

VALIDUS HOLDINGS LTD
Form 10-Q
August 05, 2016
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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 June 30, 2016

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)

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

As of August 3, 2016 there were 80,337,635 outstanding Common Shares, \$0.175 par value per share, of the registrant.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Validus Holdings, Ltd.

Consolidated Balance Sheets

As at June 30, 2016 (unaudited) and December 31, 2015

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

	June 30, 2016 (unaudited)	December 31, 2015
Assets		
Fixed maturities trading, at fair value (amortized cost: 2016—\$5,524,027; 2015—\$5,556,965)	\$5,511,586	\$5,510,331
Short-term investments trading, at fair value (amortized cost: 2016—\$2,369,704; 2015—\$1,941,615)	2,369,654	1,941,635
Other investments, at fair value (cost: 2016—\$338,669; 2015—\$315,963)	359,526	336,856
Cash and cash equivalents	568,798	723,109
Restricted cash	96,022	73,270
Total investments and cash	8,945,586	8,585,201
Investments in affiliates, equity method (cost: 2016—\$86,101; 2015—\$70,186)	99,278	88,065
Premiums receivable	1,372,000	658,682
Deferred acquisition costs	283,213	181,002
Prepaid reinsurance premiums	145,567	77,992
Securities lending collateral	10,224	4,863
Loss reserves recoverable	442,987	350,586
Paid losses recoverable	27,648	23,071
Income taxes recoverable	8,526	16,228
Deferred tax asset	23,745	21,661
Receivable for investments sold	13,736	39,766
Intangible assets	118,426	121,258
Goodwill	196,758	196,758
Accrued investment income	24,925	23,897
Other assets	105,625	126,782
Total assets	\$11,818,244	\$10,515,812
Liabilities		
Reserve for losses and loss expenses	\$3,122,717	\$2,996,567
Unearned premiums	1,621,563	966,210
Reinsurance balances payable	92,488	75,380
Securities lending payable	10,690	5,329
Deferred tax liability	3,552	3,847
Payable for investments purchased	52,718	77,475
Accounts payable and accrued expenses	149,593	627,331
Notes payable to AlphaCat investors	370,982	75,493
Senior notes payable	245,261	245,161
Debentures payable	537,987	537,668
Total liabilities	\$6,207,551	\$5,610,461
Commitments and contingent liabilities		
Redeemable noncontrolling interest	1,532,283	1,111,714

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Shareholders' equity		
Preferred shares (Issued and Outstanding: 2016—6,000; 2015—nil)	\$ 150,000	\$—
Common shares (Issued: 2016—161,252,871; 2015—160,570,772; Outstanding: 2016—80,772,238; 2015—82,900,617)	28,219	28,100
Treasury shares (2016—80,480,633; 2015—77,670,155)	(14,084) (13,592)
Additional paid-in capital	883,701	1,002,980
Accumulated other comprehensive loss	(18,182) (12,569)
Retained earnings	2,836,602	2,634,056
Total shareholders' equity available to Validus	3,866,256	3,638,975
Noncontrolling interest	212,154	154,662
Total shareholders' equity	\$4,078,410	\$3,793,637

Total liabilities, noncontrolling interests and shareholders' equity \$11,818,244 \$10,515,812

The accompanying notes are an integral part of these Consolidated Financial Statements (unaudited).

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Validus Holdings, Ltd.

Consolidated Statements of Comprehensive Income

For the Three and Six Months Ended June 30, 2016 and 2015 (unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues				
Gross premiums written	\$764,042	\$726,168	\$1,936,833	\$1,845,392
Reinsurance premiums ceded	(36,229)	(55,418)	(204,064)	(246,743)
Net premiums written	727,813	670,750	1,732,769	1,598,649
Change in unearned premiums	(154,090)	(98,062)	(587,778)	(450,071)
Net premiums earned	573,723	572,688	1,144,991	1,148,578
Net investment income	39,257	33,611	68,718	64,640
Net realized gains on investments	2,724	2,244	2,140	6,413
Change in net unrealized gains (losses) on investments	31,428	(34,676)	78,872	(1,449)
(Loss) income from investment affiliate	(589)	284	(4,702)	3,060
Other insurance related income and other income	824	100	2,237	1,040
Foreign exchange gains (losses)	6,286	(2,671)	12,531	(6,936)
Total revenues	653,653	571,580	1,304,787	1,215,346
Expenses				
Losses and loss expenses	307,130	266,146	531,577	507,075
Policy acquisition costs	107,966	104,323	215,159	202,734
General and administrative expenses	89,688	84,025	175,896	168,260
Share compensation expenses	10,727	9,242	21,964	18,296
Finance expenses	14,166	18,682	29,369	39,649
Total expenses	529,677	482,418	973,965	936,014
Income before taxes, income from operating affiliates and (income) attributable to AlphaCat investors	123,976	89,162	330,822	279,332
Tax (expense) benefit	(1,706)	(2,549)	412	(5,114)
Income (loss) from operating affiliates	—	1,738	(23)	5,722
(Income) attributable to AlphaCat investors	(6,114)	—	(10,714)	—
Net income	\$116,156	\$88,351	\$320,497	\$279,940
Net (income) attributable to noncontrolling interest	(21,193)	(22,561)	(58,724)	(40,739)
Net income available to Validus	94,963	65,790	261,773	239,201
Dividends on preferred shares	—	—	—	—
Net income available to Validus common shareholders	\$94,963	\$65,790	\$261,773	\$239,201
Comprehensive income				
Net income	\$116,156	\$88,351	\$320,497	\$279,940
Other comprehensive (loss) income				
Change in foreign currency translation adjustments	(3,287)	2,763	(5,315)	(256)
Change in minimum pension liability, net of tax	479	422	396	157
Change in fair value of cash flow hedge	64	390	(694)	(411)
Other comprehensive (loss) income	(2,744)	3,575	(5,613)	(510)
Comprehensive (income) attributable to noncontrolling interest	(21,193)	(22,561)	(58,724)	(40,739)

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Comprehensive income available to Validus	\$92,219	\$69,365	\$256,160	\$238,691
Earnings per share				
Weighted average number of common shares and common share equivalents outstanding				
Basic	81,950,833	84,003,549	82,386,047	83,627,396
Diluted	83,373,003	87,313,154	83,785,659	87,448,142
Basic earnings per share available to Validus common shareholders	\$1.16	\$0.77	\$3.18	\$2.83
Earnings per diluted share available to Validus common shareholders	\$1.14	\$0.75	\$3.12	\$2.74
Cash dividends declared per common share	\$0.35	\$0.32	\$0.70	\$0.64

The accompanying notes are an integral part of these Consolidated Financial Statements (unaudited).

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Validus Holdings, Ltd.
 Consolidated Statements of Shareholders' Equity
 For the Six Months Ended June 30, 2016 and 2015 (unaudited)
 (Expressed in thousands of U.S. dollars)

	Six Months Ended June 30,	
	2016	2015
	(unaudited)	(unaudited)
Preferred shares		
Balance - beginning of period	\$—	\$—
Preferred shares issued	150,000	—
Balance - end of period	\$150,000	\$—
Common shares		
Balance - beginning of period	\$28,100	\$27,222
Common shares issued, net	119	494
Balance - end of period	\$28,219	\$27,716
Treasury shares		
Balance - beginning of period	\$(13,592)	\$(12,545)
Repurchase of common shares	(492)	(595)
Balance - end of period	\$(14,084)	\$(13,140)
Additional paid-in capital		
Balance - beginning of period	\$1,002,980	\$1,207,493
Offering expenses on preferred shares	(5,148)	—
Common shares issued, net	(7,504)	14,366
Repurchase of common shares	(128,591)	(142,628)
Share compensation expenses	21,964	18,296
Balance - end of period	\$883,701	\$1,097,527
Accumulated other comprehensive loss		
Balance - beginning of period	\$(12,569)	\$(8,556)
Other comprehensive loss	(5,613)	(510)
Balance - end of period	\$(18,182)	\$(9,066)
Retained earnings		
Balance - beginning of period	\$2,634,056	\$2,372,972
Dividends on preferred shares	—	—
Dividends on common shares	(59,227)	(57,874)
Net income	320,497	279,940
Net (income) attributable to noncontrolling interest	(58,724)	(40,739)
Balance - end of period	\$2,836,602	\$2,554,299
Total shareholders' equity available to Validus	\$3,866,256	\$3,657,336
Noncontrolling interest	\$212,154	\$153,523
Total shareholders' equity	\$4,078,410	\$3,810,859

The accompanying notes are an integral part of these Consolidated Financial Statements (unaudited).

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Validus Holdings, Ltd.
 Consolidated Statements of Cash Flows
 For the Six Months Ended June 30, 2016 and 2015 (unaudited)
 (Expressed in thousands of U.S. dollars)

	Six Months Ended June 30,	
	2016	2015
	(unaudited)(unaudited)	
Cash flows provided by operating activities		
Net income	\$ 320,497	\$ 279,940
Adjustments to reconcile net income to cash provided by operating activities:		
Share compensation expenses	21,964	18,296
Amortization of discount on senior notes	54	54
Loss (income) from investment affiliate	4,702	(3,060)
Net realized gains on investments	(2,140)	(6,413)
Change in net unrealized (gains) losses on investments	(78,872)	1,449
Amortization of intangible assets	2,832	2,832
Loss (income) from operating affiliates	23	(5,722)
Foreign exchange (gains) losses included in net income	(6,289)	7,729
Amortization of premium on fixed maturity investments	8,710	12,395
Change in:		
Premiums receivable	(719,070)	(566,100)
Deferred acquisition costs	(102,211)	(92,020)
Prepaid reinsurance premiums	(67,575)	(79,304)
Loss reserves recoverable	(95,429)	644
Paid losses recoverable	(4,571)	(2,253)
Income taxes recoverable	7,423	(13,931)
Deferred tax asset	(2,529)	908
Accrued investment income	(1,183)	984
Other assets	(5,272)	90,625
Reserve for losses and loss expenses	147,305	(50,240)
Unearned premiums	655,353	529,374
Reinsurance balances payable	18,610	(34,472)
Deferred tax liability	(308)	2,329
Accounts payable and accrued expenses	(32,581)	(61,570)
Net cash provided by operating activities	69,443	32,474
Cash flows used in investing activities		
Proceeds on sales of fixed maturity investments	1,376,077	2,237,966
Proceeds on maturities of fixed maturity investments	184,413	186,594
Purchases of fixed maturity investments	(1,537,608)	(2,337,990)
Purchases of short-term investments, net	(428,040)	(154,804)
(Purchases) sales of other investments, net	(19,796)	4,101
Increase in securities lending collateral	(5,361)	(6,551)
Redemption from operating affiliates	369	—
Investment in investment affiliates, net	(16,305)	(23,115)
(Increase) decrease in restricted cash	(22,752)	32,984
Net cash used in investing activities	(469,003)	(60,815)

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Cash flows provided by (used in) financing activities		
Net proceeds on issuance of notes payable to AlphaCat investors	294,748	—
Net proceeds on issuance of preferred shares	144,852	—
Issuance of common shares, net	(7,385)	14,860
Purchases of common shares under share repurchase program	(129,083)	(143,223)
Dividends paid on preferred shares	—	—
Dividends paid on common shares	(59,961)	(58,718)
Increase in securities lending payable	5,361	6,551
Third party investment in redeemable noncontrolling interest	381,250	452,700
Third party redemption of redeemable noncontrolling interest	(10,800)	(80,433)
Third party investment in noncontrolling interest	171,674	9,600
Third party distributions of noncontrolling interest	(127,103)	(158,175)
Third party subscriptions deployed on AlphaCat Funds and Sidecars	(411,336)	(117,400)
Net cash provided by (used in) financing activities	252,217	(74,238)
Effect of foreign currency rate changes on cash and cash equivalents		
	(6,968)	(8,730)
Net decrease in cash and cash equivalents	(154,311)	(111,309)
Cash and cash equivalents - beginning of period	723,109	550,401
Cash and cash equivalents - end of period	\$568,798	\$439,092
Taxes paid during the period	\$3,837	\$14,192
Interest paid during the period	\$27,552	\$27,248
The accompanying notes are an integral part of these Consolidated Financial Statements (unaudited).		

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

1. Basis of preparation and consolidation

These unaudited Consolidated Financial Statements (the "Consolidated Financial Statements") have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 in Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. This Quarterly Report on Form 10-Q should be read in conjunction with the financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the U.S. Securities and Exchange Commission (the "SEC").

The Company consolidates in these Consolidated Financial Statements the results of operations and financial position of all voting interest entities ("VOE") in which the Company has a controlling financial interest and all variable interest entities ("VIE") in which the Company is considered to be the primary beneficiary. The consolidation assessment, including the determination as to whether an entity qualifies as a VIE or VOE, depends on the facts and circumstances surrounding each entity.

During the fourth quarter of 2015, the Company early adopted Accounting Standards Update ("ASU") 2015-02, "Consolidation (Topic 810) Amendments to the Consolidation Analysis" issued by the United States Financial Accounting Standards Board ("FASB"), which changed the method in which the Company determines whether entities are consolidated by the Company. The adoption of this amended accounting guidance was implemented utilizing a full retrospective application for all periods presented in the Company's Consolidated Financial Statements.

The amended guidance includes changes in the identification of the primary beneficiary of investment companies considered to be VIEs. These changes resulted in the Company concluding that it is considered to be the primary beneficiary of the AlphaCat sidecars, the AlphaCat ILS funds and the BetaCat ILS funds and therefore the Company is required to consolidate these entities. The adoption of the amended guidance also resulted in the Company concluding that it was no longer required to consolidate PaCRe Ltd. ("PaCRe") due to the change in the VIE definition of "kick-out" rights under the amended guidance. The cumulative effect of these changes on the Company's retained earnings through the six months ended June 30, 2015 was a gain of \$405.

The following tables present the impact of the application of the amended accounting guidance on the Company's Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2015 and Consolidated Statement of Cash Flows for the six months ended June 30, 2015:

	Three Months Ended June 30, 2015		
	As previously reported	Adjustment for adoption of new consolidation guidance	Revised
Total revenues	\$591,492	\$ (19,912)	\$571,580
Total expenses	480,511	1,907	482,418
Net income	81,657	6,694	88,351
Net (income) attributable to noncontrolling interest	(17,644)	(4,917)	(22,561)
Net income available to Validus	64,013	1,777	65,790
Comprehensive income available to Validus	67,588	1,777	69,365
Basic earnings per share available to common shareholders	\$0.75	\$ 0.02	\$0.77

Earnings per diluted share available to common shareholders \$0.73 \$ 0.02 \$0.75

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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)

	Six Months Ended June 30, 2015		
	As previously reported	Adjustment for adoption of new consolidation guidance	Revised
Total revenues	\$ 1,280,697	\$ (65,351)	\$ 1,215,346
Total expenses	934,010	2,004	936,014
Net income	294,045	(14,105)	279,940
Net (income) attributable to noncontrolling interest	(56,621)	15,882	(40,739)
Net income available to Validus	237,424	1,777	239,201
Comprehensive income available to Validus	236,914	1,777	238,691
Basic earnings per share available to common shareholders	\$ 2.81	\$ 0.02	\$ 2.83
Earnings per diluted share available to common shareholders	\$ 2.72	\$ 0.02	\$ 2.74

Six Months Ended June 30, 2015

	As previously reported	Adjustment for adoption of new consolidation guidance	Revised
Net cash (used in) provided by operating activities	\$ (228,841)	\$ 261,315	\$ 32,474
Net cash used in investing activities	(290,517)	229,702	(60,815)
Net cash provided by (used in) financing activities	389,593	(463,831)	(74,238)
Effect of foreign currency rate changes on cash and cash equivalents	(13,765)	5,035	(8,730)
Net decrease in cash	(143,530)	32,221	(111,309)
Cash and cash equivalents - beginning of period	577,240	(26,839)	550,401
Cash and cash equivalents - end of period	433,710	5,382	439,092

In the opinion of management, these Consolidated Financial Statements reflect all adjustments (including normal recurring adjustments) considered necessary for a fair statement of the Company's financial position and results of operations as at the end of and for the periods presented. All significant intercompany accounts and transactions have been eliminated. The results of operations for any interim period are not necessarily indicative of the results for a full year.

The preparation of these financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes that the amounts included in the Consolidated Financial Statements reflect its best estimates and assumptions, actual results could differ materially from those estimates. The Company's principal estimates include:

- reserve for losses and loss expenses;
- premium estimates for business written on a line slip or proportional basis;
- the valuation of goodwill and intangible assets;
- reinsurance recoverable balances including the provision for uncollectible amounts; and
- investment valuation of financial assets.

The term "ASC" used in these notes refers to Accounting Standard Codification issued by the FASB.

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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)

2. Recent accounting pronouncements

Recently Issued Accounting Standards Not Yet Adopted

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)” (ASU 2014-09).

The guidance in this ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In March and April 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers (Topic 606) - Principal versus Agent Considerations (Reporting Revenue Gross versus Net)” and ASU 2016-10, “Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing”. The amendments in these ASU's clarify the implementation guidance within ASU 2014-09 on principal versus agent considerations and the aspects of identifying performance obligations, respectively, while retaining the related principals in those areas. In May 2016, the FASB issued ASU 2016-12, “Revenue from Contracts with Customers (Topic 606) - Narrow-Scope Improvements and Practical Expedients”. The amendments in this ASU do not change the core principle of the guidance in Topic 606. Rather, the amendments provide clarifying guidance in a few narrow areas and add practical expedients to reduce the potential for diversity in practice as well as the cost and complexity of applying the guidance. The original effective date for the amendments in ASU 2014-09 was for annual reporting periods beginning after December 15, 2016; however, in August 2015, the FASB delayed the effective date by one year through the issuance of ASU 2015-14, “Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date”. As such, the new effective date is for interim and annual reporting periods beginning after December 15, 2017. Entities may adopt the standard as of the original effective date; however, earlier adoption is not permitted. The Company is currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”. The amendments in this ASU increase the transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requiring the disclosure of key information about leasing arrangements. The amendments in this ASU are effective for interim and annual reporting periods beginning after December 15, 2018. Early adoption is permitted. The Company is currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation-Stock Compensation (Topic 718) - Improvements to Employee Share-Based Payment Accounting”. The amendments in this ASU simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The amendments in this ASU are effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments - Credit Losses (Topic 326)”. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. This guidance is effective for annual periods beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted for annual periods beginning after December 15, 2018, and interim periods within those fiscal years. The Company is currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

3. Investments

During the fourth quarter of 2015, the Company enhanced disclosures around the allocation of invested assets and the related returns between managed and non-managed investments. Managed investments represent assets governed by the Company's investment policy statement ("IPS"), whereas non-managed investments represent assets held in support of consolidated AlphaCat VIEs which are not governed by the Company's IPS. Refer to Note 5, "Variable interest entities," for further details. As such, prior period disclosures have been revised to conform to current period presentation.

The Company classifies its fixed maturity and short-term investments as trading and accounts for its other investments in accordance with U.S. GAAP guidance for "Financial Instruments." As such, all investments are carried at fair value with interest and dividend income and realized and unrealized gains and losses included in net income for the period. The amortized cost (or cost), gross unrealized gains and (losses) and fair value of the Company's investments as at June 30, 2016 were as follows:

	Amortized Cost (or Cost)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Managed investments				
U.S. government and government agency	\$ 924,350	\$ 7,536	\$ (83)	\$ 931,803
Non-U.S. government and government agency	217,796	2,146	(4,692)	215,250
U.S. states, municipalities, political subdivisions	278,756	7,049	(393)	285,412
Agency residential mortgage-backed securities	662,468	14,713	(398)	676,783
Non-agency residential mortgage-backed securities	23,858	271	(740)	23,389
U.S. corporate	1,539,711	20,350	(4,014)	1,556,047
Non-U.S. corporate	367,473	3,264	(6,331)	364,406
Bank loans	613,414	574	(16,926)	597,062
Asset-backed securities	429,890	2,352	(2,902)	429,340
Commercial mortgage-backed securities	308,712	6,048	(727)	314,033
Total fixed maturities	5,366,428	64,303	(37,206)	5,393,525
Short-term investments	189,678	—	(50)	189,628
Other investments				
Fund of hedge funds	1,457	—	(498)	959
Hedge funds	12,463	6,162	—	18,625
Private equity investments	62,119	14,457	(3,270)	73,306
Investment funds	203,128	743	—	203,871
Overseas deposits	55,301	—	—	55,301
Mutual funds	4,201	3,263	—	7,464
Total other investments	338,669	24,625	(3,768)	359,526
Total managed investments	\$ 5,894,775	\$ 88,928	\$ (41,024)	\$ 5,942,679
Non-managed investments				
Catastrophe bonds	\$ 157,599	\$ 2,114	\$ (1,652)	\$ 158,061
Short-term investments	2,180,026	—	—	2,180,026
Total non-managed investments	2,337,625	2,114	(1,652)	2,338,087
Total investments	\$ 8,232,400	\$ 91,042	\$ (42,676)	\$ 8,280,766

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

The amortized cost (or cost), gross unrealized gains and (losses) and fair value of the Company's investments as at December 31, 2015 were as follows:

	Amortized Cost (or Cost)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Managed investments				
U.S. government and government agency	\$ 940,428	\$ 333	\$ (3,559)	\$ 937,202
Non-U.S. government and government agency	241,549	257	(3,838)	237,968
U.S. states, municipalities, political subdivisions	299,929	2,322	(962)	301,289
Agency residential mortgage-backed securities	606,676	6,361	(2,455)	610,582
Non-agency residential mortgage-backed securities	27,025	310	(415)	26,920
U.S. corporate	1,503,614	1,594	(15,257)	1,489,951
Non-U.S. corporate	453,178	797	(7,405)	446,570
Bank loans	592,981	275	(17,045)	576,211
Asset-backed securities	440,363	344	(3,583)	437,124
Commercial mortgage-backed securities	263,310	131	(3,306)	260,135
Total fixed maturities	5,369,053	12,724	(57,825)	5,323,952
Short-term investments	237,349	20	—	237,369
Other investments				
Fund of hedge funds	1,457	—	(40)	1,417
Hedge funds	14,018	6,962	—	20,980
Private equity investments	53,489	12,751	(2,469)	63,771
Investment funds	188,121	600	—	188,721
Overseas deposits	54,484	—	—	54,484
Mutual funds	4,394	3,089	—	7,483
Total other investments	315,963	23,402	(2,509)	336,856
Total managed investments	\$ 5,922,365	\$ 36,146	\$ (60,334)	\$ 5,898,177
Non-managed investments				
Catastrophe bonds	\$ 187,847	\$ 635	\$ (2,103)	\$ 186,379
Short-term investments	1,704,266	—	—	1,704,266
Total non-managed investments	1,892,113	635	(2,103)	1,890,645
Total investments	\$ 7,814,478	\$ 36,781	\$ (62,437)	\$ 7,788,822

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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)

(a) Fixed maturity investments

The following table sets forth certain information regarding the investment ratings of the Company's fixed maturity investments as at June 30, 2016 and December 31, 2015.

	June 30, 2016		December 31, 2015	
	Fair Value	% of Total	Fair Value	% of Total
Managed fixed maturities				
AAA	\$2,446,839	44.1 %	\$2,367,642	43.0 %
AA	508,086	9.2 %	569,386	10.3 %
A	1,045,965	18.8 %	1,031,326	18.7 %
BBB	741,800	13.4 %	691,538	12.6 %
Total investment grade managed fixed maturities	4,742,690	85.5 %	4,659,892	84.6 %
BB	227,436	4.0 %	235,724	4.3 %
B	183,127	3.3 %	179,069	3.2 %
CCC	8,331	0.2 %	5,706	0.1 %
CC	113	0.0 %	1,015	0.0 %
NR	231,828	4.2 %	242,546	4.4 %
Total non-investment grade managed fixed maturities	650,835	11.7 %	664,060	12.0 %
Total managed fixed maturities	\$5,393,525	97.2 %	\$5,323,952	96.6 %
Non-managed catastrophe bonds				
BBB	\$—	0.0 %	\$1,911	0.0 %
Total investment grade non-managed catastrophe bonds	—	0.0 %	1,911	0.0 %
BB	41,412	0.7 %	70,962	1.3 %
B	6,161	0.1 %	30,698	0.6 %
NR	110,488	2.0 %	82,808	1.5 %
Total non-investment grade non-managed catastrophe bonds	158,061	2.8 %	184,468	3.4 %
Total non-managed fixed maturities	158,061	2.8 %	186,379	3.4 %
Total fixed maturities	\$5,551,586	100.0 %	\$5,510,331	100.0 %

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Validus Holdings, Ltd.

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

The amortized cost and fair value amounts for the Company's fixed maturity investments held at June 30, 2016 and December 31, 2015 are shown below by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

	June 30, 2016		December 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Managed investments				
Due in one year or less	\$349,115	\$348,137	\$367,132	\$366,019
Due after one year through five years	2,990,421	2,996,295	2,965,920	2,936,053
Due after five years through ten years	485,899	492,101	548,183	539,083
Due after ten years	116,065	113,447	150,444	148,036
	3,941,500	3,949,980	4,031,679	3,989,191
Asset-backed and mortgage-backed securities	1,424,928	1,443,545	1,337,374	1,334,761
Total managed fixed maturities	\$5,366,428	\$5,393,525	\$5,369,053	\$5,323,952
Non-managed catastrophe bonds				
Due in one year or less	\$28,445	\$29,328	\$7,504	\$7,544
Due after one year through five years	128,614	128,185	165,093	163,575
Due after five years through ten years	540	548	15,250	15,260
Due after ten years	—	—	—	—
Total non-managed fixed maturities	157,599	158,061	187,847	186,379
Total fixed maturities	\$5,524,027	\$5,551,586	\$5,556,900	\$5,510,331

(b) Other investments

The following tables set forth certain information regarding the Company's other investment portfolio as at June 30, 2016 and December 31, 2015:

Other investments	Fair Value as at June 30, 2016	Investments with redemption restrictions	Investments without redemption restrictions	Redemption frequency (a)	Redemption notice period (a)
Fund of hedge funds	\$959	\$ 959	\$ —		
Hedge funds	18,625	18,625	—		
Private equity investments	73,306	73,306	—		
Investment funds	203,871	181,536	22,335	Daily	2 days
Overseas deposits	55,301	55,301	—		
Mutual funds	7,464	—	7,464	Daily	Daily
Total other investments	\$359,526	\$ 329,727	\$ 29,799		

(a) The redemption frequency and notice periods only apply to investments without redemption restrictions.

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Validus Holdings, Ltd.

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

Other investments	Fair value as at December 31, 2015	Investments with redemption restrictions	Investments without redemption restrictions	Redemption frequency (a)	Redemption notice period (a)
Fund of hedge funds	\$ 1,417	\$ 1,417	\$ —		
Hedge funds	20,980	20,980	—		
Private equity investments	63,771	63,771	—		
Investment funds	188,721	167,910	20,811	Daily	2 days
Overseas deposits	54,484	54,484	—		
Mutual funds	7,483	—	7,483	Daily	Daily
Total other investments	\$ 336,856	\$ 308,562	\$ 28,294		

(a) The redemption frequency and notice periods only apply to investments without redemption restrictions.

Other investments include alternative investments in various funds and pooled investment schemes. These alternative investments employ various investment strategies primarily involving, but not limited to, investments in collateralized obligations, fixed income securities, private equities, distressed debt and equity securities.

Certain securities included in other investments are subject to redemption restrictions and are unable to be redeemed from the funds. Distributions from these funds will be received as the underlying investments of the funds are liquidated. Currently, it is not known to the Company when these underlying assets will be sold by their investment managers; however, it is estimated that the majority of the underlying assets of the investments would liquidate over five to ten years from inception of the funds. In addition, one of the investment funds with a fair value of \$171,187 (December 31, 2015: \$167,910), has a lock-up period of three years as at June 30, 2016 and may also impose a redemption gate. A lock-up period refers to the initial amount of time an investor is contractually required to remain invested before having the ability to redeem. Typically, the imposition of a gate delays a portion of the requested redemption, with the remaining portion settled in cash shortly after the redemption date. Furthermore, the underlying investments held in the overseas deposit funds are liquid and will generally trade freely in an open market. However, the Company's ability to withdraw from the overseas deposit funds is restricted by an annual and quarterly funding and release process for Lloyd's market participants.

The Company's maximum exposure to any of these alternative investments is limited to the amount invested and any remaining capital commitments. Refer to Note 15, "Commitments and contingencies," for further details. As at June 30, 2016, the Company does not have any plans to sell any of the other investments listed above.

(c) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Managed investments				
Fixed maturities and short-term investments	\$30,621	\$29,433	\$58,638	\$57,106
Other investments	8,026	4,014	8,898	7,202
Restricted cash, cash and cash equivalents	380	427	1,245	843
Securities lending income	12	6	17	9
Total gross investment income	39,039	33,880	68,798	65,160
Investment expenses	(2,190)	(2,026)	(4,026)	(3,870)
Total managed net investment income	\$36,849	\$31,854	\$64,772	\$61,290

Non managed investments

Fixed maturities and short-term investments	\$1,977	\$1,733	\$3,272	\$3,307
Restricted cash, cash and cash equivalents	431	24	674	43
Total non-managed net investment income	2,408	1,757	3,946	3,350
Total net investment income	\$39,257	\$33,611	\$68,718	\$64,640

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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)

Managed net investment income from other investments includes distributed and undistributed net income from certain investment funds.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Managed fixed maturities, short-term and other investments				
Gross realized gains	\$3,306	\$6,140	\$6,523	\$12,449
Gross realized (losses)	(786)	(4,036)	(5,089)	(6,165)
Net realized gains on investments	2,520	2,104	1,434	6,284
Change in net unrealized gains (losses) on investments	30,052	(33,926)	77,130	743
Total net realized and change in net unrealized gains (losses) on managed investments	\$32,572	\$(31,822)	\$78,564	\$7,027
Non-managed fixed maturities, short-term and other investments				
Gross realized gains	\$204	\$140	\$715	\$140
Gross realized (losses)	—	—	(9)	(11)
Net realized gains on investments	204	140	706	129
Change in net unrealized (losses) on investments	1,376	(750)	1,742	(2,192)
Total net realized and change in net unrealized (losses) on non-managed investments	1,580	(610)	2,448	(2,063)
Total net realized and change in net unrealized gains (losses) on total investments	\$34,152	\$(32,432)	\$81,012	\$4,964

(e) Pledged investments

The following tables outline investments and cash pledged as collateral under the Company's credit facilities. For further details on the credit facilities, please refer to Note 13, "Debt and financing arrangements."

June 30, 2016

Description	Commitment	Issued and Outstanding	Investments and cash pledged as collateral
\$85,000 syndicated unsecured letter of credit facility	\$85,000	\$ —	\$ —
\$300,000 syndicated secured letter of credit facility	300,000	105,575	151,166
\$24,000 secured bi-lateral letter of credit facility	24,000	11,805	48,380
AlphaCat Re secured letter of credit facility	20,000	20,000	30,191
IPC bi-lateral facility	25,000	5,666	—
\$236,000 Flagstone bi-lateral facility	236,000	195,622	322,520
Total	\$690,000	\$ 338,668	\$ 552,257

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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)

Description	December 31, 2015		
	Commitment	Issued and Outstanding	Investments and cash pledged as collateral
\$85,000 syndicated unsecured letter of credit facility	\$85,000	\$ —	\$ —
\$300,000 syndicated secured letter of credit facility	300,000	235,540	370,909
\$24,000 secured bi-lateral letter of credit facility	24,000	10,543	47,607
AlphaCat Re secured letter of credit facility	30,000	30,000	30,153
IPC bi-lateral facility	25,000	9,241	—
\$236,000 Flagstone bi-lateral facility	236,000	193,764	377,866
Total	\$700,000	\$ 479,088	\$ 826,535

In addition, \$4,687,599 of cash and cash equivalents, restricted cash, short-term investments and fixed maturity investments were pledged during the normal course of business as at June 30, 2016 (December 31, 2015: \$4,056,788). Of those, \$4,564,394 were held in trust (December 31, 2015: \$4,007,215). Pledged assets are generally for the benefit of the Company's cedants and policyholders, to support AlphaCat's fully collateralized reinsurance transactions and to facilitate the accreditation of Validus Reinsurance, Ltd., Validus Reinsurance (Switzerland) Ltd. ("Validus Re Swiss") and Talbot as an alien insurer/reinsurer by certain regulators.

During December 2014, Validus Reinsurance, Ltd. established a Multi-Beneficiary Reinsurance Trust ("MBRT") to collateralize its (re)insurance liabilities associated with and for the benefit of U.S. domiciled cedants, and was approved as a trustee reinsurer in the State of New Jersey. As a result, cedants domiciled in that state will receive automatic credit in their regulatory filings for the reinsurance provided prospectively by the Company. As of June 30, 2016, Validus Reinsurance, Ltd. was approved as a trustee reinsurer in 48 states as well as Puerto Rico and the District of Columbia. In addition, Validus Re Swiss established a MBRT in December 2015 and was approved as a trustee reinsurer in 9 states as at June 30, 2016.

4. Fair value measurements

(a) Classification within the fair value hierarchy

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

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

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

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

Level 3 - Fair values are measured based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect the Company's own judgments about assumptions where there is little,

if any, market activity for that asset or liability that market participants might use.

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

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

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Validus Holdings, Ltd.

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

At June 30, 2016, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Fair value based on NAV practical expedient	Total
Managed investments					
U.S. government and government agency	\$—	\$931,803	\$—	\$—	\$931,803
Non-U.S. government and government agency	—	215,250	—	—	215,250
U.S. states, municipalities and political subdivisions	—	285,412	—	—	285,412
Agency residential mortgage-backed securities	—	676,783	—	—	676,783
Non-agency residential mortgage-backed securities	—	23,389	—	—	23,389
U.S. corporate	—	1,556,047	—	—	1,556,047
Non-U.S. corporate	—	364,406	—	—	364,406
Bank loans	—	353,914	243,148	—	597,062
Asset-backed securities	—	416,957	12,383	—	429,340
Commercial mortgage-backed securities	—	314,033	—	—	314,033
Total fixed maturities	—	5,137,994	255,531	—	5,393,525
Short-term investments	186,276	3,352	—	—	189,628
Other investments					
Fund of hedge funds	—	—	—	959	959
Hedge funds	—	—	—	18,625	18,625
Private equity investments	—	—	—	73,306	73,306
Investment funds	—	22,335	—	181,536	203,871
Overseas deposits	—	—	—	55,301	55,301
Mutual funds	—	7,464	—	—	7,464
Total other investments	—	29,799	—	329,727	359,526
Total managed investments	\$186,276	\$5,171,145	\$255,531	\$329,727	\$5,942,679
Non-managed investments					
Catastrophe bonds	\$—	\$120,543	\$37,518	\$—	\$158,061
Short-term investments	2,180,026	—	—	—	2,180,026
Total non-managed investments	2,180,026	120,543	37,518	—	2,338,087
Total investments	\$2,366,302	\$5,291,688	\$293,049	\$329,727	\$8,280,766

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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)

At December 31, 2015, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Fair value based on NAV	Total
				based on practical expedient	
Managed investments					
U.S. government and government agency	\$—	\$937,202	\$—	\$—	\$937,202
Non-U.S. government and government agency	—	237,968	—	—	237,968
U.S. states, municipalities and political subdivisions	—	301,289	—	—	301,289
Agency residential mortgage-backed securities	—	610,582	—	—	610,582
Non-agency residential mortgage-backed securities	—	26,920	—	—	26,920
U.S. corporate	—	1,489,951	—	—	1,489,951
Non-U.S. corporate	—	446,570	—	—	446,570
Bank loans	—	343,874	232,337	—	576,211
Asset-backed securities	—	437,124	—	—	437,124
Commercial mortgage-backed securities	—	260,135	—	—	260,135
Total fixed maturities	—	5,091,615	232,337	—	5,323,952
Short-term investments	222,678	14,691	—	—	237,369
Other investments					
Fund of hedge funds	—	—	—	1,417	1,417
Hedge funds	—	—	—	20,980	20,980
Private equity investments	—	—	—	63,771	63,771
Investment funds	—	20,811	—	167,910	188,721
Overseas deposits	—	—	—	54,484	54,484
Mutual funds	—	7,483	—	—	7,483
Total other investments	—	28,294	—	308,562	336,856
Total managed investments	\$222,678	\$5,134,600	\$232,337	\$308,562	\$5,898,177
Non-managed investments					
Catastrophe bonds	\$—	\$172,879	\$13,500	\$—	\$186,379
Short-term investments	1,704,266	—	—	—	1,704,266
Total non-managed investments	1,704,266	172,879	13,500	—	1,890,645
Total investments	\$1,926,944	\$5,307,479	\$245,837	\$	