

VALIDUS HOLDINGS LTD  
Form 10-Q  
August 07, 2014

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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Form 10-Q

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2014

Commission file number 001-33606

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

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BERMUDA (State or other jurisdiction of incorporation or organization)	98-0501001 (I.R.S. Employer Identification No.)
29 Richmond Road, Pembroke, Bermuda HM 08 (Address of principal executive offices and zip code)	
(441) 278-9000 (Registrant's telephone number, including area code)	

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of August 5, 2014 there were 91,018,718 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 June 30, 2014 (unaudited) and December 31, 2013

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

	June 30, 2014 (unaudited)	December 31, 2013
<b>Assets</b>		
Fixed maturities, at fair value (amortized cost: 2014—\$5,115,945; 2013—\$5,522,853)	\$5,154,629	\$5,542,258
Short-term investments, at fair value (amortized cost: 2014—\$816,651; 2013—\$751,784)	1,820	751,778
Other investments, at fair value (cost: 2014—\$717,908; 2013—\$637,728)	783,423	618,316
Cash and cash equivalents	1,166,410	1,056,346
Total investments and cash	7,921,282	7,968,698
Investments in affiliates	213,619	141,243
Premiums receivable	1,215,454	697,233
Deferred acquisition costs	210,642	134,269
Prepaid reinsurance premiums	178,291	103,251
Securities lending collateral	1,321	3,392
Loss reserves recoverable	338,734	370,154
Paid losses recoverable	59,682	80,080
Intangible assets	104,327	106,407
Goodwill	20,393	20,393
Accrued investment income	18,008	18,876
Other assets	156,651	202,436
Total assets	\$10,438,404	\$9,846,432
<b>Liabilities</b>		
Reserve for losses and loss expenses	\$2,867,307	\$3,030,399
Unearned premiums	1,372,768	824,496
Reinsurance balances payable	162,114	154,874
Securities lending payable	1,787	3,858
Deferred income taxes	20,522	19,086
Net payable for investments purchased	44,713	19,383
Accounts payable and accrued expenses	138,906	278,187
Notes payable to operating affiliates	622,950	439,272
Senior notes payable	247,252	247,198
Debentures payable	541,350	541,416
Total liabilities	\$6,019,669	\$5,558,169
<b>Commitments and contingent liabilities</b>		
Redeemable noncontrolling interest	66,282	86,512
<b>Shareholders' equity</b>		
	\$27,161	\$27,036

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Common shares, 571,428,571 authorized, par value \$0.175 (Issued: 2014—155,205,796; 2013—154,488,497; Outstanding: 2014—91,394,939; 2013—96,044,312)		
Treasury shares (2014—63,810,857; 2013—58,444,185)	(11,167	) (10,228 )
Additional paid-in-capital	1,492,472	1,677,894
Accumulated other comprehensive income (loss)	2,460	(617 )
Retained earnings	2,266,180	2,010,009
Total shareholders' equity available to Validus	3,777,106	3,704,094
Noncontrolling interest	575,347	497,657
Total shareholders' equity	\$4,352,453	\$4,201,751
Total liabilities, noncontrolling interests and shareholders' equity	\$10,438,404	\$9,846,432
The accompanying notes are an integral part of these consolidated financial statements (unaudited).		

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Validus Holdings, Ltd.

Consolidated Statements of Comprehensive Income

For the Three and Six Months Ended June 30, 2014 and 2013 (unaudited)

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

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2014	2013	2014	2013
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Revenues</b>				
Gross premiums written	\$655,674	\$702,313	\$1,667,665	\$1,807,073
Reinsurance premiums ceded	(50,565 )	(121,396 )	(245,473 )	(308,612 )
Net premiums written	605,109	580,917	1,422,192	1,498,461
Change in unearned premiums	(139,106 )	(33,459 )	(473,232 )	(419,942 )
Net premiums earned	466,003	547,458	948,960	1,078,519
Net investment income	21,286	26,210	44,648	51,859
Net realized gains on investments	7,858	3,409	11,598	5,130
Change in net unrealized gains (losses) on investments	45,427	(141,348 )	101,120	(148,585 )
Income from investment affiliate	779	1,753	6,127	3,230
Other income	5,235	4,418	19,065	7,103
Foreign exchange gains (losses)	3,158	(8,223 )	(3,320 )	(1,301 )
Total revenues	549,746	433,677	1,128,198	995,955
<b>Expenses</b>				
Losses and loss expenses	158,745	265,044	321,416	409,815
Policy acquisition costs	78,953	87,152	164,602	180,763
General and administrative expenses	73,842	70,967	148,287	151,246
Share compensation expenses	8,341	6,638	15,488	8,956
Finance expenses	16,126	17,566	32,026	31,935
Transaction expenses	3,252	—	3,252	—
Total expenses	339,259	447,367	685,071	782,715
Income (loss) before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	210,487	(13,690 )	443,127	213,240
Tax (expense) benefit	(1,391 )	(93 )	(1,351 )	225
Income from operating affiliates	4,892	3,793	9,819	7,316
(Income) attributable to operating affiliate investors	(25,316 )	(20,264 )	(57,026 )	(30,341 )
Net income (loss)	\$188,672	\$(30,254 )	\$394,569	\$190,440
Net (income) loss attributable to noncontrolling interest	(35,305 )	60,976	(78,814 )	63,525
Net income available to Validus	\$153,367	\$30,722	\$315,755	\$253,965
<b>Other comprehensive income (loss)</b>				
Foreign currency translation adjustments	2,615	186	3,077	(9,599 )
Other comprehensive income (loss)	\$2,615	\$186	\$3,077	\$(9,599 )
Comprehensive income available to Validus	\$155,982	\$30,908	\$318,832	\$244,366

Earnings per share

Weighted average number of common shares and common share equivalents outstanding

Basic	90,952,523	103,133,188	92,202,261	105,259,813
Diluted	95,276,836	104,734,643	96,538,178	107,393,822

Basic earnings per share available to common shareholders	\$1.67	\$0.28	\$3.39	\$2.26
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Earnings per diluted share available to common shareholders	\$1.61	\$0.28	\$3.27	\$2.21
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Cash dividends declared per share	\$0.30	\$0.30	\$0.60	\$2.60
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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 Six Months Ended June 30, 2014 and 2013 (unaudited)

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

	June 30, 2014 (unaudited)	June 30, 2013 (unaudited)
Common shares		
Balance - Beginning of period	\$27,036	\$26,722
Common shares issued, net	125	267
Balance - End of period	\$27,161	\$26,989
Treasury shares		
Balance - Beginning of period	\$(10,228	) \$(7,836
Repurchase of common shares	(939	) (1,699
Balance - End of period	\$(11,167	) \$(9,535
Additional paid-in capital		
Balance - Beginning of period	\$1,677,894	\$2,160,478
Common shares redeemed, net	(4,510	) (488
Repurchase of common shares	(196,400	) (355,485
Share compensation expenses	15,488	8,956
Balance - End of period	\$1,492,472	\$1,813,461
Accumulated other comprehensive income (loss)		
Balance - Beginning of period	\$(617	) \$(2,953
Amounts reclassified to retained earnings	—	4,290
Other comprehensive income (loss)	3,077	(9,599
Balance - End of period	\$2,460	) \$(8,262
Retained earnings		
Balance - Beginning of period	\$2,010,009	\$1,844,416
Dividends	(59,584	) (298,888
Net income	394,569	190,440
Net (income) loss attributable to noncontrolling interest	(78,814	) 63,525
Amounts reclassified from accumulated other comprehensive income (loss)	—	(4,290
Balance - End of period	\$2,266,180	\$1,795,203
Total shareholders' equity available to Validus	\$3,777,106	\$3,617,856
Noncontrolling interest	\$575,347	\$427,755
Total shareholders' equity	\$4,352,453	\$4,045,611

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 Six Months Ended June 30, 2014 and 2013 (unaudited)

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

	June 30, 2014 (unaudited)	June 30, 2013 (unaudited)
Cash flows provided by (used in) operating activities		
Net income	\$394,569	\$190,440
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	15,488	8,956
Gain on sale of subsidiary	(709)	) —
Gain on deconsolidation of subsidiary	(1,372)	) —
Amortization of discount on senior notes	54	54
Income from investment affiliate	(6,127)	) (3,230 )
Net realized gains on investments	(11,598)	) (5,130 )
Change in net unrealized (gains) losses on investments	(101,120)	) 148,585
Amortization of intangible assets	2,080	2,080
Income from operating affiliates	(9,819)	) (7,316 )
Foreign exchange (gains) losses included in net income	(11,629)	) 30,868
Amortization of premium on fixed maturities	8,116	10,163
Change in:		
Premiums receivable	(514,339)	) (558,107 )
Deferred acquisition costs	(76,373)	) (60,035 )
Prepaid reinsurance premiums	(75,040)	) (125,293 )
Loss reserves recoverable	32,983	20,000
Paid losses recoverable	20,322	23,840
Income taxes recoverable	—	(852 )
Accrued investment income	864	1,903
Other assets	31,388	22,009
Reserve for losses and loss expenses	(172,189)	) (216,535 )
Unearned premiums	548,272	545,235
Reinsurance balances payable	5,979	186,906
Deferred income taxes	1,539	2,081
Accounts payable and accrued expenses	(63,896)	) (23,517 )
Net cash provided by operating activities	17,443	193,105
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	1,979,658	2,686,285
Proceeds on maturities of investments	384,259	316,860
Purchases of fixed maturities	(1,929,428)	) (3,318,638 )
(Purchases) sales of short-term investments, net	(92,572)	) 500,191
Purchases of other investments	(75,198)	) (23,674 )
Decrease (increase) in securities lending collateral	2,071	(1,675 )
Redemption of investment in operating affiliates	57,025	79,307
Purchase of investment in investment affiliate	—	(6,904 )

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Proceeds on sale of subsidiary	16,459	—
Net cash provided by investing activities	342,274	231,752
Cash flows provided by (used in) financing activities		
Net (repayment of) proceeds on issuance of notes payable to operating affiliates	(44,423	) 262,037
Redemption of common shares, net	(4,385	) (221 )
Purchases of common shares under share repurchase program	(197,339	) (357,184 )
Dividends paid	(61,036	) (297,539 )
(Decrease) increase in securities lending payable	(2,071	) 1,675
Investment in third party redeemable noncontrolling interest	46,504	49,790
Investment in third party noncontrolling interest	—	58,500
Net cash used in financing activities	(262,750	) (282,942 )
Effect of foreign currency rate changes on cash and cash equivalents	13,097	(44,233 )
Net increase in cash	110,064	97,682
Cash and cash equivalents - beginning of period	\$1,056,346	\$1,219,379
Cash and cash equivalents - end of period	\$1,166,410	\$1,317,061
Taxes paid (recovered) during the period	\$877	\$(1,326 )
Interest paid during the period	\$27,224	\$24,955
The accompanying notes are an integral part of these consolidated financial statements (unaudited).		

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

1. Basis of preparation and consolidation

These unaudited Consolidated Financial Statements (the "Consolidated Financial Statements") include Validus Holdings, Ltd. and its wholly and majority owned 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 on Form 10-Q should be read in conjunction with the financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the U.S. Securities and Exchange Commission (the "SEC").

In the opinion of management, these Consolidated Financial Statements reflect all adjustments (including normal recurring adjustments) 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. To facilitate comparison of information, certain amounts in prior periods have been reclassified to conform to current period presentation. The consolidated statement of cash flows for the six months ended June 30, 2013 includes a reclassification of \$19,400 that increased net cash flows used in financing activities and net cash flows provided by operating activities to revise the presentation of subscriptions received in advance from third party investors. For the three and six months ended June 30, 2013, \$20,264 and \$30,341 respectively, have been reclassified into income attributable to operating affiliate investors from finance expenses to conform to current period presentation. All significant intercompany accounts and transactions have been eliminated. The results of operations for any interim period are not necessarily indicative of the results for a full year. The preparation of these 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. While management believes that the amounts included in the Consolidated Financial Statements reflect its best estimates and assumptions, actual results could differ materially from those estimates. The Company's principal estimates include:

- 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 uncollectible amounts; and
- investment valuation of financial assets.

The term "ASC" used in these notes refers to Accounting Standard Codification issued by the U.S. Financial Accounting Standards Board ("FASB").

2. Recent accounting pronouncements

Adoption of New Accounting Standards

Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity

In March 2013, the FASB issued Accounting Standard Update No. 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity" (ASU 2013-05). The objective of this Update is to resolve the diversity in practice about whether Subtopic 810-10, Consolidation-Overall, or Subtopic 830-30, Foreign Currency Matters-Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a

subsidiary within a foreign entity. The amendments became effective for the Company on January 1, 2014. Adoption of this guidance did not have a material impact on the Company's Consolidated Financial Statements.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

**Financial Services - Investment Companies - Amendments to the Scope, Measurement, and Disclosure Requirements**  
In June 2013, the FASB issued Accounting Standard Update No. 2013-08, "Financial Services - Investment Companies - Amendments to the Scope, Measurement, and Disclosure Requirements" (ASU 2013-08). The amendments in this Update change the assessment of whether an entity is an investment company by developing a new two-tiered approach for that assessment, which requires an entity to possess certain fundamental characteristics while allowing judgment in assessing other typical characteristics. The new approach requires an entity to assess all of the characteristics of an investment company and consider its purpose and determine whether it is an investment company. The amendments became effective for the Company on January 1, 2014. The Company performed an assessment and has concluded that the AlphaCat ILS funds meet the characteristics outlined in this Update and therefore will continue to be treated as investment companies.

**Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists**

In July 2013, the FASB issued Accounting Standard Update No. 2013-11 "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" (ASU 2013-11). This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward is not available to settle any additional income taxes that would result from the disallowance of a tax position at the reporting date, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The amendments became effective for the Company on January 1, 2014. Adoption of this guidance did not have a material impact on the Company's Consolidated Financial Statements.

**Recently Issued Accounting Standards Not Yet Adopted**

In May 2014, the FASB issued Accounting Standard Update No. 2014-09, "Revenue from Contracts with Customers" (ASU 2014-09). The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in this Update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Earlier adoption is not permitted. The Company is currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

In June 2014, the FASB issued Accounting Standard Update No. 2014-12, "Compensation - Stock Compensation (Topic 718) - Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period" (ASU 2014-12). The amendments in this Update apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target (for example, an initial public offering or a profitability target) could be achieved and still be eligible to vest in the award if and when the performance target is achieved. The amendments in this Update are effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Earlier adoption is permitted. The Company is currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.



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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

## 3. Investments

## (a) Fixed maturity, short-term and other 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 changes in net unrealized gains or losses included in earnings.

The amortized cost (or cost), gross unrealized gains and (losses) and estimated fair value of investments at June 30, 2014 were as follows:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	\$ 1,030,570	\$ 3,028	\$(1,821)	) \$ 1,031,777
Non-U.S. government and government agency	440,408	7,689	(1,027)	) 447,070
U.S. states, municipalities and political subdivisions	48,732	760	(52)	) 49,440
Agency residential mortgage-backed securities	307,246	8,459	(600)	) 315,105
Non-agency residential mortgage-backed securities	18,001	295	(515)	) 17,781
U.S. corporate	1,303,436	10,869	(1,796)	) 1,312,509
Non-U.S. corporate	685,884	8,442	(738)	) 693,588
Bank loans	517,697	3,692	(664)	) 520,725
Catastrophe bonds	37,500	573	(10)	) 38,063
Asset-backed securities	605,079	1,868	(205)	) 606,742
Commercial mortgage-backed securities	121,392	469	(32)	) 121,829
Total fixed maturities	5,115,945	46,144	(7,460)	) 5,154,629
Total short-term investments (a) (b)	816,651	170	(1)	) 816,820
Other investments				
Fund of hedge funds	2,820	115	(921)	) 2,014
Hedge funds (a)	566,519	136,390	(79,013)	) 623,896
Private equity investments	10,965	4,520	—	) 15,485
Investment funds	131,406	284	—	) 131,690
Mutual funds	6,198	4,140	—	) 10,338
Total other investments	717,908	145,449	(79,934)	) 783,423
Total investments including noncontrolling interests	\$ 6,650,504	\$ 191,763	\$(87,395)	) \$ 6,754,872
Noncontrolling interest (a)	\$ (521,862)	) \$(118,540)	) \$ 71,112	) \$(569,290)
Redeemable noncontrolling interest (b)	\$ (8,305)	) \$—	) \$—	) \$(8,305)
Total investments excluding noncontrolling interests	\$ 6,120,337	\$ 73,223	\$(16,283)	) \$ 6,177,277

Included in the short-term investments and the hedge funds balances are investments held by PaCRe in which the (a) Company has an equity interest of 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

Included in the short-term investments balance are investments held by one AlphaCat ILS fund which is (b) consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

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

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	\$ 1,368,826	\$2,589	\$(6,736)	) \$1,364,679
Non-U.S. government and government agency	454,578	6,511	(2,021)	) 459,068
U.S. states, municipalities and political subdivisions	42,978	459	(317)	) 43,120
Agency residential mortgage-backed securities	305,450	8,310	(2,261)	) 311,499
Non-agency residential mortgage-backed securities	16,530	143	(914)	) 15,759
U.S. corporate	1,328,960	9,208	(5,684)	) 1,332,484
Non-U.S. corporate	711,581	5,917	(3,173)	) 714,325
Bank loans	712,859	5,659	(1,402)	) 717,116
Catastrophe bonds	72,000	2,551	—	) 74,551
Asset-backed securities	509,091	1,409	(843)	) 509,657
Total fixed maturities	5,522,853	42,756	(23,351)	) 5,542,258
Total short-term investments (b)	751,734	45	(1)	) 751,778
Other investments				
Fund of hedge funds	3,141	83	(921)	) 2,303
Hedge funds (a)	584,518	71,641	(95,076)	) 561,083
Private equity investments	12,333	1,410	(258)	) 13,485
Investment funds	31,537	92	—	) 31,629
Mutual funds	6,199	3,617	—	) 9,816
Total other investments	637,728	76,843	(96,255)	) 618,316
Total investments including noncontrolling interests	\$ 6,912,315	\$119,644	\$(119,607)	) \$6,912,352
Noncontrolling interest (a)	(512,121)	) (62,850)	) 85,569	(489,402)
Redeemable noncontrolling interest (b)	\$ (18,365)	) \$—	\$—	) \$(18,365)
Total investments excluding noncontrolling interests	\$ 6,381,829	\$56,794	\$(34,038)	) \$6,404,585

Included in the hedge funds balance are investments held by PaCRE in which the Company has an equity interest of (a) 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

Included in the short-term investments balance are investments held by two AlphaCat ILS funds which are (b) consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

As of June 30, 2014, the Company changed the methodology of assigning investment ratings to its fixed maturities portfolio. In prior periods, investment ratings were the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. As of June 30, 2014, investment ratings are the median of Moody's, Standard & Poor's and Fitch, presented in Standard & Poor's equivalent rating. For investments where only two ratings are available, the lower of the two ratings shall apply, 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. The December 31, 2013 comparative data was restated as a result, to conform to current period presentation.



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The following table sets forth certain information regarding the investment ratings of the Company's fixed maturities portfolio as at June 30, 2014 and December 31, 2013.

	June 30, 2014		December 31, 2013		
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total	
AAA	\$2,366,249	45.9	% \$2,510,781	45.3	%
AA	719,122	13.9	% 696,998	12.6	%
A	1,196,059	23.2	% 1,233,716	22.3	%
BBB	307,522	6.0	% 323,085	5.8	%
Total investment-grade fixed maturities	4,588,952	89.0	% 4,764,580	86.0	%
BB	256,714	5.0	% 354,992	6.4	%
B	282,032	5.5	% 383,639	6.9	%
CCC	10,406	0.2	% 2,453	—	%
CC	2,385	—	% 2,496	0.1	%
C	157	—	% 235	—	%
D/NR	13,983	0.3	% 33,863	0.6	%
Total non-investment grade fixed maturities	565,677	11.0	% 777,678	14.0	%
Total fixed maturities	\$5,154,629	100.0	% \$5,542,258	100.0	%

The amortized cost and estimated fair value amounts for fixed maturities held at June 30, 2014 and December 31, 2013 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.

	June 30, 2014		December 31, 2013	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$399,741	\$402,887	\$688,855	\$692,768
Due after one year through five years	3,296,209	3,320,485	3,603,459	3,613,847
Due after five years through ten years	357,818	359,382	396,389	395,633
Due after ten years	10,459	10,418	3,079	3,095
	4,064,227	4,093,172	4,691,782	4,705,343
Asset-backed and mortgage-backed securities	1,051,718	1,061,457	831,071	836,915
Total fixed maturities	\$5,115,945	\$5,154,629	\$5,522,853	\$5,542,258

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Fixed maturities and short-term investments	\$22,207	\$26,151	\$45,504	\$53,682
Cash and cash equivalents	996	1,629	2,953	2,162
Securities lending income	2	—	4	—
Total gross investment income	23,205	27,780	48,461	55,844
Investment expenses	(1,919)	(1,570)	(3,813)	(3,985)
Total net investment income	\$21,286	\$26,210	\$44,648	\$51,859



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

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

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Fixed maturities, short-term and other investments				
Gross realized gains (a)	\$9,813	\$7,152	\$15,109	\$17,872
Gross realized (losses)	(1,955)	(3,743)	(3,511)	(12,742)
Net realized gains on investments	7,858	3,409	11,598	5,130
Change in net unrealized gains (losses) on investments (a)	45,427	(141,348)	101,120	(148,585)
Total net realized gains and change in net unrealized gains (losses) on investments including noncontrolling interest	53,285	(137,939)	112,718	(143,455)
Noncontrolling interest (a)	(33,207)	63,694	(75,209)	68,345
Total net realized gains and change in net unrealized gains (losses) on investments excluding noncontrolling interest	\$20,078	\$(74,245)	\$37,509	\$(75,110)

Includes change in net unrealized gains (losses) and realized gains on investments held by PaCRE in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors and is included in the Consolidated Statements of Comprehensive Income as net (income) loss attributable to noncontrolling interest.

(d) Pledged investments

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

	June 30, 2014		
Description	Commitment	Issued and Outstanding	Investments and cash pledged as collateral
\$400,000 syndicated unsecured letter of credit facility	\$400,000	\$—	\$—
\$525,000 syndicated secured letter of credit facility	525,000	305,330	478,430
\$200,000 secured bi-lateral letter of credit facility	200,000	17,602	35,415
Talbot FAL facility	25,000	25,000	30,990
PaCRE senior secured letter of credit facility	10,000	294	—
AlphaCat Re secured letter of credit facility	30,000	30,000	30,040
IPC bi-lateral facility	40,000	19,572	96,188
\$375,000 Flagstone bi-lateral facility	375,000	292,067	477,122
Total	\$1,605,000	\$689,865	\$1,148,185
	December 31, 2013		
Description	Commitment	Issued and Outstanding	Investments and cash pledged as collateral
\$400,000 syndicated unsecured letter of credit facility	\$400,000	\$—	\$—
\$525,000 syndicated secured letter of credit facility	525,000	358,567	507,620
\$200,000 secured bi-lateral letter of credit facility	200,000	16,726	130,256
Talbot FAL facility	25,000	25,000	30,801

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PaCRE senior secured letter of credit facility	10,000	294	—
AlphaCat Re secured letter of credit facility	24,800	24,800	24,806
IPC bi-lateral facility	40,000	20,177	98,465
\$375,000 Flagstone bi-lateral facility	375,000	305,686	454,458
Total	\$1,599,800	\$751,250	\$1,246,406

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Validus Holdings, Ltd.

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In addition, \$2,906,871 of cash and cash equivalents and investments were pledged during the normal course of business as at June 30, 2014 (December 31, 2013: \$2,947,475). Of those, \$2,901,739 were held in trust (December 31, 2013: \$2,942,508). Pledged assets are generally for the benefit of the Company's cedants and policyholders, to support AlphaCat's fully collateralized reinsurance transactions and to facilitate the accreditation of Talbot as an alien insurer/reinsurer by certain regulators.

4. Fair value measurements

(a) Classification within the fair value hierarchy

Fair value is defined as the price to sell an asset or transfer a liability in an orderly transaction between market participants. 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 unadjusted quoted prices 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.

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

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

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

Level 3 - Fair values are measured based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect the Company's own judgments about assumptions where there is little, if any, market activity for that asset or liability that market participants might use.

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the instrument. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment.

Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This may lead us to change the selection of our valuation technique (for example, from market to cash flow approach) or may cause us to use multiple valuation techniques to estimate the fair value of a financial instrument. These circumstances could cause an instrument to be reclassified between levels within the fair value hierarchy.

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

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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At June 30, 2014, 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	\$—	\$1,031,777	\$—	\$1,031,777
Non-U.S. government and government agency	—	447,070	—	447,070
U.S. states, municipalities and political subdivisions	—	49,440	—	49,440
Agency residential mortgage-backed securities	—	315,105	—	315,105
Non-agency residential mortgage-backed securities	—	17,781	—	17,781
U.S. corporate	—	1,312,509	—	1,312,509
Non-U.S. corporate	—	693,588	—	693,588
Bank loans	—	520,725	—	520,725
Catastrophe bonds	—	33,062	5,001	38,063
Asset-backed securities	—	606,742	—	606,742
Commercial mortgage-backed securities	—	121,829	—	121,829
Total fixed maturities	—	5,149,628	5,001	5,154,629
Total short-term investments (a) (b)	801,944	14,876	—	816,820
Other investments				
Fund of hedge funds	—	—	2,014	2,014
Hedge funds (a)	—	—	623,896	623,896
Private equity investments	—	—	15,485	15,485
Investment funds	—	31,690	100,000	131,690
Mutual funds	—	10,338	—	10,338
Total other investments	—	42,028	741,395	783,423
Total investments including noncontrolling interests	\$801,944	\$5,206,532	\$746,396	\$6,754,872
Noncontrolling interest (a)	\$(22,500)	\$—	\$(546,790)	\$(569,290)
Redeemable noncontrolling interest (b)	\$(8,305)	\$—	\$—	\$(8,305)
Total investments excluding noncontrolling interests	\$771,139	\$5,206,532	\$199,606	\$6,177,277

Included in the short-term investments and the hedge funds balances are investments held by PaCRE in which the (a) Company has an equity interest of 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

Included in the short-term investments balance are investments held by one AlphaCat ILS fund which is (b) consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

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

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

	Level 1	Level 2	Level 3	Total
U.S. government and government agency	\$—	\$1,364,679	\$—	\$1,364,679
Non-U.S. government and government agency	—	459,068	—	459,068
U.S. states, municipalities and political subdivisions	—	43,120	—	43,120
Agency residential mortgage-backed securities	—	311,499	—	311,499
Non-agency residential mortgage-backed securities	—	15,759	—	15,759
U.S. corporate	—	1,332,484	—	1,332,484
Non-U.S. corporate	—	714,325	—	714,325
Bank loans	—	717,116	—	717,116
Catastrophe bonds	—	74,551	—	74,551
Asset-backed securities	—	509,657	—	509,657
Total fixed maturities	—	5,542,258	—	5,542,258
Total short-term investments (b)	747,215	4,563	—	751,778
Other investments				
Fund of hedge funds	—	—	2,303	2,303
Hedge funds (a)	—	—	561,083	561,083
Private equity investments	—	—	13,485	13,485
Investment fund	—	31,629	—	31,629
Mutual funds	—	9,816	—	9,816
Total other investments	—	41,445	576,871	618,316
Total investments including noncontrolling interests	\$747,215	\$5,588,266	\$576,871	\$6,912,352
Noncontrolling interest (a)	\$—	\$—	\$(489,402)	\$(489,402)
Redeemable noncontrolling interest (b)	\$(18,365)	\$—	\$—	\$(18,365)
Total investments excluding noncontrolling interests	\$728,850	\$5,588,266	\$87,469	\$6,404,585

Included in the hedge funds balance are investments held by PaCRE in which the Company has an equity interest of (a) 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

Included in the short-term investments balance are investments held by two AlphaCat ILS funds which are (b) consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

At June 30, 2014, Level 3 investments excluding the noncontrolling interests totaled \$199,606 (December 31, 2013: \$87,469), representing 3.2% (December 31, 2013: 1.4%) of total investments, excluding noncontrolling interests, measured at fair value on a recurring basis.

(b) Level 1 assets measured at fair value

Short term investments

Short term investments categorized as Level 1 consist primarily of highly liquid securities, all with maturities less than one year from the date of purchase. The fair value of the Company's portfolio of short term investments are generally determined using amortized cost which approximates fair value. The Company has determined that certain of its short-term investments, held in highly liquid money market-type funds, should be included in Level 1 as their fair values are based on quoted market prices in active markets.



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(c) Level 2 assets measured at fair value

Fixed maturity investments

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

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

Prices are generally verified using third party data. Securities which are priced by an index provider are generally included in the index.

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

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

U.S. government and government agency

U.S. government and government agency securities consist primarily of debt securities issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association. Fixed maturity investments included in U.S. government and government agency securities are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources and integrate other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The fair value of each security is individually computed using analytical models which incorporate option adjusted spreads and other daily interest rate data.

Non-U.S. government and government agency

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

U.S. states, municipalities and political subdivisions

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

Agency residential mortgage-backed securities

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

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Non-agency residential mortgage-backed securities

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

U.S. corporate

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

Non-U.S. corporate

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

Bank loans

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

Catastrophe bonds

Catastrophe bonds are based on broker or underwriter bid indications. To the extent that these indications are based on significant unobservable inputs, the relevant bonds will be classified as a Level 3 asset.

Asset-backed securities

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

market data. In addition, a spread is applied to the relevant benchmark and used to discount the cash flows noted above to determine the fair value of the securities held in this sector.

Commercial mortgage-backed securities

Commercial mortgage backed securities are investment-grade debt primarily priced by pricing services. The pricing services apply dealer quotes and other available trade information such as bids and off