VALIDUS HOLDINGS LTD
Form 10-Q
November 06, 2012

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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 September 30, 2012

Commission file number 001-33606

VALIDUS HOLDINGS, LTD.
(Exact name of registrant as specified in its charter)

BERMUDA	98-0501001
(State or other jurisdiction of incorporation or organization)	(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 x No o

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

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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of November 5, 2012 there were 93,506,829 outstanding Common Shares, $0.175 par value per share, of the registrant.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

Validus Holdings, Ltd.
Consolidated Balance Sheets
As at September 30, 2012 (unaudited) and December 31, 2011
(Expressed in thousands of U.S. dollars, except share and per share information)

	September 30, 2012 (unaudited)	December 31, 2011
Assets		
Fixed maturities, at fair value (amortized cost: 2012—$4,803,217; 2011—$4,859,705)	$4,887,622	$4,894,145
Short-term investments, at fair value (amortized cost: 2012—$275,099; 2011—$280,299)	275,324	280,191
Other investments, at fair value (amortized cost: 2012—$511,310; 2011—$15,002)	525,441	16,787
Cash and cash equivalents	1,005,829	832,844
Total investments and cash	6,694,216	6,023,967
Investments in affiliates	99,312	53,031
Premiums receivable	781,991	646,354
Deferred acquisition costs	155,456	121,505
Prepaid reinsurance premiums	144,788	91,381
Securities lending collateral	10,383	7,736
Loss reserves recoverable	317,252	372,485
Paid losses recoverable	36,209	90,495
Income taxes recoverable	5,019	—
Intangible assets	111,611	114,731
Goodwill	20,393	20,393
Accrued investment income	19,945	25,906
Other assets	67,245	50,487
Total assets	$8,463,820	$7,618,471
Liabilities		
Reserve for losses and loss expenses	$2,562,604	$2,631,143
Unearned premiums	1,034,605	772,382
Reinsurance balances payable	87,955	119,899
Securities lending payable	10,849	8,462
Deferred income taxes	22,848	16,720
Net payable for investments purchased	26,629	1,256
Accounts payable and accrued expenses	86,128	83,402
Senior notes payable	247,063	246,982
Debentures payable	289,800	289,800
Total liabilities	$4,368,481	$4,170,046
Commitments and contingent liabilities		
Shareholders’ equity		
Common shares, 571,428,571 authorized, par value $0.175 (Issued: 2012—136,632,448; 2011—134,503,065; Outstanding: 2012—93,494,391; 2011—99,471,080)	$23,911	$23,538
Treasury shares (2012—43,138,057; 2011—35,031,985)	(7,549)	(6,131)

Additional paid-in-capital	1,657,767	1,893,890
Accumulated other comprehensive (loss)	(4,565)	(6,601)
Retained earnings	1,964,289	1,543,729
Total shareholders’ equity available to Validus	3,633,853	3,448,425
Noncontrolling interest	461,486	—
Total shareholders’ equity	$4,095,339	$3,448,425
Total liabilities and shareholders’ equity	$8,463,820	$7,618,471

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 (Loss)
For the Three and Nine Months Ended September 30, 2012 and 2011 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Three Months Ended		Nine Months Ended	
	September 30, 2012 (unaudited)	September 30, 2011 (unaudited)	September 30, 2012 (unaudited)	September 30, 2011 (unaudited)
Revenues				
Gross premiums written	$390,215	$391,129	$1,854,593	$1,846,412
Reinsurance premiums ceded	(45,743)	(30,586)	(271,847)	(272,752)
Net premiums written	344,472	360,543	1,582,746	1,573,660
Change in unearned premiums	130,632	98,081	(208,816)	(259,863)
Net premiums earned	475,104	458,624	1,373,930	1,313,797
Net investment income	25,489	27,747	79,134	84,216
Net realized gains on investments	9,063	5,246	22,749	23,177
Net unrealized gains (losses) on investments	86,345	(27,848)	53,442	(22,150)
(Loss) from investment affiliate	(160)	—	(558)	—
Other income	7,324	—	22,209	2,201
Foreign exchange gains (losses)	1,103	(19,932)	3,617	(22,390)
Total revenues	604,268	443,837	1,554,523	1,378,851
Expenses				
Losses and loss expenses	155,455	226,067	541,136	909,572
Policy acquisition costs	98,623	77,405	252,884	232,931
General and administrative expenses	70,547	35,926	198,557	145,244
Share compensation expenses	7,345	7,382	19,583	27,059
Finance expenses	9,362	10,935	39,347	41,297
Transaction expenses	3,784	13,583	3,784	13,583
Total expenses	345,116	371,298	1,055,291	1,369,686
Net income before taxes and income from operating affiliates	259,152	72,539	499,232	9,165
Tax (expense)	(1,343)	(2,538)	(1,886)	(1,050)
Income from operating affiliates	6,235	—	13,194	—
Net income	$264,044	$70,001	$510,540	$8,115
Net (income) attributable to noncontrolling interest	(56,746)	(13,516)	(11,386)	(14,110)
Net income (loss) available (attributable) to Validus	$207,298	$56,485	$499,154	$(5,995)
Other comprehensive income (loss)				
Foreign currency translation adjustments	1,400	(413)	2,036	523
Other comprehensive income (loss)	$1,400	$(413)	$2,036	$523
Comprehensive income (loss) available (attributable) to Validus	$208,698	$56,072	$501,190	$(5,472)
Earnings per share				

Weighted average number of common shares and common share equivalents outstanding				
Basic	93,368,775	98,961,795	97,016,034	98,430,686
Diluted	98,236,490	100,823,335	102,333,515	98,430,686
Basic earnings (loss) per share available (attributable) to common shareholders	$2.20	$0.55	$5.09	$(0.12)
Diluted earnings (loss) per share available (attributable) to common shareholders	$2.11	$0.54	$4.88	$(0.12)
Cash dividends declared per share	$0.25	$0.25	$0.75	$0.75

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 Nine Months Ended September 30, 2012 and 2011 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	September 30, 2012 (unaudited)	September 30, 2011 (unaudited)
Common shares		
Balance - Beginning of period	$23,538	$23,247
Common shares issued, net	373	216
Balance - End of period	$23,911	$23,463
Treasury shares		
Balance - Beginning of period	$(6,131)	$(6,096)
Repurchase of common shares	(1,418)	(35)
Balance - End of period	$(7,549)	$(6,131)
Additional paid-in capital		
Balance - Beginning of period	$1,893,890	$1,860,960
Common shares issued, net	2,551	4,838
Repurchase of common shares	(258,257)	(5,960)
Share compensation expenses	19,583	27,059
Balance - End of period	$1,657,767	$1,886,897
Accumulated other comprehensive (loss)		
Balance - Beginning of period	$(6,601)	$(5,455)
Foreign currency translation adjustments	2,036	523
Balance - End of period	$(4,565)	$(4,932)
Retained earnings		
Balance - Beginning of period	$1,543,729	$1,632,175
Dividends	(78,594)	(81,608)
Net income	510,540	8,115
Net (income) attributable to noncontrolling interest	(11,386)	(14,110)
Balance - End of period	$1,964,289	$1,544,572
Total shareholders' equity available to Validus	$3,633,853	$3,443,869
Noncontrolling interest	$461,486	$146,223
Total shareholders' equity	$4,095,339	$3,590,092

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 Nine Months Ended September 30, 2012 and 2011 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	September 30, 2012 (unaudited)		September 30, 2011 (unaudited)	
Cash flows provided by (used in) operating activities				
Net income	$510,540		$8,115	
Adjustments to reconcile net income to cash provided by (used in) operating activities:				
Share compensation expenses	19,583		27,059	
Amortization of discount on senior notes	81		81	
Loss from investment affiliate	558		—	
Net realized (gains) on investments	(22,749	)	(23,177	)
Net unrealized (gains) losses on investments	(53,442	)	22,150	
Amortization of intangible assets	3,120		3,120	
Income from operating affiliates	(13,194	)	—	
Foreign exchange (gains) losses included in net income	(17,064	)	9,602	
Amortization of premium on fixed maturities	19,214		23,470	
Change in:				
Premiums receivable	(132,292	)	(239,934	)
Deferred acquisition costs	(33,951	)	(30,797	)
Prepaid reinsurance premiums	(53,407	)	(70,214	)
Loss reserves recoverable	57,574		(103,048	)
Paid losses recoverable	54,559		(52,853	)
Income taxes recoverable	(5,041	)	(2,164	)
Accrued investment income	6,015		6,620	
Other assets	(16,050	)	7,740	
Reserve for losses and loss expenses	(80,954	)	530,925	
Unearned premiums	262,223		330,077	
Reinsurance balances payable	(33,487	)	40,206	
Deferred income taxes	6,241		(518	)
Accounts payable and accrued expenses	4,948		(16,557	)
Net cash provided by operating activities	483,025		469,903	
Cash flows provided by (used in) investing activities				
Proceeds on sales of investments	2,528,442		3,424,462	
Proceeds on maturities of investments	385,642		266,594	
Purchases of fixed maturities	(2,832,179	)	(3,697,544	)
Sales (purchases) of short-term investments, net	5,123		(273,939	)
(Purchases) sales of other investments	(499,178	)	4,364	
(Increase) in securities lending collateral	(2,387	)	(1,907	)
Purchase of investment in operating affiliates	(26,500	)	—	
Purchase of investment in investment affiliate	(3,798	)	—	
Net cash (used in) investing activities	(444,835	)	(277,970	)
Cash flows provided by (used in) financing activities				

Issuance of common shares, net	2,924	5,054
Purchases of common shares under share repurchase program	(259,675)	(5,995)
Dividends paid	(81,391)	(81,108)
Increase in securities lending payable	2,387	1,907
Third party investment in noncontrolling interest	450,100	132,113
Net cash provided by financing activities	114,345	51,971
Effect of foreign currency rate changes on cash and cash equivalents	20,450	(8,662)
Net increase in cash	172,985	235,242
Cash and cash equivalents - beginning of period	$832,844	$620,740
Cash and cash equivalents - end of period	$1,005,829	$855,982
Taxes paid (recovered) during the period	$3,640	$(3,676)
Interest paid during the period	$37,122	$39,336

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

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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 for the year ended December 31, 2011, 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. Actual results could differ from these estimates. 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 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 April 2, 2012, the Company joined with other investors in capitalizing PaCRe, Ltd. (“PaCRe”) a new Class 4 Bermuda reinsurer formed for the purpose of writing high excess property catastrophe reinsurance. Validus Reinsurance, Ltd. (“Validus Re”) has an equity interest in PaCRe and as Validus Re holds a majority of PaCRe's outstanding voting rights, the financial statements of PaCRe are included in the consolidated financial statements of the Company. The portion of PaCRe's earnings attributable to third party investors for the three and nine months ended September 30, 2012 is recorded in the consolidated Statements of Comprehensive Income (loss) as net income attributable to noncontrolling interest. Refer to Note 5 "Noncontrolling interest" for further information.

On May 29, 2012, the Company joined with other investors in capitalizing AlphaCat Re 2012, Ltd. (“AlphaCat Re 2012”) a new special purpose reinsurer formed for the purpose of writing collateralized reinsurance with a particular focus on windstorm risks for Florida domiciled insurance companies. Validus Re has an equity interest and voting interest in AlphaCat Re 2012 which is below 50%, therefore the investment in AlphaCat Re 2012 is included as an equity method investment in the consolidated financial statements of the Company. Refer to Note 4 “Investments in affiliates” for further information.

2. Recent accounting pronouncements

(a) Adoption of New Accounting Standards

Fair Value Measurement and Disclosures

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, "Amendments to Achieve Common Fair Value
Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" ("ASU 2011-04"). The objective of ASU 2011-04 is to provide common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the amendments do not result in a change in the application of the requirements in ASC Topic 820 "Fair Value Measurements". ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. Effective January 1, 2012, the Company prospectively adopted this amended guidance. The adoption of this guidance did not impact our results of operations, financial condition or liquidity. The adoption of this guidance did not have a significant impact on the current disclosures included in Note 3 "Investments".

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Presentation of Comprehensive Income
In June 2011, the FASB issued Accounting Standards Update No. 2011-05, "Presentation of Comprehensive Income" ("ASU 2011-05"). The objective of ASU 2011-05 is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. ASU 2011-05 is effective for interim and annual periods beginning after December 15, 2011. In December 2011, the FASB issued Accounting Standards Update No. 2011-12, "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05". ASU 2011-12 indefinitely defers certain reclassification adjustment provisions of ASU 2011-05. ASU 2011-12 is also effective for interim and annual periods beginning after December 15, 2011. Effective January 1, 2012, the Company retrospectively adopted this guidance. The adoption of this guidance did not impact our results of operations, financial condition or liquidity.
Technical Amendments and Corrections to SEC Sections
In July 2012, the FASB issued Accounting Standards Update No. 2012-3, “Technical Amendments and Corrections to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 114, Technical Amendments Pursuant to SEC Release No. 33-9250, and Corrections Related to FASB Accounting Standards Update 2010-22 (SEC Update)” (“ASU 2012-3”). ASU 2012-3 is effective upon issuance. The adoption of this guidance did not impact our results of operations, financial condition or liquidity.

(b) Recently Issued Accounting Standards Not Yet Adopted

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. ASU 2011-11 is effective for interim and annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of this guidance; however, since this update affects disclosures only, it is not expected to have a material impact on the Company's consolidated financial statements.

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, "Testing Indefinite-Lived Intangible Assets for Impairment" ("ASU 2012-02"). The objective of ASU 2012-02 is to simplify how entities test intangibles for impairment. The amendments permit an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment described in ASC Topic 350 "Intangibles - Goodwill and Other - General Intangibles Other than Goodwill." The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued. The Company has evaluated the impact of this guidance and has concluded that it will not have a material impact on the Company's consolidated financial statements.

In October 2012, the FASB issued Accounting Standards Update No. 2012-04, “Technical Corrections and Improvements” (“ASU - 2012-04”). The objective of ASU 2012-04 is to clarify the Codification, correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Additionally, the amendments will make the Codification easier to understand and the fair value measurement guidance easier to apply by eliminating inconsistencies and providing needed clarifications. The amendments that will not have transition guidance will be effective upon issuance. For public entities, the amendments that are subject to the transition guidance will be effective for fiscal periods beginning after December 15, 2012. 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.

3. Investments

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 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.

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(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.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement. Level 3 inputs are unobservable inputs for the asset or liability.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices or alternative indices including overnight repos and commercial paper.

Level 2 includes financial instruments that are valued through independent external sources using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. The Company performs internal procedures on the valuations received from independent external sources. Investments in U.S. and Non-U.S. government/agency securities, corporate bonds, mortgage backed securities, bank loans, municipal bonds and asset-backed securities are classified as Level 2 in the fair value hierarchy. The fair value of these securities is derived from index providers, pricing vendors and broker quotations based on inputs that are observable for the asset such as reported trades, bids, offers, benchmark yields and broker-dealer quotes. Catastrophe bonds are classified as Level 2 in the fair value hierarchy as determined by reference to direct dealer quotations. Those indications are based on current market conditions, including liquidity and transactional history, recent issue price of similar catastrophe bonds and seasonality of the underlying risks.

Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. An investment in four Paulson & Co. Inc. managed hedge funds and an investment in a fund of hedge funds are the only financial instruments in this category as at September 30, 2012. For each respective hedge fund investment, the Company obtains and reviews the valuation methodology used by the fund administrators and investment managers 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 consist of an investment in four Paulson & Co. Inc. managed hedge funds (the "hedge funds"), a fund of hedge funds and a deferred compensation trust held in mutual funds. The hedge funds were valued at $512,138 at September 30, 2012. The funds' administrator provides monthly reported NAVs with a one-month delay in its valuation. As a result, the funds' administrator's August 31, 2012 NAV was used as a partial basis for fair value measurement in the Company's September 30, 2012 balance sheet. The fund manager provides an estimate of the NAV at September 30, 2012 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. As this valuation technique incorporates both observable and significant unobservable inputs, the fund is classified as a Level 3 asset. 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. Immaterial variances are recorded in the following reporting period. These managed hedge funds are subject to quarterly liquidity.

The fund of hedge funds includes a side pocket valued at $4,521 at September 30, 2012. 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 August 31, 2012 NAV was used as a basis for fair value measurement in the Company’s September 30, 2012 balance sheet. The fund manager provides an estimate of the fund NAV at September 30, 2012 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

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estimated NAV that incorporates relevant valuation sources on a timely basis. 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.

At September 30, 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	$—	$1,229,273	$—	$1,229,273
Non-U.S. Government and Government Agency	—	307,760	—	307,760
States, municipalities, political subdivision	—	42,538	—	42,538
Agency residential mortgage-backed securities	—	421,975	—	421,975
Non-Agency residential mortgage-backed securities	—	23,832	—	23,832
U.S. corporate	—	1,242,888	—	1,242,888
Non-U.S. corporate	—	598,253	—	598,253
Bank loans	—	602,856	—	602,856
Catastrophe bonds	—	38,466	—	38,466
Asset-backed securities	—	379,781	—	379,781
Commercial mortgage-backed securities	—	—	—	—
Total fixed maturities	—	4,887,622	—	4,887,622
Short-term investments	241,972	33,352	—	275,324
Fund of hedge funds	—	—	5,117	5,117
Hedge funds (a)	—	—	512,138	512,138
Mutual funds	—	8,186	—	8,186
Total	$241,972	$4,929,160	$517,255	$5,688,387
Noncontrolling interest (a)	—	—	(460,924)	(460,924)
Total investments excluding noncontrolling interest	$241,972	$4,929,160	$56,331	$5,227,463

(a) The Company has an equity interest of 10% in PaCRe, the remaining 90% interest is held by third party investors.

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At December 31, 2011, 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	$—	$1,182,393	$—	$1,182,393
Non-U.S. Government and Government Agency	—	449,358	—	449,358
States, municipalities, political subdivision	—	26,291	—	26,291
Agency residential mortgage-backed securities	—	468,054	—	468,054
Non-Agency residential mortgage-backed securities	—	32,706	—	32,706
U.S. corporate	—	1,329,758	—	1,329,758
Non-U.S. corporate	—	579,675	—	579,675
Bank loans	—	467,256	—	467,256
Catastrophe bonds	—	29,952	—	29,952
Asset-backed securities	—	328,299	—	328,299
Commercial mortgage-backed securities	—	403	—	403
Total fixed maturities	—	4,894,145	—	4,894,145
Short-term investments	257,854	22,337	—	280,191
Fund of hedge funds	—	—	5,627	5,627
Private equity investment	—	—	3,253	3,253
Mutual funds	—	7,907	—	7,907
Total	$257,854	$4,924,389	$8,880	$5,191,123

At September 30, 2012, Level 3 investments excluding the noncontrolling interest totaled $56,331, representing 1.1% of total investments, excluding noncontrolling interest, measured at fair value on a recurring basis. At December 31, 2011, Level 3 investments totaled $8,880 representing 0.2% of total investments measured at fair value on a recurring basis.

The following tables present a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the three and nine month periods ending September 30, 2012 and 2011:

	Three Months Ended September 30, 2012		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$—	$454,793	$454,793
Purchases	—	—	—
Sales	—	(218)	(218)
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	13	13
Unrealized gains	—	61,746	61,746
Amortization	—	—	—
Transfers	—	921	921
Level 3 investments - End of period	$—	$517,255	$517,255
Noncontrolling interest (a)	—	(460,924)	(460,924)
Level 3 investments excluding noncontrolling interest	$—	$56,331	$56,331

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	Three Months Ended September 30, 2011		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$—	$9,776	$9,776
Purchases	—	—	—
Sales	—	(556)	(556)
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	73	73
Unrealized (losses)	—	(526)	(526)
Amortization	—	—	—
Transfers	—	—	—
Level 3 investments - End of period	$—	$8,767	$8,767

	Nine Months Ended September 30, 2012		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$—	$8,880	$8,880
Purchases	—	500,000	500,000
Sales	—	(1,115)	(1,115)
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	61	61
Unrealized gains	—	11,762	11,762
Amortization	—	—	—
Transfers	—	(2,333)	(2,333)
Level 3 investments - End of period	$—	$517,255	$517,255
Noncontrolling interest (a)	—	(460,924)	(460,924)
Level 3 investments excluding noncontrolling interest	$—	$56,331	$56,331

	Nine Months Ended September 30, 2011		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$—	$12,892	$12,892
Purchases	—	—	—
Sales	—	(4,365)	(4,365)
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	508	508
Unrealized (losses)	—	(268)	(268)
Amortization	—	—	—
Transfers	—	—	—
Level 3 investments - End of period	$—	$8,767	$8,767

(a) The Company has an equity interest of 10% in PaCRe, the remaining 90% interest is held by third party investors.

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There have not been any transfers between Levels 1 and 2 during the three or nine months ended September 30, 2012. During the three months ended September 30, 2012, there was a transfer of an investment into Level 3 of the fair value hierarchy. This transfer was due to the conversion of a bank loan to an other investment. During the three months ended June 30, 2012, there was a transfer of the private equity investment out of Level 3 “Other investments” to “Investments in affiliates.” Refer to Note 4 “Investments in affiliates.”

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Fixed maturities and short-term investments	$25,703	$27,773	$79,450	$84,243
Cash and cash equivalents	1,770	1,864	5,536	5,132
Securities lending income	3	7	9	31
Total gross investment income	27,476	29,644	84,995	89,406
Investment expenses	(1,987)	(1,897)	(5,861)	(5,190)
Net investment income	$25,489	$27,747	$79,134	$84,216

(c) Fixed maturity, short-term investments, other investments and cash equivalents

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

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Fixed maturities, short-term and other investments and cash equivalents				
Gross realized gains	$10,187	$8,794	$29,610	$37,591
Gross realized (losses)	(1,124)	(3,548)	(6,861)	(14,414)
Net realized gains on investments	9,063	5,246	22,749	23,177
Net unrealized gains (losses) on securities lending	223	(26)	260	15
Change in net unrealized gains (losses) on investments	86,122	(27,822)	53,182	(22,165)
Total net realized gains and change in net unrealized gains (losses) on investments	$95,408	$(22,602)	$76,191	$1,027
Noncontrolling interest (a)	(55,806)	—	(10,924)	—
Total net realized gains and change in net unrealized gains (losses) on investments excluding noncontrolling interest	$39,602	$(22,602)	$65,267	$1,027

(a) The Company has an equity interest of 10% in PaCRe, the remaining 90% interest is held by third party investors.

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The amortized cost, gross unrealized gains and (losses) and estimated fair value of investments at September 30, 2012 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and Government Agency	$1,219,610	$9,676	$(13)	$1,229,273
Non-U.S. Government and Government Agency	300,227	7,836	(303)	307,760
States, municipalities, political subdivision	41,690	859	(11)	42,538
Agency residential mortgage-backed securities	405,317	16,757	(99)	421,975
Non-Agency residential mortgage-backed securities	25,013	564	(1,745)	23,832
U.S. corporate	1,214,986	28,176	(274)	1,242,888
Non-U.S. corporate	585,454	12,940	(141)	598,253
Bank loans	596,316	7,177	(637)	602,856
Catastrophe bonds	37,750	716	—	38,466
Asset-backed securities	376,854	3,070	(143)	379,781
Commercial mortgage-backed securities	—	—	—	—
Total fixed maturities	4,803,217	87,771	(3,366)	4,887,622
Total short-term investments	275,099	229	(4)	275,324
Fund of hedge funds	5,111	331	(325)	5,117
Hedge funds (a)	500,000	12,138	—	512,138
Mutual funds	6,199	1,987		8,186
Total other investments	511,310	14,456	(325)	525,441
Total	$5,589,626	$102,456	$(3,695)	$5,688,387
Noncontrolling interest (a)	(450,000)	(10,924)	$—	$(460,924)
Total investments excluding noncontrolling interest	$5,139,626	$91,532	$(3,695)	$5,227,463

(a) The Company has an equity interest of 10% in PaCRe, the remaining 90% interest is held by third party investors.

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The amortized cost, gross unrealized gains and (losses) and estimated fair value of investments at December 31, 2011 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and Government Agency	$ 1,170,810	$ 11,630	$ (47)	$ 1,182,393
Non-U.S. Government and Government Agency	446,258	9,173	(6,073)	449,358
States, municipalities, political subdivision	25,715	586	(10)	26,291
Agency residential mortgage-backed securities	451,751	16,622	(319)	468,054
Non-Agency residential mortgage-backed securities	39,134	143	(6,571)	32,706
U.S. corporate	1,314,375	24,932	(9,549)	1,329,758
Non-U.S. corporate	577,743	6,320	(4,388)	579,675
Bank loans	475,770	2,435	(10,949)	467,256
Catastrophe bonds	29,250	702	—	29,952
Asset-backed securities	328,497	900	(1,098)	328,299
Commercial mortgage-backed securities	402	1	—	403
Total fixed maturities	4,859,705	73,444	(39,004)	4,894,145
Total short-term investments	280,299	1	(109)	280,191
Fund of hedge funds	5,244	383	—	5,627
Private equity investment	3,253	—	—	3,253
Mutual funds	6,505	1,402	—	7,907
Total other investments	15,002	1,785	—	16,787
Total	$ 5,155,006	$ 75,230	$ (39,113)	$ 5,191,123

The following table sets forth certain information regarding the investment ratings of the Company’s fixed maturities portfolio as at September 30, 2012 and December 31, 2011. 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.

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	September 30, 2012			December 31, 2011		
	Estimated Fair Value	% of Total		Estimated Fair Value	% of Total	
AAA	$762,664	15.6	%	$882,912	18.0	%
AA	2,068,034	42.3	%	2,077,981	42.5	%
A	1,059,408	21.7	%	1,078,793	22.0	%
BBB	358,781	7.3	%	345,091	7.1	%
Investment grade	4,248,887	86.9	%	4,384,777	89.6	%
BB	352,150	7.2	%	254,409	5.2	%
B	263,625	5.4	%	231,420	4.7	%
CCC	5,578	0.1	%	12,578	0.3	%
CC	3,075	0.1	%	4,605	0.1	%
D/NR	14,307	0.3	%	6,356	0.1	%
Non-Investment grade	638,735	13.1	%	509,368	10.4	%
Total Fixed Maturities	$4,887,622	100.0	%	$4,894,145	100.0	%

The amortized cost and estimated fair value amounts for fixed maturity securities held at September 30, 2012 and December 31, 2011 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.

	September 30, 2012		December 31, 2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$535,216	$538,572	$520,631	$523,107
Due after one year through five years	3,047,712	3,104,660	3,160,647	3,186,711
Due after five years through ten years	409,467	414,702	350,459	346,654
Due after ten years	3,638	4,100	8,184	8,211
	3,996,033	4,062,034	4,039,921	4,064,683
Asset-backed and mortgage-backed securities	807,184	825,588	819,784	829,462
Total	$4,803,217	$4,887,622	$4,859,705	$4,894,145

The Company has a four-year, $525,000 secured letter of credit facility provided by a syndicate of commercial banks (the “Four Year Facility”). At September 30, 2012, approximately $318,506 (December 31, 2011: $nil) of letters of credit were issued and outstanding under this facility for which $396,691 of investments were pledged as collateral (December 31, 2011: $nil). In 2007, the Company entered into a $100,000 standby letter of credit facility which provides Funds at Lloyd’s (the “Talbot FAL Facility”). On November 19, 2009, the Company entered into a Second Amendment to the Talbot FAL Facility to reduce the commitment from $100,000 to $25,000. At September 30, 2012, $25,000 (December 31, 2011: $25,000) of letters of credit were issued and outstanding under the Talbot FAL Facility for which $43,836 of investments were pledged as collateral (December 31, 2011: $44,623). In addition, $2,187,135 of investments were held in trust at September 30, 2012 (December 31, 2011: $2,129,570). Of those, $1,842,391 were held in trust for the benefit of Talbot’s cedants and policyholders, and to facilitate the accreditation of Talbot as an alien insurer/reinsurer by certain regulators (December 31, 2011: $1,686,586). In 2009, the Company entered into a $500,000 secured letter of credit facility provided by Citibank Europe plc (the "Secured Bi-Lateral Letter of Credit Facility"). At September 30, 2012 approximately $88,191 (December 31, 2011: $nil) letters of credit were issued and outstanding under this facility for which $110,964 of investments were pledged as collateral (December 31, 2011: $nil).

The Company assumed two letters of credit facilities as part of the acquisition of IPC Holdings, Ltd. (the "IPC Acquisition"). The facilites consisted of a Credit Facility between IPC, IPCRe Limited, the Lenders party thereto and Wachovia Bank, National Association (the "IPC Syndicated Facility") and a Letters of Credit Master Agreement between Citibank N.A. and IPCRe Limited (the "IPC Bi-Lateral Facility"). At March 31, 2010, the IPC Syndicated Facility was closed. At September 30, 2012, the IPC Bi-Lateral Facility had $51,009 (December 31, 2011: $57,146) letters of credit issued and outstanding for which $98,476

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(December 31, 2011: $105,428) of investments were held in an associated collateral account.

(d) Securities lending

The Company participates in a securities lending program whereby certain securities from its portfolio are loaned to third parties for short periods of time through a lending agent. The Company retains all economic interest in the securities it lends and receives a fee from the borrower for the temporary use of the securities. Collateral in the form of cash, government securities and letters of credit is required at a rate of 102% of the market value of the loaned securities and is held by a third party. As at September 30, 2012, the Company had $10,576 (December 31, 2011: $8,286) in securities on loan. During the three months ended September 30, 2012, the Company recorded a $223 unrealized gain on this collateral on its Statements of Comprehensive Income (Loss) (September 30, 2011: unrealized loss $26). During the nine months ended September 30, 2012, the Company recorded a $260 unrealized gain on this collateral on its Statements of Comprehensive Income (Loss) (September 30, 2011: unrealized gain $15).

Securities lending collateral reinvested includes overnight repos with an average reset period of 3.0 days (December 31, 2011: 3.9 days). As at September 30, 2012, the securities lending collateral reinvested by the Company in connection with its securities lending program was allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	10,383	—	—	10,383
Total	$10,383	$—	$—	$10,383

As at December 31, 2011, the securities lending collateral reinvested by the Company in connection with its securities lending program was allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
Corporate	$—	$255	$—	$255
Cash and cash equivalents	7,481	—	—	7,481
Total	$7,481	$255	$—	$7,736

The following table sets forth certain information regarding the investment ratings of the Company's securities lending collateral reinvested as at September 30, 2012 and December 31, 2011. 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.

	September 30, 2012			December 31, 2011		
	Estimated Fair Value	% of Total		Estimated Fair Value	% of Total	
NR	10,383	100.0	%	255	3.3	%
	10,383	100.0	%	255	3.3	%
NR- Short-term investments (a)	—	—	%	7,481	96.7	%
Total	$10,383	100.0	%	$7,736	100.0	%

(a) This amount relates to certain short-term investments with short original maturities which are generally not rated.

The amortized cost and estimated fair value amounts for securities lending collateral reinvested by the Company at September 30, 2012 and December 31, 2011 are shown by contractual maturity below. 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.

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	September 30, 2012		December 31, 2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$10,849	$10,383	$7,462	$7,481
Due after one year through five years	—	—	1,000	255
Total	$10,849	$10,383	$8,462	$7,736

4. Investments in affiliates

(a) Operating affiliates

AlphaCat Re 2011, Ltd.

On May 25, 2011, the Company joined with other investors in capitalizing AlphaCat Re 2011, a special purpose reinsurer formed for the purpose of writing collateralized reinsurance and retrocessional reinsurance. At the time of formation, Validus Re had a majority voting equity interest in AlphaCat Re 2011 and as a result the financial statements of AlphaCat Re 2011 were included in the consolidated financial statements of the Company.

On December 23, 2011, AlphaCat Re 2011 completed a secondary offering of its common shares to third party investors, along with a partial sale of Validus Re's common shares to one of the third party investors.

As a result of these transactions, Validus Re maintained an equity interest in AlphaCat Re 2011, however its share of AlphaCat Re 2011's outstanding voting rights decreased to 43.7%. As a result of the Company's voting interest falling below 50%, the individual assets and liabilities and corresponding noncontrolling interest of AlphaCat Re 2011 were derecognized from the consolidated balance sheet of the Company as at December 31, 2011 and the remaining investment in AlphaCat Re 2011 has been treated as an equity method investment as at September 30, 2012. The portion of AlphaCat Re 2011's earnings attributable to third party investors for the year ended December 31, 2011 was recorded in the Consolidated Statements of Comprehensive Income (loss) as net income attributable to noncontrolling interest.

AlphaCat Re 2012, Ltd.

On May 29, 2012, the Company joined with other investors in capitalizing AlphaCat Re 2012, a new special purpose reinsurer formed for the purpose of writing collateralized reinsurance with a particular focus on windstorm risks for Florida domiciled insurance companies. The Company holds an equity interest of 37.9% and a voting interest of 49.0% in AlphaCat Re 2012, therefore the investment has been treated as an equity method investment as at September 30, 2012.

The following table presents a reconciliation of the beginning and ending investment in operating affiliate balances for the three and nine months ended September 30, 2012:

	Three Months Ended September 30, 2012		
	Investment in operating affiliate (AlphaCat Re 2011)	Investment in operating affiliate (AlphaCat Re 2012)	Total
As at June 30, 2012	$59,238	$27,252	$86,490
Purchase of shares	—	—	—
Income from operating affiliates	4,079	2,156	6,235
As at September 30, 2012	$63,317	$29,408	$92,725

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	Nine Months Ended September 30, 2012		
	Investment in operating affiliate (AlphaCat Re 2011)	Investment in operating affiliate (AlphaCat Re 2012)	Total
As at December 31, 2011	$53,031	$—	$53,031
Purchase of shares	—	26,500	26,500
Income from operating affiliates	10,286	2,908	13,194
As at September 30, 2012	$63,317	$29,408	$92,725

The following table presents the Company's investments in AlphaCat Re 2011 and AlphaCat Re 2012, as at September 30, 2012:

	Investment in non-consolidated affiliate			
	Investment at cost	Voting ownership %	Equity Ownership	Carrying Value
AlphaCat Re 2011	$41,389	43.7 %	22.3 %	$63,317
AlphaCat Re 2012	$26,500	49.0 %	37.9 %	$29,408

(b) Investment affiliate

Aquiline Financial Services Fund II L.P.

On December 20, 2011, Validus Re entered into an Assignment and Assumption Agreement (the "Agreement") with Aquiline Capital Partners LLC, a Delaware limited liability company (the "Assignor") and Aquiline Capital Partners II GP (Offshore) Ltd., a Cayman Islands company limited by shares (the "General Partner") pursuant to which Validus Re has assumed 100% of the Assignor's interest in Aquiline Financial Services Fund II L.P. (the "Partnership") representing a total capital commitment of $50,000 (the "Commitment"), as a limited partner in the Partnership (the "Transferred Interest"). The Transferred Interest is governed by the terms of an Amended and Restated Exempted Limited Partnership Agreement dated as of July 2, 2010 (the "Limited Partnership Agreement"). Pursuant to the terms of the Limited Partnership Agreement, the Commitment will expire on July 2, 2015.

The private equity limited partnership provides quarterly capital account statements with a three-month delay in its valuation. As a result, the limited partnership's June 30, 2012 capital account statement was used as a basis for calculation of the Company's share of partnership income for the period.

The following table presents a reconciliation of the beginning and ending investment in the Company's investment affiliate balances for the three and nine months ended September 30, 2012:

	Three Months Ended September 30, 2012
	Investment in limited partnership (Aquiline Financial Services Fund II L.P)
As at June 30, 2012	$6,317
Capital contributions	430
(Loss) from investment affiliate	(160)
As at September 30, 2012	$6,587

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	Nine Months Ended September 30, 2012 Investment in limited partnership (Aquiline Financial Services Fund II L.P) (a)
As at December 31, 2011	$3,253
Capital contributions	5,328
Net unrealized loss on investments (a)	(1,436)
(Loss) from investment affiliate	(558)
As at September 30, 2012	$6,587

(a) As at December 31, 2011 and March 31, 2012, this investment was included in "Other investments" as a level 3 investment in the fair value hierarchy, hence the change in fair value was included in net unrealized (losses) gains on investments.

The following table presents the Company's investment in Aquiline as at September 30, 2012:

	Investment in non-consolidated affiliate			
	Investment at cost	Voting ownership %	Equity Ownership	Carrying Value
Aquiline Financial Services Fund II L.P	$8,581	— %	6.8 %	$6,587

5. Noncontrolling interest

On April 2, 2012, the Company joined with other investors in capitalizing PaCRe a new Class 4 Bermuda reinsurer formed for the purpose of writing high excess property catastrophe reinsurance. Validus Re has a majority voting equity interest in PaCRe and as a result, the financial statements of PaCRe are included in the consolidated financial statements of the Company. The portion of PaCRe's earnings attributable to third party investors for the three and nine months ended September 30, 2012 is recorded in the consolidated Statements of Comprehensive Income (loss) as net income attributable to noncontrolling interest.

The following table presents a reconciliation of the beginning and ending balances of noncontrolling interest for the three and nine months ended September 30, 2012:

	Three Months Ended September 30, 2012 Noncontrolling interest
Balance - June 30, 2012	$404,740
Purchase of shares by noncontrolling interest	—
Net Income:	
Net income attributable to noncontrolling interest	56,746
Balance - September 30, 2012	$461,486

	Nine Months Ended September 30, 2012 Noncontrolling interest
Balance - April 2, 2012	$—
Purchase of shares by noncontrolling interest	450,100
Net Income:	
Net income attributable to noncontrolling interest	11,386

Balance - September 30, 2012	$461,486

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6. Derivative instruments used in hedging activities

The Company enters into derivative instruments for risk management purposes, specifically to hedge unmatched foreign currency exposures and interest rate exposures. As at September 30, 2012 the Company held a foreign currency forward contract to mitigate the risk of foreign currency exposure of unpaid losses denominated in Chilean Pesos (CLP) as well as foreign currency forward contracts to mitigate the risk of fluctuations in the Euro to U.S. dollar exchange rates. As at September 30, 2012, the Company held two interest rate swap contracts to mitigate the risk of interest rate exposure on the payment of interest on the Company's junior subordinated debentures.

The following table summarizes information on the location and amount of the derivative fair value on the consolidated balance sheet at September 30, 2012:

		Asset derivatives		Liability derivatives	
Derivatives designated as hedging instruments:	Notional amount	Balance Sheet location	Fair value	Balance Sheet location	Fair value
Foreign exchange contracts	$43,243	Other assets	$1,469	Accounts payable and accrued expenses	$173
Interest rate swap contracts	$289,800	Other assets	$—	Accounts payable and accrued expenses	$195

The following table summarizes information on the location and amount of the derivative fair value on the consolidated balance sheet at December 31, 2011:

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Derivatives designated as hedging instruments:	Notional amount	Asset derivatives Balance Sheet location	Fair value	Liability derivatives Balance Sheet location	Fair value
Foreign exchange contracts	$75,323	Other assets	$476	Accounts payable and accrued expenses	$—

(a) Classification within the fair value hierarchy

As described in Note 3 "Investments", under U.S. GAAP, a company must determine the appropriate level in the fair value
hierarchy for each fair value measurement. The assumptions used within the valuation are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Accordingly, these derivatives were classified within Level 2 of the fair value hierarchy.

(b) Derivative instruments designated as a fair value hedge

The Company designates its derivative instruments as fair value hedges and formally and contemporaneously documents all relationships between the hedging instruments and hedged items and links the hedging derivatives to specific assets and liabilities. The Company assesses the effectiveness of the hedges, both at inception and on an on-going basis and determines whether the hedges are highly effective in offsetting changes in fair value of the linked hedged items. The Company assesses the effectiveness of its designated hedges on an individual currency basis. If the ratio obtained with this method is within the range of 80% to 125%, the Company considers the hedge effective.

The following table provides the total impact on earnings relating to the derivative instruments formally designated as fair value hedges along with the impact of the related hedged items for the three and nine months ended September 30, 2012:

		Three Months Ended September 30, 2012		
Derivatives designated as fair value hedges and related hedged item:	Location of gain (loss) recognized in income	Amount of gain (loss) recognized in income on derivative	Amount of gain (loss) on hedged item recognized in income attributable to risk being hedged	Amount of gain (loss) recognized in income on derivative (ineffective portion)
Foreign exchange	Foreign exchange gains (losses)	$1,749	$ (1,749)	$ —

		Three Months Ended September 30, 2011		
Derivatives designated as fair value hedges and related hedged item:	Location of gain (loss) recognized in income	Amount of gain (loss) recognized in income on derivative	Amount of gain (loss) on hedged item recognized in income attributable to risk being hedged	Amount of gain (loss) recognized in income on derivative (ineffective portion)
Foreign exchange	Foreign exchange gains (losses)	$(617)	$ 617	$ —

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		Nine Months Ended September 30, 2012		
Derivatives designated as fair value hedges and related hedged item:	Location of gain (loss) recognized in income	Amount of gain (loss) recognized in income on derivative	Amount of gain (loss) on hedged item recognized in income attributable to risk being hedged	Amount of gain (loss) recognized in income on derivative (ineffective portion)
Foreign exchange	Foreign exchange gains (losses)	$130	$ (130)	$ —

		Nine Months Ended September 30, 2011		
Derivatives designated as fair value hedges and related hedged item:	Location of gain (loss) recognized in income	Amount of gain (loss) recognized in income on derivative	Amount of gain (loss) on hedged item recognized in income attributable to risk being hedged	Amount of gain (loss) recognized in income on derivative (ineffective portion)
Foreign exchange	Foreign exchange gains (losses)	$(3,542)	$ 3,542	$ —

(c) Derivative instruments designated as a cash flow hedge
The Company designates its interest rate derivative instruments as cash flow hedges and formally and contemporaneously documents all relationships between the hedging instruments and hedged items and links the hedging derivatives to specific assets and liabilities. The Company assesses the effectiveness of the hedges, both at inception and on an on-going basis and determines whether the hedges are highly effective in offsetting changes in fair value of the linked hedged items. The Company currently applies the long haul method when assessing the hedge's effectiveness.

The following table provides the total impact on other comprehensive income and earnings relating to the derivative instruments formally designated as cash flow hedges along with the impact of the related hedged items for the three and nine months ended September 30, 2012:

		Three and Nine Months Ended September 30, 2012			
Derivatives designated as cash flow hedges and related hedged item:	Location of the effective portion recognized in other comprehensive (loss) recognized in income	Location of the effective portion subsequently reclassified to earnings and the ineffective portion excluded from effectiveness testing	Amount of effective portion recognized in other comprehensive income	Amount of effective portion subsequently reclassified to earnings	Amount of ineffective portion excluded from effectiveness testing
Interest rate swap contracts	Other comprehensive income	Finance expenses	$ 195	$(195)	$—

There was no interest rate swap contract activity for the three and nine months ended September 30, 2011.

7. Reserve for losses and loss expenses

Reserves for losses and loss expenses are based in part upon the estimation of case losses reported from brokers, insureds and ceding companies. The Company also uses statistical and actuarial methods to estimate ultimate expected losses and loss expenses. The period of time from the occurrence of a loss, the reporting of a loss to the Company and the settlement of the Company's liability may be several months or years. During this period, additional facts and trends may be revealed. As these factors become apparent, case reserves will be adjusted, sometimes requiring an increase or decrease in the overall reserves of the Company, and at other times requiring a reallocation of incurred but not reported reserves to specific case reserves. These estimates are reviewed and adjusted regularly, and such adjustments, if any, are reflected in earnings in the period in which they become known. While

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management believes that it has made a reasonable estimate of ultimate losses, there can be no assurances that ultimate losses and loss expenses will not exceed the total reserves.

The following table represents an analysis of paid and unpaid losses and loss expenses incurred and a reconciliation of the beginning and ending unpaid losses and loss expenses for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Reserve for losses and loss expenses, beginning of period	$2,591,299	$2,620,360	$2,631,143	$2,035,973
Losses and loss expenses recoverable	(371,484)	(439,805)	(372,485)	(283,134)
Net reserves for losses and loss expenses, beginning of period	2,219,815	2,180,555	2,258,658	1,752,839
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:				
Current year	205,219	287,149	658,884	1,022,875
Prior years	(49,764)	(61,082)	(117,748)	(113,303)
Total incurred losses and loss expenses	155,455	226,067	541,136	909,572
Total net paid losses	(144,628)	(200,256)	(569,380)	(484,559)
Foreign exchange	14,710	(26,654)	14,938	1,860
Net reserve for losses and loss expenses, end of period	2,245,352	2,179,712	2,245,352	2,179,712
Losses and loss expenses recoverable	317,252	386,200	317,252	386,200
Reserve for losses and loss expenses, end of period	$2,562,604	$2,565,912	$2,562,604	$2,565,912

8. Reinsurance

The Company enters into reinsurance and retrocession agreements in order to mitigate its accumulation of loss, reduce its liability on individual risks, enable it to underwrite policies with higher limits and increase its aggregate capacity. The cession of insurance and reinsurance does not legally discharge the Company from its primary liability for the full amount of the policies, and the Company is required to pay the loss and bear collection risk if the reinsurer fails to meet its obligations under the reinsurance or retrocession agreement. Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying liabilities.

(a) Credit risk

The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- or better rated by Standard & Poor's or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. At September 30, 2012, 96.9% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A- or better and included $109,087 of IBNR recoverable (December 31, 2011: $125,298). Reinsurance recoverables by reinsurer are as follows:

	September 30, 2012	December 31, 2011

	Reinsurance Recoverable	% of Total		Reinsurance Recoverable	% of Total	
Top 10 reinsurers	$267,154	75.6	%	$323,315	69.8	%
Other reinsurers’ balances > $1 million	77,005	21.8	%	132,417	28.6	%
Other reinsurers’ balances < $1 million	9,302	2.6	%	7,248	1.6	%
Total	$353,461	100.0	%	$462,980	100.0	%

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	September 30, 2012			
Top 10 Reinsurers	Rating	Reinsurance Recoverable	% of Total	
Lloyd's Syndicates	A+	$70,065	26.2	%
Everest Re	A+	45,964	17.2	%
Hannover Re	AA-	39,308	14.7	%
Allianz	AA-	25,000	9.4	%
Transatlantic Re	A+	20,557	7.7	%
Swiss Re	AA-	17,335	6.5	%
Munich Re	AA-	14,413	5.4	%
XL Re	A	13,107	4.9	%
Platinum Underwriters	A-	10,942	4.1	%
Tokio Millenium Re Ltd.	AA-	10,463	3.9	%
Total		$267,154	100.0	%

	December 31, 2011			
Top 10 Reinsurers	Rating	Reinsurance Recoverable	% of Total	
Lloyd's Syndicates	A+	$77,419	24.0	%
Allianz	AA-	59,764	18.5	%
Hannover Re	AA-	39,762	12.3	%
Everest Re	A+	38,618	11.9	%
Transatlantic Re	A+	21,344	6.6	%
Tokio Millenium Re Ltd.	AA-	20,432	6.3	%
Fully Collateralized	NR	18,140	5.6	%
Odyssey Reinsurance Company	A-	16,737	5.2	%
Platinum Underwriters	A	15,833	4.9	%
Munich Re	AA-	15,266	4.7	%
Total		$323,315	100.0	%

At September 30, 2012 and December 31, 2011, the provision for uncollectible reinsurance relating to losses recoverable was $6,431 and $6,821, respectively. To estimate the provision for uncollectible reinsurance recoverable, the reinsurance recoverable is first allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment is applied. As part of this process, ceded IBNR is allocated by reinsurer. Of the $353,461 reinsurance recoverable at September 30, 2012 (December 31, 2011: $462,980), $9,997 was fully collateralized (December 31, 2011: $18,140).

The Company uses a default analysis to estimate uncollectible reinsurance. The primary components of the default analysis are reinsurance recoverable balances by reinsurer and default factors used to determine the portion of a reinsurer's balance deemed to be uncollectible. Default factors require considerable judgment and are determined using the current rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions.

9. Share capital

(a) Authorized and issued

The Company's authorized share capital is 571,428,571 voting and non-voting shares with a par value of $0.175 per share. The holders of common voting shares are entitled to receive dividends and are allocated one vote per share, provided that, if the controlled shares of any shareholder or group of related shareholders constitute more than 9.09 percent of the outstanding common shares of the Company, their voting power will be reduced to 9.09 percent.

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On June 5, 2012, the Company announced the final results of its “modified Dutch auction” tender offer. Pursuant to this tender offer the Company purchased 6,383,884 of its common shares at a price of $32.00 per common share for a total cost of $204,284, excluding fees and expenses relating to the tender offer. The Company funded the purchase of the shares in the tender offer using cash on hand.

The Company may from time to time repurchase its securities, including common shares, Junior Subordinated Deferrable Debentures and Senior Notes. The Company has repurchased approximately 43,138,057 common shares for an aggregate purchase price of $1,206,845 from the inception of its share repurchase program to September 30, 2012. The Company had $122,328 remaining under its authorized share repurchase program as of September 30, 2012.

The Company expects the purchases under its share repurchase program to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company’s capital position relative to internal and rating agency targets, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of Directors at any time.

The following table is a summary of the common shares issued and outstanding:

	Common Shares
Common shares issued, December 31, 2011	134,503,065
Restricted share awards vested, net of shares withheld	1,545,024
Restricted share units vested, net of shares withheld	15,173
Options exercised	439,065
Warrants exercised	130,121
Common shares issued, September 30, 2012	136,632,448
Shares repurchased	(43,138,057)
Common shares outstanding, September 30, 2012	93,494,391

	Common Shares
Common shares issued, December 31, 2010	132,838,111
Restricted share awards vested, net of shares withheld	534,658
Restricted share units vested, net of shares withheld	9,496
Employee seller shares vested	197,174
Options exercised	457,465
Warrants exercised	34,340
Direct issuance of common stock	363
Common shares issued, September 30, 2011	134,071,607
Shares repurchased	(35,031,985)
Common shares outstanding, September 30, 2011	99,039,622

(b) Warrants

During the three and nine months ended September 30, 2012, 264,127 warrants were exercised which resulted in the issuance of 130,121 common shares. During the three and nine months ended September 30, 2011, 72,598 warrants were exercised which resulted in the issuance of 34,340 common shares.

(c) Deferred share units

Under the terms of the Company's Director Stock Compensation Plan, non-management directors may elect to receive their director fees in deferred share units rather than cash. The number of share units distributed in case of election under the plan is

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equal to the amount of the annual retainer fee otherwise payable to the director on such payment date divided by 100% of the fair market value of a share on such payment date. Additional deferred share units are issued in lieu of dividends that accrue on these deferred share units. The total outstanding deferred share units at September 30, 2012 were 4,965 (December 31, 2011: 4,850).

(d) Dividends

On February 9, 2012, the Company announced a quarterly cash dividend of $0.25 (2011: $0.25) per common share and $0.25 per common share equivalent for which each outstanding warrant is exercisable. This dividend was paid on March 30, 2012 to holders of record on March 15, 2012.

On May 2, 2012, the Company announced a quarterly cash dividend of $0.25 (2011: $0.25) per common share and $0.25 per common share equivalent for which each outstanding warrant is exercisable. This dividend was paid on June 29, 2012 to holders of record on June 15, 2012.

On July 25, 2012, the Company announced a quarterly cash dividend of $0.25 (2011: $0.25) per common share and $0.25 per common share equivalent for which each outstanding warrant is exercisable. This dividend was paid on September 28, 2012 to holders of record on September 14, 2012.

10. Stock plans

(a) Long Term Incentive Plan and Short Term Incentive Plan

The Company's Amended and Restated 2005 Long Term Incentive Plan ("LTIP") provides for grants to employees of options, stock appreciation rights ("SARs"), restricted shares, restricted share units, performance shares, dividend equivalents or other share-based awards. In addition, the Company may issue restricted share awards or restricted share units in connection with awards issued under its annual Short Term Incentive Plan ("STIP"). The total number of shares reserved for issuance under the LTIP and STIP are 13,126,896 shares of which 3,148,786 shares are remaining. The LTIP and STIP are administered by the Compensation Committee of the Board of Directors. No SARs have been granted to date. Grant prices are established at the fair market value of the Company's common shares at the date of grant.

i.Options

Options may be exercised for voting common shares upon vesting. Options have a life of 10 years and vest either ratably or at the end of the required service period from the date of grant. Fair value of the option awards at the date of grant is determined using the Black-Scholes option-pricing model. The following weighted average assumptions were used for all grants to date:

Year	Weighted average risk free interest rate	Weighted average dividend yield	Expected life (years)	Expected volatility
2009	3.9%	3.7%	2	34.6%
2010 (a)	n/a	n/a	n/a	n/a
2011 (a)	n/a	n/a	n/a	n/a

(a) The Company has not granted any stock options awards since September 4, 2009.

Expected volatility is based on stock price volatility of comparable publicly-traded companies. The Company used the simplified method consistent with U.S. GAAP authoritative guidance on stock compensation expenses to estimate expected lives for options granted during the period as historical exercise data was not available and the options met the requirement as set out in the guidance.

Share compensation expenses in respect of options of $nil were recorded for the three months ended September 30, 2012 (2011: $183). Share compensation expenses in respect of options of $142 were recorded for the nine months ended September 30, 2012 (2011: $1,609). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

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Activity with respect to options for the nine months ended September 30, 2012 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2011	2,263,012	$6.69	$20.12
Options granted	—	—	—
Options exercised	(439,065)	7.44	17.73
Options forfeited	—	—	—
Options outstanding, September 30, 2012	1,823,947	$6.52	$20.69
Options exercisable at September 30, 2012	1,823,947	$6.52	$20.69

Activity with respect to options for the nine months ended September 30, 2011 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2010	2,723,684	$6.74	$20.19
Options granted	—	—	—
Options exercised	(457,465)	6.97	20.56
Options forfeited	(370)	10.30	20.39
Options outstanding, September 30, 2011	2,265,849	$6.70	$20.12
Options exercisable at September 30, 2011	2,182,810	$6.62	$20.01

At September 30, 2012, there were $nil (December 31, 2011: $141) of total unrecognized share compensation expenses in respect of options that are expected to be recognized over a weighted-average period of 0.0 years (December 31, 2011: 0.2 years).

ii.Restricted share awards

Restricted shares granted under the LTIP and STIP vest either ratably or at the end of the required service period and contain certain restrictions during the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $6,626 were recorded for the three months ended September 30, 2012 (2011: $6,265). Share compensation expenses of $18,742 were recorded for the nine months ended September 30, 2012 (2011: $21,213). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested restricted share awards for the nine months ended September 30, 2012 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2011	3,003,547	$25.77
Restricted share awards granted	901,506	31.38
Restricted share awards vested	(1,678,905)	24.36

Restricted share awards forfeited	(30,801)	28.10
Restricted share awards outstanding, September 30, 2012	2,195,347	$29.12

Activity with respect to unvested restricted share awards for the nine months ended September 30, 2011 was as follows:

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	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2010	3,114,039	$24.33
Restricted share awards granted	610,469	31.95
Restricted share awards vested	(669,649)	24.91
Restricted share awards forfeited	(14,271)	27.11
Restricted share awards outstanding, September 30, 2011	3,040,588	$25.72

At September 30, 2012, there were $49,528 (December 31, 2011: $40,809) of total unrecognized share compensation expenses in respect of restricted share awards that are expected to be recognized over a weighted-average period of 2.8 years (December 31, 2011: 2.4 years).

iii.Restricted share units

Restricted share units under the LTIP and STIP vest either ratably or at the end of the required service period and contain certain restrictions during the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $132 were recorded for the three months ended September 30, 2012 (2011: $122). Share compensation expenses of $363 were recorded for the nine months ended September 30, 2012 (2011: $333). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested restricted share units for the nine months ended September 30, 2012 was as follows:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2011	53,312	$27.60
Restricted share units granted	16,633	31.77
Restricted share units vested	(22,818)	26.49
Restricted share units issued in lieu of cash dividends	1,162	28.36
Restricted share units forfeited	(1,393)	28.57
Restricted share units outstanding, September 30, 2012	46,896	$29.61

Activity with respect to unvested restricted share units for the nine months ended September 30, 2011 was as follows:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2010	47,049	$25.04
Restricted share units granted	18,388	32.10
Restricted share units vested	(13,340)	24.72
Restricted share units issued in lieu of cash dividends	704	26.87
Restricted share units forfeited	—	—
Restricted share units outstanding, September 30, 2011	52,801	$27.60

At September 30, 2012, there were $1,111 (December 31, 2011: $985) of total unrecognized share compensation expenses in respect of restricted share units that are expected to be recognized over a weighted-average period of 2.8 years (December 31, 2011: 2.7 years).

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iv.Performance share awards

The Performance Share Awards ("PSAs") contain a performance based component. The performance component relates to the compounded growth in the Dividend Adjusted Diluted Book Value per Share over a three year period. For PSAs granted during the period, the grant date Diluted Book Value per Share ("DBVPS") is based on the DBVPS at the end of the most recent financial reporting year. The Dividend Adjusted Performance Period End DBVPS will be the DBVPS three years after the grant date DBVPS. The fair value estimate earns over the requisite attribution period and the estimate will be reassessed at the end of each performance period which will reflect any adjustments in the consolidated statements of income in the period in which they are determined.

Share compensation expenses of $587 were recorded for the three months ended September 30, 2012 (2011: $739). Share compensation expenses of $336 for the nine months ended September 30, 2012 (2011: $1,611). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested performance share awards for the nine months ended September 30, 2012 was as follows:

	Performance Share Awards	Weighted Average Grant Date Fair Value
Performance share awards outstanding, December 31, 2011	279,019	$30.77
Performance share awards granted	41,128	31.38
Performance share awards vested	—	—
Performance share awards cancelled	(99,302)	28.70
Performance share awards outstanding, September 30, 2012	220,845	$31.81

Activity with respect to unvested performance share awards for the nine months ended September 30, 2011 was as follows:

	Performance Share Awards	Weighted Average Grant Date Fair Value
Performance share awards outstanding, December 31, 2010	132,401	$28.70
Performance share awards granted	146,618	32.64
Performance share awards vested	—	—
Performance share awards forfeited	—	—
Performance share awards outstanding, September 30, 2011	279,019	$30.77

At September 30, 2012, there were $3,882 (December 31, 2011: $5,677) of total unrecognized share compensation expenses in respect of PSAs that are expected to be recognized over a weighted-average period of 1.9 years (December 31, 2011: 2.1 years).

(b) Employee seller shares

Pursuant to the Share Sale Agreement for the purchase of Talbot Holdings, Ltd. ("Talbot"), the Company issued 1,209,741 restricted shares to Talbot employees (the "employee seller shares"). Upon consummation of the acquisition, the employee seller shares were validly issued, fully-paid and non-assessable and entitled to vote and participate in distributions and dividends in accordance with the Company's Bye-laws. However, the employee seller shares were subject to a restricted period during which they were subject to forfeiture (as implemented by repurchase by the Company for a nominal amount). Forfeiture of employee seller shares would have generally occurred in the event that any such Talbot employee's employment terminated, with certain exceptions, prior to the end of the restricted period. The restricted period ended for 25% of the employee seller shares on each anniversary of the closing date of July 2, 2007 for all Talbot employees other than Talbot's Chairman, such that on July 2, 2011 the potential for forfeiture was completely extinguished.

As of July 2, 2011, the employee seller shares were fully expensed. Share compensation expenses of $73 and $2,293 were

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recorded for the three and nine months ended September 30, 2011, respectively.

Total share compensation expenses

The breakdown of share compensation expenses by award type was as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Options	$—	$183	$142	$1,609
Restricted share awards	6,626	6,265	18,742	21,213
Restricted share units	132	122	363	333
Performance share awards	587	739	336	1,611
Employee seller shares	—	73	—	2,293
Total	$7,345	$7,382	$19,583	$27,059

11. Debt and financing arrangements

(a) Financing structure and finance expenses

The financing structure at September 30, 2012 was:

	Commitment	Outstanding (a)	Drawn
2006 Junior Subordinated Deferrable Debentures	$150,000	$150,000	$150,000
2007 Junior Subordinated Deferrable Debentures	200,000	139,800	139,800
2010 Senior Notes due 2040	250,000	250,000	247,063
$400,000 syndicated unsecured letter of credit facility	400,000	—	—
$525,000 syndicated secured letter of credit facility	525,000	318,506	—
$500,000 bi-lateral secured letter of credit facility	500,000	88,191	—
Talbot FAL Facility (b)	25,000	25,000	—
PaCRe senior secured letter of credit facility	10,000	—	—
IPC Bi-Lateral Facility	80,000	51,009	—
Total	$2,140,000	$1,022,506	$536,863

The financing structure at December 31, 2011 was:

	Commitment	Outstanding (a)	Drawn
2006 Junior Subordinated Deferrable Debentures	$150,000	$150,000	$150,000
2007 Junior Subordinated Deferrable Debentures	200,000	139,800	139,800
2010 Senior Notes due 2040	250,000	250,000	246,982
$340,000 syndicated unsecured letter of credit facility	340,000	—	—
$60,000 bilateral unsecured letter of credit facility	60,000	—	—
$500,000 secured letter of credit facility	500,000	333,179	—
Talbot FAL Facility (b)	25,000	25,000	—
IPC Bi-Lateral Facility	80,000	57,146	—
Total	$1,605,000	$955,125	$536,782

(a) Indicates utilization of commitment amount, not drawn borrowings.

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(b) Talbot operates in Lloyd's through a corporate member, Talbot 2002 Underwriting Capital Ltd ("T02"), which is the sole participant in Syndicate 1183. Lloyd's sets T02's required capital annually based on Syndicate 1183's business plan, rating environment, reserving environment together with input arising from Lloyd's discussions with, inter alia, regulatory and rating agencies. Such capital, called Funds at Lloyd's ("FAL"), comprises: cash, investments and undrawn letters of credit provided by various banks.

Finance expenses consist of interest on our junior subordinated deferrable debentures and senior notes, the amortization of debt offering costs, fees relating to our credit facilities and the costs of FAL as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
2006 Junior Subordinated Deferrable Debentures	$1,628	$1,456	$4,729	$8,272
2007 Junior Subordinated Deferrable Debentures	1,211	3,029	7,072	9,086
2010 Senior Notes due 2040	5,597	5,597	16,792	16,791
Credit facilities	852	1,508	10,530	4,821
AlphaCat Re 2011 fees (a)	—	(807)	—	2,112
Talbot FAL Facility	30	152	93	215
Talbot other interest	44	—	131	—
Total	$9,362	$10,935	$39,347	$41,297

(a) Includes preferred share dividends and finance expenses attributable to AlphaCat Re 2011.

(b) $250,000 2010 Senior Notes due 2040

On January 21, 2010, the Company offered and sold $250,000 of Senior Notes due 2040 (the "2010 Senior Notes") in a registered public offering. The 2010 Senior Notes mature on January 26, 2040, and are redeemable at the Company's option in whole any time or in part from time to time at a make-whole redemption price. The Company may redeem the notes in whole, but not in part, at any time upon the occurrence of certain tax events as described in the notes prospectus supplement. The 2010 Senior Notes bear interest at the rate of 8.875% per annum from January 26, 2010 to maturity or early redemption. Interest on the 2010 Senior Notes is payable semi-annually in arrears on January 26 and July 26 of each year, commencing on July 26, 2010. The net proceeds of $243,967 from the sale of the 2010 Senior Notes, after the deduction of commissions paid to the underwriters in the transaction and other expenses, was used by the Company for general corporate purposes, which included the repurchase of its outstanding capital stock and payment of dividends to shareholders. Debt issuance costs of $2,808 were deferred as an asset and amortized over the life of the 2010 Senior Notes.

The 2010 Senior Notes are unsecured and unsubordinated obligations of the Company and rank equally in right of payment with all of the Company's existing and future unsecured and unsubordinated indebtedness. The 2010 Senior Notes will be effectively junior to all of the Company's future secured debt, to the extent of the value of the collateral securing such debt, and will rank senior to all our existing and future subordinated debt. The 2010 Senior Notes will be structurally subordinated to all obligations of the Company's subsidiaries.

Future expected payments of principal on the 2010 Senior Notes are as follows:

2012	$—
2013	—
2014	—

2015	—
2016 and thereafter	250,000
Total minimum future payments	$250,000

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(c) Junior subordinated deferrable debentures

On June 15, 2006, the Company participated in a private placement of $150,000 of junior subordinated deferrable interest debentures due 2036 (the “2006 Junior Subordinated Deferrable Debentures”). The 2006 Junior Subordinated Deferrable Debentures mature on June 15, 2036, are redeemable at the Company’s option at par beginning June 15, 2011, and require quarterly interest payments by the Company to the holders of the 2006 Junior Subordinated Deferrable Debentures. Interest was payable at 9.069% per annum through June 15, 2011, and thereafter at a floating rate of three-month LIBOR plus 355 basis points, reset quarterly. The proceeds of $150,000 from the sale of the 2006 Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, were used by the Company to fund Validus Re segment operations and for general working capital purposes. Debt issuance costs of $3,750 were deferred as an asset and are amortized to income over the five year optional redemption period.

On June 21, 2007, the Company participated in a private placement of $200,000 of junior subordinated deferrable interest debentures due 2037 (the “2007 Junior Subordinated Deferrable Debentures”). The 2007 Junior Subordinated Deferrable Debentures mature on June 15, 2037, are redeemable at the Company’s option at par beginning June 15, 2012, and require quarterly interest payments by the Company to the holders of the 2007 Junior Subordinated Deferrable Debentures. Interest was payable at 8.480% per annum through June 15, 2012, and thereafter at a floating rate of three-month LIBOR plus 295 basis points, reset quarterly. The proceeds of $200,000 from the sale of the 2007 Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, were used by the Company to fund the purchase of Talbot Holdings Ltd. Debt issuance costs of $2,000 were deferred as an asset and are amortized to income over the five year optional redemption period.

Future expected payments of principal on the 2006 and 2007 Junior Subordinated Deferrable Debentures are as follows:

2012	$—
2013	—
2014	—
2015	—
2016 and thereafter	289,800
Total minimum future payments	$289,800

(d) Credit facilities

(i) $400,000 syndicated unsecured letter of credit facility and $525,000 syndicated secured letter of credit facility

On March 9, 2012, the Company, Validus Re Americas, Ltd. ("Validus Re Americas"), PaCRe and Validus Re entered into a $400,000 four year unsecured credit facility with Deutsche Bank Securities Inc., as syndication agent, JPMorgan Chase Bank, N.A. as administrative agent, Lloyds Securities Inc. and Suntrust Bank, as co-documentation agents and the lenders party thereto, which provides for letter of credit availability for the Company and certain designated subsidiaries of the Company and revolving credit availability for the Company (the "Four Year Unsecured Facility") (the full $400,000 of which is available for letters of credit and/or revolving loans). The Four Year Unsecured Facility was provided by a syndicate of commercial banks arranged by J.P. Morgan Securities LLC, Deutsche Bank Securities Inc., Lloyds Securities Inc. and SunTrust Robinson Humphrey, Inc. Letters of credit under the Four Year Unsecured Facility are available to support obligations in connection with the insurance business of the Company and its subsidiaries. Loans under the Four Year Unsecured Facility are available for the general corporate and working capital purposes of the Company. The Company may request that existing lenders under the Four Year Unsecured Facility or prospective additional lenders agree to make available additional commitments from time to time so long as the aggregate commitments under the Four Year Unsecured Facility do not exceed $500,000. Letter of credit fees are payable on account of each letter of credit issued under the Four Year Unsecured Facility at a rate per annum equal to an applicable rate. Borrowings under the Four Year Unsecured Facility bear interest, at the option of the Company, at the base rate (the higher of the prime rate announced by JPMorgan Chase Bank, N.A., the federal funds effective rate plus 0.5%, and the adjusted LIBOR rate plus 1.0%) or the adjusted LIBOR rate applicable to such loans, plus an applicable rate.

Also on March 9, 2012, the Company, Validus Re Americas and Validus Re entered into a $525,000 four-year secured credit

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facility with Deutsche Bank Securities Inc., as syndication agent, JPMorgan Chase Bank, N.A. as administrative agent, Lloyds Securities Inc. and Suntrust Bank, as co-documentation agents and the lenders party thereto, which provides for letter of credit availability for the Company and certain designated subsidiaries of the Company (the "Four Year Secured Facility" and together with the Four Year Unsecured Facility, the "Credit Facilities"). The Four Year Secured Facility was provided by a syndicate of commercial banks arranged by J.P. Morgan Securities LLC, Deutsche Bank Securities Inc., Lloyds Securities Inc. and SunTrust Robinson Humphrey, Inc. Letters of credit under the Four Year Secured Facility will be available to support obligations in connection with the insurance business of the Company and its subsidiaries. The Company may request that existing lenders under the Four Year Secured Facility or prospective additional lenders agree to make available additional commitments from time to time so long as the aggregate commitments under the Four Year Secured Facility do not exceed $700,000. The obligations of the Company and its designated subsidiaries under the Four Year Secured Facility are secured by cash and securities deposited into cash collateral accounts from time to time with The Bank of New York Mellon. Letter of credit fees are payable on account of each letter of credit issued under the Four Year Secured Facility at a rate per annum equal to an applicable rate. Borrowings under the Four Year Secured Facility bear interest at the base rate (the higher of the prime rate announced by JPMorgan Chase Bank, N.A., the federal funds effective rate plus 0.5%, and the adjusted LIBOR rate plus 1.0%).

The Credit Facilities contain covenants that include, among other things (i) the requirement that the Company initially maintain a minimum level of consolidated net worth of at least $2,600,000 and, commencing with the end of the fiscal quarter ending September 30, 2012, to be increased quarterly by an amount equal to 50.0% of the Company's consolidated net income (if positive) for such quarter plus 50.0% of the aggregate increases in the consolidated shareholders' equity of the Company during such fiscal quarter by reason of the issuance and sale of common equity interests of the Company, including upon any conversion of debt securities of the Company into such equity interests, (ii) the requirement that the Company maintain at all times a consolidated total debt to consolidated total capital ratio not greater than 0.35:1.00, and (iii) the requirement that Validus Re and any other material insurance subsidiaries maintain a financial strength rating by A.M. Best of not less than "B++" (Fair). In addition, the Credit Facilities contain customary negative covenants applicable to the Company and its subsidiaries, including limitations on the ability to pay dividends and other payments in respect of equity interests at any time that the Company is otherwise in default with respect to certain provisions under the respective Credit Facilities, limitations on the ability to incur liens, sell assets, merge or consolidate with others, enter into transactions with affiliates, and limitations on the ability of its subsidiaries to incur indebtedness. The Credit Facilities also contain customary affirmative covenants, representations and warranties and events of default for credit facilities of its type.

As of September 30, 2012, there was $318,506 in outstanding letters of credit under the Four Year Secured Facility (December 31, 2011: $nil) and $nil outstanding under the Four Year Unsecured Facility (December 31, 2011: $nil).

As of September 30, 2012, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Credit Facilities.
On March 9, 2012, upon entering into the Credit Facilities, the Company terminated its (a) three-year bi-lateral $60,000 unsecured revolving credit facility, dated March 12, 2010 with Lloyds TSB Bank plc, (b) $340,000 three-year unsecured credit facility, dated March 12, 2010 with Deutsche Bank Securities Inc., as syndication agent and JPMorgan Chase Bank, N.A. as administrative agent and (c) $500,000 five-year secured credit facility, dated March 12, 2007 with Deutsche Bank Securities Inc., as syndication agent and JPMorgan Chase Bank, N.A. as administrative agent. No early termination penalties were incurred.

(ii) Talbot FAL Facility

On November 28, 2007, Talbot entered into a $100,000 standby Letter of Credit facility (the “Talbot FAL Facility”) to provide Funds at Lloyd’s for the 2008 and 2009 underwriting years of account; this facility is guaranteed by the Company and is secured against the assets of Validus Re. The Talbot FAL Facility was provided by a syndicate of commercial banks arranged by Lloyds TSB Bank plc and ING Bank N.V., London Branch.

On November 19, 2009, the Company entered into an Amendment and Restatement of the Talbot FAL Facility to reduce the commitment from $100,000 to $25,000, and to extend the support to the 2010 and 2011 underwriting years of account. On November 18, 2011, the Company entered into an Amendment and Restatement of the Talbot FAL Facility to extend the support to the 2012 and 2013 years of account.

As amended, the Talbot FAL Facility contains affirmative covenants that include, among other things, (i) the requirement

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that we initially maintain a minimum level of consolidated net worth of at least $2,589,615, and commencing with the end of the fiscal quarter ending December 31, 2011 to be increased quarterly by an amount equal to 50% of our consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, and (ii) the requirement that we maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00.

The Talbot FAL Facility also contains restrictions on our ability to incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others. Other than in respect of existing and future preferred and hybrid securities, the payment of dividends and other payments in respect of equity interests are not permitted at any time that we are in default with respect to certain provisions under the Credit Facilities. As of September 30, 2012, the Company had $25,000 (December 31, 2011: $25,000) in outstanding letters of credit under this facility.

As of September 30, 2012, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Talbot FAL Facility.

(iii) IPC Syndicated Facility and IPC Bi-Lateral Facility

IPC obtained letters of credit through the IPC Syndicated Facility and the IPC Bi-Lateral Facility (the “IPC Facilities”). In July, 2009, certain terms of these facilities were amended including suspending IPC’s ability to increase existing letters of credit or to issue new letters of credit. Effective March 31, 2010, the IPC Syndicated Facility was closed. As of September 30, 2012, $51,009 of outstanding letters of credit were issued under the IPC Bi-Lateral Facility (December 31, 2011: $57,146).

As of September 30, 2012, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the IPC Bi-Lateral Facility.

(iv) $500,000 secured bi-lateral facility

On August 10, 2009, Validus Re entered into an uncommitted $500,000 secured bi-lateral letter of credit facility with Citibank Europe plc (the “Secured Bi-Lateral Letter of Credit Facility”). Letters of credit were first issued under the Secured Bi-Lateral Letter of Credit Facility during the first quarter of 2012. As of September 30, 2012, $88,191 of letters of credit were outstanding under the Secured Bi-Lateral Facility. The Secured Bi-Lateral Letter of Credit Facility has no fixed termination date and as of September 30, 2012, Validus Re is in compliance with all terms and covenants thereof.

(v) $10,000 PaCRe Senior secured letter of credit facility

On May 11, 2012, PaCRe (as Borrower) and its subsidiary, PaCRe Investments, Ltd. (as Guarantor) entered into a 364-Day secured revolving credit and letter of credit facility with JPMorgan Chase Bank, N.A. This facility provides for revolving borrowings by the Borrower and for letters of credit issued by the Borrower to be used to support its reinsurance obligations in aggregate amount of $10,000. As of September 30, 2012, no letters of credit or revolving loans were issued under this facility.

12. Commitments and contingencies

(a) Concentrations of credit risk

The Company's investments are managed following prudent standards of diversification. The Company attempts to limit its credit exposure by purchasing high quality fixed income investments to maintain an average portfolio credit quality of AA- or higher with mortgage and commercial mortgage-backed issues having an aggregate weighted average credit quality of AAA. In addition, the Company limits its exposure to any single issuer to 3% or less, excluding treasury and agency securities. With the exception of the Company's bank loan portfolio, the minimum credit rating of any security purchased is Baa3/BBB- and where investments are downgraded, the Company permits a holding of up to 2% in aggregate market value, or 10% with written pre-authorization. At September 30, 2012, 1.1% of the portfolio, excluding bank loans, had a split rating below Baa3/BBB- and the Company did not have an aggregate exposure to any single issuer of more than 1.0% of its investment portfolio, other than with respect to government and agency securities.

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(b) Funds at Lloyd's

The amounts provided under the Talbot FAL Facility would become a liability of the Company in the event of Syndicate 1183 declaring a loss at a level between $507,000 and $532,000 which would call on this arrangement. Talbot operates in Lloyd's through a corporate member, Talbot 2002 Underwriting Capital Ltd ("T02"), which is the sole participant in Syndicate 1183. Lloyd's sets T02's required capital annually based on syndicate 1183's business plan, rating environment, reserving environment together with input arising from Lloyd's discussions with, inter alia, regulatory and rating agencies. Such capital, called Funds at Lloyd's (“FAL”), comprises: cash, investments and undrawn letters of credit provided by various banks. The amounts of cash, investments and letters of credit at September 30, 2012 amounted to $532,500 (December 31, 2011: $473,800) of which $25,000 is provided under the Talbot FAL Facility (December 31, 2011: $25,000).

(c) Lloyd's Central Fund

Whenever a member of Lloyd's is unable to pay its debts to policyholders, such debts may be payable by the Lloyd's Central Fund. If Lloyd's determines that the Central Fund needs to be increased, it has the power to assess premium levies on current Lloyd's members up to 3% of a member's underwriting capacity in any one year. The Company does not believe that any assessment is likely in the foreseeable future and has not provided any allowance for such an assessment. However, based on the Company's 2012 estimated premium income at Lloyd's of £600,000, the September 30, 2012 exchange rate of £1 equals $1.6122 and assuming the maximum 3% assessment, the Company would be assessed approximately $29,020.

(d) Aquiline Commitment

On December 20, 2011, Validus Re entered into an Assignment and Assumption Agreement (the "Agreement") with Aquiline Capital Partners LLC, a Delaware limited liability company (the "Assignor") and Aquiline Capital Partners II GP (Offshore) Ltd., a Cayman Islands company limited by shares (the "General Partner") pursuant to which Validus Re has assumed 100% of the Assignor's interest in Aquiline Financial Services Fund II L.P. (the "Partnership") representing a total capital commitment of $50,000 (the "Commitment"), as a limited partner in the Partnership (the "Transferred Interest"). The Transferred Interest is governed by the terms of an Amended and Restated Exempted Limited Partnership Agreement dated as of July 2, 2010 (the "Limited Partnership Agreement"). Pursuant to the terms of the Limited Partnership Agreement, the Commitment will expire on July 2, 2015. Validus Re's remaining commitment at September 30, 2012 was $41,419.

(e) Acquisition of Flagstone Reinsurance, S.A.

On August 30, 2012, the Company and Flagstone Reinsurance Holdings, S.A. (“Flagstone”) announced that the boards of directors of both the Company and Flagstone had approved a definitive merger agreement pursuant to which the Company will acquire all of the issued and outstanding shares of Flagstone. Under the terms of the agreement, Flagstone shareholders will receive 0.1935 Company voting common shares and $2.00 in cash for each Flagstone share. On the date of the announcement, the transaction provided Flagstone shareholders with a 19.4% premium and $8.43 of value per share based on the closing share price for each of the Company and Flagstone as of Wednesday, August 29, 2012 and represents an aggregate equity value of $623.2 million. For United States tax purposes, the proposed transaction is intended to be tax-free to Flagstone shareholders with respect to the Company's voting common shares they receive.

Completion of the transaction, which is expected to occur in the fourth quarter of 2012, is subject to customary closing conditions, including obtaining regulatory approvals and the approval of Flagstone’s shareholders. The combined company will maintain the Company's name, headquarters and executive management. The Company has obtained agreements from investment funds associated with Lightyear Capital and Trilantic Capital Partners, which collectively own approximately 22.5% of the outstanding Flagstone shares, to vote in favor of the transaction. Flagstone's shareholders are scheduled to vote on the transaction on November 28, 2012.

13. Related party transactions

The transactions listed below are classified as related party transactions as each counter party has either a direct or indirect shareholding in the Company.

Aquiline Capital Partners, LLC and its related companies ("Aquiline"), which own 6,255,943 shares in the Company, hold warrants to purchase 2,756,088 shares, and have two employees on the Company's Board of Directors who do not receive

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compensation from the Company, are shareholders of Group Ark Insurance Holdings Ltd. ("Group Ark"). Christopher E. Watson, a director of the Company, also serves as a director of Group Ark. Pursuant to reinsurance agreements with a subsidiary of Group Ark, the Company recognized gross premiums written during the three and nine months ended September 30, 2012 of $6,167 (2011: $53) and $7,582 (2011:$1,464) of which $569 was included in premiums receivable at September 30, 2012 (December 31, 2011: $330). The Company also recognized reinsurance premiums ceded during the three and nine months ended September 30, 2012 of $nil (2011: $nil) and $nil (2011:$163) of which $nil was included in reinsurance balances payable at September 30, 2012 (December 31, 2011: $21). Earned premium adjustments of $5,019 (2011: $451) and $5,751 (2011:$1,129) were incurred during the three and nine months ended September 30, 2012.

Aquiline is also a shareholder of Tiger Risk Partners LLC ("Tiger Risk"). Christopher E. Watson, a director of the Company serves as a director of Tiger Risk. Pursuant to certain reinsurance contracts, the Company recognized brokerage expenses paid to Tiger Risk for the three and nine months ended September 30, 2012 of $58 (2011: $57) and $2,418 (2011:$1,138) of which $1,492 was included in accounts payable and accrued expenses at September 30, 2012 (December 31, 2011: $86).

On November 24, 2009, the Company entered into an Investment Management Agreement with Conning, Inc. ("Conning") to manage a portion of the Company's investment portfolio. Aquiline acquired Conning on June 16, 2009. John J. Hendrickson and Jeffrey W. Greenberg, directors of the Company, each serve as a director of Conning Holdings Corp., the parent company of Conning and Michael Carpenter, one of the Company's directors, serves as a director of a subsidiary company of Conning Holdings Corp. Investment management fees incurred under this agreement for the three and nine months ended September 30, 2012 were $207 (2011: $200) and $611 (2011:$580) respectively, of which $205 was included in accounts payable and accrued expenses at September 30, 2012 (December 31, 2011: $203).

On December 20, 2011, Validus Re entered into an Assignment and Assumption Agreement (the "Agreement") with Aquiline Capital Partners LLC, a Delaware limited liability company (the "Assignor") and Aquiline Capital Partners II GP
(Offshore) Ltd., a Cayman Islands company limited by shares (the "General Partner") pursuant to which Validus Re has assumed 100% of the Assignor's interest in Aquiline Financial Services Fund II L.P. (the "Partnership") representing a total capital commitment of $50,000 (the "Commitment"), as a limited partner in the Partnership (the "Transferred Interest"). Messrs. Greenberg and Watson, directors of the Company, serve as managing principal and senior principal, respectively, of Aquiline Capital Partners LLC. For the three and nine months ended September 30, 2012, the Company incurred $674 (2011: $nil) and $2,560 (2011:$nil) in partnership fees and made $430 (2011: nil) and $5,328 (2011: $nil) of capital contributions respectively, of which $nil was included in accounts payable and accrued expenses at September 30, 2012 (December 31, 2011: $nil).

Certain shareholders of the Company and their affiliates, as well as the employers of or entities otherwise associated with certain directors and officers or their affiliates, have purchased insurance and/or reinsurance from the Company in the ordinary course of business on terms the Company believes were no more favorable to these (re)insureds than those made available to other customers.

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14. Earnings per share

The following table sets forth the computation of basic and diluted earnings (loss) per share for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Basic earnings per share				
Income	$264,044	$70,001	$510,540	$8,115
(Income) attributable to noncontrolling interest	(56,746)	(13,516)	(11,386)	(14,110)
Income (loss) available (attributable) to Validus	207,298	56,485	499,154	(5,995)
Less: Dividends and distributions declared on outstanding warrants	(1,663)	(1,966)	(5,121)	(5,916)
Income (loss) available (attributable) to common shareholders	$205,635	$54,519	$494,033	$(11,911)
Weighted average number of common shares outstanding	93,368,775	98,961,795	97,016,034	98,430,686
Basic earnings (loss) per share available (attributable) to common shareholders	$2.20	$0.55	$5.09	$(0.12)
Diluted earnings per share				
Income (loss)	$264,044	$70,001	$510,540	$8,115
Loss (income) attributable to noncontrolling interest	(56,746)	(13,516)	(11,386)	(14,110)
Income (loss) available (attributable) to Validus	207,298	56,485	499,154	(5,995)
Less: Dividends and distributions declared on outstanding warrants	—	(1,966)	—	(5,916)
Income (loss) available (attributable) to common shareholders	$207,298	$54,519	$499,154	$(11,911)
Weighted average number of common shares outstanding	93,368,775	98,961,795	97,016,034	98,430,686
Share equivalents:				
Warrants	3,248,788	—	3,116,298	—
Stock options	716,693	603,581	777,245	—
Unvested restricted shares	902,234	1,257,959	1,423,938	—
Weighted average number of diluted common shares outstanding	98,236,490	100,823,335	102,333,515	98,430,686
Diluted earnings (loss) per share available (attributable) to common shareholders	$2.11	$0.54	$4.88	$(0.12)

Share equivalents that would result in the issuance of common shares of 2,724 (2011: 175,454) and 231,621 (2011: 223,518) were outstanding for the three and nine months ended September 30, 2012, but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

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15. Subsequent events

Hurricane Sandy
On October 29, 2012 Hurricane Sandy made landfall on the eastern seaboard of the United States causing widespread flooding and property damage across a number of states. The Company is continuing to review its in-force contracts and preliminary loss information from clients for this event and expects that aggregated net losses from this event will likely have a significant impact on our fourth quarter 2012 results.
Quarterly Dividend

On November 1, 2012, the Company announced a quarterly cash dividend of $0.25 per each common share and $0.25 per
common share equivalent for which each outstanding warrant is exercisable, payable on December 28, 2012 to holders of record on December 14, 2012.

16. Segment information

The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. and Talbot Holdings Ltd. from which three operating segments have been determined under U.S. GAAP segment reporting. 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 segment structure. This change included the AlphaCat group of companies as a separate operating segment. "AlphaCat segment" was included as an additional segment and includes the Company's investments in AlphaCat Re 2011, AlphaCat Re 2012 and PaCRe. Prior period comparatives have been restated to reflect the change in segmentation. The Company's operating segments are strategic business units that offer different products and services. They are managed and have capital allocated separately because each business requires different strategies.

Validus Re Segment

The Validus Re segment is focused on short-tail lines of reinsurance. The primary lines in which the segment conducts business are property, marine and specialty which includes agriculture, aerospace and aviation, financial lines of business, nuclear, terrorism, life, accident & health, workers' compensation, crisis management, contingency, motor and technical lines.

AlphaCat Segment

The AlphaCat segment manages strategic relationships that leverage the Company's underwriting and investment expertise and earns management, performance and underwriting fees primarily from the Company's operating affiliates, AlphaCat Re 2011 and AlphaCat Re 2012, as well as an investment in PaCRe.

Validus Re Consolidated

The Validus Re consolidated group of companies represents the Validus Reinsurance, Ltd. consolidated U.S. GAAP results.

Talbot Segment

The Talbot segment focuses on a wide range of marine and energy, war, political violence, commercial property, financial institutions, contingency, bloodstock, accident & health and aviation classes of business on an insurance or facultative reinsurance basis and principally property, aerospace and marine classes of business on a treaty reinsurance basis.

Corporate and other reconciling items

The Company has a "Corporate" function, which includes the activities of the parent company, and which carries out certain functions for the group. "Corporate" includes non-core' underwriting expenses, predominantly general and administrative and stock compensation expenses. "Corporate" also denotes the activities of certain key executives such as the Chief Executive Officer and Chief Financial Officer. For internal reporting purposes, "Corporate" is reflected separately, however "Corporate" is not considered an operating segment under these circumstances. Other reconciling items include, but are not limited to, the elimination of intersegment revenues and expenses and unusual items that are not allocated to segments. Corporate also includes transaction

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expenses relating to the costs incurred in connection with the proposed acquisition of Flagstone Reinsurance Holdings, S.A in 2012 and the proposed acquisition of Transatlantic Holdings, Inc. in 2011.

The following tables summarize the results of our operating segments and "Corporate":

Three Months Ended September 30, 2012	Validus Re Segment	AlphaCat Segment	Legal Entity Adjustments	Validus Re Consolidated	Talbot Segment	Corporate & Eliminations	Total
Underwriting income							
Gross premiums written	$145,010	$2,934	$—	$ 147,944	$260,755	$(18,484)	$390,215
Reinsurance premiums ceded	(10,426)	—	—	(10,426)	(53,801)	18,484	(45,743)
Net premiums written	134,584	2,934	—	137,518	206,954	—	344,472
Change in unearned premiums	107,728	2,591	—	110,319	20,313	—	130,632
Net premiums earned	242,312	5,525	—	247,837	227,267	—	475,104
Underwriting deductions							
Losses and loss expenses	66,890	—	—	66,890	88,565	—	155,455
Policy acquisition costs	37,785	547	—	38,332	61,640	(1,349)	98,623
General and administrative expenses	16,938	2,087	1,142	20,167	36,605	13,775	70,547
Share compensation expenses	2,076	84	135	2,295	2,200	2,850	7,345
Total underwriting deductions	123,689	2,718	1,277	127,684	189,010	15,276	331,970
Underwriting income (loss)	$118,623	$2,807	$(1,277)	$ 120,153	$38,257	$(15,276)	$143,134
Net investment income	19,644	1,193	—	20,837	5,260	(608)	25,489
Other income	1,543	7,674	1,620	10,837	680	(4,193)	7,324
Finance expenses	(789)	(56)	—	(845)	(73)	(8,444)	(9,362)
Operating income (loss) before taxes and income from operating affiliates	139,021	11,618	343	150,982	44,124	(28,521)	166,585
Tax (expense)	(2)	—	—	(2)	(11)	(1,330)	(1,343)
Income from operating affiliates	—	6,235	—	6,235	—	—	6,235

Net operating income (loss)	$139,019	$17,853	$343	$157,215	$44,113	$(29,851)	$171,477
Net realized gains on investments	6,643	300	—	6,943	2,120	—	9,063
Net unrealized gains on investments	19,232	62,432	—	81,664	4,681	—	86,345
(Loss) from investment affiliate	(160)	—	—	(160)	—	—	(160)
Foreign exchange gains (losses)	8	30	—	38	1,146	(81)	1,103
Transaction expenses (b)	—	—	—	—	—	(3,784)	(3,784)
Net income (loss)	$164,742	$80,615	$343	$245,700	$52,060	$(33,716)	$264,044
Net (income) attributable to noncontrolling interest	—	(56,746)	—	(56,746)	—	—	(56,746)
Net income (loss) available (attributable) to Validus	$164,742	$23,869	$343	$188,954	$52,060	$(33,716)	$207,298
Selected ratios:							
Net premiums written / Gross premiums written	92.8%	100.0%			79.4%		88.3%
Losses and loss expenses	27.6%	0.0%			39.0%		32.7%
Policy acquisition costs	15.6%	9.9%			27.1%		20.8%
General and administrative expenses (a)	7.8%	39.3%			17.1%		16.4%
Expense ratio	23.4%	49.2%			44.2%		37.2%
Combined ratio	51.0%	49.2%			83.2%		69.9%
Total assets	$4,729,344	$768,612			$2,931,174	$34,690	$8,463,820

(a) Ratios are based on net premiums earned. The general and administrative expense ratio includes share compensation expenses.

(b) The transaction expenses relate to costs incurred in connection with the proposed acquisition of Flagstone Reinsurance Holdings, S.A.

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Three Months Ended September 30, 2011	Validus Re Segment	AlphaCat Segment	Legal Entity Adjustments	Validus Re Consolidated	Talbot Segment	Corporate & Eliminations	Total
Underwriting income							
Gross premiums written	$163,863	$18,940	$—	$182,803	$238,937	$(30,611)	$391,129
Reinsurance premiums ceded	(5,646)	—	—	(5,646)	(55,551)	30,611	(30,586)
Net premiums written	158,217	18,940	—	177,157	183,386	—	360,543
Change in unearned premiums	81,997	8,758	—	90,755	7,326	—	98,081
Net premiums earned	240,214	27,698	—	267,912	190,712	—	458,624
Underwriting deductions							
Losses and loss expenses	128,823	—	—	128,823	97,244	—	226,067
Policy acquisition costs	40,592	3,326	(1,084)	42,834	36,651	(2,080)	77,405
General and administrative expenses	7,358	2,167	620	10,145	21,745	4,036	35,926
Share compensation expenses	2,190	26	284	2,500	1,903	2,979	7,382
Total underwriting deductions	178,963	5,519	(180)	184,302	157,543	4,935	346,780
Underwriting income (loss)	$61,251	$22,179	$180	$83,610	$33,169	$(4,935)	$111,844
Net investment income	22,807	751	—	23,558	6,451	(2,262)	27,747
Other income	2,187	2,225	(1,102)	3,310	(1)	(3,309)	—
Finance expenses	(2,632)	787	—	(1,845)	(151)	(8,939)	(10,935)
Operating income (loss) before taxes	83,613	25,942	(922)	108,633	39,468	(19,445)	128,656
Tax (expense)	(7)	—	—	(7)	(2,345)	(186)	(2,538)
Net operating income (loss)	$83,606	$25,942	$(922)	$108,626	$37,123	$(19,631)	$126,118
Net realized gains (losses) on investments	4,538	(25)	—	4,513	733	—	5,246
Net unrealized (losses) gains on investments	(26,298)	324	—	(25,974)	(1,875)	1	(27,848)
Foreign exchange (losses)	(9,778)	(164)	—	(9,942)	(9,943)	(47)	(19,932)
Transaction expenses (b)	—	—	—	—	—	(13,583)	(13,583)

Net income (loss)	$52,068	$26,077	$(922)	$77,223	$26,038	$(33,260)	$70,001
Net (income) attributable to noncontrolling interest	—	(13,516)	—	(13,516)	—	—	(13,516)
Net income (loss) available (attributable) to Validus	$52,068	$12,561	$(922)	$63,707	$26,038	$(33,260)	$56,485
Selected ratios:							
Net premiums written / Gross premiums written	96.6 %	100.0 %			76.8 %		92.2 %
Losses and loss expenses	53.6 %	0.0 %			51.0 %		49.3 %
Policy acquisition costs	16.9 %	12.0 %			19.2 %		16.9 %
General and administrative expenses (a)	4.0 %	7.9 %			12.4 %		9.4 %
Expense ratio	20.9 %	19.9 %			31.6 %		26.3 %
Combined ratio	74.5 %	19.9 %			82.6 %		75.6 %
Total assets	$4,810,032	$400,233			$2,773,597	$16,877	$8,000,740

(a) Ratios are based on net premiums earned. The general and administrative expense ratio includes share compensation expenses.

(b) The transaction expenses relate to costs incurred in connection with the Company's proposed acquisition of Transatlantic Holdings, Inc. Transaction expenses are primarily comprised of legal, financial advisory and audit related services.

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Nine Months Ended September 30, 2012	Validus Re Segment	AlphaCat Segment	Legal Entity Adjustments	Validus Re Consolidated	Talbot Segment	Corporate & Eliminations	Total
Underwriting income							
Gross premiums written	$1,052,726	$21,607	$—	$1,074,333	$837,536	$(57,276)	$1,854,593
Reinsurance premiums ceded	(137,504)	—	—	(137,504)	(191,619)	57,276	(271,847)
Net premiums written	915,222	21,607	—	936,829	645,917	—	1,582,746
Change in unearned premiums	(177,215)	(9,832)	—	(187,047)	(21,769)	—	(208,816)
Net premiums earned	738,007	11,775	—	749,782	624,148	—	1,373,930
Underwriting deductions							
Losses and loss expenses	244,286	—	—	244,286	296,850	—	541,136
Policy acquisition costs	113,659	1,185	(25)	114,819	142,181	(4,116)	252,884
General and administrative expenses	48,332	5,521	3,457	57,310	100,910	40,337	198,557
Share compensation expenses	5,914	195	446	6,555	5,347	7,681	19,583
Total underwriting deductions	412,191	6,901	3,878	422,970	545,288	43,902	1,012,160
Underwriting income (loss)	$325,816	$4,874	$(3,878)	$326,812	$78,860	$(43,902)	$361,770
Net investment income	64,915	2,672	—	67,587	16,475	(4,928)	79,134
Other income	4,229	22,237	4,528	30,994	2,033	(10,818)	22,209
Finance expenses	(6,628)	(495)	—	(7,123)	(224)	(32,000)	(39,347)
Operating income (loss) before taxes and income from operating affiliates	388,332	29,288	650	418,270	97,144	(91,648)	423,766
Tax (expense)	(11)	—	—	(11)	(562)	(1,313)	(1,886)
Income from operating affiliates	—	13,194	—	13,194	—	—	13,194
Net operating income (loss)	$388,321	$42,482	$650	$431,453	$96,582	$(92,961)	$435,074
Net realized gains on investments	17,708	216	—	17,924	4,825	—	22,749
Net unrealized gains on investments	35,400	12,316	—	47,716	5,726	—	53,442

(Loss) from investment affiliate	(558)	—	—	(558)	—	—	(558)
Foreign exchange gains (losses)	2,461	47	—	2,508	1,334	(225)	3,617
Transaction expenses (b)	—	—	—	—	—	(3,784)	(3,784)
Net income (loss)	$443,332	$55,061	$650	$499,043	$108,467	$(96,970)	$510,540
Net (income) attributable to noncontrolling interest	—	(11,386)	—	(11,386)	—	—	(11,386)
Net income (loss) available (attributable) to Validus	$443,332	$43,675	$650	$487,657	$108,467	$(96,970)	$499,154
Selected ratios:							
Net premiums written / Gross premiums written	86.9%	100.0%			77.1%		85.3%
Losses and loss expenses	33.1%	0.0%			47.6%		39.4%
Policy acquisition costs	15.4%	10.1%			22.8%		18.4%
General and administrative expenses (a)	7.4%	48.5%			17.0%		15.9%
Expense ratio	22.8%	58.6%			39.8%		34.3%
Combined ratio	55.9%	58.6%			87.4%		73.7%
Total assets	$4,729,344	$768,612			$2,931,174	$34,690	$8,463,820

(a) Ratios are based on net premiums earned. The general and administrative expense ratio includes share compensation expenses.

(b) The transaction expenses relate to costs incurred in connection with the proposed acquisition of Flagstone Reinsurance Holdings, S.A.

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Nine Months Ended September 30, 2011	Validus Re Segment	AlphaCat Segment	Legal Entity Adjustments	Validus Re Consolidated	Talbot Segment	Corporate & Eliminations	Total
Underwriting income							
Gross premiums written	$1,058,642	$77,050	$—	$1,135,692	$778,880	$(68,160)	$1,846,412
Reinsurance premiums ceded	(150,669)	—	—	(150,669)	(190,243)	68,160	(272,752)
Net premiums written	907,973	77,050	—	985,023	588,637	—	1,573,660
Change in unearned premiums	(194,529)	(37,595)	—	(232,124)	(27,739)	—	(259,863)
Net premiums earned	713,444	39,455	—	752,899	560,898	—	1,313,797
Underwriting deductions							
Losses and loss expenses	533,402	—	—	533,402	376,170	—	909,572
Policy acquisition costs	115,355	4,615	(1,301)	118,669	116,174	(1,912)	232,931
General and administrative expenses	32,947	4,122	3,780	40,849	82,396	21,999	145,244
Share compensation expenses	7,118	74	786	7,978	6,648	12,433	27,059
Total underwriting deductions	688,822	8,811	3,265	700,898	581,388	32,520	1,314,806
Underwriting income (loss)	$24,622	$30,644	$(3,265)	$52,001	$(20,490)	$(32,520)	$(1,009)
Net investment income	68,901	2,697	—	71,598	19,413	(6,795)	84,216
Other income	4,223	5,398	(1,180)	8,441	2,194	(8,434)	2,201
Finance expenses	(5,924)	(2,136)	—	(8,060)	(214)	(33,023)	(41,297)
Operating income (loss) before taxes	91,822	36,603	(4,445)	123,980	903	(80,772)	44,111
Tax (expense)	(13)	—	—	(13)	(760)	(277)	(1,050)
Net operating income (loss)	$91,809	$36,603	$(4,445)	$123,967	$143	$(81,049)	$43,061
Net realized gains on investments	17,453	531	—	17,984	5,193	—	23,177
Net unrealized (losses) gains on investments	(18,597)	(1,335)	—	(19,932)	(2,219)	1	(22,150)
Foreign exchange (losses)	(19,314)	(325)	—	(19,639)	(2,632)	(119)	(22,390)
Transaction expenses	—	—	—	—	—	(13,583)	(13,583)

Net income (loss)	$71,351	$35,474	$(4,445)	$102,380	$485	$(94,750)	$8,115
Net (income) attributable to noncontrolling interest	—	(14,110)	—	(14,110)	—	—	(14,110)
Net income (loss) available (attributable) to Validus	$71,351	$21,364	$(4,445)	$88,270	$485	$(94,750)	$(5,995)
Selected ratios:							
Net premiums written / Gross premiums written	85.8%	100.0%			75.6%		85.2%
Losses and loss expenses	74.8%	0.0%			67.1%		69.2%
Policy acquisition costs	16.2%	11.7%			20.7%		17.7%
General and administrative expenses (a)	5.6%	10.6%			15.9%		13.1%
Expense ratio	21.8%	22.3%			36.6%		30.8%
Combined ratio	96.6%	22.3%			103.7%		100.0%
Total assets	$4,810,032	$400,233			$2,773,597	$16,877	$8,000,740

(a) Ratios are based on net premiums earned. The general and administrative expense ratio includes share compensation expenses.

(b) The transaction expenses relate to costs incurred in connection with the Company's proposed acquisition of Transatlantic Holdings, Inc. Transaction expenses are primarily comprised of legal, financial advisory and audit related services.

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The Company's exposures are generally diversified across geographic zones. The following tables set forth the gross premiums written allocated to the territory of coverage exposure for the periods indicated:

	Three Months Ended September 30, 2012					
	Gross Premiums Written					
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%
United States	$58,972	$2,204	$27,899	$(1,978)	$87,097	22.4 %
Worldwide excluding United States (a)	9,202	—	64,687	(4,586)	69,303	17.8 %
Europe	11,255	513	10,426	(739)	21,455	5.5 %
Latin America and Caribbean	4,522	—	29,194	(2,069)	31,647	8.1 %
Japan	727	—	1,916	(136)	2,507	0.6 %
Canada	263	—	3,696	(262)	3,697	0.9 %
Rest of the world (b)	7,773	217	—	—	7,990	2.0 %
Sub-total, non United States	33,742	730	109,919	(7,792)	136,599	34.9 %
Worldwide including United States (a)	14,178	—	17,571	(1,245)	30,504	7.8 %
Marine and Aerospace (c)	38,118	—	105,366	(7,469)	136,015	34.9 %
Total	$145,010	$2,934	$260,755	$(18,484)	$390,215	100.0 %

	Three Months Ended September 30, 2011					
	Gross Premiums Written					
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%
United States	$53,058	$4,940	$34,615	$(4,286)	$88,327	22.6 %
Worldwide excluding United States (a)	15,410	—	62,570	(8,265)	69,715	17.8 %
Europe	14,722	—	6,660	(919)	20,463	5.2 %
Latin America and Caribbean	5,886	—	33,836	(4,285)	35,437	9.1 %
Japan	9,679	—	3,571	(306)	12,944	3.3 %
Canada	306	—	2,480	(306)	2,480	0.6 %
Rest of the world (b)	3,063	—	—	—	3,063	0.8 %
Sub-total, non United States	49,066	—	109,117	(14,081)	144,102	36.8 %
Worldwide including United States (a)	15,675	14,000	14,997	(1,836)	42,836	11.0 %
Marine and Aerospace (c)	46,064	—	80,208	(10,408)	115,864	29.6 %
Total	$163,863	$18,940	$238,937	$(30,611)	$391,129	100.0 %

(a) Represents risks in two or more geographic zones.
(b) Represents risks in one geographic zone.
(c) Not classified as geographic area as marine and aerospace risks can span multiple geographic areas and are not fixed locations in some instances.

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	Nine Months Ended September 30, 2012					
	Gross Premiums Written					
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%
United States	$426,875	$18,778	$89,595	$(6,213)	$529,035	28.5 %
Worldwide excluding United States (a)	36,047	—	202,281	(13,892)	224,436	12.1 %
Europe	83,473	1,333	39,871	(2,503)	122,174	6.6 %
Latin America and Caribbean	30,735	—	82,935	(5,439)	108,231	5.8 %
Japan	31,704	—	6,003	(373)	37,334	2.0 %
Canada	587	—	9,366	(589)	9,364	0.6 %
Rest of the world (b)	59,781	496	—	—	60,277	3.3 %
Sub-total, non United States	242,327	1,829	340,456	(22,796)	561,816	30.4 %
Worldwide including United States (a)	92,931	1,000	50,737	(3,047)	141,621	7.6 %
Marine and Aerospace (c)	290,593	—	356,748	(25,220)	622,121	33.5 %
Total	$1,052,726	$21,607	$837,536	$(57,276)	$1,854,593	100.0 %

	Nine Months Ended September 30, 2011					
	Gross Premiums Written					
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%
United States	$454,539	$57,188	$96,627	$(8,490)	$599,864	32.5 %
Worldwide excluding United States (a)	44,968	—	187,741	(11,234)	221,475	12.0 %
Europe	83,188	1,229	41,604	(1,480)	124,541	6.7 %
Latin America and Caribbean	41,804	633	74,369	(26,856)	89,950	4.9 %
Japan	43,748	—	6,327	(406)	49,669	2.7 %
Canada	416	—	8,731	(416)	8,731	0.5 %
Rest of the world (b)	48,059	—	—	—	48,059	2.6 %
Sub-total, non United States	262,183	1,862	318,772	(40,392)	542,425	29.4 %
Worldwide including United States (a)	92,455	18,000	41,033	(2,378)	149,110	8.1 %
Marine and Aerospace (c)	249,465	—	322,448	(16,900)	555,013	30.0 %
Total	$1,058,642	$77,050	$778,880	$(68,160)	$1,846,412	100.0 %

(a) Represents risks in two or more geographic zones.
(b) Represents risks in one geographic zone.
(c) Not classified as geographic area as marine and aerospace risks can span multiple geographic areas and are not fixed locations in some instances.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of the Company's consolidated results of operations for the three and nine months ended September 30, 2012 and 2011 and the Company's consolidated financial condition, liquidity and capital resources at September 30, 2012 and December 31, 2011. This discussion and analysis should be read in conjunction with the audited consolidated financial statements and related notes for the fiscal year ended December 31, 2011, the discussions of critical accounting policies and the qualitative and quantitative disclosure about market risk contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

For a variety of reasons, the Company's historical financial results may not accurately indicate future performance. See "Cautionary Note Regarding Forward-Looking Statements." The Risk Factors set forth in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011 present a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained herein.

Executive Overview

The Company underwrites from three distinct global operating segments, Validus Re, Talbot and AlphaCat. Validus Re, the Company's principal reinsurance operating segment, operates as a Bermuda-based provider of short-tail reinsurance products on a global basis. Talbot, the Company's principal insurance operating segment manages Syndicate 1183 at Lloyd's of London ("Lloyd's") and which writes short-tail insurance products on a worldwide basis. The AlphaCat segment manages strategic relationships that leverage the Company's underwriting and investment expertise and earns management, performance and underwriting fees primarily from our agreements with AlphaCat Re 2011, AlphaCat Re 2012 and PaCRe. In addition, the AlphaCat segment earns income from our equity interests in AlphaCat Re 2011 and AlphaCat Re 2012 as well as our investment in PaCRe.

The Company's strategy has been to concentrate primarily on short-tail risks, which has been an area where management believes current prices and terms provide an attractive risk adjusted return and the management team has proven expertise. The Company's profitability in any given period is based upon premium and investment revenues, less net losses and loss expenses, acquisition expenses and operating expenses. Financial results in the insurance and reinsurance industry are influenced by the frequency and/or severity of claims and losses, including as a result of catastrophic events, changes in interest rates, financial markets and general economic conditions, the supply of insurance and reinsurance capacity and changes in legal, regulatory and judicial environments.

On April 2, 2012, the Company capitalized PaCRe, a new Class 4 Bermuda reinsurer formed for the purpose of writing high excess property catastrophe reinsurance. PaCRe was funded with $500.0 million of contributed capital. Validus invested $50.0 million in PaCRe's common equity. The Company will underwrite business for PaCRe, for which it will be paid a profit commission based on the company's underwriting results. As Validus Re holds a majority of PaCRe's outstanding voting rights, the financial statements of PaCRe are included in the consolidated financial statements for the Company. The portion of PaCRe's earnings attributable to third party investors for three and nine months ended September 30, 2012 is recorded in the consolidated Statements of Comprehensive Income (Loss) as "Net (income) loss attributable to noncontrolling interest."

On May 29, 2012, the Company announced that it has joined with other investors in capitalizing AlphaCat Re 2012. AlphaCat Re 2012 is a new special purpose reinsurer formed for the purpose of writing collateralized reinsurance with a particular focus on windstorm risks for Florida domiciled insurance companies. AlphaCat Re 2012 was funded with $70.0 million of equity capital. The Company will underwrite business for AlphaCat Re 2012, for which it will be paid a commission for originating the business and a profit commission based on underwriting results. Validus Re has an equity interest and voting rights in AlphaCat Re 2012 which is below 50%, therefore the investment in AlphaCat Re 2012 is included as an equity method investment in the consolidated financial statements of the Company.

On August 30, 2012, the Company and Flagstone Reinsurance Holdings, S.A. ("Flagstone") announced that the boards of directors of both the Company and Flagstone had approved a definitive merger agreement pursuant to which the Company will acquire all of the issued and outstanding shares of Flagstone. Under the terms of the agreement, Flagstone shareholders will receive 0.1935 Company voting common shares and $2.00 in cash for each Flagstone share. On the date of the announcement, the transaction provided Flagstone shareholders with a 19.4% premium and $8.43 of value per share based on the closing share price for each of the Company and Flagstone as of Wednesday, August 29, 2012 and represents an aggregate equity value of $623.2 million. For United States tax purposes, the proposed transaction is intended to be tax-free to Flagstone shareholders with respect to the

Company's voting common shares they receive.
Completion of the transaction, which is expected to occur in the fourth quarter of 2012, is subject to customary closing conditions, including obtaining regulatory approvals and the approval of Flagstone’s shareholders. The combined company will maintain the Company's name, headquarters and executive management. The Company has obtained agreements from investment funds associated with Lightyear Capital and Trilantic Capital Partners, which collectively own approximately 22.5% of the outstanding Flagstone shares, to vote in favor of the transaction. Flagstone's shareholders are scheduled to vote on the transaction on November 28, 2012.

Business Outlook and Trends

We underwrite global specialty property insurance and reinsurance and have large aggregate exposures to natural and man-made disasters. The occurrence of claims from catastrophic events results in substantial volatility, and can have material adverse effects on the Company’s financial condition and results and ability to write new business. This volatility affects results for the period in which the loss occurs because U.S. accounting principles do not permit reinsurers to reserve for such catastrophic events until they occur. Catastrophic events of significant magnitude historically have been relatively infrequent, although management believes the property catastrophe reinsurance market has experienced a higher level of worldwide catastrophic losses in terms of both frequency and severity in the period from 1992 to the present. We also expect that increases in the values and concentrations of insured property will increase the severity of such occurrences in the future. The Company seeks to reflect these trends when pricing contracts.

Property and other reinsurance premiums have historically risen in the aftermath of significant catastrophic losses. As loss reserves are established, industry surplus is depleted and the industry’s capacity to write new business diminishes. At the same time, management believes that there is a heightened awareness of exposure to natural catastrophes on the part of cedants, rating agencies and catastrophe modeling firms, resulting in an increase in the demand for reinsurance protection.

The global property and casualty insurance and reinsurance industry has historically been highly cyclical. The Company was formed in October 2005 in response to the supply/demand imbalance resulting from the large industry losses in 2004 and 2005. In the aggregate, the Company observed substantial increases in premium rates in 2006 compared to 2005 levels. During the years ended December 31, 2007 and 2008, the Company experienced increased competition in most lines of business. Capital provided by new entrants or by the commitment of additional capital by existing insurers and reinsurers increased the supply of insurance and reinsurance which resulted in a softening of rates in most lines. However, during 2008, the insurance and reinsurance industry incurred material losses and capital declines due to Hurricanes Ike and Gustav and the global financial crisis. In the wake of these events, the January 2009 renewal season saw decreased competition and increased premium rates due to relatively scarce capital and increased demand. During 2009, the Company observed reinsurance demand stabilization and industry capital recovery from investment portfolio gains. In 2009, there were few notable large losses affecting the worldwide (re)insurance industry and no major hurricanes making landfall in the United States. In 2010, the Company continued to see increased competition and decreased premium rates in most classes of business with the exception of offshore energy, Latin America, financial institutions and political risk lines. During 2010 there was an increased level of catastrophe activity, principally the Chilean earthquake and the Deepwater Horizon events. In 2011, the Company continued to see increased catastrophe activity, principally the Tohuku and Christchurch earthquakes. During 2011, while the Company continued to see strong competition for business there were also positive rate movements, particularly on loss affected lines.

During the January 2012 renewal season, the Validus Re segment showed rate improvement relative to 2011. This improvement was largely due to the large catastrophe loss activity during 2011. During the first quarter of 2012, Talbot experienced rate increases in loss affected lines without seeing a systemic rise in rates across all lines.

During the July 2012 renewal period, the Validus Re segment experienced rate improvements in the U.S. property lines while European and Latin American property rates were unchanged. The Talbot segment experienced a rate increase of 3.7% across the portfolio, with some lines performing in line with expectations and other lines either de-risking or reassessing the portfolio.

Financial Measures

The Company believes the following financial indicators are important in evaluating performance and measuring the overall growth in value generated for shareholders:

Annualized return on average equity represents the level of net income available to shareholders generated from the average shareholders’ equity during the period. Annualized return on average equity is calculated by dividing the net income available to Validus for the period by the average shareholders’ equity available to Validus during the period. Average shareholders’ equity available to Validus is the average of the beginning, ending and intervening quarter end shareholders' equity available to Validus balances. Percentages for the quarter and interim periods are annualized. The Company's objective is to generate superior returns on capital that appropriately reward shareholders for the risks assumed and to grow premiums written only when returns meet or exceed internal requirements. Details of annualized return on average equity are provided below.

	Three Months Ended September 30,		Year Ended December 31,
	2012	2011	2011
Annualized return on average equity	23.3 %	6.6 %	0.6 %

The increase in annualized return on average equity for the three months ended September 30, 2012 was driven primarily by an increase in net income. Net income available to Validus for the three months ended September 30, 2012 increased by $150.8 million, or 267.0% compared to the three months ended September 30, 2011. The increase in net income for the three months ended September 30, 2012 was primarily due to a favorable movement of $114.2 million in net unrealized gains (losses) on investments and an increase in underwriting income of $31.3 million.

Diluted book value per common share is considered by management to be an appropriate measure of our returns to common shareholders, as we believe growth in our book value on a diluted basis ultimately translates into growth of our stock price. Diluted book value per common share increased by $3.99, or 12.4%, from $32.28 at December 31, 2011 to $36.27 at September 30, 2012. The increase was due to the income generated in the nine months ended September 30, 2012. Diluted book value per common share is a Non-GAAP financial measure. The most comparable U.S. GAAP financial measure is book value per common share. Diluted book value per common share is calculated based on total shareholders' equity plus the assumed proceeds from the exercise of outstanding options and warrants, divided by the sum of common shares, unvested restricted shares, options and warrants outstanding (assuming their exercise). A reconciliation of diluted book value per common share to book value per common share is presented below in the section entitled "Other Non-GAAP Financial Measures."

Cash dividends per common share are an integral part of the value created for shareholders. On November 1, 2012, the Company announced a quarterly cash dividend of $0.25 per each common share and $0.25 per common share equivalent for which each outstanding warrant is exercisable, payable on December 28, 2012 to holders of record on December 14, 2012.

Underwriting income (loss) measures the performance of the Company's core underwriting function, excluding revenues and expenses such as net investment income (loss), other income, finance expenses, net realized and unrealized gains (losses) on investments, income (loss) from investment and operating affiliates, foreign exchange gains (losses) and transaction expenses. The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company's core insurance and reinsurance operations. The most comparable U.S. GAAP financial measure is net income. Underwriting income for the three months ended September 30, 2012 and 2011 was $143.1 million and $111.8 million, respectively. Underwriting income (loss) is a non-GAAP financial measure as described in detail and reconciled in the section below entitled "Underwriting Income."

Managed gross premiums written, a non-GAAP financial measure, represents gross premiums written by the Company and its operating affiliates. Managed gross premiums written differs from total gross premiums written, which the Company believes is the most directly comparable GAAP measure, due to the inclusion of premiums written on behalf of the Company's operating affiliates, AlphaCat Re 2011 and AlphaCat Re 2012, which are accounted for under the equity method of accounting. A reconciliation of managed gross premiums written to gross premiums written, the most comparable U.S. GAAP financial measure, is presented in below in the section entitled

"Other Non-GAAP Financial Measures."

Critical Accounting Policies and Estimates

There are certain accounting policies that the Company considers to be critical due to the judgment and uncertainty inherent in the application of those policies. In calculating financial statement estimates, the use of different assumptions could produce materially different estimates. The Company believes the following critical accounting policies affect significant estimates used in the preparation of our consolidated financial statements:

- Premiums;
- Reinsurance premiums ceded and reinsurance recoverable;
- Investment valuation; and

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- Reserve for losses and loss expenses.

Critical accounting policies and estimates are discussed further in Item 7, Management's Discussion and Analysis of Results of Operations and Financial Condition in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Segment Reporting

Management has determined that the Company operates in three operating segments. The three significant operating segments are Validus Re, AlphaCat and Talbot.

Results of Operations

Validus Re commenced operations on December 16, 2005. The Company’s fiscal year ends on December 31. Financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information.

The following table presents results of operations for the three and nine months ended September 30, 2012 and 2011:

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(Dollars in thousands)	Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Underwriting income				
Gross premiums written	$390,215	$391,129	$1,854,593	$1,846,412
Reinsurance premiums ceded	(45,743)	(30,586)	(271,847)	(272,752)
Net premiums written	344,472	360,543	1,582,746	1,573,660
Change in unearned premiums	130,632	98,081	(208,816)	(259,863)
Net premiums earned	475,104	458,624	1,373,930	1,313,797
Underwriting deductions				
Losses and loss expenses	155,455	226,067	541,136	909,572
Policy acquisition costs	98,623	77,405	252,884	232,931
General and administrative expenses	70,547	35,926	198,557	145,244
Share compensation expenses	7,345	7,382	19,583	27,059
Total underwriting deductions	331,970	346,780	1,012,160	1,314,806
Underwriting income (loss) (a)	143,134	111,844	361,770	(1,009)
Net investment income	25,489	27,747	79,134	84,216
Other income	7,324	—	22,209	2,201
Finance expenses	(9,362)	(10,935)	(39,347)	(41,297)
Operating income before taxes and income from operating affiliates	166,585	128,656	423,766	44,111
Tax (expense)	(1,343)	(2,538)	(1,886)	(1,050)
Income from operating affiliates	6,235	—	13,194	—
Net operating income (a)	171,477	126,118	435,074	43,061
Net realized gains on investments	9,063	5,246	22,749	23,177
Net unrealized gains (losses) on investments	86,345	(27,848)	53,442	(22,150)
(Loss) from investment affiliate	(160)	—	(558)	—
Foreign exchange gains (losses)	1,103	(19,932)	3,617	(22,390)
Transaction expenses (c)	(3,784)	(13,583)	(3,784)	(13,583)
Net income	264,044	70,001	510,540	8,115
Net (income) attributable to noncontrolling interest	(56,746)	(13,516)	(11,386)	(14,110)
Net income (loss) available (attributable) to Validus	$207,298	$56,485	$499,154	$(5,995)
Selected ratios:				
Net premiums written / Gross premiums written	88.3%	92.2%	85.3%	85.2%
Losses and loss expenses	32.7%	49.3%	39.4%	69.2%
Policy acquisition costs	20.8%	16.9%	18.4%	17.7%
General and administrative expenses (b)	16.4%	9.4%	15.9%	13.1%
Expense ratio	37.2%	26.3%	34.3%	30.8%
Combined ratio	69.9%	75.6%	73.7%	100.0%

a) Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income and net operating income that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation of underwriting income to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled "Underwriting Income".

b) The general and administrative expense ratio includes share compensation expenses.

c) The transaction expenses relate to costs incurred in connection with the proposed acquisition of Flagstone Reinsurance Holdings, S.A. The transaction expenses for 2011 relate to costs incurred in connection with the Company's proposed acquisition of Transatlantic Holdings, Inc. Transaction expenses are primarily comprised of legal, financial advisory and audit related services.

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Validus Re				
Gross premiums written	$145,010	$163,863	$1,052,726	$1,058,642
Reinsurance premiums ceded	(10,426)	(5,646)	(137,504)	(150,669)
Net premiums written	134,584	158,217	915,222	907,973
Change in unearned premiums	107,728	81,997	(177,215)	(194,529)
Net premiums earned	242,312	240,214	738,007	713,444
Losses and loss expenses	66,890	128,823	244,286	533,402
Policy acquisition costs	37,785	40,592	113,659	115,355
General and administrative expenses	16,938	7,358	48,332	32,947
Share compensation expenses	2,076	2,190	5,914	7,118
Total underwriting deductions	123,689	178,963	412,191	688,822
Underwriting income (a)	$118,623	$61,251	$325,816	$24,622
AlphaCat				
Gross premiums written	$2,934	$18,940	$21,607	$77,050
Reinsurance premiums ceded	—	—	—	—
Net premiums written	2,934	18,940	21,607	77,050
Change in unearned premiums	2,591	8,758	(9,832)	(37,595)
Net premiums earned	5,525	27,698	11,775	39,455
Policy acquisition costs	547	3,326	1,185	4,615
General and administrative expenses	2,087	2,167	5,521	4,122
Share compensation expenses	84	26	195	74
Total underwriting deductions	2,718	5,519	6,901	8,811
Underwriting income (a)	$2,807	$22,179	$4,874	$30,644
Legal Entity adjustments				
Policy acquisition costs	$—	$(1,084)	$(25)	$(1,301)
General and administrative expenses	1,142	620	3,457	3,780
Share compensation expenses	135	284	446	786
Total underwriting deductions	1,277	(180)	3,878	3,265
Underwriting (loss) income (a)	$(1,277)	$180	$(3,878)	$(3,265)
Talbot				
Gross premiums written	$260,755	$238,937	$837,536	$778,880
Reinsurance premiums ceded	(53,801)	(55,551)	(191,619)	(190,243)
Net premiums written	206,954	183,386	645,917	588,637
Change in unearned premiums	20,313	7,326	(21,769)	(27,739)
Net premiums earned	227,267	190,712	624,148	560,898
Losses and loss expenses	88,565	97,244	296,850	376,170

Policy acquisition costs	61,640	36,651	142,181	116,174
General and administrative expenses	36,605	21,745	100,910	82,396
Share compensation expenses	2,200	1,903	5,347	6,648
Total underwriting deductions	189,010	157,543	545,288	581,388
Underwriting income (loss) (a)	$38,257	$33,169	$78,860	$(20,490)
Corporate & Eliminations				
Gross premiums written	$(18,484)	$(30,611)	$(57,276)	$(68,160)
Reinsurance premiums ceded	18,484	30,611	57,276	68,160
Net premiums written	—	—	—	—
Policy acquisition costs	(1,349)	(2,080)	(4,116)	(1,912)
General and administrative expenses	13,775	4,036	40,337	21,999
Share compensation expenses	2,850	2,979	7,681	12,433
Total underwriting deductions	15,276	4,935	43,902	32,520
Underwriting (loss) (a)	$(15,276)	$(4,935)	$(43,902)	$(32,520)
Total underwriting income (loss) (a)	$143,134	$111,844	$361,770	$(1,009)

a) Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income that is not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation of this measure to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled "Underwriting Income."

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Three Months Ended September 30, 2012 compared to Three Months Ended September 30, 2011

Net income available to Validus for the three months ended September 30, 2012 was $207.3 million compared to $56.5 million for the three months ended September 30, 2011, an increase of $150.8 million or 267.0%. The primary factors driving the increase in net income were:

- A favorable movement of $114.2 million in net unrealized gains (losses) on investments, of which $55.8 million is attributable to noncontrolling interest;

- Increase in underwriting income of $31.3 million primarily due to:

- An increase in net premiums earned of $16.5 million;

- A decrease in underwriting deductions of $14.8 million due primarily to a decrease in losses and loss expenses of $70.6 million partially offset by an increase in general and administrative expenses of $34.6 million; and

- A favorable movement in foreign exchange gains (losses) of $21.0 million,

The change in net income available to Validus for the three months ended September 30, 2012 of $150.8 million as compared to the three months ended September 30, 2011 is described in the following table:

	Three Months Ended September 30, 2012 Increase (Decrease) Over the Three Months Ended September 30, 2011				
(Dollars in thousands)	Validus Re	AlphaCat	Talbot	Corporate and Eliminations (a)	Total
Notable losses - decrease in net loss and loss expenses (b)	$3,900	$—	$10,750	—	$14,650
Less: Notable losses - decrease in net reinstatement premiums (b)	(2,333)	—	—	—	(2,333)
Other underwriting income (loss)	55,805	(19,372)	(5,662)	(11,798)	18,973
Underwriting income (loss) (c)	57,372	(19,372)	5,088	(11,798)	31,290
Net investment income	(3,163)	442	(1,191)	1,654	(2,258)
Other income	(644)	5,449	681	1,838	7,324
Finance expenses	1,843	(843)	78	495	1,573
Operating income (loss) before taxes and income from operating affiliates	55,408	(14,324)	4,656	(7,811)	37,929
Tax benefit (expense)	5	—	2,334	(1,144)	1,195
Income from operating affiliates	—	6,235	—	—	6,235
Net operating income (loss)	55,413	(8,089)	6,990	(8,955)	45,359
Net realized gains on investments	2,105	325	1,387	—	3,817
Net unrealized gains (losses) on investments	45,530	62,108	6,556	(1)	114,193
(Loss) from investment affilate	(160)	—	—	—	(160)
Foreign exchange gains (losses)	9,786	194	11,089	(34)	21,035

Transaction expenses	—	—	—	9,799	9,799
Net income	112,674	54,538	26,022	809	194,043
Net (income) attributable to noncontrolling interest	—	(43,230)	—	—	(43,230)
Net income available to Validus	$112,674	$11,308	$26,022	$809	$150,813

(a) The Corporate and Eliminations column includes legal entity adjustments.

(b) Notable losses for the three months ended September 30, 2012 included: U.S. drought and Hurricane Isaac. Notable losses for the three months ended September 30, 2011 included: Danish floods and Hurricane Irene. Excludes the reserve for potential development on 2011 notable loss events.

(c) Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income (loss) that is not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation of this measure to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled "Underwriting Income."

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Gross Premiums Written

Gross premiums written for the three months ended September 30, 2012 were $390.2 million compared to $391.1 million for the three months ended September 30, 2011, a decrease of $0.9 million or 0.2%. Details of gross premiums written by line of business are provided below.

(Dollars in thousands)	Three Months Ended September 30, 2012 Gross Premiums Written	Three Months Ended September 30, 2011