

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

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 No

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

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

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

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

As of April 20, 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 estimation of losses related to catastrophes and other large losses, measurements of potential losses in the fair value of our investment portfolio and derivative contracts, our expectations regarding pricing and other market conditions, our growth prospects, and valuations of the potential impact of movements in interest rates, equity prices, credit spreads and foreign currency rates. Forward-looking statements only reflect our expectations and are not guarantees of performance.

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

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

actual claims exceeding our loss reserves,

general economic, capital and credit market conditions,

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

the effects of emerging claims 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,

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loss of business provided to us by our major brokers,

changes in accounting policies or practices,

the use of industry catastrophe models and changes to 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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Table of Contents**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)

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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.

Table of Contents**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.

Table of Contents**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.

Table of Contents**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

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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.

Table of Contents**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
<i>Changes in:</i>		
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

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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.

Table of Contents**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:

Three months ended March 31,	2011			2010		
	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

Table of Contents**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	

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- (1) Residential mortgage-backed securities (RMBS) originated by U.S. agencies.
- (2) Commercial mortgage-backed securities (CMBS).
- (3) Asset-backed securities (ABS) include debt tranching securities collateralized primarily by auto loans, student loans, credit cards, and other asset types. This asset class also includes an insignificant position in collateralized loan obligations (CLOs) and collateralized debt obligations (CDOs).
- (4) 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 tranching 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.

Table of Contents**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.

Table of Contents**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 tranching 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.

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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,

Table of Contents**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
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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

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

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

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**

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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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AXIS CAPITAL HOLDINGS LIMITED

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

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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 tranch 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 tranch 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.

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

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

	Quoted Prices in 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		