------|
| CMBS                           | -            | 312,691       | -          | 312,691       |
| Non-Agency RMBS                | -            | 165,713       | -          | 165,713       |
| ABS                            | -            | 582,714       | 49,328     | 632,042       |
| Municipals                     | -            | 1,222,711     | -          | 1,222,711     |
|                                | 765,519      | 10,123,703    | 50,878     | 10,940,100    |
| Equity securities              |              |               |            |               |
| Common stocks                  | 347,455      | -             | -          | 347,455       |
| Exchange-traded funds          | 213,981      | -             | -          | 213,981       |
| Foreign bond mutual funds      | -            | 116,124       | -          | 116,124       |
|                                | 561,436      | 116,124       | -          | 677,560       |
| Other investments              |              |               |            |               |
| Hedge funds                    | -            | 248,208       | 296,101    | 544,309       |
| Credit funds                   | -            | 38,308        | 50,143     | 88,451        |
| CLO-Equities                   | -            | -             | 66,560     | 66,560        |
|                                | -            | 286,516       | 412,804    | 699,320       |
| Short-term investments         | -            | 149,909       | -          | 149,909       |
| Other assets (see Note 5)      | -            | 38,175        | -          | 38,175        |
| <b>Total</b>                   | \$ 1,326,955 | \$ 10,714,427 | \$ 463,682 | \$ 12,505,064 |
| <b>Liabilities</b>             |              |               |            |               |
| Other liabilities (see Note 5) | \$ -         | \$ 2,035      | \$ -       | \$ 2,035      |

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

During 2012 and 2011, we had no transfers between Levels 1 and 2.

**Level 3 Fair Value Measurements**

Except for hedge funds and credit funds priced using NAV as a practical expedient and certain fixed maturities priced using broker-dealer quotes (underlying inputs are not available), the following table quantifies the significant unobservable inputs we have used in estimating fair value at March 31, 2012 for our investments classified as Level 3 in the fair value hierarchy:

|                                    | <b>Fair Value</b> | <b>Valuation Technique</b> | <b>Unobservable Input</b>           | <b>Range</b>    | <b>Weighted Average</b> |
|------------------------------------|-------------------|----------------------------|-------------------------------------|-----------------|-------------------------|
| ABS - CLO Debt                     | \$ 48,744         | Discounted cash flow       | Credit spreads                      | 5.9% - 7.7%     | 6.4%                    |
|                                    |                   |                            | Illiquidity discount <sup>(1)</sup> | 5.0% - 20.0%    | 8.7%                    |
| Other investments - CLO - Equities | \$ 60,909         | Discounted cash flow       | Default rates                       | 4.0% - 5.0%     | 4.3%                    |
|                                    |                   |                            | Loss severity rate                  | 53.5%           | 53.5%                   |
|                                    |                   |                            | Collateral spreads                  | 2.6% - 4.2%     | 3.2%                    |
|                                    |                   |                            | Estimated maturity dates            | 2.3 - 6.5 years | 5.3 years               |

(1) Judgmentally determined based on limited trades of similar securities observed in the secondary markets.

ABS where fair value is estimated through the use of a discounted cash flow model (income approach) is limited to our holdings of CLO Debt. These securities represent primarily holdings of investment-grade debt tranches within collateralized loan obligations with underlying collateral of loans originated primarily by U.S. corporations. For estimating the fair values of the CLO Debt securities, in the absence of actively trading secondary markets for these securities, we discount the estimated cash flows based on current credit spreads for similar securities, derived from observable offer prices. As these securities are thinly traded in the secondary markets, we apply an illiquidity discount to these discounted cash flows in developing our estimate of fair value. Significant increases (decreases) in either of the significant unobservable inputs (credit spread, illiquidity discount) in isolation would result in lower (higher) fair value estimates for our CLO Debt. The interrelationship between these inputs is insignificant. These inputs are updated on a quarterly basis and the reasonableness of the resulting prices is assessed through a comparison to observable offer prices for similar securities.

The CLO Equities market continues to be mostly inactive with only a small number of transactions being observed in the market and fewer still involving transactions in our CLO Equities. Accordingly, we continue to rely on the use of our internal discounted cash flow model (income approach) to estimate fair value of CLO Equities. Of the significant inputs into this model, the default and loss severity rates are the most judgmental unobservable market inputs to which the valuation of CLO Equities is most sensitive. A significant increase (decrease) in either of these significant inputs in isolation would result in lower (higher) fair value estimates for our CLO Equities and, in general, a change in default rate assumptions will be accompanied by a directionally similar change in loss severity rate assumptions.

On a quarterly basis, our valuation processes for both CLO Debt and CLO Equities include a review of the underlying cash flows and key assumptions used in the discounted cash flow models. We review and update the above significant unobservable inputs based on data obtained from secondary markets, including from the managers of the CLOs we hold, as well as actual default and loss severity experienced to date for our CLO securities. We also take into consideration any recent credit downgrades on our CLOs. Additionally, we adjust the estimated maturities for CLO Equities when there is a significant change in the maturities of the underlying loan portfolios.



**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:

|  | Opening<br>Balance | Transfers<br>into<br>Level<br>3 | Transfers<br>out of<br>Level 3 | Included in<br>earnings<br>(1) | Included<br>in OCI (2) | Purchases        | Sales              | Settlements/<br>Distributions | Closing<br>Balance | Change<br>in<br>unrealized<br>investment<br>gain/loss (3) |
|--|--------------------|---------------------------------|--------------------------------|--------------------------------|------------------------|------------------|--------------------|-------------------------------|--------------------|---|
| <b>Three months ended March 31, 2012</b> |                    |                                 |                                |                                |                        |                  |                    |                               |                    |   |
| <b>Fixed maturities</b>                  |                    |                                 |                                |                                |                        |                  |                    |                               |                    |   |
| Corporate debt                           | \$ 1,550           | \$ -                            | \$ -                           | \$ -                           | \$ -                   | \$ -             | \$ -               | \$ -                          | \$ 1,550           | \$ -  |
| Non-Agency RMBS                          | -                  | -                               | -                              | -                              | -                      | -                | -                  | -                             | -                  | -   |
| ABS                                      | 49,328             | -                               | -                              | -                              | 1,263                  | -                | -                  | (176)                         | 50,415             | -   |
|  | 50,878             | -                               | -                              | -                              | 1,263                  | -                | -                  | (176)                         | 51,965             | -   |
| <b>Other investments</b>                 |                    |                                 |                                |                                |                        |                  |                    |                               |                    |   |
| Hedge funds                              | 296,101            | -                               | -                              | 18,502                         | -                      | -                | -                  | -                             | 314,603            | 18,502  |
| Credit funds                             | 50,143             | -                               | -                              | 3,030                          | -                      | -                | -                  | (2,990)                       | 50,183             | 3,030   |
| CLO-Equities                             | 66,560             | -                               | -                              | 3,389                          | -                      | -                | -                  | (9,041)                       | 60,908             | 3,389   |
|  | 412,804            | -                               | -                              | 24,921                         | -                      | -                | -                  | (12,031)                      | 425,694            | 24,921  |
| <b>Total assets</b>                      | <b>\$ 463,682</b>  | <b>\$ -</b>                     | <b>\$ -</b>                    | <b>\$ 24,921</b>               | <b>\$ 1,263</b>        | <b>\$ -</b>      | <b>\$ -</b>        | <b>\$ (12,207)</b>            | <b>\$ 477,659</b>  | <b>\$ 24,921</b>  |
| <b>Three months ended March 31, 2011</b> |                    |                                 |                                |                                |                        |                  |                    |                               |                    |   |
| <b>Fixed maturities</b>                  |                    |                                 |                                |                                |                        |                  |                    |                               |                    |   |
| Corporate debt                           | \$ 1,550           | \$ -                            | \$ -                           | \$ -                           | \$ -                   | \$ -             | \$ -               | \$ -                          | \$ 1,550           | \$ -  |
| Non-Agency RMBS                          | 19,678             | -                               | (7,509)                        | -                              | 54                     | -                | -                  | (617)                         | 11,606             | -   |
| ABS                                      | 43,178             | -                               | -                              | -                              | -                      | -                | -                  | -                             | 43,178             | -   |
|  | 64,406             | -                               | (7,509)                        | -                              | 54                     | -                | -                  | (617)                         | 56,334             | -   |
| <b>Other investments</b>                 |                    |                                 |                                |                                |                        |                  |                    |                               |                    |   |
| Hedge funds                              | 358,277            | -                               | -                              | 7,952                          | -                      | 45,000           | (21,585)           | -                             | 389,644            | 7,952   |
| Credit funds                             | 104,756            | -                               | -                              | 4,929                          | -                      | -                | (5,478)            | -                             | 104,207            | 5,161   |
| CLO-Equities                             | 56,263             | -                               | -                              | 12,150                         | -                      | -                | -                  | (8,151)                       | 60,262             | 12,150  |
|  | 519,296            | -                               | -                              | 25,031                         | -                      | 45,000           | (27,063)           | (8,151)                       | 554,113            | 25,263  |
| <b>Total assets</b>                      | <b>\$ 583,702</b>  | <b>\$ -</b>                     | <b>\$ (7,509)</b>              | <b>\$ 25,031</b>               | <b>\$ 54</b>           | <b>\$ 45,000</b> | <b>\$ (27,063)</b> | <b>\$ (8,768)</b>             | <b>\$ 610,447</b>  | <b>\$ 25,263</b>  |

(1) Gains and losses included in earnings on fixed maturities are included in net realized investment gains (losses). Gains and (losses) included in earnings on other investments are included in net investment income.

(2) Gains and losses included in other comprehensive income ( OCI ) on fixed maturities are included in unrealized gains (losses) arising during the period.



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(3) Change in unrealized investment gain/(loss) relating to assets held at the reporting date.

### Transfers into Level 3 from Level 2

There were no transfers into Level 3 during the three months ended March 31, 2012 and 2011.

### Transfers out of Level 3 into Level 2

The transfers to Level 2 from Level 3 in the three months ended March 31, 2011 were primarily due to the availability of observable market inputs and multiple quotes from pricing vendors and broker-dealers as a result of the return of liquidity in the credit markets. There were no such transfers during the quarter ended March 31, 2012.

**Table of Contents****AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****4. FAIR VALUE MEASUREMENTS (CONTINUED)****Financial Instruments Not Carried at Fair Value**

U.S. GAAP guidance over disclosures about the fair value of financial instruments are also applicable to financial instruments not carried at fair value, except for certain financial instruments, including insurance contracts.

The carrying values of cash equivalents (including restricted amounts), accrued investment income, receivable for investments sold, certain other assets, payable for investments purchased and other liabilities approximated their fair values at March 31, 2012, due to their respective short maturities. As these financial instruments are not actively traded, their respective fair values are classified within Level 2.

At March 31, 2012, our senior notes are recorded at amortized cost with a carrying value of \$995 million (2011: \$995 million) and have a fair value of \$1,066 million (2011: \$1,039 million). The fair values of these securities were obtained from a third party pricing service and pricing was based on the spread above the risk-free yield curve. These spreads are generally obtained from the new issue market, secondary trading and broker-dealer quotes. As these spreads and the yields for the risk-free yield curve are observable market inputs, the fair values of our senior notes are classified within Level 2.

**5. DERIVATIVE INSTRUMENTS**

The following table summarizes the balance sheet classification of derivatives recorded at fair values. The notional amount of derivative contracts represents the basis upon which pay or receive amounts are calculated and is presented in the table to quantify the volume of our derivative activities. Notional amounts are not reflective of credit risk.

|  | March 31, 2012                   |   |   | December 31, 2011                |   |   |
|--|----------------------------------|---|---|----------------------------------|---|---|
|  | Derivative<br>Notional<br>Amount | Asset<br>Derivative<br>Fair<br>Value <sup>(1)</sup> | Liability<br>Derivative<br>Fair<br>Value <sup>(1)</sup> | Derivative<br>Notional<br>Amount | Asset<br>Derivative<br>Fair<br>Value <sup>(1)</sup> | Liability<br>Derivative<br>Fair<br>Value <sup>(1)</sup> |
| <b>Derivatives designated as hedging instruments</b>     |                                  |   |   |                                  |   |   |
| Foreign exchange forward contracts                       | \$ 323,431                       | \$ -  | \$ 1,575  | \$ 540,176                       | \$ 16,519   | \$ -  |
| <b>Derivatives not designated as hedging instruments</b> |                                  |   |   |                                  |   |   |
| <i>Relating to investment portfolio:</i>                 |                                  |   |   |                                  |   |   |
| Foreign exchange forward contracts                       | 328,001                          | 2,349   | 4,393   | 287,711                          | 7,012   | 1,783   |
| <i>Relating to underwriting portfolio:</i>               |                                  |   |   |                                  |   |   |
| Foreign exchange forward contracts                       | \$ 753,257                       | 4,612   | 1,557   | \$ 955,728                       | 14,644  | 252   |
| <b>Total derivatives</b>                                 |                                  | \$ 6,961  | \$ 7,525  |                                  | \$ 38,175   | \$ 2,035  |

(1) Asset and liability derivatives are classified within other assets and other liabilities on the Consolidated Balance Sheets.

**Fair Value Hedges**

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

The following table provides the total impact on earnings relating to foreign exchange forward contracts designated as fair value hedges along with the impact of the related hedged investment portfolio for the periods indicated:

**Table of Contents****AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****5. DERIVATIVE INSTRUMENTS (CONTINUED)**

| Three months ended March 31,                        | 2012            | 2011            |
|---|-----------------|-----------------|
| Foreign exchange forward contracts                  | \$ (10,568)     | \$ (30,481)     |
| Hedged investment portfolio                         | 12,515          | 33,746          |
| <b>Hedge ineffectiveness recognized in earnings</b> | <b>\$ 1,947</b> | <b>\$ 3,265</b> |

**Derivative Instruments not Designated as Hedging Instruments***a) Relating to Investment Portfolio*

Within our investment portfolio we are exposed to foreign currency risk. Accordingly, the fair values for our investment portfolio are partially influenced by the change in foreign exchange rates. We may enter into foreign exchange forward contracts to manage the effect of this currency risk. These foreign currency hedging activities are not designated as specific hedges for financial reporting purposes.

In addition, our external equity investment managers have the discretion to hold foreign currency exposures as part of their total return strategy.

The increase in the notional amount of investment-related derivatives since December 31, 2011 was consistent with an increase in the carrying value of Australian dollar and euro-denominated fixed maturities being hedged.

*b) Relating to Underwriting Portfolio*

Our (re)insurance 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 (re)insurance contracts 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.

The decrease in the notional amount of underwriting related derivatives since December 31, 2011, was primarily due to settlement of our foreign denominated liabilities relating to the catastrophe losses incurred from the New Zealand and Japanese earthquakes.

The total unrealized and realized gains (losses) recognized in earnings for derivatives not designated as hedges were as follows:

|  | Location of Gain (Loss) Recognized<br>in Income on Derivative | Three months ended<br>March 31, |            |
|--|---|---------------------------------|------------|
|  |   | 2012                            | 2011       |
| <b>Derivatives not designated as hedging instruments</b> |   |                                 |            |
| <i>Relating to investment portfolio:</i>                 |   |                                 |            |
| Foreign exchange forward contracts                       | Net realized investment gains (losses)                        | \$ (5,882)                      | \$ (9,100) |

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*Relating to underwriting portfolio:*

|                                    |                                 |                 |                    |
|------------------------------------|---------------------------------|-----------------|--------------------|
| Currency collar options            | Foreign exchange gains (losses) | -               | 697                |
| Foreign exchange forward contracts | Foreign exchange gains (losses) | <b>13,454</b>   | (3,004)            |
| <b>Total</b>                       |                                 | <b>\$ 7,572</b> | <b>\$ (11,407)</b> |

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

| <b>Three months ended March 31,</b>                                  | <b>2012</b>         | <b>2011</b>         |
|--|---------------------|---------------------|
| Gross reserve for losses and loss expenses, beginning of period      | \$ 8,425,045        | \$ 7,032,375        |
| Less reinsurance recoverable on unpaid losses, beginning of period   | (1,736,823)         | (1,540,633)         |
| <b>Net reserve for losses and loss expenses, beginning of period</b> | <b>6,688,222</b>    | <b>5,491,742</b>    |
| <br>Net incurred losses related to:                                  |                     |                     |
| Current year   | 555,922             | 1,069,505           |
| Prior years  | (45,232)            | (49,704)            |
|  | <b>510,690</b>      | <b>1,019,801</b>    |
| <br>Net paid losses related to:                                      |                     |                     |
| Current year   | (23,215)            | (13,640)            |
| Prior years  | (381,762)           | (213,147)           |
|  | <b>(404,977)</b>    | <b>(226,787)</b>    |
| <br>Foreign exchange and other                                       | <b>66,039</b>       | <b>62,690</b>       |
| <br>Net reserve for losses and loss expenses, end of period          | <b>6,859,974</b>    | <b>6,347,446</b>    |
| Reinsurance recoverable on unpaid losses, end of period              | <b>1,739,370</b>    | <b>1,666,415</b>    |
| <b>Gross reserve for losses and loss expenses, end of period</b>     | <b>\$ 8,599,344</b> | <b>\$ 8,013,861</b> |

We write business with loss experience generally characterized as low frequency and high severity in nature, which results in volatility in our financial results. During the three months ended March, 2011, we recognized aggregate net loss and loss expenses \$581 million in relation to the Japanese earthquake and tsunami, the Christchurch, New Zealand earthquake and Australian weather events.

Natural catastrophe activity was notably high in the 2011 calendar year, in terms of both frequency and severity, and our results for that year were impacted by numerous events, including: the Japanese earthquake and tsunami; two significant earthquakes near Christchurch, New Zealand; Australian weather events, including severe flooding and the landfall of Cyclone Yasi; a series of severe storms in several regions of the U.S. during April and May, certain of which spawned tornadoes; flooding across a widespread area of Thailand; a cloudburst in Denmark; Hurricane Irene; and Tropical Storm Lee. We derive our estimated net losses in relation to catastrophe events such as these from ground-up assessments of our in-force contracts and treaties providing coverage in the affected regions. We also consider current industry insured loss

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estimates, market share analyses and catastrophe modeling analyses, when appropriate, in addition to the information available to date from clients, brokers and loss adjusters.

During the three months ended March 31, 2012, we continued to monitor paid and incurred loss development for catastrophe events of prior years and updated our estimates of ultimate losses accordingly; in the aggregate, there was no material change during the quarter. We caution, however, that the magnitude and complexity of losses arising from certain of these events, in particular the Japanese earthquake and tsunami, the New Zealand earthquakes and the Thai floods, inherently increase the level of uncertainty and, therefore, the amount of management judgment involved in arriving at our estimates. As a result, our actual losses for these events may ultimately differ materially from our current estimates.

Net losses and loss expenses incurred include net favorable prior year reserve development of \$45 million and \$50 million for the three months ended March 31, 2012 and 2011, respectively. Prior year reserve development arises from changes to loss estimates recognized in the current year that relate to losses incurred in previous calendar years.

**Table of Contents****AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****6. RESERVE FOR LOSSES AND LOSS EXPENSES (CONTINUED)**

The following table summarizes net favorable reserve development by segment:

| <b>Three months ended March 31,</b> | <b>2012</b>      | <b>2011</b> |
|-------------------------------------|------------------|-------------|
| Insurance                           | <b>\$ 14,897</b> | \$ 14,728   |
| Reinsurance                         | <b>30,335</b>    | 34,976      |
| <b>Total</b>                        | <b>\$ 45,232</b> | \$ 49,704   |

Overall, a large portion of the net favorable year period reserve development in both 2012 and 2011 was generated from the property, marine, and aviation lines of our insurance segment and the property and catastrophe lines of our reinsurance segment. These lines of business, the majority of which have short-tail exposures, contributed \$19 million and \$38 million of the total net favorable reserve development in the first quarters of 2012 and 2011, respectively. The favorable development on these lines of business primarily reflected the recognition of better than expected loss emergence.

Approximately \$24 million and \$16 million of the net favorable reserve development in the first quarter of 2012 and 2011, respectively, was generated from professional lines insurance and reinsurance business. This favorable development was driven by increased incorporation of our own historical claims experience into our estimation of ultimate loss ratios for accident years 2007 and prior, with less weighting being given to information derived from industry benchmarks.

**7. SHARE-BASED COMPENSATION****Restricted Stock**

The following table provides a reconciliation of the beginning and ending balance of nonvested restricted stock (including restricted stock units) for the three months ended March 31, 2012:

|  | <b>Number of<br/>Restricted<br/>Stock</b> | <b>Weighted Average<br/>Grant Date<br/>Fair Value</b> |
|--|---|---|
| Nonvested restricted stock - beginning of period | 3,816                                     | \$ 32.69  |
| Granted  | 1,828                                     | 31.51   |
| Vested   | (1,208)                                   | 31.98   |
| Forfeited  | (12)                                      | 32.64   |



|   |              |           |              |
|---|--------------|-----------|--------------|
| <b>Nonvested restricted stock - end of period</b> | <b>4,424</b> | <b>\$</b> | <b>32.32</b> |
|---|--------------|-----------|--------------|

For the three months ended March 31, 2012, we incurred share-based compensation costs of \$12 million (2011: \$10 million) and recorded tax benefits thereon of \$2 million (2011: \$2 million). The fair value of shares vested during the three months ended March 31, 2012 was \$39 million (2011: \$62 million). At March 31, 2012 there were \$131 million of unrecognized share-based compensation costs, which are expected to be recognized over the weighted average period of 3.0 years.

**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 (loss) per common share:

| <b>At and for the three months ended March 31,</b>          | <b>2012</b>    | <b>2011</b>      |
|---|----------------|------------------|
| <b>Basic earnings (loss) per common share</b>               |                |                  |
| Net income (loss)   | \$ 135,837     | \$ (374,541)     |
| Preferred share dividends                                   | 9,219          | 9,219            |
| Loss on repurchase of preferred shares                      | 4,621          | -                |
| <b>Net income (loss) available to common shareholders</b>   | <b>121,997</b> | <b>(383,760)</b> |
| <b>Weighted average common shares outstanding</b>           | <b>125,782</b> | <b>113,351</b>   |
| <b>Basic earnings (loss) per common share</b>               | <b>\$ 0.97</b> | <b>\$ (3.39)</b> |
| <b>Diluted earnings (loss) per common share</b>             |                |                  |
| Net income (loss) available to common shareholders          | \$ 121,997     | \$ (383,760)     |
| <b>Weighted average common shares outstanding - basic</b>   | <b>125,782</b> | <b>113,351</b>   |
| Stock compensation plans                                    | 886            | -                |
| <b>Weighted average common shares outstanding - diluted</b> | <b>126,668</b> | <b>113,351</b>   |
| <b>Diluted earnings (loss) per common share</b>             | <b>\$ 0.96</b> | <b>\$ (3.39)</b> |

For the three months ended March 31, 2012, 1,901,575 shares for stock compensation plans were excluded in the computation of diluted earnings per share because their effect would have been anti-dilutive. Due to the loss for the same period in 2011, all share equivalents were anti-dilutive and were excluded from the computation.

**9. SHAREHOLDERS EQUITY****a) Preferred Shares**

On March 19, 2012, we issued \$400 million of 6.875% Series C Preferred shares, par value \$0.0125 per share, with a liquidation preference of \$25.00 per share. We may redeem the shares on or after April 15, 2017 at a redemption price of \$25.00 per share. Dividends on the Series C Preferred shares are non-cumulative. Consequently, if the board of directors does not authorize and declare a dividend for any period, holders of the Series C Preferred shares will not be entitled to receive a dividend for such period, and such undeclared dividend will not accumulate and be

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payable. Holders of the Series C Preferred shares will be entitled to receive, only when, as and if declared by the board of directors, non-cumulative cash dividends from the original issue date, quarterly in arrears on the fifteenth day of January, April, July and October of each year, commencing on July 15, 2012, without accumulation of any undeclared dividends. To the extent declared, these dividends will accumulate, with respect to each dividend period, in an amount per share equal to 6.875% of the liquidation preference per annum.

The holders of the Series C Preferred shares, as well as our previously issued Series A and B preferred shares, have no voting rights other than the right to elect a specified number of directors if preferred share dividends are not declared and paid for a specified period.

On March 19, 2012, we issued an irrevocable notice of redemption for 6,000,000 of our 7.25% Series A Preferred shares, representing \$150 million in aggregate liquidation preference, at a price equal to the liquidation preference without accumulation of any undeclared dividends. In connection with this notice, we recognized a \$5 million loss on redemption (calculated as the difference between the redemption price and the carrying value of the Series A Preferred shares redeemed), which was recognized as a reduction in determining our net income available to common shareholders. This redemption closed on April 18, 2012; accordingly, the associated redemption proceeds are reflected in other liabilities in our Consolidated Balance Sheets. Following this redemption, 4,000,000 Series A Preferred Shares, representing \$100 million in aggregate liquidation preference, remain outstanding.

**Table of Contents****AXIS CAPITAL HOLDINGS LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****9. SHAREHOLDERS EQUITY (CONTINUED)****b) Common shares**

The following table presents our common shares issued and outstanding:

| <b>Three months ended March 31,</b>             | <b>2012</b>     | <b>2011</b> |
|---|-----------------|-------------|
| Shares issued, balance at beginning of period   | <b>170,159</b>  | 154,912     |
| Shares issued                                   | <b>1,249</b>    | 1,908       |
| <b>Total shares issued at end of period</b>     | <b>171,408</b>  | 156,820     |
| Treasury shares, balance at beginning of period | <b>(44,571)</b> | (42,519)    |
| Shares repurchased                              | <b>(1,472)</b>  | (399)       |
| <b>Total treasury shares at end of period</b>   | <b>(46,043)</b> | (42,918)    |
| <b>Total shares outstanding</b>                 | <b>125,365</b>  | 113,902     |

**c) Treasury Shares**

The following table presents our share repurchases, which are held in treasury:

| <b>Three months ended March 31,</b>    | <b>2012</b>      | <b>2011</b> |
|--|------------------|-------------|
| <b>In the open market:</b>             |                  |             |
| Total shares                           | <b>1,197</b>     | -           |
| Total cost                             | <b>\$ 38,756</b> | \$ -        |
| Average price per share <sup>(1)</sup> | <b>\$ 32.38</b>  | \$ -        |
| <b>From employees:</b>                 |                  |             |
| Total shares                           | <b>275</b>       | 399         |

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|  |           |           |
|--|-----------|-----------|
| Total cost                             | \$ 8,955  | \$ 14,527 |
| Average price per share <sup>(1)</sup> | \$ 32.52  | \$ 36.43  |
| <b>Total</b>                           |           |           |
| Total shares                           | 1,472     | 399       |
| Total cost                             | \$ 47,711 | \$ 14,527 |
| Average price per share <sup>(1)</sup> | \$ 32.41  | \$ 36.43  |

(1) Calculated using whole figures.

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**Table of Contents**

**AXIS CAPITAL HOLDINGS LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**10. COMMITMENTS AND CONTINGENCIES**

**a) Legal Proceedings**

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

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

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

**b) Dividends for Common Shares and Preferred Shares**

On March 1, 2012, our Board of Directors declared a dividend of \$0.24 per common share to shareholders of record at the close of business on March 30, 2012 and payable on April 16, 2012. 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 7.50% Preferred Share. The Series A Preferred Share dividend is payable on April 16, 2012 to shareholders of record at the close of business on March 30, 2012 and the Series B Preferred Share dividend is payable on June 1, 2012 to shareholders of record at the close of business on May 15, 2012.

**c) Reinsurance Purchase Commitment**

We purchase reinsurance coverage for our insurance lines of business. The minimum reinsurance premiums are contractually due in advance on a quarterly basis. Accordingly at March 31, 2012, we have an outstanding reinsurance purchase commitment of \$31 million.

**11. SUBSEQUENT EVENT**

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On April 10, 2012, we completed a cash tender offer for any and all of our outstanding 7.50% Series B Preferred shares, par value \$0.0125 per share, at a price of \$102.81 per share. As a result, we purchased 2,461,150 Series B Preferred shares, for approximately \$253 million. In connection with this tender offer, we will recognize a \$9 million loss on redemption (calculated as the difference between the redemption price and the carrying value of the Series B Preferred shares redeemed) in determining our second quarter 2012 net income available to common shareholders. Following the completion of the tender offer, 38,850 Series B Preferred shares, representing \$4 million in aggregate liquidation preference, remain outstanding. We may redeem these shares on or after December 1, 2015, at a redemption price of \$100.00 per share.

**Table of Contents****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, 2011. Tabular dollars are in thousands, except per share amounts. Amounts in tables may not reconcile due to rounding differences.

|  | <b>Page</b> |
|--|-------------|
| <b><u>First Quarter 2012 Financial Highlights</u></b>                                | 32          |
| <b><u>Executive Summary</u></b>  | 33          |
| <b><u>Underwriting Results - Group</u></b>   | 36          |
| <b><u>Results by Segment: For the three months ended March 31, 2012 and 2011</u></b> | 41          |
| i) <u>Insurance Segment</u>  | 41          |
| ii) <u>Reinsurance Segment</u>   | 43          |
| <b><u>Other Expenses, Net</u></b>  | 46          |
| <b><u>Net Investment Income and Net Realized Investment Gains/Losses</u></b>         | 47          |
| <b><u>Cash and Investments</u></b>   | 49          |
| <b><u>Liquidity and Capital Resources</u></b>  | 52          |
| <b><u>Critical Accounting Estimates</u></b>  | 54          |
| <b><u>New Accounting Standards</u></b>   | 54          |
| <b><u>Off-Balance Sheet and Special Purpose Entity Arrangements</u></b>              | 54          |
| <b><u>Non-GAAP Financial Measures</u></b>  | 55          |



**Table of Contents**

**FIRST QUARTER 2012 FINANCIAL HIGHLIGHTS**

**First Quarter 2012 Consolidated Results of Operations**

Net income available to common shareholders of \$122 million, or \$0.97 per share basic and \$0.96 diluted

Operating income of \$136 million, or \$1.07 per diluted share<sup>(1)</sup>

Gross premiums written of \$1.5 billion

Net premiums written of \$1.4 billion

Net premiums earned of \$846 million

Net favorable prior year reserve development of \$45 million, pre-tax

Underwriting income of \$63 million and combined ratio of 94.8%

Net investment income of \$116 million

Net realized investment gains of \$14 million

**First Quarter 2012 Consolidated Financial Condition**

Total cash and investments of \$14.2 billion; fixed maturities, cash and short-term securities comprise 89% of total cash and investments and have an average credit rating of AA-

\$9.4 billion, or 66%, of our cash and investment portfolio invested in investment-grade, short-term and intermediate-maturity fixed income holdings (excluding restricted investments), where cash proceeds from sales are expected to be available within one to three business days under normal market conditions

Total assets of \$19.0 billion

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Reserve for losses and loss expenses of \$8.6 billion and reinsurance recoverable of \$1.8 billion

Total debt of \$995 million and a debt to total capital ratio of 14.4%

Repurchased 1.5 million common shares for total cost of \$48 million; remaining authorization under the repurchase program approved by our Board of Directors of \$505 million at April 26, 2012

Issuance of \$400 million of 6.875% Series C preferred shares, in conjunction with the notice of redemption for \$150 million of 7.25% Series A preferred shares and a tender offer for 7.50% Series B preferred shares, which resulted in a \$246 million repurchase on April 10, 2012

Common shareholders' equity of \$5.1 billion; diluted book value per common share of \$39.53

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

**Table of Contents****EXECUTIVE SUMMARY****Business Overview**

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

Our strategy is to leverage our expertise, experience and relationships to expand our business globally. We manage a book of business diversified both geographically and by product line. We seek to provide high-quality products and services to our clients, while maintaining profitability and generating superior returns on equity over the underwriting cycle. We are focused on organic growth, which we have supplemented with small acquisitions, while managing a portfolio of diversified and attractively priced risks. Our execution on this strategy in the first three months of 2012 included:

the continuing growth of our new accident & health line, focused on specialty accident and health products; and

taking advantage of rate increases and select opportunities for premium growth in our insurance segment.

In addition, during the first quarter of 2012 we effectively lowered the future dividend rate on our preferred equity. This was achieved via the issuance of \$400 million of 6.875% Series C shares, in conjunction with notice of redemption for \$150 million of our 7.25% Series A preferred shares and a tender offer for our 7.50% Series B preferred shares, which resulted in a \$246 million repurchase on April 10, 2012.

**Results of Operations**

| <b>Three months ended March 31,</b>                       | <b>2012</b>       | <b>% Change</b> | <b>2011</b>         |
|---|-------------------|-----------------|---------------------|
| <b>Underwriting income (loss):</b>                        |                   |                 |                     |
| Insurance   | \$ 10,562         | nm              | \$ (48,027)         |
| Reinsurance   | 52,127            | nm              | (413,278)           |
| Net investment income                                     | 116,023           | 5%              | 110,655             |
| Net realized investment gains                             | 14,491            | (52%)           | 30,144              |
| Other expenses, net                                       | (57,366)          | 6%              | (54,035)            |
| <b>Net income (loss)</b>                                  | <b>135,837</b>    | <b>nm</b>       | <b>(374,541)</b>    |
| Preferred share dividends                                 | (9,219)           | -               | (9,219)             |
| Loss on repurchase of preferred shares                    | (4,621)           | -               | -                   |
| <b>Net income (loss) available to common shareholders</b> | <b>\$ 121,997</b> | <b>nm</b>       | <b>\$ (383,760)</b> |
| <b>Operating income (loss)</b>                            | <b>\$ 135,734</b> | <b>nm</b>       | <b>\$ (398,866)</b> |

nm not meaningful

***Underwriting Results***

We recognized total underwriting income of \$63 million for the first quarter of 2012, compared with an underwriting loss of \$461 million for the first quarter of 2011. The primary driver of the difference was a significantly lower level of natural catastrophe-related losses. During the first quarter of 2011, we recognized estimated pre-tax net losses (net of related reinstatement premiums) of \$577 million for the Japanese earthquake and tsunami, the February earthquake near Christchurch, New Zealand ( New Zealand II ) and Australian floods/Cyclone Yasi.

Our insurance segment's first quarter 2011 underwriting loss included pre-tax net losses (inclusive of related premiums to reinstate reinsurance protection) of \$50 million in relation to the natural catastrophe events noted above. First quarter 2012 underwriting results also improved due to growth in net premiums earned, driven by the expansion of our business over the past year; however, this was partially offset by commensurate growth in acquisition costs and general and administrative expenses. In addition, first quarter 2012

## **Table of Contents**

underwriting income benefited from a comparatively lower current accident year loss ratio, driven by a lower level of large loss activity, as well as rate and business mix changes.

The \$465 million improvement in the reinsurance segment's underwriting result for the quarter was primarily attributable to the significantly lower level of natural catastrophe-related losses described above; associated pre-tax net losses for the segment (net of related reinstatement and accelerated premiums) were \$527 million for the first quarter of 2011. Exclusive of these catastrophe losses, the segment's current accident year loss ratio was higher in the first quarter of 2012 as a result of higher attritional loss ratios for property-related and credit and bond lines of business and business mix changes. An increase in acquisition costs also contributed to variance in underwriting results between quarters.

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

The \$5 million increase in net investment income compared to the first quarter of 2011 was driven by a \$15 million increase in income from our alternative investment portfolio (other investments), primarily resulting from improved returns on our hedge funds reflective of global equity market gains. This was partially offset by a reduction in income from our fixed maturity portfolio, driven by lower reinvestment yields.

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

During each period presented, we realized investment-related gains on sale, reflective of changes in fixed income allocations.

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

The increase in net other expenses for the quarter was primarily due to foreign exchange rate movements; appreciation in the euro against the U.S. dollar drove foreign exchange losses on the remeasurement of our net insurance-related liabilities during both quarters, although the impact was \$5 million greater in the first quarter of 2012.

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

In conjunction with effective reduction of the dividend rate on our preferred equity base previously discussed, we issued an irrevocable notice of redemption for \$150 million of our 7.25% Series A preferred shares. As a result, the proportionate share of issue costs were written-off and resulted in the recognition of a \$5 million dollar loss in arriving at net income available to common shareholders. As these issue costs were recognized in shareholders' equity when the Series A shares were originally issued, the recognition of this loss during the first quarter of 2012 did not impact book value. Refer to Item 1, Note 9 to the Consolidated Financial Statements for further details.

## **Outlook**

Pricing improvements are visible in many of our lines and geographies and we remain hopeful that the industry is progressing through the early stages of a cycle change. Broadly, the current rate environment has not improved sufficiently to warrant a dramatic increase in our underwriting activity. However, we will continue evaluate market conditions and opportunistically pursue the business we consider most attractive.

**Table of Contents****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:

| <b>Three months ended and at March 31,</b>  | <b>2012</b>     | <b>2011</b> |
|---|-----------------|-------------|
| ROACE (annualized) <sup>(1)</sup>           | <b>9.7%</b>     | (31.3%)     |
| Operating ROACE (annualized) <sup>(2)</sup> | <b>10.8%</b>    | (32.5%)     |
| DBV per common share <sup>(3)</sup>         | <b>\$ 39.53</b> | \$ 35.69    |
| Cash dividends declared per common share    | <b>\$ 0.24</b>  | \$ 0.23     |

(1) Return on average common equity ( ROACE ) is calculated by dividing annualized net income (loss) available to common shareholders for the period by the average shareholders' equity determined by using the common shareholders' equity balances at the beginning and end of the period.

(2) Operating ROACE is calculated by dividing annualized operating income (loss) for the period by the average common shareholders' equity determined by using the common shareholders' equity balances at the beginning and end of the period. Annualized operating ROACE is a non-GAAP financial measure as defined in SEC Regulation G. See *Non-GAAP Financial Measures* for reconciliation to the nearest GAAP financial measure (ROACE).

(3) Diluted book value ( DBV ) represents total common shareholders' equity divided by the number of common shares and diluted common share equivalents outstanding, determined using the treasury stock method.

**Return on Equity**

Our underwriting loss, driven by catastrophe-related losses, was the primary driver of the negative operating ROACE for the first quarter of 2011. A comparative absence of significant catastrophe activity, as well as an increase in net investment income, contributed to an improved return in 2012; however, this was partially offset by a reduction in net favorable prior year reserve development.

In addition to the changes noted above for operating ROACE, ROACE also includes net realized investment gains, foreign exchange losses and the loss on repurchase of preferred shares. Foreign exchange losses exceeded net realized investment gains by \$6 million in the first quarter of 2012; in contrast, net realized investment gains exceeded foreign exchange losses by \$15 million in the first quarter of 2011. Combined with the non-recurring loss on repurchase of preferred shares in the three months ended March 31, 2012, these items explain the variances between ROACE and operating ROACE.

**Diluted book value per common share**

Our DBV per common share increased 11% from that of a year ago, primarily reflective the generation of \$515 million in net income available to common shareholders over the past twelve months. The execution of common share repurchases at a discount to book value in the most recent two quarters also contributed to diluted book value growth.

**Table of Contents****UNDERWRITING RESULTS GROUP**

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

| <b>Three months ended March 31,</b>             | <b>2012</b>      | <b>% Change</b> | <b>2011</b>         |
|---|------------------|-----------------|---------------------|
| <b>Revenues:</b>                                |                  |                 |                     |
| Gross premiums written                          | \$ 1,525,168     | (2%)            | \$ 1,548,430        |
| Net premiums written                            | 1,367,186        | (2%)            | 1,400,779           |
| Net premiums earned                             | 846,362          | 7%              | 788,201             |
| Other insurance related income                  | 631              |                 | 763                 |
| <b>Expenses:</b>                                |                  |                 |                     |
| Current year net losses and loss expenses       | (555,922)        |                 | (1,069,505)         |
| Prior year reserve development                  | 45,232           |                 | 49,704              |
| Acquisition costs                               | (168,397)        |                 | (135,356)           |
| General and administrative expenses             | (105,217)        |                 | (95,112)            |
| <b>Underwriting income (loss)<sup>(1)</sup></b> | <b>\$ 62,689</b> | <b>nm</b>       | <b>\$ (461,305)</b> |

nm not meaningful

(1) Refer to Item 1, Note 2 to the Consolidated Financial Statements, for a reconciliation of underwriting income (loss) to Income (loss) before income taxes for the periods indicated above.

**UNDERWRITING REVENUES*****Premiums Written:***

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

| <b>Three months ended March 31,</b> | <b>Gross Premiums Written</b> |               |                     |
|-------------------------------------|-------------------------------|---------------|---------------------|
|                                     | <b>2012</b>                   | <b>Change</b> | <b>2011</b>         |
| Insurance                           | \$ 524,678                    | 23%           | \$ 424,991          |
| Reinsurance                         | 1,000,490                     | (11%)         | 1,123,439           |
| <b>Total</b>                        | <b>\$ 1,525,168</b>           | <b>(2%)</b>   | <b>\$ 1,548,430</b> |

% ceded

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|              |            |              |            |
|--------------|------------|--------------|------------|
| Insurance    | 28%        | (4) pts      | 32%        |
| Reinsurance  | 1%         | - pts        | 1%         |
| <b>Total</b> | <b>10%</b> | <b>- pts</b> | <b>10%</b> |

|              | Net Premiums Written |             |                     |
|--------------|----------------------|-------------|---------------------|
|              | 2012                 | % Change    | 2011                |
| Insurance    | \$ 378,614           | 31%         | \$ 289,316          |
| Reinsurance  | 988,572              | (11%)       | 1,111,463           |
| <b>Total</b> | <b>\$ 1,367,186</b>  | <b>(2%)</b> | <b>\$ 1,400,779</b> |

Gross premiums written in our reinsurance segment decreased by \$123 million this quarter, largely driven by a reduction in catastrophe business where we are withholding capacity until market pricing better reflects risk. Our trade credit and bond reinsurance premiums also decreased, as we managed our European exposure base in light of current economic conditions and changes in contract



**Table of Contents**

terms. Partially offsetting these reductions was an increase in professional lines business, driven by the consolidation of one client's program and, to a lesser extent, increases on renewal.

In our insurance segment, gross premiums written were up \$100 million quarter-over-quarter. Approximately half of this growth was attributable to our accident & health line, primarily due to the renewal of one reinsurance treaty that was written in the first and second quarters of 2011 and was subsequently grown and entirely written this quarter. The remaining increase related to growth in our marine, property and professional insurance lines. Rate increases and new business opportunities drove the increases in marine and property, with a portion of marine growth also due to timing. Growth in professional lines primarily related to select growth initiatives, largely in Europe, Canada and Australia.

***Net Premiums Earned:***

Net premiums earned by segment were as follows:

| Three months ended March 31, | 2012              |             | 2011              |             | % Change  |
|------------------------------|-------------------|-------------|-------------------|-------------|-----------|
| Insurance                    | \$ 390,254        | 46%         | \$ 327,648        | 42%         | 19%       |
| Reinsurance                  | 456,108           | 54%         | 460,553           | 58%         | (1%)      |
| <b>Total</b>                 | <b>\$ 846,362</b> | <b>100%</b> | <b>\$ 788,201</b> | <b>100%</b> | <b>7%</b> |

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

Growth in net premiums earned for our insurance segment was primarily driven by recent gross premiums written growth in our accident & health and professional lines. In our reinsurance segment, catastrophe net premiums earned decreased, driven by the previously discussed gross premiums written reduction as well as a comparative absence of reinstatement premiums. However, the impact of this reduction was largely offset by earned premium increases related to growth in our motor and trade credit and bond reinsurance business during recent quarters.

**UNDERWRITING EXPENSES**

The following table provides a breakdown of our combined ratio:

| Three months ended March 31,                            | 2012         | % Point Change | 2011          |
|---|--------------|----------------|---------------|
| Current accident year loss ratio                        | 65.7%        | (70.0)         | 135.7%        |
| Prior year reserve development                          | (5.4%)       | 0.9            | (6.3%)        |
| Acquisition cost ratio                                  | 19.9%        | 2.8            | 17.1%         |
| General and administrative expense ratio <sup>(1)</sup> | 14.6%        | (0.2)          | 14.8%         |
| <b>Combined ratio</b>                                   | <b>94.8%</b> | <b>(66.5)</b>  | <b>161.3%</b> |

(1) The general and administration expense ratio includes corporate expenses not allocated to underwriting segments of 2.2% and 2.7% for the three months ended March 31, 2012 and 2011, respectively. These costs are discussed further in the *Other Expenses, Net* section below.

**Current Accident Year Loss Ratio**

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The 70.0 percentage point reduction in our current accident year loss ratio was primarily driven by a significant decrease in the level of natural catastrophe-related losses.

During the three months ended March 31, 2011, we recognized aggregate pre-tax net losses (net of related reinstatement premiums) of \$577 million for the Japanese earthquake and tsunami, New Zealand II and the Australian weather events; the majority of this amount emanated from our reinsurance segment. Eliminating the impact of these losses, our first quarter 2012 current accident year loss ratio was slightly higher than for the comparable period of 2011, driven by an increase in loss activity (including U.S. tornadoes) and changes in business mix.

**Table of Contents****Prior Year Reserve Development**

Natural catastrophe activity was notably high in the 2011 calendar year, in terms of both frequency and severity, and our results for that year were impacted by numerous events, including: the Japanese earthquake and tsunami; two significant earthquakes near Christchurch, New Zealand; Australian weather events, including severe flooding and the landfall of Cyclone Yasi; a series of severe storms in several regions of the U.S. during April and May, certain of which spawned tornadoes; flooding across a widespread area of Thailand; a cloudburst in Denmark; Hurricane Irene; and Tropical Storm Lee. We derive our estimated net losses in relation to catastrophe events such as these from ground-up assessments of our in-force contracts and treaties providing coverage in the affected regions. We also consider current industry insured loss estimates, market share analyses and catastrophe modeling analyses, when appropriate, in addition to the information available to date from clients, brokers and loss adjusters.

During the three months ended March 31, 2012, we continued to monitor paid and incurred loss development for catastrophe events of prior years and updated our estimates of ultimate losses accordingly; in the aggregate, there was no material change during the quarter. We caution, however, that the magnitude and complexity of losses arising from certain of these events, in particular the Japanese earthquake and tsunami, the New Zealand earthquakes and the Thai floods, inherently increase the level of uncertainty and, therefore, the amount of management judgment involved in arriving at our estimates. As a result, our actual losses for these events may ultimately differ materially from our current estimates.

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

| <b>Three months ended March 31,</b> | <b>2012</b>      | <b>2011</b> |
|-------------------------------------|------------------|-------------|
| Insurance                           | <b>\$ 14,897</b> | \$ 14,728   |
| Reinsurance                         | <b>30,335</b>    | 34,976      |
| <b>Total</b>                        | <b>\$ 45,232</b> | \$ 49,704   |

**Overview**

Overall, a large portion of the net favorable year reserve development in both 2012 and 2011 was generated from the property, marine, and aviation lines of our insurance segment and the property and catastrophe lines of our reinsurance segment. These lines of business, the majority of which have short-tail exposures, contributed \$19 million and \$38 million of the total net favorable reserve development in the first quarters of 2012 and 2011, respectively. The favorable development on these lines of business primarily reflected the recognition of better than expected loss emergence.

Approximately \$24 million and \$16 million of the net favorable reserve development in the first quarter of 2012 and 2011, respectively, was generated from professional lines insurance and reinsurance business. This favorable development was driven by increased incorporation of our own historical claims experience into our estimate of ultimate expected loss ratios for accident years 2007 and prior, with less weighting being given to information derived from industry benchmarks.

We caution that conditions and trends that impacted the development of our liabilities in the past may not necessarily occur in the future.

The following sections provide further details on prior year reserve development by segment, line of business and accident year.

**Table of Contents****Insurance Segment:**

| <b>Three months ended March 31,</b> | <b>2012</b>      | <b>2011</b>      |
|-------------------------------------|------------------|------------------|
| Property and other                  | \$ 4,647         | \$ 16,090        |
| Marine                              | 5,530            | 2,445            |
| Aviation                            | 1,322            | 921              |
| Credit and political risk           | (38)             | (32)             |
| Professional lines                  | 4,338            | 2,301            |
| Liability                           | (902)            | (6,997)          |
| <b>Total</b>                        | <b>\$ 14,897</b> | <b>\$ 14,728</b> |

In the first quarter of 2012, we recognized \$15 million of net favorable prior year reserve development, the principal components of which were:

\$5 million of net favorable prior year reserve development on property and other business, primarily emanating from the 2010 and 2011 accident years and due to better than expected loss emergence.

\$6 million of net favorable prior year reserve development on marine business, spanning a number of accident years and primarily attributable to better than expected loss emergence on offshore energy business.

\$4 million of net favorable prior year reserve development on professional lines business, primarily related to the 2005 through 2007 accident years, for reasons discussed in the overview.

In the first quarter of 2011, we recognized \$15 million of net favorable prior year reserve development, the principal components of which were:

\$16 million of net favorable prior year reserve development on property and other business, the majority of which emanated from the 2010 accident year and related to better than expected loss emergence with respect to the December flooding in Australia. This included an \$8 million reduction for one particular policy, following the receipt of updated information.

\$2 million of net favorable prior year reserve development on professional lines business, primarily for the 2007 and prior accident years, for reasons discussed in the overview. However, this was partially offset by \$4 million of net adverse reserve development on the 2010 accident year.

\$7 million of net adverse prior year reserve development on liability business, primarily related to the 2010 accident year and driven by the receipt of two notable claims.

**Reinsurance Segment:**

| <b>Three months ended March 31,</b> | <b>2012</b>      | <b>2011</b>      |
|-------------------------------------|------------------|------------------|
| Property and other                  | \$ 7,661         | \$ 17,891        |
| Credit and bond                     | 3,888            | 9,931            |
| Professional lines                  | 19,348           | 13,614           |
| Motor                               | (665)            | (5,791)          |
| Liability                           | 103              | (669)            |
| <b>Total</b>                        | <b>\$ 30,335</b> | <b>\$ 34,976</b> |

In the first quarter of 2012, we recognized \$30 million of net favorable prior year reserve development, the principal components of which were:

**Table of Contents**

\$8 million of net favorable prior year reserve development on property and other business, primarily related to \$9 million of net favorable prior year reserve development on crop reserves. Of this amount, \$5 million related to the 2011 accident year and was largely due to updated information for one particular claim. The remainder related to the 2010 accident year and was due to better than expected loss emergence.

\$4 million of net favorable prior year development on trade credit and bond reinsurance lines of business, largely related to the 2011 accident year, in recognition of better than expected loss emergence and updated information from our cedants.

\$19 million of net favorable prior year reserve development on professional lines reinsurance business, primarily on the 2006 and 2007 accident years, for reasons discussed in the overview.

In the first quarter of 2011, we recognized \$35 million of net favorable prior year reserve development, the principal components of which were:

\$18 million of net favorable prior year reserve development on property and other business consisting largely of:

\$17 million of net favorable prior year reserve development on property business, primarily spanning the 2007 through 2010 accident years and due to better than expected loss emergence.

\$3 million of net favorable prior year reserve development on crop reserves related to the 2009 accident year due to better than expected loss emergence.

\$10 million of net favorable prior year development on trade credit and bond reinsurance lines of business, largely related to the 2009 and 2010 accident years, in recognition of better than expected loss emergence and updated information from our cedants.

\$14 million of net favorable prior year reserve development on professional lines reinsurance business, primarily on the 2006 and 2005 accident years, for reasons discussed in the overview.

\$6 million of net adverse prior year reserve development on motor business, primarily on 2009 and 2010 accident year non-proportional business and due to changes in assumptions relating to settlement practices in the U.K. motor market (namely, Periodic Payment Orders, or PPOs ).

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

Results from our insurance segment were as follows:

| <b>Three months ended March 31,</b>       | <b>2012</b>      | <b>% Change</b> | <b>2011</b>        |
|---|------------------|-----------------|--------------------|
| <b>Revenues:</b>                          |                  |                 |                    |
| Gross premiums written                    | \$ 524,678       | 23%             | \$ 424,991         |
| Net premiums written                      | 378,614          | 31%             | 289,316            |
| Net premiums earned                       | 390,254          | 19%             | 327,648            |
| Other insurance related income            | 631              |                 | 763                |
| <b>Expenses:</b>                          |                  |                 |                    |
| Current year net losses and loss expenses | (256,621)        |                 | (281,361)          |
| Prior year reserve development            | 14,897           |                 | 14,728             |
| Acquisition costs                         | (61,155)         |                 | (42,079)           |
| General and administrative expenses       | (77,444)         |                 | (67,726)           |
| <b>Underwriting income (loss)</b>         | <b>\$ 10,562</b> | <b>nm</b>       | <b>\$ (48,027)</b> |

| <b>Ratios:</b>                   |              | <b>% Point<br/>Change</b> |               |
|----------------------------------|--------------|---------------------------|---------------|
| Current year loss ratio          | 65.8%        | (20.1)                    | 85.9%         |
| Prior year reserve development   | (3.9%)       | 0.6                       | (4.5%)        |
| Acquisition cost ratio           | 15.7%        | 2.9                       | 12.8%         |
| General and administrative ratio | 19.9%        | (0.8)                     | 20.7%         |
| <b>Combined ratio</b>            | <b>97.5%</b> | <b>(17.4)</b>             | <b>114.9%</b> |

nm not meaningful

***Gross Premiums Written:***

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

| <b>Three months ended March 31,</b> | <b>2012</b> | <b>2011</b> | <b>% Change</b> |
|-------------------------------------|-------------|-------------|-----------------|
|-------------------------------------|-------------|-------------|-----------------|

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|                           |                   |             |                   |             |            |
|---------------------------|-------------------|-------------|-------------------|-------------|------------|
| Property                  | \$ 137,251        | 26%         | \$ 116,231        | 27%         | 18%        |
| Marine                    | 85,448            | 16%         | 63,655            | 15%         | 34%        |
| Terrorism                 | 6,748             | 1%          | 6,270             | 1%          | 8%         |
| Aviation                  | 3,674             | 1%          | 2,803             | 1%          | 31%        |
| Credit and political risk | 3,601             | 1%          | 10,801            | 3%          | (67%)      |
| Professional lines        | 145,602           | 28%         | 136,544           | 32%         | 7%         |
| Liability                 | 45,411            | 9%          | 44,878            | 11%         | 1%         |
| Accident & health         | 96,943            | 18%         | 43,809            | 10%         | 121%       |
| <b>Total</b>              | <b>\$ 524,678</b> | <b>100%</b> | <b>\$ 424,991</b> | <b>100%</b> | <b>23%</b> |

Approximately half of the \$100 million growth in gross premiums written for the first quarter related to our accident & health line, primarily due to the renewal of one reinsurance treaty that was written in the first and second quarters of 2011 and was subsequently grown and entirely written this quarter. The increase noted for property reflected both rate increases and new business opportunities,



**Table of Contents**

including our renewable energy initiative. Finally, growth in professional lines business primarily related to new business generated from select growth initiatives, largely in Europe, Canada and Australia.

**Premiums Ceded:** Premiums ceded in the current quarter were \$146 million, or 28% of gross premiums written, compared with \$136 million, or 32%, in the comparable period in 2011. The reduction in the ceded ratio was primarily attributable to a greater proportion of accident & health business this quarter, for which we did not purchase significant reinsurance. Excluding accident & health, cession rates were broadly comparable at 34% and 36% for the three months ended March 31, 2012 and 2011, respectively.

**Net Premiums Earned:**

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

| Three months ended March 31, | 2012              |             | 2011              |             | % Change   |
|------------------------------|-------------------|-------------|-------------------|-------------|------------|
| Property                     | \$ 101,111        | 26%         | \$ 92,075         | 28%         | 10%        |
| Marine                       | 44,132            | 11%         | 29,282            | 9%          | 51%        |
| Terrorism                    | 9,273             | 2%          | 8,197             | 3%          | 13%        |
| Aviation                     | 15,478            | 4%          | 16,571            | 5%          | (7%)       |
| Credit and political risk    | 22,788            | 6%          | 27,001            | 8%          | (16%)      |
| Professional lines           | 142,015           | 37%         | 124,124           | 38%         | 14%        |
| Liability                    | 20,721            | 5%          | 22,497            | 7%          | (8%)       |
| Accident & health            | 34,736            | 9%          | 7,901             | 2%          | 340%       |
| <b>Total</b>                 | <b>\$ 390,254</b> | <b>100%</b> | <b>\$ 327,648</b> | <b>100%</b> | <b>19%</b> |

The increase in net premiums earned was driven by our accident & health line, commensurate with gross premiums written growth since the launch of this product offering in 2010. Our professional lines business also contributed to the increase, reflecting recent growth driven by targeted initiatives and geographic expansion (including our Australian and Canadian operations).

**Loss Ratio:**

The table below shows the components of our loss ratio:

| Three months ended March 31,   | 2012         | % Point Change | 2011         |
|--------------------------------|--------------|----------------|--------------|
| Current accident year          | 65.8%        | (20.1)         | 85.9%        |
| Prior year reserve development | (3.9%)       | 0.6            | (4.5%)       |
| <b>Loss ratio</b>              | <b>61.9%</b> | <b>(19.5)</b>  | <b>81.4%</b> |

**Current Accident Year Loss Ratio**

The 20.1 percentage point reduction in the insurance segment's current accident year loss ratio was primarily driven by a decrease in the level of natural catastrophe-related losses.

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During the three months ended March 31, 2011, we recognized aggregate pre-tax net losses (inclusive of related premiums to reinstate our reinsurance protection) of \$50 million for the Japanese earthquake and tsunami, New Zealand II and the Australian weather events. The remaining reduction in the current accident year ratio was largely attributable to a lower level of large loss activity, as well as the impact of rate and business mix changes.

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

**Table of Contents**

**Acquisition Cost Ratio:** Recent growth in accident & health gross premiums written introduced some upward movement in the acquisition cost ratio for the segment; excluding this business, the acquisition cost ratios for the three months ended March 31, 2012 and 2011 were 14% and 13%, respectively.

**General and Administrative Expense Ratio:** Total general and administrative expenses increased for the quarter, primarily due to additional staffing costs associated with the continued build-out of the segment's global platform over the past year. However, the general and administrative expense ratio declined in comparison to the prior period, due to the increase in net premiums earned.

**REINSURANCE SEGMENT**

Results from our reinsurance segment were as follows:

| Three months ended March 31,              | 2012             | % Change              | 2011                |
|---|------------------|-----------------------|---------------------|
| <b>Revenues:</b>                          |                  |                       |                     |
| Gross premiums written                    | \$ 1,000,490     | (11%)                 | \$ 1,123,439        |
| Net premiums written                      | 988,572          | (11%)                 | 1,111,463           |
| Net premiums earned                       | 456,108          | (1%)                  | 460,553             |
| <b>Expenses:</b>                          |                  |                       |                     |
| Current year net losses and loss expenses | (299,301)        |                       | (788,144)           |
| Prior year reserve development            | 30,335           |                       | 34,976              |
| Acquisition costs                         | (107,242)        |                       | (93,277)            |
| General and administrative expenses       | (27,773)         |                       | (27,386)            |
| <b>Underwriting income (loss)</b>         | <b>\$ 52,127</b> | <b>nm</b>             | <b>\$ (413,278)</b> |
| <b>Ratios:</b>                            |                  |                       |                     |
|   |                  | <b>% Point Change</b> |                     |
| Current year loss ratio                   | 65.6%            | (105.5)               | 171.1%              |
| Prior year reserve development            | (6.6%)           | 1.0                   | (7.6%)              |
| Acquisition cost ratio                    | 23.5%            | 3.2                   | 20.3%               |
| General and administrative ratio          | 6.1%             | 0.2                   | 5.9%                |
| <b>Combined ratio</b>                     | <b>88.6%</b>     | <b>(101.1)</b>        | <b>189.7%</b>       |

nm not meaningful

**Gross Premiums Written:**

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

| Three months ended March 31, | 2012       |     | 2011       |     | % Change |
|------------------------------|------------|-----|------------|-----|----------|
| Catastrophe                  | \$ 146,423 | 15% | \$ 253,218 | 23% | (42%)    |
| Property                     | 182,446    | 18% | 182,204    | 16% | -        |
| Professional lines           | 113,342    | 11% | 93,273     | 8%  | 22%      |

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|                 |                     |             |                     |             |              |
|-----------------|---------------------|-------------|---------------------|-------------|--------------|
| Credit and bond | 203,948             | 20%         | 236,645             | 21%         | (14%)        |
| Motor           | 198,210             | 20%         | 195,114             | 17%         | 2%           |
| Liability       | 94,627              | 10%         | 99,015              | 9%          | (4%)         |
| Engineering     | 43,036              | 4%          | 50,664              | 5%          | (15%)        |
| Other           | 18,458              | 2%          | 13,306              | 1%          | 39%          |
| <b>Total</b>    | <b>\$ 1,000,490</b> | <b>100%</b> | <b>\$ 1,123,439</b> | <b>100%</b> | <b>(11%)</b> |

**Table of Contents**

The \$123 million, or 11%, reduction in gross premiums written was largely driven by a \$107 million reduction in catastrophe business; this decrease was largely driven by our decision to withhold capacity until market pricing better reflects risk. Our trade credit and bond reinsurance premiums also decreased, as we managed our European exposure base in light of current economic conditions and changes in contract terms. Partially offsetting these reductions was an increase in professional lines business; this growth was largely driven by the consolidation of one client's program and, to a lesser extent, increases on renewal. While our motor reinsurance premiums were broadly comparable, there was an underlying shift in business mix. We reduced our participation in U.K. non-proportional business in light of recent settlement trends; this was more than offset by a higher volume of proportional business, related to both renewal timing and new business.

***Net Premiums Earned:***

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

| Three months ended March 31, | 2012              |             | 2011              |             | %<br>Change |
|------------------------------|-------------------|-------------|-------------------|-------------|-------------|
| Catastrophe                  | \$ 91,300         | 20%         | \$ 121,485        | 26%         | (25%)       |
| Property                     | 85,394            | 19%         | 86,786            | 19%         | (2%)        |
| Professional lines           | 71,670            | 15%         | 67,555            | 15%         | 6%          |
| Credit and bond              | 68,960            | 15%         | 62,243            | 13%         | 11%         |
| Motor                        | 59,553            | 13%         | 44,091            | 10%         | 35%         |
| Liability                    | 53,796            | 12%         | 54,254            | 12%         | (1%)        |
| Engineering                  | 17,386            | 4%          | 18,190            | 4%          | (4%)        |
| Other                        | 8,049             | 2%          | 5,949             | 1%          | 35%         |
| <b>Total</b>                 | <b>\$ 456,108</b> | <b>100%</b> | <b>\$ 460,553</b> | <b>100%</b> | <b>(1%)</b> |

First quarter 2011 catastrophe net premiums earned included \$7 million related to the recognition of reinstatement premiums following the occurrence of natural catastrophe events during that quarter; the remaining quarter-over-quarter decrease was largely attributable to the previously described reduction in gross premiums written. Growth in net premiums earned for our motor and trade credit and bond reinsurance lines largely reflected increases in business written during recent quarters.

**Loss Ratio:**

The table below shows the components of our loss ratio:

| Three months ended March 31,   | 2012         | % Point<br>Change | 2011          |
|--------------------------------|--------------|-------------------|---------------|
| Current accident year          | 65.6%        | (105.5)           | 171.1%        |
| Prior year reserve development | (6.6%)       | 1.0               | (7.6%)        |
| <b>Loss ratio</b>              | <b>59.0%</b> | <b>(104.5)</b>    | <b>163.5%</b> |

**Current Accident Year Loss Ratio**

The 105.5 percentage point reduction in the reinsurance segment's current accident year loss ratio was primarily driven by a significant decrease in the level of natural catastrophe-related losses.

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During the three months ended March 31, 2011, we recognized aggregate pre-tax net losses (net of related reinstatement premiums) of \$527 million for the Japanese earthquake and tsunami, New Zealand II and the Australian weather events. Exclusive of these catastrophe losses, higher attritional loss ratios for property-related lines of business (including U.S. tornadoes) and credit and bond business, as well as business mix changes led to a higher current accident year loss ratio.

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

**Table of Contents**

***Acquisition Cost Ratio:*** The increase in the acquisition cost ratio was primarily driven by business mix changes, with commission adjustments based on actual results for contracts written in prior years also contributing.

**Table of Contents****OTHER EXPENSES (REVENUES), NET**

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

| Three months ended March 31,         | 2012             | % Change  | 2011             |
|--------------------------------------|------------------|-----------|------------------|
| Corporate expenses                   | \$ 18,435        | (14%)     | \$ 21,408        |
| Foreign exchange losses              | 20,447           | 36%       | 15,058           |
| Interest expense and financing costs | 15,636           | (1%)      | 15,860           |
| Income tax expense                   | 2,848            | 67%       | 1,709            |
| <b>Total</b>                         | <b>\$ 57,366</b> | <b>6%</b> | <b>\$ 54,035</b> |

**Corporate Expenses:** Our corporate expenses include holding company costs necessary to support our worldwide insurance and reinsurance operations and costs associated with operating as a publicly-traded company. As a percentage of net premiums earned, corporate expenses were 2.2% and 2.7% for the first quarter of 2012 and 2011, respectively.

**Foreign Exchange Losses:** Some of our business is written in currencies other than the U.S. Dollar. The foreign exchange losses in the three months ended March 31, 2012 were primarily due to the remeasurement of our net insurance-related liabilities denominated in euro and Sterling, following the appreciation of those currencies against the U.S. Dollar. In comparison, the appreciation of the euro was the primary driver for the foreign exchange losses in the three months ended March 31, 2011.

**Income Tax Expense:** Income tax expense is generated primarily through our foreign operations in the United States and Europe. Our effective tax rate, which is calculated as income tax expense divided by income before tax, was 2.1% for the first quarter of 2012 compared with (0.5)% for the same period of 2011. This effective rate can vary between periods depending on the distribution of net income (loss) amongst tax jurisdictions. We generated a consolidated net loss for the first quarter of 2011 due to the significant catastrophe activity; the majority of this loss was borne by our Bermudian operations. Our U.S. and European operations generated taxable income for the first quarter 2011; as such, we recognized an income tax expense for that period.



**Table of Contents****NET INVESTMENT INCOME AND NET REALIZED INVESTMENT GAINS/LOSSES****Net Investment Income**

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

| <b>Three months ended March 31,</b> | <b>2012</b>       | <b>% Change</b> | <b>2011</b>       |
|-------------------------------------|-------------------|-----------------|-------------------|
| Fixed maturities                    | \$ 79,637         | (10%)           | \$ 88,581         |
| Other investments                   | 40,420            | 60%             | 25,311            |
| Cash and cash equivalents           | 1,608             | (25%)           | 2,153             |
| Equity securities                   | 1,110             | 35%             | 824               |
| Short-term investments              | 154               | (60%)           | 387               |
| <b>Gross investment income</b>      | <b>122,929</b>    | <b>5%</b>       | <b>117,256</b>    |
| Investment expense                  | (6,906)           | 5%              | (6,601)           |
| <b>Net investment income</b>        | <b>\$ 116,023</b> | <b>5%</b>       | <b>\$ 110,655</b> |
| <b>Pre-tax yield:<sup>(1)</sup></b> |                   |                 |                   |
| Fixed maturities                    | 2.9%              |                 | 3.4%              |
| Cash and cash equivalents           | 0.6%              |                 | 0.7%              |

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

**Fixed Maturities**

Despite larger average investment balances during the period, net investment income declined because of lower yields in both the U.S. and European markets during the current quarter. For the three months ended March 31, 2012, our pre-tax yield on fixed maturities was 2.9%, a decrease of 52 basis points from the same quarter in 2011.

**Other Investments**

The following table provides a breakdown of total net investment income from other investments:

| <b>Three months ended March 31,</b> | <b>2012</b> | <b>2011</b> |
|-------------------------------------|-------------|-------------|
| Hedge funds                         | \$ 24,266   | \$ 4,050    |

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|                                   |                  |                  |
|-----------------------------------|------------------|------------------|
| Funds of hedge funds              | 7,771            | 3,903            |
| Credit funds                      | 4,993            | 5,209            |
| CLO - equity tranching securities | 3,390            | 12,149           |
| <b>Total</b>                      | <b>\$ 40,420</b> | <b>\$ 25,311</b> |

**Pre-tax return on other investments<sup>(1)</sup>** **5.6%** **4.7%**

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

The increase in total net investment income from other investments is driven primarily by our hedge funds and funds of hedge funds which had both higher returns and larger average investment balances in the current year quarter. The improved performance of our hedge funds and funds of hedge funds reflected the positive direction of the global equity markets in general, with our long/short equity hedge funds accounting for \$19 million of the current quarter's net investment income from other investments.

**Table of Contents****Net Realized Investment Gains (Losses)**

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

| <b>Three months ended March 31,</b>            | <b>2012</b>      | <b>2011</b> |
|--|------------------|-------------|
| <i>On sale of investments:</i>                 |                  |             |
| Fixed maturities and short-term investments    | \$ 20,040        | \$ 34,215   |
| Equity securities                              | 2,295            | 3,704       |
|  | <b>22,335</b>    | 37,919      |
| OTTI charges recognized in earnings            | (3,909)          | (1,940)     |
| Change in fair value of investment derivatives | (5,882)          | (9,100)     |
| Fair value hedges                              | 1,947            | 3,265       |
| <b>Net realized investment gains</b>           | <b>\$ 14,491</b> | \$ 30,144   |

**On sale of investments**

The net realized investment gains on the sale of fixed maturities in the first quarter of 2012 relate primarily to sales of U.S. corporate debt securities, agency MBS and non-U.S. government securities as a result of minor sector reallocations and sales for operating and financing activities. The decline in net realized gains on the sale of investments is driven primarily by net gains of \$14 million realized on certain medium-term notes (MTNs) during the prior year quarter. The last of our MTNs matured during 2011.

**Change in fair value of investment derivatives**

From time to time, we may economically hedge the foreign exchange exposure of non-U.S. denominated securities by entering into foreign exchange contracts. During 2012, we hedged securities denominated primarily in Canadian dollars, Sterling, euro and Australian dollars. The unrealized losses of \$6 million for the quarter were primarily driven by our exposure to the euro, which appreciated 3% against the U.S. dollar during the quarter. These hedges did not qualify for fair value hedge accounting and accordingly, the corresponding unrealized gains on the hedged securities are recorded as part of accumulated other comprehensive income in shareholders' equity.

**Total Return**

The following table provides a breakdown of the total return on cash and investments for the period indicated:

| <b>Three months ended March 31,</b>                           | <b>2012</b> | <b>2011</b> |
|---|-------------|-------------|
| Net investment income   | \$ 116,023  | \$ 110,655  |
| Net realized investments gains                                | 14,491      | 30,144      |
| Change in net unrealized gains/losses, net of currency hedges | 157,324     | (21,763)    |

|              |                   |            |
|--------------|-------------------|------------|
| <b>Total</b> | <b>\$ 287,838</b> | \$ 119,036 |
|--------------|-------------------|------------|

|   |                      |               |
|---|----------------------|---------------|
| <b>Average cash and investments<sup>(1)</sup></b> | <b>\$ 13,921,715</b> | \$ 12,872,228 |
|---|----------------------|---------------|

|  |             |      |
|--|-------------|------|
| <b>Total return on average cash and investments, pre-tax<sup>(2)</sup></b> | <b>2.1%</b> | 0.9% |
|--|-------------|------|

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

(2) Excluding the impact of foreign exchange fluctuation of unhedged portfolios that match foreign-denominated insurance liabilities, the total return would be 1.8% for 2012 (2011: 0.4%).

**Table of Contents****CASH AND INVESTMENTS**

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

|  | March 31, 2012            |                      | December 31, 2011         |                      |
|--|---------------------------|----------------------|---------------------------|----------------------|
|  | Amortized Cost<br>or Cost | Fair Value           | Amortized Cost<br>or Cost | Fair Value           |
| Fixed maturities                               | \$ 11,214,712             | \$ 11,440,643        | \$ 10,821,338             | \$ 10,940,100        |
| Equity securities                              | 703,938                   | 757,038              | 699,566                   | 677,560              |
| Other investments                              | 684,373                   | 769,554              | 650,955                   | 699,320              |
| Short-term investments                         | 50,264                    | 50,264               | 149,909                   | 149,909              |
| <b>Total investments</b>                       | <b>\$ 12,653,287</b>      | <b>\$ 13,017,499</b> | <b>\$ 12,321,768</b>      | <b>\$ 12,466,889</b> |
| <b>Cash and cash equivalents<sup>(1)</sup></b> | <b>\$ 1,173,771</b>       | <b>\$ 1,173,771</b>  | <b>\$ 1,082,838</b>       | <b>\$ 1,082,838</b>  |

(1) Includes restricted cash and cash equivalents of \$152 million and \$101 million for 2012 and 2011, respectively.

The amortized cost/cost of our total investments increased by \$332 million from December 31, 2011, primarily due to investing a portion of our operating cash flows generated during the quarter. The fair value of our total investments increased by \$551 million from December 31, 2011, due to net contributions and improved valuations.

The following provides a further analysis on our investment portfolio by asset classes.

**Table of Contents****Fixed Maturities**

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

|                            | March 31, 2012       |             | December 31, 2011    |             |
|----------------------------|----------------------|-------------|----------------------|-------------|
|                            | Fair Value           | % of Total  | Fair Value           | % of Total  |
| <b>Fixed maturities:</b>   |                      |             |                      |             |
| U.S. government and agency | \$ 1,236,631         | 11%         | \$ 1,148,267         | 10%         |
| Non-U.S. government        | 1,064,455            | 9%          | 1,212,451            | 11%         |
| Corporate debt             | 3,785,320            | 33%         | 3,609,591            | 33%         |
| Agency RMBS                | 2,812,098            | 25%         | 2,636,634            | 24%         |
| CMBS                       | 440,687              | 4%          | 312,691              | 3%          |
| Non-Agency RMBS            | 155,205              | 1%          | 165,713              | 2%          |
| ABS                        | 802,040              | 7%          | 632,042              | 6%          |
| Municipals <sup>(1)</sup>  | 1,144,207            | 10%         | 1,222,711            | 11%         |
| <b>Total</b>               | <b>\$ 11,440,643</b> | <b>100%</b> | <b>\$ 10,940,100</b> | <b>100%</b> |

**Credit ratings:**

|                            |                      |             |                      |             |
|----------------------------|----------------------|-------------|----------------------|-------------|
| U.S. government and agency | \$ 1,236,631         | 11%         | \$ 1,148,267         | 10%         |
| AAA <sup>(2)</sup>         | 5,138,248            | 45%         | 4,783,578            | 44%         |
| AA                         | 1,088,132            | 10%         | 1,345,583            | 12%         |
| A                          | 1,997,933            | 17%         | 1,949,612            | 18%         |
| BBB                        | 1,386,711            | 12%         | 1,181,156            | 11%         |
| Below BBB <sup>(3)</sup>   | 592,988              | 5%          | 531,904              | 5%          |
| <b>Total</b>               | <b>\$ 11,440,643</b> | <b>100%</b> | <b>\$ 10,940,100</b> | <b>100%</b> |

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

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

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

Our asset class allocations within our fixed maturities portfolio have not changed significantly since December 31, 2011. At March 31, 2012, our fixed maturities had a weighted average credit rating of AA- (2011: AA-) with an average duration of 2.9 years (2011: 2.8 years). When incorporating short-term investments and cash and cash equivalents into the calculation (bringing the total to \$12.7 billion), the average credit rating would be AA- (2011: AA-) and the average duration would be 2.6 years (2011: 2.5 years).

During the quarter, net unrealized gains increased to \$226 million from \$119 million at December 31, 2011. The asset classes experiencing the most improvement were non-U.S. governments and corporate debt. Pricing of both asset classes was significantly improved due to changes in foreign currency exchange rates, most notably the strengthening of the euro against the U.S. dollar, while corporate debt also benefited from modest spread tightening during the quarter.

**Equities**

During the quarter, net unrealized gains/losses swung from a net unrealized loss of \$22 million at December 31, 2011 to a net unrealized gain of \$53 million at March 31, 2012. This significant improvement was driven primarily by the rally in the global equity markets that continued during the first quarter of 2012.

**Table of Contents*****Other Investments***

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

|                                     | <b>March 31, 2012</b> |             | <b>December 31, 2011</b> |      |
|-------------------------------------|-----------------------|-------------|--------------------------|------|
| <b><u>Hedge funds</u></b>           |                       |             |                          |      |
| Long/short equity funds             | <b>\$ 283,749</b>     | <b>37%</b>  | \$ 214,498               | 31%  |
| Multi-strategy funds                | <b>238,522</b>        | <b>31%</b>  | 230,750                  | 33%  |
| Event-driven funds                  | <b>104,075</b>        | <b>13%</b>  | 99,061                   | 14%  |
| <b>Total hedge funds</b>            | <b>626,346</b>        | <b>81%</b>  | 544,309                  | 78%  |
| <b><u>Credit funds</u></b>          |                       |             |                          |      |
| Leveraged bank loan funds           | <b>62,290</b>         | <b>8%</b>   | 69,132                   | 10%  |
| Event-driven funds                  | <b>20,009</b>         | <b>3%</b>   | 19,319                   | 3%   |
| <b>Total credit funds</b>           | <b>82,299</b>         | <b>11%</b>  | 88,451                   | 13%  |
| <b>Total hedge and credit funds</b> | <b>708,645</b>        | <b>92%</b>  | 632,760                  | 91%  |
| <b>CLO - Equities</b>               | <b>60,909</b>         | <b>8%</b>   | 66,560                   | 9%   |
| <b>Total other investments</b>      | <b>\$ 769,554</b>     | <b>100%</b> | \$ 699,320               | 100% |

The increase in the fair value of our hedge fund holdings during 2012 reflects \$50 million of subscriptions into long/short equity funds and \$32 million of pricing appreciation as our hedge funds benefited from the continued rally in the global equity markets. The fair value of our credit funds declined due to the collection of \$11 million of cash distributions and redemptions, partly offset by \$5 million of pricing appreciation.

The decrease in the fair value of our CLO - Equities since December 31, 2011, was primarily due to cash distributions of \$9 million received during the quarter, partly offset by \$3 million of improved valuations.

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES**

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, 2011 for a general discussion of our liquidity and capital resources. During the first three months of 2012, we effectively reduced the dividend rate on our preferred equity through three separate transactions, described in further detail below. In addition, we continued execution of common stock repurchases under the program authorized by our Board of Directors.

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

|  | March 31, 2012      | December 31, 2011   |
|--|---------------------|---------------------|
| Long-term debt   | \$ 994,806          | \$ 994,664          |
| Preferred shares   | 750,000             | 500,000             |
| Common equity  | 5,149,179           | 4,944,079           |
| Shareholders' equity                                       | 5,899,179           | 5,444,079           |
| <b>Total capital</b>                                       | <b>\$ 6,893,985</b> | <b>\$ 6,438,743</b> |
| <b>Ratio of debt to total capital</b>                      | <b>14.4%</b>        | <b>15.4%</b>        |
| <b>Ratio of debt and preferred equity to total capital</b> | <b>25.3%</b>        | <b>23.2%</b>        |

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

Our Consolidated Balance Sheet for March 31, 2012 reflects two of our three preferred share transactions (discussed further below): the issuance of \$400 million in Series C shares and the redemption of \$150 million of Series A shares. The \$250 million increase in preferred equity noted in the table above was attributable to the recognition of these transactions. In addition, during March 2012, we launched a tender offer for our Series B shares; this tender offer closed in April 2012, resulting in the repurchase of shares with an aggregate liquidation value of \$246 million. The equity reduction related to this Series B tender offer will be reflected in our second quarter 2012 Consolidated Balance Sheet. As a result of this timing difference, the increase in our debt and preferred equity to total capital ratio noted in the table above is expected to be temporary; adjusting the applicable March 31, 2012 amounts above for the actual results of our Series B repurchase, our debt and preferred equity to total capital ratio is 22.6%. We believe that our financial flexibility remains strong.

**Preferred Shares Transactions**

On March 19, 2012, we issued 16 million newly designated 6.875% Series C preferred shares with a liquidation preference of \$25.00 per share for gross proceeds of \$400 million. Net of issue costs, this issuance resulted in a \$394 million increase in total capital. Dividends on the Series C preferred shares are non-cumulative; to the extent declared, dividends will accumulate, with respect to each dividend period, in an amount per



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share equal to 6.875% of the liquidation preference per annum. We may redeem the shares on or after April 15, 2017 at a redemption price of \$25.00 per share.

Concurrent with the closing of the Series C preferred share issuance, we issued an irrevocable notice of redemption for six million of our previously outstanding 7.25% Series A Preferred shares at the \$25.00 per share redemption price. This redemption closed on April 18, 2012; accordingly, our March 31, 2012 preferred share balance and total capital reflected a \$150 million reduction. Following this redemption, four million Series A preferred shares, representing \$100 million in aggregate liquidation preference, remain outstanding.

On April 10, 2012, we closed a cash tender offer for any and all of our outstanding 7.50% Series B Preferred shares at a price of \$102.81 per share. As a result, we purchased 2,461,150 Series B Preferred shares, for \$253 million (including an aggregate \$7 million premium in excess of liquidation value); this amount will be reflected as a reduction in total capital during the second quarter of 2012.

**Table of Contents**

Following the completion of the tender offer, 38,850 Series B Preferred shares, representing \$4 million in aggregate liquidation preference, remain outstanding. We may redeem these shares on or after December 1, 2015, at a redemption price of \$100.00 per share.

During the three months ended March 31, 2012, our common equity increased by \$205 million. The following table reconciles our opening and closing common equity positions:

| <b>Three months ended March 31,</b>   | <b>2012</b>         |
|---|---------------------|
| <b>Common equity - opening</b>  | <b>\$ 4,944,079</b> |
| Net income  | 135,837             |
| Change in unrealized appreciation on available for sale investments, net of tax | 149,219             |
| Share-based compensation  | 12,000              |
| Share repurchases   | (47,711)            |
| Common share dividends  | (31,035)            |
| Preferred share dividends   | (9,219)             |
| Preferred share issue costs   | (6,032)             |
| Foreign currency translation adjustment and other                               | 2,041               |
| <b>Common equity - closing</b>  | <b>\$ 5,149,179</b> |

During the first three months of 2012, we repurchased 1.5 million common shares for a total of \$48 million (including \$39 million pursuant to our Board-authorized share repurchase program and \$9 million relating to shares purchased in connection with the vesting of restricted stock awards granted under our 2007 Long-Term Equity Compensation Plan). At April 26, 2012, the remaining authorization under the common share repurchase program approved by our Board of Directors was \$505 million (refer to Part II, Item 2 *Unregistered Sales of Equity Securities and Use of Proceeds* for additional information).

Our net paid losses may increase in the short-term due to the recently significant level of natural catastrophe activity. However, we continue to expect that cash flows generated from our operations, combined with the liquidity provided by our investment portfolio, will be sufficient to cover our required cash outflows and other contractual commitments through the foreseeable future.

**Table of Contents**

**CRITICAL ACCOUNTING ESTIMATES**

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

As disclosed in our 2011 Annual Report on Form 10-K, we believe that the material items requiring such subjective and complex estimates are our:

reserves for losses and loss expenses;

reinsurance recoverable balances;

premiums;

fair value measurements for our financial assets and liabilities; and

assessments of other-than-temporary impairments (OTTI).

We believe that the critical accounting estimates discussion in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2011 continues to describe the significant estimates and judgments included in the preparation of our Consolidated Financial Statements.

**NEW ACCOUNTING STANDARDS**

See Item 1, Note 1 to the Consolidated Financial Statements for a discussion of recently issued accounting pronouncements that we have not yet adopted.

**OFF-BALANCE SHEET AND SPECIAL PURPOSE ENTITY ARRANGEMENTS**

At March 31, 2012, we have not entered into any off-balance sheet arrangements, as defined by Item 303(a)(4) of Regulation S-K.

**Table of Contents****NON-GAAP FINANCIAL MEASURES**

In this report, we have presented operating income (loss), which is a non-GAAP financial measure as defined in Regulation G. Operating income (loss) represents after-tax operational results without consideration of after-tax net realized investment gains (losses), foreign exchange losses (gains) and losses on repurchase of preferred shares. In addition, we have presented diluted operating earnings (loss) per share and operating return on average common equity (operating ROACE), which are derived from the non-GAAP operating income (loss) measure. These measures can be reconciled to the nearest GAAP financial measures as follows:

| <b>Three months ended March 31,</b>  | <b>2012</b>       | <b>2011</b>         |
|--|-------------------|---------------------|
| Net income (loss) available to common shareholders                                   | \$ 121,997        | \$ (383,760)        |
| Net realized investment gains, net of tax <sup>(1)</sup>                             | (11,210)          | (30,142)            |
| Foreign exchange losses, net of tax <sup>(2)</sup>                                   | 20,326            | 15,036              |
| Loss on repurchase of preferred shares, net of tax <sup>(3)</sup>                    | 4,621             | -                   |
| <b>Operating income (loss)</b>   | <b>\$ 135,734</b> | <b>\$ (398,866)</b> |
| <br>   |                   |                     |
| Net income (loss) per share - diluted  | \$ 0.96           | \$ (3.39)           |
| Net realized investment gains, net of tax  | (0.09)            | (0.26)              |
| Foreign exchange losses, net of tax  | 0.16              | 0.13                |
| Loss on repurchase of preferred shares, net of tax                                   | 0.04              | -                   |
| <b>Operating income (loss) per share - diluted</b>                                   | <b>\$ 1.07</b>    | <b>\$ (3.52)</b>    |
| <br>   |                   |                     |
| Weighted average common shares and common share equivalents - diluted <sup>(4)</sup> | 126,668           | 113,351             |
| <br>   |                   |                     |
| Average common shareholders' equity  | \$ 5,046,629      | \$ 4,907,275        |
| <br>   |                   |                     |
| ROACE (annualized)   | 9.7%              | (31.3%)             |
| <br>   |                   |                     |
| Operating ROACE (annualized)   | 10.8%             | (32.5%)             |

(1) Tax cost of \$3,281 and \$2 for the three months ended March 31, 2012 and 2011, respectively. Tax impact is estimated by applying the statutory rates of applicable jurisdictions, after consideration of other relevant factors including the ability to utilize capital losses.

(2) Tax benefit of \$120 and \$22 for the three months ended March 31, 2012 and 2011, respectively. Tax impact is estimated by applying the statutory rates of applicable jurisdictions, after consideration of other relevant factors including the tax status of specific foreign exchange transactions.

(3) Tax impact is nil.

(4) Refer to Note 8 to the Consolidated Financial Statements for further details on the dilution calculation.

We present our results of operations in the way we believe will be most meaningful and useful to investors, analysts, rating agencies and others who use our financial information to evaluate our performance. This includes the presentation of operating income (loss), in total and on a per share basis, and annualized operating return on average common equity which is based on the operating income (loss) measure.

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Although the investment of premiums to generate income and realized investment gains (or losses) is an integral part of our operations, the determination to realize investment gains (or losses) is independent of the underwriting process and is heavily influenced by the availability of market opportunities. Furthermore, many users believe that the timing of the realization of investment gains (or losses) is somewhat opportunistic for many companies.

Foreign exchange losses (gains) in our Consolidated Statements of Operations are primarily driven by the impact of foreign exchange rate movements on net insurance related-liabilities. However, this movement is only one element of the overall impact of foreign exchange rate fluctuations on our financial position. In addition, we recognize unrealized foreign exchange losses (gains) on our available-for-sale investments in other comprehensive income and foreign exchange losses (gains) realized upon the sale of these investments in net realized investments gain (losses). These unrealized and realized foreign exchange rate movements generally offset a large portion of the foreign exchange losses (gains) reported separately in earnings, thereby minimizing the impact of foreign exchange rate movements on

**Table of Contents**

total shareholders' equity. As such, the Statement of Operations foreign exchange losses (gains) in isolation are not a fair representation of the performance of our business.

Losses on repurchase of preferred shares arise from non-recurring capital transaction and, therefore are not reflective of underlying business performance.

In this regard, certain users of our financial statements evaluate earnings excluding after-tax net realized investment gains (losses), foreign exchange losses (gains) and losses on repurchase of preferred shares to understand the profitability of recurring sources of income.

We believe that showing net income available to common shareholders exclusive of net realized gains (losses), foreign exchange losses (gains) and losses on repurchase of preferred shares reflects the underlying fundamentals of our business. In addition, we believe that this presentation enables investors and other users of our financial information to analyze performance in a manner similar to how our management analyzes the underlying business performance. We also believe this measure follows industry practice and, therefore, facilitates comparison of our performance with our peer group. We believe that equity analysts and certain rating agencies that follow us, and the insurance industry as a whole, generally exclude these items from their analyses for the same reasons.

**Table of Contents**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

Refer to Item 7A included in our 2011 Form 10-K. There have been no material changes to this item since December 31, 2011.

**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 our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)) as of March 31, 2012. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2012, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and is accumulated and communicated to management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

The Company's management has performed an evaluation, with the participation of the Company's Chief Executive Officer and the Company's Chief Financial Officer, of changes in the Company's internal control over financial reporting that occurred during the quarter ended March 31, 2012. Based upon that evaluation, there were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



**Table of Contents**

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

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

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

**ITEM 1A. RISK FACTORS**

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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, 2011.

**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table sets forth information regarding the number of shares we repurchased during the three months ended March 31, 2012:

**ISSUER PURCHASES OF EQUITY SECURITIES****Common Shares**

| <b>Period</b>       | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid Per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(a)</sup></b> | <b>Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Announced Plans or Programs<sup>(b)</sup></b> |
|---------------------|---|-------------------------------------|---|---|
| January 1-31, 2012  | 2,900                                   | \$ 31.68                            | -   | \$ 543.5 million  |
| February 1-29, 2012 | 1,036,408                               | \$ 32.60                            | 766,264   | \$ 518.5 million  |
| March 1-31, 2012    | 432,857                                 | \$ 31.96                            | 430,500   | \$ 504.7 million  |
| <b>Total</b>        | <b>1,472,165</b>                        |                                     | <b>1,196,764</b>  | <b>\$ 504.7 million</b>   |

**Preferred Shares**

| <b>Period</b>    | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid Per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>(c)</sup></b> | <b>Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Announced Plans or Programs</b> |
|------------------|---|-------------------------------------|---|---|
| March 1-31, 2012 | 6,000,000                               | \$ 25.00                            | -   | \$ 0.0 million  |
| <b>Total</b>     | <b>6,000,000</b>                        |                                     | <b>-</b>  | <b>\$ 0.0 million</b>   |

(a) From time to time, we purchase shares in connection with the vesting of restricted stock awards granted to our employees under our 2007 Long-Term Equity Compensation Plan. The purchase of these shares is separately authorized and is not part of our Board-authorized share repurchase program, described below.

(b) On September 24, 2010, our Board of Directors approved a new share repurchase plan to repurchase up to \$750 million of our common shares until December 31, 2012. Share repurchases may be effected from time to time in open market or privately negotiated transactions, depending on market conditions.

(c) On March 19, 2012 we issued an irrevocable notice of redemption for a portion of our 7.25% Series A Preferred shares. This redemption closed on April 18, 2012.

**Table of Contents**

**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(Amendment No. 1) (No. 333-103620) filed on April 16, 2003).
  - 3.2 Amended and Restated Bye-Laws (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 filed on May 15, 2009).
  - 4.1 Specimen Common Share Certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (Amendment No. 3) (No. 333-103620) filed on June 10, 2003).
  - 4.2 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).
  - 4.4 Certificate of Designations setting from the specific rights, preferences, limitations and other terms of the Series C Preferred Shares (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on March 19, 2012).
  - 4.5 Form of stock certificate evidencing Series C Preferred Shares (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on March 19, 2012).
  - 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - \*101 The following financial information from AXIS Capital Holdings Limited's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 formatted in XBRL: (i) Consolidated Balance Sheets at March 31, 2012 and December 31, 2011; (ii) Consolidated Statements of Operations for the three months ended March 31, 2012 and 2011; (iii) Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2012 and 2011; (iv) Consolidated Statements of Changes in Shareholders' Equity for the three months ended March 31, 2012 and 2011; (v) Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011; and (vi) Notes to Consolidated Financial Statements, tagged as blocks of text and in detail.

\* As provided in Rule 406T of Regulation S-T, this information is furnished herewith and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934. Such exhibit will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934 unless AXIS Capital Holdings Limited specifically incorporates it by reference.

**Table of Contents**

**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: April 27, 2012

**AXIS CAPITAL HOLDINGS LIMITED**

By:

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

/s/ ALBERT BENCHIMOL  
Albert Benchimol  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)