AXIS CAPITAL HOLDINGS LTD
Form 10-Q
November 03, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2009

OR

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

OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-31721

AXIS CAPITAL HOLDINGS LIMITED

(Exact name of registrant as specified in its charter)

BERMUDA

(State or other jurisdiction of incorporation or organization)

98-0395986

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

92 Pitts Bay Road, Pembroke, Bermuda HM 08

(Address of principal executive offices and zip code)

(441) 496-2600

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 ¨ 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 October 30, 2009 there were 142,464,979 Common Shares, $0.0125 par value per share, of the registrant outstanding.

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PART I FINANCIAL INFORMATION

Cautionary Statement Regarding Forward-looking Statements

This quarterly report contains forward-looking statements within the meaning of the U.S. federal securities laws. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in the United States securities laws. In some cases, these statements can be identified by the use of forward-looking words such as may, should, could, anticipate, estimate, expect plan, believe, predict, potential and intend. Forward-looking statements contained in this report may include information regarding our 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 of natural and man-made disasters,
- actual claims exceeding our loss reserves,
- general economic, capital and credit market conditions,
- the failure of any of the loss limitation methods we employ,
- the effects of emerging claims and coverage issues,
- the failure of our cedants to adequately evaluate risks,
- the loss of one or more key executives,
- a decline in our ratings with rating agencies,
- loss of business provided to us by our major brokers,

- changes in accounting policies or practices,
- changes in governmental regulations,
- increased competition,
- changes in the political environment of certain countries in which we operate or underwrite business,
- fluctuations in interest rates, credit spreads, equity prices and/or currency values, and
- the other matters set forth under Item 1A, Risk Factors and Item 7, Management s Discussion and Analysis of Financial Conditions and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

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ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2009 (UNAUDITED) AND DECEMBER 31, 2008

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

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

See accompanying notes to Consolidated Financial Statements

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

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

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

Cash dividends declared per common share	**$ 0.20**	$ 0.185	**$ 0.60**	$ 0.555

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

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

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

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

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

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

See accompanying notes to Consolidated Financial Statements.

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AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

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

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

See accompanying notes to Consolidated Financial Statements

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

Basis of Presentation

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

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

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

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

Significant Accounting Policies

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

Investments

Investments available for sale

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

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

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

We assess quarterly whether available-for-sale investments with unrealized losses represent impairments that are other than temporary. There are several factors that are considered in the assessment of a security including, but not limited to: (i) the extent and duration of the decline, (ii) the reason for the decline (e.g. credit spread widening, credit event), (iii) the historical and implied future volatility of the fair value, (iv) the financial condition of, and near-term prospects of, the issuer and (v) the collateral structure and credit support of the security, if applicable.

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Investments available for sale (continued)

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

Under the new guidance, if the impaired fixed maturity security meets one of the first two criteria above, the entire difference between the security s fair value and its amortized cost is recorded as an OTTI charge in the Consolidated Statements of Operations. However, if the impairment arises due to an anticipated credit loss on the security (third criterion above), we recognize only the credit component of the OTTI amount in earnings with a corresponding adjustment to amortized cost (new cost basis). The non-credit component (e.g. interest rates, market conditions, etc.) of the OTTI amount is recognized in accumulated other comprehensive income (AOCI) in shareholders equity. The new amortized cost is accreted into net investment income.

For equity securities we continue to consider our ability and intent to hold an equity security in an unrealized loss position for a reasonable period of time to allow for a full recovery. When it is determined that the decline in value of an equity security is other-than-temporary, we adjust the carrying value of the equity security to its fair value, with a corresponding charge to earnings.

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

Other investments

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

Short-term investments

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

Foreign Currency Translation

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

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Adoption of New Accounting Standards

Fair Value Measurements

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

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

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

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

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

Business Combinations

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

Determination of the Useful Life of Intangible Assets

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Financial Guarantee Insurance Contracts

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

Earnings per Share

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

Subsequent Events

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

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Recently Issued Accounting Standards Not Yet Adopted

Transfers and Servicing of Financial Assets

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

Consolidations

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

Fair Value Measurement of Liabilities

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

Fair Value Measurement of Certain Alternative Investments

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

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2. SEGMENT INFORMATION

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

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

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2. SEGMENT INFORMATION (CONTINUED)

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

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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:

At September 30, 2009	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Non-credit OTTI in AOCI[3]
Fixed maturities:					
U.S. government and agency	**$ 1,917,915**	**$ 22,324**	**$ (3,773)**	**$ 1,936,466**	**$ -**
Non-U.S. government	**516,781**	**18,078**	**(648)**	**534,211**	**-**
Corporate debt	**3,358,709**	**118,787**	**(35,571)**	**3,441,925**	**5,786**
Residential MBS[1]	**1,964,280**	**50,909**	**(39,880)**	**1,975,309**	**10,131**
Commercial MBS	**788,288**	**10,510**	**(52,254)**	**746,544**	**957**
ABS[2]	**407,005**	**7,253**	**(28,741)**	**385,517**	**11,748**
Municipals	**635,482**	**30,691**	**(3,213)**	**662,960**	**394**
Total fixed maturities	**$ 9,588,460**	**$ 258,552**	**$ (164,080)**	**$ 9,682,932**	**$ 29,016**
Equities:					
Common stock	**$ 129,055**	**$ 16,522**	**$ (8,033)**	**137,544**	
Preferred stock	**-**	**-**	**-**	**-**	
Total equities	**$ 129,055**	**$ 16,522**	**$ (8,033)**	**$ 137,544**	

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

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

(1) Residential mortgage-backed securities (MBS) include agency pass-through securities and collateralized mortgage obligations.

(2) Asset-backed securities (ABS) include debt tranched securities collateralized by sub-prime mortgages, auto loans, credit cards, and other asset types. This asset class also includes an insignificant position in collateralized loan obligations (CLOs) and collateralized debt obligations (CDOs).

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

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

Contractual Maturities

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

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

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

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

Gross Unrealized Losses

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

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

At December 31, 2008						
Fixed maturities:						
U.S. government and agency	$ -	$ -	$ 84,208	$ (908)	$ 84,208	$ (908)
Non-U.S. government	-	-	162,203	(12,696)	162,203	(12,696)
Corporate debt	428,311	(329,445)	1,057,684	(145,937)	1,485,995	(475,382)
Residential MBS	75,916	(16,266)	385,527	(80,070)	461,443	(96,336)
Commercial MBS	138,132	(49,091)	611,631	(121,216)	749,763	(170,307)
ABS	59,597	(18,878)	300,585	(33,772)	360,182	(52,650)
Municipals	-	-	71,510	(3,572)	71,510	(3,572)
Total fixed maturities	$ 701,956	$ (413,680)	$ 2,673,348	$ (398,171)	$ 3,375,304	$ (811,851)
Equities:						
Common stock	$ 2,286	$ (3,083)	$ 71,071	$ (45,537)	$ 73,357	$ (48,620)
Preferred stock	-	-	21,446	(9,949)	21,446	(9,949)

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

Fixed Maturities

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

We concluded that the above securities in an unrealized loss position were temporarily impaired based on a detailed analysis of the underlying credit, projected cash flows to be collected, and other qualitative factors. Further, at September 30, 2009, we did not intend to sell the above securities in an unrealized loss position and it is more likely than not that we will not be required to sell these securities before the anticipated recovery of their amortized costs.

Equity Securities

At September 30, 2009, 50 securities (2008: 149) were in an unrealized loss position and six of these securities (2008: nil) have been in a continuous unrealized loss position for 12 months or greater. Based on our OTTI quarterly review process and our ability and intent to hold these securities for a reasonable period of time sufficient for a recovery of fair value, we concluded that the above equities in an unrealized loss position were temporarily impaired.

Credit Ratings

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

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

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

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

b) Other Investments

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

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

c) Net Investment Income

Net investment income was derived from the following sources:

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

d) Net Realized Investment Gains (Losses)

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

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

(1) Refer to Note 6 Derivative Instruments

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

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

Fixed maturities

As disclosed in Note 2, on April 1, 2009, we adopted a new accounting standard which amended the previous OTTI recognition model for fixed maturities. For securities we intended to sell in the near term, we impaired $3 million of residential MBS during the three months ended September 30, 2009. For the nine months ended September 30, 2009, we impaired $2 million of corporate debt, $7 million of residential MBS and $11 million of commercial MBS that we intended to sell.

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

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

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

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

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

Credit losses are calculated based on the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to the impairment. The significant inputs and the methodology used to estimate the credit losses for which a portion of the OTTI was recognized in AOCI were as follows:

Corporate Debt:

Our projected cash flows for corporate debt securities are primarily driven by our assumptions regarding the probability of default and the timing and amount of recoveries associated with defaults. Our default and recovery rate assumptions are based on credit rating, credit analysis, industry analyst reports and forecasts, Moody s historical default data and any other data relevant to the recoverability of the security. Additionally, for medium-term notes (MTNs), our projected cash flows include significant inputs such as future credit spreads and use of leverage over the expected duration of each MTN.

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. INVESTMENTS (CONTINUED)

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

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

Residential MBS and Commercial MBS:

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

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

ABS:

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

Equities

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

e) Securities Lending

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

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

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

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

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

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors, including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This may lead us to change the selection of our valuation technique (from market to cash flow approach) or may cause us to use multiple valuation techniques to estimate the fair value of a financial instrument. This circumstance could cause an instrument to be reclassified between levels.

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

Fixed Maturities

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

The valuations for fixed maturity securities are generally obtained from third party pricing services for identical or comparable securities or through the use of pricing matrix models using observable market inputs such as yield curves, credit risks and spreads, measures of volatility, and prepayment speeds. Pricing from third party pricing services are sourced from multiple vendors, and we maintain a vendor hierarchy by asset type based on historical pricing experience and vendor expertise.

Where pricing is unavailable from pricing services, we obtain unbinding quotes from broker-dealers or use an internal model to estimate fair value. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. These securities are classified within Level 3 and consisted primarily of CLO debt tranched securities, private corporate debt securities and certain residential MBS at September 30, 2009.

Equity Securities

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

Other Investments

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

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

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

Derivative Instruments

a) Forward Contracts and Options

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

b) Insurance Derivative Contract

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

- The timing of the receipt of death benefits as well as the amount of premiums to be paid to maintain the policies in force, both of which are directly correlated to life expectancy assumptions for a portfolio of 188 lives;
- The proceeds of selling the unmatured life settlement contracts in 2017; and
- The risk margin that a market participant would require for providing this indemnity.

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

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

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

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

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

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AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

4. FAIR VALUE MEASUREMENTS (CONTINUED)

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

Three months ended September 30, 2009	Balance at beginning of period	Total net realized and unrealized gains / losses included in net income (1)	Change in net unrealized gains / losses included in other comprehensive income	Net purchases, sales, and distributions	Net transfers in (out) of Level 3	Balance at end of period	Unrealized gains / losses for Level 3 Assets/ Liabilities held at the reporting date
Assets							
Fixed maturities							
U.S. government and agency	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Non-U.S. government	-	-	-	-	-	-	-
Corporate debt	16,923	-	(986)	(111)	436	16,262	(5,689)
Residential MBS	20,692	-	502	808	(7,557)	14,445	(940)
Commercial MBS							