

VALIDUS HOLDINGS LTD
Form 10-K
February 15, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012
Commission file number 001-33606
VALIDUS HOLDINGS, LTD.
(Exact name of registrant as specified in its charter)

BERMUDA
(State or other jurisdiction of
incorporation or organization)

98-0501001
(I.R.S. Employer
Identification No.)

29 Richmond Road, Pembroke, Bermuda HM 08
(Address of principal executive offices and zip code)
(441) 278-9000
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class: Common Shares, \$0.175 par value per share	Name of Each Exchange on Which Registered: New York Stock Exchange
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Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2012 was \$2,077.0 million computed upon the basis of the closing sales price of the Common Shares on June 30, 2012. For the purposes of this computation, shares held by directors and officers of the registrant have been excluded. Such exclusion is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

As of February 13, 2013, there were 107,468,544 outstanding Common Shares, \$0.175 par value per share, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates information from certain portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the fiscal year ended December 31, 2012.

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This Annual Report on Form 10-K contains “Forward-Looking Statements” as defined in the Private Securities Litigation Reform Act of 1995. A non-exclusive list of the important factors that could cause actual results to differ materially from those in such Forward-Looking Statements is set forth herein under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Cautionary Note Regarding Forward-Looking Statements.”

PART I

All amounts presented in this part are in U.S. dollars except as otherwise noted.

Item 1. Business

Overview

Validus Holdings, Ltd. (the “Company”) was incorporated under the laws of Bermuda on October 19, 2005. Our initial investor, which we refer to as our founding investor, is Aquiline Capital Partners LLC, a private equity firm dedicated to investing in financial services companies. Other sponsoring investors included private equity funds managed by Goldman Sachs Capital Partners, Vestar Capital Partners, New Mountain Capital and Merrill Lynch Global Private Equity. The Company conducts its operations worldwide through three operating segments which have been determined under U.S. GAAP segment reporting, Validus Reinsurance, Ltd. (“Validus Re”), Talbot Holdings Ltd. (“Talbot”) and AlphaCat Managers, Ltd. (“AlphaCat”). The Company provides reinsurance, insurance and insurance linked securities management. Validus Re is a Bermuda based reinsurer focused on short tail lines of reinsurance. Talbot is the Bermuda parent of the specialty insurance group primarily operating within the Lloyd's insurance market through Syndicate 1183. AlphaCat is a Bermuda based investment adviser, managing third-party capital in insurance linked securities and other investments in the property catastrophe reinsurance space.

We seek to establish ourselves as a leader in the global insurance and reinsurance markets. Our principal operating objective is to use our capital efficiently by underwriting primarily short-tail insurance and reinsurance contracts with superior risk and return characteristics. Our primary underwriting objective is to construct a portfolio of short-tail insurance and reinsurance contracts which maximizes our return on equity subject to prudent risk constraints on the amount of capital we expose to any single event. We manage our risks through a variety of means, including contract terms, portfolio selection, diversification criteria, including geographic diversification criteria, and proprietary and commercially available third-party vendor catastrophe models.

Since our formation in 2005, we have been able to achieve substantial success in the development of our business. Selected examples of our accomplishments are as follows:

• Raising approximately \$1.0 billion of initial equity capital in December 2005 and underwriting \$217.4 million in gross premiums written for the January 2006 renewal season;

• At the time of the Company’s formation an executive management team was assembled with an average of 20 years of industry experience and senior expertise spanning multiple aspects of the global insurance and reinsurance business;

• Building a risk analytics staff comprised of over 40 experts, many of whom have PhDs and Masters degrees in related fields;

• Developing Validus Capital Allocation and Pricing System (“VCAPS”), a proprietary computer-based system for modeling, pricing, allocating capital and analyzing catastrophe-exposed risks;

• Acquiring all of the outstanding shares of Talbot Holdings Ltd. on July 2, 2007;

• Completing an initial public offering (“IPO”) on July 30, 2007;

• Acquiring all of the outstanding shares of IPC Holdings Ltd. (“IPC”) on September 4, 2009;

• Raising \$185.0 million of initial capital for AlphaCat Re 2011, Ltd. (“AlphaCat Re 2011”) on May 25, 2011 and a further \$71.0 million of additional capital on December 23, 2011;

• Raising \$500.0 million of capital for PaCRe, Ltd. (“PaCRe”) a new Class 4 Bermuda reinsurer formed for the purpose of writing high excess property catastrophe reinsurance, on April 2, 2012;

• Raising \$70.0 million of capital for AlphaCat Re 2012, Ltd. (“AlphaCat Re 2012”) on May 29, 2012;

• Acquiring all of the outstanding shares of Flagstone Reinsurance Holdings, S.A. (“Flagstone”) on November 30, 2012;

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Raising \$230.0 million of capital for Alpha Cat 2013, Ltd. ("AlphaCat 2013") on December 17, 2012 and receiving \$219.4 million of third party subscriptions for AlphaCat Insurance Linked Securities ("ILS") Funds; Increasing the annual dividend by 20% from \$1.00 to \$1.20 per common share and per common share equivalent and announcing a \$2.00 special dividend per common share and per common share equivalent on February 6, 2013; and Repurchasing approximately 43.7 million common shares for an aggregate purchase price of \$1,227.1 million and paying an aggregate amount of \$467.6 million in dividends from inception of the Company to February 13, 2013.

Our Operating Subsidiaries

The following chart shows how our Company and its principal operating subsidiaries are organized.

For a complete list of the Company's subsidiaries, see Exhibit 21.

(a) AlphaCat Re 2012 and AlphaCat 2013 are non-consolidated operating affiliates.

Operating Segments

Validus Re: Validus Re, the Company's principal reinsurance operating subsidiary, operates as a Bermuda-based provider of short-tail reinsurance products on a global basis. Validus Re concentrates on first-party risks, which are property risks and other reinsurance lines commonly referred to as short-tail in nature due to the relatively brief period between the occurrence and payment of a claim.

Validus Re was registered as a Class 4 insurer under The Insurance Act 1978 of Bermuda, amendments thereto and related regulations (the "Insurance Act") in November 2005. It commenced operations with approximately \$1.0 billion of equity capital and a balance sheet unencumbered by any historical losses relating to the 2005 hurricane season, the events of September 11, 2001, asbestos or other legacy exposures affecting our industry.

Validus Re entered the global reinsurance market in 2006 during a period of imbalance between the supply of underwriting capacity available for reinsurance on catastrophe-exposed property, marine and energy risks and demand for such reinsurance coverage.

On September 4, 2009, the Company acquired all of the outstanding shares of IPC. The primary lines in which IPC conducted business were property catastrophe reinsurance and, to a limited extent, property-per-risk excess, aviation (including satellite) and

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other short-tail reinsurance on a worldwide basis. For segmental reporting purposes, the results of IPC's operations since the acquisition date have been included within the Validus Re segment in the consolidated financial statements. On November 30, 2012, the Company acquired all of the outstanding shares of Flagstone, strengthening the Company's leading property catastrophe reinsurance and short-tail specialty insurance platform. The primary lines in which Flagstone conducted business were property catastrophe reinsurance, property pro rata and per-risk excess and short tail specialty and casualty reinsurance such as aviation, energy, personal accident and health, satellite, marine and workers' compensation catastrophe. For segmental reporting purposes, the results of Flagstone's operations since the acquisition date have been included within the Validus Re segment in the consolidated financial statements. The following are the primary lines in which Validus Re conducts its business. Details of gross premiums written by line of business are provided below:

(Dollars in thousands)	Year Ended December 31, 2012		Year Ended December 31, 2011		Year Ended December 31, 2010	
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)
Property	\$771,617	68.2 %	\$786,937	70.6 %	\$778,794	71.5 %
Marine	257,469	22.7 %	232,401	20.9 %	227,135	20.8 %
Specialty	102,873	9.1 %	95,155	8.5 %	83,514	7.7 %
Total	\$1,131,959	100.0 %	\$1,114,493	100.0 %	\$1,089,443	100.0 %

Property: Validus Re underwrites property catastrophe reinsurance, property per risk reinsurance and property pro rata reinsurance.

Property catastrophe: Property catastrophe reinsurance provides reinsurance for insurance companies' exposures to an accumulation of property and related losses from separate policies, typically relating to natural disasters or other catastrophic events. Property catastrophe reinsurance is generally written on an excess of loss basis, which provides coverage to primary insurance companies when aggregate claims and claim expenses from a single occurrence from a covered peril exceed a certain amount specified in a particular contract. Under these contracts, the Company provides protection to an insurer for a portion of the total losses in excess of a specified loss amount, up to a maximum amount per loss specified in the contract. In the event of a loss, most contracts provide for coverage of a second occurrence following the payment of a premium to reinstate the coverage under the contract, which is referred to as a reinstatement premium. The coverage provided under excess of loss reinsurance contracts may be on a worldwide basis or limited in scope to specific regions or geographical areas. Coverage can also vary from "all property" perils, which is the most expansive form of coverage, to more limited coverage of specified perils such as windstorm-only coverage. Property catastrophe reinsurance contracts are typically "all risk" in nature, providing protection against losses from earthquakes and hurricanes, as well as other natural and man-made catastrophes such as floods, tornadoes, fires and storms. The predominant exposures covered are losses stemming from property damage and business interruption coverage resulting from a covered peril. Certain risks, such as war or nuclear contamination may be excluded, partially or wholly, from certain contracts. Gross premiums written on property catastrophe business during the year ended December 31, 2012 were \$598.0 million.

Property per risk: Property per risk reinsurance provides reinsurance for insurance companies' excess retention on individual property and related risks, such as highly-valued buildings. Per risk excess of loss reinsurance protects insurance companies on their primary insurance risks on a "single risk" basis. A "risk" in this context might mean the insurance coverage on one building or a group of buildings or the insurance coverage under a single policy which the reinsured treats as a single risk. Coverage is usually triggered by a large loss sustained by an individual risk rather than by smaller losses which fall below the specified retention of the reinsurance contract. Such property per risk coverages are generally written on an excess of loss basis, which provides the reinsured protection beyond a specified amount up to the limit set within the reinsurance contract. Gross premiums written on property per risk business during the year ended December 31, 2012 were \$59.3 million.

Property pro rata: Property pro rata contracts require that the reinsurer share the premiums as well as the losses and loss expenses in an agreed proportion with the cedant. Gross premiums written on property pro rata business during

the year ended December 31, 2012 were \$114.2 million.

Marine: Validus Re underwrites reinsurance on marine risks covering damage to or losses of marine vessels and cargo, third-party liability for marine accidents and physical loss and liability from principally offshore energy properties. Validus Re underwrites marine on an excess of loss basis and on a pro rata basis. Gross premiums written on marine business during the year ended December 31, 2012 were \$257.5 million.

Specialty: Validus Re underwrites other lines of business depending on an evaluation of pricing and market conditions, which include aerospace and aviation, agriculture, financial lines of business, terrorism, life, accident & health, nuclear, workers'

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compensation, crisis management, contingency, motor and technical lines. The Company seeks to underwrite other specialty lines with very limited exposure correlation with its property, marine and energy portfolios. With the exception of the aerospace line of business, which has a meaningful portion of its gross premiums written volume on a proportional basis, the Company's other specialty lines are written on an excess of loss basis. Gross premiums written on specialty business during the year ended December 31, 2012 were \$102.9 million.

AlphaCat: The AlphaCat segment manages strategic relationships that leverage the Company's underwriting and investment expertise and earns management, performance and underwriting fees. AlphaCat Managers, Ltd. ("AlphaCat Managers"), formed in 2008, is a core element within the Validus Group strategic initiative to expand into capital market activities by participating in the market for Insurance Linked Securities ("ILS"). ILS are financial instruments whose fundamental value is determined by insurance losses caused by natural catastrophes such as major earthquakes and hurricanes. As the returns of ILS are primarily driven by natural catastrophes, when carefully structured, they are generally uncorrelated with the overall financial market, making ILS an attractive asset class for capital market investors.

AlphaCat helps investors take full advantage of this uncorrelated asset class through various funds and sidecars, accessing the market via AlphaCat Reinsurance Ltd., a Bermuda provider of fully collateralized property catastrophe reinsurance and retrocession capacity. AlphaCat invests in private reinsurance transactions, as well as catastrophe bonds, a common type of ILS issued by insurance and reinsurance companies. AlphaCat leverages the Validus Group's extensive business sourcing, underwriting, research and analytic capabilities to construct ILS portfolios subject to prudent risk constraints.

During the first quarter of 2012, to better align the Company's operating and reporting structure with its current strategy, there was a change in the Company's segment structure. This change included the AlphaCat group of companies as a separate operating segment. The AlphaCat segment was included as an additional segment and includes AlphaCat Re 2011, AlphaCat Re 2012, AlphaCat 2013, PaCRE and other affiliated investment funds. Prior period comparatives have been restated to reflect the change in segmentation.

Talbot: On July 2, 2007, the Company acquired all of the outstanding shares of Talbot. Talbot is the Bermuda parent of a specialty insurance group primarily operating within the Lloyd's insurance market through Syndicate 1183. The acquisition of Talbot provided the Company with significant benefits in terms of product line and geographic diversification as well as offering the Company broader access to underwriting expertise. Similar to Validus Re, Talbot writes primarily short-tail lines of business but, as a complement to Validus Re, focuses mostly on insurance, as opposed to reinsurance risks, and on specialty lines where Validus Re currently has limited or no presence (e.g., war, financial institutions, contingency, accident and health). In addition, Talbot provides the Company with access to the Lloyd's marketplace where Validus Re does not operate. As a London-based insurer, Talbot also writes the majority of its premiums on risks outside the United States. Talbot's team of underwriters have, in many cases, spent most of their careers writing niche, short-tail business and bring their expertise to bear on expanding the Company's short-tail insurance franchise.

The Company has expanded and diversified its business through Syndicate 1183's access to Lloyd's license agreements with regulators around the world. Talbot Underwriting Risk Services Ltd., Talbot Underwriting Services, (U.S.) Ltd., Talbot Underwriting (MENA) Ltd., Validus Reasegueros, Inc., Validus Re Chile S.A. and Talbot Risk Services Pte, Ltd., act as approved Lloyd's coverholders for Syndicate 1183.

The following are the primary lines in which Talbot conducts its business. Details of gross premiums written by line of business are provided below:

	Year Ended December 31, 2012		Year Ended December 31, 2011		Year Ended December 31, 2010			
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)		
Property	\$324,910	30.2	% \$306,317	30.2	% \$314,769	32.1	%	
Marine	396,207	36.7	% 341,821	33.7	% 315,102	32.1	%	
Specialty	357,519	33.1	% 365,984	36.1	% 351,202	35.8	%	

