UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2003

OR

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

For the transition period from _____ to _____

Commission file number 1-10804

XL CAPITAL LTD

(Exact name of registrant as specified in its charter)

CAYMAN ISLANDS (State or other Jurisdiction of incorporation or organization)	98-0191089 (I.R.S. Employer Identification No.)

XL House, One Bermudiana Road, Hamilton, Bermuda HM 11
(address of principal executive offices and zip code)

(441) 292-8515
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant v

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [X] No [_]

As of November 7, 2003, there were 137,269,539 outstanding Class A Ordinary Shares, $0.01 par value per share, of the registrant.

XL CAPITAL LTD
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PART I — FINANCIAL INFORMATION
ITEM 1. Financial Statements

XL CAPITAL LTD
CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands)

	(Unaudited) September 30, 2003	December 31, 2002
ASSETS		
Investments:		
Fixed maturities at fair value (amortized cost: 2003, $17,355,112; 2002, $14,118,527)	$ 17,878,214	$ 14,482,647
Equity securities, at fair value (cost: 2003, $505,081; 2002, $661,377)	548,845	575,010
Short-term investments, at fair value (amortized cost: 2003, $986,294; 2002, $1,001,179)	983,367	1,002,076
Total investments available for sale	19,410,426	16,059,733

Investments in affiliates	1,855,989	1,750,005
Other investments	163,530	146,061
Total investments	21,429,945	17,955,799
Cash and cash equivalents	2,059,609	3,557,815
Accrued investment income	294,600	226,862
Deferred acquisition costs	809,485	688,281
Prepaid reinsurance premiums	1,171,335	957,036
Premiums receivable	4,448,404	3,592,713
Reinsurance balances receivable	1,446,154	1,239,970
Unpaid losses and loss expenses recoverable	5,366,501	5,012,655
Goodwill and other intangible assets	1,677,726	1,653,700
Deferred tax asset, net	302,932	320,624
Other assets	580,159	441,914
Total assets	$ 39,586,850	$ 35,647,369
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Unpaid losses and loss expenses	$ 15,161,821	$ 13,202,736
Deposit liabilities	3,539,431	2,373,047
Future policy benefit reserves	2,621,123	2,516,949
Unearned premiums	5,161,493	4,028,299
Notes payable and debt	1,898,959	1,877,957
Reinsurance balances payable	1,973,925	1,924,150
Net payable for investments purchased	112,219	1,546,276
Other liabilities	1,659,511	1,551,443
Minority interest	57,158	56,923
Total liabilities	$ 32,185,640	$ 29,077,780
Commitments and Contingencies		

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands, except share amounts)

	(Unaudited) September 30, 2003	December 31, 2002
Shareholders' Equity:		
Series A preference ordinary shares, 9,200,000 authorized, par value $0.01, issued and outstanding: 2003 and 2002, 9,200,000	$ 92	$ 92
Series B preference ordinary shares, 11,500,000 authorized, par value $0.01, issued and outstanding: 2003 and 2002, 11,500,000	115	115
Series C preference ordinary shares, 20,000,000 authorized, par value $0.01, issued and outstanding: 2003 and 2002, Nil	—	—
Class A ordinary shares, 999,990,000 authorized, par value $0.01, issued and outstanding: 2003, 137,258,121; 2002, 136,063,184	1,372	1,360
Contributed surplus	3,940,945	3,979,979
Accumulated other comprehensive income	587,496	184,814
Deferred compensation	(52,272)	(31,282)
Retained earnings	2,923,462	2,434,511
Total shareholders' equity	$ 7,401,210	$ 6,569,589
Total liabilities and shareholders' equity	$ 39,586,850	$ 35,647,369

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF INCOME
(U.S. dollars and shares in thousands, except per share amounts)

	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2003	2002	2003	2002
Revenues:				
Net premiums earned	$ 1,785,448	$ 2,147,981	$ 4,912,888	$ 4,270,237
Net investment income	190,763	187,315	573,218	533,185
Net realized (losses) gains on investments	(8,693)	(23,086)	80,331	(239,108)
Net realized and unrealized (losses) gains on derivative instruments	(28,346)	9,484	(26,110)	(5,126)
Equity in net income (loss) of investment affiliates	26,240	(1,976)	87,344	38,140
Fee income and other	3,920	10,082	25,989	38,490
Total revenues	$ 1,969,332	$ 2,329,800	$ 5,653,660	$ 4,635,818
Expenses:				
Net losses and loss expenses incurred	$ 1,173,558	$ 834,205	$ 2,996,387	$ 2,298,600
Claims and policy benefits	99,954	803,741	302,737	870,320
Acquisition costs	323,913	272,510	862,775	632,502
Operating expenses	213,311	168,419	597,738	494,470
Exchange gains	(4,076)	(15,382)	(30,130)	(46,952)
Interest expense	49,671	51,815	142,093	133,576
Amortization of intangible assets	375	875	1,125	1,500
Total expenses	$ 1,856,706	$ 2,116,183	$ 4,872,725	$ 4,384,016
Income before minority interest, income tax and equity in net (income) loss of insurance and financial affiliates	$ 112,626	$ 213,617	$ 780,935	$ 251,802
Minority interest in net income of subsidiary	763	2,494	5,791	6,528
Income tax	14,890	24,286	45,929	61,140

Equity in net (income) loss of insurance and financial affiliates	(12,078)	401	12,487	(47)
Net income	109,051	186,436	716,728	184,181
Preference share dividends	(10,080)	(2,369)	(30,241)	(2,369)
Net income available to ordinary shareholders	$ 98,971	$ 184,067	$ 686,487	$ 181,812
Weighted average ordinary shares and ordinary share equivalents outstanding — basic	136,826	135,790	136,744	135,551
Weighted average ordinary shares and ordinary share equivalents outstanding — diluted	138,423	137,349	138,170	137,291
Earnings per ordinary share and ordinary share equivalent — basic	$ 0.72	$ 1.36	$ 5.02	$ 1.34
Earnings per ordinary share and ordinary share equivalent — diluted	$ 0.71	$ 1.34	$ 4.97	$ 1.32

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(U.S. dollars and shares in thousands)

	(Unaudited)		(Unaudited)	
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net income	$ 109,051	$ 186,436	$ 716,728	$ 184,181
Change in net unrealized appreciation of investments, net of tax	(87,261)	221,758	321,713	186,292
Foreign currency translation adjustments, net	(10,077)	7,230	80,969	62,658
Comprehensive income	$ 11,713	$ 415,424	$ 1,119,410	$ 433,131

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(U.S. dollars in thousands)

	(Unaudited) Nine Months Ended September 30,	
	2003	2002
Series A and B Preference Ordinary Shares:		
Balance—beginning of year	$ 207	$ —
Issue of shares	—	92
Balance—end of period	$ 207	$ 92
Class A Ordinary Shares:		
Balance—beginning of year	$ 1,360	$ 1,347
Issue of shares	5	1
Exercise of stock options	7	10
Balance—end of period	$ 1,372	$ 1,358
Contributed Surplus:		
Balance—beginning of year	$ 3,979,979	$ 3,378,549
Issue of preference shares	—	222,251
Issue of restricted shares	33,224	18,492
Contingent capital costs	(109,931)	—
Stock option expense	3,748	—
Exercise of stock options	33,925	46,401
Balance—end of period	$ 3,940,945	$ 3,665,693
Accumulated Other Comprehensive Income (Loss):		
Balance—beginning of year	$ 184,814	$ (213,013)
Net change in unrealized gains on investment portfolio, net of tax	316,358	186,605
Net change in unrealized gains on investment portfolio of affiliates	5,355	(313)
Currency translation adjustments	80,969	62,658
Balance—end of period	$ 587,496	$ 35,937
Deferred Compensation:		
Balance—beginning of year	$ (31,282)	$ (27,177)
Issue of restricted shares	(33,291)	(18,243)
Amortization	12,301	10,650
Balance—end of period	$ (52,272)	$ (34,770)
Retained Earnings:		
Balance—beginning of year	$ 2,434,511	$ 2,297,478
Net income	716,728	184,181
Dividends on Series A and B preference ordinary shares	(30,241)	(2,369)
Dividends on Class A ordinary shares	(197,295)	(197,350)
Repurchase of ordinary shares	(241)	(1,574)

Balance—end of period	$ 2,923,462	$ 2,280,366
Total Shareholders' Equity	$ 7,401,210	$ 5,948,676

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
CONSOLIDATED STATEMENTS OF CASH FLOWS
(U.S. dollars in thousands)

	(Unaudited) Nine Months Ended September 30	
	2003	2002
Cash flows provided by operating activities:		
Net income	$ 716,728	$ 184,181
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net realized (gains) losses on investments	(80,331)	239,108
Net realized and unrealized losses on derivative instruments	26,110	5,126
Amortization of premiums (discounts) on fixed maturities	24,880	(14,141)
Accretion of convertible debt	18,989	18,582
Equity in net income of investment, insurance and financial affiliates	(74,857)	(38,187)
Amortization of deferred compensation	12,301	10,650
Accretion of deposit liabilities	74,391	55,105
Deposit liabilities and future policy benefit reserves	141,385	749,435
Unpaid losses and loss expenses	1,959,084	326,909
Unearned premiums	1,133,194	1,518,316
Premiums receivable	(855,691)	(1,392,912)
Unpaid losses and loss expenses recoverable	(353,846)	653,039
Prepaid reinsurance premiums	(214,299)	(243,925)
Reinsurance balances receivable	(206,184)	225,405
Deferred acquisition costs	(121,204)	(256,461)
Deferred tax asset	17,692	135,338
Other	13,595	(46,623)
Total adjustments	1,515,209	1,944,764
Net cash provided by operating activities	2,231,937	2,128,945
Cash flows used in investing activities:		
Proceeds from sale of fixed maturities and short-term investments	21,035,695	29,042,703
Proceeds from redemption of fixed maturities and short-term investments	10,595,397	2,417,057
Proceeds from sale of equity securities	1,004,284	556,325
Purchases of fixed maturities and short-term investments	(36,423,057)	(33,122,165)
Purchases of equity securities	(667,636)	(423,763)
Investments in affiliates, net of dividends received	(30,330)	(677,128)
Acquisition of subsidiaries, net of cash acquired	(161,181)	(43,143)
Other investments	(2,893)	18,568
Proceeds from purchase and sale of leasehold property	45,307	—
Fixed assets and other	—	(3,557)
Net cash used in investing activities	(4,604,414)	(2,235,103)
Cash flows provided by financing activities:		
Proceeds from exercise of stock options	33,932	46,399
Proceeds from issue of preference shares	—	222,175
Repurchase of shares	(241)	(1,575)
Dividends paid	(227,536)	(197,350)
Proceeds from notes payable and debt	—	596,814
Repayment of notes payable and debt	—	(350,000)
Net proceeds from deposit liabilities	1,067,533	663,306
Net cash provided by financing activities	873,688	979,769
Effects of exchange rate changes on foreign currency cash	583	(27)
(Decrease) increase in cash and cash equivalents	(1,498,206)	873,584
Cash and cash equivalents — beginning of period	$ 3,557,815	$ 1,863,861
Cash and cash equivalents — end of period	$ 2,059,609	$ 2,737,445

See accompanying Notes to Consolidated Financial Statements

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(U.S. dollars in thousands)

1. Basis of Preparation and Consolidation

These unaudited consolidated financial statements include the accounts of the Company and all of its subsidiaries and have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim finar

ults for a full year. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the repo

To facilitate period-to-period comparisons, certain reclassifications have been made to prior period consolidated financial statement amounts to conform to current period presentation. There was no effect on net income from these cl

Unless the context otherwise indicates, references herein to the Company include XL Capital Ltd and its consolidated subsidiaries.

2. Accounting Pronouncements

(U.S. dollars in thousands)

In December 2002, the Financial Accounting Statements Board ("FASB") issued FAS 148, "Accounting for Stock-Based Compensation — Transition and Disclosure". FAS 148 amends FAS 123, "Accounting for Stock-Based Comp

Effective January 1, 2003, the Company has adopted the fair value recognition provisions of FAS 123, as amended by FAS 148, under the prospective method for options granted subsequent to January 1, 2003. Prior to 2003, the Co

income would have been higher. The following table illustrates the net effect on net income and earnings per ordinary share if the fair value method had been applied to all outstanding and unvested awards in each period presented:

	Three months ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
Net income available to ordinary shareholders—as reported	$ 98,971	$ 184,067	$ 686,487	$ 181,812
Add: Stock based employee compensation expense included in reported net income, net of related tax	1,660	—	3,748	—
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(11,675)	(15,205)	(37,362)	(41,618)
Pro forma net income available to ordinary shareholders	$ 88,956	$ 168,862	$ 652,873	$ 140,194
Earnings per ordinary share:				
Basic — as reported	$ 0.72	$ 1.36	$ 5.02	$ 1.34
Basic — pro forma	$ 0.65	$ 1.24	$ 4.77	$ 1.03
Diluted — as reported	$ 0.71	$ 1.34	$ 4.97	$ 1.32
Diluted — pro forma	$ 0.64	$ 1.23	$ 4.73	$ 1.02

2. Accounting Pronouncements (continued)

In April 2003, FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("FAS 149"). FAS 149 amends and clarifies financial accounting and reporting for derivative instru

tracts and new contracts entered into after June 30, 2003. The adoption of FAS 149 did not have a material effect on the Company’s financial condition and results of operations.

In January 2003, FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). The objective of FIN 46 is to improve financial reporting by companies involved with variable interest entities. This new model for consolidation applies to an entity in which either (1) the powers or rights of the equity holders do not give them sufficient decision making powers or (2) the equity investment at risk is insufficient to finance that entity’s activities without receiving additional subordinated financial support from other parties. FIN 46 requires a variable interest entity to be consolidated by the company that is subject to a majority of the risk of loss from the variable interest entity’s activities or that is entitled to receive a majority of the entity’s residual returns or both. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. As amended by FASB Staff Position ("FSP") No. FIN 46-6, FIN 46 is effective for variable interests in a variable interest entity created before February 1, 2003 at the end of the first interim or annual period ending after December 15, 2003. The Company does not expect the adoption of FIN 46 to have a material effect on its results of operations or financial condition.

In April 2003, the FASB cleared Derivative Implementation Guidance Issue No. B36, "Embedded Derivatives: Modified Coinsurance Arrangements and Debt Instruments That Incorporate Credit Risk Exposures Than Are Unrelated

categories into the trading category on the date the guidance is initially applied. This guidance is effective for the periods beginning after September 15, 2003. The Company is currently evaluating the effects of implementing Issue B36, howe

In July 2003, the Accounting Standards Executive Committee issued Statement of Position 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts" ("SOP 03-1"), which provides guidance on accounting and reporting by insurance enterprises for certain non-traditional long duration contracts and for separate accounts. The provisions of this SOP 03-1 are effective for financial statements for fiscal years beginning after December 15, 2003. The Company is currently reviewing the potential impact of SOP 03-1 on its financial

statements.

3. Segment Information

The Company is organized into three operating segments — insurance, reinsurance and financial products and services — in addition to a corporate segment that includes the general investment and financing operations of the Comp

3. Segment Information (continued)

General, life and annuity and financial operations are disclosed separately by segment. General operations include property and casualty lines of business.

(U.S. dollars in thousands)
(U.S. dollars in thousands, except ratios)

The Company evaluates the performance of each segment based on underwriting results for general operations, net income from life and annuity operations and contribution from financial operations. Other items of revenue and exp

Certain lines of business within general operations written by the Company have loss experience generally characterized as low frequency and high severity. This may result in volatility in both the Company's results and operational

The following is an analysis of results by segment together with a reconciliation to net income:

Quarter Ended September 30, 2003:

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 995,857	$ 667,856	$ —	$ 1,663,713
Fee income and other	2,648	1,865	—	4,513
Net losses and loss expenses	611,617	558,047	—	1,169,664
Acquisition costs	154,549	152,978	—	307,527
Operating expenses (1)	119,184	33,411	—	152,595
Exchange gains	(6,477)	(247)	—	(6,724)
Underwriting profit (loss)	$ 119,632	$ (74,468)	$ —	$ 45,164
Life and Annuity Operations:				
Life premiums earned	$ —	$ 62,600	$ 23,828	$ 86,428
Fee income and other	—	—	62	62
Claims and policy benefits	—	81,460	18,494	99,954
Acquisition costs	—	6,880	4,537	11,417
Operating expenses (1)	—	2,012	2,083	4,095
Exchange losses	—	2,648	—	2,648
Net investment income	—	35,446	7,690	43,136
Interest expense	—	—	3,304	3,304
Net income from life and annuity operations	$ —	$ 5,046	$ 3,162	$ 8,208
Financial Operations:				
Net premiums earned			$ 35,307	$ 35,307
Fee income and other			(655)	(655)
Net losses and loss expenses			3,894	3,894
Acquisition costs			4,969	4,969
Operating expenses (1)			10,467	10,467
Underwriting profit			$ 15,322	$ 15,322
Investment income — financial guarantee			$ 5,461	$ 5,461
Net realized and unrealized losses on weather and energy derivatives			(10,528)	(10,528)
Operating expenses — weather and energy (1)			4,771	4,771
Equity in net income of financial affiliates			12,078	12,078
Minority interest			2,588	2,588
Contribution from financial operations			$ 14,974	$ 14,974

See footnotes on following page.

3. Segment Information (continued)

Quarter Ended September 30, 2003 (continued):

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income — general operations				$ 142,166
Net realized and unrealized gains on investments and derivative instruments (3)				(26,511)
Equity in net income of investment and insurance affiliates				26,240
Interest expense (2)				46,367
Amortization of intangible assets				375
Corporate operating expenses				41,383
Minority interest				(1,825)
Income tax				14,890
Net Income				$ 109,051
General Operations:				
Loss and loss expense ratio (4)	61.4 %	83.6 %		70.3 %
Underwriting expense ratio (4)	27.5 %	27.9 %		27.7 %
Combined ratio (4)	88.9 %	111.5 %		98.0 %

(1) Operating expenses exclude corporate operating expenses, shown separately.
(2) Interest expense excludes interest expense related to life and annuity operations shown separately.
(3) This includes net realized losses on investments of $8.7 million, net realized and unrealized losses on investment derivatives of $16.0 million and net unrealized losses on credit derivatives of $1.8 million.
(4) Ratios are based on net premiums earned from general operations, excluding fee income and other. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(U.S. dollars in thousands, except ratios)

3. Segment Information (continued)

Quarter Ended September 30, 2002:

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 838,112	$ 506,569	$ —	$ 1,344,681
Fee income and other	5,728	3,464	—	9,192
Net losses and loss expenses	511,554	316,645	—	828,199
Acquisition costs	154,732	113,909	—	268,641
Operating expenses (1)	95,278	29,944	—	125,222
Exchange gains	(6,768)	(8,614)	—	(15,382)
Underwriting profit	$ 89,044	$ 58,149	$ —	$ 147,193
Life and Annuity Operations:				
Life premiums earned	$ —	$ 786,383	$ —	$ 786,383
Fee income and other	—	—	—	—
Claims and policy benefits	—	803,741	—	803,741
Acquisition costs	—	3,852	—	3,852
Operating expenses (1)	—	1,337	—	1,337
Net investment income	—	26,263	—	26,263
Net income from life and annuity operations	$ —	$ 3,716	$ —	$ 3,716
Financial Operations:				
Net premiums earned			$ 16,917	$ 16,917
Fee income and other			890	890
Net losses and loss expenses			6,006	6,006
Acquisition costs			17	17
Operating expenses (1)			11,586	11,586
Underwriting profit			$ 198	$ 198
Investment income — financial guarantee			$ 7,782	$ 7,782
Net realized and unrealized gains on weather and energy derivatives			14,022	14,022
Operating expenses — weather and energy (1)			4,371	4,371
Equity in net loss of financial affiliates			(500)	(500)
Minority interest			2,494	2,494
Contribution from financial operations			$ 14,637	$ 14,637

See footnotes on following page

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(U.S. dollars in thousands, except ratios)

3. Segment Information (continued)

Quarter Ended September 30, 2002 (continued):

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income — general operations				$ 153,270
Net realized and unrealized loss on investments and derivative instruments (2)				(27,624)
Equity in net loss of investment and insurance affiliates				(1,877)
Interest expense				51,815
Amortization of intangible assets				875
Corporate operating expenses				25,903
Minority interest				—
Income tax				24,286
Net Income				$ 186,436
General Operations:				
Loss and loss expense ratio (3)	61.0 %	62.5 %		61.6 %
Underwriting expense ratio (3)	29.9 %	28.4 %		29.3 %
Combined ratio (3)	90.9 %	90.9 %		90.9 %

(1) Operating expenses exclude corporate operating expenses, which are shown separately.

(2) This includes net realized losses on investments of $23.1 million, net realized and unrealized losses on investment derivatives of $2.7 million and net unrealized losses on credit derivatives of $1.8 million.

(3) Ratios are based on net premiums earned from general operations, excluding fee income and other. The underwriting expense ratio excludes exchange gains and losses.

(U.S. dollars in thousands, except ratios)

3. Segment Information (continued)

Nine Months Ended September 30, 2003:

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 2,747,163	$ 1,817,957	$ —	$ 4,565,120
Fee income and other	6,365	19,658	—	26,023
Net losses and loss expenses	1,684,825	1,285,385	—	2,970,210
Acquisition costs	422,828	399,193	—	822,021
Operating expenses (1)	321,977	104,665	—	426,642
Exchange gains	(5,709)	(23,455)	—	(29,164)
Underwriting profit	$ 329,607	$ 71,827	$ —	$ 401,434
Life and Annuity Operations:				
Life premiums earned	$ —	$ 202,442	$ 47,239	$ 249,681
Fee income and other	—	—	112	112
Claims and policy benefits	—	264,996	37,741	302,737
Acquisition costs	—	20,749	5,997	26,746
Operating expenses (1)	—	6,233	6,174	12,407
Exchange gains	—	(966)	—	(966)
Net investment income	—	100,590	20,239	120,829
Interest expense	—	—	8,231	8,231
Net income from life and annuity operations	$ —	$ 12,020	$ 9,447	$ 21,467
Financial Operations:				
Net premiums earned			$ 98,087	$ 98,087
Fee income and other			(146)	(146)
Net losses and loss expenses			26,177	26,177
Acquisition costs			14,008	14,008
Operating expenses (1)			32,773	32,773
Underwriting profit			$ 24,983	$ 24,983
Investment income — financial guarantee			$ 16,134	$ 16,134
Net realized and unrealized gains on weather and energy derivatives			5,105	5,105
Operating expenses — weather and energy (1)			15,581	15,581
Equity in net income of financial affiliates			29,254	29,254
Minority interest.			7,886	7,886
Contribution from financial operations			$ 52,009	$ 52,009

See footnotes on following page

3. Segment Information (continued)

Nine Months Ended September 30, 2003 (continued):

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income — general operations				$ 436,255
Net realized and unrealized gains on investments and derivative instruments (3)				49,116
Equity in net income of investment and insurance affiliates				45,603
Interest expense (2)				133,862
Amortization of intangible assets				1,125
Corporate operating expenses				110,335
Minority interest				(2,095)
Income tax				45,929
Net Income				$ 716,728
General Operations:				
Loss and loss expense ratio (4)	61.3 %	70.7 %		65.1 %
Underwriting expense ratio (4)	27.1 %	27.7 %		27.3 %
Combined ratio (4)	88.4 %	98.4 %		92.4 %

(1) Operating expenses exclude corporate operating expenses, shown separately.
(2) Interest expense excludes interest expense related to life and annuity operations shown separately.
(3) This includes net realized gains on investments of $80.3 million, net realized and unrealized losses on investment derivatives of $7.5 million and net unrealized losses on credit derivatives of $23.7 million.
(4) Ratios are based on net premiums earned from general operations, excluding fee income and other. The underwriting expense ratio excludes exchange gains and losses.

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(U.S. dollars in thousands, except ratios)

3. Segment Information (continued)

Nine Months Ended September 30, 2002:

	Insurance	Reinsurance	Financial Products and Services	Total
General Operations:				
Net premiums earned	$ 1,968,844	$ 1,423,036	$ —	$ 3,391,880
Fee income and other	23,159	12,869	—	36,028
Net losses and loss expenses	1,280,730	1,008,838	—	2,289,568
Acquisition costs	314,341	306,418	—	620,759
Operating expenses (1)	295,492	79,651	—	375,143
Exchange gains	(31,061)	(15,891)	—	(46,952)
Underwriting profit	$ 132,501	$ 56,889	$ —	$ 189,390
Life and Annuity Operations:				
Life premiums earned	$ —	$ 836,073	$ —	$ 836,073
Fee income and other	—	2	—	2
Claims and policy benefits	—	870,320	—	870,320
Acquisition costs	—	5,723	—	5,723
Operating expenses	—	3,611	—	3,611
Net investment income	—	58,606	—	58,606
Net income from life and annuity operations	$ —	$ 15,027	$ —	$ 15,027
Financial Operations:				
Net premiums earned			$ 42,284	$ 42,284
Fee income and other			2,460	2,460
Net losses and loss expenses			9,032	9,032
Acquisition costs			6,020	6,020
Operating expenses (1)			30,935	30,935
Underwriting loss			$ (1,243)	$ (1,243)
Investment income — financial guarantee			$ 20,402	$ 20,402
Net realized and unrealized gains on weather and energy derivatives			17,934	17,934
Operating expenses — weather and energy (1)			11,450	11,450
Equity in net income of financial affiliates			1,988	1,988
Minority interest			6,629	6,629
Contribution from financial operations			$ 21,002	$ 21,002

See footnotes on following page

XL CAPITAL LTD
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(U.S. dollars in thousands, except ratios)

3. Segment Information (continued)

Nine Months Ended September 30, 2002 (continued):

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income — general operations				$ 454,177
Net realized and unrealized losses on investments and derivative instruments (2)				(262,168)
Equity in net income of investment and insurance affiliates				36,199
Interest expense				133,576
Amortization of intangible assets				1,500
Corporate operating expenses				73,331
Minority interest				(101)
Income tax				61,140
Net Income				$ 184,181
General Operations:				
Loss and loss expense ratio (3)	65.0 %	70.9 %		67.5 %
Underwriting expense ratio (3)	31.0 %	27.1 %		29.4 %
Combined ratio (3)	96.0 %	98.0 %		96.9 %

(1) Operating expenses exclude corporate operating expenses, shown separately.
(2) This includes net realized losses on investments of $239.1 million, net realized and unrealized losses on investment derivatives of $12.5 million, and net unrealized losses on credit derivatives of $10.6 million.
(3) Ratios are based on net premiums earned from general operations, excluding fee income and other. The underwriting expense ratio excludes exchange gains and losses.

(U.S. dollars in thousands)

3. **Segment Information (continued)**

The following tables summarize the Company's gross premiums written, net premiums written and net premiums earned by line of business:

Quarter Ended September 30, 2003:

	Gross Premiums Written	Net Premiums Written	Net Premiums Earned
General Operations:			
Casualty insurance	$ 795,603	$ 579,527	$ 532,528
Casualty reinsurance	330,019	333,039	260,628
Property catastrophe (2)	63,750	19,821	72,904
Other property	423,768	241,329	351,902
Marine, energy, aviation and satellite	263,406	200,542	214,499
Accident and health	13,487	10,187	21,125
Other insurance (1)	164,009	109,378	139,866
Other reinsurance (1)	54,569	50,080	70,261
Total general operations	2,108,611	1,543,903	1,663,713
Financial Operations	91,642	89,585	35,307
Life and Annuity Operations	88,988	84,296	86,428
Total	$ 2,289,241	$ 1,717,784	$ 1,785,448

Quarter Ended September 30, 2002:

	Gross Premiums Written	Net Premiums Written	Net Premiums Earned
General Operations:			
Casualty insurance	$ 591,682	$ 404,144	$ 390,787
Casualty reinsurance	257,744	251,722	197,518
Property catastrophe (2)	87,966	(8,961)	66,002
Other property	382,548	267,922	303,946
Marine, energy, aviation and satellite	232,268	178,816	166,842
Accident and health	37,437	26,430	50,677
Other insurance (1)	118,278	95,180	86,482
Other reinsurance (1)	103,855	87,172	82,427
Total general operations	1,811,778	1,302,425	1,344,681
Financial Operations	42,880	26,205	16,917
Life and Annuity Operations	793,074	787,503	786,383
Total	$ 2,647,732	$ 2,116,133	$ 2,147,981

See footnotes on following page.

3. **Segment Information (continued)**

The following tables summarize the Company's gross premiums written, net premiums written and net premiums earned by line of business:

Nine Months Ended September 30, 2003:

	Gross Premiums Written	Net Premiums Written	Net Premiums Earned
General Operations:			
Casualty insurance	$ 2,264,093	$ 1,625,595	$ 1,434,288
Casualty reinsurance	1,109,247	1,014,889	715,246
Property catastrophe	306,733	252,561	185,943
Other property	1,454,679	994,583	985,242
Marine, energy, aviation and satellite	1,022,211	801,991	727,611
Accident and health	87,374	76,168	69,952
Other insurance (1)	361,087	235,396	271,232
Other reinsurance (1)	349,274	294,208	175,606
Total general operations	6,954,698	5,295,391	4,565,120
Financial Operations	242,674	238,047	98,087
Life and Annuity Operations	276,201	245,312	249,681
Total	$ 7,473,573	$ 5,778,750	$ 4,912,888

Nine Months Ended September 30, 2002:

	Gross Premiums Written	Net Premiums Written	Net Premiums Earned
General Operations:			
Casualty insurance	$ 1,663,483	$ 1,185,941	$ 925,277
Casualty reinsurance	914,183	828,620	556,345
Property catastrophe	350,452	215,459	179,901
Other property	1,344,602	910,043	775,978
Marine, energy, aviation and satellite	839,507	589,297	448,780
Accident and health	134,548	101,121	117,871
Other insurance (1)	479,399	411,433	255,395
Other reinsurance (1)	267,920	212,431	132,333

(U.S. dollars in thousands)

Total general operations	5,994,094	4,454,345	3,391,880
Financial Operations	145,001	123,301	42,284
Life and Annuity Operations	851,570	836,000	836,073
Total	$ 6,990,665	$ 5,413,646	$ 4,270,237

(1) Other insurance and reinsurance premiums written and earned include political risk, surety, bonding, warranty and other lines.

(2) Property catastrophe net premiums written reflected the renewal of a significant portion of the Company's retrocession program during the quarters ended September 30, 2003 and 2002.

4. Unpaid Losses and Loss Expenses

During the quarter ended September 30, 2003, the Company incurred net losses and loss expenses of $184.0 million due to higher than expected losses in its North American reinsurance operations primarily from the 1997 to 2000 underwriting years for claims arising from general liability, medical malpractice, professional and surety lines written in the former NAC Re. Adverse development is the result of actual reported claims being greater than expected losses that are determined actuarially using historical loss development patterns.

The Company has begun an in depth claims audit and review of the ceding companies records in order to obtain more information to be able to estimate the ultimate loss reserves on this book of business as the information currently in the Company's possession is insufficient to estimate any further adverse development. As a result of this claims audit and review, the Company may record additional net losses and loss expenses in the fourth quarter of 2003. In the event such losses occur, this could result in income statement charges in the fourth quarter of 2003 that could be material to the Company's operating results and may negatively impact the Company's financial strength, debt, claims paying and other ratings from external agencies.

5. Notes Payable and Debt and Financing Arrangements

The Company entered into a new $100.0 million letter of credit facility in January 2003 to provide additional capacity to support the Company's U.S. non-admitted business and this facility was subsequently increased to $200.0 mill

In February 2003, the Company entered into an aggregate of $300.0 million of commercial paper-based credit facilities (the "Credit Facilities"). These facilities were increased to $500.0 million in June 2003. The proceeds of advances under the facilities were used to fund a trust account to collateralize the reinsurance obligations of the Company. The Company could face additional obligations under the Credit Facilities prior to the stated maturity of February 25, 2007, if certain events were to occur, including, but not limited to the Company's insolvency, withdrawal of assets from the Regulation 114 trust by the ceding company, the downgrade of the Company's credit ratings below certain specified levels, or the failure of the agent to have a first priority perfected security interest in the collateral posted by the Company. At maturity, the Company will be obligated to make payments in an amount equal to the principal and accrued interest outstanding under the credit facilities. The issued securities and the Company's repayment obligations are recorded as a net balance on the Company's balance sheet.

In June 2003, the Company renewed its principal revolving credit and letter of credit facility. The facility was increased from $2.0 billion to $2.5 billion of which up to $675 million is available as revolving credit and up to $2.3 billi

In July 2003, the Company entered into a contingent capital transaction with an aggregate value of $500 million. This transaction also includes an insurance trust that provides the Company's cedants with statutory relief under state insurance regulations in the U.S. Under the terms of this facility, the Company has acquired an irrevocable option to issue preference ordinary shares into a trust in return for proceeds raised from investors. This option may be exercised by the Company at any time. In addition, the Company may be required to issue preference ordinary shares to the trust under certain circumstances, including, but not limited to, the non-payment of the option premium and a ratings downgrade of the Company. In connection with this transaction, the fair value of the future option premiums of $102.5 million has been charged to "Contributed Surplus" by creating a deferred liability (included in "Other Liabilities") in the consolidated balance sheet during the quarter ended September 30, 2003. The Company began amortizing this liability in the third quarter 2003 with additional interest expense on a quarterly basis of approximately $1.0 million, decreasing slightly in subsequent periods, for the next 10 years.

(U.S. dollars in thousands)

The decline in the Company’s ordinary share price in the period prior to the second "put" date for the Liquid Yield Option Notes ä ("LYONs") of September 7, 2003 resulted in an increase in the accretion rate on the LYONs for the subsequent twelve month period of 64.5 basis points, for a total rate of 3.52%. The additional cost was approximately $2.0 million. None of these securities were "put" to the Company on September 7, 2003 and all of such securities remain fully outstanding.

6. Exposures under Guaranties

The Company provides and reinsures financial guaranties issued to support public and private borrowing arrangements. Financial guaranties are conditional commitments that guarantee the performance of an obligor to a third party, typically the timely repayment of principal and interest. The Company’s potential liability in the event of non-payment by the issuer of the insured obligation is represented by its proportionate share of the aggregate outstanding principal on such insured obligation. In synthetic transactions, the Company guarantees payment obligations of counterparties under credit derivatives. The Company does not record a carrying value for future installment premiums on financial guaranties as they are recognized over the term of th

e contract.

The net outstanding exposure as at September 30, 2003 of financial guaranty aggregate insured portfolios was $48.2 billion, which includes credit derivative exposures of $10.6 billion. The carrying value for these credit derivatives

7. Derivative Instruments

The Company enters into derivative instruments for both risk management and trading purposes. The Company is exposed to potential loss from various market risks and manages its market risks based on guidelines established by r

The following table summarizes the net realized and unrealized (losses) gains on derivative instruments included in net income for the three and nine months ended September 30, 2003 and 2002.

	Three Months Ended September 30, 2003	Three Months Ended September 30, 2002	Nine Months Ended September 30, 2003	Nine Months Ended September 30, 2002
Credit derivatives	$ (1,752)	$ (1,788)	$ (23,682)	$ (10,556)
Weather and energy risk management derivatives	(10,528)	14,022	5,105	17,934
Investment derivatives	(16,066)	(2,750)	(7,533)	(12,504)

(U.S. dollars in thousands except share and per share amounts)

Net realized and unrealized (losses) gains on derivatives	$	(28,346)	$	9,484	$	(26,110)	$	) (5,126

8. **XL Capital Finance (Europe) plc**

XL
Capital Finance (Europe) plc ("XLFE") is a wholly owned finance subsidiary of the Company. In January 2002, XLFE issued $600 million par value 6.5% Guaranteed Senior Notes due January 2012. These Notes are fully and unconditio
ability to obtain funds from its subsidiaries to satisfy any of its obligations under this guarantee is subject to certain contractual restrictions, applicable laws and statutory requirements of the various countries in which the Company operates including Bermuda, the U.S. and the U.K., among others. Required statutory capital and surplus for the principal operating subsidiaries of the Company was $2.5 billion as of December 31, 2002.

9. **Computation of Earnings Per Ordinary Share and Ordinary Share Equivalent**

	Three Months Ended September 30				Nine Months Ended September 30			
	2003		2002		2003		2002	
Basic earnings per ordinary share:								
Net income	$	109,051	$	186,436	$	716,728	$	184,181
Less: preference share dividends		(10,080)		(2,369)		(30,241)		(2,369)
Net income available to ordinary shareholders	$	98,971	$	184,067	$	686,487	$	181,812
Weighted average ordinary shares outstanding		136,826		135,790		136,774		135,551
Basic earnings per ordinary share	$	0.72	$	1.36	$	5.02	$	1.34
Diluted earnings per ordinary share:								
Net income	$	109,051	$	186,436	$	716,728	$	184,181
Less: preference share dividends		(10,080)		(2,369)		(30,241)		(2,369)
Net income available to ordinary shareholders	$	98,971	$	184,067	$	686,487	$	181,812
Weighted average ordinary shares outstanding—basic		136,826		135,790		136,744		135,551
Average stock options outstanding (1)		1,597		1,559		1,426		1,740
Weighted average ordinary shares outstanding—diluted		138,423		137,349		138,170		137,291
Diluted earnings per ordinary share	$	0.71	$	1.34	$	4.97	$	1.32
Dividends per ordinary share	$	0.48	$	0.47	$	1.44	$	1.41

(1) Net of shares repurchased under the treasury stock method.

Future weighted average number of shares outstanding may be affected by the convertible debt issued by the Company during 2001. Due to the contingent nature of the conversion features of the debt, there was no effect on diluted e

10. **Annuity and Life Re (Holdings), Ltd.**

The Company recognized an other than temporary decline in the value of its investment in Annuity & Life Re (Holdings) Ltd., an insurance affiliate, of $40.9 million in the quarter ended March 31, 2003. The investment was written

During the quarter ended September 30, 2003, the Company exercised its rights to terminate a retrocession agreement with Annuity and Life Reassurance, Ltd ("ALRe") related to certain blocks of U.S. based term life mortality reinsurance business novated to the Company from ALRe in December 2002.

11. Business Combinations

During the quarter ended September 30, 2003, the Company exercised its option and settled the liability related to the purchase of the remaining 33% ownership of Le Mans Re from Les Mutuelles du Mans Assurances Group ("MM

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

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2003
COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2002
(U.S. dollars in thousands, except per share amounts)

General

The following is a discussion of the Company's financial condition and liquidity and results of operations. Certain aspects of the Company's business have loss experience characterized as low frequency and high severity. This may

This "Management's Discussion and Analysis of Financial Condition and Results of Operations" contains forward-looking statements which involve inherent risks and uncertainties. Statements that are not historical facts, including s

This discussion and analysis should be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations", and the audited Consolidated Financial Statements and notes thereto p

Critical Accounting Policies

See the discussion of the Company's critical accounting policies in Item 7 of the Company's Form 10-K for the year ended December 31, 2002. That discussion is updated for the disclosures below.

Unpaid Losses and Losses Expenses

As disclosed in Item 7 of the Company's Form 10-K for the year ended December 31, 2002, the total net unpaid loss and loss expense reserves includes both reported and incurred but not reported ("IBNR") reserves. IBNR reserves are calculated by the Company's actuaries using standard actuarial methodologies. At December 31, 2002 the Company had net unpaid loss and loss expense reserves of $1.6 billion related to its casualty reinsurance business, including approximately $500.0 million specifically related to its North American casualty reinsurance business for the 1997 to 2000 accident years. Casualty business generally has a longer tail (meaning a longer period of time between receipt of the premium and the ultimate settlement of the claim) than the Company's other lines of business. Reinsurance operations also, by their nature, add further complications to the reserving process in that there is an inherent lag in the timing and reporting of a loss event from an insured or ceding company through a broker to the reinsurer. As a result, more judgment is used to establish reserves for ultimate claims in the Company's casualty reinsurance operations than most of the other lines of business.

During the quarter ended September 30, 2003, the Company had adverse prior period development of the North American casualty reinsurance reserves and incurred net losses and loss expenses of $184.0 million. This adverse prior period development was mainly due to higher than expected losses for the 1997 to 2000 underwriting years related to claims arising from the former NAC Re book of business, primarily from general liability, medical malpractice, professional and surety lines. Adverse development is the result of actual reported claims being greater than expected losses that the Company determines actuarially using historical loss development patterns.

The Company has begun an in depth claims audit and review of the ceding companies records in order to obtain more information to be able to estimate the ultimate loss reserves on this book of business as the information currently in the Company's possession is insufficient to estimate any further adverse development. As a result of this claims audit and review, the Company may record additional net losses and loss expenses in the fourth quarter of 2003. In the event such losses occur, this could result in income statement charges in the fourth quarter of 2003 that could be material to the Company's operating results and may negatively impact the Company's financial strength, debt, claims paying and other ratings as measured by external agencies.

See further discussion below "Reinsurance- General Operations".

Results of Operations

The following table presents a summary of the Company's net income available to ordinary shareholders for the three months ended September 30, 2003 and 2002:

(U.S. dollars and shares in thousands, except per share amounts)

	(Unaudited) Three Months Ended September 30	
	2003	2002
Net income available to ordinary shareholders	$ 98,971	$ 184,067
Earnings per ordinary share — basic	$ 0.72	$ 1.36
Earnings per ordinary share — diluted	$ 0.71	$ 1.34
Weighted average number of ordinary shares and ordinary share equivalents — basic	136,826	135,790
Weighted average number of ordinary shares and ordinary share equivalents — diluted	138,423	137,349

Net income available to ordinary shareholders decreased in the third quarter of 2003 compared to the third quarter of 2002 primarily due to a decrease in underwriting profit related to the Company's general reinsurance operations. I

em
iums earned from continued pricing increases and new business written in 2003 for the Company's general insurance and reinsurance operations. In addition, there has been an increase in the Company's equity earnings from investment affi

Segments

Insurance Operations

General insurance business written includes risk management and specialty lines. Risk management products comprise global property and casualty insurance programs for large multinational companies, including umbrella liability,

lo
ss experience that is low frequency and high severity. As a result, large losses, though infrequent, can have a significant impact on the Company's results of operations, financial condition and liquidity. The Company attempts to mitigate thi

The following table summarizes the underwriting results for this segment:

(U.S. dollars in thousands)

	(Unaudited) Three Months Ended September 30,		
	2003	2002	% Change
Net premiums earned	$ 995,857	$ 838,112	18.8 %
Fee income and other	2,648	5,728	(53.8)%
Net losses and loss expenses	611,617	511,554	19.6 %
Acquisition costs	154,549	154,732	(0.1)%
Operating expenses	119,184	95,278	25.1 %
Exchange gains	(6,477)	(6,768)	(4.3)%
Underwriting profit	$ 119,632	$ 89,044	34.4 %

Net premiums earned increased in the quarter ended September 30, 2003 compared to the quarter ended September 30, 2002 primarily due to continued growth in net premiums written from significant pricing increases, new busines

Fee income and other declined in the third quarter of 2003 as compared to the third quarter of 2002 primarily due to the discontinuance at the end of 2002 of consulting and administration services provided by the Company for empl

Exchange gains in the quarters ended September 30, 2003 and 2002 were primarily due to a decline in the value of the U.S. dollar against other currencies, primarily U.K. sterling and euros, in those operations that transact in multiple currencies. The gain in the third quarter of 2003 was partially reduced by a hedge put in place by the Company in February 2003 to cover part of its exposure to a U.K. sterling reinsurance recoverable balance.

The following table presents the ratios for this segment:

	(Unaudited) Three Months Ended September 30	
	2003	2002
Loss and loss expense ratio	61.4 %	61.0 %
Underwriting expense ratio	27.5 %	29.9 %
Combined ratio	88.9 %	90.9 %

The loss and loss expense ratio increased slightly in the quarter ended September 30, 2003 as compared to the quarter ended September 30, 2002 due primarily to an increase in reported professional liability losses of approximately $

The decrease in the underwriting expense ratio from 29.9% in the third quarter of 2002 to 27.5% in the third quarter of 2003 is due to a reduction in the acquisition expense ratio from 18.5% to 15.5%. This decrease is due primarily t

Reinsurance Operations

Reinsurance — General Operations

General reinsurance business written includes casualty, property, accident and health and other specialty reinsurance on a global basis. The Company's reinsurance property business generally has loss experience characterized as low

The following table summarizes the underwriting results for the general operations of this segment:

(U.S. dollars in thousands)

	(Unaudited) Three Months Ended September 30		
	2003	2002	% Change
Net premiums earned	$ 667,856	$ 506,569	31.8 %
Fee income and other	1,865	3,464	(46.2)%
Net losses and loss expenses	558,047	316,645	76.2 %
Acquisition costs	152,978	113,909	34.3 %
Operating expenses	33,411	29,944	11.6 %
Exchange gains	(247)	(8,614)	(97.1)%
Underwriting (loss) profit	$ (74,468)	$ 58,149	NM

* NM — Not Meaningful

Net premiums earned in the third quarter of 2003 increased 31.8% compared to the third quarter of 2002 primarily due to the continued growth in business written in 2003 and 2002. Growth in business written is mainly due to pricin

Fee income and other decreased in the third quarter of 2003, due to a decline in fees earned on deposit liability contracts. Fee income and other is expected to vary in future periods as earning patterns are due to contractual terms and

The net exchange gains in the quarters ended September 30, 2003 and 2002 were primarily due to a decline in the value of the U.S. dollar against other currencies, primarily the euro, in those operations that transact in multiple curre

The following table presents the ratios for this segment:

	(Unaudited) Three Months Ended September 30	
	2003	2002
Loss and loss expense ratio	83.6 %	62.5 %
Underwriting expense ratio	27.9 %	28.4 %
Combined ratio	111.5 %	90.9 %

The increase in the loss and loss expense ratio in the third quarter of 2003 as compared to the third quarter of 2002 is due primarily to an increase in net losses incurred of $184.0 million related to higher than expected losses in its North American reinsurance operations mainly from newly reported casualty claims for the 1997 to 2000 underwriting years. These lines of business include general liability, medical malpractice, professional and surety lines.

The Company merged with NAC Re (now known as XL Reinsurance America, Inc) ("XLRA") in mid 1999. Since the merger, reported losses to XLRA have exceeded expected loss development, increasing estimated ultimate loss a

The Company's expected loss development is actuarially determined based on historical claims analysis and projected trends. Actual reported losses may vary from expected loss development from quarter to quarter. Generally, as an underwriting year matures, the level of newly reported claims decreases and typically, unless the Company receives additional reported claims that are significantly higher or lower than expected, estimated ultimate loss reserves are not adjusted prior to a full actuarial review.

During the quarter ended September 30, 2003, the Company received a significant increase, approximately $83.0 million, in reported claims in excess of the Company's expected claims development. In addition, during the third quarter the Company completed an actuarial review for the longer tail lines, including the liability and surety lines at XLRA, using data evaluated as of March 31, 2003. As a result, the Company recorded an increase in net unpaid losses and

loss expenses of $184.0 million in the quarter ended September 30, 2003 to reflect this adverse loss development.

As a result of this significant prior period adverse loss development, the Company has begun an extensive claims review of the relevant cedents. This in depth claims review should enable the Company to have more complete information to be able to determine ultimate loss reserves. The results of this review may result in the Company having to record additional net incurred losses for this business in the fourth quarter of 2003. In the event such losses occur, this could result in income statement charges in the fourth quarter of 2003 that could be material to the Company's operating results and may negatively impact the Company's financial strength, debt, claims paying and other ratings as measured by external agencies. As a result, the Company also may be required to raise additional capital, for ratings or regulatory purposes in the event such losses occur. The Company would attempt to satsify any such additional capital requirements through the issuance of non-common equity (ordinary share capital) instruments to the extent practicable consistent with applicable rating agency and regulatory requirements. See "—Financial Condition and Liquidity" for further information.

In the quarter ended, September 30, 2002 the Company had losses incurred of approximately $30.0 million related to the European floods. Excluding this loss and excluding the adverse prior period development in the quarter ended September 30, 2003, the loss and loss expenses ratio was 56.0% in both periods.

The small decrease in the underwriting expense ratio in the third quarter of 2003 as compared to the third quarter of 2002 was primarily due to a decrease in the operating expense ratio (5.9% to 5.0%) driven by the larger increase in

Reinsurance — Life and Annuity Operations

Life business written by the reinsurance operations is primarily European life reinsurance. This includes term assurances, group life, critical illness cover, immediate annuities and disability income business. Due to the nature of thes

The following summarizes net income from life and annuity operations:

(U.S. dollars in thousands)

	(Unaudited) Three Months Ended September 30		
	2003	2002	% Change
Net premiums earned	$ 62,600	$ 786,383	NM
Claims and policy benefits	81,460	803,741	NM
Acquisition costs	6,880	3,852	78.6
Operating expenses	2,012	1,337	50.5 %
Exchange losses	2,648	—	NM
Net investment income	35,446	26,263	35.0 %
Net income from life and annuity operations	$ 5,046	$ 3,716	35.8 %

Net premiums earned in the three months ended September 30, 2002 included a large contract written consisting of a U.K. portfolio of annuities. This contract increased net premiums earned and claims and policy benefits by $762.7

Claims and policy benefits include reserves related to new business written in the quarter and the accretion of policy benefit reserves related to contracts where investment assets are acquired with the assumption of the policy benefit

Financial Products and Services — Financial Operations

Financial Products and Services business written includes insurance, reinsurance and derivative solutions for complex financial risks including financial guaranty insurance and reinsurance, municipal reinvestment contracts and func

Financial guaranty insurance and reinsurance generally guarantees payments of interest and principal on an issuer’s obligations when due. Obligations guaranteed or enhanced by the Company range in duration and premiums are rec

The Company’s weather and energy risk management products include customized solutions designed to assist corporate customers, primarily energy companies and utilities, to manage portions of their financial exposure to variatio

Financial affiliates includes the Company’s 20% ownership in FSA International Ltd, a financial guarantee insurer, and 42% of Primus Guaranty Ltd ("Primus"), a provider of single name credit risk protection.

The following table summarizes the contribution for this segment:

(U.S. dollars in thousands)

	(Unaudited) Three Months Ended September 30		
	2003	2002	% Change
Net premiums earned	$ 35,307	$ 16,917	108.7 %
Fee income and other	(655)	890	NM
Net losses and loss expenses	3,894	6,006	(35.2)%
Acquisition costs	4,969	17	NM
Operating expenses	10,467	11,586	(9.7)%
Underwriting profit	$ 15,322	$ 198	NM
Net investment income — financial guarantee	$ 5,461	$ 7,782	(29.8)%
Net realized and unrealized (losses) gains on weather and energy derivatives	(10,528)	14,022	NM
Operating expenses — weather and energy	4,771	4,371	9.2 %
Equity in net income (loss) of financial affiliates	12,078	(500)	NM
Minority interest	2,588	2,494	3.8 %
Contribution from financial operations	$ 14,974	$ 14,637	2.3 %
Net realized and unrealized losses on credit default swaps	$ (1,752)	$ (1,788)	(2.0) %

Net premiums earned increased in the third quarter of 2003 as compared to the third quarter of 2002 primarily due to continuing growth in new financial guaranty business written and the earning of financial guarantee business writt

Net losses and loss expenses in the quarter ended September 30, 2003 decreased as compared to the third quarter ended September 30, 2002 and included a reduction in reserves of $4.8 million relating to business written and earned

Acquisition costs increased by approximately $5.0 million in the third quarter of 2003 as compared to the third quarter of 2002 due to an increase in ceding commissions paid, lower reinsurance commissions received and increased a

Operating expenses decreased in the third quarter of 2003 as compared to the third quarter of 2002 due to an increase in the level of underwriting expenses deferred. The expense amount deferred is based upon the amount of net pre

Net investment income related to financial guaranty business decreased in the third quarter of 2003 as compared to the third quarter of 2002 primarily due to lower interest rates.

The net realized and unrealized losses on weather and energy derivatives in the third quarter of 2003 of $10.5 million reflected a positive mark-to-market of weather based exposures that was more than offset by a negative mark to m

The equity in net income from financial affiliates increased in the third quarter of 2003 as compared to the second quarter of 2002 due primarily to increased earnings at Primus resulting from growth in underlying protection written

The increase in minority interest in the third quarter of 2003 as compared to the third quarter of 2002 is due to an increase in the profitability of the Company’s subsidiary, XL Financial Assurance Ltd. of which 15% is held by a mino

In prior periods, the Company’s credit derivatives written at primary layers on a partially funded or finite basis were included in the insurance segment. Effective January 1, 2003 the Company manages all credit default swap transac underlying credit quality for certain credit pools. The vast majority of financial guaranty coverage that is written in swap form pertains to tranches of collateralized debt obligations and asset backed securities, particularly the higher rated tranches v

Financial Products and Services — Life and Annuity Operations

The Company commenced writing life and annuity business in this segment in the fourth quarter of 2002. The Company commenced writing municipal reinvestment contracts in 2002 and funding agreements in 2003 whereby the Co

The following summarizes net income from life and annuity operations:

(U.S. dollars in thousands)

	(Unaudited) Three Months Ended September 30	
	2003	**2002**
Net premiums earned	$ 23,828	$ —
Fee income and other	62	—
Claims and policy benefits	18,494	—
Acquisition costs	4,537	—
Operating expenses	2,083	—
Net investment income	7,690	—
Interest expense	3,304	—
Net income from life and annuity operations	$ 3,162	$ —

Net premiums earned related to certain blocks of U.S. based term life mortality reinsurance business written that were novated to the Company from Annuity and Life Reassurance, Ltd ("ALRe") in December 2002. Net premiums earned, claims and policy benefit reserves and acquisition costs all related to this novated block of business. During the quarter ended September 30, 2003, the Company exercised its right to terminate a retrocession agreement of certain of these exposures with ALRe.

Operating expenses reflect the build-out of the overall life and annuity business, including expenses associated with the municipal reinvestment contract business.

Net investment income in the third quarter of 2003 related to investment assets acquired in connection with the acquisition of future policy benefit reserves and interest earned on the municipal reinvestment contracts and funding agr

Interest expense relates to the accretion of the deposit liabilities associated with the municipal reinvestment contracts and funding contracts written in this segment. At September 30, 2003, the Company had balances of approximatel

Investment Activities

The following table illustrates the change in net investment income for general operations and net realized and unrealized losses on investments and investment derivative instruments for the quarters ended September 30, 2003 and 2

(U.S. dollars in thousands)

	(Unaudited) Three Months Ended September 30		
	2003	**2002**	**% Change**

Net investment income — general operations	$ 142,166	$ 153,270	(7.2)%
Equity in net income (loss) of investment affiliates (Note 1)	26,240	(1,976)	NM
Net realized losses on investments	(8,693)	(23,086)	(62.3)%
Net realized and unrealized (losses) gains on investment derivative instruments	(16,066)	(2,750)	NM %

Note 1. Equity in net income of investment affiliates for the quarter ended September 30, 2003 includes income on the alternative investment portfolio for the three months ending August 31, 2003 as compared to three months endec

Net investment income related to general operations decreased in the third quarter of 2003 as compared to the third quarter of 2002 due primarily to a decline in investment yields on the portfolio which was partially offset by a highe

Equity in net income of investment affiliates increased in the third quarter of 2003 included improved performance of certain of the Company’s investment funds and investments in management companies as compared to lower ove

At September 30, 2003 and 2002, approximately 70% and 60% respectively of the investment portfolio could not be meaningfully compared to applicable public market indices. This includes the deposit and regulatory holdings that

Asset/Liability Portfolios	**Quarter ended September 30, 2003**	**Quarter ended September 30, 2002**
U.S. Investment Grade, Moderate Duration	0.1%	3.7%
Lehman Aggregate Bond Index	(0.1) %	4.6 %
Relative Performance	0.2%	(0.9)%
U.S. Investment Grade, Low Duration	2.1%	0.1%
Salomon 1-3 Year Treasury Index	0.4%	2.4%
Relative Performance	1.7%	(2.3)%
Euro Aggregate, Unhedged	0.4%	3.7%
Lehman Euro Aggregate Index	0.3%	4.6%
Relative Performance	0.1%	(0.9)%
Pan European, Hedged	1.6%	4.6%
Merrill U.K. / Merrill Pan Europe Composite	1.1%	5.9%
Relative Performance	0.5%	(1.3)%
U.K. Sterling, Unhedged (Note 1)	N/A	4.5%
Merrill U.K. Sterling Broad Index, 1-10 Years (Note 1)	N/A	4.2%
Relative Performance	N/A	0.3%

Risk Asset Portfolios — Fixed Income	Quarter ended September 30, 2003	Quarter ended September 30, 2002
U.S. Moderate Grade	1.0%	(1.2)%
Investment Grade / High Yield Composite	0.5%	2.3%
Relative Performance	0.5%	(3.5)%
U.S. High Yield	2.8%	0.5%
CS First Boston High Yield Index	3.0%	(2.8)%
Relative Performance	(0.2)%	3.3%
Risk Asset Portfolios — Equities		
U.S. Large Cap Growth Equity	4.0%	(14.8)%
Russell 1000 Growth Index	3.9%	(15.0)%
Relative Performance	0.1%	0.2%
U.S. Large Cap Value Equity	3.6%	(17.7)%
Russell 1000 Value Index	2.0%	(18.9)%
Relative Performance	1.6%	1.2%
U.S. Small Cap Equity	9.7%	(20.6)%
Russell 2000 Index	9.0%	(21.4)%
Relative Performance	0.7%	0.8%
Non-U.S. Equity	11.2%	(19.2)%
MSCI EAFE Index	8.1%	(19.7)%
Relative Performance	3.1%	0.5%
Risk Asset Portfolios — Alternative Investments		
Alternative Investments (Note 2)	0.9%	0.0%
Standard and Poor's 500 Index (Note 2)	5.1%	(17.3)%
Relative Performance	(4.2)%	17.3%

Note 1. All Sterling portfolios are now managed relative to custom liability benchmarks. Comparisons to market indices are no longer relevant.

Note 2. The alternative investment portfolio returns and the Standard and Poor's 500 Index returns for the quarter ended September 30, 2003 includes returns for the three months ending August 31, 2003, as compared with three

Net realized losses on investments in the third quarter of 2003 included net realized losses of $3.7 million from sales of investments and net realized losses of approximately $5.0 million related to the write-down of certain of the Co

Net realized losses on investments in the third quarter of 2002 of $23.1 million included net realized gains of approximately $7.4 million from sales of investments and realized losses of approximately $30.5 million relating to the wr

The Company's process for identifying declines in the fair value of investments that are other than temporary involves consideration of several factors. These factors include : (i) the time period during which there has been a signific

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t of the security is written down to fair value and the previously unrealized loss is therefore realized.

Net Unrealized Gains and Losses on Investments

At September 30, 2003, the Company had net unrealized gains on fixed income securities of $566.9 million and net unrealized losses on equities of $3.0 million. Of these amounts, gross unrealized losses on fixed income securities a

At September 30, 2003, approximately 2,830 fixed income securities out of a total of approximately 17,685 securities were in an unrealized loss position. The largest unrealized loss in the fixed income portfolio was $6.6 million. Ap

The following is an analysis of how long each of those securities with an unrealized loss at September 30, 2003 had been in a continual unrealized loss position:

(U.S. dollars in thousands)

Type of Securities	Length of time in a continual unrealized loss position		Amount of unrealized loss at September 30, 2003
Fixed Income and Short-Term	Less than six months	$	71,297 71,297
	At least 6 months but less than 12 months		9,898
	At least 12 months but less than 2 years		6,219
	Over 2 years		777
	Total	$	88,191
Equities	Less than six months	$	5,665
	At least 6 months but less than 12 months		3,705
	At least 12 months but less than 2 years		1,036
	Over 2 years		53
	Total	$	10,459

At September 30, 2003, the following was the maturity profile of the fixed income securities that were in a gross unrealized loss position:

(U.S. dollars in thousands)

Maturity profile in years of fixed income securities in a continual unrealized loss position		**Amount of unrealized loss at September 30, 2003**
Less than 1 year remaining	$	2,385
More than 1 and less than 5 years remaining		10,176
More than 5 and less than 10 years remaining		30,093
More than 10 and less than 20 years remaining		17,609
20 years or more remaining		20,341
Mortgage backed securites		7,587
Total	$	88,191

The Company operates a risk asset portfolio that includes high yield (below investment grade) fixed income securities. These represented approximately 5.3% of the total fixed income portfolio market value at September 30, 2003. T

(U.S. dollars in thousands)

Length of time in a continual unrealized loss position		**Amount of unrealized loss at September 30, 2003**
Less than six months	$	7,726
At least 6 months but less than 12 months		807
At least 12 months but less than 2 years		3,445
More than 2 years		360
Total	$	12,338

<u>Investment derivatives</u>

Net realized and unrealized gains and losses on investment derivatives in the third quarter of each of 2003 and 2002 resulted from the Company's investment strategy to economically hedge against interest and foreign exchange risk

Other Revenues and Expenses

The following table sets forth other revenues and expenses for the three months ended September 30, 2003 and 2002:

(U.S. dollars in thousands)

	(Unaudited) Three Months Ended September 30		
	2003	2002	% Change
Equity in net income of insurance affiliates	$ —	$ (401)	NM
Amortization of intangible assets	375	875	(57.2)%
Corporate operating expenses	41,383	25,903	59.8 %
Interest expense	46,367	51,815	(10.5)%
Minority interest	(1,825)	—	NM
Income tax expense	14,890	24,286	(38.7)%

Corporate operating expenses in the quarter ended September 30, 2003 increased compared to the three months ended September 30, 2002 due primarily to the continued build out of the Company's global infrastructure in developin

The decrease in interest expense reflected a lower accretion charge on the deposit liabilities and a decrease in interest expense relating to notes payable and debt. Accretion on the deposit liabilities for the three months ended September 30, 2003 and 2002 were $22.4 million and $26.7 million, respectively. This decrease reflects an adjustment in the accretion rate subsequent to the third quarter 2002 due to a favorable development of expected payment patterns. Interest expense relating to notes payable and debt declined from $25.1 million to $22.9 million due to the inclusion of amortization of debt issuance expenses in the third quarter of 2002 related to the issue of the Liquid Yield Option Notes ("LYONS") in 2001. These debt issuance expenses were amortized to the first put date which

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sulted in no comparable expense in the current quarter. In July 2003, the Company entered into a contingent capital transaction with an aggregate value of $500.0 million ("ABC securities"). In connection with this transaction, the fair value of the future put premium costs have been transferred from contributed surplus to a liability during the quarter ended September 30, 2003 and an interest expense of approximately $1.0 million recorded. The amortization of this liability will result in additional interest expense of approximately $1.0 million, on a quarterly basis, and decreasing in subsequent periods, for the next 10 years. See "Financial Condition and Liquidity" for further information.

Minority interest in the quarter ended September 30, 2003 relates to a net loss incurred in one of the Company's insurance subsidiaries where the Company owns 91%. Net income of this subsidiary was flat for the quarter ended Sep

The decrease in the Company's income taxes arose principally from a decrease in the profitability of certain of the Company's U.S. operations.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003
COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2002
(U.S. Dollars in thousands, Except Per Share Amounts)

Results of Operations

The following table presents a summary of the Company's net income available to ordinary shareholders for the nine months ended September 30, 2003 and 2002:

(U.S. dollars in thousands, except per share amounts)

	(Unaudited) Nine Months Ended September 30			
	2003		2002	
Net income available to ordinary shareholders	$	686,487	$	181,812
Earnings per ordinary share — basic	$	5.02	$	1.34
Earnings per ordinary share — diluted	$	4.97	$	1.32
Weighted average number of ordinary shares and ordinary share equivalents — basic		136,744		135,551
Weighted average number of ordinary shares and ordinary share equivalents — diluted		138,170		137,291

Net income available to ordinary shareholders increased significantly in the first nine months of 2003 compared to the first nine months of 2002 primarily due to two factors. First, in the nine months ended September 30, 2003, net r

Second, there was an increase in the underwriting profit from the Company's general insurance and reinsurance operations from $189.4 million in the first nine months of 2002 to $401.4 million in the first nine months of 2003. This increase in underwriting profit was primarily due to additional loss reserves of $200.0 million recorded in the third quarter of 2002 related to the September 11 event. In addition, the increase in underwriting profit has been due to growth in net premium earned from pricing increases in renewal and new business written. The increase in net premium earned was partially offset by incurred losses in the third quarter of 2003 from the reinsurance general operations, related to prior period adverse development of $184.0 million, in the Company's North American casualty business written mainly for the underwriting years 1997 to 2000. This is discussed further in the "Segments" below.

Segments

Insurance Operations

The following table summarizes the underwriting results for this segment:

(U.S. dollars in thousands)

	(Unaudited) Nine Months Ended September 30, 2003	2002	% Change
Net premiums earned	$ 2,747,163	$ 1,968,844	39.5 %
Fee income and other	6,365	23,159	(72.5)%
Net losses and loss expenses	1,684,825	1,280,730	31.6 %
Acquisition costs	422,828	314,341	34.5 %
Operating expenses	321,977	295,492	9.0 %
Exchange gains	(5,709)	(31,061)	(81.6)%
Underwriting profit	$ 329,607	$ 132,501	148.8 %

Net premiums earned increased in the nine months ended September 30, 2003 compared to the nine months ended September 30, 2002 primarily due to growth in net premiums written from continued significant pricing increases, n

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Fee income and other declined in the nine months ended September 30, 2003 as compared to the nine months ended September 30, 2002 primarily due to the discontinuance at the end of 2002 of consulting and administration servic

Exchange gains in the nine months ended September 30, 2003 and 2002 related primarily to an increase in the value of U.K. sterling against the U.S. dollar where the value of certain monetary net assets denominated in this currency

The following table presents the ratios for this segment:

	(Unaudited) Nine Months Ended September 30 2003	2002
Loss and loss expense ratio	61.3 %	65.0 %
Underwriting expense ratio	27.1 %	31.0 %
Combined ratio	88.4 %	96.0 %

The loss and loss expense ratio decreased in the nine months ended September 30, 2003 compared to the nine months ended September 30, 2002 primarily due to an increase of reserves of $73.0 million in the second quarter of 2002

The underwriting expense ratio was lower in the nine months ended September 30, 2003 compared to the nine months ended September 30, 2002 due to both lower operational and acquisition expense ratios. The reduction in the ope

months
ended September 30, 2002) is due primarily to the growth in net premiums earned occurring at a greater rate than the growth in operating expenses. Operating expenses generally do not change in direct proportion to changes in net premiums earned. The decrease in the acquisition expense ratio (15.4% for the nine months ended September 30, 2003 as compared to 16.0% for the nine months ended September 30, 2002) was primarily due to a general reduction in the level of commissions and a change in the mix of business being earned. The acquisition expense ratio in the nine months ended September 30, 2002 benefited from a decrease of approximately $19.3 million in acquisition expenses related to the purchase accounting treatment of deferred acquisition costs related to the acquired Winterthur International operations.

Reinsurance Operations

Reinsurance — General Operations

The following table summarizes the underwriting results for the general operations of this segment:

(U.S. dollars in thousands)

	(Unaudited) Nine Months Ended September 30		
	2003	**2002**	**% Change**
Net premiums earned	$ 1,817,957	$ 1,423,036	27.8 %
Fee income and other	19,658	12,869	52.8 %
Net losses and loss expenses	1,285,385	1,008,838	27.4 %
Acquisition costs	399,193	306,418	30.3 %
Operating expenses	104,665	79,651	31.4 %
Exchange gains	(23,455)	(15,891)	47.6 %
Underwriting profit	$ 71,827	$ 56,889	26.3 %

Net premiums earned in the first nine months of 2003 increased 27.8% compared to the first nine months of 2002 due in part, to the continued strong growth and pricing increases in business written in 2003 and 2002. Pricing increas

Fee income and other increased in the nine months ended September 30, 2003 due to fees earned on deposit liability contracts in the first quarter of 2003. Fee income and other is expected to vary in future periods as earning patterns

The net exchange gains in the nine months ended September 30, 2003 and 2002 were primarily due to a decline in the value of the U.S. dollar against other currencies, primarily euros, in the first six months of 2003 in those operatio

The following table presents the ratios for this segment:

	(Unaudited) Nine Months Ended September 30	
	2003	**2002**
Loss and loss expense ratio	70.7 %	70.9 %
Underwriting expense ratio	27.7 %	27.1 %
Combined ratio	98.4 %	98.0 %

There were no significant catastrophic losses affecting the Company in the nine months ended September 30, 2003. The slight decrease in the loss and loss expense ratio in the nine months ended September 30, 2003 compared to the same period of 2002 is due to several offsetting factors. First, there was an increase in reserves of $127.0 million in the third quarter of 2002 related to the September 11 event and $30.0 million related to the European floods. In the nine months ended September 30, 2003, there was an increase in net incurred losses of $184.0 million in the third quarter of 2003 related to prior period adverse development of the Company's North American casualty business written mainly in the 1997 through 2000 underwriting years. Excluding the above mentioned items, the loss ratio in the nine months ended September 30, 2003 was 60.6%, on a comparable basis to 59.9% for the nine months ended September 30, 2002. This increase is primarily due to losses arising from the U.S. tornadoes in the second quarter of 2003, partially offset by improved terms and conditions and price increases on current year's net premiums earned.

The increase in the underwriting expense ratio in the nine months ended September 30, 2003 as compared to the same period of 2002 is primarily due to an increase in both the operating expense and acquisition expense ratio. The in

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Reinsurance — Life and Annuity Operations

The following summarizes net income from life and annuity operations:

(U.S. dollars in thousands)

	(Unaudited) Nine Months Ended September 30		
	2003	2002	% Change
Net premiums earned	$ 202,442	$ 836,073	(75.8)%
Fee income and other	—	2	NM
Claims and policy benefits	264,996	870,320	(69.6)%
Acquisition costs	20,749	5,723	NM
Operating expenses	6,233	3,611	72.6 %
Exchange gains	(966)	—	NM
Net investment income	100,590	58,606	71.6 %
Net income from life and annuity operations	$ 12,020	$ 15,027	(20.0)%

* NM — Not Meaningful

Life net premiums earned in the nine months of 2002 included a large contract written in the third quarter of 2002 consisting of a U.K. portfolio of annuities. This contract increased net premiums earned and claims and policy benefi

Claims and policy benefits, excluding this large contract, also increased in line with the growth in net premiums earned and include the accretion of policy benefit reserves related to contracts where investment assets are acquired wi

Excluding this large contract, acquisition costs have increased by a larger percentage than the increase in net premiums earned in the first nine months of 2003 as compared to 2002 due to the change in mix of new business being ear

Operating expenses and net investment income both increased in the first nine months of 2003 as compared to the first nine months of 2002 due to the expansion of this business.

Exchange gains in the nine months ended September 30, 2003 related primarily to the decline in the value of the dollar against the value of the euro.

Financial Products and Services Operations

The following table summarizes the underwriting results for this segment:

(U.S. dollars in thousands)

	(Unaudited) Nine Months Ended September 30		
	2003	2002	% Change
Net premiums earned	$ 98,087	$ 42,284	132.0 %
Fee income and other	(146)	2,460	(105.9)%
Net losses and loss expenses	26,177	9,032	189.8 %
Acquisition costs	14,008	6,020	132.7 %
Operating expenses	32,773	30,935	5.9 %
Underwriting profit (loss)	$ 24,983	$ (1,243)	NM
Net investment income – financial guarantee	$ 16,134	$ 20,402	(20.9)%
Net realized and unrealized gains on weather and energy derivatives	5,105	17,934	(71.5)%
Operating expenses— weather and energy	15,581	11,450	36.1 %
Equity in net income of financial affiliates	29,254	1,988	NM
Minority interest	7,886	6,629	19.0 %
Contribution from financial operations	$ 52,009	$ 21,002	147.6 %
Net realized and unrealized losses on credit derivatives	$ (23,682)	$ (10,556)	(124.3)%

Net premiums earned increased in the first nine months of 2003 as compared to the first nine months of 2002 primarily due to continuing growth in new financial guaranty business written and the earning in the current period of fina

Net losses and loss expenses in the nine months ended September 30, 2003 increased as compared to the first nine months of 2002 due primarily to the Company’s policy of establishing incurred but not reported reserves, which incr

Acquisition costs increased in line with the increase in net premium earned in the first nine months of 2003 as compared to 2002.

Operating expenses related to both the financial guaranty and weather and energy businesses increased in the first nine months of 2003 as compared to the first nine months of 2002 due to the continued expansion of these operations

Net investment income from financial guaranty operations declined in the nine months ended September 30, 2003 as compared to the nine months ended September 2002 primarily due to a decline in general market interest rates.

The fair value adjustment for weather and energy risk management derivative products in the first nine months of 2003 decreased as compared to the first nine months of 2002 due primarily to the negative mark-to-market of natural

Equity in net income of financial affiliates increased in the first nine months of 2003 as compared to the first nine months of 2002 primarily due to increased earnings in the second and third quarter of 2003 related to the Company’s

The increase in minority interest in the first nine months of 2003 as compared to the first nine months of 2002 is due to an increase in the profitability of XL Financial Assurance Ltd., of which 15% is held by a minority shareholder.

In periods prior to January 1, 2003, the Company’s credit derivative transactions written at primary layers on a partially funded or finite basis were included in the insurance segment. Effective January 1, 2003 the Company manages

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tains to tranches of collateralized debt obligations and asset backed securities, particularly the higher rated tranches with 84% covering "A" to "AAA" tranches.

Financial Products and Services— Life and Annuity Operations

The Company commenced writing life and annuity business in this segment in the fourth quarter of 2002.

The following summarizes net income from life and annuity operations:

(U.S. dollars in thousands)

	(Unaudited) Nine Months Ended September 30	
	2003	**2002**
Net premiums earned	$ 47,239	$ —
Fee income and other	112	—
Claims and policy benefits	37,741	—
Acquisition costs	5,997	—
Operating expenses	6,174	—

Net investment income		20,239		—
Interest expense		8,231		—
Net income from life and annuity operations	$	9,447	$	—

Net
premiums earned related to certain blocks of U.S. based term life mortality reinsurance business written that were novated to the Company from ALRe in December 2002. Net premiums earned, claims and policy benefit reserves and acquisition costs all related to this novated block of business. During the quarter ended September 30, 2003, the Company exercised its rights to terminate a retrocession agreement of certain of these exposures with ALRe.

Operating expenses reflect the continued build-out of the overall life and annuity business, including expenses associated with the municipal reinvestment contract business.

Net investment income in the nine months of 2003 related to investment assets acquired in connection with the acquisition of future policy benefit reserves and interest earned on investment assets related to the municipal reinvestme

Interest expense relates to the accretion of the deposit liabilities associated with the municipal reinvestment contracts and funding contracts written in this segment. At September 30, 2003, the Company had balances of $1.1 billion o

Investment Activities

The following table illustrates the change in net investment income for general operations and net realized and unrealized losses on investments and investment derivative instruments for the periods ended September 30, 2003 and 20

(U.S. dollars in thousands)

	(Unaudited) Nine Months Ended September 30				
		2003		2002	% Change
Net investment income — general operations	$	436,255	$	454,177	(3.9)%
Equity in net income of investment affiliates (Note 1)		87,344		38,140	129.0 %
Net realized gains (losses) on investments		80,331		(239,108)	NM
Net realized and unrealized losses on investment derivative instruments		(7,533)		(12,504)	(39.7)%

Note 1. Equity in net income of investment affiliates for the nine months ended September 30, 2003 includes income on the alternative investment portfolio for the eight months ending August 31, 2003 only, as opposed to nine r

Net investment income related to general operations decreased in the first nine months of 2003 as compared to the first nine months of 2002 reflecting the continuing decline in yields partially offset by the growth in the investment b

Equity in net income of investment affiliates increased in the first nine months of 2003 compared to the first nine months of 2002 due mainly to strong performance of certain of the Company’s investment funds and investments in m

At September 30, 2003 and 2002, approximately 70% and 60% respectively of the investment portfolio could not be meaningfully compared to applicable public market indices. This includes the deposit and regulatory holdings that

	Nine Months ended September 30, 2003	Nine Months ended September 30, 2002
Asset/Liability Portfolios		
U.S. Investment Grade, Moderate Duration	4.4%	7.1%
Lehman Aggregate Bond Index	3.8%	8.6%
Relative Performance	0.6%	(1.5)%
U.S. Investment Grade, Low Duration	4.1%	1.8%
Salomon 1-3 Year Treasury Index	1.7%	4.9%
Relative Performance	2.4%	(3.1)%

	Nine Months ended September 30, 2003	Nine Months ended September 30, 2002
Euro Aggregate, Unhedged	4.7%	5.4%
Lehman Euro Aggregate Index	4.8%	7.3%
Relative Performance	(0.1)%	(1.9)%
Pan European, Hedged	14.2%	15.1%
Merrill U.K. / Merrill Pan Europe Composite	12.3%	17.8%
Relative Performance	1.9%	(2.7)%
U.K. Sterling, Unhedged (Note 1)	N/A	7.4%
Merrill U.K. Sterling Broad Index, 1-10 Years (Note 1)	N/A	7.4%
Relative Performance	N/A	—
Risk Asset Portfolios — Fixed Income		
U.S. Moderate Grade	14.5%	(4.6)%
Investment Grade / High Yield Composite	10.8%	3.1%
Relative Performance	3.7%	(7.7)%
U.S. High Yield	16.9%	(10.6)%
CS First Boston High Yield Index	20.9%	(2.7)%
Relative Performance	(4.0)%	(7.9)%
Risk Asset Portfolios — Equities		
U.S. Large Cap Growth Equity	17.3%	(29.9)%
Russell 1000 Growth Index	17.4%	(32.8)%
Relative Performance	(0.1)%	2.9%
U.S. Large Cap Value Equity	16.4%	(18.8)%
Russell 1000 Value Index	13.6%	(22.8)%
Relative Performance	2.8%	4.0%
U.S. Small Cap Equity	30.7%	(19.3)%
Russell 2000 Index	28.4%	(25.2)%
Relative Performance	2.3%	5.9%

Non-U.S. Equity	20.2%	(19.0)%
MSCI EAFE Index	18.4%	(21.0)%
Relative Performance	1.8%	2.0%
Risk Asset Portfolios — Alternative Investments		
Alternative Investments (Note 2)	5.6%	4.2%
Standard and Poor's 500 Index (Note 2)	16.0%	(28.2)%
Relative Performance	(10.4)%	32.4%

Note 1. All Sterling portfolios are now managed relative to custom liability benchmarks. Comparisons to market indices are no longer relevant.

Note 2. The alternative investment portfolio returns and the Standard and Poor's 500 Index returns for the nine months ended September 30, 2003 includes returns for the eight months ended August 31, 2003 only, as opposed to

Net realized gains on investments in the first nine months of 2003 included net realized gains of $205.2 million from sales of investments and net realized losses of approximately $118.7 million related to the write-down of certain o

Net realized losses on investments in the first nine months of 2002 included a loss of $92.5 million of certain fixed income and equity telecommunications securities, including WorldCom and Adelphia, and a loss of $105.0 million o

The Company's process for identifying declines in the fair value of investments that are other than temporary involves consideration of several factors. These factors include: (i) the time period during which there has been a significa

os

t of the security is written down to fair value and the previously unrealized loss is therefore realized.

Net realized and unrealized losses on investment derivatives in the nine months ended September 30, 2003, of $7.5 million as compared to a loss of $12.5 million in the nine months ended September 30, 2002, primarily resulted fro

Other Revenues and Expenses

The following table sets forth other revenues and expenses for the nine months ended September 30, 2003 and 2002:

(U.S. dollars in thousands)

(Unaudited)
Nine Months Ended

	September 30		
	2003	2002	% Change
Equity in net (loss) income of insurance affiliates	$ (41,741)	$ 1,941	NM
Amortization of intangible assets	1,125	1,500	(25.0)%
Corporate operating expenses	110,335	73,331	50.5 %
Interest expense	133,862	133,576	0.2 %
Minority interest	(2,095)	(101)	NM
Income tax expense	45,929	61,140	(24.9)%

The equity in net loss of insurance affiliates for the nine months ended September 30, 2003 includes an other than temporary decline of $40.9 million in the value of the Company's investment in Annuity and Life Re (Holdings), Ltd

Corporate operating expenses in the nine months ended September 30, 2003 increased compared to the nine months ended September 30, 2002 due primarily to the continued build-out of the Company's global infrastructure in devel

The increase in interest expense reflected higher accretion charge on the deposit liabilities due to growth in this business, partially offset by a lower expense on notes payable and debt. Accretion on the deposit liabilities for the nine r

Minority interest in the nine months ended September 30, 2003 relates to a net loss incurred in one of the Company's 9% owned insurance subsidiaries in the third quarter of 2003. The net loss of this subsidiary was significantly low

The decrease in the Company's income taxes arose principally from a decrease in the profitability of certain of the Company's U.S. and European operations during the second and third quarters of 2003.

Financial Condition and Liquidity

As a holding company, the Company's assets consist primarily of its investments in subsidiaries, and the Company's future cash flows depend on the availability of dividends or other statutorily permissible payments from its subsidi

The Company and its subsidiaries provide no guarantees or other commitments (express or implied) of financial support to the Company's subsidiaries or affiliates, except for express written financial support provided by XL Insurar

The Company's ability to underwrite business is dependent upon the quality of its claims paying and financial strength ratings as evaluated by independent rating agencies. As a result, in the event that the Company is downgraded, its ability to write business may be adversely affected particularly, in financial guaranty and long-tailed insurance and reinsurance lines of business. In the normal course of business, the Company evaluates its capital needs to support the volume of business written in order to maintain its claims paying and financial strength ratings. As a result of the Company's announcement of the $184.0 million prior period adverse loss development in the third quarter of 2003, certain of the Company's ratings have been recently amended. As reviewed by Standard & Poor's, the "A+" counterparty credit, "A+" senior unsecured debt and "A-" preferred stock ratings on XL Capital Ltd (and its core holding companies) have been placed on CreditWatch with negative implications. The "AA" counterparty credit and financial strength ratings of the XL America pool members, which include XL Select Insurance Company, XL Specialty Insurance Company, XL Insurance America, Inc. Greenwich Insurance Company, Indian Harbor Insurance Company, XL Insurance Company of New York, Inc., and XL Reinsurance America Inc. were also placed on Credit

Watch with negative implications by Standard & Poor's. As reviewed by Moody’s, the “A1” senior unsecured rating for XL Capital Ltd (and its core holding companies), the “Aa2” financial strength ratings for the XL America pool members, XL Re Ltd., and the U.K.-based XL Insurance Company Limited have been confirmed, while the outlook for these entities has been changed from stable to negative. Fitch downgraded the XL Capital Ltd (and its core holding companies) long-term issuer and senior debt rating from “A+” to “A” and the outlook is ‘Stable’. None of the agencies that rate the Company's financial guaranty subsidiaries have taken any rating actions against them, changed their outlooks or put them on CreditWatch. The Company may be required to raise additional capital in the future to maintain its ratings or those of its subsidiaries. See "—Liquidity and Capital Resources".

Unrelated to the Company's third quarter adverse loss development, A.M. Best announced a rating methodology change in August 2003. As a result of this methodology change, A.M. Best revised downward the senior debt rating for XL Capital Ltd (and its other core holding companies) from “A+” to “A”.

Financial Condition

At September 30, 2003, total investments available for sale and cash, net of unsettled investment trades, were $21.4 billion compared to $18.1 billion at December 31, 2002. This increase in investment assets related primarily to cash

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nally recognized rating agency. Using the Standard & Poor’s rating scale, the average quality of the fixed income portfolio was "AA". In addition, the net unrealized gain on investments available for sale increased by $285.3 million in the ni

For the nine months ended September 30, 2003 currency translation adjustment gains were $81.0 million. This is shown as part of accumulated other comprehensive income and primarily related to unrealized gains on foreign curren

The Company establishes reserves to provide for estimated claims, the general expenses of administering the claims adjustment process and for losses incurred but not reported. These reserves are calculated using actuarial and other

Inflation can, among other things, potentially result in larger claims. The Company’s underwriting philosophy is to adjust premiums in response to inflation.

Liquidity and Capital Resources

Certain business written by the Company has loss experience generally characterized as having low frequency and high severity. This may result in volatility in both the Company’s results and operational cash flows. Operational cas

nd

$2.1 billion, respectively. The significant cash flow from operating activities is also reflected in the growth of investment assets.

Unpaid losses and loss expenses recoverable grew by 7% from December 31, 2002 reflecting, in part, the growth of the underlying business as evidenced by the similar growth in unpaid losses and loss expenses. In addition, there w

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consolidated financial statements for the year ended December 31, 2002, note 6(c) included in item 8 of Form 10-K.

During the three months ended September 30, 2003, the Company exercised its option and settled the related euro liability relating to the purchase of the remaining 33% ownership of Le Mans Re for approximately $161.2 million.

In the nine months ended September 30, 2003, the Company invested approximately $30.3 million in new investment affiliates.

In July 2003, the Company acquired new offices at 70 Gracechurch Street, London which will become the Company's new London headquarters. The acquisition was under a purchase, sale and leaseback transaction. The move to the new premises is expected to be in the summer of 2004 and will consolidate the Company's London businesses in one location. The Company has recognized a capital lease asset and liability of approximately $150.0 million related to this transaction and there have not been any significant capital expenditures related to leasehold improvements during the period to September 30, 2003.

As at September 30, 2003, the Company had bank, letter of credit and loan facilities available from a variety of sources including commercial banks totaling $5.5 billion, of which $1.9 billion in debt was outstanding. In addition, $2.

The following table presents the Company's indebtedness under outstanding securities and lenders' commitments as at September 30, 2003:

(U.S. dollars in thousands)

				Payments Due By Period			
Notes Payable And Debt	**Commitment**	**In Use**	**Year Of Expiry**	**Less Than 1 Year**	**1 To 3 Years**	**4 To 5 Years**	**After 5 Years**
364-day revolver	$ 675,000	$ —	2004	$ —	$ —	$ —	$ —
7.15% Senior Notes	99,985	99,985	2005	—	100,000	—	—
6.58% Guaranteed Senior Notes	255,000	255,000	2011	—	—	—	255,000
6.50% Guaranteed Senior Notes (1)	597,361	597,361	2012	—	—	—	600,000
Zero Coupon Convertible Debentures ("CARZ") (1)	638,130	638,130	2021	—	—	—	1,010,833
Liquid Yield Option Notes ä ("LYONS") (1)	308,483	308,483	2021	—	—	—	514,622
Total	$ 2,573,959	$ 1,898,959		$ —	$ 100,000	$ —	$ 2,380,455

(1) "Commitment" and "In Use" data represent September 30, 2003 accreted values. "Payments due by period" represents ultimate redemption values. The convertibles may be "put" or converted by the bondholders at various times prior

The total pre-tax interest expense on the borrowings described above was $67.7 million and $78.5 million for the nine months ended September 30, 2003 and 2002, respectively.

The decline in the Company’s ordinary share price in the period prior to the second "put" date for the LYONs of September 7, 2003 resulted in an increase in the accretion rate on the LYONs for the subsequent twelve month period c

The following table presents, as at September 30, 2003, the Company’s letter of credit facilities available, in use and when those facilities are due to expire:

				Amount Of Commitment Expiration Per Period			
Other Commercial Commitments	**Commitment**	**In Use**	**Year Of Expiry**	**Less Than 1 Year**	**1 To 3 Years**	**4 To 5 Years**	**After 5 Years**
Letter of Credit Facilities	$ 3,377,343	$ 2,459,486	2003/4	$ 3,377,343	$ —	$ —	$ —

The Company has several letter of credit facilities provided on a syndicated and bilateral basis from commercial banks. These facilities (as well as the off balance sheet collateral and contingent capital arrangements described below)

the availability of credit from banks utilized by the Company. In the event that such credit support is insufficient, the Company could be required to provide alternative security to cedants. This could take the form of additional insurance tru

The Company entered into a new $100.0 million letter of credit facility in January 2003 to provide additional capacity to support the Company’s U.S. non-admitted business. This facility was subsequently increased to $200.0 million

In February 2003, the Company entered into an aggregate of $300.0 million of commercial paper-based credit facilities (the "Credit Facilities"). These facilities were increased to $500.0 million in June 2003. The proceeds of advances under the Credit Facilities were used to fund a trust account to collateralize the reinsurance obligations of the Company under an intercompany quota share reinsurance agreement. The Company could face additional obligations under the Credit Facilities prior to the stated maturity of February 25, 2007, if certain events were to occur, including, but not limited to the Company’s insolvency, withdrawal of assets from the Regulation 114 trust by the ceding company, the downgrade of the Company’s credit ratings below certain specified levels, or the failure of the agent to have a first priority perfected security interest in the collateral posted by the Company. At maturity, the Company will be obligated to make payments in an amount equal to the principal and accrued interest outstanding under the Credit Facilities. The issued securities and the Company’s repayment obligations are recorded as a net balance on the Company’s balance sheet.

In June 2003, the Company renewed its principal revolving credit and letter of credit facility. The facility was increased from $2.0 billion to $2.5 billion of which up to $675 million is available as revolving credit and up to $2.3 billi

In July 2003, the Company entered into a contingent capital transaction with an aggregate value of $500.0 million. This transaction also provides the Company with an insurance trust that provides the Company with statutory relief u

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the put premiums and other related costs, in total of $109.9 million was charged to "Contributed Surplus" and a deferred liability was established (included with "Other liabilities") of $102.5 million in the consolidated balance sheet at Septe

For information regarding cross-default and certain other provisions in the Company’s debt and convertible securities documents, see Item 7 of the Company’s Form 10-K for the year ended December 31, 2002.

The Company has had several share repurchase programs in the past as part of its capital management strategy. On January 9, 2000, the Board of Directors authorized a program for the repurchase of shares up to $500.0 million. Und

With respect to variable interest entities, the consolidation requirements of FASB Interpretation No. 46 "Consolidation of Variable Interest Entities" ("FIN 46") apply immediately to variable interest entities created after January 31, 2003. As amended by FASB Staff Position ("FSP") No. FIN 46-6, FIN 46 is effective for variable interests in a variable interest entity created before February 1, 2003 at the end of the first interim or annual period ending after December 15, 2003. The Company has restructured its variable interest entities (or determined that it is not required to consolidate such entities under FIN 46) and therefore does not expect the adoption of FIN 46 to have a material effect on its results of operations or financial condition. For more information regarding variable interest entities and other off-balance sheet arrangements, see Item 7 of the Company’s Form 10-K for the year ended December 31, 2002.

As a result of the Company's $184.0 million prior period adverse loss development in the third quarter of 2003 or the results of the claims review currently being performed, the Company may be required to raise additional capital for ratings or regulatory purposes. The Company would attempt to satisfy any such additional capital requirement through the issuance of non-common equity (ordinary share capital) instruments to the extent practicable and consistent with applicable rating agency and regulatory requirements.

Current Outlook

The Company expects to complete the claims review related to the adverse prior period loss development for the casualty reinsurance business written in the fourth quarter of 2003. The completion of this claims review may result in a further increase in net losses and loss expenses incurred in the fourth quarter of 2003. In the event such losses occur, this could result in income statement charges in the fourth quarter of 2003 that could be material to the Company’s operating results and may negatively impact the Company’s financial strength, debt, claims paying and other ratings as measured by external agencies.

The Company expects that the current year favorable market conditions, particularly in its casualty insurance and reinsurance business, and improved underwriting terms and conditions will continue into 2004. Further, the Company

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company enters into derivatives and other financial instruments for risk management and trading purposes. The Company’s derivative transactions can expose the Company to credit derivative risk, weather and energy risk, investment market risk, and foreign currency exchange rate risk. The Company manages these risks based on guidelines established by senior management. Derivative instruments are carried at fair value with resulting changes in fair value recognized in income in the period in which they occur.

Value-at-risk ("VaR") is one of the standard tools used by management to estimate potential losses in fair values using historical rates, market movements and credit spreads to estimate the volatility and correlation of these factors to

This risk management discussion and the estimated amounts generated from the sensitivity and VaR analyses presented in this document are forward-looking statements of market risk assuming certain adverse market conditions occ

Credit Derivatives

The Company has written certain financial guaranty transactions in derivative or swap form. The Company does not actively trade these transactions and generally issues and holds these contracts to maturity. Changes in fair value ca

Weather and Energy Derivatives

The Company offers weather and energy risk management products in insurance or derivative form to end-users, and manages the risks in the over-the-counter and exchange traded derivatives markets. In addition to entering into tra

The Company's aggregate average, low and high seasonal VaR amounts for its weather risk management portfolio, calculated at a 99% confidence level, during the period ended September 30, 2003 were $126.9 million, $100.1 mill

amounts for each of its seasonal portfolios. The Company's aggregation methodology yields a conservative aggregate portfolio VaR given that current weather events and patterns have an immaterial effect on expectations for future seasons a

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ounts.

For the energy portfolio, VaR is calculated using a one-day holding period. Management has established a daily VaR limit for this portfolio of $3.5 million. The Company's average, low and high daily VaR amounts calculated at a 9

The following table summarizes the movement in the fair value of weather and energy derivative contracts outstanding during the nine months ended September 30, 2003:

(U.S. dollars in thousands)

	Nine Months Ended September 30, 2003
Fair value of contracts outstanding, beginning of the year	$ (6,024)
Option premiums received, net of premiums realized (1)	(16,142)
Reclassification of settled contracts to realized (2)	160,300
Other changes in fair value (3)	(178,332)
Fair value of contracts outstanding, end of period	$ (40,198)

(1) For the nine month period ended September 30, 2003, the Company collected $197.1 million of paid premiums and realized $181.0 million of premiums on expired transactions for a net increase in the balance sheet derivative liability of $16.1 million.

(2) The Company paid $160.3 million to settle derivative positions during the nine month period ended September 30, 2003, resulting in a reclassification of this amount from unrealized to realized and a reduction in the balance sheet derivative liability.

(3) This represents the effects of changes in commodity prices, the time value of options, and other valuation adjustments (of $178.3 million) on the Company's derivative positions, primarily attributable to the hedges of the

positions that realized $181.0 million of premiums.

The change in fair value of contracts outstanding at September 30, 2003 as compared to the beginning of the year is primarily due to the increased volume of weather and energy derivative contracts written during the first nine months of

The following table summarizes the maturity of weather and energy derivative contracts outstanding as of September 30, 2003:

(U.S. dollars in thousands)

Source of Fair Value	Less Than 1 Year	1-3 Years	4-5 Years	Greater Than 5 Years	Total Fair Value
Prices actively quoted	$ (54,805)	$ (98)	$ —	$ —	$ (54,903)
Prices based on models and other valuation methods	(932)	12,550	3,087	—	14,705
Total fair value of contracts outstanding	$ (55,737)	$ 12,452	$ 3,087	$ —	$ (40,198)

In managing its weather and energy risk management business, the Company seeks to identify, assess, monitor and manage its market, credit, operational and legal risks in accordance with defined policies and procedures. The Comp

inherent in the Company’s weather and energy risk management business and cannot be wholly eliminated despite the Company’s risk management policies, procedures and methodologies.

Investment Market Risk

The Company’s investment portfolio consists of exposures to fixed income securities, equities, alternative investments, derivatives, business and other investments, and cash. These securities and investments are denominated in both

The Company’s earnings are directly affected by changes in the valuations of the securities and investments held in the investment portfolio. These valuation changes reflect changes in interest rates (e.g. changes in the level, slope and curvature of the yield curves, volatility of interest rates, mortgage prepayment speeds and credit spreads), credit quality, equity prices (e.g. changes in prices and volatilities of individual securities, equity baskets and equity indices) and foreign currency exchange rates (e.g. changes in spot prices, forward prices and volatilities of currency rates). Market risk therefore arises due to the uncertainty surrounding the future valuations of these different assets, the factors that impact their values and the impact that this could have on the Company’s earnings.

The Company seeks to manage the risks of the investment portfolio through a combination of asset class, country, industry and security level diversification and investment manager allocations. Further, individual security and issuer

The Company’s direct use of investment derivatives includes futures, forwards, swaps and option contracts that derive their value from underlying assets, indices, references rates or a combination of these factors. When investment g

ze

cash holdings to purchase equity indexed derivatives and to adjust the duration of a portfolio of fixed income securities to match the duration of related deposit liabilities.

Investment Value-At-Risk

In the third quarter of 2003, the Company introduced a new, more widely used risk management system to generate the investment VaR and to stress test the investment portfolio. Although the overall methodology is consistent betw

The VaR of the total investment portfolio at September 30, 2003, based on a 95% confidence level with a one month holding period, was approximately $531.0 million. The VaR of all investment related derivatives, excluding invest

To complement the VaR analysis, which is based on normal market environments, the Company considers the impact on the investment portfolio in several different historical stress periods to analyze the effect of unusual market co

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uld expect to lose approximately 6.1% of the portfolio if the most damaging event stress tested was repeated, all other things held equal. Given the investment portfolio allocations as at September 30, 2003, the Company would expect to gai

Investment Credit Risk

The Company is exposed to credit risk through its portfolio of debt securities which has historically been a significant exposure in the investment portfolio. As at September 30, 2003, the average credit quality of the Company’s tota

The Company’s total fixed income portfolio credit quality breakdown as at September 30, 2003 is shown in the following table:

Rating	Percentage of Total Fixed Income Exposure(1)
AAA	58.5%
AA	8.5%
A	16.9%
BBB	10.8%
BB and Below	5.3%

(1) Portfolio includes fixed maturities, short term investments, cash and cash equivalents and net payable for investments purchased.

Individual corporate holdings in the portfolio are diversified, exceeding 1,000 separate issuer exposures as at September 30, 2003. As at September 30, 2003, the top 10 corporate exposures represented approximately 6% of the total

Top 10 Corporate Exposures as at September 30, 2003(1)	Percentage of Total Fixed Income Exposure
Citigroup Inc.	0.84%
JP Morgan Chase & Co.	0.76%
General Electric Company	0.74%
Morgan Stanley	0.68%
HSBC Holdings plc	0.67%
General Motors Corporation	0.53%
Ford Motor Company	0.49%
Bank of America Corporation	0.45%
American International Group, Inc.	0.43%
Verizon Communications Inc.	0.43%

(1) Corporate exposures include parent and affiliated companies that issue fixed income securities. In some cases a portion of the market value may be invested in bonds that are securitized or have sufficient credit enhancement that pro

Interest Rate and Equity Price Risk

The Company believes that VaR is an appropriate indicator of the risk of the investment portfolio; however an immediate 100 basis point adverse shift in global bond curves as at September 30, 2003 would decrease the market value

In evaluating the impact of price changes in the equity portfolio, a 10% adverse change in global equity prices as at September 30, 2003 would reduce the market value of the equity portfolio by approximately $54.9 million.

At September 30, 2003, bond and stock index futures outstanding were $31.1 million with underlying investments having a market value of $0.9 billion. Losses of $7.8 million were realized on these contracts for the nine months en

Foreign Currency Exchange Risk

The Company uses foreign exchange contracts to manage its exposure to the effects of fluctuating foreign currencies on the value of its foreign currency fixed maturities and certain of its foreign currency equity investments. These c

el

y, with an unrealized gain of $0.05 million in 2003 and an unrealized loss of $1.1 million in 2002. For the nine months ended September 30, 2003 and 2002, realized losses of $2.2 million and realized losses of $3.8 million, respectively, and

The Company also manages the exchange volatility arising on certain administration costs denominated in foreign currencies. Throughout the year, forward contracts are entered into to acquire foreign currencies at an agreed rate in t

In February 2003, the Company entered into a series of forward exchange contracts to cover approximately 60%, or $116.7 million (£70 million), of the Company's exposure to a U.K. sterling reinsurance recoverable balance at one

ITEM 4. CONTROLS AND PROCEDURES

The Company has carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effec

There have been no changes in the Company's internal controls over financial reporting identified in connection with the evaluation described above that occurred during the Company's fiscal period covered by this report that has m

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 ("PSLRA") provides a "safe harbor" for forward-looking statements. Any prospectus, prospectus supplement, the Company's Annual Report to ordinary shareholders, any proxy

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"plan", "believe", "project", "anticipate", "will", and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the PSLRA or otherwise.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements. The Company believes that these factors include, but are not limited to, the following: (i) the results of the reserve review and claims audits expected to be completed in the fourth quarter of 2003; (ii) rate increases and improvements in terms and conditions may not be as large or significant as the Company is currently projecting; (iii) the timely and full recoverability of reinsurance placed by the Company with third parties, or other amounts due to the Company, including, without limitation, amounts due to the Company from the Seller in connection with the Company's acquisition of Winterthur International; (iv) the projected amount of ceded reinsurance recoverables and

the ratings and creditworthiness of reinsurers may change; (v) the timing of claims payments being faster or the receipt of reinsurance recoverables being slower than anticipated by the Company; (vi) ineffectiveness or obsolescence of the Co

om

pany's investments and the Company's access to such markets; (x) the potential impact on the Company from government-mandated insurance coverage for acts of terrorism; (xi) the potential impact of off-balance sheet arrangements on the

l; (xix) the effects of mergers, acquisitions and divestitures; (xx) changes in rating agency policies or practices or in the ratings assigned to the Company and its subsidiaries; (xxi) changes in accounting policies or practices or the application

XL CAPITAL LTD
PART II — OTHER INFORMATION

Item 4. **Submission of Matters to a Vote of Security Holders**

None.

Item 6. Exhibits and Reports on Form 8-K

(a) **Exhibits**

10.67	Amendment No. 1, dated as of July 1, 2003, to the Pledge Agreement, dated December 18, 2001, made by XL Investments Ltd., XL Re Ltd, XL Insurance (Bermuda) Ltd, and XL Europe Ltd as the Grantors, in favor of Citibank, N.A. as the Bank.
31	Certifications pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
99.1	XL Capital Assurance Inc. unaudited condensed financial statements for the three and nine month periods ended September 30, 2003 and 2002.
99.2	XL Financial Assurance Ltd. unaudited condensed financial statements for the three and nine month periods ended September 30, 2003 and 2002.

(b) **Reports on Form-8-K**

Current Report on Form 8-K filed on August 21, 2003, under Item 5 and Item 7 thereof.

Current Report on Form 8-K filed on July 14, 2003, under Item 5 and Item 7 thereof.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

XL CAPITAL LTD
(Registrant)

Dated:
November 14, 2003

/S/ Brian M. O’Hara

Brian M. O’Hara
President and Chief Executive Officer

Dated:
November 14, 2003

/S/ Jerry De St. Paer

Jerry de St. Paer
Executive Vice President and Chief Financial Officer

EXHIBIT INDEX

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AMENDMENT NO. 1
TO
PLEDGE AGREEMENT

This is Amendment No. 1, effective as of June 24, 2002 (this "Amendment"), to the Pledge Agreement, dated as of December 17, 2001 (the "Pledge Agreement"), made by XL Investments Ltd., a company organized under the laws of Bern

In consideration of the agreements made in this Amendment and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to be legally bound, the Grantors and the Bank hereby

1. Section 1.1(a) of the Pledge Agreement is hereby amended to read in its entirety as follows:

"Designated Accounts" shall mean, collectively, the custodial securities accounts maintained with the Custodian pursuant to terms of the Custody Agreement

and set forth on Annex A hereto, as it may be amended from time to time. Custodial securities account(s) maintained by a Grantor with the Custodian may be designated as Designated Accounts pursuant to a Supplemental Document; provided, however, that no custodial securities account may be a Designated Account if any party to the Custody Agreement other than the Grantor maintaining such account has any interest therein or in any securities entitlements or other financial assets credited thereto; and provided, further, that Designated Accounts shall not include any securities account which has been withdrawn from the category of Designated Accounts pursuant to Section 2.3(a)(v) of this Agreement. Annex A shall be amended to reflect each addition or withdrawal of a securities account as a Designated Account."

2. Section 2.3(a) of the Pledge Agreement is hereby amended by deleting the first parenthetical thereof and by amending 'three' to 'four' in the clause 2.3 (a)(v).

3. Annex A attached hereto is hereby also made Annex A to the Pledge Agreement.

4. The provisions of Article VI of the Pledge Agreement are incorporated herein and shall apply, *mutatis mutandis*, to this Amendment.

5. Except as expressly amended hereby, the Pledge Agreement shall continue in full force and effect.

IN WITNESS WHEREOF, each of the parties hereto has executed and delivered this Agreement.

XL INVESTMENTS LTD

By /s/ CHRISTOPHER V. GREETHAM
Name: CHRISTOPHER V. GREETHAM
Title: Executive Vice President and Chief Investment Officer

XL RE LTD

By /s/ CHRISTOPHER V. GREETHAM
Name: CHRISTOPHER V. GREETHAM
Title: Executive Vice President and Chief Investment Officer

XL INSURANCE (BERMUDA) LTD

By /s/ CHRISTOPHER A. COELHO
Name: CHRISTOPHER A. COELHO
Title: Senior Vice President and Chief Financial Officer

XL EUROPE LTD
By /s/ FIONA MULDOON
Name: FIONA MULDOON
Title: Chief Financial Officer & Company Secretary

CITIBANK, N.A.

By /s/ PHIL ARCH
Name: PHIL ARCH
Title: Vice President

Dated as of July 1, 2003

CERTIFICATION
OF CHIEF EXECUTIVE OFFICER

XL CAPITAL LTD

Pursuant to Section 302 of the

Sarbanes-Oxley Act of 2002

(Chapter 63, Title 18 U.S.C. §§ 1350(a) and (b))

I, Brian M. O'Hara, certify that:

1. I have reviewed this report on Form 10-Q of XL Capital Ltd;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circu

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operati

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fo

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the re

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2003

By: /s/ BRIAN M. O'HARA

Brian M. O'Hara

President and Chief Executive Officer

CERTIFICATION
OF CHIEF FINANCIAL OFFICER

XL CAPITAL LTD

Pursuant to Section 302 of the

Sarbanes-Oxley Act of 2002

(Chapter 63, Title 18 U.S.C. §§ 1350(a) and (b))

I, Jerry de St. Paer, certify that:

1. I have reviewed this report on Form 10-Q of XL Capital Ltd;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circu

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operati

4. The registrant’s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material informatio

b) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls

c) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fo

5. The registrant’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the re

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 14, 2003

By: /s/ JERRY DE ST. PAER

Jerry de St. Paer

Executive Vice President and

Chief Financial Officer

CERTIFICATION
ACCOMPANYING FORM 10-Q REPORT
of
XL CAPITAL LTD
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Chapter 63, Title 18 U.S.C. §§ 1350(a)
and (b))

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chapter 63, Title 18 U.S.C. §§ 1350(a) and (b)), each of the undersigned hereby certifies that the Quarterly Report on Form 1

Dated:

November 14, 2003

/s/ BRIAN M. O'HARA
Brian M. O'Hara
President and Chief Executive Officer
XL Capital Ltd

Dated:

November 14, 2003

/s/ JERRY DE ST. PAER
Jerry de St. Paer
Executive Vice President and Chief
Financial Officer
XL Capital Ltd

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electron

XL CAPITAL ASSURANCE INC.
AND SUBSIDIARY

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
FOR THE THREE AND NINE MONTH PERIODS ENDED
SEPTEMBER 30, 2003 AND 2002

XL Capital Assurance Inc. and Subsidiary
Condensed Consolidated Balance Sheets

(UNAUDITED)
(U.S. Dollars in thousands except number of shares and per share amounts)

	As At September 30, 2003	As At December 31, 2002
Assets		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost: 2003 - $144,269; 2002 - $110,927)	$ 148,249	$ 115,301
Short-term investments, at fair value, which approximates cost	5,305	20,153
Total investments	153,554	135,454
Cash and cash equivalents	63,287	44,714
Premiums receivable	6,845	2,713
Accrued investment income	1,503	1,375
Reinsurance balances recoverable on unpaid losses	16,467	9,594
Prepaid reinsurance premium	266,767	151,950
Deferred Federal income tax benefit	6,344	5,003
Intangible assets - acquired licenses	11,529	11,529
Other assets	14,494	7,564
Total assets	$ 540,790	$ 369,896
Liabilities and Shareholder's Equity		
Liabilities:		
Deferred premium revenue	$ 291,780	$ 163,129
Unpaid losses and loss adjustment expenses	17,952	10,380
Deferred ceding commissions, net	29,649	11,654
Reinsurance premiums payable	32,057	19,441
Accounts payable and accrued expenses	20,171	12,541
Intercompany payable to affiliates	9,065	10,289
Total liabilities	400,674	227,434
Shareholder's Equity:		
Common stock (par value $7,500 at September 30, 2003 and December 31, 2002, 2,000 shares authorized, issued and outstanding at September 30, 2003 and December 31, 2002)	15,000	15,000
Additional paid-in capital	139,154	139,154
Accumulated other comprehensive income (Net of deferred Federal income tax liability of: 2003 - $1,376; 2002 - $1,562)	2,604	2,812
Accumulated deficit	(16,642)	(14,504)
Total shareholder's equity	140,116	142,462
Total liabilities and shareholder's equity	$ 540,790	$ 369,896

See notes to condensed consolidated financial statements.

XL Capital Assurance Inc. and Subsidiary
Condensed Consolidated Statements of Operations and Comprehensive Income

(UNAUDITED)
(U.S. Dollars in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
Revenues				
Gross premiums written	$ 72,755	$ 18,540	$ 183,881	$ 106,594
Ceded premiums written	(64,535)	(17,285)	(165,685)	(97,236)
Net premiums written	8,220	1,255	18,196	9,358
Change in deferred premium revenue	(6,511)	(401)	(13,834)	(7,379)
Net premiums earned (Net of ceded earned premium for the nine months of $ 50,868 in 2003 and $21,105 in 2002)	1,709	854	4,362	1,979
Net investment income	1,515	1,458	4,369	4,374
Net realized (losses) gains on investments	(429)	339	(233)	913
Net realized and unrealized gains (losses) on credit derivatives	500	(27)	1,471	157
Other income	1,200	—	1,200	—
Total revenues	4,495	2,624	11,169	7,423
Expenses				
Net losses and loss adjustment expenses (net of ceded losses and loss adjustment expenses for the nine months of	140	213	1,028	495

$8,607 in 2003 and $5,274 in 2002)				
Net operating expenses	4,009	4,067	13,431	14,244
Total expenses	4,149	4,280	14,459	14,739
Income (Loss) before Federal income tax expense (benefit)	346	(1,656)	(3,290)	(7,316)
Deferred Federal income tax expense (benefit)	12	(571)	(1,152)	(2,558)
Net income (loss)	334	(1,085)	(2,138)	(4,758)
Other comprehensive (loss) income	(1,225)	1,753	(208)	2,257
Comprehensive (loss) income	$ (891)	$ 668	$ (2,346)	$ (2,501)

See notes to condensed consolidated financial statements.

XL Capital Assurance Inc. and Subsidiary
Condensed Consolidated Statements of Changes in Shareholder's Equity

(UNAUDITED)
(U.S. Dollars in thousands)

	Nine months ended September 30, 2003	Year ended December 31, 2002
Common Shares		
Number of shares, beginning of year	2,000	2,000
Number of shares, end of period	2,000	2,000
Common Stock		
Balance - beginning of year	$15,000	$15,000
Balance-end of period	15,000	15,000
Additional Paid-In Capital		
Balance - beginning of year	139,154	119,154
Capital contribution	—	20,000
Balance-end of period	139,154	139,154
Accumulated Other Comprehensive Income		
Balance - beginning of year	2,812	1,054
Net change in unrealized appreciation of investments, net of deferred Federal income tax (benefit) expense of $(186) in 2003 and $970 in 2002	(208)	1,758
Balance-end of period	2,604	2,812
Accumulated Deficit		
Balance - beginning of year	(14,504)	(9,255)
Net loss	(2,138)	(5,249)
Balance-end of period	(16,642)	(14,504)
Total shareholder's equity	$140,116	$142,462

See notes to condensed consolidated financial statements.

XL Capital Assurance Inc. and Subsidiary Condensed Consolidated Statements of Cash Flows
(UNAUDITED)
(U.S. Dollars in thousands)

	Nine months ended September 30, 2003	Nine months ended September 30, 2002
Cash flows from operating activities:		
Net loss	$ (2,138)	$ (4,758)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Net realized losses (gains) on sale of investments	233	(913)
Net realized and unrealized (gains) losses on credit derivatives	(544)	166
Amortization of premium on bonds	782	551
Increase in unpaid losses and loss adjustment expenses, net	699	603

(U.S. Dollars)

Increase in deferred premium revenue, net	13,834	7,379
Increase in deferred ceding commissions, net	17,995	5,635
Increase (decrease) in reinsurance premiums payable	12,616	(10,428)
Increase in premiums receivable	(4,132)	(2,111)
(Increase) decrease in accrued investment income	(128)	122
Deferred Federal income tax benefit	(1,152)	(2,558)
Increase in accounts payable and accrued expenses	1,402	1,578
(Decrease) increase in intercompany payable to affiliates	(1,224)	227
Other	(1,139)	242
Total adjustments	39,242	493
Net cash provided by (used in) operating activities	37,104	(4,265)
Cash flows from investing activities:		
Proceeds from sale of fixed maturities and short-term investments	72,095	29,357
Proceeds from maturity of fixed maturities and short-term investments	26,129	125,799
Purchase of fixed maturities and short-term investments	(117,733)	(167,359)
Increase (decrease) in payable for securities purchased	978	(12,974)
Net cash used in investing activities	(18,531)	(25,177)
Cash flows from financing activities:		
Capital contribution	—	20,000
Net cash provided by financing activities	—	20,000
Increase (decrease) in cash and cash equivalents	18,573	(9,442)
Cash and cash equivalents-beginning of year	44,714	39,204
Cash and cash equivalents-end of period	$ 63,287	$ 29,762

See notes to condensed consolidated financial statements.

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1. Organization and Ownership

XL Capital Assurance Inc. and subsidiary (the “Company”) is a wholly owned subsidiary of XL Reinsurance America Inc. (“XL RE AM”), formerly known as NAC Reinsurance Corporation, which is an indirect wholly owned subsidiary of X.L. A

The Company is an insurance company domiciled in the State of New York. The Company is engaged in the business of providing credit enhancement by writing financial guaranty insurance policies on asset-backed structured finance, essential in

The Company was formed on September 13, 1999 and became licensed as a financial guaranty insurer in New York upon its merger with an affiliate, X.L. Risk Solutions, Inc. on September 30, 1999.

On February 22, 2001 XL RE AM acquired all the outstanding shares of The London Assurance of America, Inc. (“LAA”). LAA was incorporated in New York on July 25, 1991. Prior to its purchase by XL RE AM, LAA was a New York-domicil

On May 15, 2002, the Company capitalized XL Capital Assurance (U.K.) Limited, (“XLCA-UK”), an insurance company organized under the laws of England. XLCA-UK is a direct wholly owned subsidiary of the Company.

2. Basis of Presentation and Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its subsidiary and are unaudited. The results include the consolidation of XLCA-UK, accounted for as a subsidiary with effect from April 24

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These stat

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2. Basis of Presentation and Consolidation (continued)

The preparation of condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the fir

(U.S. Dollars)

3. Credit Default Swaps

Credit default swaps are recorded at fair value which is determined using a model developed by the Company and is dependent upon a number of factors including changes in interest rates, credit spreads, changes in credit quality, expected recover

The credit default swap portfolio is structured pools of corporate obligations that were awarded investment grade ratings at the deals' inception. At September 30, 2003, approximately 86% of the portfolio was rated AAA with the remaining 14% a

The net fair value adjustment for the nine-month periods ended September 30, 2003 and 2002 was an unrealized gain of $544,007 and an unrealized loss of $166,000, respectively. The components of the Company's net credit default swap asset an

	At September 30, 2003	At December 31, 2002
Asset		
Gross Credit Derivative Gains	$5,074,851	$ 27,498
Reinsurance	4,664,588	21,098
Net Asset	$ 410,263	$ 6,400
Liability		
Gross Credit Derivative Losses	$8,051,549	$7,447,219
Reinsurance	7,493,165	6,748,691
Net Liability	$ 558,384	$ 698,528

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4. Recent Accounting Pronouncements

In December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" ("SFAS 148"). SFAS 148 amends FA

In January 2003, FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). The objective of FIN 46 is to improve financial reporting by companies involved with variable interest entities. This new model for cons

ff Position No. FIN 46-6, FIN 46 is effective for variable interests in a variable interest entity created before February 1, 2003 at the end of the first interim or annual period ending after December 15, 2003. The adoption of FIN 46 is not expected t

In April 2003, FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, inclu

5. Variable Interest Entities

The Company participates in transactions which utilize variable interest entities in the ordinary course of business. The Company provides financial guaranty insurance of structured transactions backed by pools of assets of specified types, municipal obligations supported by the issuers' ability to charge fees for specified services or projects, and corporate risk obligations including essential infrastructure projects and obligations backed by receivables from future sales of commodities and other specified services. The obligations related to these transactions are often securitized through off-balance sheet variable interest entities. In synthetic transactions, the Company guarantees payment obligations of counterparties, including variable interest entities, through credit default swaps referencing asset portfolios. The Company only provides financial guaranty insurance of the senior interests of these variable interest entities that would otherwise be rated investment gra

de, without the Company's credit enhancement, for fixed premiums at market rates, but does not hold any equity positions or subordinated debt in these off-balance sheet arrangements. Accordingly, the Company does not consider its participation to be a significant variable interest in the entity and therefore these variable interest entities are not consolidated.

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6. Tax Sharing Agreement

The Company’s U.S. Federal income tax return is consolidated with XLA and its subsidiaries. XLA maintains a tax sharing agreement with its subsidiaries, whereby the consolidated U.S. Federal income tax liability is allocated among affiliates in

7. Facultative Quota Share Reinsurance Treaty

On October 6, 1999, the Company entered into a Facultative Quota Share Reinsurance Treaty (“Treaty”) with XL Financial Assurance Ltd. (“XLFA”), a Bermuda financial guaranty insurer, which is 86.8% owned by XL Insurance. The remaining

XL Insurance entered into a reinsurance agreement dated October 6, 1999 with the Company, that unconditionally and irrevocably guarantees the full and complete performance of all obligations of XLFA to the Company under the above describe

The Company entered into a Facultative Master Certificate (the “XL Re Treaty”) with XL RE AM, a New York insurance corporation with administrative offices in Stamford, Connecticut and the direct parent of the Company. The XL Re Treaty is

XL FINANCIAL ASSURANCE LTD.

(Incorporated in Bermuda)

CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

FOR THE THREE AND NINE MONTH PERIODS ENDED

SEPTEMBER 30, 2003 AND 2002

XL FINANCIAL ASSURANCE LTD.

CONDENSED BALANCE SHEET S

AS AT SEPTEMBER 30, 2003 AND DECEMBER 31, 2002

(UNAUDITED)

(U.S. dollars in thousands, except number of shares and per share amounts)

	2003 $	2002 $
Assets:		
Investments :		
Fixed maturities, at fair value		
(amortized cost: 2003 - $363,951; 2002 - $273,241)	368,759	279,296
Short-term investments, at fair value		
(amortized cost: 2003 - $192,693; 2002 - $76,411)	192,722	76,451
Total investments available for sale	561,481	355,747
Cash and cash equivalents	21,625	125,073
Accrued investment income	3,195	1,926
Reinsurance balances receivable	34,205	21,066
Deferred acquisition costs	46,407	19,324
Prepaid reinsurance premiums	92,231	71,129
Unpaid losses and loss expenses recoverable	6,444	3,678
Net receivable for investments sold	1,605	—
Amounts due from parent and affiliates	9,956	13,769
Derivative assets	4,664	1,375
Other assets	88	79
Total assets	781,901	613,166

Liabilities, Redeemable Preferred Shares and Shareholders' Equity		
Liabilities:		
Accounts payable and accrued liabilities	705	1,139
Derivative liabilities	7,493	17,643
Deferred premium revenue	324,083	188,464
Unpaid losses and loss expenses	28,082	14,064
Reinsurance premiums payable	8,873	23,697
Net payable for investments purchased	—	168
Dividend payable on preferred shares	1,458	1,950
Total liabilities	370,694	247,125
Redeemable Preferred Shares:		
Redeemable preferred shares (par value of $120 per share; 10,000 shares authorized; 363 issued and outstanding as at September 30, 2003 and December 31, 2002, respectively)	44	44
Additional paid-in capital	38,956	38,956
Total redeemable preferred shares	39,000	39,000
Shareholders' Equity:		
Common shares (par value of $120 per share; 10,000 shares authorized; 2,057 issued and outstanding as at September 30, 2003 and December 31, 2002, respectively)	247	247
Additional paid-in capital	220,653	220,653
Accumulated other comprehensive income	4,837	6,095
Retained earnings	146,470	100,046
Total shareholders' equity	372,207	327,041
Total liabilities, redeemable preferred shares and shareholders' equity	781,901	613,166

The accompanying notes are an integral part of these condensed financial statements.

XL FINANCIAL ASSURANCE LTD.

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2003 AND 2002

(UNAUDITED)

(U.S. dollars in thousands)

	Three Months ended September 30,		Nine Months ended September 30,	
	2003 $	**2002 $**	**2003 $**	**2002 $**
REVENUES :				
Net premiums earned	19,964	9,465	52,076	23,949
Net investment income	3,904	6,324	11,378	16,028
Net realized gains (losses) on investments	(609)	8,643	1,825	12,671
Net realized and unrealized gains (losses) on derivative instruments	5,480	(654)	27,009	12,370
Total revenues	28,739	23,778	92,288	65,018
EXPENSES :				
Losses and loss expenses	2,031	2,395	12,907	6,079
Acquisition costs	7,905	3,172	21,668	9,963
Operating expenses	1,550	1,585	5,140	4,785
Total expenses	11,486	7,152	39,715	20,827
NET INCOME	17,253	16,626	52,573	44,191
COMPREHENSIVE INCOME				
Net income	17,253	16,626	52,573	44,191
Unrealized (losses) gains	(2,447)	13,682	567	18,730
Less: reclassification for (losses) gains realized in income	(609)	8,643	1,825	12,671
Other comprehensive (losses) gains	(1,838)	5,039	(1,258)	6,059
COMPREHENSIVE INCOME	15,415	21,665	51,315	50,250

The accompanying notes are an integral part of these condensed financial statements.

XL FINANCIAL ASSURANCE LTD.

CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2003 AND FOR THE YEAR ENDED DECEMBER 31, 2002

(UNAUDITED)

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

	September 30, 2003	December 31, 2002
Common Shares – Authorized		
Number of shares, beginning of year and period	2,057	2,057
Number of shares, end of year and period	2,057	2,057
	$	$
Common Shares – Issued		
Balance - beginning of year and period	247	247
Balance - end of year and period	247	247
Additional Paid-in Capital		
Balance - beginning of year and period	220,653	220,653
Balance - end of year and period	220,653	220,653
Accumulated Other Comprehensive (Loss) Income		
Balance - beginning of year and period	6,095	1,998
Net change in unrealized (depreciation) appreciation of investments	(1,258)	4,097
Balance - end of year and period	4,837	6,095
Retained Earnings		
Balance - beginning of year and period	100,046	37,237
Net income	52,573	69,492
Dividends on preferred shares	(6,149)	(6,683)
Balance - end of year and period	146,470	100,046
TOTAL SHAREHOLDERS' EQUITY	372,207	327,041

The accompanying notes are an integral part of these condensed financial statements.

XL FINANCIAL ASSURANCE LTD.

CONDENSED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTH PERIODS ENDED SEPTEMBER 30, 2003 AND 2002

(UNAUDITED)

(U.S. dollars in thousands)

	2003 $	2002 $
Cash flows provided by operating activities:		
Net income for the period	52,573	44,191
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized gains on investments	(1,825)	(12,671)
Amortization of discount on fixed maturities	(429)	(857)
Net realized gains on investment derivatives	(3,267)	—
Net realized and unrealized gains on credit derivatives excluding cash received and paid	(13,439)	(3,637)
Accrued investment income	(1,269)	1,362
Reinsurance premiums receivable	(13,139)	9,675
Deferred acquisition costs	(27,083)	1,608
Prepaid reinsurance premiums	(21,102)	(51,894)
Unpaid losses and loss expenses recoverable	(2,766)	(3,051)
Amounts due from parent and affiliates	3,813	(7,722)
Accounts payable and accrued liabilities	(434)	(624)
Reinsurance premiums payable	(14,824)	12,124
Deferred premium revenue	135,619	75,220
Unpaid losses and loss expenses	14,018	12,040
Other assets and liabilities	(9)	(9)
Total adjustments	53,864	31,564
Net cash provided by operating activities	106,437	75,755
Cash flows used in investing activities:		
Proceeds from sale of fixed maturities and short-term investments	238,602	1,927,070
Proceeds from redemption of fixed maturities and short-term investments	4,111,110	179,452
Purchase of fixed maturities and short-term investments	(4,552,957)	(2,133,939)
Net cash used in investing activities	(203,245)	(27,417)
Cash flows used in financing activities:		
Dividends paid on preferred shares	(6,640)	(6,665)
Increase (decrease) in Cash and Cash Equivalents	(103,448)	41,673
Cash and Cash Equivalents – Beginning of year	125,073	50,243
Cash and Cash Equivalents – End of period	21,625	91,916

The accompanying notes are an integral part of these condensed financial statements.

XL FINANCIAL ASSURANCE LTD.

NOTES TO CONDENSED FINANCIAL STATEMENTS

FOR NINE MONTH PERIODS ENDED SEPTEMBER 30, 2003 AND 2002

(UNAUDITED)

(U.S. dollars in thousands)

1. Organization and Business

XL Financial Assurance Ltd. (the "Company") was incorporated with limited liability under the Bermuda Companies Act 1981 on October 14, 1998 and is registered as a Class 3 insurer under The Insu

ecurity Assurance Holdings Ltd.

The Company is primarily engaged in the business of providing reinsurance of financial guaranties on asset-backed and municipal obligations underwritten by XL Insurance (Bermuda) Ltd, Financial S

pools of assets such as residential mortgage loans, consumer or trade receivables, securities or other assets having ascertainable cash flows or market value. The municipal obligations reinsured by the

y loss events. In addition, in the normal course of business, the Company seeks to reduce the loss that may arise from such events by reinsuring certain levels of risks in various areas of exposure with c

On October 6, 1999, the Company entered into a Facultative Quota Share Reinsurance Treaty ("Treaty") with XL Capital Assurance Inc. ("XLCA"). The Treaty was amended and restated on June 22, 2

On December 6, 2000, the Company entered into an excess of loss agreement, which reinsures 100% of net incurred losses in excess of $250 million up to a limit of liability of $100 million. On June 3

2. Significant Accounting Policies

Basis of Preparation

The accompanying condensed financial statements have been prepared by the Company and are unaudited. In the opinion of management, all adjustments, which include only normal recurring adjustm

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XL FINANCIAL ASSURANCE LTD.

NOTES TO CONDENSED FINANCIAL STATEMENTS

FOR NINE MONTH PERIODS ENDED SEPTEMBER 30, 2003 AND 2002

(UNAUDITED)

(U.S. dollars in thousands)

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been

The preparation of condensed financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets a

Certain comparative figures have been reclassified to conform with the current year’s presentation.

Recent Accounting Pronouncements

In April 2003, FASB issued Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149"). SFAS No. 149

No. 149 is effective for contracts entered into or modified after June 30, 2003 and is applied prospectively. The effect of adoption of this standard on the Company's financial condition has been evalua

In January 2003, FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). The objective of FIN 46 is to improve financial reporting by companies involved with variable interest entities. This new model for consolidation applies to an entity in which either (1) the powers or rights of the equity holders do not give them sufficient decision making powers or (2) the equity investment at risk is insufficient to finance that entity’s activities without receiving additional subordinated financial support from other parties. FIN 46 requires a variable interest entity to be consolidated by the company that is subject to a majority of the risk of loss from the variable interest entity’s activities or that is entitled to receive a majority of the entity's residual returns or both. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. As amended by FASB Staff Position ("FSP") No. FIN 46-6, FIN 46 is effective for variable interests in a VIE created before February 1, 2003 at the end of the first interim or annual period ending after December 15, 2003. The Company does not expect the adoption of FIN 46 to have a material effect on our results of operation or financial position.

In December 2002, the Financial Accounting Standards Board ("FASB") issued FAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure". FAS 148 amends FAS 123, "Accou

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XL FINANCIAL ASSURANCE LTD.

NOTES TO CONDENSED FINANCIAL STATEMENTS

FOR NINE MONTH PERIODS ENDED SEPTEMBER 30, 2003 AND 2002

(UNAUDITED)

(U.S. dollars in thousands)

subsidiaries subsequent to January 1, 2003, in accordance with SFAS No. 123, as amended by SFAS No. 148. The effect of the adoption of SFAS No. 148 on the Company for the first nine months of 2

3. Derivative Instruments

Credit default swaps issued by the Company meet the definition of a derivative under FAS 133. The Company has recorded these products at fair value, modeled on prevailing market conditions and ce

Credit default swaps generally enhance a synthetic portfolio of securities. The credit ratings of the underlying securities vary and a single rating is calculated for the portfolio at the inception of the tran

The credit default swap portfolio is structured pools of corporate obligations that were awarded investment grade ratings at the deals' inception. At September 30, 2003, approximately 88.7% of the por

The rated tranches are fair valued using changes in credit spreads to reflect current market conditions. The Company will also consider the characteristics and credit ratings of the underlying portfolio in

The Company's credit default swap portfolio generally requires the Company to meet payment obligations for referenced credits within the portfolio in the event of specific credit events after erosion or exhaustion of various first loss protection levels. These credit events are contract specific, but generally cover bankruptcy, failure to pay and repudiation.

4. Variable Interest Entities

The Company utilizes variable interest entities (as defined in FIN 46) indirectly in the ordinary course of the Company's business. The obligations related to these transactions are often securitized thro

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5. Reinsurance

The effect of reinsurance on premiums written and earned for the three and nine month periods ended September 30, 2003 and 2002 is shown below:

	Assumed $	Ceded $	Net $
Three months ended September 30, 2003			
Premium written	78,863	(12,442)	66,421
Premium earned	26,053	(6,089)	19,964
Losses and loss adjustment expenses	1,695	336	2,031
Three months ended September 30, 2002			
Premium written	24,627	(23,148)	1,479
Premium earned	15,387	(5,922)	9,465
Losses and loss adjustment expenses	3,906	(1,511)	2,395
Nine months ended September 30, 2003			
Premium written	206,412	(39,820)	166,592
Premium earned	70,794	(18,718)	52,076
Losses and loss adjustment expenses	15,672	(2,765)	12,907
Nine months ended September 30, 2002			
Premium written	110,777	(63,770)	47,007
Premium earned	36,555	(12,606)	23,949
Losses and loss adjustment expenses	9,311	(3,232)	6,079