VALIDUS HOLDINGS LTD
Form 10-Q
November 06, 2009

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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, 2009
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.)

19 Par-La-Ville Road, Hamilton, Bermuda HM 11
(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 þ **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 o **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 þ	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** þ

As of November 6, 2009, there were 131,134,398 outstanding Common Shares, $0.175 par value per share, of the registrant.

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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

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Validus Holdings, Ltd.
Consolidated Balance Sheets
As at September 30, 2009 (Unaudited) and December 31, 2008

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

	September 30, 2009 (Unaudited)	December 31, 2008
Assets		
Fixed maturities, at fair value		
(amortized cost: 2009 - $4,566,801; 2008 - $2,553,018)	$ 4,590,143	$ 2,454,501
Short-term investments, at fair value		
(amortized cost: 2009 - $595,557; 2008 - $379,537)	594,581	377,036
Other investments, at fair value		
(amortized cost: 2009 - $126,301)	129,012	
Cash and cash equivalents	393,788	449,848
Total investments and cash	5,707,524	3,281,385
Premiums receivable	723,029	408,259
Deferred acquisition costs	139,157	108,156
Prepaid reinsurance premiums	101,711	22,459
Securities lending collateral	100,053	98,954
Loss reserves recoverable	172,101	208,796
Paid losses recoverable	10,064	1,388
Net receivable for investments sold		490
Income taxes recoverable	3,027	1,365
Intangibles assets	124,096	127,217
Goodwill	20,393	20,393
Accrued investment income	43,190	20,433
Other assets	32,726	23,185
Total assets	$ 7,177,071	$ 4,322,480
Liabilities		
Reserve for losses and loss expenses	$ 1,624,743	$ 1,305,303
Unearned premiums	955,049	539,450
Reinsurance balances payable	40,879	33,042
Securities lending payable	101,040	105,688
Deferred income taxes	26,110	21,779
Net payable for investments purchased	39,224	
Accounts payable and accrued expenses	119,534	74,184
Debentures payable	304,300	304,300
Total liabilities	3,210,879	2,383,746

Shareholders equity				
Common shares, 571,428,571 authorized, par value $0.175				
Issued and outstanding (2009 - 131,107,196; 2008 - 75,624,697)		22,944		13,235
Additional paid-in-capital		2,748,121		1,412,635
Accumulated other comprehensive (loss)		(4,976)		(7,858)
Retained earnings		1,200,103		520,722
Total shareholders equity		3,966,192		1,938,734
Total liabilities and shareholders equity	$	7,177,071	$	4,322,480

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

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Validus Holdings, Ltd.
Consolidated Statements of Operations and Comprehensive Income (Loss)
For the three and nine months ended September 30, 2009 and 2008 (Unaudited)

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

	Three months ended		Nine months ended	
	September 30, 2009 (Unaudited)	September 30, 2008 (Unaudited)	September 30, 2009 (Unaudited)	September 30, 2008 (Unaudited)
Revenues				
Gross premiums written	$ 331,028	$ 269,236	$ 1,365,951	$ 1,170,749
Reinsurance premiums ceded	(67,687)	(35,139)	(202,489)	(121,438)
Net premiums written	263,341	234,097	1,163,462	1,049,311
Change in unearned premiums	111,376	105,229	(141,786)	(108,823)
Net premiums earned	374,717	339,326	1,021,676	940,488
Gain on bargain purchase, net of expenses	302,950		287,099	
Net investment income	29,532	36,379	83,267	108,857
Realized gain on repurchase of debentures				8,752
Net realized gains (losses) on investments	5,429	(13,667)	(20,642)	(8,348)
Net unrealized gains (losses) on investments	50,437	(14,649)	109,839	(72,608)
Other income	1,101	1,269	2,875	3,666
Foreign exchange (losses)	(5,244)	(44,933)	(1,012)	(35,843)
Total revenues	758,922	303,725	1,483,102	944,964
Expenses				
Losses and loss expenses	134,152	318,464	390,736	580,578
Policy acquisition costs	64,236	60,425	190,125	173,545
General and administrative expenses	46,036	30,120	125,315	101,139
Share compensation expenses	5,862	6,012	18,848	19,818
Finance expenses	11,257	14,517	29,732	48,796
Total expenses	261,543	429,538	754,756	923,876
Net income (loss) before taxes	497,379	(125,813)	728,346	21,088
Income tax benefit (expenses)	1,799	(487)	3,301	(4,992)
Net income (loss)	$ 499,178	$ (126,300)	$ 731,647	$ 16,096
Comprehensive income				
Foreign currency translation adjustments	(915)	(1,556)	2,882	(1,479)

Comprehensive income (loss)	$ 498,263	$ (127,856)	$ 734,529	$ 14,617
Earnings per share				
Weighted average number of common shares and common share equivalents outstanding				
Basic	92,492,373	74,864,724	81,458,329	74,435,840
Diluted	95,834,809	74,864,724	84,626,505	77,922,718
Basic earnings (loss) per share	$ 5.38	$ (1.71)	$ 8.92	$ 0.15
Diluted earnings (loss) per share	$ 5.21	$ (1.71)	$ 8.65	$ 0.14
Cash dividends declared per share	$ 0.20	$ 0.20	$ 0.60	$ 0.60

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, 2009 and 2008 (Unaudited)

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

	September 30, 2009 (Unaudited)	September 30, 2008 (Unaudited)
Common shares		
Balance Beginning of period	$ 13,235	$ 12,985
Issue of common shares	9,709	119
Balance End of period	$ 22,944	$ 13,104
Additional paid-in capital		
Balance Beginning of period	$ 1,412,635	$ 1,384,604
Issue of common shares, net of expenses	1,311,207	(518)
Share compensation expenses	24,279	19,818
Balance End of period	$ 2,748,121	$ 1,403,904
Accumulated other comprehensive (loss)		
Balance Beginning of period	$ (7,858)	$ (49)
Currency translation adjustments	2,882	(1,479)
Balance End of period	$ (4,976)	$ (1,528)
Retained earnings		
Balance Beginning of period	$ 520,722	$ 537,260
Dividends	(52,266)	(52,225)
Net Income	731,647	16,096
Balance End of period	$ 1,200,103	$ 501,131
Total shareholders equity	$ 3,966,192	$ 1,916,611

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

Validus Holdings, Ltd.
Consolidated Statements of Cash Flows
For the nine months ended September 30, 2009 and 2008 (Unaudited)

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

	September 30, 2009 (Unaudited)	September 30, 2008 (Unaudited)
Cash flows provided by (used in) operating activities		
Net income	$ 731,647	$ 16,096
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	24,279	19,818
Realized gain on repurchase of debentures		(8,752)
Bargain purchase gain	(352,349)	
Net realized losses on investments	20,642	8,348
Net unrealized (gains) losses on investments	(109,838)	72,608
Amortization of intangible assets	24,792	3,121
Foreign exchange (gains) losses on cash and cash equivalents included in net income	(10,487)	19,768
Amortization of premium on fixed maturities	8,969	2,226
Change in:		
Premiums receivable	(134,007)	(134,822)
Deferred acquisition costs	(8,914)	(26,635)
Prepaid reinsurance premiums	(75,617)	(28,149)
Loss reserves recoverable	42,634	(41,145)
Paid losses recoverable	(8,621)	4,279
Income taxes recoverable	(1,486)	2,436
Accrued investment income	66	(4,466)
Other assets	(557)	3,861
Reserve for losses and loss expenses	(8,900)	369,962
Unearned premiums	210,099	147,461
Reinsurance balances payable	3,903	17,779
Deferred income taxes	4,731	6,083
Accounts payable and accrued expenses	(12,602)	(52,500)
Net cash provided by operating activities	348,384	397,377
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	2,247,581	1,770,892
Proceeds on maturities of investments	466,065	264,103
Purchases of fixed maturities	(2,792,562)	(2,355,159)
Sales (purchases) of short-term investments, net	91,354	(74,290)
Purchases of other investments	(2,047)	
Decrease in securities lending collateral	4,649	2,597
Purchase of subsidiary, net of cash acquired	(376,878)	

Net cash (used in) investing activities		(361,838)	(391,857)
Cash flows provided by (used in) financing activities			
Repurchase of debentures			(36,948)
Issue of common shares, net of expenses		(1,774)	(398)
Dividends paid		(50,938)	(50,570)
(Decrease) in securities lending payable		(4,649)	(2,597)
Net cash (used in) financing activities		(57,361)	(90,513)
Effect of foreign currency rate changes on cash and cash equivalents		14,755	(24,338)
Net (decrease) in cash		(56,060)	(109,331)
Cash and cash equivalents beginning of period		449,848	444,698
Cash and cash equivalents end of period	$	393,788	335,367
Taxes paid (recovered) during the period	$	1,395	(2,467)
Interest paid during the period	$	20,016	20,802

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

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

1. Basis of preparation and consolidation

These unaudited consolidated financial statements include Validus Holdings, Ltd. and its wholly owned subsidiaries (together, the Company) and have been prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In 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 Company s Annual Report on Form 10-K for the year ended December 31, 2008, 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 major 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.

2. Significant accounting policies

In addition to the policies set forth below, the significant accounting policies described in Part II, Item 8 of the Company s Annual Report on Form 10-K for the year ended December 31, 2008 should be read and considered.

a) Business combinations

On September 4, 2009, the Company acquired all of the outstanding shares of IPC Holdings, Ltd. (IPC). The transaction was accounted for as an acquisition method business combination. Accordingly, the purchase price was allocated to assets and liabilities based on their estimated fair value at the acquisition date. The consideration for the net assets acquired was concluded upon prior to the assessment of the fair value of the net assets at the acquisition date. Therefore, the excess of the value of the net assets acquired over the purchase price was recorded as gain on bargain purchase and is shown as a separate component of revenues in the Company s Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and nine months ended September 30, 2009. Significant judgment is required to arrive at an estimate of fair value and changes to assumptions used could lead to a materially different result. Certain amounts in IPC s financial statements have been reclassified to conform to the Company s accounting policies.

b) Other investments

Other investments consist of an investment in a fund of hedge funds and a deferred compensation trust. All investment transactions are recorded on a first-in-first-out basis and realized gains and losses on the sale of

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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)
investments are determined on the basis of amortized cost. Other investments are carried at fair value with interest and dividend income, income distributions and realized and unrealized gains and losses included in net investment income. The fair value of other investments is generally established on the basis of the net valuation criteria established by the managers of the investments. These net valuations are determined based upon the valuation criteria established by the governing documents of such investments. In addition, due to a lag in reporting, some of the Company s fund managers, fund administrators, or both, are unable to provide final fund valuations as of the Company s current reporting date. In these circumstances, the Company estimates the fair value of these funds by starting with the prior month s fund valuation, adjusting these valuations for capital calls, redemptions or distributions and the impact of changes in foreign currency exchange rates, and then estimating the return for the current period. In circumstances in which the Company estimates the return for the current period, it uses all credible information available. This principally includes preliminary estimates reported by its fund managers, obtaining the valuation of underlying portfolio investments where such underlying investments are publicly traded and therefore have a readily observable price, using information that is available to the Company with respect to the underlying investments, reviewing various indices for similar investments or asset classes, as well as estimating returns based on the results of similar types of investments for which the Company has reported results, or other valuation methods, as necessary. Actual final fund valuations may differ, perhaps materially so, from the Company s estimates and these differences are recorded in the period they become known as a change in estimate.

3. Recent accounting pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued authoritative guidance on *Business Combinations* and *Consolidation* which are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. In April 2009, the FASB issued further authoritative guidance on business combinations that amended previous guidance on the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets acquired and liabilities assumed in a business combination that arise from contingencies. Significant changes arising from this update, which impact current and future acquisitions include the determination of the purchase price and treatment of transaction expenses, restructuring charges and negative goodwill as follows;

Purchase Price The purchase price is determined as of the acquisition date, which is the date that the acquirer obtains control. Under previous guidance, the date the business combination was announced was used as the effective date in determining the purchase price;

Transaction Expenses All costs associated with purchase transactions must be expensed as incurred. Under previous guidance, all such costs could be capitalized and included as part of transaction purchase price, adding to the amount of goodwill recognized;

Restructuring Costs Expected restructuring costs are not recorded at the closing date, but rather after the transaction. The only costs to be included as a liability at the closing date are those for which an acquirer is obligated at the time of the closing. Under previous guidance, restructuring costs that were planned to occur after the closing of the transaction were recognized and recorded at the closing date as a liability;

Negative Goodwill/Bargain Purchases Where total fair value of net assets acquired exceeds consideration paid (creating negative goodwill), the acquirer will record a gain as a result of the bargain purchase, to be recognized through the income statement at the close of the transaction. Under previous guidance, negative goodwill was recognized as a pro rata reduction of the assets assumed to allow the net assets acquired to equal the consideration paid; and

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

Noncontrolling Interests In a partial or step acquisition where control is obtained, 100% of goodwill and identifiable net assets are recognized at fair value and the noncontrolling (sometimes called minority interest) interest is also recorded at fair value. Under previous guidance, in a partial acquisition only the controlling interest s share of goodwill was recognized, the controlling interest s share of identifiable net assets was recognized at fair value and the noncontrolling interest s share of identifiable net assets was recognized at carrying value. A noncontrolling interest is now recognized in the equity section, presented separately from the controlling interest s equity. Under previous guidance, noncontrolling interest in general was recorded in the mezzanine section.

As a result of the adoption of this update the Company has expensed as incurred the transaction costs related to the definitive Amalgamation Agreement dated July 9, 2009 among IPC, Validus Holdings, Ltd and Validus, Ltd (the Amalgamation Agreement) with IPC, as described in Note 4. The adoption of this update on business combinations and consolidation materially impacts the consolidated financial statement recognition and measurement of current and future acquisitions.

In June 2008, the FASB issued authoritative guidance on the *Balance Sheet* presentation of instruments granted in Share-based Payment transactions. This update addresses whether instruments granted in share-based payment transactions may be participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing basic earnings per share (EPS) pursuant to the two-class method. This update is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

In January 2009, the FASB issued authoritative guidance on *Investments Other* and the beneficial interests in securitized financial assets that amends certain recognition aspects of other-than-temporary impairments (OTTI). This update is effective prospectively for interim and annual periods ending after December 15, 2008. Retrospective application of this update to a prior interim or annual period is prohibited. As the Company s investment portfolio is classified as trading, the adoption of this guidance has not had a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued authoritative guidance on *Fair Value Measurements and Disclosures* and the recognition and presentation of other-than-temporary impairments (OTTI). The fair value measurement update includes guidance on; (1) estimating the fair value of an asset or liability (financial and nonfinancial) when the volume and level of activity for the asset or liability have significantly decreased; and (2) identifying transactions that are not orderly. The primary change to the OTTI model for debt securities is the change in focus from an entity s intent and ability to hold a security until recovery. Instead, an OTTI is triggered if; (1) an entity has the intent to sell the security; (2) it is more likely than not that it will be required to sell the security before recovery; or (3) it does not expect to recover the entire amortized cost basis of the security. Both updates are effective for interim and annual periods ending after June 15, 2009. The adoption of these updates has not had a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued authoritative guidance on interim disclosures about fair value of *Financial Instruments"*. This update expands the fair value disclosures required for specified financial instruments for interim periods of publicly traded entities. This update also requires entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim basis and to highlight any changes of the methods and significant assumptions from prior periods. This update is effective for interim and annual periods ending after June 15, 2009. As this update only expands certain disclosures requirements it has not had a material impact on the Company s consolidated financial statements.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

In May 2009, the FASB issued authoritative guidance on management s assessment of *Subsequent Events*. This update clarifies that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued or are available to be issued. This update is effective prospectively for interim and annual periods ending after June 15, 2009. The adoption of this update has not had a material impact on management s existing processes for assessing subsequent events, and consequently the Company s consolidated financial statements.

In June 2009, the FASB issued authoritative guidance on accounting for *Transfers and Servicing* of financial assets which amends previous derecognition guidance. This update addresses practices that have developed that are not consistent with the original intent and key requirements and concerns that derecognized financial assets and related obligations should continue to be reported in the transferors financial statements. This update is effective for financial asset transfers in the interim and annual periods beginning after November 15, 2009. Early adoption is prohibited. The adoption of this update is not expected to have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued authoritative guidance which amends the *Consolidation* guidance that applies to Variable Interest Entities (VIEs). This update amends the guidance for the identification of VIEs and their primary beneficiaries and the financial statement disclosures required. This update is effective for interim and annual periods beginning after November 15, 2009. Early adoption is prohibited. The adoption of this update is not expected to have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued authoritative guidance which prescribes the use of the FASB Accounting Standards Codification (the Codification) as the authoritative source of U.S. *Generally Accepted Accounting Principles* (GAAP). All of its content carries the same level of authority, effectively superseding previous guidance to include only two levels of U.S. GAAP: authoritative and nonauthoritative. This update is effective for interim and annual periods ending after September 15, 2009. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

In August 2009, the FASB updated guidance on *Fair Value Measurements and Disclosures* of liabilities. This update clarifies that the quoted price for the identical liability, when traded as an asset in an active market, is also a Level 1 measurement for that liability when no adjustment to the quoted price is required. In the absence of a Level 1 measurement, an entity must use one or more prescribed valuation techniques to estimate fair value. This update is effective for the first interim or annual reporting period beginning after August 28, 2009. The adoption of this update will not have a material impact on the Company s consolidated financial statements and affected disclosures only.

In August 2009, the FASB proposed updated guidance on improving *Fair Value Measurements and Disclosures*. The proposed updated would clarify existing requirements regarding disclosures of inputs and valuation techniques and levels of disaggregation. In addition, the proposed updated would require new disclosures on (1) sensitivity disclosures regarding the effect of changing Level 3 inputs if the change in the fair value measurement would change significantly, (2) significant transfers in and out of Levels 1 and 2 and the reasons that such transfers were made, and (3) additional disclosure in the reconciliation of Level 3 activity, including information on a gross basis for purchases, sales, issuances, and settlements. An effective date has not been established. As this update only expands certain disclosure requirements it is not expected to have a material impact on the Company s consolidated financial statements.

In September 2009, the FASB updated guidance on accounting for uncertainty in *Income Taxes* and disclosure amendments for nonpublic entities. This update provides guidance on (1) what constitutes a tax position for a pass-through or not-for-profit entity, (2) determining when an income tax is attributed to the reporting entity or its

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
owners, and (3) application of accounting for uncertainty in income taxes to a group of related entities composed of both taxable and nontaxable entities. The guidance is effective for interim and annual periods ending after September 15, 2009. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

In September 2009, the FASB updated guidance on *Fair Value Measurements and Disclosures* of certain alternative investments. This guidance offer investors a practical expedient for measuring the fair value of investments in certain entities that calculate net asset value per share. This guidance is effective for interim and annual reporting periods ending after December 15, 2009. Early adoption is permitted. This update was not adopted for the Company s interim period ended September 30, 2009. The adoption of this update is not expected to have a material impact on the Company s consolidated financial statements.

4. Business combination

On September 4, 2009, the Company acquired all of the outstanding shares of IPC (the IPC Acquisition). Pursuant to an Amalgamation Agreement, the Company acquired all of IPC s outstanding common shares in exchange for 0.9727 Company common shares and $7.50 cash per IPC common share. IPC s operations are focused on short-tail lines of reinsurance. The primary lines in which IPC conducted business were property catastrophe reinsurance and, to a limited extent, property-per-risk excess, aviation (including satellite) and other short-tail reinsurance on a worldwide basis. The acquisition of IPC was undertaken to gain a strategic advantage in the current reinsurance market and increase the Company s capital base.

The aggregate purchase price paid by the Company was $1,746,224 for adjusted tangible net assets acquired of $2,076,902. The global financial crisis and related market illiquidity have led to several publicly traded companies trading at substantial discounts. This was the primary factor responsible for a purchase price less than the book value of IPC s net assets, and the recognition of a bargain purchase gain on acquisition.

The estimates of fair values for tangible assets acquired and liabilities assumed are determined by management based on various market and income analyses and recent asset appraisals. Significant judgment is required to arrive at these estimates of fair value and changes to assumptions used could lead to materially different results.

An adjustment of $50,000 was made to IPC s net assets acquired in respect of the termination fee (the Max Termination Fee) paid under the Agreement and Plan of Amalgamation among Max Capital Group Ltd. (Max), IPC and IPC Limited (the Max Amalgamation Agreement). This Max Termination Fee was advanced to IPC by Validus on July 9, 2009, but was repayable in certain circumstances.

In addition, the Company at closing recorded a $21,671 intangible asset for the acquired IPC customer relationships. This intangible asset relates to the acquired broker distribution network and is fair valued using a variation of the income approach. Under this approach, the Company estimated the present value of expected future cash flows to an assumed hypothetical market participant resulting from the existing IPC customer relationships, considering attrition, and discounting at a weighted average cost of capital. The composition of purchase price and fair value of net assets acquired is summarized as follows:

Total allocable purchase price	
IPC shares outstanding at September 4, 2009	56,110,096
Exchange ratio	0.9727
Validus common shares issued	54,578,268

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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)

Total allocable purchase price		
Validus closing share price on September 4, 2009	$ 24.10	
Total value of Validus shares to be issued		$ 1,315,337
Total cash consideration paid at $7.50 per IPC share		420,826
Share compensation awards issued to IPC employees pursuant to the Amalgamation Agreement and earned prior to the Amalgamation		10,061
Total allocable purchase price		1,746,224
Tangible Assets Acquired		
Cash and investments	$ 2,463,374	
Receivables (a)	202,278	
Tangible Assets Acquired		2,665,652
Liabilities Acquired		
Net loss reserves and paid losses recoverable	$ 304,957	
Unearned premiums, net of expenses	180,370	
Other liabilities	53,423	
Liabilities acquired		538,750
Net tangible assets acquired, at fair value		2,126,902
Max Termination Fee		(50,000)
Net tangible assets acquired, at fair value, adjusted		2,076,902
Bargain purchase gain before establishment of intangible assets		330,678
Intangible asset customer relationships		21,671
Bargain purchase gain on acquisition of IPC		$ 352,349

(a) The fair value of receivables approximates the gross contractual amounts receivable.

The Company also incurred transaction and termination expenses related to the acquisition. Transaction expenses are primarily comprised of legal, corporate advisory, and audit related services. Termination expenses are primarily comprised of severance costs and accelerated share compensation costs in connection with certain IPC employment contracts that have been terminated. Finally, the customer relationships intangible asset has been fully amortized as it not expected to significantly contribute to the Company s future cash flows beyond the balance sheet date. The gain on

bargain purchase, net of expenses has been presented as a separate line item in the Company s Consolidated Statements of Operations and Comprehensive Income (Loss), and is composed of the following:

	September 30, 2009	
	Three months ended	**Nine months ended**
Bargain purchase gain on acquisition of IPC	$ 352,349	$ 352,349
Transaction expenses	(13,597)	(29,448)
Termination expenses	(14,131)	(14,131)
Amortization of intangible asset customer relationships	(21,671)	(21,671)
Gain on bargain purchase, net of expenses	$ 302,950	$ 287,099

Validus Holdings, Ltd.
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The following selected unaudited information has been provided to present a summary of the results of IPC since the acquisition date, that have been included within the Validus Re segment in the consolidated financial statements.

	From Acquisition Date to September 30, 2009
Net premiums written	$ (658)
Total revenue	57,434
Total expenses	13,550
Net income	$ 43,884

Supplemental Pro Forma Information

Operating results of IPC have been included in the consolidated financial statements from the September 4, 2009 acquisition date. The following selected unaudited pro forma information has been provided to present a summary of the combined results of the Company and IPC, assuming the transaction had been effected on January 1, 2008. The unaudited pro forma data is for informational purposes only and does not necessarily represent results that would have occurred if the transaction had taken place on the basis assumed above.

	Three months ended	
	September 30, 2009	September 30, 2008
Net premiums written	$ 288,605	$ 293,647
Total revenue	609,620	327,033
Total expenses	274,365	545,898
Net income	335,255	(218,865)
Basic earnings per share	$ 3.61	$ (2.95)
Diluted earnings per share	$ 3.50	$ (2.95)

	Nine months ended	
	September 30, 2009	September 30, 2008
Net premiums written	$ 1,544,270	$ 1,407,062
Total revenue	1,620,181	1,122,443
Total expenses	841,921	1,074,763
Net income	778,260	47,680
Basic earnings per share	$ 9.49	$ 0.57
Diluted earnings per share	$ 9.20	$ 0.54

5. Investments

During the first quarter of 2007, the Company adopted authoritative guidance on fair value measurements and disclosures and financial instruments. Prior to January 1, 2007, the Company s investments in fixed maturities were

classified as available-for-sale and carried at fair value, with related net unrealized gains or losses excluded from earnings and included in shareholders equity as a component of accumulated other comprehensive income. The Company believes that accounting for its investment portfolio as trading more closely reflects its investment guidelines. Beginning on January 1, 2007, the Company s investments in fixed maturities were 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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(Expressed in thousands of U.S. dollars, except share and per share information)

(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 but for which the Company typically obtained independent external valuation information including U.S. and U.K. Treasuries, 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. Sustainably 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. Financial instruments in this category include U.S. Treasuries, sovereign debt, corporate debt and U.S. agency and non-agency mortgage and asset-backed securities. Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. Financial instruments in this category include certain residential mortgage-backed securities.

Other investments consist of an investment in a fund of hedge funds and a deferred compensation trust. The fund investment manager provides monthly reported net asset values (NAV) with a one-month delay in its valuation. As a result, the fund investment manager s August 31, 2009 NAV was used as a partial basis for fair value measurement in the Company s September 30, 2009 balance sheet. The fund investment manager s NAV relies on an estimate of the performance of the fund based on the month end positions from the underlying third-party funds. The Company combines the fund investment manager s primarily market approach NAV with relevant valuation sources obtained on a timelier basis. As this combined approach valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset. The foundation for the income approach is the amount and timing of future cash flows. To determine the reasonableness of the combined approach NAV, the Company assesses the variance between the combined approach NAV and the one-month delayed fund investment manager s NAV. These variances are recorded in the following reporting period.

On August 28, 2009, the Company sold short equity index futures contracts with the goal of hedging until closing of the IPC acquisition and liquidation of IPC s mutual fund equity portfolio exposure. The contracts were closed when the equity positions were fully redeemed on September 9, 2009. The Company experienced a $3.3 million realized investment loss as a result of the futures contracts.

At September 30, 2009, the Company s investments were allocated between Levels 1, 2 and 3 as follows:

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

	Level 1	Level 2	Level 3	Total
U.S. Government and Government Agency	$	$ 1,182,985	$	$ 1,182,985
Non-U.S. Government and Government Agency		464,940		464,940
States, municipalities, political subdivision		8,642		8,642
Agency residential mortgage-backed securities		645,849		645,849
Non-Agency residential mortgage-backed securities		66,400	96,527	162,927
U.S. corporate		1,170,782		1,170,782
Non-U.S. corporate		827,048		827,048
Catastrophe bonds		21,368		21,368
Asset-backed securities		52,381		52,381
Commercial mortgage-backed securities		53,221		53,221
Total fixed maturities		4,493,616	96,527	4,590,143
Total short-term investments	592,325	2,256		594,581
Total other investments		11,614	117,398	129,012
Total	$ 592,325	$ 4,507,486	$ 213,925	$ 5,313,736

At December 31, 2008, 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	$	$ 768,344	$	$ 768,344
Non-U.S. Government and Government Agency		96,073		96,073
States, municipalities, political subdivision		15,516		15,516
Agency residential mortgage-backed securities		433,736		433,736
Non-Agency residential mortgage-backed securities		119,813	111,318	231,131
U.S. corporate		443,847		443,847
Non-U.S. corporate		125,700		125,700
Catastrophe bonds		10,872		10,872
Asset-backed securities		137,023		137,023
Commercial mortgage-backed securities		192,259		192,259
Total fixed maturities		2,343,183	111,318	2,454,501
Total short-term investments	365,357	11,679		377,036
Total	$ 365,357	$ 2,354,862	$ 111,318	$ 2,831,537

At September 30, 2009, Level 3 investments totaled $213,925, representing 4.0% of total investments measured at fair value on a recurring basis. At December 31, 2008, Level 3 investments totaled $111,318, representing 3.9% of total investments measured at fair value on a recurring basis.

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs as at September 30, 2009 and December 31, 2008:

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

	Nine months ended September 30, 2009	Year ended December 31, 2008
Level 3 investments Beginning of period	$ 111,318	$
Payments and purchases	115,351	
Sales and maturities	(822)	(59)
Realized losses	(1,284)	
Unrealized losses	1,133	(14,603)
Amortization	(11,771)	(4,048)
Transfers in		130,028
Level 3 investments End of period	$ 213,925	$ 111,318

(b) Net investment income

Net investment income was derived from the following sources:

	Three months ended		Nine months ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Fixed maturities and short-term investments	$ 29,427	$ 32,443	$ 82,341	$ 98,654
Cash and cash equivalents	742	4,308	2,623	11,524
Securities lending income	171	261	683	1,150
Gross investment income	30,340	37,012	85,647	111,328
Investment expenses	(808)	(633)	(2,380)	(2,471)
Net investment income	$ 29,532	$ 36,379	$ 83,267	$ 108,857

(c) Fixed maturity and short-term investments

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

	Three months ended		Nine months ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Fixed maturities, short-term and other investments and cash equivalents				
Gross realized gains	$ 9,795	$ 3,653	$ 23,175	$ 14,965
Gross realized losses	(4,366)	(17,320)	(43,817)	(23,313)
Net realized gains (losses) on investments	5,429	(13,667)	(20,642)	(8,348)

Change in unrealized gains (losses) on securities lending	1,441		(2,422)	5,747		(3,316)
Change in unrealized gains (losses) on investments	48,996		(12,227)	104,092		(69,292)
Total net realized gains (losses) and change in unrealized gains (losses) on investments	$ 55,866	$	(28,316)	$ 89,197	$	(80,956)

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at September 30, 2009 were as follows:

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	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Government and Government Agency	$ 1,165,337	$ 17,707	$ (59)	$ 1,182,985
Non-U.S. Government and Government Agency	467,741	7,365	(10,166)	464,940
States, municipalities, political subdivision	8,500	142		8,642
Agency residential mortgage-backed securities	629,725	16,431	(307)	645,849
Non-Agency residential mortgage-backed securities	198,597	817	(36,487)	162,927
U.S. corporate	1,146,483	25,432	(1,133)	1,170,782
Non-U.S. corporate	825,255	8,731	(6,938)	827,048
Catastrophe bonds	20,757	731	(120)	21,368
Asset-backed securities	52,196	723	(538)	52,381
Commercial mortgage-backed securities	52,210	1,015	(4)	53,221
Total fixed maturities	4,566,801	79,094	(55,752)	4,590,143
Total short-term investments	595,557	38	(1,014)	594,581
Total other investments	126,301	2,711		129,012
Total	$ 5,288,659	$ 81,843	$ (56,766)	$ 5,313,736

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at December 31, 2008 were as follows:

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Government and Government Agency	$ 732,155	$ 36,189	$	$ 768,344
Non-U.S. Government and Government Agency	115,389	4,403	(23,719)	96,073
States, municipalities, political subdivision	14,954	562		15,516
Agency residential mortgage-backed securities	425,533	8,358	(155)	433,736
Non-Agency residential mortgage-backed securities	299,346	6	(68,221)	231,131
U.S. corporate	454,810	2,126	(13,089)	443,847

Non-U.S. corporate	140,807	1,696	(16,803)	125,700
Catastrophe bonds	11,012	2	(142)	10,872
Asset-backed securities	141,209		(4,186)	137,023
Commercial mortgage-backed securities	217,803		(25,544)	192,259
Total fixed maturities	2,553,018	53,342	(151,859)	2,454,501
Total short-term investments	379,537	55	(2,556)	377,036
Total	$ 2,932,555	$ 53,397	$ (154,415)	$ 2,831,537

The following table sets forth certain information regarding the investment ratings of the Company s fixed maturities portfolio as at September 30, 2009 and December 31, 2008. 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, 2009		December 31, 2008	
	Estimated fair value	% of total	Estimated fair value	% of total
AAA	$ 2,831,934	61.7%	$ 1,941,349	79.1%
AA	578,547	12.6%	146,923	6.0%
A	978,886	21.3%	338,966	13.8%
BBB	71,914	1.6%	12,427	0.5%
Investment grade	4,461,281	97.2%	2,439,665	99.4%
BB	33,907	0.7%	7,416	0.3%
B	42,358	1.0%	7,420	0.3%
CCC	51,045	1.1%		0.0%
NR	1,552	0.0%		0.0%
Non-Investment grade	128,862	2.8%	14,836	0.6%
Total fixed maturities	$ 4,590,143	100.0%	$ 2,454,501	100.0%

The amortized cost and estimated fair value amounts for fixed maturity securities held at September 30, 2009 and December 31, 2008 are shown 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, 2009		December 31, 2008	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due in one year or less	$ 322,574	$ 323,395	$ 277,137	$ 279,727
Due after one year through five years	2,896,645	2,932,941	1,143,494	1,134,275
Due after five years through ten years	412,464	416,835	17,451	17,493
Due after ten years	2,391	2,595	31,045	28,858
	3,634,074	3,675,766	1,469,127	1,460,353
Asset-backed and mortgage-backed securities	932,727	914,377	1,083,891	994,148
Total	$ 4,566,801	$ 4,590,143	$ 2,553,018	$ 2,454,501

The Company has a five year, $500,000 secured letter of credit facility provided by a syndicate of commercial banks. At September 30, 2009, approximately $269,231 (December 31, 2008: $199,186) of letters of credit were issued and outstanding under this facility for which $365,238 of investments were pledged as collateral (December 31, 2008: $258,573). In 2007, the Company entered into a $100,000 standby letter of credit facility which provides Funds at Lloyd s. At September 30, 2009, $100,000 (December 31, 2008: $100,000) of letters of credit were issued and

outstanding under this facility for which $129,041 of investments were pledged as collateral (December 31, 2008: $144,149). In addition, $1,297,788 of investments were held in trust at September 30, 2009, (December 31, 2008: $1,100,235). Of those, $1,188,295 were held in trust for the benefit of Talbot s cedants and policyholders, and to facilitate the accreditation as an alien insurer/reinsurer by certain regulators (December 31, 2008: $1,032,267).

The Company assumed two letters of credit facilities as part of the IPC Acquisition. A $250,000 Credit Agreement between IPC Holdings, Ltd., IPCRe Limited, the Lenders party thereto and Wachovia Bank, National Association (the IPC Syndicated Facility) and a $350,000 Letters of Credit Master Agreement between Citibank N.A. and IPCRe Limited (the IPC Bi-Lateral Facility). At September 30, 2009, the IPC Syndicated Facility had $38,602 letters of credit issued and outstanding for which

Validus Holdings, Ltd.
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$39,760 investments were pledged as collateral. At September 30, 2009, the IPC Bi-Lateral Facility had $91,071 letters of credit issued and outstanding for which $321,760 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, 2009, the Company had $98,840 (December 31, 2008: $103,266) in securities on loan. During the nine months ended September 30, 2009, the Company recorded a $5,747 unrealized gain on this collateral on its Statements of Operations (September 30, 2008: unrealized loss $3,316).

Securities lending collateral reinvested is primarily comprised of corporate floating rate securities with an average reset period of 23.4 days (December 31, 2008: 26.7 days). As at September 30, 2009, 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	$	$ 14,140	$	$ 14,140
Agency		14,879		14,879
Asset-backed securities		11,382		11,382
Cash equivalents and short-term investments	4,981	54,671		59,652
Total	$ 4,981	$ 95,072	$	$ 100,053

As at December 31, 2008, the securities lending collateral reinvested lending by the Company in connection with its securities program was allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
Corporate	$	$ 57,574	$	$ 57,574
Asset-backed securities		18,228		18,228
Cash equivalents and short-term investments	7,390	15,762		23,152
Total	$ 7,390	$ 91,564	$	$ 98,954

The following table sets forth certain information regarding the investment ratings of the Company s securities lending collateral reinvested as at September 30, 2009 and December 31, 2008. 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, 2009		December 31, 2008	
	Estimated fair value	% of total	Estimated fair value	% of total
AAA	$ 85,919	85.8%	$ 45,137	45.7%
AA	8,985	9.0%	37,608	37.9%
A		0.0%	8,729	8.8%
NR	168	0.2%	90	0.1%
	95,072	95.0%	91,564	92.5%
NR- Cash (1)	4,981	5.0%	7,390	7.5%
Total	$ 100,053	100.0%	$ 98,954	100.0%

(1) This amount relates to cash and is therefore not a rated security.

The amortized cost and estimated fair value amounts for securities lending collateral reinvested held at September 30, 2009 and December 31, 2008 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.

	September 30, 2009		December 31, 2008	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due in one year or less	$ 74,587	$ 74,530	$ 24,390	$ 23,152
Due after one year through five years	26,453	25,523	81,298	75,802
Total	$ 101,040	$ 100,053	$ 105,688	$ 98,954

6. 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, 2009, 99.3% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A- or better and included $62,631 of IBNR recoverable (December 31, 2008: $71,580). Reinsurance recoverables by reinsurer are as follows:

	September 30, 2009		**December 31, 2008**	
	Reinsurance recoverable	**% of Total**	**Reinsurance reoverable**	**% of Total**
Top 10 reinsurers	$ 167,265	91.8%	198,403	94.4%
Other reinsurers balances > $1 million	6,105	3.4%	8,987	4.3%
Other reinsurers balances < $1 million	8,795	4.8%	2,794	1.3%
Total	$ 182,165	100.0%	210,184	100.0%

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		September 30, 2009	
Top 10 Reinsurers	**Rating**	**Reinsurance recoverable**	**% of Total**
Fully collateralized reinsurers	NR	$ 55,601	33.1%
Hannover Re	AA-	28,711	17.2%
Lloyd s Syndicates	A	25,977	15.5%
Allianz	AA	14,035	8.4%
Munich Re	AA-	11,742	7.0%
Swiss Re	A+	11,003	6.6%
Aspen	A	7,282	4.4%
Transatlantic Re	A+	5,781	3.5%
Platinum	A	3,941	2.4%
Brit	A	3,192	1.9%
Total		$ 167,265	100.0%

At September 30, 2009 and December 31, 2008, the provision for uncollectible reinsurance relating to losses recoverable was $3,221 and $3,228, respectively. To estimate the provision for uncollectible reinsurance recoverable, the reinsurance recoverable must first be allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment must be applied. As part of this process, ceded IBNR is allocated by reinsurer. Of the $182,165 reinsurance recoverable at September 30, 2009, $55,601 was fully collateralized (December 31, 2008: $83,511).

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.

(b) Collateralized quota share retrocession treaties

On December 22, 2007, Validus Re entered into a collateralized retrocessional reinsurance agreement with an unaffiliated third party whereby the Company cedes certain business underwritten in the marine offshore energy lines. For the three months ended September 30, 2009 and 2008 Validus Re ceded $392 and $3,994 of premiums written through this agreement, respectively. The earned portions of premiums ceded for the three months ended September 30, 2009 and 2008 were $392 and $7,744, respectively. For the nine months ended September 30, 2009 and 2008 Validus Re ceded $1,491 and $18,554 of premiums written through this agreement, respectively. The earned portions of premiums ceded for the nine months ended September 30, 2009 and 2008 were $1,671 and $14,230, respectively.

7. 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 each. 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 September 4, 2009, the Company acquired all of the outstanding shares of IPC from a group of institutional and other investors. Pursuant to the Amalgamation Agreement, the Company acquired all of IPC s outstanding common shares in exchange for the Company s common shares and cash. The Company issued 54,556,762 common shares (excluding 21,506 restricted share awards) valued at $24.10 per share as partial consideration for the IPC Acquisition.

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

	Common shares
Common shares outstanding, December 31, 2008	75,624,697
IPC Acquisition issuance	54,556,762
Restricted share awards vested	376,354
Restricted share units vested	51,423
Employee seller shares vested	248,085
Options exercised	12,033
Warrants exercised	237,842
Common shares outstanding, September 30, 2009	131,107,196

	Common shares
Common shares outstanding, December 31, 2007	74,199,836
Restricted share awards vested	777,953
Employee seller shares vested	515,103
Options exercised	112,825
Warrants exercised	18,980
Common shares outstanding, December 31, 2008	75,624,697

b) Warrants

During the three months ended September 30, 2009, nil warrants were exercised. During the nine months ended September 30, 2009, 728,010 warrants were exercised which resulted in the net share issuance of 237,842 common shares. During the three months ended September 30, 2008, nil warrants were exercised. During the nine months ended September 30, 2008, 31,580 warrants were exercised which resulted in the net share issuance of 18,980 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 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, 2009 were 4,543 (December 31, 2008: 4,430).

d) Dividends

On November 4, 2009, the Company announced a quarterly cash dividend of $0.20 (2008: $0.20) per common share and $0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on December 31, 2009 to holders of record on December 15, 2009.

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8. Stock plans

a) Long-term incentive plan

The Company s Long Term Incentive Plan (LTIP) provides for grants to employees of any option, stock appreciation right (SAR), restricted share, restricted share unit, performance share, performance unit, dividend equivalent or other share-based award. The total number of shares reserved for issuance under the LTIP is 13,126,896 shares. The LTIP is administered by the Compensation Committee of the Board of Directors. No SARs or performance shares have been granted to date. Grant prices are established at the estimated fair market value of the Company s common shares at the date of grant.

In accordance with the terms of the Amalgamation Agreement, the IPC 2007 Stock Incentive Plan, was assumed by Validus on the acquisition date and this resulted in the issuance of 21,603 restricted share awards, 218,804 restricted share units, 199,315 performance share units and 650,557 non-qualified options.

b) LTIP options

Options granted under the LTIP 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. All options granted in 2009 were as a result of the Amalgamation Agreement. Grant prices are established at the estimated fair value of the Company s common shares at the date of grant 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
2007 and prior years	4.5%	0.0%	7	30.0%
2008	3.5%	3.2%	7	30.0%
2009	3.9%	3.7%	2	34.6%

Expected volatility is based on stock price volatility of comparable publicly-traded companies. The Company uses 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 is not available and the options met the requirement as set out in the bulletin.

Share compensation expenses of $1,063 were recorded for the three months ended September 30, 2009 (2008: $1,080). Share compensation expenses of $3,037 were recorded for the nine months ended September 30, 2009 (2008: $3,171). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to the options for the nine months ended September 30, 2009 was as follows:

	Options	Weighted average grant date fair value	Weighted average grant date exercise price
Options outstanding, December 31, 2008	2,799,938	$ 7.57	$ 18.23
Options granted	650,557	3.42	27.27
Options exercised	(12,033)	6.32	21.11
Options forfeited	(7,646)	10.30	20.39

Options outstanding, September 30, 2009	3,430,816	$	6.80	$	19.93
Options exercisable at September 30, 2009	1,520,416	$	7.56	$	17.89

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Activity with respect to options for the year ended December 31, 2008 was as follows:

	Options		Weighted average grant date fair value		Weighted average grant date exercise price
Options outstanding, December 31, 2007	2,761,176	$	7.61	$	17.82
Options granted	164,166		6.73		24.73
Options exercised	(112,825)		7.38		17.57
Options forfeited	(12,579)		8.56		18.69
Options outstanding, December 31, 2008	2,799,938	$	7.57	$	18.23
Options exercisable at December 31, 2008	1,396,353	$	7.46	$	17.63

At September 30, 2009, there were $5,794 (December 31, 2008: $9,139) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.5 years (December 31, 2008: 2.2 years).

c) LTIP restricted shares

Restricted shares granted under the LTIP vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $3,621 were recorded for the three months ended September 30, 2009 (2008: $3,767). Share compensation expenses of $12,008 were recorded for the nine months ended September 30, 2009 (2008: $10,334). 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 shares for the nine months ended September 30, 2009 was as follows:

	Restricted shares		Weighted average grant date fair value
Restricted shares outstanding, December 31, 2008	2,307,402	$	22.73
Restricted shares granted	736,030		24.62
Restricted shares vested	(459,910)		22.32
Restricted shares forfeited	(4,517)		21.19
Restricted shares outstanding, September 30, 2009	2,579,005	$	23.34

Activity with respect to unvested restricted shares for the period ended December 31, 2008 was as follows:

Weighted

	Restricted shares		average grant date fair value
Restricted shares outstanding, December 31, 2007	2,158,220	$	20.44
Restricted shares granted	1,007,083		24.09
Restricted shares vested	(822,370)		18.55
Restricted shares forfeited	(35,531)		21.87
Restricted shares outstanding, December 31, 2008	2,307,402	$	22.73

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At September 30, 2009, there were $40,978 (December 31, 2008: $35,915) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.9 years (December 31, 2008: 3.2 years).

d) Employee seller shares

Pursuant to the Share Sale Agreement for the purchase of 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 are subject to a restricted period during which they are subject to forfeiture (as implemented by repurchase by the Company for a nominal amount). Forfeiture of employee seller shares will generally occur in the event that any such Talbot employee s employment terminates, with certain exceptions, prior to the end of the restricted period. The restricted period will end 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 after four years forfeiture will be completely extinguished.

Share compensation expenses of $1,285 were recorded for the three months ended September 30, 2009 (2008: $1,153). Share compensation expenses of $3,874 were recorded for the nine months ended September 30, 2009 (2008: $6,286). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested employee seller shares for the nine months ended September 30, 2009 was as follows:

	Employee seller shares		Weighted average grant date fair value
Employee seller shares outstanding, December 31, 2008	663,375	$	22.01
Employee seller shares granted			
Employee seller shares vested	(248,085)		22.01
Employee seller shares forfeited	(3,799)		22.01
Employee seller shares outstanding, September 30, 2009	411,491	$	22.01

Activity with respect to unvested employee seller shares for the year ended December 31, 2008 was as follows:

	Employee seller shares		Weighted average grant date fair value
Employee seller shares outstanding, December 31, 2007	1,209,741	$	22.01
Employee seller shares granted			
Employee seller shares vested	(515,103)		22.01
Employee seller shares forfeited	(31,263)		22.01
Employee seller shares outstanding, December 31, 2008	663,375	$	22.01

At September 30, 2009, there were $8,146 (December 31, 2008: $12,157) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.8 years (December 31, 2008: 2.5 years).

e) Restricted share units

Restricted share units under the LTIP vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $2,802 were recorded for the three months ended September 30, 2009 (2008: $12). Share compensation expenses of $2,838 were recorded for the nine months ended

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September 30, 2009 (2008: $27) related to restricted share units. 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, 2009 was as follows:

	Restricted share units		Weighted average grant date fair value
Restricted share units outstanding, December 31, 2008	11,853	$	25.28
Restricted share units granted	228,136		24.76
Restricted share units vested	(51,753)		24.76
Restricted share units forfeited			
Restricted share units outstanding, September 30, 2009	188,236	$	24.79

Activity with respect to unvested restricted share units for the year ended December 31, 2008 was as follows:

	Restricted share units		Weighted average grant date fair value
Restricted share units outstanding, December 31, 2007		$	
Restricted share units granted	11,853		25.28
Restricted share units vested			
Restricted share units forfeited			
Restricted share units outstanding, December 31, 2008	11,853	$	25.28

At September 30, 2009, there were $687 (December 31, 2008: $223) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 3.2 years (December 31, 2008: 4.6 years). Additional restricted share units are issued in lieu of accrued dividends from unvested restricted share units. As at September 30, 2009, unvested restricted share units issued in lieu of dividends were 708 (December 31, 2008: 315).

f) Performance share units

In accordance with the terms of the Amalgamation Agreement, the IPC 2007 Stock Incentive Plan, the plan under which the IPC Performance Share Units were granted, was assumed by Validus.

The PSUs contain both a market and performance based component. The market component is defined as the relative total shareholder return as compared to the BSX Bermuda Insurance Index. The performance component relates to the annual return on equity on an operating basis based on opening shareholders equity. At inception of the three year cycle for the PSU awards, IPC estimated the fair value of the market and the performance based components of the PSUs granted under the IPC 2007 Stock incentive plan together with a forfeiture rate and recorded the compensation expense in its consolidated statements of income over the course of such period. The fair value estimate in respect of the market based component was set and earns over the requisite attribution period and is not adjusted unless the total shareholder return as compared to the BSX Bermuda Insurance Index falls below the 35th

percentile minimum. The estimate in respect of the performance component was reassessed at the end of each quarter as IPC s financial results evolved and IPC reflected any adjustments in the consolidated statements of income in the period in which they are determined. The PSUs contain a lock-in provision at the end of each year within the three year cycle.

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Share compensation expenses of $2,522 were recorded for the three and nine months ended September 30, 2009 related to performance share units. Activity with respect to unvested performance share units for the nine months ended September 30, 2009 was as follows:

	Performance share units	Weighted average grant date fair value
Performance share units outstanding, December 31, 2008		$
Performance share units granted	199,315	24.76
Performance share units vested		
Performance share units forfeited		
Performance share units outstanding, September 30, 2009	199,315	$ 24.76

At September 30, 2009, there were $77 of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.0 years.

g) Share compensation expenses

Total share compensation expenses include 5,431 of IPC-related termination expenses which have been included to the gain on bargain purchase, net of expenses in the Statements of Operations. The breakdown of share compensation expenses was as follows:

	Three months ended		Nine months ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
LTIP options	$ 1,063	$ 1,080	$ 3,037	$ 3,171
LTIP restricted shares	3,621	3,767	12,008	10,334
Employee seller shares	1,285	1,153	3,874	6,286
LTIP restricted share units	2,802	12	2,838	27
Performance share units	2,522		2,522	
Total	$ 11,293	$ 6,012	$ 24,279	$ 19,818

9. Debt and financing arrangements

a) Financing structure and finance expenses

The financing structure at September 30, 2009 was:

	Commitment	Outstanding (1)	Drawn
9.069% Junior Subordinated Deferrable Debentures	$ 150,000	$ 150,000	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	200,000	154,300	154,300
$200,000 unsecured letter of credit facility	200,000		
$500,000 secured letter of credit facility	500,000	269,231	

$250,000 IPC Syndicated facility	250,000	38,602	
$350,000 IPC Bi-Lateral facility	350,000	91,071	
Talbot FAL facility (2)	100,000	100,000	
Talbot third party FAL facility (2)	121,515	121,515	
Total	$ 1,871,515	$ 924,719	$ 304,300

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(Expressed in thousands of U.S. dollars, except share and per share information)
The financing structure at December 31, 2008 was:

	Commitment	Outstanding (1)	Drawn
9.069% Junior Subordinated Deferrable Debentures	$ 150,000	$ 150,000	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	200,000	154,300	154,300
$200,000 unsecured letter of credit facility	200,000		
$500,000 secured letter of credit facility	500,000	199,186	
Talbot FAL facility (2)	100,000	100,000	
Talbot third party FAL facility (2)	144,015	144,015	
Total	$ 1,294,015	$ 747,501	$ 304,300

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

(2) 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, 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, 2009	**September 30, 2008**	**September 30, 2009**	**September 30, 2008**
9.069% Junior Subordinated Deferrable Debentures	$ 3,588	$ 3,588	$ 10,765	$ 10,765
8.480% Junior Subordinated Deferrable Debentures	3,348	3,509	10,044	11,517
Credit facilities	395	218	1,235	692
Talbot letter of credit facilities	62	44	167	169
Talbot other interest		(194)		(81)
Talbot third party FAL facility	3,864	7,352	7,521	25,734
Total	$ 11,257	$ 14,517	$ 29,732	$ 48,796

(b) 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 9.069% Junior Subordinated Deferrable Debentures). The 9.069%

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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 9.069% Junior Subordinated Deferrable Debentures. Interest will be 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 9.069% Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, are being 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 8.480% Junior Subordinated Deferrable Debentures). The 8.480% 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 8.480% Junior Subordinated Deferrable Debentures. Interest will be 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 8.480% 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.

On April 29, 2008, the Company repurchased from an unaffiliated financial institution $45,700 principal amount of its 8.480% Junior Subordinated Deferrable Debentures due 2037 at an aggregate price of $36,560, plus accrued and unpaid interest of $474. The repurchase resulted in the recognition of a realized gain of $8,752 for the year ended December 31, 2008.

Future expected payments of interest and principal on the Junior Subordinated Deferrable Debentures assuming that the Company exercises its call option at the earliest opportunity are as follows:

2009	$ 6,672
2010	26,688
2011	169,887
2012	160,842
2013 and thereafter	
Total minimum future payments	$ 364,089

(c) Credit facilities

On March 12, 2007, the Company entered into a $200,000 three-year unsecured facility, as subsequently amended on October 25, 2007 and September 4, 2009, which provides for letter of credit availability for Validus Re and our other subsidiaries and revolving credit availability for the Company (the Three Year Facility) (the full $200,000 of which is available for letters of credit and/or revolving loans), and a $500,000 five-year secured letter of credit facility, as subsequently amended on October 25, 2007 and September 4, 2009, which provides for letter of credit availability for Validus Re and our other subsidiaries (the Five Year Facility and together with the Three Year Facility, the Credit Facilities). The Credit Facilities were provided by a syndicate of commercial banks arranged by J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc.

As amended, 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 70% of consolidated net worth as

calculated using the pro forma balance sheet included in the definitive proxy statement relating to the IPC Acquisition and, commencing with the end of the fiscal quarter ending September 30, 2009 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, (ii) the requirement that the Company

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maintain at all times a consolidated total debt to consolidated total capitalization 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). For purposes of covenant compliance (i) net worth is calculated with investments carried at amortized cost and (ii) consolidated total debt does not include the Company s junior subordinated deferrable debentures. The credit facilities also contain restrictions on our ability to pay dividends and other payments in respect of equity interests at any time that we are otherwise in default with respect to certain provisions under the credit facilities, make investments, incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others.

As of September 30, 2009 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Credit Facilities.

As of September 30, 2009, we had $269,231 in outstanding letters of credit under our five-year secured letter of credit facility (December 31, 2008: $199,186) and no amounts were outstanding under our three-year unsecured facility (December 31, 2008: $nil).

On October 25, 2007, the Company entered into the First Amendment to the Credit Facilities to provide for, among other things, additional capacity to incur up to $100,000 under a new Funds at Lloyd s Letter of Credit Facility (as described below) to support underwriting capacity provided to Talbot 2002 Underwriting Ltd through Syndicate 1183 at Lloyd s of London for the 2008 and 2009 underwriting years of account. The amendment also modifies certain provisions in the Credit Facilities in order to permit dividend payments on existing and future preferred and hybrid securities notwithstanding certain events of default.

On September 4, 2009 the Company entered into the Second Amendment to the Credit Facilities to provide for, among other things, the IPC Acquisition.

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; 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 July 23, 2009 the Company entered into the First Amendment to the Talbot FAL Facility to provide for, among other things, the IPC Acquisition. As amended, the Talbot FAL Facility contains affirmative covenants that include, among other things, (i) the requirement that we initially maintain a minimum level of consolidated net worth of at least 70% of consolidated net worth as calculated using the pro forma balance sheet included in the definitive proxy statement relating to the IPC Acquisition, and commencing with the end of the fiscal quarter ending September 30, 2009 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 make investments, 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, 2009 the Company had $100,000 in outstanding letters of credit under this facility and was in compliance with all covenants and restrictions.

IPC obtains letters of credit through the IPC Syndicated Facility and the IPC Bi-Lateral Facility. In July, 2009, certain terms of these facilities were amended including suspending IPCRe s ability to increase existing letters of credit or to issue new letters of credit. With respect of the IPC Syndicated Facility, IPCRe provides the banks security by depositing cash in the amount of 103% of the aggregate letters of credit outstanding. Effective September 30, 2009, there were outstanding letters of credit of $129,673 of which $38,602 were issued from the IPC Syndicated Facility

with $91,071 issued from the IPC Bi-Lateral Facility.

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(d) Funds at Lloyd s

Talbot s underwriting at Lloyd s is supported by Funds at Lloyd s (FAL) comprising: cash, investments and undrawn letters of credit provided by various banks on behalf of various companies and persons under reinsurance and other agreements. The FAL are provided in exchange for payment calculated principally by reference to the syndicate s results, as appropriate, when they are declared. The amounts of cash, investments and letters of credit at September 30, 2009 supporting the 2009 underwriting year amount to $346,750 all of which is provided by the Company. A third party FAL facility comprising $121,515 which supports the 2007 and prior underwriting years has now been withdrawn from Lloyd s and placed in escrow, however, the funds remain available to pay losses on that year.

10. 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 triple-A. In addition, the Company limits its exposure to any single issuer to 3% or less, excluding treasury and agency securities. The minimum credit rating of any security purchased is A-/A3 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, 2009, 3.8% of the portfolio had a split rating below A-/A3 and the Company did not have an aggregate exposure to any single issuer of more than 1.8% of our investment portfolio, other than with respect to government and agency securities.

b) Funds at Lloyd s

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. The amounts of cash, investments and letters of credit at September 30, 2009 amounted to $346,750 (December 31, 2008: $351,394).

The FAL are provided for each year of account as follows:

	2009 Underwriting year	2008 Underwriting year
Talbot FAL facility	$ 100,000	$ 100,000
Group funds	246,750	216,483
Total	$ 346,750	$ 316,483

The amounts which the Company provides as FAL are not available for distribution to the Company for the payment of dividends. Talbot s corporate member may also be required to maintain funds under the control of Lloyd s in excess of its capital requirement and such funds also may not be available for distribution to the Company for the payment of dividends.

The amounts provided under the Talbot FAL facility would become a liability of the group in the event of the syndicate declaring a loss at a level which would call on this arrangement.

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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 2009 estimated premium income at Lloyd s of £400,000 the September 30, 2009 exchange rate of £1 equals $1.60 and assuming the maximum 3% assessment the Company would be assessed approximately $19,200.

11. Related party transactions

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

a) The Company entered into an agreement on December 8, 2005 with BlackRock Financial Management, Inc. (BlackRock) under which BlackRock was appointed as an investment manager of part of Company s investment portfolio. Merrill Lynch is a shareholder of BlackRock. Merrill Lynch entities, which are now wholly-owned subsidiaries of Bank of America Corp, own 6,134,530 non-voting shares in the Company, hold warrants to purchase 1,067,187 shares and have an employee on the Company s Board of Directors who does not receive compensation from the Company. Merrill Lynch s warrants are convertible to non-voting shares. Under the terms of the investment manager agreement with Blackrock, the Company incurred expenses of $576 during the three months ended September 30, 2009 (2008: $401) and $1,554 during the nine months ended September 30, 2009 (2008: $1,624), of which $1,219 was included in accounts payable and accrued expenses at September 30, 2009 (December 31, 2008: $584).

b) The Company entered into an agreement on December 8, 2005 with Goldman Sachs Asset Management and its affiliates (GSAM) under which GSAM was appointed as an investment manager of part of the Company s investment portfolio. Goldman Sachs entities, own 14,057,137 non-voting shares in the Company, hold warrants to purchase 1,604,410 non-voting shares, and have an employee on the Company s Board of Directors who does not receive compensation from the Company. The Company incurred expenses of $373 during the three months ended September 30, 2009 (2008: $291) and $1,099 during the nine months ended September 30, 2009 (2008: $1,038), of which $317 was included in accounts payable and accrued expenses at September 30, 2009 (December 31, 2008: $641).

c) Vestar Capital entities, which own 8,571,427 shares in the Company, hold warrants to purchase 972,810 shares, are shareholders of PARIS RE Holdings Limited (Paris Re), and have an employee on the Company s Board of Directors who does not receive compensation from the Company. Pursuant to reinsurance agreements with Paris Re, the Company recognized gross premiums written of $nil during the three months ended September 30, 2009 (2008: $nil) and $6,634 during the nine months ended September 30, 2009 (2008: $5,885), of which $7,147 was included in premiums receivable at September 30, 2009 (December 31, 2008: $4,412). The earned premium adjustments of $1,710 (2008: $(194)) and $5,101 (2008: $2,389) were recorded for the three and nine months ended September 30, 2009, respectively.

d) Aquiline Capital Partners, LLC and its related companies (Aquiline), which own 6,886,342 shares in the Company, hold warrants to purchase 3,193,865 shares, and have three employees on the Board of Directors who do not receive compensation from the Company, are shareholders of Group Ark Insurance Holdings Ltd. (Group Ark). Pursuant to reinsurance agreements with Group Ark, the Company recognized $nil (2008: $nil) of gross premiums written and $158 (2008: $433) of reinsurance premiums ceded during the three months ended September 30, 2009 and recognized $nil (2008: $nil) of gross premiums written and $953 (2008: $1,531) of reinsurance premiums ceded during the nine months ended September 30, 2009, of which $319 was included in reinsurance balances payable at September 30,

2009 (December 31, 2008: $60).

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
e) Certain members of the Company s management and staff have provided guarantees to 1384 Capital Ltd, a company formed to indirectly facilitate the provision of Funds at Lloyd s (FAL). The Company paid $118 of finance expenses to such management and staff in respect of such provision of FAL for the three months ended September 30, 2009 (2008: $227) and $261 for the nine months ended September 30, 2009 (2008: $806), all of which was included in accounts payable and accrued expenses at September 30, 2009 (December 31, 2008: $803). An amount of $9 was included in general and administrative expenses in respect of the reimbursement of expenses relating to such FAL provision for the three months ended September 30, 2009 (2008: $nil). An amount of $25 was included in general and administrative expenses in respect of the reimbursement of expenses relating to such FAL provision for the nine months ended September 30, 2009 (2008: $2).

12. Earnings per share

The following table sets forth the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2009 and 2008:

	Three months ended		Nine months ended	
	September 30, 2009	**September 30, 2008**	**September 30, 2009**	**September 30, 2008**
Basic earnings (loss) per share				
Income (loss)	$ 499,178	$ (126,300)	$ 731,647	$ 16,096
less: Dividends and distributions declared on outstanding warrants	(1,591)	(1,739)	(4,917)	(5,217)
Income (loss) available to common shareholders	$ 497,587	$ (128,039)	$ 726,730	$ 10,879
Weighted average number of common shares outstanding	92,492,373	74,864,724	81,458,329	74,435,840
Basic earnings (loss) per share	$ **5.38**	$ **(1.71)**	$ **8.92**	$ **0.15**
Diluted earnings (loss) per share				
Income (loss)	$ 499,178	$ (126,300)	$ 731,647	$ 16,096
less: Dividends and distributions declared on outstanding warrants		(1,739)		(5,217)
Income (loss) available to common shareholders	$ 499,178	$ (128,039)	$ 731,647	$ 10,879
Weighted average number of common shares outstanding	92,492,373	74,864,724	81,458,329	74,435,840
Share equivalents:				

Warrants	2,146,172		2,086,546	2,065,282
Stock options	466,525		378,144	182,268
Unvested restricted shares	729,739		703,486	1,239,328
Weighted average number of diluted common shares outstanding	95,834,809	74,864,724	84,626,505	77,922,718
Diluted earnings (loss) per share	$ **5.21**	$ **(1.71)**	$ **8.65**	$ **0.14**

Share equivalents that would result in the issuance of common shares of 175,994 and nil were outstanding for the three months ended September 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive. Share equivalents that would result in the issuance of common shares of 178,473 and 94,925 were outstanding for the nine months ended September 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

13. Subsequent Event

No material subsequent events were noted from the balance sheet date through to November 6, 2009.

14. Segment information

The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. and Talbot Holdings Ltd. from which two operating segments have been determined under U.S. GAAP segment reporting. 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

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, nuclear, terrorism, life and accident & health and workers compensation catastrophe.

Talbot

The Talbot segment focuses on a wide range of marine and energy, war, political violence, commercial property, financial institutions, contingency, bloodstock & livestock, accident & health classes of business on an insurance or facultative reinsurance basis. 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 functions for the group. Corporate also denotes the activities of certain key executives such as the Chief Executive Officer and Chief Financial Officer. The only revenue earned by Corporate is a minor amount of interest income that is incidental to the activities of the enterprise. For internal reporting purposes, Corporate is reflected separately as a business unit, however Corporate is not considered an operating segment under these circumstances and U.S. GAAP segment reporting. 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.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

The following tables summarize the underwriting results of our operating segments and corporate segment:

Three months ended September 30, 2009	Validus Re	Talbot	Corporate & Eliminations	Total
Gross premiums written	$ 124,704	$ 227,325	$ (21,001)	$ 331,028
Reinsurance premiums ceded	(38,435)	(50,253)	21,001	(67,687)
Net premiums written	86,269	177,072		263,341
Change in unearned premiums	113,499	(2,123)		111,376
Net premiums earned	199,768	174,949		374,717
Losses and loss expenses	45,987	88,165		134,152
Policy acquisition costs	32,648	33,106	(1,518)	64,236
General and administrative expenses	17,987	23,424	4,625	46,036
Share compensation expenses	1,766	1,371	2,725	5,862
Underwriting income (loss)	**$ 101,380**	**$ 28,883**	**$ (5,832)**	**$ 124,431**
Net investment income (loss)	23,420	7,629	(1,517)	29,532
Net realized gains on investments	5,397	32		5,429
Net unrealized gains on investments	40,893	9,544		50,437
Other income	1,847	772	(1,518)	1,101
Finance expenses	(393)	(3,926)	(6,938)	(11,257)
Foreign exchange gains (losses)	739	(5,983)		(5,244)
Gain on bargain purchase, net of expenses			302,950	302,950
Net income before taxes	**173,283**	**36,951**	**287,145**	**497,379**
Income tax (expense) benefit	(41)	1,840		1,799
Net income	**$ 173,242**	**$ 38,791**	**$ 287,145**	**$ 499,178**
Selected ratios (1)				
Losses and loss expenses	23.0%	50.4%		35.8%
Policy acquisition costs	16.3%	18.9%		17.1%
General and administrative expenses	9.9%	14.2%		13.8%
Expense ratio	26.2%	33.1%		30.9%
Combined ratio	**49.2%**	**83.5%**		**66.7%**

Total assets	$ **5,087,544**	**$ 2,049,647**	**$ 39,880**	**$ 7,177,071**

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

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

Three months ended September 30, 2008	Validus Re	Talbot	Corporate & Eliminations	Total
Gross premiums written	$ 125,029	$ 157,307	$ (13,100)	$ 269,236
Reinsurance premiums ceded	(36,286)	(11,953)	13,100	(35,139)
Net premiums written	88,743	145,354		234,097
Change in unearned premiums	92,653	12,576		105,229
Net premiums earned	181,396	157,930		339,326
Losses and loss expenses	217,081	101,383		318,464
Policy acquisition costs	26,520	34,026	(121)	60,425
General and administrative expenses	7,972	17,851	4,297	30,120
Share compensation expenses	1,809	1,164	3,039	6,012
Underwriting (loss) income	**$ (71,986)**	**$ 3,506**	**$ (7,215)**	**$ (75,695)**
Net investment income	25,984	11,737	(1,342)	36,379
Net realized (losses) on investments	(12,528)	(1,139)		(13,667)
Net unrealized (losses) gains on investments	(15,946)	1,297		(14,649)
Other income	121	1,269	(121)	1,269
Finance expenses	(213)	(7,201)	(7,103)	(14,517)
Foreign exchange (losses)	(22,919)	(22,014)		(44,933)
Net (loss) before taxes	**(97,487)**	**(12,545)**	**(15,781)**	**(125,813)**
Income tax (expense)	(31)	(456)		(487)
Net (loss)	**$ (97,518)**	**$ (13,001)**	**$ (15,781)**	**$ (126,300)**
Selected ratios (1):				
Losses and loss expenses	119.7%	64.2%		93.9%
Policy acquisition costs	14.6%	21.5%		17.8%
General and administrative expenses	5.4%	12.0%		10.6%
Expense ratio	20.0%	33.5%		28.4%
Combined ratio	**139.7%**	**97.7%**		**122.3%**

Total assets	$ **2,741,721**	$ **1,763,614**	$ **4,261**	$ **4,509,596**

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

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

The following tables summarize the underwriting results of our operating segments and corporate segment:

Nine months ended September 30, 2009	**Validus Re**	**Talbot**	**Corporate & Eliminations**	**Total**
Gross premiums written	$ 734,390	$ 690,357	$ (58,796)	$ 1,365,951
Reinsurance premiums ceded	(94,794)	(166,491)	58,796	(202,489)
Net premiums written	639,596	523,866		1,163,462
Change in unearned premiums	(101,684)	(40,102)		(141,786)
Net premiums earned	537,912	483,764		1,021,676
Losses and loss expenses	142,570	248,166		390,736
Policy acquisition costs	90,346	102,378	(2,599)	190,125
General and administrative expenses	45,928	65,565	13,822	125,315
Share compensation expenses	4,986	5,804	8,058	18,848
Underwriting income (loss)	$ **254,082**	$ **61,851**	$ **(19,281)**	$ **296,652**
Net investment income	64,989	22,816	(4,538)	83,267
Net realized (losses) on investments	(14,282)	(6,360)		(20,642)
Net unrealized gains on investments	95,693	14,146		109,839
Other income	3,034	2,440	(2,599)	2,875
Finance expenses	(1,233)	(7,688)	(20,811)	(29,732)
Foreign exchange (losses) gains	(641)	(427)	56	(1,012)
Gain on bargain purchase, net of expenses			287,099	287,099
Net income before taxes				