

VALIDUS HOLDINGS LTD
Form 10-Q
August 01, 2012

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 June 30, 2012

Commission file number 001-33606

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

BERMUDA 98-0501001
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

29 Richmond Road, Pembroke, Bermuda HM 08
(Address of principal executive offices and zip code)

(441) 278-9000
(Registrant's telephone number, including area code)

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

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

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

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

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

As of July 24, 2012 there were 93,985,765 outstanding Common Shares, \$0.175 par value per share, of the registrant.

Table of Contents

INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements:</u>	
<u>Consolidated Balance Sheets as at June 30, 2012 (unaudited) and December 31, 2011</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Income (Loss) for the Three and Six Months Ended June 30, 2012 and 2011 (unaudited)</u>	<u>2</u>
<u>Consolidated Statements of Shareholders' Equity for the Six Months Ended June 30, 2012 and 2011 (unaudited)</u>	<u>2</u>
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2012 and 2011 (unaudited)</u>	<u>2</u>
<u>Notes to Consolidated Financial Statements (unaudited)</u>	<u>3</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>27</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>84</u>
<u>Item 4. Controls and Procedures</u>	<u>85</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>86</u>
<u>Item 1A. Risk Factors</u>	<u>86</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>86</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>87</u>
<u>Item 4. Mine Safety Disclosure</u>	<u>87</u>
<u>Item 5. Other Information</u>	<u>87</u>
<u>Item 6. Exhibits</u>	<u>87</u>
<u>Signatures</u>	<u>88</u>

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

Validus Holdings, Ltd.

Consolidated Balance Sheets

As at June 30, 2012 (unaudited) and December 31, 2011

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

	June 30, 2012 (unaudited)	December 31, 2011
Assets		
Fixed maturities, at fair value (amortized cost: 2012 - \$4,715,764; 2011 - \$4,859,705)	\$4,772,899	\$4,894,145
Short-term investments, at fair value (amortized cost: 2012 - \$310,715; 2011 - \$280,299)	310,703	280,191
Other investments at fair value (amortized cost: 2012 - \$510,900; 2011 - \$15,002)	463,018	16,787
Cash and cash equivalents	903,310	832,844
Total investments and cash	6,449,930	6,023,967
Investments in affiliates	92,807	53,031
Premiums receivable	977,431	646,354
Deferred acquisition costs	176,172	121,505
Prepaid reinsurance premiums	176,387	91,381
Securities lending collateral	3,456	7,736
Loss reserves recoverable	371,484	372,485
Paid losses recoverable	32,395	90,495
Income taxes recoverable	2,651	—
Intangible assets	112,651	114,731
Goodwill	20,393	20,393
Accrued investment income	21,399	25,906
Other assets	62,412	50,487
Total assets	\$8,499,568	\$7,618,471
Liabilities		
Reserve for losses and loss expenses	\$2,591,299	\$2,631,143
Unearned premiums	1,196,836	772,382
Reinsurance balances payable	185,456	119,899
Securities lending payable	4,145	8,462
Deferred income taxes	19,197	16,720
Net payable for investments purchased	6,451	1,256
Accounts payable and accrued expenses	76,774	83,402
Senior notes payable	247,036	246,982
Debentures payable	289,800	289,800
Total liabilities	\$4,616,994	\$4,170,046
Commitments and contingent liabilities		
Shareholders' equity		
Common shares, 571,428,571 authorized, par value \$0.175 (Issued: 2012 - 135,374,491; 2011 - 134,503,065; Outstanding: 2012 - 93,411,062; 2011 -	\$23,691	\$23,538

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99,471,080)		
Treasury shares (2012 - 41,963,429; 2011 - 35,031,985)	(7,343) (6,131)
Additional paid-in-capital	1,684,781	1,893,890
Accumulated other comprehensive (loss)	(5,965	) (6,601)
Retained earnings	1,782,670	1,543,729
Total shareholders' equity available to Validus	3,477,834	3,448,425
Noncontrolling interest	404,740	—
Total shareholders' equity	\$3,882,574	\$3,448,425
Total liabilities and shareholders' equity	\$8,499,568	\$7,618,471

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

Validus Holdings, Ltd.

Consolidated Statements of Comprehensive Income (Loss)

For the Three and Six Months Ended June 30, 2012 and 2011 (unaudited)

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

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues				
Gross premiums written	\$627,089	\$605,387	\$1,464,378	\$1,455,283
Reinsurance premiums ceded	(119,052)	(132,346)	(226,104)	(242,166)
Net premiums written	508,037	473,041	1,238,274	1,213,117
Change in unearned premiums	(60,410)	(47,401)	(339,448)	(357,944)
Net premiums earned	447,627	425,640	898,826	855,173
Net investment income	25,885	26,494	53,645	56,469
Net realized gains on investments	6,154	11,552	13,686	17,931
Net unrealized (losses) gains on investments	(53,574)	18,526	(32,903)	5,698
(Loss) from investment affiliate	(398)	—	(398)	—
Other income	5,994	595	14,885	2,201
Foreign exchange (losses) gains	(652)	(1,991)	2,514	(2,458)
Total revenues	431,036	480,816	950,255	935,014
Expenses				
Losses and loss expenses	153,692	207,307	385,681	683,505
Policy acquisition costs	76,129	78,230	154,261	155,526
General and administrative expenses	61,635	60,841	128,010	109,318
Share compensation expenses	6,800	7,628	12,238	19,677
Finance expenses	13,706	16,361	29,985	30,362
Total expenses	311,962	370,367	710,175	998,388
Net income (loss) before taxes and income from operating affiliates	119,074	110,449	240,080	(63,374)
Tax (expense) benefit	(404)	29	(543)	1,488
Income from operating affiliates	3,592	—	6,959	—
Net income (loss)	\$122,262	\$110,478	\$246,496	\$(61,886)
Net loss (income) attributable to noncontrolling interest	45,360	(594)	45,360	(594)
Net income (loss) available (attributable) to Validus	\$167,622	\$109,884	\$291,856	\$(62,480)
Other comprehensive (loss) income				

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Foreign currency translation adjustments	(757)	(21)	636	936
Other comprehensive (loss) income	\$(757)	\$(21)	\$636	\$936
Comprehensive income (loss) available (attributable) to Validus	\$166,865	\$109,863	\$292,492	\$(61,544)
Earnings per share				
Weighted average number of common shares and common share equivalents outstanding				
Basic	98,254,186	98,385,924	98,839,663	98,165,132
Diluted	103,667,967	104,562,450	104,382,030	98,165,132
Basic earnings (loss) per share available (attributable) to common shareholders	\$1.69	\$1.10	\$2.92	\$(0.68)
Diluted earnings (loss) per share available (attributable) to common shareholders	\$1.62	\$1.05	\$2.80	\$(0.68)
Cash dividends declared per share	\$0.25	\$0.25	\$0.50	\$0.50

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

Validus Holdings, Ltd.

Consolidated Statements of Shareholders' Equity

For the Six Months Ended June 30, 2012 and 2011 (unaudited)

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

	June 30, 2012 (unaudited)	June 30, 2011 (unaudited)
Common shares		
Balance - Beginning of period	\$23,538	\$23,247
Common shares issued, net	153	167
Balance - End of period	\$23,691	\$23,414
Treasury shares		
Balance - Beginning of period	\$(6,131)	\$(6,096)
Repurchase of common shares	(1,212)	(35)
Balance - End of period	\$(7,343)	\$(6,131)
Additional paid-in capital		
Balance - Beginning of period	\$1,893,890	\$1,860,960
Common shares (redeemed) issued, net	(1,307)	6,071
Repurchase of common shares	(220,040)	(5,960)
Share compensation expenses	12,238	19,677
Balance - End of period	\$1,684,781	\$1,880,748
Accumulated other comprehensive (loss)		
Balance - Beginning of period	\$(6,601)	\$(5,455)
Foreign currency translation adjustments	636	936
Balance - End of period	\$(5,965)	\$(4,519)
Retained earnings		

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Balance - Beginning of period	\$1,543,729	\$1,632,175
Dividends	(52,915) (54,890
Net income (loss)	246,496	(61,886
Net loss (income) attributable to noncontrolling interest	45,360	(594
Balance - End of period	\$1,782,670	\$1,514,805
Total shareholders' equity available to Validus	\$3,477,834	\$3,408,317
Noncontrolling interest	\$404,740	\$134,895
Total shareholders' equity	\$3,882,574	\$3,543,212

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

Validus Holdings, Ltd.

Consolidated Statements of Cash Flows

For the Six Months Ended June 30, 2012 and 2011 (unaudited)

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

	June 30, 2012 (unaudited)	June 30, 2011 (unaudited)
Cash flows provided by (used in) operating activities		
Net income (loss)	\$246,496	\$(61,886
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	12,238	19,677
Amortization of discount on senior notes	54	54
Loss from investment affiliate	398	—
Net realized (gains) on investments	(13,686	) (17,931
Net unrealized losses (gains) on investments	32,903	(5,698
Amortization of intangible assets	2,080	2,080
Income from operating affiliates	(6,959) —
Foreign exchange (gains) included in net income	(5,844	) (12,729
Amortization of premium on fixed maturities	12,253	16,247
Change in:		
Premiums receivable	(330,214	) (475,119
Deferred acquisition costs	(54,667	) (52,827
Prepaid reinsurance premiums	(85,006	) (106,312
Loss reserves recoverable	1,475	(155,002
Paid losses recoverable	58,149	(2,825
Income taxes recoverable	(2,720	) (2,400
Accrued investment income	4,534	12,406
Other assets	(11,777	) 9,351
Reserve for losses and loss expenses	(43,198	) 575,832
Unearned premiums	424,454	464,256
Reinsurance balances payable	65,154	116,080
Deferred income taxes	2,565	(2,611
Accounts payable and accrued expenses	(3,518	) (11,029
Net cash provided by operating activities	305,164	309,614
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	1,829,294	2,654,804

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Proceeds on maturities of investments	295,192	195,055	
Purchases of fixed maturities	(1,975,225) (2,613,981)
Purchases of short-term investments, net	(31,629	) (451,706)
(Purchases) sales of other investments	(500,632	) 3,809	
Decrease in securities lending collateral	4,317	960	
Purchase of investment in operating affiliates	(26,500) —	
Purchase of investment in investment affiliate	(3,368) —	
Net cash (used in) investing activities	(408,551	) (211,059)
Cash flows provided by (used in) financing activities			
(Redemption) issuance of common shares, net	(1,154	) 6,238	
Purchases of common shares under share repurchase program	(221,252	) (5,995)
Dividends paid	(56,260	) (54,000)
Decrease in securities lending payable	(4,317	) (960)
Third party investment in noncontrolling interest	450,100	134,301	
Net cash provided by financing activities	167,117	79,584	
Effect of foreign currency rate changes on cash and cash equivalents	6,736	17,042	
Net increase in cash	70,466	195,181	
Cash and cash equivalents - beginning of period	\$832,844	\$620,740	
Cash and cash equivalents - end of period	\$903,310	\$815,921	
Taxes paid (recovered) during the period	\$3,764	\$(3,373)
Interest paid during the period	\$20,117	\$23,823	
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 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 in Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. This Quarterly Report should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the U.S. Securities and Exchange Commission (the "SEC").

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

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

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

2. Recent accounting pronouncements

(a) Adoption of New Accounting Standards

Fair Value Measurement and Disclosures

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, "Amendments to Achieve Common Fair Value

Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" ("ASU 2011-04"). The objective of ASU 2011-04 is to provide common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs.

Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the amendments do not result in a change in the application of the requirements in ASC Topic 820 "Fair Value Measurements". ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011.

Effective January 1, 2012, the Company prospectively adopted this amended guidance. The adoption of this guidance did not impact our results of operations, financial condition or liquidity. The adoption of this guidance did not have a significant impact on the current disclosures included in Note 3 "Investments".

Presentation of Comprehensive Income

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, "Presentation of Comprehensive Income" ("ASU 2011-05"). The objective of ASU 2011-05 is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. ASU 2011-05 is effective for interim and annual periods beginning after December 15, 2011. In December 2011, the FASB issued

Accounting Standards Update No. 2011-12, "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05". ASU 2011-12 indefinitely defers certain reclassification adjustment provisions of ASU 2011-05. ASU 2011-12 is also effective for interim and annual periods beginning after December 15, 2011. Effective January 1, 2012, the Company retrospectively adopted this guidance. The adoption of this guidance did not impact our results of operations, financial condition or liquidity.

(b) Recently Issued Accounting Standards Not Yet Adopted

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, "Disclosures about Offsetting Assets and

Liabilities" ("ASU 2011-11"). The objective of ASU 2011-11 is to enhance disclosures by requiring improved information about financial instruments and derivative instruments in relation to netting arrangements. ASU 2011-11 is effective for interim and annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of this guidance; however, since this update affects disclosures only, it is not expected to have a material impact on the Company's consolidated financial statements.

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

3. Investments

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

(a) Classification within the fair value hierarchy

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

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

Level 1 primarily consists of financial instruments whose value is based on quoted market prices or alternative indices including overnight repos and commercial paper. Level 2 includes financial instruments that are valued through independent external sources using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, prepayment speeds, default rates, loss severity, current market and contractual

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)

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. and U.K. Treasuries, sovereign debt, corporate debt, catastrophe bonds, U.S. agency and non-agency mortgage and asset-backed securities and bank loans. Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. An investment in four Paulson & Co. Inc. managed hedge funds and an investment in a fund of hedge funds are the only financial instruments in this category as at June 30, 2012. For each respective hedge fund investment, the Company obtains and reviews the valuation methodology used by the fund administrators and investment managers to ensure that the hedge fund investments are following fair value principles consistent with U.S. GAAP in determining the net asset value ("NAV").

Other investments consist of an investment in four Paulson & Co. Inc. managed hedge funds (the "hedge funds"), a fund of hedge funds and a deferred compensation trust held in mutual funds. The hedge funds were valued at \$450,131 at June 30, 2012. The funds' administrator provides monthly reported NAVs with a one-month delay in its valuation. As a result, the funds' administrator's May 31, 2012 NAV was used as a partial basis for fair value measurement in the Company's June 30, 2012 balance sheet. The fund manager provides an estimate of the NAV at June 30, 2012 based on estimated performance. The Company adjusts fair value to the fund manager's estimated NAV that incorporates relevant valuation sources on a timely basis. As this valuation technique incorporates both observable and significant unobservable inputs, the fund is classified as a Level 3 asset. To determine the reasonableness of the estimated NAV, the Company assesses the variance between the fund manager's estimated NAV and the fund administrator's NAV. Immaterial variances are recorded in the following reporting period. These managed hedge funds are subject to quarterly liquidity.

The fund of hedge funds is a side pocket valued at \$4,662 at June 30, 2012. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is unknown. The fund's administrator provides a monthly reported NAV with a one-month delay in its valuation. As a result, the fund administrator's May 31, 2012 NAV was used as a basis for fair value measurement in the Company's June 30, 2012 balance sheet. The fund manager provides an estimate of the fund NAV at June 30, 2012 based on the estimated performance provided from the underlying third-party funds. To determine the reasonableness of the NAV, the Company compares the one-month delayed fund administrator's NAV to the fund manager's estimated NAV that incorporates relevant valuation sources on a timely basis. Immaterial variances are recorded in the following reporting period. As this valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset.

At June 30, 2012, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

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)

	Level 1	Level 2	Level 3	Total
U.S. Government and Government Agency	\$—	\$1,139,424	\$—	\$1,139,424
Non-U.S. Government and Government Agency	—	331,601	—	331,601
States, municipalities, political subdivision	—	42,844	—	42,844
Agency residential mortgage-backed securities	—	449,464	—	449,464
Non-Agency residential mortgage-backed securities	—	23,069	—	23,069
U.S. corporate	—	1,271,768	—	1,271,768
Non-U.S. corporate	—	559,479	—	559,479
Bank loans	—	566,017	—	566,017
Catastrophe bonds	—	36,702	—	36,702
Asset-backed securities	—	352,531	—	352,531
Commercial mortgage-backed securities	—	—	—	—
Total fixed maturities	—	4,772,899	—	4,772,899
Short-term investments	282,061	28,642	—	310,703
Fund of hedge funds	—	—	4,662	4,662
Hedge funds (a)	—	—	450,131	450,131
Mutual funds	—	8,225	—	8,225
Total	\$282,061	\$4,809,766	\$454,793	\$5,546,620
Noncontrolling interest (a)	—	—	(405,118)	(405,118)
Total investments excluding noncontrolling interest	\$282,061	\$4,809,766	\$49,675	\$5,141,502

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

At December 31, 2011, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. Government and Government Agency	\$—	\$1,182,393	\$—	\$1,182,393
Non-U.S. Government and Government Agency	—	449,358	—	449,358
States, municipalities, political subdivision	—	26,291	—	26,291
Agency residential mortgage-backed securities	—	468,054	—	468,054
Non-Agency residential mortgage-backed securities	—	32,706	—	32,706
U.S. corporate	—	1,329,758	—	1,329,758
Non-U.S. corporate	—	579,675	—	579,675
Bank loans	—	467,256	—	467,256
Catastrophe bonds	—	29,952	—	29,952
Asset-backed securities	—	328,299	—	328,299
Commercial mortgage-backed securities	—	403	—	403
Total fixed maturities	—	4,894,145	—	4,894,145
Short-term investments	257,854	22,337	—	280,191
Fund of hedge funds	—	—	5,627	5,627
Private equity investment	—	—	3,253	3,253
Mutual funds	—	7,907	—	7,907
Total	\$257,854	\$4,924,389	\$8,880	\$5,191,123

At June 30, 2012, Level 3 investments excluding the noncontrolling interest totaled \$49,675, representing 1.0% of total

5

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)

investments, excluding noncontrolling interest, measured at fair value on a recurring basis. At December 31, 2011, Level 3 investments totaled \$8,880 representing 0.2% of total investments measured at fair value on a recurring basis.

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

	Three Months Ended June 30, 2012		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	\$—	\$8,325	\$8,325
Purchases	—	500,000	500,000
Sales	—	(277	) (277
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	21	21
Unrealized (losses)	—	(48,494	) (48,494
Amortization	—	—	—
Transfers	—	(4,782	) (4,782
Level 3 investments - End of period	\$—	\$454,793	\$454,793
Noncontrolling interest (a)	—	(405,118	) (405,118
Level 3 investments excluding noncontrolling interest	\$—	\$49,675	\$49,675
	Three Months Ended June 30, 2011		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	\$—	\$10,713	\$10,713
Purchases	—	—	—
Sales	—	(1,247	) (1,247
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	175	175
Unrealized gains	—	135	135
Amortization	—	—	—
Transfers	—	—	—
Level 3 investments - End of period	\$—	\$9,776	\$9,776

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)

	Six Months Ended June 30, 2012		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	\$—	\$ 8,880	\$ 8,880
Purchases	—	500,000	500,000
Sales	—	(896	) (896
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	48	48
Unrealized (losses)	—	(49,986	) (49,986
Amortization	—	—	—
Transfers	—	(3,253	) (3,253
Level 3 investments - End of period	\$—	\$ 454,793	\$ 454,793
Noncontrolling interest (a)	—	(405,118	) (405,118
Level 3 investments excluding noncontrolling interest	\$—	\$ 49,675	\$ 49,675

	Six Months Ended June 30, 2011		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	\$—	\$ 12,892	\$ 12,892
Purchases	—	—	—
Sales	—	(3,809	) (3,809
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	435	435
Unrealized gains	—	258	258
Amortization	—	—	—
Transfers	—	—	—
Level 3 investments - End of period	\$—	\$ 9,776	\$ 9,776

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

There have not been any transfers between Levels 1 and 2 during the three or six months ended June 30, 2012. During the three months ended June 30, 2012, there was a transfer of the private equity investment out of Level 3 “Other investments” to “Investments in affiliates.” Refer to Note 4 “Investments in affiliates.”

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Fixed maturities and short-term investments	\$ 26,471	\$ 27,535	\$ 53,747	\$ 56,470
Cash and cash equivalents	1,449	687	3,766	3,268
Securities lending income	1	8	6	24

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Total gross investment income	27,921	28,230	57,519	59,762
Investment expenses	(2,036) (1,736) (3,874) (3,293
Net investment income	\$25,885	\$26,494	\$)