AXIS CAPITAL HOLDINGS LTD
Form 10-Q
April 29, 2011
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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 March 31, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-31721

AXIS CAPITAL HOLDINGS LIMITED

(Exact name of registrant as specified in its charter)

BERMUDA

(State or other jurisdiction of incorporation or organization)

98-0395986

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

92 Pitts Bay Road, Pembroke, Bermuda HM 08

(Address of principal executive offices and zip code)

(441) 496-2600

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

As of April 20, 2011 there were 129,413,662 Common Shares, $0.0125 par value per share, of the registrant outstanding.

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PART I FINANCIAL INFORMATION

Cautionary Statement Regarding Forward-looking Statements

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

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

the occurrence and magnitude of natural and man-made disasters,

actual claims exceeding our loss reserves,

general economic, capital and credit market conditions,

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

the effects of emerging claims and coverage issues,

the failure of our cedants to adequately evaluate risks,

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

the loss of one or more key executives,

a decline in our ratings with rating agencies, loss of business provided to us by our major brokers,

changes in accounting policies or practices,

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

changes in governmental regulations,

increased competition,

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

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

the other matters set forth under Item 1A, *Risk Factors* and Item 7, *Management s Discussion and Analysis of Financial Condition and Results of Operations* included in our Annual Report on Form 10-K for the year ended December 31, 2010.

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

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ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED BALANCE SHEETS

MARCH 31, 2011 (UNAUDITED) AND DECEMBER 31, 2010

	2011	2010
	(in thousands)	
Assets		
Investments:		
Fixed maturities, available for sale, at fair value *(Amortized cost 2011: $10,591,298; 2010: $10,346,243)*	**$ 10,726,390**	$ 10,482,897
Equity securities, available for sale, at fair value *(Cost 2011: $466,429; 2010: $327,207)*	**502,096**	349,254
Other investments, at fair value	**554,113**	519,296
Short-term investments, at amortized cost	**132,512**	172,719
Total investments	**11,915,111**	11,524,166
Cash and cash equivalents	**963,266**	929,515
Restricted cash and cash equivalents	**122,923**	115,840
Accrued interest receivable	**94,013**	96,364
Insurance and reinsurance premium balances receivable	**1,880,305**	1,343,665
Reinsurance recoverable on unpaid and paid losses	**1,688,778**	1,577,547
Deferred acquisition costs	**498,598**	359,300
Prepaid reinsurance premiums	**212,808**	221,396
Goodwill and intangible assets	**102,847**	103,231
Other assets	**195,275**	174,707
Total assets	**$ 17,673,924**	$ 16,445,731
Liabilities		
Reserve for losses and loss expenses	**$ 8,013,861**	$ 7,032,375
Unearned premiums	**2,938,328**	2,333,676
Insurance and reinsurance balances payable	**141,483**	164,927
Senior notes	**994,246**	994,110
Other liabilities	**231,523**	275,422
Net payable for investments purchased	**164,903**	20,251
Total liabilities	**12,484,344**	10,820,761
Commitments and Contingencies		
Shareholders equity		
Preferred shares - Series A and B	**500,000**	500,000
Common shares *(2011: 156,820; 2010: 154,912 shares issued and 2011: 113,902; 2010: 112,393 shares outstanding)*	**1,958**	1,934
Additional paid-in capital	**2,074,982**	2,059,708
Accumulated other comprehensive income	**155,192**	176,821
Retained earnings	**3,853,076**	4,267,608
Treasury shares, at cost *(2011: 42,918; 2010: 42,519 shares)*	**(1,395,628)**	(1,381,101)

Total shareholders equity	**5,189,580**	5,624,970
Total liabilities and shareholders equity	**$ 17,673,924**	$ 16,445,731

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2011 AND 2010

	2011	2010
	(in thousands, except for per share amounts)	
Revenues		
Net premiums earned	$ 788,201	$ 696,192
Net investment income	110,655	104,619
Other insurance related income	763	626
Net realized investment gains:		
Other-than-temporary impairment losses	(2,155)	(6,957)
Portion of impairment losses transferred to (from) other comprehensive income	215	1,449
Other realized investment gains	32,084	21,684
Total net realized investment gains	30,144	16,176
Total revenues	929,763	817,613
Expenses		
Net losses and loss expenses	1,019,801	468,262
Acquisition costs	135,356	116,649
General and administrative expenses	116,520	99,769
Foreign exchange losses (gains)	15,058	(8,147)
Interest expense and financing costs	15,860	8,688
Total expenses	1,302,595	685,221
Income (loss) before income taxes	(372,832)	132,392
Income tax expense	1,709	11,361
Net income (loss)	(374,541)	121,031
Preferred share dividends	9,219	9,219
Net income (loss) available to common shareholders	$ (383,760)	$ 111,812
Per share data		
Net income (loss) per common share:		
Basic net income (loss)	$ (3.39)	$ 0.87
Diluted net income (loss)	$ (3.39)	$ 0.79
Weighted average number of common shares outstanding - basic	113,351	128,202
Weighted average number of common shares outstanding - diluted	113,351	142,176
Cash dividends declared per common share	$ 0.23	$ 0.21

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2011 AND 2010

	2011	2010
	(in thousands)	
Net income (loss)	**$ (374,541)**	$ 121,031
Other comprehensive income, net of tax:		
Available for sale investments:		
Unrealized gains arising during the period	**12,782**	94,589
Portion of other-than-temporary impairment losses recognized in other comprehensive income	**(215)**	(1,449)
Adjustment for re-classification of realized investment (gains) losses and net impairment losses recognized in net income	**(35,949)**	(12,834)
Foreign currency translation adjustment	**1,753**	(484)
Comprehensive income (loss)	**$ (396,170)**	$ 200,853

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2011 AND 2010

	2011	2010
	(in thousands)	
Preferred shares - Series A and B		
Balance at beginning and end of period	**$ 500,000**	$ 500,000
Common shares (par value)		
Balance at beginning of period	**1,934**	1,903
Shares issued	**24**	26
Balance at end of period	**1,958**	1,929
Additional paid-in capital		
Balance at beginning of period	**2,059,708**	2,014,815
Shares issued	**1,410**	364
Stock options exercised	**3,417**	2,414
Share-based compensation expense	**10,447**	10,357
Balance at end of period	**2,074,982**	2,027,950
Accumulated other comprehensive income (loss)		
Balance at beginning of period	**176,821**	85,633
Unrealized appreciation (depreciation) on available for sale investments, net of tax:		
Balance at beginning of period	**161,802**	87,438
Unrealized gains (losses) arising during the period, net of reclassification adjustment	**(23,167)**	81,755
Portion of other-than-temporary impairment losses	**(215)**	(1,449)
Balance at end of period	**138,420**	167,744
Cumulative foreign currency translation adjustments, net of tax:		
Balance at beginning of period	**16,829**	803
Foreign currency translation adjustment	**1,753**	(484)
Balance at end of period	**18,582**	319
Supplemental Executive Retirement Plans (SERPs):		
Balance at beginning of period	**(1,810)**	(2,608)
Net actuarial gain (loss)	**-**	-
Balance at end of period	**(1,810)**	(2,608)
Balance at end of period	**155,192**	165,455
Retained earnings		
Balance at beginning of period	**4,267,608**	3,569,411

Net income (loss)	**(374,541)**	121,031
Series A and B preferred share dividends	**(9,219)**	(9,219)
Common share dividends	**(30,772)**	(31,453)
Balance at end of period	**3,853,076**	3,649,770
Treasury shares, at cost		
Balance at beginning of period	**(1,381,101)**	(671,518)
Shares repurchased for treasury	**(14,527)**	(297,567)
Balance at end of period	**(1,395,628)**	(969,085)
Total shareholders equity	**$ 5,189,580**	$ 5,376,019

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2011 AND 2010

	2011	2010
	(in thousands)	
Cash flows from operating activities:		
Net income (loss)	$ (374,541)	$ 121,031
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized investment (gains) losses	(30,144)	(16,176)
Net realized and unrealized gains of other investments	(25,031)	(16,265)
Amortization of fixed maturities	20,134	8,879
Other amortization and depreciation	3,435	2,153
Share-based compensation expense	10,447	10,357
Changes in:		
Accrued interest receivable	2,351	5,152
Reinsurance recoverable balances	(111,231)	(21,746)
Deferred acquisition costs	(139,298)	(117,963)
Prepaid reinsurance premiums	8,588	10,503
Reserve for loss and loss expenses	981,486	195,389
Unearned premiums	604,652	538,886
Insurance and reinsurance balances, net	(560,084)	(444,000)
Other items	(113,075)	59,262
Net cash provided by operating activities	277,689	335,462
Cash flows from investing activities:		
Purchases of:		
Fixed maturities	(3,794,801)	(2,761,817)
Equity securities	(167,697)	(7,707)
Other investments	(45,000)	-
Short-term investments	(163,980)	(200,931)
Proceeds from the sale of:		
Fixed maturities	3,237,485	2,632,428
Equity securities	32,903	8,526
Other investments	34,222	44,187
Short-term investments	125,041	134,102
Proceeds from redemption of fixed maturities	469,745	272,128
Proceeds from redemption of short-term investments	78,649	52,200
Purchase of other assets	(6,388)	(1,761)
Change in restricted cash and cash equivalents	(7,083)	(55,258)
Net cash (used in) provided by investing activities	(206,904)	116,097
Cash flows from financing activities:		
Net proceeds from issuance of senior notes	-	494,870
Repurchase of shares	(14,527)	(297,567)
Dividends paid - common shares	(29,320)	(31,390)
Dividends paid - preferred shares	(9,219)	(9,219)
Proceeds from issuance of common shares	4,851	2,804

Net cash (used in) provided by financing activities	**(48,215)**	159,498
Effect of exchange rate changes on foreign currency cash	**11,181**	(20,342)
Increase in cash and cash equivalents	**33,751**	590,715
Cash and cash equivalents - beginning of period	**929,515**	788,614
Cash and cash equivalents - end of period	**$ 963,266**	$ 1,379,329

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES
Basis of Presentation

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

The consolidated balance sheet at March 31, 2011 and the consolidated statements of operations, comprehensive income (loss), shareholders equity and cash flows for the periods ended March 31, 2011 and 2010 have not been audited. The balance sheet at December 31, 2010 is derived from our audited financial statements.

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

The following information should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2010. Tabular dollar and share amounts are in thousands, except per share amounts.

Significant Accounting Policies

There have been no changes to our significant accounting policies as described in our Annual Report on Form 10-K for the year ended December 31, 2010.

Adoption of New Accounting Standards

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

Effective January 1, 2011, we prospectively adopted amended FASB guidance that modified the definition of the types of costs that can be capitalized in relation to the acquisition of new and renewal insurance contracts. The amended guidance requires costs to be incremental or directly related to the successful acquisition of new or renewal contracts in order to be capitalized as a deferred acquisition cost. Capitalized costs would include incremental direct costs, such as commissions paid to brokers. Additionally, the portion of employee salaries and benefits directly related to time spent for acquired contracts would be capitalized. Costs that fall outside the revised definition must be expensed when incurred. In accordance with the transitional provisions of this amended guidance, we elected not to capitalize acquisition costs that we did not previously capitalize, namely those costs related to employee salaries and benefits. The adoption of this guidance did not impact our results of operations, financial condition or liquidity.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2. SEGMENT INFORMATION

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

The following tables summarize the underwriting results of our reportable segments for the periods indicated and the carrying values of goodwill and intangible assets at March 31, 2011 and 2010:

		2011			2010	
Three months ended March 31,	**Insurance**	**Reinsurance**	**Total**	**Insurance**	**Reinsurance**	**Total**
Gross premiums written	**$ 424,991**	**$ 1,123,439**	**$ 1,548,430**	$ 372,929	$ 1,052,272	$ 1,425,201
Net premiums written	**289,316**	**1,111,463**	**1,400,779**	206,812	1,036,823	1,243,635
Net premiums earned	**327,648**	**460,553**	**788,201**	256,281	439,911	696,192
Other insurance related income	**763**	**-**	**763**	626	-	626
Net losses and loss expenses	**(266,633)**	**(753,168)**	**(1,019,801)**	(130,703)	(337,559)	(468,262)
Acquisition costs	**(42,079)**	**(93,277)**	**(135,356)**	(31,141)	(85,508)	(116,649)
General and administrative expenses	**(67,726)**	**(27,386)**	**(95,112)**	(61,610)	(21,851)	(83,461)
Underwriting income (loss)	**$ (48,027)**	**$ (413,278)**	**(461,305)**	$ 33,453	$ (5,007)	28,446
Corporate expenses			**(21,408)**			(16,308)
Net investment income			**110,655**			104,619
Net realized investment gains			**30,144**			16,176
Foreign exchange (losses) gains			**(15,058)**			8,147
Interest expense and financing costs			**(15,860)**			(8,688)
Income (loss) before income taxes			**$ (372,832)**			$ 132,392
Net loss and loss expense ratio	**81.4%**	**163.5%**	**129.4%**	51.0%	76.7%	67.3%
Acquisition cost ratio	**12.8%**	**20.3%**	**17.1%**	12.2%	19.4%	16.7%
General and administrative expense ratio	**20.7%**	**5.9%**	**14.8%**	24.0%	5.0%	14.3%
Combined ratio	**114.9%**	**189.7%**	**161.3%**	87.2%	101.1%	98.3%
Goodwill and intangible assets	**$ 102,847**	**$ -**	**$ 102,847**	$ 91,271	$ -	$ 91,271

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS

a) Fixed Maturities and Equities

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

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Non-credit OTTI in AOCI[5]
At March 31, 2011					
Fixed maturities					
U.S. government and agency	**$ 1,068,362**	**$ 2,764**	**$ (2,176)**	**$ 1,068,950**	**$ -**
Non-U.S. government	**822,952**	**18,497**	**(3,110)**	**838,339**	**-**
Corporate debt	**3,963,915**	**108,577**	**(19,808)**	**4,052,684**	**-**
Agency RMBS[1]	**2,608,846**	**38,574**	**(24,723)**	**2,622,697**	**-**
CMBS[2]	**460,320**	**23,460**	**(1,534)**	**482,246**	**-**
Non-Agency RMBS	**231,382**	**3,545**	**(7,290)**	**227,637**	**(6,855)**
ABS[3]	**660,796**	**11,837**	**(15,014)**	**657,619**	**(568)**
Municipals[4]	**774,725**	**10,006**	**(8,513)**	**776,218**	**(350)**
Total fixed maturities	**$ 10,591,298**	**$ 217,260**	**$ (82,168)**	**$ 10,726,390**	**$ (7,773)**
Equity securities	**$ 466,429**	**$ 41,524**	**$ (5,857)**	**$ 502,096**	
At December 31, 2010					
Fixed maturities					
U.S. government and agency	$ 856,711	$ 7,101	$ (3,692)	$ 860,120	$ -
Non-U.S. government	777,236	9,321	(13,759)	772,798	-
Corporate debt	4,054,048	144,956	(36,096)	4,162,908	-
Agency RMBS	2,571,124	43,160	(20,702)	2,593,582	-
CMBS	454,288	21,998	(1,501)	474,785	-
Non-Agency RMBS	252,460	3,287	(11,545)	244,202	(7,443)
ABS	668,037	8,856	(15,050)	661,843	(1,275)
Municipals	712,339	11,870	(11,550)	712,659	(350)
Total fixed maturities	$ 10,346,243	$ 250,549	$ (113,895)	$ 10,482,897	$ (9,068)
Equity securities	$ 327,207	$ 26,761	$ (4,714)	$ 349,254	

(1) Residential mortgage-backed securities (RMBS) originated by U.S. agencies.
(2) Commercial mortgage-backed securities (CMBS).
(3) Asset-backed securities (ABS) include debt tranched securities collateralized primarily by auto loans, student loans, credit cards, and other asset types. This asset class also includes an insignificant position in collateralized loan obligations (CLOs) and collateralized debt obligations (CDOs).
(4) Includes bonds issued by states, municipalities, and political subdivisions.
(5) Represents the non-credit component of the other-than-temporary impairment (OTTI) losses, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

Gross Unrealized Loss

The following tables summarize fixed maturities and equities in an unrealized loss position and the aggregate fair value and gross unrealized loss by length of time the security has continuously been in an unrealized loss position:

	12 months or greater		Less than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At March 31, 2011						
Fixed maturities						
U.S. government and agency	**$ -**	**$ -**	**$ 556,922**	**$ (2,176)**	**$ 556,922**	**$ (2,176)**
Non-U.S. government	**42,367**	**(1,370)**	**123,240**	**(1,740)**	**165,607**	**(3,110)**
Corporate debt	**116,387**	**(3,802)**	**1,103,781**	**(16,006)**	**1,220,168**	**(19,808)**
Agency RMBS	**750**	**(11)**	**1,446,973**	**(24,712)**	**1,447,723**	**(24,723)**
CMBS	**590**	**(4)**	**77,332**	**(1,530)**	**77,922**	**(1,534)**
Non-Agency RMBS	**79,201**	**(7,041)**	**24,159**	**(249)**	**103,360**	**(7,290)**
ABS	**40,584**	**(12,895)**	**159,157**	**(2,119)**	**199,741**	**(15,014)**
Municipals	**12,622**	**(1,624)**	**289,946**	**(6,889)**	**302,568**	**(8,513)**
Total fixed maturities	**$ 292,501**	**$ (26,747)**	**$ 3,781,510**	**$ (55,421)**	**$ 4,074,011**	**$ (82,168)**
Equity securities	**$ 5,250**	**$ (609)**	**$ 50,968**	**$ (5,248)**	**$ 56,218**	**$ (5,857)**
At December 31, 2010						
Fixed maturities						
U.S. government and agency	$ -	$ -	$ 453,207	$ (3,692)	$ 453,207	$ (3,692)
Non-U.S. government	83,572	(6,062)	302,431	(7,697)	386,003	(13,759)
Corporate debt	160,161	(13,123)	1,087,683	(22,973)	1,247,844	(36,096)
Agency RMBS	735	(42)	1,308,690	(20,660)	1,309,425	(20,702)
CMBS	1,164	(59)	48,701	(1,442)	49,865	(1,501)
Non-Agency RMBS	100,074	(10,030)	57,095	(1,515)	157,169	(11,545)
ABS	40,617	(12,871)	155,491	(2,179)	196,108	(15,050)
Municipals	23,681	(3,118)	288,130	(8,432)	311,811	(11,550)
Total fixed maturities	$ 410,004	$ (45,305)	$ 3,701,428	$ (68,590)	$ 4,111,432	$ (113,895)
Equity securities	$ 4,347	$ (601)	$ 122,317	$ (4,113)	$ 126,664	$ (4,714)

Fixed Maturities

At March 31, 2011, 1,098 fixed maturities (2010: 1,150) were in an unrealized loss position of $82 million (2010: $114 million) of which $15 million (2010: $15 million) of this balance was related to securities below investment grade or not rated.

At March 31, 2011, 167 (2010: 206) securities have been in continuous unrealized loss position for 12 months or greater and have a fair value of $293 million (2010: $410 million). These securities were primarily non-agency RMBS and ABS with a weighted average S&P credit rating of A- and BBB-, respectively while at December 31, 2010, the securities were primarily corporate debt, non-agency RMBS and ABS with a weighted average S&P credit rating of A+, A- and BBB-, respectively. We concluded that these securities as well as the remaining securities in an unrealized loss position are temporarily depressed and are expected to recover in value as the securities approach maturity. Further, at March 31, 2011, we did not intend to sell these securities in an unrealized loss position and it is more likely than not that we will not be required to sell these securities before the anticipated recovery of their amortized costs.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

Equity Securities

At March 31, 2011, 59 securities (2010: 71) were in an unrealized loss position and 12 of these securities (2010: 12) have been in a continuous unrealized loss position for 12 months or greater. Based on our OTTI quarterly review process and our ability and intent to hold these securities for a reasonable period of time sufficient for a full recovery, we concluded that the above equities in an unrealized loss position were temporarily impaired at March 31, 2011 and December 31, 2010.

b) Other Investments

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

	March 31, 2011		December 31, 2010	
Funds of hedge funds	**$ 238,519**	**43.0%**	$ 235,240	45.3%
Hedge funds	**151,125**	**27.3%**	123,036	23.7%
Long/short credit	**80,809**	**14.6%**	82,846	16.0%
Distressed securities	**23,399**	**4.2%**	21,911	4.2%
CLO - equity tranched securities	**60,261**	**10.9%**	56,263	10.8%
Total other investments	**$ 554,113**	**100.0%**	$ 519,296	100.0%

The major categories and related investment strategies for our investments in hedge and credit funds are as follows:

Types of funds	Investment Strategy
Funds of hedge funds	Seek to achieve attractive risk-adjusted returns by investing in a large pool of hedge funds across a diversified range of hedge fund strategies.
Hedge funds	Seek to achieve attractive risk-adjusted returns primarily through multi-strategy and long/short equity approaches. Multi-strategy funds invest in a variety of asset classes on a long and short basis and may employ leverage. Long/short equity funds invest primarily in equity securities (or derivatives) on a long and short basis and may employ leverage.
Long/short credit	Seek to achieve attractive risk-adjusted returns by executing a credit trading strategy involving selecting long and short positions in primarily below investment-grade credit.

Distressed securities	Seek to achieve attractive risk-adjusted returns by executing a strategy which assesses the issuer s ability to improve its operations and often attempts to influence the process by which the issuer restructures its debt.

In aggregate, our hedge funds (including funds of hedge funds) are redeemable within one year, subject to prior written redemption notice varying from 45 to 95 days. This includes recognition of certain funds we hold which restrict new investor redemptions during a lock-up period. A lock-up period is the initial amount of time an investor is contractually required to hold the security before having the ability to redeem. Another common restriction is the suspension of redemptions (known as gates) which may be implemented by the general partner or investment manager of the fund in order to defer, in whole or in part, the redemption request in the event the aggregate amount of redemption requests exceeds a predetermined percentage of the fund s net assets or to prevent certain adverse regulatory, or any other reasons that may render the manager unable to promptly and accurately calculate the fund s net asset value. During the three months ended March 31, 2011, no gates were imposed on our redemption requests. Additionally, certain hedge funds may be allowed to invest a portion of their assets in illiquid securities, such as private equity or convertible debt. In such cases, a common mechanism used is a side-pocket, whereby the illiquid security is assigned to a designated account. Generally, the investor loses its redemption rights in the designated account. Only when the illiquid security is sold, or otherwise deemed liquid by the fund,

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

may investors redeem their interest. At March 31, 2011, the fair value of our hedge funds held in side-pockets was $4 million (2010: $4 million). At March 31, 2011 and December 31, 2010, redemptions receivable were insignificant.

At March 31, 2011, we had $43 million (2010: $46 million) of a long/short credit fund that we do not have the ability to liquidate at our own discretion as the fund is beyond its investment period and is currently distributing capital to its investors. Of the remaining credit fund holdings (long/short credit and distressed securities), 32% (2010: 32%) of the carrying value has annual or semi-annual liquidity and 68% (2010: 68%) has quarterly liquidity, subject to prior written redemption notice varying from 65 to 95 days. At March 31, 2011 and December 31, 2010, none of our credit funds had established side-pockets.

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

c) Net Investment Income

Net investment income was derived from the following sources:

Three months ended March 31,	**2011**	**2010**
Fixed maturities	**$ 88,581**	$ 91,118
Other investments	**25,311**	16,265
Cash and cash equivalents	**2,153**	1,735
Equities	**824**	588
Short-term investments	**387**	220
Gross investment income	**117,256**	109,926
Investment expenses	**(6,601)**	(5,307)
Net investment income	**$ 110,655**	$ 104,619

d) Net Realized Investment Gains (Losses)

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

Three months ended March 31,	**2011**	**2010**

Gross realized gains	**$ 76,332**	$ 59,963
Gross realized losses	**(38,413)**	(41,338)
Net OTTI recognized in earnings	**(1,940)**	(5,508)
Net realized gains on fixed maturities and equities	**35,979**	13,117
Change in fair value of investment derivatives[1]	**(9,100)**	(158)
Fair value hedges:[1]		
Derivative instruments	**(30,481)**	34,927
Hedged investments	**33,746**	(31,710)
Net realized investment gains	**$ 30,144**	$ 16,176

(1) Refer to Note 6 Derivative Instruments

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

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

Three months ended March 31,	**2011**	**2010**
Fixed maturities:		
Corporate debt	**$ 1,026**	$ 1,650
Non-Agency RMBS	**370**	1,064
ABS	**61**	1,126
Municipals	**483**	-
	1,940	3,840
Equities	**-**	1,668
Total OTTI recognized in earnings	**$ 1,940**	$ 5,508

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

Three months ended March 31,	**2011**	**2010**
Balance at beginning of period	**$ 57,498**	$ 162,390
Credit impairments recognized on securities not previously impaired	**-**	344
Additional credit impairments recognized on securities previously impaired	**(96)**	587
Change in recoveries of future cash flows expected to be collected	**(5)**	485
Securities sold/redeemed/matured	**(48,022)**	(5,963)
Balance at end of period	**$ 9,375**	$ 157,843

For the three months ended March 31, 2011, there were no significant credit loss events. The $48 million decrease in the above table for the first quarter of 2011 was primarily driven by the maturity of one medium-term note that was previously impaired in 2009. This security matured with a realized gain of $14 million.

4. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

Fair value is defined as the price to sell an asset or transfer a liability (i.e. the exit price) in an orderly transaction between market participants. We use a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. The hierarchy is broken down into three levels as follows:

Level 1 Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments.

Level 2 Valuations based on quoted prices in active markets for similar assets or liabilities, quoted prices for identical assets or liabilities in inactive markets, or for which significant inputs are observable (e.g. interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect our own assumptions about assumptions that market participants might use.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment.

Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This may lead us to change the selection of our valuation technique (from market to cash flow approach) or may cause us to use multiple valuation techniques to estimate the fair value of a financial instrument. This circumstance could cause an instrument to be reclassified between levels.

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

Fixed Maturities

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

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

U.S. government and agency

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

Non-U.S. government

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

Corporate debt

Corporate debt securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair values of these securities are generally determined using the spread above the risk-free yield curve. These spreads are generally obtained from the new issue market, secondary trading and broker-dealer quotes. As these spreads and the yields for the risk-free yield curve are observable market inputs, the fair values of our corporate debt securities are classified within Level 2. Where pricing is unavailable from pricing services, we obtain non-binding quotes from broker-dealers. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. In this event, securities are classified within Level 3 and consisted of private corporate debt securities at March 31, 2011.

MBS

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

ABS

ABS include mostly investment-grade bonds backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, student loan receivables, credit card receivables, and CLO debt tranched securities originated by a variety of financial institutions. Similarly to MBS, the fair values of ABS are priced through the use of a model which uses prepayment speeds and spreads sourced primarily from the new issue market. As the significant inputs used to price ABS are observable market inputs, the fair values of ABS are classified within Level 2. Where pricing is unavailable from pricing services, we obtain non-binding quotes from broker-dealers or use a discounted cash flow model to estimate fair value. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. At March 31, 2011, the use of a discounted cash flow model was limited to our investment in CLO debt tranched securities and included the following significant inputs: default and loss severity rates, collateral spreads, and risk free yield curves, which have not changed since December 31, 2010. As most of these inputs are unobservable, these securities are classified within Level 3.

Municipals

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

Equity Securities

Equity securities include U.S. and foreign common stocks as well as a foreign bond mutual fund. For common stocks we classified these within Level 1 as their fair values are based on quoted market prices in active markets. Our investment in the foreign bond mutual fund has daily liquidity, with redemption based on the net asset value of the fund. Accordingly, we have classified this investment as Level 2.

Other Investments

As a practical expedient, we estimate fair values for hedge and credit funds using net asset values as advised by external fund managers or third party administrators. As our investment in hedge and credit funds have redemption restrictions (see Note 3 for further details), we have classified these investments as Level 3.

CLO Equities were classified within Level 3 as we estimated the fair value for these securities using an income approach valuation technique (internal discounted cash flow model) due to the lack of observable, relevant trades in the secondary markets. At March 31, 2011, we have not changed our significant inputs (default rates, loss severity rate and estimated maturity dates) in our valuation model since December 31, 2010.

Derivative Instruments

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

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

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

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
At March 31, 2011				
Assets				
Fixed maturities				
U.S. government and agency	**$ 831,638**	**$ 237,312**	**$ -**	**$ 1,068,950**
Non-U.S. government	**-**	**838,339**	**-**	**838,339**
Corporate debt	**-**	**4,051,134**	**1,550**	**4,052,684**
Agency RMBS	**-**	**2,622,697**	**-**	**2,622,697**
CMBS	**-**	**482,246**	**-**	**482,246**
Non-Agency RMBS	**-**	**216,031**	**11,606**	**227,637**
ABS	**-**	**614,441**	**43,178**	**657,619**
Municipals	**-**	**776,218**	**-**	**776,218**
	831,638	**9,838,418**	**56,334**	**10,726,390**
Equity securities	**421,757**	**80,339**	**-**	**502,096**
Other investments	**-**	**-**	**554,113**	**554,113**
Other assets (see Note 6)	**-**	**19,575**	**-**	**19,575**
Total	**$ 1,253,395**	**$ 9,938,332**	**$ 610,447**	**$ 11,802,174**
Liabilities				
Other liabilities (see Note 6)	**$ -**	**$ 29,552**	**$ -**	**$ 29,552**
At December 31, 2010				
Assets				
Fixed maturities				
U.S. government and agency	$ 588,281	$ 271,839	$ -	$ 860,120
Non-U.S. government	-	772,798	-	772,798
Corporate debt	-	4,161,358	1,550	4,162,908
Agency RMBS	-	2,593,582	-	2,593,582
CMBS	-	474,785	-	474,785
Non-Agency RMBS		224,524	19,678	244,202
ABS	-	618,665	43,178	661,843
Municipals	-	712,659	-	712,659
	588,281	9,830,210	64,406	10,482,897

Equity securities	271,451	77,803	-	349,254
Other investments	-	-	519,296	519,296
Other assets (see Note 6)	-	6,641	-	6,641
Total	$ 859,732	$ 9,914,654	$ 583,702	$ 11,358,088
Liabilities				
Other liabilities (see Note 6)	$ -	$ 14,986	$ -	$ 14,986

During 2011 and 2010, we had no transfers between Levels 1 and 2.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

Level 3 financial instruments

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

	Fixed Maturities Corporate Debt	CMBS	Non-Agency RMBS	ABS	Total	Other Investments	Total Assets
Three months ended March 31, 2011							
Balance at beginning of period	**$ 1,550**	**$ -**	**$ 19,678**	**$ 43,178**	**$ 64,406**	**$ 519,296**	**$ 583,702**
Total net realized and unrealized gains included in net income(1)	**-**	**-**	**-**	**-**	**-**	**25,031**	**25,031**
Total net realized and unrealized losses included in net income(1)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Change in net unrealized gains included in other comprehensive income	**-**	**-**	**54**	**-**	**54**	**-**	**54**
Change in net unrealized losses included in other comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Purchases	**-**	**-**	**-**	**-**	**-**	**45,000**	**45,000**
Sales	**-**	**-**	**-**	**-**	**-**	**(27,063)**	**(27,063)**
Settlements / distributions	**-**	**-**	**(617)**	**-**	**(617)**	**(8,151)**	**(8,768)**
Transfers into Level 3	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Transfers out of Level 3	**-**	**-**	**(7,509)**	**-**	**(7,509)**	**-**	**(7,509)**
Balance at end of period	**$ 1,550**	**$ -**	**$ 11,606**	**$ 43,178**	**$ 56,334**	**$ 554,113**	**$ 610,447**
Level 3 gains / losses included in earnings attributable to the change in unrealized gains /losses relating to those assets held at the reporting date	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ 25,263**	**$ 25,263**
Three months ended March 31, 2010							
Balance at beginning of period	$ 18,130	$ 2,409	$ 6,639	$ 43,585	$ 70,763	$ 520,188	$ 590,951
Total net realized and unrealized gains included in net income(1)	-	-	-	-	-	14,902	14,902
Total net realized and unrealized losses included in net income(1)	(1,550)	-	-	-	(1,550)	-	(1,550)
Change in net unrealized gains included in other comprehensive income	1,623	32	274	106	2,035	-	2,035
Change in net unrealized losses included in other comprehensive income	(34)	(238)	(20)	(24)	(316)	-	(316)
Purchases	-	3,474	-	4,000	7,474	-	7,474
Sales	-	-	-	-	-	(42,593)	(42,593)
Settlements / distributions	-	(111)	(353)	(4)	(468)	(5,031)	(5,499)
Transfers into Level 3	-	-	780	-	780	-	780
Transfers out of Level 3	-	(2,119)	(3,900)	-	(6,019)	-	(6,019)

Balance at end of period	$ 18,169	$ 3,447	$ 3,420	$ 47,663	$ 72,699	$ 487,466	$ 560,165
Level 3 gains / losses included in earnings attributable to the change in unrealized gains /losses relating to those assets held at the reporting date	$ (1,550)	$ -	$ -	$ -	$ (1,550)	$ 14,902	$ 13,352

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

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

Transfers into Level 3 from Level 2

The transfers to Level 3 from Level 2 made in 2010 were due to a reduction in the volume of recently executed transactions or a lack of available quotes from pricing vendors and broker-dealers. None of the transfers were as a result of changes in valuation methodology that we made.

Transfers out of Level 3 into Level 2

The transfers to Level 2 from Level 3 made in 2010 and 2011 were primarily due to the availability of observable market inputs and multiple quotes from pricing vendors and broker-dealers as a result of the return of liquidity in the credit markets.

Fair Values of Financial Instruments

The carrying amount of financial assets and liabilities presented on the Consolidated Balance Sheets as at March 31, 2011, and December 31, 2010 approximated their fair values with the exception of senior notes. At March 31, 2011, the senior notes are recorded at amortized cost with a carrying value of $994 million (2010: $994 million) and have a fair value of $1,037 million (2010: $1,018 million).

5. RESERVE FOR LOSSES AND LOSS EXPENSES

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

Three months ended March 31,	**2011**	**2010**
Gross reserve for losses and loss expenses, beginning of period	**$ 7,032,375**	$ 6,564,133
Less reinsurance recoverable on unpaid losses, beginning of period	**(1,540,633)**	(1,381,058)
Net reserve for losses and loss expenses, beginning of period	**5,491,742**	5,183,075
Net incurred losses related to:		
Current year	**1,069,505**	549,728
Prior years	**(49,704)**	(81,466)
	1,019,801	468,262
Net paid losses related to:		
Current year	**(13,640)**	(11,306)
Prior years	**(213,147)**	(249,727)

	(226,787)	(261,033)
Foreign exchange and other	**62,690**	(58,144)
Net reserve for losses and loss expenses, end of period	**6,347,446**	5,332,160
Reinsurance recoverable on unpaid losses, end of period	**1,666,415**	1,427,362
Gross reserve for losses and loss expenses, end of period	**$ 8,013,861**	$ 6,759,522

We write business with loss experience generally characterized as low frequency and high severity in nature, which results in volatility in our financial results. During the three months ended March 31, 2011, we recognized net loss and loss expenses of $204 million and $289 million, respectively, in relation to the Christchurch, New Zealand and Japanese earthquakes. Our estimated net losses in relation to these events were derived from ground-up assessments of our in-force contracts and treaties providing coverage in the affected regions and are consistent with our market shares in those regions. We also considered current industry insured loss estimates, market share analyses and catastrophe modeling analyses, when appropriate, in addition to the information available to date from clients, brokers and loss adjusters. Industry-wide insured loss estimates for these events, as well as our own estimates remain subject to change as additional actual loss data becomes available. Actual losses in relation to these events may ultimately differ materially from current loss estimates.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

5. RESERVE FOR LOSSES AND LOSS EXPENSES (CONTINUED)

The proximity of the Japanese earthquake to our reporting date means that very limited information is yet available to us, inherently increasing the amount of management judgment required to arrive at our estimate of net losses and the associated uncertainty. In addition, a number of other factors limit our ability to accurately estimate the quantum of losses associated with this event including, but not limited to, the magnitude of the event and associated damage, uncertainties about the extent and nature of damages and corresponding coverages (including business interruption and contingent business interruption coverages), the ultimate size of losses to be assumed by Japan s cooperative mutuals and limitations associated with modeled losses.

Net losses and loss expenses incurred include net favorable prior year reserve development of $50 million and $81 million for the three months ended March 31, 2011 and 2010, respectively. Prior year reserve development arises from changes to loss estimates recognized in the current year that relate to losses incurred in previous calendar years.

The following table summarizes net favorable reserve development by segment:

Three months ended March 31,	**2011**	**2010**
Insurance	**$ 14,728**	$ 25,369
Reinsurance	**34,976**	56,097
Total	**$ 49,704**	$ 81,466

Overall, a significant portion of the net favorable prior period reserve development in the first quarters of 2011 and 2010 was generated from the property, marine, and aviation lines of our insurance segment and the property and catastrophe lines of our reinsurance segment. These lines of business, the majority of which have short-tail exposures, contributed 75% and 63% of the total net favorable reserve development in the first quarters of 2011 and 2010, respectively. The favorable development on these lines of business primarily reflects the recognition of better than expected loss emergence, rather than explicit changes in our actuarial assumptions.

Approximately $16 million and $36 million of the net favorable reserve development in the first quarter of 2011 and 2010, respectively, was generated from professional lines insurance and reinsurance business. This favorable development was driven by increased incorporation of our own historical claims experience into our estimation of ultimate loss ratios for accident years 2007 and prior, with less weighting being given to information derived from industry benchmarks.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

6. DERIVATIVE INSTRUMENTS

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

	March 31, 2011			December 31, 2010		
	Derivative Notional Amount	Asset Derivative Fair Value(1)	Liability Derivative Fair Value(1)	Derivative Notional Amount	Asset Derivative Fair Value(1)	Liability Derivative Fair Value(1)
Fair value hedges						
Foreign exchange contracts	**$ 567,450**	**$ 10,272**	**$ 14,338**	$ 612,845	$ -	$ 13,748
Derivatives not designated as hedges						
Relating to investment portfolio:						
Foreign exchange contracts	**241,136**	**96**	**6,416**	154,990	2,182	746
Relating to underwriting portfolio:						
Currency collar options	**38,200**	**696**	**-**	-	-	-
Foreign exchange contracts	**$ 698,192**	**8,511**	**8,798**	$ 110,564	4,459	492
Total derivatives		**$ 19,575**	**$ 29,552**		$ 6,641	$ 14,986

(1) Asset and liability derivatives are classified within other assets and other liabilities on the balance sheet.

Fair Value Hedges

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

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

Three months ended March 31,	**2011**	**2010**
Foreign exchange contracts	**$ (30,481)**	$ 34,927

Hedged investment portfolio	**33,746**	(31,710)
Hedge ineffectiveness recognized in earnings	**$ 3,265**	$ 3,217

Derivative Instruments not Designated as Hedges

a) Relating to Investment Portfolio

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

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6. DERIVATIVE INSTRUMENTS (CONTINUED)

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

The significant increase in the notional amount of investment related derivatives since December 31, 2010, was primarily due to hedging an increase in Canadian and Euro denominated fixed maturities.

b) Relating to Underwriting Portfolio

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

The significant increase in the notional amount of underwriting related derivatives since December 31, 2010, was primarily due to hedging our foreign denominated liability exposure relating to the significant catastrophe losses incurred from the New Zealand and Japanese earthquakes.

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

	Location of Gain (Loss) Recognized in Income on Derivative	Three months ended March 31, 2011	2010
Relating to investment portfolio:			
Foreign exchange contracts	Net realized investment gains (losses)	**$ (9,100)**	$ (158)
Relating to underwriting portfolio:			
Currency collar options	Foreign exchange gains (losses)	**697**	
Foreign exchange contracts	Foreign exchange gains (losses)	**(3,004)**	3,064
Total		**$ (11,407)**	$ 2,906

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7. SHARE-BASED COMPENSATION

Restricted Stock

The following table provides a reconciliation of the beginning and ending balance of nonvested restricted stock (including restricted stock units) for the three months ended March 31, 2011:

	Number of Restricted Stock	Weighted Average Grant Date Fair Value
Nonvested restricted stock - beginning of period	3,882	$ 31.95
Granted	1,725	36.44
Vested	(1,704)	35.09
Forfeited	(72)	29.43
Nonvested restricted stock - end of period	**3,831**	**$ 32.63**

For the three months ended March 31, 2011, we incurred share-based compensation costs of $10 million (2010: $10 million) and recorded tax benefits thereon of $2 million (2010: $2 million). The total grant-date fair value of shares vested during the three months ended March 31, 2011 was $60 million (2010: $58 million). At March 31, 2011 there were $111 million (2010: $91 million) of unrecognized share-based compensation costs, which are expected to be recognized over the weighted average period of 3.2 years (2010: 3.0 years).

8. EARNINGS PER COMMON SHARE

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

At and for the three months ended March 31,	**2011**	**2010**
Basic earnings (loss) per common share		
Net income available to common shareholders	**$ (383,760)**	$ 111,812
Weighted average common shares outstanding	**113,351**	128,202
Basic earnings (loss) per common share	**$ (3.39)**	$ 0.87
Diluted earnings (loss) per common share		
Net income (loss) available to common shareholders	**$ (383,760)**	$ 111,812

Weighted average common shares outstanding - basic	**113,351**	128,202
Warrants	-	11,675
Stock compensation plans	-	2,299
Weighted average common shares outstanding - diluted	**113,351**	142,176
Diluted earnings (loss) per common share	**$ (3.39)**	$ 0.79

Due to the net loss incurred in the three months ended March 31, 2011, all the share equivalents were anti-dilutive. For the same period in 2010, 400,834 share equivalents were excluded in the computation of diluted earnings per share because their effect would have been anti-dilutive.

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