

VALIDUS HOLDINGS LTD

Form 10-Q

May 07, 2010

Table of Contents

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

Form 10-Q

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

For the quarterly period ended March 31, 2010
Commission file number 001-33606

VALIDUS HOLDINGS, LTD.

(Exact name of registrant as specified in its charter)

BERMUDA

*(State or other jurisdiction of
incorporation or organization)*

98-0501001

*(I.R.S. Employer
Identification No.)*

29 Richmond Road, Pembroke, Bermuda HM 08

(Address of principal executive offices and zip code)

(441) 278-9000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller
reporting company)

Smaller reporting
company

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

Yes No

As of May 7, 2010, there were 123,664,337 outstanding Common Shares, \$0.175 par value per share, of the registrant.

INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements:</u>	
<u>Consolidated Balance Sheets as at March 31, 2010 (unaudited) and December 31, 2009</u>	2
<u>Consolidated Statements of Operations and Comprehensive Income for the Three Months Ended March 31, 2010 and 2009 (unaudited)</u>	3
<u>Consolidated Statements of Shareholders' Equity for the Three Months Ended March 31, 2010 and 2009 (unaudited)</u>	4
<u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2010 and 2009 (unaudited)</u>	5
<u>Notes to Consolidated Financial Statements (unaudited)</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	34
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	68
<u>Item 4. Controls and Procedures</u>	71
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	71
<u>Item 1A. Risk Factors</u>	71
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	71
<u>Item 3. Defaults Upon Senior Securities</u>	72
<u>Item 4. (Removed and Reserved)</u>	72
<u>Item 5. Other Information</u>	73
<u>Item 6. Exhibits</u>	73
<u>Signatures</u>	74
<u>EX-10.4</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32</u>	

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM I. FINANCIAL STATEMENTS****Validus Holdings, Ltd.**

Consolidated Balance Sheets

As at March 31, 2010 (unaudited) and December 31, 2009

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

	March 31, 2010 (unaudited)	December 31, 2009
Assets		
Fixed maturities, at fair value (amortized cost: 2010 - \$5,173,255; 2009 - \$4,870,395)	\$ 5,181,042	\$ 4,869,378
Short-term investments, at fair value (amortized cost: 2010 - \$308,514; 2009 - \$482,632)	308,502	481,766
Other investments, at fair value (amortized cost: 2010 - \$31,717; 2009 - \$35,941)	34,398	37,615
Cash and cash equivalents	478,476	387,585
Total investments and cash	6,002,418	5,776,344
Premiums receivable	803,921	551,616
Deferred acquisition costs	165,158	112,329
Prepaid reinsurance premiums	103,950	73,164
Securities lending collateral	99,230	90,350
Loss reserves recoverable	198,956	181,765
Paid losses recoverable	18,261	14,782
Net receivable for investments sold	13,879	
Income taxes recoverable	2,261	2,043
Intangible assets	122,015	123,055
Goodwill	20,393	20,393
Accrued investment income	42,867	38,077
Other assets	39,267	35,222
Total assets	\$ 7,632,576	\$ 7,019,140
Liabilities		
Reserve for losses and loss expenses	\$ 1,976,889	\$ 1,622,134
Unearned premiums	1,083,591	724,104
Reinsurance balances payable	44,715	65,414
Securities lending payable	100,000	90,106
Deferred income taxes	24,104	24,508
Net payable for investments purchased		44,145
Accounts payable and accrued expenses	107,119	127,809
Senior notes payable	246,793	
Debentures payable	289,800	289,800
Total liabilities	3,873,011	2,988,020

Commitments and contingent liabilities

Shareholders equity

Common shares, 571,428,571 authorized, par value \$0.175 Issued and outstanding (2010 -123,910,430; 2009 - 128,459,478)	23,081	23,033
Treasury shares	(1,397)	(553)
Additional paid-in-capital	2,555,243	2,675,680
Accumulated other comprehensive (loss)	(6,658)	(4,851)
Retained earnings	1,189,296	1,337,811
Total shareholders equity	3,759,565	4,031,120
Total liabilities and shareholders equity	\$ 7,632,576	\$ 7,019,140

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

Table of Contents**Validus Holdings, Ltd.**

Consolidated Statements of Operations and Comprehensive Income (Loss)

For the Three Months Ended March 31, 2010 and 2009 (unaudited)

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

	Three Months Ended	
	March 31, 2010	March 31, 2009
	(unaudited)	(unaudited)
Revenues		
Gross premiums written	\$ 870,934	\$ 609,892
Reinsurance premiums ceded	(90,739)	(72,512)
Net premiums written	780,195	537,380
Change in unearned premiums	(322,501)	(218,621)
Net premiums earned	457,694	318,759
Net investment income	34,299	26,772
Net realized gains (losses) on investments	11,398	(23,421)
Net unrealized gains on investments	15,413	22,153
Other income	888	757
Foreign exchange (losses)	(8,764)	(4,200)
Total revenues	510,928	340,820
Expenses		
Losses and loss expenses	478,531	131,834
Policy acquisition costs	76,176	61,449
General and administrative expenses	53,569	38,079
Share compensation expenses	6,576	7,354
Finance expenses	15,151	7,723
Total expenses	630,003	246,439
Net (loss) income before taxes	(119,075)	94,381
Tax benefit	697	526
Net (loss) income	\$ (118,378)	\$ 94,907
Comprehensive income		
Foreign currency translation adjustments	(1,807)	(196)
Comprehensive (loss) income	\$ (120,185)	\$ 94,711

Earnings per share

Weighted average number of common shares and common share equivalents outstanding

Basic	126,633,277	75,744,577
Diluted	126,633,277	79,102,643

Basic (loss) earnings per share	\$ (0.95)	\$ 1.23
--	-----------	---------

Diluted (loss) earnings per share	\$ (0.95)	\$ 1.20
--	-----------	---------

Cash dividends declared per share	\$ 0.22	\$ 0.20
--	---------	---------

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

Table of Contents**Validus Holdings, Ltd.**

Consolidated Statements of Shareholders' Equity

For the Three Months Ended March 31, 2010 and 2009 (unaudited)

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

	March 31, 2010 (unaudited)	March 31, 2009 (unaudited)
Common shares		
Balance Beginning of period	\$ 23,033	\$ 13,235
Issue of common shares	48	36
Balance End of period	\$ 23,081	\$ 13,271
Treasury shares		
Balance Beginning of period	\$ (553)	\$
Repurchase of common shares	(844)	
Balance End of period	\$ (1,397)	\$
Additional paid-in capital		
Balance Beginning of period	\$ 2,675,680	\$ 1,412,635
Issue of common shares, net of expenses	300	(387)
Repurchase of common shares	(127,313)	
Share compensation expenses	6,576	7,354
Balance End of period	\$ 2,555,243	\$ 1,419,602
Accumulated other comprehensive (loss)		
Balance Beginning of period	\$ (4,851)	\$ (7,858)
Foreign currency translation adjustments	(1,807)	(196)
Balance End of period	\$ (6,658)	\$ (8,054)
Retained earnings		
Balance Beginning of period	\$ 1,337,811	\$ 520,722
Dividends	(30,137)	(17,462)
Net (loss) income	(118,378)	94,907
Balance End of period	\$ 1,189,296	\$ 598,167
Total shareholders' equity	\$ 3,759,565	\$ 2,022,986

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

Table of Contents**Validus Holdings, Ltd.**

Consolidated Statements of Cash Flows

For the Three Months Ended March 31, 2010 and 2009 (unaudited)

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

	March 31, 2010 (unaudited)	March 31, 2009 (unaudited)
Cash flows provided by (used in) operating activities		
Net (loss) income	\$ (118,378)	\$ 94,907
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	6,576	7,354
Net realized (gains) losses on investments	(11,398)	23,421
Net unrealized (gains) on investments	(15,413)	(22,153)
Amortization of intangible assets	1,040	1,040
Foreign exchange losses on cash and cash equivalents included in net income	4,538	559
Amortization of premium on fixed maturities	3,713	1,702
Change in:		
Premiums receivable	(255,394)	(193,076)
Deferred acquisition costs	(52,829)	(35,344)
Prepaid reinsurance premiums	(30,786)	(37,160)
Loss reserves recoverable	(18,871)	4,413
Paid losses recoverable	(3,509)	(3,051)
Income taxes recoverable	(41)	(653)
Accrued investment income	(4,875)	(86)
Other assets	(6,557)	3,083
Reserve for losses and loss expenses	366,176	15,064
Unearned premiums	359,487	255,782
Reinsurance balances payable	(19,203)	33,260
Deferred income taxes	(624)	93
Accounts payable and accrued expenses	(19,686)	(1,288)
Net cash provided by operating activities	183,966	147,867
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	1,226,380	873,352
Proceeds on maturities of investments	113,341	222,402
Purchases of fixed maturities	(1,693,657)	(1,232,740)
Sales of short-term investments, net	173,233	94,644
Sales of other investments	4,383	
(Increase) decrease in securities lending collateral	(9,894)	319
Net cash (used in) investing activities	(186,214)	(42,023)
Cash flows provided by (used in) financing activities		
Net proceeds on issuance of senior notes	246,793	

Edgar Filing: VALIDUS HOLDINGS LTD - Form 10-Q

Issue of common shares, net of expenses	348	(351)
Purchases of common shares under share repurchase program	(128,157)	
Dividends paid	(29,944)	(17,462)
Increase (decrease) in securities lending payable	9,894	(319)
Net cash provided by (used in) financing activities	98,934	(18,132)
Effect of foreign currency rate changes on cash and cash equivalents	(5,795)	(1,762)
Net increase in cash	90,891	85,950
Cash and cash equivalents beginning of period	387,585	449,848
Cash and cash equivalents end of period	\$ 478,476	\$ 535,798
Taxes (recovered) paid during the period	\$ (184)	\$ 299
Interest paid during the period	\$ 6,365	\$ 6,672

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

Table of Contents**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 and majority owned subsidiaries (together, the Company) and have been prepared in accordance with generally accepted accounting principles in the United States of America (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, 2009, 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. The terms ASC used in these notes refer to Accounting Standard Codifications issued by the United States Financial Accounting Standards Board (FASB).

The consolidated financial statements include the results and operations and cash flows of IPC Holdings Ltd. (IPC), since the date of acquisition, September 4, 2009 and not any prior periods (including for comparative purposes) except where indicated as Pro Forma financial information.

2. Recent accounting pronouncements

In June 2009, the FASB issued authoritative guidance on accounting for *Transfers and Servicing* (ASC 860). 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 January 1, 2010. The adoption of this guidance has not had 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) (ASC 810). 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 January 1, 2010. The adoption of this update has not had a material impact on the Company's consolidated financial statements.

In January 2010, the FASB issued authoritative guidance on *Fair Value Measurements and Disclosures* (ASC 820). This update requires additional disclosures regarding (1) significant transfers in and out of Levels 1 and 2 and the reasons that such transfers were made; (2) inputs and valuation techniques used to measure fair value for financial assets and liabilities that fall in either Level 2 or Level 3; (3) the activity within Level 3 fair value measurements, including information on a gross basis for purchases, sales, issuances, and settlements; and (4) disaggregation of financial assets and liabilities measured at fair value into classes of financial assets and liabilities.

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

This guidance is effective for interim and annual reporting periods beginning January 1, 2010, except for Level 3 reconciliation disclosures which are effective for interim and annual periods beginning January 1, 2011. The adoption of this update has not had a material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued authoritative guidance which amends the *Subsequent Events* guidance (ASC 855). The guidance requires SEC filers to evaluate subsequent events through the date the financial statements are issued, and also exempts SEC filers from disclosing the date through which subsequent events have been evaluated. This update is effective immediately for financial statements that are (1) issued or available to be issued or (2) revised. The adoption of this update has not had a material impact on the Company's consolidated financial statements.

In March 2010, the FASB issued authoritative guidance which clarifies the *Embedded Derivatives* guidance in ASC 815. All entities that enter into contracts containing an embedded credit derivative feature related to the transfer of credit risk that is not only in the form of subordination of one financial instrument to another will be affected by the amendments. The amendments in this update are effective for interim periods beginning after June 15, 2010. The Company is currently evaluating the impact of this guidance, however it is not expected to have a material impact on the Company's consolidated financial statements.

3. Investments

The Company's investments in fixed maturities are classified as trading and carried at fair value, with related net unrealized gains or losses included in earnings. The Company has adopted all authoritative guidance in effect as of the balance sheet date regarding certain market conditions that allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable.

(a) Classification within the fair value hierarchy

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

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

Level 1 primarily consists of financial instruments whose value is based on quoted market prices or alternative indices including 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. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. The Company performs internal procedures on the valuations received from independent external sources. Financial instruments in this category include U.S. Treasuries, sovereign debt, corporate debt, catastrophe bonds 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.

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

The Company's external investment advisors have noted illiquidity and dislocation in the non-Agency RMBS market during 2010 and 2009. During the period ended March 31, 2010 and 2009, the Company identified certain non-Agency RMBS securities in its portfolio trading in inactive markets ("identified RMBS securities"). In order to gauge market activity for the identified RMBS securities, management, with assistance from external investment advisors, reviewed the pricing sources for each security in the portfolio. The Company utilized various pricing vendors to obtain market pricing information for investment securities.

Consistent with U.S. GAAP, market approach fair value measurements for securities trading in inactive markets are not determinative. In weighing the fair value measurements resulting from market approach and income approach valuation techniques, the Company has placed less reliance on the market approach fair value measurements. The income approach valuation technique determines the fair value of each security on the basis of contractual cash flows, discounted using a risk-adjusted discount rate. As the proposed valuation technique incorporates both observable and significant unobservable inputs, these securities are included as Level 3 assets with respect to the fair value hierarchy. The foundation for the income approach is the amount and timing of future cash flows.

Other investments consist of an investment in a fund of hedge funds and a deferred compensation trust. During the fourth quarter of 2009, a majority of the fund of hedge funds was redeemed. The remaining portion is a side pocket valued at \$21,919 at March 31, 2010. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is unknown. 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 February 28, 2010 NAV was used as a partial basis for fair value measurement in the Company's March 31, 2010 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 utilizes the fund investment manager's primary market approach estimated NAV that incorporates relevant valuation sources on a timely basis. As this valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset. To determine the reasonableness of the estimated NAV, the Company assesses the variance between the estimated NAV and the one-month delayed fund investment manager's NAV. Immaterial variances are recorded in the following reporting period.

At March 31, 2010, 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	\$	\$ 2,128,426	\$	\$ 2,128,426
Non-U.S. Government and Government Agency States, municipalities, political subdivision		652,902 27,013		652,902 27,013
Agency residential mortgage-backed securities		492,800		492,800
Non-Agency residential mortgage-backed securities		51,232	76,943	128,175
U.S. corporate		1,184,692		1,184,692
Non-U.S. corporate		449,645		449,645
Catastrophe bonds		51,771		51,771
Asset-backed securities		29,828		29,828
Commercial mortgage-backed securities		35,790		35,790
 Total fixed maturities		 5,104,099	 76,943	 5,181,042
Short-term investments	307,833	669		308,502
Other investments				
Hedge fund			21,919	21,919
Mutual funds		12,479		12,479

Total	\$ 307,833	\$ 5,117,247	\$ 98,862	\$ 5,523,942
--------------	------------	--------------	-----------	--------------

8

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

At December 31, 2009, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. Government and Government Agency	\$	\$ 1,918,811	\$	\$ 1,918,811
Non-U.S. Government and Government Agency		673,680		673,680
States, municipalities, political subdivision		19,359		19,359
Agency residential mortgage-backed securities		551,610		551,610
Non-Agency residential mortgage-backed securities		52,233	85,336	137,569
U.S. corporate		1,027,225		1,027,225
Non-U.S. corporate		409,398		409,398
Catastrophe bonds		52,351		52,351
Asset-backed securities		36,712		36,712
Commercial mortgage-backed securities		42,663		42,663
Total fixed maturities		4,784,042	85,336	4,869,378
Short-term investments	479,552	2,214		481,766
Other investments				
Hedge fund			25,670	25,670
Mutual funds		11,945		11,945
Total	\$ 479,552	\$ 4,798,201	\$ 111,006	\$ 5,388,759

At March 31, 2010, Level 3 investments totaled \$98,862, representing 1.8% of total investments measured at fair value on a recurring basis. At December 31, 2009, Level 3 investments totaled \$111,006, representing 2.1% 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 March 31, 2010 and December 31, 2009:

	Three Months Ended March 31, 2010		
	Fixed	Other	Total Fair
	Maturity	Investments	Market
	Investments		Value
Level 3 investments - Beginning of period	\$ 85,336	\$ 25,670	\$ 111,006
Payments and purchases			
Sales and maturities		(4,384)	(4,384)
Realized gains		174	174
Unrealized (losses) gains	(4,266)	459	(3,807)
Amortization	(4,127)		(4,127)
Transfers in			
Level 3 investments - End of period	\$ 76,943	\$ 21,919	\$ 98,862

Year Ended December 31, 2009

	Fixed Maturity	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	\$ 111,318	\$	\$ 111,318
Payments and purchases		115,351	115,351
Sales and maturities	(822)	(92,004)	(92,826)
Realized (losses) gains	(1,284)	1,609	325
Unrealized (losses) gains	(7,329)	714	(6,615)
Amortization	(16,547)		(16,547)
Transfers in			
Level 3 investments End of period	\$ 85,336	\$ 25,670	\$ 111,006

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended	
	March	
	31, 2010	March 31, 2009
Fixed maturities and short-term investments	\$ 35,755	\$ 26,517
Cash and cash equivalents	586	761
Securities lending income	70	339
Total gross investment income	36,411	27,617
Investment expenses	(2,112)	(845)
Net investment income	\$ 34,299	\$ 26,772

(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	
	March	
	31, 2010	March 31, 2009
Fixed maturities, short-term and other investments and cash equivalents		
Gross realized gains	\$ 12,765	\$ 9,453
Gross realized (losses)	(1,367)	(32,874)
Net realized gains (losses) on investments	11,398	(23,421)
Net unrealized (losses) gains on securities lending	(1,014)	1,092
Change in net unrealized gains on investments	16,427	21,061
Total net realized gains (losses) and change in unrealized gains (losses) of investments	26,811	(1,268)

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at March 31, 2010 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and Government Agency	\$ 2,116,773	\$ 14,946	\$ (3,293)	\$ 2,128,426
Non-U.S. Government and Government Agency	659,815	9,431	(16,344)	652,902
States, municipalities, political subdivision	26,754	286	(27)	27,013
Agency residential mortgage-backed securities	478,267	15,050	(517)	492,800
Non-Agency residential mortgage-backed securities	169,515	405	(41,745)	128,175
U.S. corporate	1,158,189	27,605	(1,102)	1,184,692
Non-U.S. corporate	448,882	6,230	(5,467)	449,645
Catastrophe bonds	50,132	1,936	(297)	51,771
Asset-backed securities	30,024	270	(466)	29,828
Commercial mortgage-backed securities	34,904	886		35,790
Total fixed maturities	5,173,255	77,045	(69,258)	5,181,042
Total short-term investments	308,514		(12)	308,502
Total other investments	31,717	2,681		34,398
Total	\$ 5,513,486	\$ 79,726	\$ (69,270)	\$ 5,523,942

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at December 31, 2009 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and Government Agency	\$ 1,912,081	\$ 12,308	\$ (5,578)	\$ 1,918,811
Non-U.S. Government and Government Agency	678,555	7,552	(12,427)	673,680
States, municipalities, political subdivision	19,310	105	(56)	19,359
Agency residential mortgage-backed securities	537,876	14,643	(909)	551,610
	176,853	481	(39,765)	137,569

Non-Agency residential mortgage-backed securities				
U.S. corporate	1,004,464	23,895	(1,134)	1,027,225
Non-U.S. corporate	411,499	4,781	(6,882)	409,398
Catastrophe bonds	51,236	1,244	(129)	52,351
Asset-backed securities	36,828	411	(527)	36,712
Commercial mortgage-backed securities	41,693	971	(1)	42,663
Total fixed maturities	4,870,395	66,391	(67,408)	4,869,378
Total short-term investments	482,632	33	(899)	481,766
Total other investments	35,941	1,674		37,615
Total	\$ 5,388,968	\$ 68,098	\$ (68,307)	\$ 5,388,759

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

The following table sets forth certain information regarding the investment ratings of the Company's fixed maturities portfolio as at March 31, 2010 and December 31, 2009. Investment ratings are the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. For investments where Moody's and Standard & Poor's ratings are not available, Fitch ratings are used and presented in Standard & Poor's equivalent rating.

	March 31, 2010		December 31, 2009	
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total
AAA	\$ 3,436,170	66.3%	\$ 3,287,879	67.5%
AA	538,950	10.4%	487,364	10.0%
A	1,031,742	19.9%	925,532	19.0%
BBB	28,315	0.5%	14,416	0.3%
Investment grade	5,035,177	97.1%	4,715,191	96.8%
BB	37,230	0.7%	45,191	0.9%
B	50,147	1.0%	59,116	1.2%
CCC	53,590	1.1%	45,194	1.0%
D/NR	4,898	0.1%	4,686	0.1%
Non-Investment grade	145,865	2.9%	154,187	3.2%
Total fixed maturities	\$ 5,181,042	100.0%	\$ 4,869,378	100.0%

The amortized cost and estimated fair value amounts for fixed maturity securities held at March 31, 2010 and December 31, 2009 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.

	March 31, 2010		December 31, 2009	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 324,276	\$ 323,807	\$ 269,889	\$ 270,688
Due after one year through five years	3,842,946	3,875,902	3,498,792	3,521,167
Due after five years through ten years	292,379	293,756	306,065	306,502
Due after ten years	944	984	2,399	2,467
	4,460,545	4,494,449	4,077,145	4,100,824
Asset-backed and mortgage-backed securities	712,710	686,593	793,250	768,554
Total	\$ 5,173,255	\$ 5,181,042	\$ 4,870,395	\$ 4,869,378

The Company has a five year, \$500,000 secured letter of credit facility provided by a syndicate of commercial banks. At March 31, 2010, approximately \$246,793 (December 31, 2009: \$225,823) of letters of credit were issued and outstanding under this facility for which \$313,805 of investments were pledged as collateral (December 31, 2009: \$314,857). In 2007, the Company entered into a \$100,000 standby letter of credit facility which provides Funds at Lloyd's (the Talbot FAL Facility). On November 19, 2009, the Company entered into a Second Amendment to the Talbot FAL Facility to reduce the commitment from \$100,000 to \$25,000. At March 31, 2010, \$25,000 (December 31, 2009: \$25,000) of letters of credit were issued and outstanding under the Talbot FAL Facility for which \$45,426 of investments were pledged as collateral (December 31, 2009: \$128,798). In addition, \$1,568,760 of investments were held in trust at March 31, 2010, (December 31, 2009: \$1,517,249). Of those, \$1,433,130 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, 2009: \$1,408,084).

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

The Company assumed two letters of credit facilities as part of the acquisition of IPC (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 March 31, 2010, the IPC Syndicated Facility was closed. At March 31, 2010, the IPC Bi-Lateral Facility had \$78,615 (December 31, 2009: \$96,047) letters of credit issued and outstanding for which \$219,091 (December 31, 2009: \$219,004) 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 March 31, 2010, the Company had \$97,967 (December 31, 2009: \$88,146) in securities on loan. During the three months ended March 31, 2010, the Company recorded a \$1,014 unrealized loss on this collateral on its Statements of Operations (March 31, 2009: unrealized gain \$1,092).

Securities lending collateral reinvested is primarily comprised of corporate floating rate securities with an average reset period of 16.8 days (December 31, 2009: 26.1 days). As at March 31, 2010, 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	\$	\$ 5,232	\$	\$ 5,232
Agency				
Asset-backed securities		998		998
Short-term investments	53,016	39,984		93,000
Total	\$ 53,016	\$ 46,214	\$	\$ 99,230

As at December 31, 2009, 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	\$	\$ 14,123	\$	\$ 14,123
Agency		9,363		9,363
Asset-backed securities		6,153		6,153
Short-term investments	730	59,981		60,711
Total	\$ 730	\$ 89,620	\$	\$ 90,350

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

The following table sets forth certain information regarding the investment ratings of the Company's securities lending collateral reinvested as at March 31, 2010 and December 31, 2009. Investment ratings are the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. For investments where Moody's and Standard & Poor's ratings are not available, Fitch ratings are used and presented in Standard & Poor's equivalent rating.

	March 31, 2010		December 31, 2009	
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total
AAA	\$ 17,011	17.2%	\$ 33,501	37.1%
AA+	12,012	12.1%	12,011	13.3%
AA		0.0%	4,998	5.5%
AA-	10,969	11.1%	19,910	22.0%
A+	1,999	2.0%	9,999	11.1%
A	3,993	4.0%	9,006	10.0%
NR	230	0.2%	195	0.2%
	46,214	46.6%	89,620	99.2%
NR- Short-term investments(1)	53,016	53.4%	730	0.8%
Total	\$ 99,230	100.0%	\$ 90,350	100.0%

(1) This amount relates to short-term investments and is therefore not a rated security.

The amortized cost and estimated fair value amounts for securities lending collateral reinvested by the Company at March 31, 2010 and December 31, 2009 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.

	March 31, 2010		December 31, 2009	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 93,000	\$ 93,000	\$ 68,895	\$ 70,074
Due after one year through five years	7,000	6,230	21,211	20,276
Total	\$ 100,000	\$ 99,230	\$ 90,106	\$ 90,350

4. Reserve for losses and loss expenses

Reserves for losses and loss expenses are based in part upon the estimation of case losses reported from brokers, insureds and ceding companies. The Company also uses statistical and actuarial methods to estimate ultimate expected losses and loss expenses. The period of time from the occurrence of a loss, the reporting of a loss to the Company and the settlement of the Company's liability may be several months or years. During this period, additional facts and trends may be revealed. As these factors become apparent, case reserves will be adjusted, sometimes requiring an increase or decrease in the overall reserves of the Company, and at other times requiring a reallocation of incurred but not reported reserves to specific case reserves. These estimates are reviewed regularly, and such adjustments, if any, are reflected in earnings in the period in which they become known. While management believes that it has made a reasonable estimate of ultimate losses, there can be no assurances that ultimate losses and loss expenses will not exceed the total reserves.

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

The following table represents an analysis of paid and unpaid losses and loss expenses incurred and a reconciliation of the beginning and ending unpaid loss expenses as at March 31, 2010 and December 31, 2009:

	Three months ended	Year ended December
	March 31, 2010	31, 2009
Reserve for losses and loss expenses, beginning of period	\$ 1,622,134	\$ 1,305,303
Losses and loss expenses recoverable	(181,765)	(208,796)
Net reserves for losses and loss expenses, beginning of period	1,440,369	1,096,507
Net reserves acquired in purchase of IPC		304,957
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:		
Current year	505,260	625,810
Prior years	(26,729)	(102,053)
Total incurred losses and loss expenses	478,531	523,757
Total net paid losses	(127,652)	(507,435)
Foreign exchange	(13,315)	22,583
Net reserve for losses and loss expenses, end of period	1,777,933	1,440,369
Losses and loss expenses recoverable	198,956	181,765
Reserve for losses and loss expenses, end of period	\$ 1,976,889	\$ 1,622,134

The Company recorded losses of \$323,874, net of reinsurance, from the Chile earthquake, windstorm Xynthia and the Melbourne hailstorm in the first quarter of 2010, offset by favorable prior year loss reserve development of \$26,729. Favorable prior year loss reserve development of \$11,478 and \$15,251 was recorded by the Validus Re and Talbot segments respectively, which was attributable primarily to a reduction in ultimate losses on the Dublin floods, Hurricane Ivan and Hurricane Katrina and lower than expected attritional loss development.

5. 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.

Table of Contents**Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

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 March 31, 2010, 98.9% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A- or better and included \$98,893 of IBNR recoverable (December 31, 2009: \$99,587). Reinsurance recoverables by reinsurer are as follows:

	March 31, 2010		December 31, 2009	
	Reinsurance	% of	Reinsurance	% of
	Recoverable	Total	Recoverable	Total
Top 10 reinsurers	\$ 174,803	80.5%	170,810	86.9%
Other reinsurers balances > \$1 million	37,247	17.1%	19,818	10.1%
Other reinsurers balances < \$1 million	5,167	2.4%	5,919	3.0%
Total	\$ 217,217	100.0%	196,547	100.0%

		March 31, 2010	
		Reinsurance	% of
Top 10 Reinsurers	Rating	Recoverable	Total
Fully collateralized reinsurers	NR	\$ 42,785	24.5%
Lloyd's Syndicates	A+	39,146	22.4%
Munich Re	AA-	16,558	9.5%
Hannover Re	AA-	15,770	9.0%
Aspen	A	12,963	7.4%
Flagstone	A-	11,245	6.4%
Brit Insurance Limited	A-	10,735	6.2%
Transatlantic Re	A+	10,732	6.1%
Swiss Re	A+	8,396	4.8%
Everest Re	A-	6,473	3.7%
Total		\$174,803	100.0%