

VALIDUS HOLDINGS LTD
Form 10-Q
May 06, 2013

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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, 2013

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)

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 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 <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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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 May 1, 2013 there were 104,353,625 outstanding Common Shares, \$0.175 par value per share, of the registrant.

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ITEM 1. FINANCIAL STATEMENTS

Validus Holdings, Ltd.

Consolidated Balance Sheets

As at March 31, 2013 (unaudited) and December 31, 2012

(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2013 (unaudited)	December 31, 2012
Assets		
Fixed maturities, at fair value (amortized cost: 2013—\$5,616,693; 2012—\$5,008,514)	\$5,676,552	\$5,085,334
Short-term investments, at fair value (amortized cost: 2013—\$368,404; 2012—\$1,112,929)	367,619	1,114,250
Other investments, at fair value (amortized cost: 2013—\$552,233; 2012—\$583,068)	532,786	564,448
Cash and cash equivalents	1,369,224	1,219,379
Total investments and cash	7,946,181	7,983,411
Investments in affiliates	128,448	172,329
Premiums receivable	1,195,430	802,159
Deferred acquisition costs	219,504	146,588
Prepaid reinsurance premiums	200,577	99,593
Securities lending collateral	1,914	225
Loss reserves recoverable	429,252	439,967
Paid losses recoverable	15,831	46,435
Income taxes recoverable	2,203	—
Intangible assets	109,529	110,569
Goodwill	20,393	20,393
Accrued investment income	19,708	21,321
Other assets	275,430	177,274
Total assets	\$10,564,400	\$10,020,264
Liabilities		
Reserve for losses and loss expenses	\$3,357,691	\$3,517,573
Unearned premiums	1,381,829	894,362
Reinsurance balances payable	187,048	138,550
Securities lending payable	2,380	691
Deferred income taxes	21,800	20,259
Net payable for investments purchased	33,101	38,346
Accounts payable and accrued expenses	111,323	167,577
AlphaCat variable funding notes	290,588	—
Senior notes payable	247,117	247,090
Debentures payable	540,212	540,709
Total liabilities	\$6,173,089	\$5,565,157
Commitments and contingent liabilities		
Shareholders' equity		
	\$26,769	\$26,722

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Common shares, 571,428,571 authorized, par value \$0.175 (Issued:
2013—152,963,762; 2012—152,698,191; Outstanding: 2013—106,282,441;
2012—107,921,259)

Treasury shares (2013—46,681,321; 2012—44,776,932)	(8,169	) (7,836)
Additional paid-in-capital	2,096,512	2,160,478	
Accumulated other comprehensive (loss)	(12,738	) (2,953)
Retained earnings	1,801,516	1,844,416	
Total shareholders' equity available to Validus	3,903,890	4,020,827	
Noncontrolling interest	487,421	434,280	
Total shareholders' equity	\$4,391,311	\$4,455,107	
Total liabilities and shareholders' equity	\$10,564,400	\$10,020,264	

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

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Validus Holdings, Ltd.

Consolidated Statements of Comprehensive Income

For the Three Months Ended March 31, 2013 and 2012 (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

	Three Months Ended	
	March 31, 2013 (unaudited)	March 31, 2012 (unaudited)
Revenues		
Gross premiums written	\$1,104,760	\$837,289
Reinsurance premiums ceded	(187,216)	(107,052)
Net premiums written	917,544	730,237
Change in unearned premiums	(386,483)	(279,038)
Net premiums earned	531,061	451,199
Net investment income	25,649	27,760
Net realized gains on investments	1,721	7,532
Net unrealized (losses) gains on investments	(7,237)	20,671
Income from investment affiliate	1,477	—
Other income	2,685	8,891
Foreign exchange gains	6,922	3,166
Total revenues	562,278	519,219
Expenses		
Losses and loss expenses	144,771	231,989
Policy acquisition costs	93,611	78,132
General and administrative expenses	80,279	66,375
Share compensation expenses	2,318	5,438
Finance expenses	24,446	16,279
Total expenses	345,425	398,213
Net income before taxes and income from operating affiliates	216,853	121,006
Tax benefit (expense)	318	(139)
Income from operating affiliates	3,523	3,367
Net income	\$220,694	\$124,234
Net loss attributable to noncontrolling interest	2,549	—
Net income available to Validus	\$223,243	\$124,234
Other comprehensive (loss) income		
Foreign currency translation adjustments	(9,785)	1,393
Other comprehensive (loss) income	\$(9,785)	\$1,393
Comprehensive income available to Validus	\$213,458	\$125,627
Earnings per share		
Weighted average number of common shares and common share equivalents outstanding		
Basic	107,386,438	99,425,140

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Diluted	110,052,999	105,096,090
Basic earnings per share available to common shareholders	\$1.94	\$1.23
Diluted earnings per share available to common shareholders	\$1.90	\$1.18
Cash dividends declared per share	\$2.30	\$0.25

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

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Validus Holdings, Ltd.

Consolidated Statements of Shareholders' Equity

For the Three Months Ended March 31, 2013 and 2012 (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2013 (unaudited)	March 31, 2012 (unaudited)
Common shares		
Balance - Beginning of period	\$26,722	\$23,538
Common shares issued, net	47	42
Balance - End of period	\$26,769	\$23,580
Treasury shares		
Balance - Beginning of period	\$(7,836)	\$(6,131)
Repurchase of common shares	(333)	(65)
Balance - End of period	\$(8,169)	\$(6,196)
Additional paid-in capital		
Balance - Beginning of period	\$2,160,478	\$1,893,890
Common shares issued (redeemed), net	3,074	(1,309)
Repurchase of common shares	(69,358)	(11,243)
Share compensation expenses	2,318	5,438
Balance - End of period	\$2,096,512	\$1,886,776
Accumulated other comprehensive (loss)		
Balance - Beginning of period	\$(2,953)	\$(6,601)
Other comprehensive (loss) income	(9,785)	1,393
Balance - End of period	\$(12,738)	\$(5,208)
Retained earnings		
Balance - Beginning of period	\$1,844,416	\$1,543,729
Dividends	(266,143)	(27,404)
Net income	220,694	124,234
Net loss attributable to noncontrolling interest	2,549	—
Balance - End of period	\$1,801,516	\$1,640,559
Total shareholders' equity available to Validus	\$3,903,890	\$3,539,511
Noncontrolling interest	\$487,421	\$—
Total shareholders' equity	\$4,391,311	\$3,539,511

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

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Validus Holdings, Ltd.

Consolidated Statements of Cash Flows

For the Three Months Ended March 31, 2013 and 2012 (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2013 (unaudited)	March 31, 2012 (unaudited)	
Cash flows provided by (used in) operating activities			
Net income	\$220,694	\$124,234	
Adjustments to reconcile net income to cash provided by (used in) operating activities:			
Share compensation expenses	2,318	5,438	
Amortization of discount on senior notes	27	27	
(Income) from investment affiliate	(1,477) —	
Net realized (gains) on investments	(1,721	) (7,532)
Net unrealized losses (gains) on investments	7,237	(20,671)
Amortization of intangible assets	1,040	1,040	
(Income) from operating affiliates	(3,523	) (3,367)
Foreign exchange losses (gains) included in net income	18,906	(13,070)
Amortization of premium on fixed maturities	5,059	7,517	
Change in:			
Premiums receivable	(400,153	) (246,039)
Deferred acquisition costs	(72,916	) (49,217)
Prepaid reinsurance premiums	(100,984	) (34,026)
Loss reserves recoverable	6,447	22,916	
Paid losses recoverable	30,438	42,903	
Income taxes recoverable	(2,132	) (1,004)
Accrued investment income	1,532	1,565	
Other assets	8,020	(10,880)
Reserve for losses and loss expenses	(138,633	) 8,702	
Unearned premiums	487,467	313,064	
Reinsurance balances payable	51,300	31,701	
Deferred income taxes	1,250	1,029	
Accounts payable and accrued expenses	(59,513	) (9,425)
Net cash provided by operating activities	60,683	164,905	
Cash flows provided by (used in) investing activities			
Proceeds on sales of investments	1,410,509	939,646	
Proceeds on maturities of investments	125,841	108,360	
Purchases of fixed maturities	(2,140,447	) (1,080,442)
Sales (purchases) of short-term investments, net	744,518	(23,943)
Sales (purchases) of other investments	31,121	(947)
(Increase) decrease in securities lending collateral	(1,689	) 7,354	
Redemption from investment in operating affiliates	50,222	—	
Purchase of investment in investment affiliate	(1,341) —	
Net cash provided by (used in) investing activities	218,734	(49,972)
Cash flows provided by (used in) financing activities			

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Net proceeds on issuance of AlphaCat variable funding notes	175,637	—	
Issuance (redemption) of common shares, net	3,121	(1,267)
Purchases of common shares under share repurchase program	(69,691	) (11,308)
Dividends paid	(262,232	) (26,997)
Increase (decrease) in securities lending payable	1,689	(7,354)
Third party investment in noncontrolling interest	55,690	—	
Net cash (used in) financing activities	(95,786	) (46,926)
Effect of foreign currency rate changes on cash and cash equivalents	(33,786	) 16,545	
Net increase in cash	149,845	84,552	
Cash and cash equivalents - beginning of period	\$1,219,379	\$832,844	
Cash and cash equivalents - end of period	\$1,369,224	\$917,396	
Taxes paid during the period	\$693	\$3,194	
Interest paid during the period	\$17,819	\$15,611	

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

1. Basis of preparation and consolidation

These unaudited consolidated financial statements include Validus Holdings, Ltd. and its subsidiaries (together, the "Company") and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 in Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. This Quarterly Report should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2012, as filed with the U.S. Securities and Exchange Commission (the "SEC").

In the opinion of management, these unaudited consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position and results of operations as at the end of and for the periods presented. Certain amounts in prior periods have been reclassified to conform to current period presentation. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The significant estimates reflected in the Company's consolidated financial statements include the reserve for losses and loss expenses, premium estimates for business written on a line slip or proportional basis, the valuation of goodwill and intangible assets, reinsurance premiums ceded and reinsurance recoverable balances including the provision for unrecoverable reinsurance recoverable balances and investment valuation. Actual results could differ from those estimates. The results of operations for any interim period are not necessarily indicative of the results for a full year. The term "ASC" used in these notes refers to Accounting Standard Codifications issued by the United States Financial Accounting Standards Board ("FASB").

On November 30, 2012, the Company acquired all of the outstanding common shares of Flagstone Reinsurance Holdings, S.A. ("Flagstone") in exchange for 0.1935 Company common shares and \$2.00 cash per Flagstone common share (the "Flagstone Acquisition"). 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.

2. Recent accounting pronouncements

(a) Adoption of new accounting standards

Disclosures about Offsetting Assets and Liabilities

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, "Disclosures about Offsetting Assets and Liabilities" ("ASU 2011-11"). The objective of ASU 2011-11 is to enhance disclosures by requiring improved information about financial instruments and derivative instruments in relation to netting arrangements.

In January 2013, the FASB issued Accounting Standards Update No. 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities" ("ASU 2013-01"). The objective of ASU 2013-01 is to address implementation issues about the scope of ASU 2011-11, Disclosures about Offsetting Assets and Liabilities. The amendments clarify that the scope of ASU 2011-11 applies to derivatives, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are

either or subject to an enforceable master netting arrangement or similar agreement. Entities with other types of financial assets and financial liabilities subject to a master netting arrangement or similar agreement also are affected because these amendments make them no longer subject to the disclosure requirements in ASU 2011-11. ASU 2011-11 and 2013-01 became effective for fiscal periods beginning on or after January 1, 2013, and as a result, the Company adopted ASU 2011-11 and 2013-01 effective January 1, 2013. The adoption of these new accounting standards impacts disclosures only; therefore they did not have an impact on the Company's consolidated financial statements. Please refer to Note 7: "Derivative instruments used in hedging activities."

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued Accounting Standard Update No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" ("ASU 2013-02"). The objective of this update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. The amendments became effective for reporting periods beginning after December 15, 2012, and as a result, the Company adopted ASU 2013-02 effective January 1, 2013. The adoption of this new accounting standard did not have an impact on the Company's consolidated financial statements.

(b) Recently issued accounting standards not yet adopted

In March 2013, the FASB issued Accounting Standard Update No. 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity" ("ASU 2013-05"). The objective of this update is to resolve the diversity in practice about whether Subtopic 810-10, Consolidation-Overall, or Subtopic 830-30, Foreign Currency Matters-Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary within a foreign entity. The amendments in this Update are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. Early adoption is permitted. The Company is currently evaluating the impact of this guidance; however it is not expected to have a material impact on the Company's consolidated financial statements.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

3. Investments

(a) Trading Securities

The Company's investments in fixed maturities, short-term investments and other investments are classified as trading and carried at fair value, with related net unrealized gains or losses included in earnings.

The amortized cost, gross unrealized gains and (losses) and estimated fair value of investments at March 31, 2013 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	\$ 1,417,884	\$ 7,150	\$(65	) \$ 1,424,969
Non-U.S. government and government agency States, municipalities, political subdivision	396,948	4,314	(5,061	) 396,201
Agency residential mortgage-backed securities	36,933	816	(18	) 37,731
Non-agency residential mortgage-backed securities	372,469	12,311	(284	) 384,496
U.S. corporate	27,010	177	(903	) 26,284
Non-U.S. corporate	1,466,941	17,990	(753	) 1,484,178
Bank loans	632,880	9,027	(915	) 640,992
Catastrophe bonds	718,427	13,617	(233	) 731,811
Asset-backed securities	47,006	748	(182	) 47,572
Total fixed maturities	500,195	2,750	(627	) 502,318
Total short-term investments	5,616,693	68,900	(9,041	) 5,676,552
Other investments	368,404	60	(845	) 367,619
Fund of hedge funds	4,192	273	(465	) 4,000
Private equity investments	12,968	258	(301	) 12,925
Hedge funds (a)	528,874	45,037	(67,143	) 506,768
Mutual funds	6,199	2,894	—	9,093
Total other investments	552,233	48,462	(67,909	) 532,786
Total	\$ 6,537,330	\$ 117,422	\$(77,795	) \$ 6,576,957
Noncontrolling interest (a)	\$(450,000	) \$(38,441	) \$60,354	\$(428,087
Total investments excluding noncontrolling interest	\$ 6,087,330	\$ 78,981	\$(17,441	) \$ 6,148,870

(a) Included in the Hedge funds balance are investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

The amortized cost, gross unrealized gains and (losses) and estimated fair value of investments at December 31, 2012 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	
U.S. government and government agency	\$ 1,091,357	\$ 7,957	\$(84	) \$ 1,099,230
Non-U.S. government and government agency States, municipalities, political subdivision	295,602	6,904	(227	) 302,279
Agency residential mortgage-backed securities	41,286	800	(23	) 42,063
Non-agency residential mortgage-backed securities	375,368	13,708	(202	) 388,874
U.S. corporate	106,536	1,266	(1,346	) 106,456
Non-U.S. corporate	1,189,173	21,681	(681	) 1,210,173
Bank loans	582,115	11,373	(223	) 593,265
Catastrophe bonds	663,217	10,593	(427	) 673,383
Asset-backed securities	56,757	481	(291	) 56,947
Total fixed maturities	607,103	5,767	(206	) 612,664
Total short-term investments	5,008,514	80,530	(3,710	) 5,085,334
Other investments	1,112,929	1,349	(28	) 1,114,250
Fund of hedge funds	4,677	299	(219	) 4,757
Private equity investments	12,857	94	—	12,951	
Hedge funds (a)	559,335	21,814	(42,623	) 538,526
Mutual funds	6,199	2,015	—	8,214	
Total other investments	583,068	24,222	(42,842	) 564,448
Total	\$ 6,704,511	\$ 106,101	\$(46,580	) \$ 6,764,032
Noncontrolling interest (a)	(450,000) (19,427) 36,690	(432,737)
Total investments excluding noncontrolling interest	\$ 6,254,511	\$ 86,674	\$(9,890	) \$ 6,331,295

(a) Included in the Hedge funds balance are investments held by PaCRE in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

The following table sets forth certain information regarding the investment ratings of the Company's fixed maturities portfolio as at March 31, 2013 and December 31, 2012. Investment ratings are the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. For investments where Moody's and Standard & Poor's ratings are not available, Fitch ratings are used and presented in Standard & Poor's equivalent rating.

	March 31, 2013		December 31, 2012		
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total	
AAA	\$820,687	14.5	% \$1,062,794	20.9	%
AA	2,338,976	41.2	% 1,862,322	36.6	%
A	1,285,519	22.6	% 1,049,969	20.6	%
BBB	447,761	7.9	% 374,447	7.4	%
Investment grade	4,892,943	86.2	% 4,349,532	85.5	%
BB	355,124	6.3	% 373,907	7.4	%
B	397,877	7.0	% 330,416	6.5	%
CCC	4,374	0.1	% 4,483	0.1	%
CC	3,261	—	% 3,259	0.1	%
D/NR	22,973	0.4	% 23,737	0.4	%
Non-Investment grade	783,609	13.8	% 735,802	14.5	%
Total Fixed Maturities	\$5,676,552	100.0	% \$5,085,334	100.0	%

The amortized cost and estimated fair value amounts for fixed maturity securities held at March 31, 2013 and December 31, 2012 are shown below by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

	March 31, 2013		December 31, 2012	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$719,492	\$725,393	\$526,529	\$530,499
Due after one year through five years	3,626,561	3,661,494	2,971,118	3,018,544
Due after five years through ten years	367,885	373,504	418,377	424,304
Due after ten years	3,081	3,063	3,483	3,993
	4,717,019	4,763,454	3,919,507	3,977,340
Asset-backed and mortgage-backed securities	899,674	913,098	1,089,007	1,107,994
Total	\$5,616,693	\$5,676,552	\$5,008,514	\$5,085,334

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended	
	March 31, 2013	March 31, 2012
Fixed maturities and short-term investments	\$27,531	\$27,276
Cash and cash equivalents	533	2,317
Securities lending income	—	5
Total gross investment income	28,064	29,598
Investment expenses	(2,415	) (1,838
Net investment income	\$25,649	\$27,760

(c) Net realized gains (losses) and change in net unrealized gains (losses)

The following represents an analysis of net realized gains and the change in net unrealized (losses) gains on investments:

	Three Months Ended	
	March 31, 2013	March 31, 2012
Fixed maturities, short-term and other investments and cash equivalents		
Gross realized gains	\$10,720	\$10,008
Gross realized (losses)	(8,999	) (2,476
Net realized gains on investments	1,721	7,532
Net unrealized gains on securities lending	—	37
Change in net unrealized (losses) gains on investments	(7,237	) 20,634
Net change in unrealized (losses) gains on investments	\$(7,237	) \$20,671
Total net realized gains and change in net unrealized (losses) gains on investments	\$(5,516	) \$28,203
Noncontrolling interest (a)	4,651	—
Total net realized gains and change in net unrealized (losses) gains on investments excluding noncontrolling interest	\$(865	) \$28,203

(a) Includes change in net unrealized (losses) on investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

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(d) Pledged investments

The following tables outline investments pledged as collateral under the Company's credit facilities. For further details of the credit facilities, please refer to Note 12: "Debt and financing arrangements."

Description	March 31, 2013		
	Commitment	Issued and Outstanding	Investments pledged as collateral
\$400,000 syndicated unsecured letter of credit facility	\$400,000	\$—	\$—
\$525,000 syndicated secured letter of credit facility	525,000	380,087	524,195
\$500,000 secured bi-lateral letter of credit facility	500,000	89,511	126,146
Talbot FAL Facility	25,000	25,000	36,830
PaCRe senior secured letter of credit facility	10,000	258	—
IPC Bi-lateral facility	80,000	25,882	98,771
\$550,000 Flagstone Bi-lateral facility	550,000	296,979	487,127
	\$2,090,000	\$817,717	\$1,273,069
Description	December 31, 2012		
	Commitment	Issued and Outstanding	Investments pledged as collateral
\$400,000 syndicated unsecured letter of credit facility	\$400,000	\$—	\$—
\$525,000 syndicated secured letter of credit facility	525,000	376,570	517,210
\$500,000 secured bi-lateral letter of credit facility	500,000	92,402	125,991
Talbot FAL Facility	25,000	25,000	41,372
PaCRe senior secured letter of credit facility	10,000	219	—
IPC Bi-lateral facility	80,000	40,613	98,593
\$550,000 Flagstone Bi-lateral facility	550,000	381,019	416,414
	\$2,090,000	\$915,823	\$1,199,580

4. Fair Value Measurements

The Company has adopted all authoritative guidance in effect as of the balance sheet date regarding certain market conditions that allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable.

(a) Classification within the fair value hierarchy

Under U.S. GAAP, a company must determine the appropriate level in the fair value hierarchy for each fair value measurement. The fair value hierarchy prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels. It gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

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The three levels of the fair value hierarchy are described below:

Level 1 - Fair values are measured based on unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access.

Level 2 - Fair values are measured 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 - Fair values are measured based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect our own judgments about assumptions where there is little, if any, market activity for that asset or liability 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 within the fair value hierarchy.

There have been no material changes in the Company's valuation techniques during the period represented by these consolidated financial statements. The following methods and assumptions were used in estimating the fair value of each class of financial instrument recorded in the Consolidated Balance Sheets.

(b) Level 1 and Level 2 assets measured at fair value

Fixed maturity investments

Fixed maturity investments included in Level 2 are U.S. government and government agency, non-U.S. government and government agency, states, municipalities, political subdivision, agency residential mortgage-backed, non-agency residential mortgage-backed, U.S. corporate, non-U.S. corporate, bank loans, catastrophe bonds and asset backed securities.

In general, the Company's fixed maturity investment portfolios are priced using pricing services, such as index providers and pricing vendors, as well as broker quotations. The pricing vendors provide pricing for a high volume of liquid securities that are actively traded. For securities that do not trade on an exchange, the pricing services generally utilize market data and other observable inputs in matrix pricing models to determine month end prices. Prices are generally verified using third party data. Securities which are priced by an index provider are generally included in the

index.

In general, broker-dealers value securities through their trading desks based on observable inputs. The methodologies include mapping securities based on trade data, bids or offers, observed spreads, and performance on newly issued securities. Broker-dealers also determine valuations by observing secondary trading of similar securities. Prices obtained from broker quotations are considered non-binding, however they are based on observable inputs and by observing secondary trading of similar securities obtained from active, non-distressed markets.

The Company considers these Level 2 inputs as they are corroborated with other market observable inputs. The techniques generally used to determine the fair value of the Company's fixed maturity investments are detailed below by asset class.

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U.S. government and government agency

Level 2 - U.S. government and agency securities consist primarily of debt securities 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. Fixed maturity investments included in U.S. government and government agency securities are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources and integrate other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The fair value of each security is individually computed using analytical models which incorporate option adjusted spreads and other daily interest rate data.

Non-U.S. government and government agency

Level 2 - Non-U.S. government and government agency securities consist of debt securities issued by non-U.S. governments and their agencies along with supranational organizations (also known as sovereign debt securities). Securities held in these sectors are primarily priced by pricing services who employ proprietary discounted cash flow models to value the securities. Key quantitative inputs for these models are daily observed benchmark curves for treasury, swap and high issuance credits. The pricing services then apply a credit spread for each security which is developed by in-depth and real time market analysis. For securities in which trade volume is low, the pricing services utilize data from more frequently traded securities with similar attributes. These models may also be supplemented by daily market and credit research for international markets.

States, municipalities, political subdivision

Level 2 - The Company's states, municipal and political subdivision portfolio contains debt securities issued by U.S. domiciled state and municipal entities. These securities are generally priced by independent pricing services using the techniques described for U.S. government and government agency securities described above.

Agency residential mortgage-backed securities

Level 2 - The Company's agency residential mortgage-backed investments are primarily priced by pricing services using a mortgage pool specific model which utilizes daily inputs from the active to be announced ("TBA") market which is very liquid, as well as the U.S. treasury market. The model also utilizes additional information, such as the weighted average maturity, weighted average coupon and other available pool level data which is provided by the sponsoring agency. Valuations are also corroborated with daily active market quotes.

Non-agency residential mortgage-backed securities

Level 2 - The Company's non-agency mortgage-backed investments include non-agency prime residential mortgage-backed fixed maturity investments. The Company has no fixed maturity investments classified as sub-prime held in its fixed maturity investments portfolio. Securities held in these sectors are primarily priced by pricing services using an option adjusted spread ("OAS") model or other relevant models, which principally utilize inputs including benchmark yields, available trade information or broker quotes, and issuer spreads. The pricing services also review collateral prepayment speeds, loss severity and delinquencies among other collateral performance indicators for the

securities valuation, when applicable.

U.S. corporate

Level 2 - Corporate debt securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The Company's corporate fixed maturity investments are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources regarding the issuer of the security and obtain credit data, as well as other observations, from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing services also consider the specific terms and conditions of the securities, including any specific features which may influence risk. In certain instances, securities are individually evaluated using a spread which is added to the U.S. treasury curve or a security specific swap curve as appropriate.

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Non - U.S. corporate

Level 2 - Non - U.S. corporate debt securities consist primarily of investment-grade debt of a wide variety of non-U.S. corporate issuers and industries. The Company's non - U.S. corporate fixed maturity investments are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources regarding the issuer of the security and obtain credit data, as well as other observations, from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing services also consider the specific terms and conditions of the securities, including any specific features which may influence risk.

Bank loans

Level 2 - The Company's bank loan investments consist primarily of below-investment-grade debt of a wide variety of corporate issuers and industries. The Company's bank loans are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources regarding the issuer of the security and obtain credit data, as well as other observations, from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing services also consider the specific terms and conditions of the securities, including any specific features which may influence risk.

Catastrophe bonds

Level 2 - Catastrophe bonds are recorded at fair value and are based on broker or underwriter bid indications.

Asset-backed securities

Level 2 - Asset backed securities include mostly investment-grade debt securities backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, student loans, credit card receivables, and CLO debt originated by a variety of financial institutions. Securities held in these sectors are primarily priced by pricing services. The pricing services apply dealer quotes and other available trade information such as bids and offers, prepayment speeds which may be adjusted for the underlying collateral or current price data, the U.S. treasury curve and swap curve as well as cash settlement. The pricing services determine the expected cash flows for each security held in this sector using historical prepayment and default projections for the underlying collateral and current market data. In addition, a spread is applied to the relevant benchmark and used to discount the cash flows noted above to determine the fair value of the securities held in this sector.

Short term investments

Level 1 & Level 2 - Short term investments consist primarily of highly liquid securities with maturities less than one year from the date of purchase. The fair value of the Company's portfolio of short term investments are generally determined using amortized cost which approximates fair value. These securities are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their amortized cost approximates fair value. The Company determined that certain of its short-term investments held in highly liquid money market-type funds would be included in Level 1 as their fair values are based on quoted market prices in active

markets.

Mutual funds

Level 2 -Mutual funds consist of two investment funds which are invested in various quoted investments. The fair value of units in the mutual funds is based on the net asset value of the fund as reported by the fund manager.

(c) Level 3 assets measured at fair value

Other investments

Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. The Company's hedge funds, a fund of hedge funds and private equity investments are the only financial instruments in this category as at March 31, 2013. For each respective hedge fund investment, the Company obtains and reviews the valuation methodology used by the fund administrators and investment managers

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to ensure that the hedge fund investments are following fair value principles consistent with U.S. GAAP in determining the net asset value ("NAV").

Other investments in Level 3 consist of hedge funds, a fund of hedge funds and private equity investments. Within the hedge fund industry, there is a general lack of transparency necessary to facilitate a detailed independent assessment of the values placed on the securities underlying the NAV provided by the fund manager or fund administrator. To address this, on a quarterly basis, we perform a number of monitoring procedures designed to assist us in the assessment of the quality of the information provided by managers and administrators. These procedures include, but are not limited to, regular review and discussion of each fund's performance with its manager and regular evaluation of fund performance against applicable benchmarks.

Hedge funds

The hedge funds were valued at \$506,768 at March 31, 2013. The hedge funds consist of an investment in four Paulson & Co. managed funds (the "Paulson hedge funds") and three investment funds assumed from the Flagstone Acquisition (the "Flagstone investment funds"). The Paulson hedge funds' administrator provides monthly reported NAVs with a one-month delay in its valuation. As a result, the funds' administrator's February 28, 2013 NAV was used as a partial basis for fair value measurement in the Company's March 31, 2013 balance sheet. The fund manager provides an estimate of the NAV at March 31, 2013 based on estimated performance. The Company adjusts fair value to the fund manager's estimated NAV that incorporates relevant valuation sources on a timely basis. To determine the reasonableness of the estimated NAV, the Company assesses the variance between the fund manager's estimated NAV and the fund administrator's NAV. Material variances are recorded in the current reporting period while immaterial variances are recorded in the following reporting period. Historically, our valuation estimates have not materially differed from the subsequent NAVs. The Flagstone investment fund administrators provide either monthly or quarterly reported NAVs with a one-month or one-quarter delay in its valuation, respectively. As a result, the February 28, 2013 NAV or the December 31, 2012 NAV was used as a basis for fair value measurement in the Company's March 31, 2013 balance sheet. As these valuation techniques incorporate both observable and significant unobservable inputs, both the Paulson hedge funds and the Flagstone investment funds are classified as Level 3 assets. The Paulson hedge funds noted above are subject to quarterly liquidity.

Private equity investments

Private equity investments consist of an investment in three private equity funds assumed from the Flagstone Acquisition. The private equity investments respective fund administrator provides either monthly or quarterly NAVs with a one-month or one-quarter delay in its valuation, respectively. As a result, the February 28, 2013 NAV or the December 31, 2012 NAV was used as a basis for fair value measurement in the Company's March 31, 2013 balance sheet. As this valuation technique incorporates both observable and significant unobservable inputs, the private equity investments are classified as Level 3 assets.

Fund of hedge funds

The fund of hedge funds includes a side pocket. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is unknown. The fund's administrator provides a monthly reported NAV with a one-month delay in its valuation. As a result, the fund administrator's February 28, 2013 NAV was used as a basis for

fair value measurement in the Company's March 31, 2013 balance sheet. The fund manager provides an estimate of the fund NAV at March 31, 2013 based on the estimated performance provided from the underlying third-party funds. To determine the reasonableness of the NAV, the Company compares the one-month delayed fund administrator's NAV to the fund manager's estimated NAV that incorporates relevant valuation sources on a timely basis. Material variances are recorded in the current reporting period while immaterial variances are recorded in the following reporting period. As this valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset.

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At March 31, 2013, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. government and government agency	\$—	\$1,424,969	\$—	\$1,424,969
Non-U.S. government and government agency	—	396,201	—	396,201
States, municipalities, political subdivision	—	37,731	—	37,731
Agency residential mortgage-backed securities	—	384,496	—	384,496
Non-agency residential mortgage-backed securities	—	26,284	—	26,284
U.S. corporate	—	1,484,178	—	1,484,178
Non-U.S. corporate	—	640,992	—	640,992
Bank loans	—	731,811	—	731,811
Catastrophe bonds	—	47,572	—	47,572
Asset-backed securities	—	502,318	—	502,318
Total fixed maturities	—	5,676,552	—	5,676,552
Short-term investments	332,663	34,956	—	367,619
Other investments				
Fund of hedge funds	—	—	4,000	4,000
Private equity investments	—	—	12,925	12,925
Hedge funds (a)	—	—	506,768	506,768
Mutual funds	—	9,093	—	9,093
Total other investments	—	9,093	523,693	532,786
Total	\$332,663	\$5,720,601	\$523,693	\$6,576,957
Noncontrolling interest (a)	—	—	(428,087	) (428,087
Total investments excluding noncontrolling interest	\$332,663	\$5,720,601	\$95,606	\$6,148,870

(a) Included in the Hedge funds balance are investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

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At December 31, 2012, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. government and government agency	\$—	\$1,099,230	\$—	\$1,099,230
Non-U.S. government and government agency	—	302,279	—	302,279
States, municipalities, political subdivision	—	42,063	—	42,063
Agency residential mortgage-backed securities	—	388,874	—	388,874
Non-agency residential mortgage-backed securities	—	106,456	—	106,456
U.S. corporate	—	1,210,173	—	1,210,173
Non-U.S. corporate	—	593,265	—	593,265
Bank loans	—	673,383	—	673,383
Catastrophe bonds	—	56,947	—	56,947
Asset-backed securities	—	612,664	—	612,664
Total fixed maturities	—	5,085,334	—	5,085,334
Short-term investments	1,063,175	51,075	—	1,114,250
Other investments				
Fund of hedge funds	—	—	4,757	4,757
Private equity investments	—	—	12,951	12,951
Hedge funds (a)				