

VALIDUS HOLDINGS LTD

Form 10-Q

August 07, 2009

**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, 2009  
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.)

**19 Par-La-Ville Road, Hamilton, Bermuda HM 11**  
(Address of principal executive offices and zip code)  
**(441) 278-9000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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 August 7, 2009, there were 76,462,412 outstanding Common Shares, \$0.175 par value per share, of the registrant.

**INDEX**

|                                                                                                                                             | <b>Page</b> |
|---------------------------------------------------------------------------------------------------------------------------------------------|-------------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>                                                                                                 |             |
| <b><u>Item 1. Financial Statements:</u></b>                                                                                                 |             |
| <u>Consolidated Balance Sheets as at June 30, 2009 (unaudited) and December 31, 2008</u>                                                    | 3           |
| <u>Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2009 and 2008 (unaudited)</u> | 4           |
| <u>Consolidated Statements of Shareholders' Equity for the six months ended June 30, 2009 and 2008 (unaudited)</u>                          | 5           |
| <u>Consolidated Statements of Cash Flows for the six months ended June 30, 2009 and 2008 (unaudited)</u>                                    | 6           |
| <u>Notes to Consolidated Financial Statements (unaudited)</u>                                                                               | 7           |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                        | 37          |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>                                                                   | 85          |
| <u>Item 4. Controls and Procedures</u>                                                                                                      | 87          |
| <b><u>PART II. OTHER INFORMATION</u></b>                                                                                                    |             |
| <u>Item 1. Legal Proceedings</u>                                                                                                            | 88          |
| <u>Item 1A. Risk Factors</u>                                                                                                                | 88          |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>                                                                  | 91          |
| <u>Item 3. Defaults Upon Senior Securities</u>                                                                                              | 91          |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u>                                                                          | 91          |
| <u>Item 5. Other Information</u>                                                                                                            | 93          |
| <u>Item 6. Exhibits</u>                                                                                                                     | 93          |
| <u>Signatures</u>                                                                                                                           | 94          |
| <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**

2

---

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

Consolidated Balance Sheets

**As at June 30, 2009 (unaudited) and December 31, 2008**

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

|                                                                                            | <b>June 30,<br/>2009</b><br>(Unaudited) | <b>December 31,<br/>2008</b> |
|--------------------------------------------------------------------------------------------|-----------------------------------------|------------------------------|
| <b>Assets</b>                                                                              |                                         |                              |
| Fixed maturities, at fair value (amortized cost: 2009 - \$2,836,299; 2008 - \$2,553,018)   | \$ 2,816,536                            | \$ 2,454,501                 |
| Short-term investments, at fair value (amortized cost: 2009 - \$324,773; 2008 - \$379,537) | 323,940                                 | 377,036                      |
| Cash and cash equivalents                                                                  | 390,090                                 | 449,848                      |
| <b>Total investments and cash</b>                                                          | <b>3,530,566</b>                        | <b>3,281,385</b>             |
| Premiums receivable                                                                        | 679,189                                 | 408,259                      |
| Deferred acquisition costs                                                                 | 145,615                                 | 108,156                      |
| Prepaid reinsurance premiums                                                               | 87,798                                  | 22,459                       |
| Securities lending collateral                                                              | 166,496                                 | 98,954                       |
| Loss reserves recoverable                                                                  | 169,666                                 | 208,796                      |
| Paid losses recoverable                                                                    | 36,624                                  | 1,388                        |
| Net receivable for investments sold                                                        |                                         | 490                          |
| Income taxes recoverable                                                                   | 1,876                                   | 1,365                        |
| Intangible assets                                                                          | 125,136                                 | 127,217                      |
| Goodwill                                                                                   | 20,393                                  | 20,393                       |
| Accrued investment income                                                                  | 19,636                                  | 20,433                       |
| Other assets                                                                               | 25,455                                  | 23,185                       |
| <b>Total assets</b>                                                                        | <b>\$ 5,008,450</b>                     | <b>\$ 4,322,480</b>          |
| <b>Liabilities</b>                                                                         |                                         |                              |
| Reserve for losses and loss expenses                                                       | \$ 1,311,935                            | \$ 1,305,303                 |
| Unearned premiums                                                                          | 856,138                                 | 539,450                      |
| Reinsurance balances payable                                                               | 101,004                                 | 33,042                       |
| Securities lending payable                                                                 | 168,923                                 | 105,688                      |
| Deferred income taxes                                                                      | 22,163                                  | 21,779                       |
| Net payable for investments purchased                                                      | 16,346                                  |                              |
| Accounts payable and accrued expenses                                                      | 75,672                                  | 74,184                       |
| Debentures payable                                                                         | 304,300                                 | 304,300                      |
| <b>Total liabilities</b>                                                                   | <b>2,856,481</b>                        | <b>2,383,746</b>             |
| Commitments and contingent liabilities                                                     |                                         |                              |
| <b>Shareholders equity</b>                                                                 | <b>13,327</b>                           | <b>13,235</b>                |

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|                                                               |                     |                     |
|---------------------------------------------------------------|---------------------|---------------------|
| Common shares, 571,428,571 authorized, par value \$0.175      |                     |                     |
| Issued and outstanding (2009 - 76,151,473; 2008 - 75,624,697) |                     |                     |
| Additional paid-in capital                                    | 1,424,378           | 1,412,635           |
| Accumulated other comprehensive (loss)                        | (4,061)             | (7,858)             |
| Retained earnings                                             | 718,325             | 520,722             |
| <b>Total shareholders equity</b>                              | <b>2,151,969</b>    | <b>1,938,734</b>    |
| <b>Total liabilities and shareholders equity</b>              | <b>\$ 5,008,450</b> | <b>\$ 4,322,480</b> |

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

**For the three and six months ended June 30, 2009 and 2008 (Unaudited)**

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

|                                              | <b>Three<br/>months<br/>ended<br/>June 30,<br/>2009</b> | <b>Three<br/>months<br/>ended<br/>June 30,<br/>2008</b> | <b>Six months<br/>ended<br/>June 30,<br/>2009</b> | <b>Six months<br/>ended<br/>June 30,<br/>2008</b> |
|----------------------------------------------|---------------------------------------------------------|---------------------------------------------------------|---------------------------------------------------|---------------------------------------------------|
|                                              | (Unaudited)                                             | (Unaudited)                                             | (Unaudited)                                       | (Unaudited)                                       |
| <b>Revenues</b>                              |                                                         |                                                         |                                                   |                                                   |
| Gross premiums written                       | \$ 425,032                                              | \$ 379,919                                              | \$ 1,034,924                                      | \$ 901,513                                        |
| Reinsurance premiums ceded                   | (62,291)                                                | (1,399)                                                 | (134,803)                                         | (86,299)                                          |
| Net premiums written                         | 362,741                                                 | 378,520                                                 | 900,121                                           | 815,214                                           |
| Change in unearned premiums                  | (34,541)                                                | (69,222)                                                | (253,162)                                         | (214,052)                                         |
| Net premiums earned                          | 328,200                                                 | 309,298                                                 | 646,959                                           | 601,162                                           |
| Net investment income                        | 26,963                                                  | 36,435                                                  | 53,735                                            | 72,478                                            |
| Realized gain on repurchase of debentures    |                                                         | 8,752                                                   |                                                   | 8,752                                             |
| Net realized (losses) gains on investments   | (2,650)                                                 | (2,425)                                                 | (26,071)                                          | 5,319                                             |
| Net unrealized gains (losses) on investments | 37,249                                                  | (42,982)                                                | 59,402                                            | (57,959)                                          |
| Other income                                 | 1,017                                                   | 1,462                                                   | 1,774                                             | 2,397                                             |
| Foreign exchange gains                       | 8,432                                                   | 911                                                     | 4,232                                             | 9,090                                             |
| <b>Total revenues</b>                        | <b>399,211</b>                                          | <b>311,451</b>                                          | <b>740,031</b>                                    | <b>641,239</b>                                    |
| <b>Expenses</b>                              |                                                         |                                                         |                                                   |                                                   |
| Losses and loss expenses                     | 124,751                                                 | 122,089                                                 | 256,585                                           | 262,113                                           |
| Policy acquisition costs                     | 64,438                                                  | 56,419                                                  | 125,887                                           | 113,120                                           |
| General and administrative expenses          | 41,200                                                  | 33,912                                                  | 79,279                                            | 71,019                                            |
| Share compensation expenses                  | 5,632                                                   | 7,271                                                   | 12,986                                            | 13,806                                            |
| Finance expenses                             | 10,752                                                  | 12,762                                                  | 18,475                                            | 34,279                                            |
| Transaction expenses                         | 15,851                                                  |                                                         | 15,851                                            |                                                   |
| <b>Total expenses</b>                        | <b>262,624</b>                                          | <b>232,453</b>                                          | <b>509,063</b>                                    | <b>494,337</b>                                    |
| <b>Net income before taxes</b>               | <b>136,587</b>                                          | <b>78,998</b>                                           | <b>230,968</b>                                    | <b>146,902</b>                                    |
| Income tax benefit (expense)                 | 976                                                     | (3,077)                                                 | 1,502                                             | (4,506)                                           |
| <b>Net income</b>                            | <b>\$ 137,563</b>                                       | <b>\$ 75,921</b>                                        | <b>\$ 232,470</b>                                 | <b>\$ 142,396</b>                                 |

**Comprehensive income**

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|                                                                                   |            |            |            |            |
|-----------------------------------------------------------------------------------|------------|------------|------------|------------|
| Foreign currency translation adjustments                                          | 3,993      | 10         | 3,797      | 77         |
| <b>Comprehensive income</b>                                                       | \$ 141,556 | \$ 75,931  | \$ 236,267 | \$ 142,473 |
| <b>Earnings per share</b>                                                         |            |            |            |            |
| Weighted average number of common shares and common share equivalents outstanding |            |            |            |            |
| Basic                                                                             | 76,138,038 | 74,233,425 | 75,941,308 | 74,221,398 |
| Diluted                                                                           | 78,942,065 | 77,257,545 | 79,022,355 | 77,793,636 |
| <b>Basic earnings per share</b>                                                   | \$ 1.79    | \$ 1.00    | \$ 3.02    | \$ 1.87    |
| <b>Diluted earnings per share</b>                                                 | \$ 1.74    | \$ 0.98    | \$ 2.94    | \$ 1.83    |
| <b>Cash dividends declared per share</b>                                          | \$ 0.20    | \$ 0.20    | \$ 0.40    | \$ 0.40    |

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

4

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

Consolidated Statements of Shareholders' Equity

**For the six months ended June 30, 2009 and 2008 (Unaudited)**

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

|                                                      | <b>June 30, 2009<br/>(Unaudited)</b> | <b>June 30, 2008<br/>(Unaudited)</b> |
|------------------------------------------------------|--------------------------------------|--------------------------------------|
| <b>Common shares</b>                                 |                                      |                                      |
| Balance Beginning of period                          | \$ 13,235                            | \$ 12,985                            |
| Issue of common shares                               | 92                                   | 8                                    |
| Balance End of period                                | \$ 13,327                            | \$ 12,993                            |
| <b>Additional paid-in capital</b>                    |                                      |                                      |
| Balance Beginning of period                          | \$ 1,412,635                         | \$ 1,384,604                         |
| Issue of common shares, net of expenses              | (1,243)                              | 503                                  |
| Share compensation expense                           | 12,986                               | 13,806                               |
| Balance End of period                                | \$ 1,424,378                         | \$ 1,398,913                         |
| <b>Accumulated other comprehensive (loss) income</b> |                                      |                                      |
| Balance Beginning of period                          | \$ (7,858)                           | \$ (49)                              |
| Currency translation adjustments                     | 3,797                                | 77                                   |
| Balance End of period                                | \$ (4,061)                           | \$ 28                                |
| <b>Retaining earnings (deficit)</b>                  |                                      |                                      |
| Balance Beginning of period                          | \$ 520,722                           | \$ 537,260                           |
| Dividends                                            | (34,867)                             | (34,809)                             |
| Net income                                           | 232,470                              | 142,396                              |
| Balance End of period                                | \$ 718,325                           | \$ 644,847                           |
| <b>Total shareholders' equity</b>                    | <b>\$ 2,151,969</b>                  | <b>\$ 2,056,781</b>                  |

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 six months ended June 30, 2009 and 2008 (Unaudited)**

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

|                                                                                         | <b>June 30, 2009</b><br><b>(Unaudited)</b> | <b>June 30, 2008</b><br><b>(Unaudited)</b> |
|-----------------------------------------------------------------------------------------|--------------------------------------------|--------------------------------------------|
| <b>Cash flows provided by (used in) operating activities</b>                            |                                            |                                            |
| Net income for the period                                                               | \$ 232,470                                 | \$ 142,396                                 |
| Adjustments to reconcile net income to cash provided by (used in) operating activities: |                                            |                                            |
| Share compensation expense                                                              | 12,986                                     | 13,806                                     |
| Realized gain on repurchase of debentures                                               |                                            | (8,752)                                    |
| Net realized losses (gains) on sales of investments                                     | 26,071                                     | (5,319)                                    |
| Net unrealized (gains) losses on investments                                            | (59,402)                                   | 57,959                                     |
| Amortization of intangible assets                                                       | 2,081                                      | 2,081                                      |
| Foreign exchange (gains) on cash and cash equivalents included in net income            | (9,593)                                    | (6,254)                                    |
| Amortization of premium on fixed maturities                                             | 4,123                                      | 1,753                                      |
| Change in:                                                                              |                                            |                                            |
| Premiums receivable                                                                     | (264,194)                                  | (208,431)                                  |
| Deferred acquisition costs                                                              | (37,460)                                   | (40,715)                                   |
| Prepaid reinsurance premiums                                                            | (63,532)                                   | (22,867)                                   |
| Loss reserves recoverable                                                               | 42,977                                     | 1,480                                      |
| Paid losses recoverable                                                                 | (34,083)                                   | 5,122                                      |
| Income taxes recoverable                                                                | (522)                                      | 482                                        |
| Accrued investment income                                                               | 680                                        | (4,520)                                    |
| Other assets                                                                            | 258                                        | (700)                                      |
| Reserve for losses and loss expenses                                                    | (18,001)                                   | 104,284                                    |
| Unearned premiums                                                                       | 316,689                                    | 236,193                                    |
| Reinsurance balances payable                                                            | 66,957                                     | 29,501                                     |
| Deferred income taxes                                                                   | (2,504)                                    | 3,489                                      |
| Accounts payable and accrued expenses                                                   | (6,190)                                    | (53,581)                                   |
| <b>Net cash provided by operating activities</b>                                        | <b>209,811</b>                             | <b>247,407</b>                             |
| <b>Cash flows provided by (used in) investing activities</b>                            |                                            |                                            |
| Proceeds on sales of investments                                                        | 1,509,773                                  | 1,109,536                                  |
| Proceeds on the maturities of investments                                               | 311,221                                    | 100,787                                    |
| Purchases of fixed maturities                                                           | (2,122,514)                                | (1,460,975)                                |
| Sales of short-term investments, net                                                    | 53,781                                     | 109,580                                    |
| (Increase) in securities lending collateral                                             | (63,235)                                   | (35,644)                                   |
| <b>Net cash (used in) investing activities</b>                                          | <b>(310,974)</b>                           | <b>(176,716)</b>                           |
| <b>Cash flows provided by (used in) financing activities</b>                            |                                            |                                            |

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|                                                                      |                   |                   |
|----------------------------------------------------------------------|-------------------|-------------------|
| Repurchase of debentures                                             |                   | (36,948)          |
| Issue of common shares, net of expenses                              | (1,182)           | 511               |
| Dividends paid                                                       | (33,973)          | (33,642)          |
| Increase in securities lending payable                               | 63,235            | 35,644            |
| <b>Net cash provided by (used in) financing activities</b>           | <b>28,080</b>     | <b>(34,435)</b>   |
| Effect of foreign currency rate changes on cash and cash equivalents | 13,325            | 6,306             |
| Net (decrease) increase in cash                                      | (59,758)          | 42,562            |
| <b>Cash and cash equivalents Beginning of period</b>                 | <b>449,848</b>    | <b>444,698</b>    |
| <b>Cash and cash equivalents End of period</b>                       | <b>\$ 390,090</b> | <b>\$ 487,260</b> |
| <b>Taxes paid during the period</b>                                  | <b>\$ 1,199</b>   | <b>\$ 410</b>     |
| <b>Interest paid during the period</b>                               | <b>\$ 13,344</b>  | <b>\$ 14,625</b>  |

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 owned subsidiaries (together, the Company) and have been prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. This Quarterly Report should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the U.S. Securities and Exchange Commission (the SEC).

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

**2. Recent accounting pronouncements**

In December 2007, the FASB issued Statements No. 141(R), Business Combinations (FAS 141(R)) and No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 (FAS 160) which are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. In April 2009, the FASB issued FASB Staff Position FAS 141(R)-1 Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies (FSP FAS 141(R)-1). FSP FAS 141(R)-1 has amended FAS 141(R)'s guidance on the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets acquired and liabilities assumed in a business combination that arise from contingencies.

Significant changes arising from FAS 141(R) and FSP FAS 141(R)-1 which impact current and future acquisitions include the determination of the purchase price and treatment of transaction expenses, restructuring charges and negative goodwill as follows:

**Purchase Price** Under FAS 141(R), the purchase price is determined as of the acquisition date, which is the date that the acquirer obtains control. Previously, the date the business combination was announced was used as the effective date in determining the purchase price;

**Transaction Expenses** Under FAS 141(R), all costs associated with purchase transactions must be expensed as incurred. Previously, all such costs could be capitalized and included as part of transaction purchase price, adding to the amount of goodwill recognized;

**Restructuring Costs** Under FAS 141(R), expected restructuring costs are not recorded at the closing date, but rather after the transaction. The only costs to be included as a liability at the closing date are



**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)

those for which an acquirer is obligated at the time of the closing. Previously, restructuring costs that were planned to occur after the closing of the transaction were recognized and recorded at the closing date as a liability;

**Negative Goodwill/Bargain Purchases** Under FAS 141(R), where total fair value of net assets acquired exceeds consideration paid (creating negative goodwill), the acquirer will record a gain as a result of the bargain purchase, to be recognized through the income statement at the close of the transaction. Previously, negative goodwill was recognized as a pro rata reduction of the assets assumed to allow the net assets acquired to equal the consideration paid; and

**Noncontrolling Interests** Under FAS 141(R), in a partial or step acquisition where control is obtained, 100% of goodwill and identifiable net assets are recognized at fair value and the noncontrolling (sometimes called minority interest) interest is also recorded at fair value. Previously, in a partial acquisition only the controlling interest's share of goodwill was recognized, the controlling interest's share of identifiable net assets was recognized at fair value and the noncontrolling interest's share of identifiable net assets was recognized at carrying value. Under FAS 160, a noncontrolling interest is now recognized in the equity section, presented separately from the controlling interest's equity. Previously, noncontrolling interest in general was recorded in the mezzanine section.

As a result of the adoption of FAS 141(R) and FSP FAS 141(R)-1 the Company has expensed as incurred the transaction costs related to the definitive amalgamation agreement with IPC Holdings, Ltd. (IPC), as described in Note 11. The adoption of FAS 141(R) and FSP FAS 141(R)-1 materially impacts the consolidated financial statement recognition and measurement of current and future acquisitions.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, **Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities** (FSP EITF 03-6-1). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions may be participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing basic earnings per share (EPS) pursuant to the two-class method described in paragraphs 60 and 61 of FASB Statement No. 128, **Earnings per Share**. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of FSP EITF 03-6-1 has not had a material impact on the Company's consolidated financial statements.

In January 2009, the FASB issued FASB Staff Position EITF 99-20-1 **Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets** (FSP EITF 99-20-1). FSP EITF 99-20-1 amends certain recognition aspects of other-than-temporary impairments (OTTI). FSP EITF 99-20-1 is effective prospectively for interim and annual periods ending after December 15, 2008. Retrospective application of FSP EITF 99-20-1 to a prior interim or annual period is prohibited. As the Company's investment portfolio is classified as trading, the adoption of the FSP EITF 99-20-1 has not had a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued FASB Staff Positions FAS 157-4 **Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly** (FSP FAS 157-4) and FAS 115-2 and FAS 124-2 **Recognition and Presentation of Other-Than-Temporary Impairments** (FSP FAS 115-2 and FAS 124-2). FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with FAS 157, **Fair Value Measurements**, specifically; (1) estimating the fair value of an asset or liability (financial and nonfinancial) when the volume and level of activity for the asset or liability have significantly decreased; and (2) identifying transactions that are not orderly. The primary change to the OTTI model for debt securities, as a result of FSP FAS 115-2 and FAS 124-2, is the change in focus from an entity's intent and ability to

hold a security until recovery. Instead, an OTTI is triggered if; (1) an entity has the intent to sell the security; (2) it is more likely than not that it will be required to sell the security before recovery; or (3) it does not expect to recover the entire amortized cost basis of the security. Both FSPs are effective for interim and annual

**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)

periods ending after June 15, 2009. The adoption of FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2 have not had a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position FAS 107-1 and APB 28-1 Interim Disclosures about Fair Value of Financial Instruments ( FSP FAS 107-1 and APB 28-1 ). FSP FAS 107-1 and APB 28-1 expands the fair value disclosures required for all financial instruments within the scope of Statement 107 to interim periods for publicly traded entities. The FSP also requires entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim basis and to highlight any changes of the methods and significant assumptions from prior periods. FSP FAS 107-1 and APB 28-1 is effective for interim and annual periods ending after June 15, 2009. As FSP FAS 107-1 and APB 28-1 only expands certain disclosures requirements it has not had a material impact on the Company's consolidated financial statements.

In May 2009, the FASB issued Statements No. 165, Subsequent Events ( FAS 165 ), which provides guidance on management's assessment of subsequent events. FAS 165 clarifies that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued or are available to be issued. FAS 165 is effective prospectively for interim and annual periods ending after June 15, 2009. The adoption of FAS 165 has not had a material impact on management's existing processes for assessing subsequent events, and consequently the Company's consolidated financial statements.

In June 2009, the FASB issued Statements No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 ( FAS 166 ) which amends the derecognition guidance in FAS 140. FAS 166 addresses practices that have developed since the issuance of FAS 140 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. FAS 166 is effective for financial asset transfers in the interim and annual periods beginning after November 15, 2009. Early adoption is prohibited. The adoption of FAS 166 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued Statements No. 167, Amendments to FASB Interpretation No. 46(R) ( FAS 167 ) which amends the consolidation guidance that applies to Variable Interest Entities ( VIEs ). FAS 167 amends the guidance for the identification of VIEs and their primary beneficiaries and the financial statement disclosures required. FAS 167 is effective for interim and annual periods beginning after November 15, 2009. Early adoption is prohibited. The adoption of FAS 167 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued Statements No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 ( FAS 168 ) which prescribes the use of the FASB Accounting Standards Codification (the Codification ) as the authoritative source of U.S. GAAP. Once the Codification is in effect, all of its content will carry the same level of authority, effectively superseding FAS 162 to include only two levels of U.S. GAAP: authoritative and nonauthoritative. FAS 168 is effective for interim and annual periods ending after September 15, 2009. The adoption of FAS 168 will not have a material impact on the Company's consolidated financial statements.

**3. Investments**

During the first quarter of 2007, the Company adopted FAS 157 and FAS 159. Prior to January 1, 2007, the Company's investments in fixed maturities were classified as available-for-sale and carried at fair value, with related net unrealized gains or losses excluded from earnings and included in shareholders' equity as a component of accumulated other comprehensive income. The Company believes that accounting for its investment portfolio as trading more closely reflects its investment guidelines. Beginning on January 1, 2007, the Company's investments in fixed maturities were classified as trading and carried at fair value, with related net unrealized gains or losses included in earnings.





**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)

During the third quarter of 2008, the Company adopted FSP FAS 157-3. Consistent with this statement, certain market conditions allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable. Effective for interim and annual periods ending after June 15, 2009, FSP FAS 157-3 has been superseded by FSP 157-4.

**(a) *Classification within the fair value hierarchy under FAS 157***

Under FAS 157, a company must determine the appropriate level in the fair value hierarchy for each fair value measurement. The fair value hierarchy in FAS 157 prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels. It gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

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

Level 1 primarily consists of financial instruments whose value is based on quoted market prices or alternative indices but for which the Company typically obtained independent external valuation information including U.S. and U.K. Treasuries, overnight repos and commercial paper. Level 2 includes financial instruments that are valued through independent external sources using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Sustainably all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. The Company performs internal procedures on the valuations received from independent external sources. Financial instruments in this category include U.S. Treasuries, sovereign debt, corporate debt and U.S. agency and non-agency mortgage and asset-backed securities. Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. Financial instruments in this category include certain residential mortgage-backed securities.

**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 June 30, 2009, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

|                                                                                            | <b>Level 1</b>    | <b>Level 2</b>      | <b>Level 3</b>    | <b>Total</b>        |
|--------------------------------------------------------------------------------------------|-------------------|---------------------|-------------------|---------------------|
| U.S. Government and Government Agency                                                      | \$                | \$ 994,086          | \$                | \$ 994,086          |
| Non-U.S. Government and Government Agency<br>States, municipalities, political subdivision |                   | 139,766<br>8,543    |                   | 139,766<br>8,543    |
| Agency residential mortgage-backed securities                                              |                   | 542,352             |                   | 542,352             |
| Non-Agency residential mortgage-backed<br>Securities                                       |                   | 80,804              | 100,952           | 181,756             |
| U.S. corporate                                                                             |                   | 619,633             |                   | 619,633             |
| Non-U.S. corporate                                                                         |                   | 169,017             |                   | 169,017             |
| Catastrophe bonds                                                                          |                   | 18,776              |                   | 18,776              |
| Asset-backed securities                                                                    |                   | 76,238              |                   | 76,238              |
| Commercial mortgage-backed securities                                                      |                   | 66,369              |                   | 66,369              |
| <b>Total fixed maturities</b>                                                              |                   | <b>2,715,584</b>    | <b>100,952</b>    | <b>2,816,536</b>    |
| <b>Total short-term investments</b>                                                        | <b>318,872</b>    | <b>5,068</b>        |                   | <b>323,940</b>      |
| <b>Total</b>                                                                               | <b>\$ 318,872</b> | <b>\$ 2,720,652</b> | <b>\$ 100,952</b> | <b>\$ 3,140,476</b> |

At December 31, 2008, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

|                                                                                            | <b>Level 1</b>    | <b>Level 2</b>      | <b>Level 3</b>    | <b>Total</b>        |
|--------------------------------------------------------------------------------------------|-------------------|---------------------|-------------------|---------------------|
| U.S. Government and Government Agency                                                      | \$                | \$ 768,344          | \$                | \$ 768,344          |
| Non-U.S. Government and Government Agency<br>States, municipalities, political subdivision |                   | 96,073<br>15,516    |                   | 96,073<br>15,516    |
| Agency residential mortgage-backed securities                                              |                   | 433,736             |                   | 433,736             |
| Non-Agency residential mortgage-backed securities                                          |                   | 119,813             | 111,318           | 231,131             |
| U.S. corporate                                                                             |                   | 443,847             |                   | 443,847             |
| Non-U.S. corporate                                                                         |                   | 125,700             |                   | 125,700             |
| Catastrophe bonds                                                                          |                   | 10,872              |                   | 10,872              |
| Asset-backed securities                                                                    |                   | 137,023             |                   | 137,023             |
| Commercial mortgage-backed securities                                                      |                   | 192,259             |                   | 192,259             |
| <b>Total fixed maturities</b>                                                              |                   | <b>2,343,183</b>    | <b>111,318</b>    | <b>2,454,501</b>    |
| <b>Total short-term investments</b>                                                        | <b>365,357</b>    | <b>11,679</b>       |                   | <b>377,036</b>      |
| <b>Total</b>                                                                               | <b>\$ 365,357</b> | <b>\$ 2,354,862</b> | <b>\$ 111,318</b> | <b>\$ 2,831,537</b> |

At June 30, 2009, Level 3 investments totaled \$100,952, representing 3.2% of total investments measured at fair value on a recurring basis. At December 31, 2008, Level 3 investments totaled \$111,318, representing 3.9% of total investments measured at fair value on a recurring basis.

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



**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>Six months<br/>ended</b> | <b>Year ended<br/>December 31,</b> |
|-------------------------------------------------------|-----------------------------|------------------------------------|
|                                                       | <b>June 30, 2009</b>        | <b>2008</b>                        |
| <b>Level 3 investments</b> <b>Beginning of period</b> | \$ 111,318                  | \$                                 |
| Payments and purchases                                |                             |                                    |
| Sales and maturities                                  | (822)                       | (59)                               |
| Realized losses                                       | (1,284)                     |                                    |
| Unrealized losses                                     | (1,495)                     | (14,603)                           |
| Amortization                                          | (6,765)                     | (4,048)                            |
| Transfers in                                          |                             | 130,028                            |
| <b>Level 3 investments</b> <b>End of period</b>       | \$ 100,952                  | \$ 111,318                         |

**(b) Net investment income**

Net investment income was derived from the following sources:

|                                             | <b>Three months ended</b>    |                          | <b>Six months ended</b>      |                          |
|---------------------------------------------|------------------------------|--------------------------|------------------------------|--------------------------|
|                                             | <b>June<br/>30,<br/>2009</b> | <b>June 30,<br/>2008</b> | <b>June<br/>30,<br/>2009</b> | <b>June 30,<br/>2008</b> |
| Fixed maturities and short-term investments | \$ 26,396                    | \$ 34,519                | \$ 52,914                    | \$ 66,210                |
| Cash and cash equivalents                   | 1,120                        | 2,378                    | 1,881                        | 7,216                    |
| Securities lending income                   | 173                          | 455                      | 512                          | 890                      |
| Total gross investment income               | 27,689                       | 37,352                   | 55,307                       | 74,316                   |
| Investment expenses                         | (726)                        | (917)                    | (1,572)                      | (1,838)                  |
| <b>Net investment income</b>                | <b>\$ 26,963</b>             | <b>\$ 36,435</b>         | <b>\$ 53,735</b>             | <b>\$ 72,478</b>         |

**(c) Fixed maturity and short-term investments**

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

|                                                               | <b>Three months ended</b>    |                          | <b>Six months ended</b>  |                          |
|---------------------------------------------------------------|------------------------------|--------------------------|--------------------------|--------------------------|
|                                                               | <b>June<br/>30,<br/>2009</b> | <b>June 30,<br/>2008</b> | <b>June 30,<br/>2009</b> | <b>June 30,<br/>2008</b> |
| Fixed maturities, short-term investments and cash equivalents |                              |                          |                          |                          |
| Gross realized gains                                          | \$ 3,928                     | \$ 2,957                 | \$ 13,381                | \$ 11,313                |
| Gross realized losses                                         | (6,578)                      | (5,382)                  | (39,452)                 | (5,994)                  |

|                                                                                                 |                  |                    |                  |                    |
|-------------------------------------------------------------------------------------------------|------------------|--------------------|------------------|--------------------|
| <b>Net realized (losses) gains on investments</b>                                               | (2,650)          | (2,425)            | (26,071)         | 5,319              |
| Change in unrealized gains (losses) of securities lending                                       | 3,214            | 317                | 4,306            | (895)              |
| Change in unrealized gains (losses) of investments                                              | 34,035           | (43,299)           | 55,096           | (57,064)           |
| <b>Total net realized (losses) gains and change in unrealized gains (losses) of investments</b> | <b>\$ 34,599</b> | <b>\$ (45,407)</b> | <b>\$ 33,331</b> | <b>\$ (52,640)</b> |

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at June 30, 2009 were 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)

|                                                   | <b>Amortized<br/>Cost</b> | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> | <b>Estimated<br/>fair<br/>value</b> |
|---------------------------------------------------|---------------------------|---------------------------------------|----------------------------------------|-------------------------------------|
| U.S. Government and Government Agency             | \$ 978,409                | \$ 16,256                             | \$ (579)                               | \$ 994,086                          |
| Non-U.S. Government and Government Agency         | 143,249                   | 5,609                                 | (9,092)                                | 139,766                             |
| States, municipalities, political subdivision     | 8,500                     | 43                                    |                                        | 8,543                               |
| Agency residential mortgage-backed securities     | 529,386                   | 13,535                                | (569)                                  | 542,352                             |
| Non-Agency residential mortgage-backed securities | 231,737                   |                                       | (49,981)                               | 181,756                             |
| U.S. corporate                                    | 610,405                   | 12,722                                | (3,494)                                | 619,633                             |
| Non-U.S. corporate                                | 173,440                   | 2,416                                 | (6,839)                                | 169,017                             |
| Catastrophe bonds                                 | 19,009                    | 84                                    | (317)                                  | 18,776                              |
| Asset-backed securities                           | 76,254                    | 981                                   | (997)                                  | 76,238                              |
| Commercial mortgage-backed securities             | 65,910                    | 494                                   | (35)                                   | 66,369                              |
| Total fixed maturities                            | 2,836,299                 | 52,140                                | (71,903)                               | 2,816,536                           |
| Total short-term investments                      | 324,773                   | 57                                    | (890)                                  | 323,940                             |
| <b>Total</b>                                      | <b>\$ 3,161,072</b>       | <b>\$ 52,197</b>                      | <b>\$ (72,793)</b>                     | <b>\$ 3,140,476</b>                 |

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

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

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

The following table sets forth certain information regarding the investment ratings of the Company's fixed maturities portfolio as at June 30, 2009 and December 31, 2008. Investment ratings are the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. For



**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 where Moody's and Standard & Poor's ratings are not available, Fitch ratings are used and presented in Standard & Poor's equivalent rating.

|                      | June 30, 2009              |               | December 31, 2008          |               |
|----------------------|----------------------------|---------------|----------------------------|---------------|
|                      | Estimated<br>fair<br>value | % of<br>total | Estimated<br>fair<br>value | % of<br>total |
| AAA                  | \$ 1,971,837               | 70.0%         | \$ 1,941,349               | 79.1%         |
| AA                   | 130,921                    | 4.7%          | 146,923                    | 6.0%          |
| A                    | 578,209                    | 20.5%         | 338,966                    | 13.8%         |
| BBB                  | 20,252                     | 0.7%          | 12,427                     | 0.5%          |
| Investment grade     | 2,701,219                  | 95.9%         | 2,439,665                  | 99.4%         |
| BB                   | 30,668                     | 1.1%          | 7,416                      | 0.3%          |
| B                    | 61,383                     | 2.2%          | 7,420                      | 0.3%          |
| CCC                  | 23,266                     | 0.8%          |                            |               |
| Non-Investment grade | 115,317                    | 4.1%          | 14,836                     | 0.6%          |
| <b>Total</b>         | <b>\$ 2,816,536</b>        | <b>100.0%</b> | <b>\$ 2,454,501</b>        | <b>100.0%</b> |

The amortized cost and estimated fair value amounts for fixed maturity securities held at June 30, 2009 and December 31, 2008 are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

|                                             | June 30, 2009       |                         | December 31, 2008   |                         |
|---------------------------------------------|---------------------|-------------------------|---------------------|-------------------------|
|                                             | Amortized<br>cost   | Estimated<br>fair value | Amortized<br>cost   | Estimated<br>fair value |
| Due in one year or less                     | \$ 275,126          | \$ 276,070              | \$ 277,137          | \$ 279,727              |
| Due after one year through five years       | 1,633,788           | 1,649,817               | 1,143,494           | 1,134,275               |
| Due after five years through ten years      | 21,715              | 21,437                  | 17,451              | 17,493                  |
| Due after ten years                         | 2,383               | 2,497                   | 31,045              | 28,858                  |
|                                             | 1,933,012           | 1,949,821               | 1,469,127           | 1,460,353               |
| Asset-backed and mortgage-backed Securities | 903,287             | 866,715                 | 1,083,891           | 994,148                 |
| <b>Total</b>                                | <b>\$ 2,836,299</b> | <b>\$ 2,816,536</b>     | <b>\$ 2,553,018</b> | <b>\$ 2,454,501</b>     |

The Company has a five year, \$500,000 secured letter of credit facility provided by a syndicate of commercial banks. At June 30, 2009, approximately \$276,955 (December 31, 2008: \$199,186) of letters of credit were issued and outstanding under this facility for which \$358,157 of investments were pledged as collateral (December 31, 2008: \$258,573). In 2007, the Company entered into a \$100,000 standby letter of credit facility which provides Funds at Lloyd's. At June 30, 2009, \$100,000 (December 31, 2008: \$100,000) of letters of credit were issued and outstanding

under this facility for which \$127,731 of investments were pledged as collateral (December 31, 2008: \$144,149). In addition, \$26,773,829 of investments are held in trust at June 30, 2009 (December 31, 2008: \$1,100,235). Of those, \$1,093,233 are held in trust for the benefit of Talbot's cedants and policyholders, and to facilitate the accreditation as an alien insurer/reinsurer by certain regulators (December 31, 2008: \$1,032,267).

**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)

**(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 June 30, 2009, the Company had \$165,565 (December 31, 2008: \$103,266) in securities on loan. During the six months ended June 30, 2009, the Company recorded a \$4,306 unrealized gain on this collateral on its Statements of Operations (June 30, 2008: unrealized loss \$895).

Securities lending collateral reinvested is primarily comprised of corporate floating rate securities with an average reset period of 15.5 days (December 31, 2008: 26.7 days). As at June 30, 2009, the securities lending collateral reinvested by the Company in connection with its securities lending program was allocated between Levels 1, 2 and 3 as follows:

|                         | <b>Level 1</b>   | <b>Level 2</b>   | <b>Level 3</b> | <b>Total</b>      |
|-------------------------|------------------|------------------|----------------|-------------------|
| Corporate               | \$               | \$ 24,328        | \$             | \$ 24,328         |
| Asset-backed securities |                  | 13,466           |                | 13,466            |
| Short-term investments  | 75,194           | 53,508           |                | 128,702           |
| <b>Total</b>            | <b>\$ 75,194</b> | <b>\$ 91,302</b> | <b>\$</b>      | <b>\$ 166,496</b> |

As at December 31, 2008, 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:

|                         | <b>Level 1</b>  | <b>Level 2</b>   | <b>Level 3</b> | <b>Total</b>     |
|-------------------------|-----------------|------------------|----------------|------------------|
| Corporate               | \$              | \$ 57,574        | \$             | \$ 57,574        |
| Asset-backed securities |                 | 18,228           |                | 18,228           |
| Short-term investments  | 7,390           | 15,762           |                | 23,152           |
| <b>Total</b>            | <b>\$ 7,390</b> | <b>\$ 91,564</b> | <b>\$</b>      | <b>\$ 98,954</b> |

The following table sets forth certain information regarding the investment ratings of the Company's securities lending collateral reinvested as at June 30, 2009 and December 31, 2008. Investment ratings are the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. For investments where Moody's and Standard & Poor's ratings are not available, Fitch ratings are used and presented in Standard & Poor's equivalent rating.

|     | <b>June 30, 2009</b>        |                   | <b>December 31, 2008</b>    |                   |
|-----|-----------------------------|-------------------|-----------------------------|-------------------|
|     | <b>Estimated fair value</b> | <b>% of total</b> | <b>Estimated fair value</b> | <b>% of total</b> |
| AAA | \$ 66,942                   | 40.2%             | \$ 45,137                   | 45.7%             |

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|              |                   |               |                  |               |
|--------------|-------------------|---------------|------------------|---------------|
| AA           | 17,392            | 10.4%         | 37,608           | 37.9%         |
| A            | 6,820             | 4.1%          | 8,729            | 8.8%          |
| NR           | 148               | 0.1%          | 90               | 0.1%          |
|              | 91,302            | 54.8%         | 91,564           | 92.5%         |
| NR- Cash (1) | 75,194            | 45.2%         | 7,390            | 7.5%          |
| <b>Total</b> | <b>\$ 166,496</b> | <b>100.0%</b> | <b>\$ 98,954</b> | <b>100.0%</b> |

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

**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 and estimated fair value amounts for securities lending collateral reinvested held at June 30, 2009 and December 31, 2008 are shown by contractual maturity below. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

|                                       | June 30, 2009     |                         | December 31, 2008 |                            |
|---------------------------------------|-------------------|-------------------------|-------------------|----------------------------|
|                                       | Amortized<br>cost | Estimated<br>fair value | Amortized<br>cost | Estimated<br>fair<br>value |
| Due in one year or less               | \$ 129,180        | \$ 128,702              | \$ 24,390         | \$ 23,152                  |
| Due after one year through five years | 39,743            | 37,794                  | 81,298            | 75,802                     |
| <b>Total</b>                          | <b>\$ 168,923</b> | <b>\$ 166,496</b>       | <b>\$ 105,688</b> | <b>\$ 98,954</b>           |

**4. Reinsurance**

The Company enters into reinsurance and retrocession agreements in order to mitigate its accumulation of loss, reduce its liability on individual risks, enable it to underwrite policies with higher limits, and increase its aggregate capacity. The cession of insurance and reinsurance does not legally discharge the Company from its primary liability for the full amount of the policies, and the Company is required to pay the loss and bear collection risk if the reinsurer fails to meet its obligations under the reinsurance or retrocession agreement. Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying liabilities.

**a) Credit risk**

The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- or better rated by Standard & Poor's or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. 99.6% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) at June 30, 2009 were from reinsurers rated A- or better and included \$57,224 of IBNR recoverable (December 31, 2008: \$71,580). Reinsurance recoverables by reinsurer are as follows:

|                                         | June 30, 2009              |               | December 31, 2008          |               |
|-----------------------------------------|----------------------------|---------------|----------------------------|---------------|
|                                         | Reinsurance<br>recoverable | % of<br>Total | Reinsurance<br>recoverable | % of<br>Total |
| Top 10 reinsurers                       | \$ 188,303                 | 91.3%         | \$ 198,403                 | 94.4%         |
| Other reinsurers balances > \$1 million | 12,177                     | 5.9%          | 8,987                      | 4.3%          |
| Other reinsurers balances < \$1 million | 5,810                      | 2.8%          | 2,794                      | 1.3%          |
| <b>Total</b>                            | <b>\$ 206,290</b>          | <b>100.0%</b> | <b>\$ 210,184</b>          | <b>100.0%</b> |

**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>Top 10 Reinsurers</b>        | <b>Rating</b> | <b>June 30, 2009</b>           |                   |
|---------------------------------|---------------|--------------------------------|-------------------|
|                                 |               | <b>Reinsurance recoverable</b> | <b>% of Total</b> |
| Fully collateralized reinsurers | NR            | \$ 74,131                      | 39.4%             |
| Hannover Re                     | AA-           | 33,860                         | 18.0%             |
| Lloyd's syndicates              | A+            | 28,427                         | 15.1%             |
| Allianz                         | AA            | 12,891                         | 6.9%              |
| Munich Re                       | AA-           | 12,135                         | 6.4%              |
| Swiss Re                        | A+            | 10,968                         | 5.8%              |
| Aspen                           | A             | 6,311                          | 3.4%              |
| Transatlantic Re                | A+            | 3,435                          | 1.8%              |
| Platinum Underwriters           | A             | 3,415                          | 1.8%              |
| Axa                             | AA            | 2,730                          | 1.4%              |
| <b>Total</b>                    |               | <b>\$ 188,303</b>              | <b>100.0%</b>     |

| <b>Top 10 Reinsurers</b>        | <b>Rating</b> | <b>December 31, 2008</b>       |                   |
|---------------------------------|---------------|--------------------------------|-------------------|
|                                 |               | <b>Reinsurance recoverable</b> | <b>% of Total</b> |
| Fully collateralized reinsurers | NR            | \$ 83,511                      | 41.9%             |
| Hannover Re                     | AA-           | 32,855                         | 16.6%             |
| Lloyd's syndicates              | A+            | 25,533                         | 12.9%             |
| Allianz                         | AA            | 14,988                         | 7.6%              |
| Swiss Re                        | AA-           | 13,207                         | 6.7%              |
| Munich Re                       | AA-           | 12,813                         | 6.5%              |
| Aspen                           | A             | 6,040                          | 3.0%              |
| Platinum Underwriters           | A             | 3,270                          | 1.6%              |
| Transatlantic Re                | A+            | 3,096                          | 1.6%              |
| Axa                             | AA            | 3,090                          | 1.6%              |
| <b>Total</b>                    |               | <b>\$ 198,403</b>              | <b>100.0%</b>     |

At June 30, 2009 and December 31, 2008, the provision for uncollectible reinsurance relating to losses recoverable was \$3,085, and \$3,228, respectively. To estimate the provision for uncollectible reinsurance recoverable, the reinsurance recoverable must first be allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment must be applied. As part of this process, ceded IBNR is allocated by reinsurer. Of the \$206,290 reinsurance recoverable at June 30, 2009, \$74,131 was fully collateralized (December 31, 2008: \$83,511).

The Company uses a default analysis to estimate uncollectible reinsurance. The primary components of the default analysis are reinsurance recoverable balances by reinsurer and default factors used to determine the portion of a reinsurer's balance deemed to be uncollectible. Default factors require considerable judgment and are determined using the current rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions.

***b) Collateralized quota share retrocession treaties***

On December 22, 2007, Validus Re entered into a collateralized retrocessional reinsurance agreement with an unaffiliated third party whereby the Company cedes certain business underwritten in the marine offshore energy lines. For the three months ended June 30, 2009 and 2008 Validus Re ceded \$209 and \$2,828 of premiums written through this agreement respectively. The earned portions of premiums ceded for the three months ended June 30, 2009 and 2008 were \$209 and \$3,721 respectively. For the six months ended June 30, 2009 and 2008 Validus Re

**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)

ceded \$1,099 and \$14,560 of premiums written through this agreement respectively. The earned portions of premiums ceded for the six months ended June 30, 2009 and 2008 were \$1,280 and \$6,485 respectively.

**5. Share capital****a) Authorized and issued**

The Company's authorized share capital is 571,428,571 voting and non-voting shares with a par value of \$0.175 each. The holders of common voting shares are entitled to receive dividends and are allocated one vote per share, provided that, if the controlled shares of any shareholder or group of related shareholders constitute more than 9.09 percent of the outstanding common shares of the Company, their voting power will be reduced to 9.09 percent.

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

|                                              | <b>Common shares</b> |
|----------------------------------------------|----------------------|
| Common shares outstanding, December 31, 2008 | 75,624,697           |
| Restricted share awards vested               | 246,585              |
| Employee seller shares vested                | 42,349               |
| Options exercised                            |                      |
| Warrants exercised                           | 237,842              |
| Common shares outstanding, June 30, 2009     | 76,151,473           |

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

**b) Warrants**

During the three and six months ended June 30, 2009, 728,010 warrants were exercised which resulted in the net share issuance of 237,842 common shares. During the three months ended June 30, 2008, 13,068 warrants were exercised which resulted in the net share issuance of 13,067 common shares. During the six months ended June 30, 2008, 31,580 warrants were exercised which resulted in the net share issuance of 18,980 common shares.

**c) Deferred share units**

Under the terms of the Company's Director Stock Compensation Plan, non-management directors may elect to receive their director fees in deferred share units rather than cash. The number of share units distributed in case of election under the plan is equal to the amount of the annual retainer fee otherwise payable to the director on such payment date divided by 100% of the fair market value of a share on such payment date. Additional deferred share units are issued in lieu of dividends that accrue on these deferred share units. The total outstanding deferred share units at June 30, 2009 were 4,508 (December 31, 2008: 4,430).

**d) Dividends**

On May 4, 2009, the Company announced a quarterly cash dividend of \$0.20 (2008: \$0.20) per common share and \$0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on June 30, 2009



to holders of record on June 15, 2009.

**6. Stock plans**

***a) Long-term incentive plan***

The Company's Long Term Incentive Plan ( LTIP ) provides for grants to employees of any option, stock appreciation right ( SAR ), restricted share, restricted share unit, performance share, performance unit, dividend equivalent or other share-based award. The total number of shares reserved for issuance under the LTIP is 13,126,896 shares. The LTIP is administered by the Compensation Committee of the Board of

**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)

Directors. No SARs, performance shares, performance units or dividend equivalents have been granted to date. Grant prices are established at the estimated fair market value of the Company's common shares at the date of grant.

**b) LTIP options**

Options granted under the LTIP may be exercised for voting common shares upon vesting. Options have a life of 10 years and vest ratably over five years from the date of grant. No options were granted since the year ended December 31, 2008. Grant prices are established at the estimated fair value of the Company's common shares at the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used for all grants to date:

| Year                 | Weighted average risk free interest rate | Weighted average dividend yield | Expected life (years) | Expected volatility |
|----------------------|------------------------------------------|---------------------------------|-----------------------|---------------------|
| 2007 and prior years | 4.5%                                     | 0.00%                           | 7                     | 30%                 |
| 2008                 | 3.5%                                     | 3.20%                           | 7                     | 30%                 |

Expected volatility is based on stock price volatility of comparable publicly-traded companies. The Company uses the simplified method outlined in the SEC Staff Accounting Bulletin 110 to estimate expected lives for options granted during the period as historical exercise data is not available and the options met the requirement as set out in the bulletin.

Share compensation expenses of \$918 were recorded for the three months ended June 30, 2009 (2008: \$1,068). Share compensation expenses of \$1,975 were recorded for the six months ended June 30, 2009 (2008: \$2,091). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to the options for the six months ended June 30, 2009 was as follows:

|                                        | Options   | Weighted average grant date fair value | Weighted average grant date exercise price |
|----------------------------------------|-----------|----------------------------------------|--------------------------------------------|
| Options outstanding, December 31, 2008 | 2,799,938 | \$ 7.57                                | \$ 18.23                                   |
| Options granted                        |           |                                        |                                            |
| Options exercised                      |           |                                        |                                            |
| Options forfeited                      | (6,536)   | 10.30                                  | 20.39                                      |
| Options outstanding, June 30, 2009     | 2,793,402 | \$ 7.56                                | \$ 18.22                                   |
| Options exercisable at June 30, 2009   | 1,531,092 | \$ 7.52                                | \$ 17.92                                   |

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

| Options | Weighted average grant date exercise price |
|---------|--------------------------------------------|
|         |                                            |

|                                          |           |    | <b>date fair<br/>value</b> |    |       |
|------------------------------------------|-----------|----|----------------------------|----|-------|
| Options outstanding, December 31, 2007   | 2,761,176 | \$ | 7.61                       | \$ | 17.82 |
| Options granted                          | 164,166   |    | 6.73                       |    | 24.73 |
| Options exercised                        | (112,825) |    | 7.38                       |    | 17.57 |
| Options forfeited                        | (12,579)  |    | 8.56                       |    | 18.69 |
| Options outstanding, December 31, 2008   | 2,799,938 | \$ | 7.57                       | \$ | 18.23 |
| Options exercisable at December 31, 2008 | 1,396,353 | \$ | 7.46                       | \$ | 17.63 |

At June 30, 2009, there were \$6,857 (December 31, 2008: \$9,139) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.8 years (December 31, 2008: 2.2 years).

**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)

**c) LTIP restricted shares**

Restricted shares granted under the LTIP vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of \$4,074 were recorded for the three months ended June 30, 2009 (2008: \$3,625). Share compensation expenses of \$8,386 were recorded for the six months ended June 30, 2009 (2008: \$6,567). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested restricted shares for the six months ended June 30, 2009 was as follows:

|                                                  | <b>Restricted<br/>shares</b> | <b>Weighted<br/>average<br/>grant<br/>date fair<br/>value</b> |
|--------------------------------------------------|------------------------------|---------------------------------------------------------------|
| Restricted shares outstanding, December 31, 2008 | 2,307,402                    | \$ 22.73                                                      |
| Restricted shares granted                        | 280,073                      | 24.70                                                         |
| Restricted shares vested                         | (291,328)                    | 22.00                                                         |
| Restricted shares forfeited                      | (3,989)                      | 21.29                                                         |
| Restricted shares outstanding, June 30, 2009     | 2,292,158                    | \$ 23.06                                                      |

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

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

At June 30, 2009, there were \$35,650 (December 31, 2008: \$35,915) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.8 years (December 31, 2008: 3.2 years).

**d) Employee seller shares**

Pursuant to the Share Sale Agreement for the purchase of Talbot, the Company issued 1,209,741 restricted shares to Talbot employees (the employee seller shares). Upon consummation of the acquisition, the employee seller shares were validly issued, fully-paid and non-assessable and entitled to vote and participate in distributions and dividends in accordance with the Company's Bye-laws. However, the employee seller shares are subject to a restricted period during which they are subject to forfeiture (as implemented by repurchase by the Company for a nominal amount). Forfeiture of employee seller shares will generally occur in the event that any such Talbot employee's employment

terminates, with certain exceptions, prior to the end of the restricted period. The restricted period will end for 25% of the employee seller shares on each anniversary of the closing date of July 2, 2007 for all Talbot employees other than Talbot's Chairman, such that after four years forfeiture will be completely extinguished. Share compensation expenses of \$619 were recorded for the three months ended June 30, 2009 (2008: \$2,567). Share compensation expenses of \$2,588 were recorded for the six

**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)

months ended June 30, 2009 (2008: \$5,134). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested employee seller shares for the six months ended June 30, 2009 was as follows:

|                                                       | <b>Employee seller<br/>shares</b> | <b>Weighted<br/>average<br/>grant<br/>date fair<br/>value</b> |
|-------------------------------------------------------|-----------------------------------|---------------------------------------------------------------|
| Employee seller shares outstanding, December 31, 2008 | 663,375                           | \$ 22.01                                                      |
| Employee seller shares granted                        |                                   |                                                               |
| Employee seller shares vested                         | (42,349)                          | 22.01                                                         |
| Employee seller shares forfeited                      | (3,799)                           | 22.01                                                         |
| Employee seller shares outstanding, June 30, 2009     | 617,227                           | \$ 22.01                                                      |

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

|                                                       | <b>Employee seller<br/>shares</b> | <b>Weighted<br/>average<br/>grant<br/>date fair<br/>value</b> |
|-------------------------------------------------------|-----------------------------------|---------------------------------------------------------------|
| Employee seller shares outstanding, December 31, 2007 | 1,209,741                         | \$ 22.01                                                      |
| Employee seller shares granted                        |                                   |                                                               |
| Employee seller shares vested                         | (515,103)                         | 22.01                                                         |
| Employee seller shares forfeited                      | (31,263)                          | 22.01                                                         |
| Employee seller shares outstanding, December 31, 2008 | 663,375                           | \$ 22.01                                                      |

At June 30, 2009, there were \$9,904 (December 31, 2008: \$12,157) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.0 years (December 31, 2008: 2.5 years).

**e) Restricted share units**

Restricted share units under the LTIP vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of \$21 were recorded for the three months ended June 30, 2009 (2008: \$11). Share compensation expenses of \$37 were recorded for the six months ended June 30, 2009 (2008: \$14) related to restricted share units. The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested restricted share units for the six months ended June 30, 2009 was as follows:

| <b>Restricted</b> | <b>Weighted<br/>average grant</b> |
|-------------------|-----------------------------------|
|-------------------|-----------------------------------|

|                                                       | <b>share<br/>units</b> |    | <b>date fair<br/>value</b> |
|-------------------------------------------------------|------------------------|----|----------------------------|
| Restricted share units outstanding, December 31, 2008 | 11,853                 | \$ | 25.28                      |
| Restricted share units granted                        | 4,044                  |    | 25.03                      |
| Restricted share units vested                         | (1,569)                |    | 24.84                      |
| Restricted share units forfeited                      |                        |    |                            |
| Restricted share units outstanding, June 30, 2009     | 14,328                 | \$ | 25.25                      |

**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)

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

|                                                       | <b>Restricted<br/>share<br/>Units</b> | <b>Weighted<br/>average grant<br/>date fair<br/>value</b> |
|-------------------------------------------------------|---------------------------------------|-----------------------------------------------------------|
| Restricted share units outstanding, December 31, 2007 |                                       | \$                                                        |
| Restricted share units granted                        | 11,853                                | 25.28                                                     |
| Restricted share units vested                         |                                       |                                                           |
| Restricted share units forfeited                      |                                       |                                                           |
| Restricted share units outstanding, December 31, 2008 | 11,853                                | \$ 25.28                                                  |

At June 30, 2009, there were \$282 (December 31, 2008: \$227) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 3.2 years (December 31, 2008: 4.3 years). Additional restricted share units are issued in lieu of accrued dividends from unvested restricted share units. As at June 30, 2009 restricted share units issued in lieu of dividends were 592 (December 31, 2008: 368).

**f) Share compensation expenses**

The breakdown of share compensation expenses was as follows:

|                             | <b>Three months<br/>ended<br/>June 30, 2009</b> | <b>Three months<br/>ended<br/>June 30, 2008</b> | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> |
|-----------------------------|-------------------------------------------------|-------------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| LTIP options                | \$ 918                                          | \$ 1,068                                        | \$ 1,975                                      | \$ 2,091                                      |
| LTIP restricted shares      | 4,074                                           | 3,625                                           | 8,386                                         | 6,567                                         |
| LTIP restricted share units | 21                                              | 11                                              | 37                                            | 14                                            |
| Employee seller shares      | 619                                             | 2,567                                           | 2,588                                         | 5,134                                         |
| <b>Total</b>                | <b>\$ 5,632</b>                                 | <b>\$ 7,271</b>                                 | <b>\$ 12,986</b>                              | <b>\$ 13,806</b>                              |

**7. Debt and financing arrangements****a) Financing structure and finance expenses**

The financing structure at June 30, 2009 was:

|                                                  | <b>Commitment</b>   | <b>Outstanding(1)</b> | <b>Drawn</b>      |
|--------------------------------------------------|---------------------|-----------------------|-------------------|
| 9.069% Junior Subordinated Deferrable Debentures | \$ 150,000          | \$ 150,000            | \$ 150,000        |
| 8.480% Junior Subordinated Deferrable Debentures | 200,000             | 154,300               | 154,300           |
| \$200,000 unsecured letter of credit facility    | 200,000             |                       |                   |
| \$500,000 secured letter of credit facility      | 500,000             | 276,955               |                   |
| Talbot FAL facility (2)                          | 100,000             | 100,000               |                   |
| Talbot third party FAL facility (2)              | 121,515             | 121,515               |                   |
| <b>Total</b>                                     | <b>\$ 1,271,515</b> | <b>\$ 802,770</b>     | <b>\$ 304,300</b> |





**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 financing structure at December 31, 2008 was:

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

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

(2) Talbot operates in Lloyd's through a corporate member, Talbot 2002 Underwriting Capital Ltd (T02), which is the sole participant in Syndicate 1183. Lloyd's sets T02's required capital annually based on syndicate 1183's business plan, rating environment, reserving environment together with input arising from Lloyd's discussions with, inter alia, regulatory and rating agencies. Such capital, called Funds at Lloyd's (FAL), comprises: cash, investments and undrawn letters of credit provided by various banks.

Finance expenses for the three months ended June 30, 2009, was \$10,752 (2008: \$12,762). Finance expenses for the six months ended June 30, 2009, was \$18,475 (2008: \$34,279). Finance expenses consist of interest on our junior subordinated deferrable debentures, the amortization of debt offering costs, fees relating to our credit facilities and the costs of FAL as follows:

|                                                  | <b>Three months ended</b> | <b>Three months ended</b> | <b>Six months ended</b> | <b>Six months ended</b> |
|--------------------------------------------------|---------------------------|---------------------------|-------------------------|-------------------------|
|                                                  | <b>June 30, 2009</b>      | <b>June 30, 2008</b>      | <b>June 30, 2009</b>    | <b>June 30, 2008</b>    |
| 9.069% Junior Subordinated Deferrable Debentures | \$ 3,589                  | \$ 3,589                  | \$ 7,177                | \$ 7,177                |
| 8.480% Junior Subordinated Deferrable Debentures | 3,348                     | 3,650                     | 6,696                   | 8,008                   |
| Credit facilities                                | 476                       | 123                       | 840                     | 474                     |
| Talbot letter of credit facilities               | 42                        | 62                        | 105                     | 125                     |
| Talbot other interest                            |                           | (19)                      |                         | 112                     |
| Talbot third party FAL facility                  | 3,297                     | 5,357                     | 3,657                   | 18,383                  |
| <b>Total</b>                                     | <b>\$ 10,752</b>          | <b>\$ 12,762</b>          | <b>\$ 18,475</b>        | <b>\$ 34,279</b>        |

**b) Junior subordinated deferrable debentures**

On June 15, 2006, the Company participated in a private placement of \$150,000 of junior subordinated deferrable interest debentures due 2036 (the 9.069% Junior Subordinated Deferrable Debentures). The 9.069% Junior Subordinated Deferrable Debentures mature on June 15, 2036, are redeemable at the Company's option at par

beginning June 15, 2011, and require quarterly interest payments by the Company to the holders of the 9.069% Junior Subordinated Deferrable Debentures. Interest will be payable at 9.069% per annum through June 15, 2011, and thereafter at a floating rate of three-month LIBOR plus 355 basis points, reset

**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)

quarterly. The proceeds of \$150,000 from the sale of the 9.069% Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, are being used by the Company to fund Validus Re segment operations and for general working capital purposes. Debt issuance costs of \$3,750 were deferred as an asset and are amortized to income over the five year optional redemption period.

On June 21, 2007, the Company participated in a private placement of \$200,000 of junior subordinated deferrable interest debentures due 2037 (the 8.480% Junior Subordinated Deferrable Debentures). The 8.480% Junior Subordinated Deferrable Debentures mature on June 15, 2037, are redeemable at the Company's option at par beginning June 15, 2012, and require quarterly interest payments by the Company to the holders of the 8.480% Junior Subordinated Deferrable Debentures. Interest will be payable at 8.480% per annum through June 15, 2012, and thereafter at a floating rate of three-month LIBOR plus 295 basis points, reset quarterly. The proceeds of \$200,000 from the sale of the 8.480% Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, were used by the Company to fund the purchase of Talbot Holdings Ltd. Debt issuance costs of \$2,000 were deferred as an asset and are amortized to income over the five year optional redemption period.

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

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

|                               |            |
|-------------------------------|------------|
| 2009                          | \$ 13,344  |
| 2010                          | 26,688     |
| 2011                          | 169,887    |
| 2012                          | 160,842    |
| 2013 and thereafter           |            |
| Total minimum future payments | \$ 370,761 |

**c) Credit facilities**

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

The credit facilities contain covenants that include, among other things, (i) the requirement that the Company initially maintain a minimum level of consolidated net worth of at least \$872,000, and commencing with the end of the fiscal quarter ending March 31, 2007 to be increased quarterly by an amount equal to 50% of our consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, (ii) the requirement that the Company maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00, and (iii) the requirement that Validus Re and any other material insurance subsidiaries maintain a financial strength rating by A.M. Best of not less than B++ (Fair). For purposes of covenant compliance (i) net worth is calculated with investments carried at amortized cost and (ii) consolidated total debt does not include the Company's junior subordinated deferrable debentures. The credit facilities

also contain restrictions on our ability to pay

**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)

dividends and other payments in respect of equity interests at any time that we are otherwise in default with respect to certain provisions under the credit facilities, make investments, incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others.

As of June 30, 2009 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the credit facilities.

As of June 30, 2009, we had \$276,955 in outstanding letters of credit under our five-year secured letter of credit facility (December 31, 2008: \$199,186) and no amounts were outstanding under our three-year unsecured facility (December 31, 2008: \$nil).

On October 25, 2007, the Company entered into the First Amendment to each of its Three-Year Unsecured Letter of Credit Facility Agreement, dated as of March 12, 2007 and its Five-Year Secured Letter of Credit Facility Agreement, dated as of March 12, 2007 (together, the Credit Facilities ), among the Company, Validus Reinsurance, Ltd., the Lenders party thereto, and JPMorgan Chase Bank, National Association, as administrative agent, to provide for, among other things, additional capacity to incur up to \$100,000 under a new Funds at Lloyd s Letter of Credit Facility ( FAL LoC Facility ) to support underwriting capacity provided to Talbot 2002 Underwriting Ltd through Syndicate 1183 at Lloyd s of London for the 2008 and 2009 underwriting years of account. The amendment also modifies certain provisions in the Credit Facilities in order to permit dividend payments on existing and future preferred and hybrid securities notwithstanding certain events of default.

On November 28, 2007, Talbot entered into a \$100,000 standby Letter of Credit facility (the Talbot FAL Facility ) to provide Funds at Lloyd s; this facility is guaranteed by the Company and is secured against the assets of Validus Re. The Talbot FAL Facility was provided by a syndicate of commercial banks arranged by Lloyds TSB Bank plc and ING Bank N.V., London Branch. The Talbot FAL Facility contains affirmative covenants that include, among other things, (i) the requirement that we initially maintain a minimum level of consolidated net worth of at least \$1,164,265, and commencing with the end of the fiscal quarter ending December 31, 2007 to be increased quarterly by an amount equal to 50% of our consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, and (ii) the requirement that we maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00.

The Talbot FAL Facility also contains restrictions on our ability to make investments, incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others. Other than in respect of existing and future preferred and hybrid securities, the payment of dividends and other payments in respect of equity interests are not permitted at any time that we are in default with respect to certain provisions under the credit facilities. As of June 30, 2009 the Company had \$100,000 in outstanding letters of credit under this facility and was in compliance with all covenants and restrictions.

**d) Funds at Lloyd s**

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

**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)

**8. Commitments and contingencies****a) Concentrations of credit risk**

The Company's investments are managed following prudent standards of diversification. The Company attempts to limit its credit exposure by purchasing high quality fixed income investments to maintain an average portfolio credit quality of AA- or higher with mortgage and commercial mortgage-backed issues having an aggregate weighted average credit quality of triple-A. In addition, the Company limits its exposure to any single issuer to 3% or less, excluding treasury and agency securities. The minimum credit rating of any security purchased is A-/A3 and where investments are downgraded, the Company permits a holding of up to 2% in aggregate market value, or 10% with written pre-authorization. At June 30, 2009, 4.3% of the portfolio had a split rating below A-/A3 and the Company did not have an aggregate exposure to any single issuer of more than 1.6% of our investment portfolio, other than with respect to government and agency securities.

**b) Funds at Lloyd's**

Talbot operates in Lloyd's through a corporate member, Talbot 2002 Underwriting Capital Ltd ( T02 ), which is the sole participant in Syndicate 1183. Lloyd's sets T02's required capital annually based on syndicate 1183's business plan, rating environment, reserving environment together with input arising from Lloyd's discussions with, inter alia, regulatory and rating agencies. Such capital, called Funds at Lloyd's ( FAL ), comprises: cash, investments and undrawn letters of credit provided by various banks. The amounts of cash, investments and letters of credit at June 30, 2009 amounted to \$346,750 (December 31, 2008: \$351,394).

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

|                     | <b>2009</b>         | <b>2008</b>         |
|---------------------|---------------------|---------------------|
|                     | <b>Underwriting</b> | <b>Underwriting</b> |
|                     | <b>year</b>         | <b>year</b>         |
| Talbot FAL facility | \$ 100,000          | \$ 100,000          |
| Group funds         | 246,750             | 216,483             |
| <b>Total</b>        | <b>\$ 346,750</b>   | <b>\$ 316,483</b>   |

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

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

**c) Lloyd's central fund**

Whenever a member of Lloyd's is unable to pay its debts to policyholders, such debts may be payable by the Lloyd's central fund. If Lloyd's determines that the central fund needs to be increased, it has the power to assess premium levies on current Lloyd's members up to 3% of a member's underwriting capacity in any one year. The Company does not believe that any assessment is likely in the foreseeable future and has not provided any allowance for such an assessment. However, based on the Company's 2009 estimated premium income at Lloyd's of £400,000, the June 30, 2009 exchange rate of £1 equals \$1.65 and assuming the maximum 3% assessment the Company would be assessed approximately \$19,800.

**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)

**9. Related party transactions**

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

- a) The Company entered into an agreement on December 8, 2005 with BlackRock Financial Management, Inc. ( BlackRock ) under which BlackRock was appointed as an investment manager of part of Company s investment portfolio. Merrill Lynch is a shareholder of Blackrock. Merrill Lynch entities, which are now wholly-owned subsidiaries of Bank of America Corp, own 6,134,530 non-voting shares in the Company, hold warrants to purchase 1,067,187 shares and have an employee on the Company s Board of Directors who does not receive compensation from the Company. Merrill Lynch s warrants are convertible to non-voting shares. Under the terms of the investment manager agreement with Blackrock, the Company incurred expenses of \$527 during the three months ended June 30, 2009 (2008: \$613) and \$978 during the six months ended June 30, 2009 (2008: \$1,223), of which \$896 was included in accounts payable and accrued expenses at June 30, 2009 (December 31, 2008: \$584).
- b) The Company entered into an agreement on December 8, 2005 with Goldman Sachs Asset Management and its affiliates ( GSAM ) under which GSAM was appointed as an investment manager of part of the Company s investment portfolio. Goldman Sachs entities, own 14,057,137 non-voting shares in the Company, hold warrants to purchase 1,604,410 non-voting shares, and have an employee on the Company s Board of Directors who does not receive compensation from the Company. The Company incurred expenses of \$368 during the three months ended June 30, 2009 (2008: \$364) and \$726 during the six months ended June 30, 2009 (2008: \$747), of which \$310 was included in accounts payable and accrued expenses at June 30, 2009 (December 31, 2008: \$641).
- c) Vestar Capital entities, which own 8,571,427 shares in the Company, hold warrants to purchase 972,810 shares, are shareholders of PARIS RE Holdings Limited ( Paris Re ), and have an employee on the Company s Board of Directors who does not receive compensation from the Company. Pursuant to reinsurance agreements with Paris Re, the Company recognized gross premiums written of \$28 during the three months ended June 30, 2009 (2008: \$nil) and \$6,634 during the six months ended June 30, 2009 (2008: \$6,079), of which \$6,986 was included in premiums receivable at June 30, 2009 (December 31, 2008: \$4,412). The earned premium adjustments of \$1,710 (2008: \$776) and \$3,416 (2008: \$1,553) was recorded for the three and six months ended June 30, 2009, respectively.
- d) Aquiline Capital Partners, LLC and its related companies ( Aquiline ), which own 6,886,342 shares in the Company, hold warrants to purchase 3,193,865 shares, and have three employees on the Board of Directors who do not receive compensation from the Company, are shareholders of Group Ark Insurance Holdings Ltd. ( Group Ark ). Pursuant to reinsurance agreements with Group Ark, the Company recognized \$nil (2008: \$nil) of gross premiums written and \$nil (2008: \$nil) of reinsurance premiums ceded during the three months ended June 30, 2009 and recognized \$nil (2008: \$688) of gross premiums written and \$800 (2008: \$1.098) of reinsurance premiums ceded during the six months ended June 30, 2009, of which \$500 was included in reinsurance balances payable at June 30, 2009 (December 31, 2008: \$60).
- e) Certain members of the Company s management and staff have provided guarantees to 1384 Capital Ltd, a company formed to indirectly facilitate the provision of Funds at Lloyd s ( FAL ). The Company paid \$115 of finance expenses to such management and staff in respect of such provision of FAL for the three months ended June 30, 2009 (2008: \$182) and \$143 for the six months ended June 30, 2009 (2008: \$579), all of which was included in accounts payable and accrued expenses at June 30, 2009 (December 31, 2008: \$803). An amount of \$nil was included in general and administrative expenses in respect of the reimbursement of expenses relating to such FAL provision for the three months ended June 30, 2009 (2008: \$nil). An amount of \$16 was included in general and administrative expenses in respect of the reimbursement of expenses relating to such FAL provision



for the six months ended June 30, 2009 (2008: \$2).

**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)

**10. Earnings per share**

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

|                                                                    | <b>Three months<br/>ended<br/>June 30,<br/>2009</b> | <b>Three months<br/>ended<br/>June 30,<br/>2008</b> | <b>Six months<br/>ended<br/>June 30,<br/>2009</b> | <b>Six months<br/>ended<br/>June 30,<br/>2008</b> |
|--------------------------------------------------------------------|-----------------------------------------------------|-----------------------------------------------------|---------------------------------------------------|---------------------------------------------------|
| <b>Basic earnings (loss) per share</b>                             |                                                     |                                                     |                                                   |                                                   |
| Net income                                                         | \$ 137,563                                          | \$ 75,921                                           | \$ 232,470                                        | \$ 142,396                                        |
| Less: Dividends and distributions declared on outstanding warrants | (1,590)                                             | (1,739)                                             | (3,326)                                           | (3,478)                                           |
| Net income available to common shareholders                        | \$ 135,973                                          | \$ 74,182                                           | \$ 229,144                                        | \$ 138,918                                        |
| Weighted average shares basic common shares outstanding            | 76,138,038                                          | 74,233,425                                          | 75,941,308                                        | 74,221,398                                        |
| Basic earnings per share                                           | \$ 1.79                                             | \$ 1.00                                             | 3.02                                              | \$ 1.87                                           |
| <b>Diluted earnings (loss) per share</b>                           |                                                     |                                                     |                                                   |                                                   |
| Net income                                                         | \$ 137,563                                          | \$ 75,921                                           | \$ 232,470                                        | \$ 142,396                                        |
| Less: Dividends and distributions declared on outstanding warrants |                                                     |                                                     |                                                   |                                                   |
| Net income available to common shareholders                        | \$ 137,563                                          | \$ 75,921                                           | \$ 232,470                                        | \$ 142,396                                        |
| Weighted average shares basic common shares outstanding            | 76,138,038                                          | 74,233,425                                          | 75,941,308                                        | 74,221,398                                        |
| Share equivalents:                                                 |                                                     |                                                     |                                                   |                                                   |
| Warrants                                                           | 1,806,372                                           | 1,631,819                                           | 2,056,733                                         | 2,074,835                                         |
| Stock options                                                      | 300,405                                             | 32,894                                              | 333,955                                           | 171,366                                           |
| Unvested restricted shares                                         | 697,250                                             | 1,359,407                                           | 690,359                                           | 1,326,037                                         |
| Weighted average shares diluted common shares outstanding          | 78,942,065                                          | 77,257,545                                          | 79,022,355                                        | 77,793,636                                        |

|                            |    |      |    |      |    |      |    |      |
|----------------------------|----|------|----|------|----|------|----|------|
| Diluted earnings per share | \$ | 1.74 | \$ | 0.98 | \$ | 2.94 | \$ | 1.83 |
|----------------------------|----|------|----|------|----|------|----|------|

Share equivalents that would result in the issuance of common shares of 198,500 and 192,534 were outstanding for the three months ended June 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive. Share equivalents that would result in the issuance of common shares of 179,713 and 63,021 were outstanding for the six months ended June 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

**11. Subsequent Event**

On July 9, 2009, the Company, Validus Ltd. (a wholly owned subsidiary of the Company) and IPC Holdings, Ltd. ( IPC ) entered into an Agreement and Plan of Amalgamation (the Amalgamation Agreement ), pursuant to which, subject to the terms and conditions therein, Validus Ltd. will amalgamate with IPC (the Amalgamation ). After the effective time of the Amalgamation, the IPC s shareholders will have the right to receive 0.9727 Validus voting common shares, par value \$0.175 per share, \$7.50 in cash, less any applicable withholding tax and without interest, and cash in lieu of fractional shares in exchange for each common share of IPC they hold, unless they exercise appraisal rights.

**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 closing of the Amalgamation is subject to customary closing conditions, including the Company and IPC shareholder approvals. Aquiline Capital Partners LLC, Vestar Capital Partners, and New Mountain Capital, LLC, which collectively owned approximately 38% of Validus' outstanding voting common shares as of July 27, 2009, have agreed to vote in favor of the issuance of Validus shares in connection with the transaction. Upon closing of the transaction, the Company's current shareholders will own approximately 62% of the combined company on a fully diluted basis, with IPC shareholders owning approximately 38%.

The boards of directors of both the Company and IPC have adopted the Amalgamation Agreement, and have deemed it fair, advisable and in the best interests of their respective companies and shareholders to enter into the Amalgamation Agreement and to consummate the transactions contemplated thereby.

The Amalgamation Agreement contains specified termination rights for the parties. The Amalgamation Agreement also provides that, if the Amalgamation Agreement is terminated under certain circumstances, the Company will be required to pay IPC a termination fee of \$16,000 or IPC will be required to pay the Company a termination fee of \$16,000.

On the same day as the execution and delivery of the Amalgamation Agreement, (1) IPC paid to Max Capital Ltd. (Max) \$50,000 in respect of the termination fee under its amalgamation agreement with Max, and (2) Validus paid to IPC \$50,000 in respect of and in reliance upon such payment by IPC to Max. In certain circumstances more fully described in the Amalgamation Agreement, IPC will be required to repay such amount to Validus in the event the Amalgamation Agreement is terminated.

A copy of the Amalgamation Agreement is referenced as Exhibit 10.1 hereto and is incorporated herein by reference. The description herein of the Amalgamation Agreement and the transactions contemplated thereby is not complete and is qualified in its entirety by reference to Amalgamation Agreement.

The Amalgamation Agreement has been included to provide investors and security holders with information regarding its terms. It is not intended to provide any other factual information about the Company, Validus Ltd., IPC or any of their respective subsidiaries or affiliates. The representations, warranties and covenants contained in the Amalgamation Agreement were made only for purposes of that agreement and as of specific dates; were solely for the benefit of the parties to the Amalgamation Agreement; may be subject to limitations agreed upon by the contracting parties, including being qualified by confidential disclosures made for the purposes of allocating contractual risk between the parties to the Amalgamation Agreement instead of establishing these matters as facts (such disclosures include information that has been included in IPC's and the Company's public disclosures, as well as additional non-public information); and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to investors. Investors are not third party beneficiaries under the Amalgamation Agreement (except for the right to receive the transaction consideration from and after the consummation of the Amalgamation) and should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or condition of IPC, the Company or Validus Ltd. or any of their respective subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations, warranties and covenants may change after the date of the Amalgamation Agreement, which subsequent information may or may not be fully reflected in the Company's public disclosures.

In connection with the signing of the Amalgamation Agreement, the Company has withdrawn and terminated its exchange offer for all of the outstanding common shares of IPC and has instructed BNY Mellon Shareowner Services to promptly return all IPC common shares previously tendered to the Company. Additionally, the Company has terminated its solicitation efforts in connection with its other previously announced alternative steps to complete a transaction with IPC, including a scheme of arrangement and calling of a special meeting of IPC shareholders.

On August 6, 2009, the Company filed with the SEC and announced that it will begin mailing, a joint proxy statement/prospectus in connection with the Amalgamation. The Company's special general meeting of shareholders

will be held on September 4, 2009. The Company expects the Amalgamation to close promptly following the receipt of the Company's and IPC's shareholder approvals, subject to the satisfaction or waiver of all closing conditions.

**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)

On July 24, 2009, the Company announced that it has entered into the Second Amendment to each of its \$500,000 five-year secured letter of credit facility and \$200,000 three-year unsecured facility, and the First Amendment to its \$100,000 Talbot FAL facility to amend a specific investment restriction clause to permit the completion of the IPC amalgamation agreement. The amendment also modifies and updates certain pricing and covenant terms.

The Company has evaluated subsequent events from the balance sheet date through to August 7, 2009.

**12. Segment information**

The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. and Talbot Holdings Ltd. from which two operating segments have been determined under FAS 131, Disclosures about Segments of and Enterprise and Related Information. The Company's operating segments are strategic business units that offer different products and services. They are managed and have capital allocated separately because each business requires different strategies.

**Validus Re**

The Validus Re segment is focused on short-tail lines of reinsurance. The primary lines in which the segment conducts business are property, marine and specialty which includes agriculture, aerospace, nuclear, terrorism, life and accident & health and workers' compensation catastrophe.

**Talbot**

The Talbot segment focuses on a wide range of marine and energy, war, political violence, commercial property, financial institutions, contingency, bloodstock & livestock, accident & health classes of business on an insurance or facultative reinsurance basis. Principally property, aerospace and marine classes of business on a treaty reinsurance basis.

**Corporate and other reconciling items**

The Company has a Corporate function, which includes the activities of the parent company, and which carries out functions for the group. Corporate also denotes the activities of certain key executives such as the Chief Executive Officer and Chief Financial Officer. The only revenue earned by Corporate is a minor amount of interest income that is incidental to the activities of the enterprise. For internal reporting purposes, Corporate is reflected separately as a business unit, however Corporate is not considered an operating segment under these circumstances and FAS 131. Other reconciling items include, but are not limited to, the elimination of intersegment revenues and expenses and unusual items that are not allocated to segments.

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

| <b><u>Three months ended June 30, 2009</u></b> | <b>Validus Re</b> | <b>Talbot</b>    | <b>Corporate<br/>and<br/>other<br/>reconciling<br/>items</b> | <b>Total</b>      |
|------------------------------------------------|-------------------|------------------|--------------------------------------------------------------|-------------------|
| Gross premiums written                         | \$ 199,560        | \$ 235,113       | \$ (9,641)                                                   | \$ 425,032        |
| Reinsurance premiums ceded                     | (43,070)          | (28,862)         | 9,641                                                        | (62,291)          |
| Net premiums written                           | 156,490           | 206,251          |                                                              | 362,741           |
| Change in unearned premiums                    | 7,207             | (41,748)         |                                                              | (34,541)          |
| Net premiums earned                            | 163,697           | 164,503          |                                                              | 328,200           |
| Losses and loss expenses                       | 41,121            | 83,630           |                                                              | 124,751           |
| Policy acquisition costs                       | 29,120            | 36,114           | (796)                                                        | 64,438            |
| General and administrative expenses            | 14,149            | 21,927           | 5,124                                                        | 41,200            |
| Share compensation expenses                    | 1,548             | 2,098            | 1,986                                                        | 5,632             |
| <b>Underwriting income (loss)</b>              | <b>\$ 77,759</b>  | <b>\$ 20,734</b> | <b>\$ (6,314)</b>                                            | <b>\$ 92,179</b>  |
| Net investment income                          | 20,783            | 7,693            | (1,513)                                                      | 26,963            |
| Net realized (losses) on investments           | (2,140)           | (510)            |                                                              | (2,650)           |
| Net unrealized gains on investments            | 35,793            | 1,456            |                                                              | 37,249            |
| Foreign exchange gains                         | 1,827             | 6,549            | 56                                                           | 8,432             |
| Other income (expenses)                        | 902               | 911              | (796)                                                        | 1,017             |
| Finance expenses                               | (477)             | (3,339)          | (6,936)                                                      | (10,752)          |
| Transaction expenses                           |                   |                  | (15,851)                                                     | (15,851)          |
| <b>Net income (loss) before taxes</b>          | <b>134,447</b>    | <b>33,494</b>    | <b>(31,354)</b>                                              | <b>136,587</b>    |
| Income tax (expenses) benefit                  | (28)              | 1,004            |                                                              | 976               |
| <b>Net income (loss)</b>                       | <b>\$ 134,419</b> | <b>\$ 34,498</b> | <b>\$ (31,354)</b>                                           | <b>\$ 137,563</b> |
| Loss and loss expense ratio (1)                | 25.1%             | 50.8%            |                                                              | 38.0%             |
| Policy acquisition cost ratio(1)               | 17.8%             | 22.0%            |                                                              | 19.6%             |
| General and administrative expense ratio(1)    | 9.6%              | 14.6%            |                                                              | 14.3%             |

|                          |              |              |          |              |
|--------------------------|--------------|--------------|----------|--------------|
| Expense ratio            | 27.4%        | 36.6%        |          | 33.9%        |
| <b>Combined ratio(1)</b> | 52.5%        | 87.4%        |          | 71.9%        |
| <b>Total assets</b>      | \$ 3,013,433 | \$ 1,988,037 | \$ 6,980 | \$ 5,008,450 |

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



**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><u>Three months ended June 30, 2008</u></b> | <b>Validus Re</b> | <b>Talbot</b>    | <b>Corporate<br/>and<br/>other<br/>reconciling<br/>items</b> | <b>Total</b>     |
|------------------------------------------------|-------------------|------------------|--------------------------------------------------------------|------------------|
| Gross premiums written                         | \$ 187,820        | \$ 197,235       | \$ (5,136)                                                   | \$ 379,919       |
| Reinsurance premiums ceded                     | (1,208)           | (5,327)          | 5,136                                                        | (1,399)          |
| Net premiums written                           | 186,612           | 191,908          |                                                              | 378,520          |
| Change in unearned premiums                    | (22,500)          | (46,722)         |                                                              | (69,222)         |
| Net premiums earned                            | 164,112           | 145,186          |                                                              | 309,298          |
| Losses and loss expenses                       | 48,677            | 73,412           |                                                              | 122,089          |
| Policy acquisition costs                       | 25,309            | 31,134           | (24)                                                         | 56,419           |
| General and administrative expenses            | 9,955             | 19,787           | 4,170                                                        | 33,912           |
| Share compensation expenses                    | 1,597             | 1,126            | 4,548                                                        | 7,271            |
| <b>Underwriting income (loss)</b>              | <b>\$ 78,574</b>  | <b>\$ 19,727</b> | <b>\$ (8,694)</b>                                            | <b>\$ 89,607</b> |
| Net investment income                          | 25,725            | 11,726           | (1,016)                                                      | 36,435           |
| Realized gain on repurchase of debentures      |                   |                  | 8,752                                                        | 8,752            |
| Net realized (losses) gains on investments     | (3,260)           | 835              |                                                              | (2,425)          |
| Net unrealized (losses) on investments         | (24,059)          | (18,923)         |                                                              | (42,982)         |
| Foreign exchange (losses) gains                | (403)             | 1,314            |                                                              | 911              |
| Other income (expenses)                        | 24                | 1,462            | (24)                                                         | 1,462            |
| Finance expenses                               | (88)              | (5,400)          | (7,274)                                                      | (12,762)         |
| <b>Net income (loss) before taxes</b>          | <b>76,513</b>     | <b>10,741</b>    | <b>(8,256)</b>                                               | <b>78,998</b>    |
| Income tax (expenses)                          | (20)              | (3,057)          |                                                              | (3,077)          |
| <b>Net income (loss)</b>                       | <b>\$ 76,493</b>  | <b>\$ 7,684</b>  | <b>\$ (8,256)</b>                                            | <b>\$ 75,921</b> |
| Loss and loss expense ratio (1)                | 29.7%             | 50.6%            |                                                              | 39.5%            |
| Policy acquisition cost ratio(1)               | 15.4%             | 21.4%            |                                                              | 18.2%            |
| General and administrative expense ratio(1)    | 7.0%              | 14.4%            |                                                              | 13.3%            |
| Expense ratio                                  | 22.4%             | 35.8%            |                                                              | 31.5%            |

|                          |              |              |          |              |
|--------------------------|--------------|--------------|----------|--------------|
| <b>Combined ratio(1)</b> | 52.1%        | 86.4%        |          | 71.0%        |
| <b>Total assets</b>      | \$ 2,784,016 | \$ 1,781,576 | \$ 4,150 | \$ 4,569,742 |

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

**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><u>Six months ended June 30, 2009</u></b> | <b>Validus Re</b> | <b>Talbot</b>    | <b>Corporate<br/>and<br/>other<br/>reconciling<br/>items</b> | <b>Total</b>      |
|----------------------------------------------|-------------------|------------------|--------------------------------------------------------------|-------------------|
| Gross premiums written                       | \$ 609,686        | \$ 463,033       | \$ (37,795)                                                  | \$ 1,034,924      |
| Reinsurance premiums ceded                   | (56,359)          | (116,239)        | 37,795                                                       | (134,803)         |
| Net premiums written                         | 553,327           | 346,794          |                                                              | 900,121           |
| Change in unearned premiums                  | (215,183)         | (37,979)         |                                                              | (253,162)         |
| Net premiums earned                          | 338,144           | 308,815          |                                                              | 646,959           |
| Losses and loss expenses                     | 96,583            | 160,002          |                                                              | 256,585           |
| Policy acquisition costs                     | 57,697            | 69,271           | (1,081)                                                      | 125,887           |
| General and administrative expenses          | 27,941            | 42,141           | 9,197                                                        | 79,279            |
| Share compensation expenses                  | 3,220             | 4,433            | 5,333                                                        | 12,986            |
| <b>Underwriting income (loss)</b>            | <b>\$ 152,703</b> | <b>\$ 32,968</b> | <b>\$ (13,449)</b>                                           | <b>\$ 172,222</b> |
| Net investment income                        | 41,569            | 15,187           | (3,021)                                                      | 53,735            |
| Net realized (losses) on investments         | (19,679)          | (6,392)          |                                                              | (26,071)          |
| Net unrealized gains on investments          | 54,800            | 4,602            |                                                              | 59,402            |
| Foreign exchange (losses) gains              | (1,380)           | 5,556            | 56                                                           | 4,232             |
| Other income (expenses)                      | 1,187             | 1,668            | (1,081)                                                      | 1,774             |
| Finance expenses                             | (840)             | (3,762)          | (13,873)                                                     | (18,475)          |
| Transaction expenses                         |                   |                  | (15,851)                                                     | (15,851)          |
| <b>Net income (loss) before taxes</b>        | <b>228,360</b>    | <b>49,827</b>    | <b>(47,219)</b>                                              | <b>230,968</b>    |
| Income tax (expenses) benefit                | (66)              | 1,568            |                                                              | 1,502             |
| <b>Net income (loss)</b>                     | <b>\$ 228,294</b> | <b>\$ 51,395</b> | <b>\$ (47,219)</b>                                           | <b>\$ 232,470</b> |
| Loss and loss expense ratio (1)              | 28.6%             | 51.8%            |                                                              | 39.7%             |
| Policy acquisition cost ratio(1)             | 17.1%             | 22.4%            |                                                              | 19.5%             |
| General and administrative expense ratio(1)  | 9.2%              | 15.1%            |                                                              | 14.3%             |
| Expense ratio                                | 26.3%             | 37.5%            |                                                              | 33.8%             |

|                          |              |              |          |              |
|--------------------------|--------------|--------------|----------|--------------|
| <b>Combined ratio(1)</b> | 54.9%        | 89.3%        |          | 73.5%        |
| <b>Total assets</b>      | \$ 3,013,433 | \$ 1,988,037 | \$ 6,980 | \$ 5,008,450 |

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

**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><u>Six months ended June 30, 2008</u></b> | <b>Validus Re</b> | <b>Talbot</b>    | <b>Corporate<br/>and<br/>Other<br/>reconciling<br/>items</b> | <b>Total</b>      |
|----------------------------------------------|-------------------|------------------|--------------------------------------------------------------|-------------------|
| Gross premiums written                       | \$ 518,869        | \$ 399,028       | \$ (16,384)                                                  | \$ 901,513        |
| Reinsurance premiums ceded                   | (24,951)          | (77,732)         | 16,384                                                       | (86,299)          |
| Net premiums written                         | 493,918           | 321,296          |                                                              | 815,214           |
| Change in unearned premiums                  | (186,151)         | (27,901)         |                                                              | (214,052)         |
| Net premiums earned                          | 307,767           | 293,395          |                                                              | 601,162           |
| Losses and loss expenses                     | 107,591           | 154,522          |                                                              | 262,113           |
| Policy acquisition costs                     | 45,712            | 67,432           | (24)                                                         | 113,120           |
| General and administrative expenses          | 19,334            | 40,710           | 10,975                                                       | 71,019            |
| Share compensation expenses                  | 2,823             | 2,102            | 8,881                                                        | 13,806            |
| <b>Underwriting income (loss)</b>            | <b>\$ 132,307</b> | <b>\$ 28,629</b> | <b>\$ (19,832)</b>                                           | <b>\$ 141,104</b> |
| Net investment income                        | 50,752            | 22,708           | (982)                                                        | 72,478            |
| Net realized (losses) gains on investments   | (1,183)           | 6,502            |                                                              | 5,319             |
| Net unrealized (losses) on investments       | (42,671)          | (15,288)         |                                                              | (57,959)          |
| Realized gain on repurchase of debentures    |                   |                  | 8,752                                                        | 8,752             |
| Foreign exchange gains                       | 7,272             | 1,818            |                                                              | 9,090             |
| Other income (expenses)                      | 24                | 2,397            | (24)                                                         | 2,397             |
| Finance expenses                             | (442)             | (18,620)         | (15,217)                                                     | (34,279)          |
| <b>Net income (loss) before taxes</b>        | <b>146,059</b>    | <b>28,146</b>    | <b>(27,303)</b>                                              | <b>146,902</b>    |
| Income tax (expenses)                        | (48)              | (4,458)          |                                                              | (4,506)           |
| <b>Net income (loss)</b>                     | <b>\$ 146,011</b> | <b>\$ 23,688</b> | <b>\$ (27,303)</b>                                           | <b>\$ 142,396</b> |
| Loss and loss expense ratio (1)              | 35.0%             | 52.7%            |                                                              | 43.6%             |
| Policy acquisition cost ratio(1)             | 14.9%             | 23.0%            |                                                              | 18.8%             |
| General and administrative expense ratio(1)  | 7.1%              | 14.6%            |                                                              | 14.1%             |
| Expense ratio                                | 22.0%             | 37.6%            |                                                              | 32.9%             |

|                          |              |              |          |              |
|--------------------------|--------------|--------------|----------|--------------|
| <b>Combined ratio(1)</b> | 57.0%        | 90.3%        |          | 76.5%        |
| <b>Total assets</b>      | \$ 2,784,016 | \$ 1,781,576 | \$ 4,150 | \$ 4,569,742 |

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

**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 exposures are generally diversified across geographic zones. The following tables set forth the gross premiums written allocated to the territory of coverage exposure for the periods indicated:

| <b>Three months ended June 30, 2009</b> |                       |                   |                     |                   |               |
|-----------------------------------------|-----------------------|-------------------|---------------------|-------------------|---------------|
| <b>Gross premiums written</b>           |                       |                   |                     |                   |               |
|                                         | <b>Validus<br/>Re</b> | <b>Talbot</b>     | <b>Eliminations</b> | <b>Total</b>      | <b>%</b>      |
| United States                           | \$ 127,975            | \$ 24,480         | \$ (259)            | \$ 152,196        | 35.8%         |
| Worldwide excluding United States       |                       |                   |                     |                   |               |
| (1)                                     | 12,445                | 67,581            | (1,593)             | 78,433            | 18.4%         |
| Europe                                  | 6,126                 | 17,595            | (551)               | 23,170            | 5.5%          |
| Latin America and Caribbean             | 7,900                 | 15,646            | (6,631)             | 16,915            | 4.0%          |
| Japan                                   | 15,500                | 3,256             |                     | 18,756            | 4.4%          |
| Canada                                  | 112                   | 2,219             | (112)               | 2,219             | 0.5%          |
| Sub-total, non United States            | 42,083                | 106,297           | (8,887)             | 139,493           | 32.8%         |
| Worldwide including United States       |                       |                   |                     |                   |               |
| (1)                                     | 19,557                | 16,461            | (393)               | 35,625            | 8.4%          |
| Marine and Aerospace (2)                | 9,945                 | 87,875            | (102)               | 97,718            | 23.0%         |
| <b>Total</b>                            | <b>\$ 199,560</b>     | <b>\$ 235,113</b> | <b>\$ (9,641)</b>   | <b>\$ 425,032</b> | <b>100.0%</b> |

| <b>Three months ended June 30, 2008</b> |                       |               |                     |              |          |
|-----------------------------------------|-----------------------|---------------|---------------------|--------------|----------|
| <b>Gross premiums written</b>           |                       |               |                     |              |          |
|                                         | <b>Validus<br/>Re</b> | <b>Talbot</b> | <b>Eliminations</b> | <b>Total</b> | <b>%</b> |
| United States                           | \$ 132,341            | \$ 18,347     | \$ (5,136)          | \$ 145,552   | 38.3%    |
| Worldwide excluding United States       |                       |               |                     |              |          |
| (1)                                     | 662                   | 58,939        |                     | 59,601       | 15.7%    |
| Europe                                  | 5,391                 | 15,343        |                     | 20,734       | 5.5%     |
| Latin America and Caribbean             | 1,264                 | 9,727         |                     | 10,991       | 2.9%     |
| Japan                                   | 9,093                 | 2,335         |                     | 11,428       | 3.0%     |
| Canada                                  |                       | 3,095         |                     | 3,095        | 0.8%     |
| Sub-total, non United States            | 16,410                | 89,439        |                     | 105,849      | 27.9%    |
| Worldwide including United States       |                       |               |                     |              |          |
| (1)                                     | 29,632                | 21,226        |                     | 50,858       | 13.4%    |
| Marine and Aerospace (2)                | 9,437                 | 68,223        |                     | 77,660       | 20.4%    |

|              |            |            |            |            |        |
|--------------|------------|------------|------------|------------|--------|
| <b>Total</b> | \$ 187,820 | \$ 197,235 | \$ (5,136) | \$ 379,919 | 100.0% |
|--------------|------------|------------|------------|------------|--------|

**Six months ended June 30, 2009****Gross premiums written**

|                                   | <b>Validus<br/>Re</b> | <b>Talbot</b> | <b>Eliminations</b> | <b>Total</b> | <b>%</b> |
|-----------------------------------|-----------------------|---------------|---------------------|--------------|----------|
| United States                     | \$ 284,859            | \$ 46,893     | \$ (5,087)          | \$ 326,665   | 31.6%    |
| Worldwide excluding United States |                       |               |                     |              |          |
| (1)                               | 40,214                | 127,191       | (9,282)             | 158,123      | 15.3%    |
| Europe                            | 47,358                | 37,908        | (3,213)             | 82,053       | 7.9%     |
| Latin America and Caribbean       | 20,119                | 32,596        | (14,893)            | 37,822       | 3.6%     |
| Japan                             | 16,707                | 3,707         |                     | 20,414       | 2.0%     |
| Canada                            | 652                   | 6,378         | (652)               | 6,378        | 0.6%     |
| Sub-total, non United States      | 125,050               | 207,780       | (28,040)            | 304,790      | 29.4%    |
| Worldwide including United States |                       |               |                     |              |          |
| (1)                               | 54,251                | 31,062        | (2,287)             | 83,026       | 8.0%     |
| Marine and Aerospace (2)          | 145,526               | 177,298       | (2,381)             | 320,443      | 31.0%    |
| <b>Total</b>                      | \$ 609,686            | \$ 463,033    | \$ (37,795)         | \$ 1,034,924 | 100.0%   |



**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>Six months ended June 30, 2008</b> |                   |                     |                   |               |
|---------------------------------------|---------------------------------------|-------------------|---------------------|-------------------|---------------|
|                                       | <b>Gross premiums written</b>         |                   |                     |                   |               |
|                                       | <b>Validus<br/>Re</b>                 | <b>Talbot</b>     | <b>Eliminations</b> | <b>Total</b>      | <b>%</b>      |
| United States                         | \$ 260,193                            | \$ 37,078         | \$ (16,384)         | \$ 280,887        | 31.1%         |
| Worldwide excluding United States     |                                       |                   |                     |                   |               |
| (1)                                   | 26,541                                | 117,236           |                     | 143,777           | 15.9%         |
| Europe                                | 39,734                                | 31,010            |                     | 70,744            | 7.8%          |
| Latin America and Caribbean           | 5,635                                 | 15,527            |                     | 21,162            | 2.3%          |
| Japan                                 | 9,448                                 | 2,898             |                     | 12,346            | 1.4%          |
| Canada                                |                                       | 5,715             |                     | 5,715             | 0.6%          |
| Sub-total, non United States          | 81,358                                | 172,386           |                     | 253,744           | 28.0%         |
| Worldwide including United States (1) | 64,912                                | 37,272            |                     | 102,184           | 11.3%         |
| Marine and Aerospace (2)              | 112,406                               | 152,292           |                     | 264,698           | 29.6%         |
| <b>Total</b>                          | <b>\$ 518,869</b>                     | <b>\$ 399,028</b> | <b>\$ (16,384)</b>  | <b>\$ 901,513</b> | <b>100.0%</b> |

(1) Represents risks in two or more geographic zones.

(2) Not classified as geographic area as marine and aerospace risks can span multiple geographic areas and are not fixed locations in some instances.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following is a discussion and analysis of the Company's consolidated results of operations for the three and six months ended June 30, 2009 and 2008 and the Company's consolidated financial condition and liquidity and capital resources at June 30, 2009 and December 31, 2008. This discussion and analysis should be read in conjunction with the audited consolidated financial statements and related notes for the fiscal year ended December 31, 2008, the discussions of critical accounting policies and the qualitative and quantitative disclosure about market risk contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

The Company was formed on October 19, 2005 and completed the acquisition of Talbot Holdings Ltd. (Talbot) on July 2, 2007. For a variety of reasons, the Company's historical financial results may not accurately indicate future performance. See Cautionary Note Regarding Forward-Looking Statements. The Risk Factors set forth in Item 1A of the Annual Report on Form 10-K for the fiscal year ended December 31, 2008 present a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained herein.

**Executive Overview**

The Company underwrites from two distinct global operating subsidiaries, Validus Re and Talbot. Validus Re, the Company's principal reinsurance operating subsidiary, operates as a Bermuda-based provider of short-tail reinsurance products on a global basis. Talbot, the Company's principal insurance operating subsidiary, operates through its two underwriting platforms: Talbot Underwriting Ltd, which manages Syndicate 1183 at Lloyd's of London (Lloyd's) which writes short-tail insurance products on a worldwide basis, and Underwriting Risk Services Ltd, which is an underwriting agency writing primarily yachts and onshore energy business on behalf of the Talbot syndicate and others.

The Company's strategy is to concentrate primarily on short-tail risks, which is an area where management believes current prices and terms provide an attractive risk adjusted return and the management team has proven expertise. The Company's profitability in any given period is based upon premium and investment revenues less net losses and loss expenses, acquisition expenses and operating expenses. Financial results in the insurance and reinsurance industry are influenced by the frequency and/or severity of claims and losses, including as a result of catastrophic events, changes in interest rates, financial markets and general economic conditions, the supply of insurance and reinsurance capacity and changes in legal, regulatory and judicial environments.

On July 9, 2009, the Company, Validus Ltd. (a wholly owned subsidiary of the Company) and IPC Holdings, Ltd. (IPC) entered into an Agreement and Plan of Amalgamation (the Amalgamation Agreement), pursuant to which, subject to the terms and conditions therein, Validus Ltd. will amalgamate with IPC (the Amalgamation). After the effective time of the Amalgamation, the IPC's shareholders will have the right to receive 0.9727 the Company's voting common shares, par value \$0.175 per share, \$7.50 in cash, less any applicable withholding tax and without interest, and cash in lieu of fractional shares in exchange for each common share of IPC they hold, unless they exercise appraisal rights.

The closing of the Amalgamation is subject to customary closing conditions, including the Company and IPC shareholder approvals. Aquiline Capital Partners LLC, Vestar Capital Partners, and New Mountain Capital, LLC, which collectively owned approximately 38% of the Company's outstanding voting common shares as of July 27, 2009, have agreed to vote in favor of the issuance of the Company's shares in connection with the transaction. Upon closing of the transaction, the Company's current shareholders will own approximately 62% of the combined company on a fully diluted basis, with IPC shareholders owning approximately 38%.

The boards of directors of both the Company and IPC have adopted the Amalgamation Agreement, and have deemed it fair, advisable and in the best interests of their respective companies and shareholders to enter into the Amalgamation Agreement and to consummate the transactions contemplated thereby.

**Table of Contents**

The Amalgamation Agreement contains specified termination rights for the parties. The Amalgamation Agreement also provides that, if the Amalgamation Agreement is terminated under certain circumstances, the Company will be required to pay IPC a termination fee of \$16 million or IPC will be required to pay the Company a termination fee of \$16 million.

On the same day as the execution and delivery of the Amalgamation Agreement, (1) IPC paid to Max Capital Ltd. ( Max ) \$50 million in respect of the termination fee under its amalgamation agreement with Max, and (2) the Company paid to IPC \$50 million in respect of and in reliance upon such payment by IPC to Max. In certain circumstances more fully described in the Amalgamation Agreement, IPC will be required to repay such amount to the Company in the event the Amalgamation Agreement is terminated.

A copy of the Amalgamation Agreement is referenced as Exhibit 10.1 hereto and is incorporated herein by reference. The description herein of the Amalgamation Agreement and the transactions contemplated thereby is not complete and is qualified in its entirety by reference to Amalgamation Agreement.

The Amalgamation Agreement has been included to provide investors and security holders with information regarding its terms. It is not intended to provide any other factual information about the Company, Validus Ltd., IPC or any of their respective subsidiaries or affiliates. The representations, warranties and covenants contained in the Amalgamation Agreement were made only for purposes of that agreement and as of specific dates; were solely for the benefit of the parties to the Amalgamation Agreement; may be subject to limitations agreed upon by the contracting parties, including being qualified by confidential disclosures made for the purposes of allocating contractual risk between the parties to the Amalgamation Agreement instead of establishing these matters as facts (such disclosures include information that has been included in IPC s and the Company s public disclosures, as well as additional non-public information); and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to investors. Investors are not third party beneficiaries under the Amalgamation Agreement (except for the right to receive the transaction consideration from and after the consummation of the Amalgamation) and should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or condition of IPC, the Company or Validus Ltd. or any of their respective subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations, warranties and covenants may change after the date of the Amalgamation Agreement, which subsequent information may or may not be fully reflected in the Company s public disclosures.

In connection with the signing of the Amalgamation Agreement, the Company has withdrawn and terminated its previously announced exchange offer for all of the outstanding common shares of IPC and has instructed BNY Mellon Shareowner Services to promptly return all IPC common shares previously tendered to the Company. Additionally, the Company has terminated its solicitation efforts in connection with its other previously announced alternative steps to complete a transaction with IPC, including a scheme of arrangement and calling of a special meeting of IPC shareholders.

On August 6, 2009, the Company filed with the SEC and announced that it will begin mailing, a joint proxy statement/prospectus in connection with the Amalgamation. The Company s special general meeting of shareholders will be held on September 4, 2009. The Company expects the Amalgamation to close promptly following the receipt of the Company s and IPC s shareholder approvals, subject to the satisfaction or waiver of all closing conditions.

**Business Outlook and Trends**

The Company was formed in October 2005 in response to the supply/demand imbalance resulting from the large industry losses in 2004 and 2005. In the aggregate, the Company observed substantial increases in premium rates in 2006 compared to 2005 levels. During the years ended December 31, 2007 and 2008, the Company had experienced increased competition in most lines of business. Capital provided by new entrants or by the commitment of additional capital by existing insurers and reinsurers has increased the supply of insurance and reinsurance which has resulted in a softening of rates in most lines. However, during 2008, the insurance and reinsurance industry incurred material losses and capital declines due to Hurricanes Ike and Gustav and the global financial crisis.

In the wake of these events, the January 2009 renewal season saw decreased competition and increased premium rates due to relatively scarce capital and increased demand. During 2009, the Company observed reinsurance



**Table of Contents**

demand stabilization and modest increases in credit market liquidity. The July 2009 renewal season continued to show notable rate increases as compared to the July 2008 renewal season. Validus Re gross premiums written at January 1, 2009 grew by 26.0% from the prior year and for the six month period ended June 30, 2009 Validus Re gross premiums written grew by 17.5% from the comparable period in the prior year. This increase was largely due to rate increases coupled with modest exposure growth.

**Financial Measures**

The Company believes the following financial indicators are important in evaluating performance and measuring the overall growth in value generated for shareholders:

*Annualized return on average equity* represents the level of net income available to shareholders generated from the average shareholders' equity during the period. The Company's objective is to generate superior returns on capital that appropriately reward shareholders for the risks assumed and to grow premiums written only when returns meet or exceed internal requirements. Details of annualized return on average equity are provided below.

|                                     | Three months ended |                  | Six months ended |                  | Year ended  |
|-------------------------------------|--------------------|------------------|------------------|------------------|-------------|
|                                     | June 30,<br>2009   | June 30,<br>2008 | June 30,<br>2009 | June 30,<br>2008 | 31,<br>2008 |
| Annualized return on average equity | 26.4%              | 15.0%            | 22.8%            | 14.3%            | 2.7%        |

The increases in annualized return on average equity were driven primarily by increased net income for the three and six month periods ended June 30, 2009. Net income for the three months ended June 30, 2009 increased by \$61.6 million or 81.2% compared to the three months ended June 30, 2008. Net income for the six months ended June 30, 2009 increased by \$90.1 million or 63.3% compared to the six months ended June 30, 2008.

Annualized return on average equity is calculated by dividing the net income for the period by the average shareholders' equity during the period. Average shareholders' equity is the average of the beginning, ending and intervening quarter end shareholders' equity balances.

*Diluted book value per common share* is considered by management to be an appropriate measure of our returns to common shareholders, as we believe growth in our book value on a diluted basis ultimately translates into growth of our stock price. Diluted book value per common share increased by \$2.30, or 9.7%, from \$23.78 at December 31, 2008 to \$26.08 at June 30, 2009. The increase was substantially due to earnings generated in the six months ended June 30, 2009, partially offset by dividend payments totaling \$0.40 per share and per share equivalent in the period. Diluted book value per common share is a Non-GAAP financial measure. The most comparable U.S. GAAP financial measure is book value per common share. Diluted book value per common share is calculated based on total shareholders' equity plus the assumed proceeds from the exercise of outstanding options and warrants, divided by the sum of common shares, unvested restricted shares, options and warrants outstanding (assuming their exercise). A reconciliation of diluted book value per common share to book value per common share is presented below in the section entitled Non-GAAP Financial Measures.

*Cash dividends per common share* are an integral part of the value created for shareholders. The Company declared quarterly cash dividends of \$0.20 per common share in each of the first two quarters of 2009. On July 28, 2009, the Company announced a quarterly cash dividend of \$0.20 per each common share and \$0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on September 30, 2009 to holders of record on August 20, 2009.

*Underwriting income* measures the performance of the Company's core underwriting function, excluding revenues and expenses such as net investment income (loss), other income, finance expenses, net realized and unrealized gains (losses) on investments, and foreign exchange gains (losses). The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company's core insurance and reinsurance operations. Underwriting income for the three months ended June 30, 2009 and 2008 was \$92.2 million and \$89.6 million, respectively. Underwriting income for the six months ended

**Table of Contents**

June 30, 2009 and 2008 was \$172.2 million and \$141.1 million, respectively. Underwriting income is a Non-GAAP financial measure as described in detail and reconciled in the section below entitled Underwriting Income.

**Critical Accounting Policies and Estimates**

There are certain accounting policies that the Company considers to be critical due to the judgment and uncertainty inherent in the application of those policies. In calculating financial statement estimates, the use of different assumptions could produce materially different estimates. The Company believes the following critical accounting policies affect significant estimates used in the preparation of our consolidated financial statements:

Reserve for losses and loss expenses;

Premiums;

Reinsurance premiums ceded and reinsurance recoverable; and

Investment valuation.

Critical accounting policies and estimates are discussed further in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

**Segment Reporting**

Management has determined that the Company operates in two reportable segments. The two segments are its significant operating subsidiaries, Validus Re and Talbot.

**Results of Operations**

Validus Re commenced operations on December 16, 2005. The Company's fiscal year ends on December 31. Financial statements are prepared in accordance with U.S. GAAP and relevant SEC guidance.

**Table of Contents**

The following table presents results of operations for the three and six ended June 30, 2009 and 2008:

|                                              | <b>Three months<br/>ended<br/>June 30, 2009</b> | <b>Three months<br/>ended<br/>June 30, 2008</b> | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> |
|----------------------------------------------|-------------------------------------------------|-------------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| <b>(Dollars in thousands)</b>                |                                                 |                                                 |                                               |                                               |
| Gross premiums written                       | \$ 425,032                                      | \$ 379,919                                      | \$ 1,034,924                                  | \$ 901,513                                    |
| Reinsurance premiums ceded                   | (62,291)                                        | (1,399)                                         | (134,803)                                     | (86,299)                                      |
| Net premiums written                         | 362,741                                         | 378,520                                         | 900,121                                       | 815,214                                       |
| Change in unearned premiums                  | (34,541)                                        | (69,222)                                        | (253,162)                                     | (214,052)                                     |
| Net premiums earned                          | 328,200                                         | 309,298                                         | 646,959                                       | 601,162                                       |
| Losses and loss expenses                     | 124,751                                         | 122,089                                         | 256,585                                       | 262,113                                       |
| Policy acquisition costs                     | 64,438                                          | 56,419                                          | 125,887                                       | 113,120                                       |
| General and administrative expenses          | 41,200                                          | 33,912                                          | 79,279                                        | 71,019                                        |
| Share compensation expense                   | 5,632                                           | 7,271                                           | 12,986                                        | 13,806                                        |
| Total underwriting expenses                  | 236,021                                         | 219,691                                         | 474,737                                       | 460,058                                       |
| Underwriting income (1)                      | 92,179                                          | 89,607                                          | 172,222                                       | 141,104                                       |
| Net investment income                        | 26,963                                          | 36,435                                          | 53,735                                        | 72,478                                        |
| Other income                                 | 1,017                                           | 1,462                                           | 1,774                                         | 2,397                                         |
| Finance (expenses)                           | (10,752)                                        | (12,762)                                        | (18,475)                                      | (34,279)                                      |
| Operating income before taxes                | 109,407                                         | 114,742                                         | 209,256                                       | 181,700                                       |
| Income tax benefit (expense)                 | 976                                             | (3,077)                                         | 1,502                                         | (4,506)                                       |
| Operating income after tax                   | 110,383                                         | 111,665                                         | 210,758                                       | 177,194                                       |
| Net realized gains (losses) on investments   | (2,650)                                         | (2,425)                                         | (26,071)                                      | 5,319                                         |
| Net unrealized gains (losses) on investments | 37,249                                          | (42,982)                                        | 59,402                                        | (57,959)                                      |
| Realized gain on repurchase of debentures    |                                                 | 8,752                                           |                                               | 8,752                                         |
| Foreign exchange gains (losses)              | 8,432                                           | 911                                             | 4,232                                         | 9,090                                         |
| Transaction (expenses)                       | (15,851)                                        |                                                 | (15,851)                                      |                                               |
| <b>Net income after taxes</b>                | <b>\$ 137,563</b>                               | <b>\$ 75,921</b>                                | <b>\$ 232,470</b>                             | <b>\$ 142,396</b>                             |
| <b>Comprehensive income</b>                  |                                                 |                                                 |                                               |                                               |
| Foreign currency translation adjustments     | 3,993                                           | 10                                              | 3,797                                         | 77                                            |
| <b>Comprehensive income</b>                  | <b>\$ 141,556</b>                               | <b>\$ 75,931</b>                                | <b>\$ 236,267</b>                             | <b>\$ 142,473</b>                             |
| <b>Selected ratios</b>                       |                                                 |                                                 |                                               |                                               |
| Net premiums written/ Gross premiums written | 85.3%                                           | 99.6%                                           | 87.0%                                         | 90.4%                                         |

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|                                          |       |       |       |       |
|------------------------------------------|-------|-------|-------|-------|
| Losses and loss expenses ratio           | 38.0% | 39.5% | 39.7% | 43.6% |
| Policy acquisition cost ratio            | 19.6% | 18.2% | 19.5% | 18.8% |
| General and administrative expense ratio | 14.3% | 13.3% | 14.3% | 14.1% |
| Expense ratio                            | 33.9% | 31.5% | 33.8% | 32.9% |
| Combined ratio                           | 71.9% | 71.0% | 73.5% | 76.5% |

(1) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income (loss) and operating income that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation underwriting income



(loss) measure  
to net income,  
the most  
comparable  
U.S. GAAP  
financial  
measure, is  
presented in  
the section  
below entitled  
Underwriting  
Income.

**Table of Contents**

| <b>(Dollars in thousands)</b>              | <b>Three months<br/>ended<br/>June 30, 2009</b> | <b>Three months<br/>ended<br/>June 30, 2008</b> | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> |
|--------------------------------------------|-------------------------------------------------|-------------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| <b><u>VALIDUS RE</u></b>                   |                                                 |                                                 |                                               |                                               |
| Gross premiums written                     | \$ 199,560                                      | \$ 187,820                                      | \$ 609,686                                    | \$ 518,869                                    |
| Reinsurance premiums ceded                 | (43,070)                                        | (1,208)                                         | (56,359)                                      | (24,951)                                      |
| Net premiums written                       | 156,490                                         | 186,612                                         | 553,327                                       | 493,918                                       |
| Change in unearned premiums                | 7,207                                           | (22,500)                                        | (215,183)                                     | (186,151)                                     |
| Net premiums earned                        | 163,697                                         | 164,112                                         | 338,144                                       | 307,767                                       |
| Losses and loss expenses                   | 41,121                                          | 48,677                                          | 96,583                                        | 107,591                                       |
| Policy acquisition costs                   | 29,120                                          | 25,309                                          | 57,697                                        | 45,712                                        |
| General and administrative expenses        | 14,149                                          | 9,955                                           | 27,941                                        | 19,334                                        |
| Share compensation expense                 | 1,548                                           | 1,597                                           | 3,220                                         | 2,823                                         |
| Total underwriting expenses                | 85,938                                          | 85,538                                          | 185,441                                       | 175,460                                       |
| Underwriting income (1)                    | 77,759                                          | 78,574                                          | 152,703                                       | 132,307                                       |
| <b><u>TALBOT</u></b>                       |                                                 |                                                 |                                               |                                               |
| Gross premiums written                     | \$ 235,113                                      | \$ 197,235                                      | \$ 463,033                                    | \$ 399,028                                    |
| Reinsurance premiums ceded                 | (28,862)                                        | (5,327)                                         | (116,239)                                     | (77,732)                                      |
| Net premiums written                       | 206,251                                         | 191,908                                         | 346,794                                       | 321,296                                       |
| Change in unearned premiums                | (41,748)                                        | (46,722)                                        | (37,979)                                      | (27,901)                                      |
| Net premiums earned                        | 164,503                                         | 145,186                                         | 308,815                                       | 293,395                                       |
| Losses and loss expenses                   | 83,630                                          | 73,412                                          | 160,002                                       | 154,522                                       |
| Policy acquisition costs                   | 36,114                                          | 31,134                                          | 69,271                                        | 67,432                                        |
| General and administrative expenses        | 21,927                                          | 19,787                                          | 42,141                                        | 40,710                                        |
| Share compensation expense                 | 2,098                                           | 1,126                                           | 4,433                                         | 2,102                                         |
| Total underwriting expenses                | 143,769                                         | 125,459                                         | 275,847                                       | 264,766                                       |
| Underwriting income (1)                    | 20,734                                          | 19,727                                          | 32,968                                        | 28,629                                        |
| <b><u>CORPORATE &amp; ELIMINATIONS</u></b> |                                                 |                                                 |                                               |                                               |
| Gross premiums written                     | \$ (9,641)                                      | \$ (5,136)                                      | \$ (37,795)                                   | \$ (16,384)                                   |
| Reinsurance premiums ceded                 | 9,641                                           | 5,136                                           | 37,795                                        | 16,384                                        |
| Net premiums written                       |                                                 |                                                 |                                               |                                               |
| Policy acquisition costs                   | (796)                                           | (24)                                            | (1,081)                                       | (24)                                          |

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|                                      |                  |                  |                   |                   |
|--------------------------------------|------------------|------------------|-------------------|-------------------|
| General and administrative expenses  | 5,124            | 4,170            | 9,197             | 10,975            |
| Share compensation                   | 1,986            | 4,548            | 5,333             | 8,881             |
| Total underwriting expenses          | 6,314            | 8,694            | 13,449            | 19,832            |
| Underwriting income (loss) (1)       | (6,314)          | (8,694)          | (13,449)          | (19,832)          |
| <b>Total underwriting income (1)</b> | <b>\$ 92,179</b> | <b>\$ 89,607</b> | <b>\$ 172,222</b> | <b>\$ 141,104</b> |

(1) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income (loss) that is not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation of this measure to net income, the most

comparable  
U.S. GAAP  
financial  
measure, is  
presented in the  
section below  
entitled  
Underwriting  
Income.

**Table of Contents****Three months ended June 30, 2009 compared to three months ended June 30, 2008**

Net income for the three months ended June 30, 2009 was \$137.6 million compared to net income of \$75.9 million for the three months ended June 30, 2008, an increase of \$61.6 million or 81.2%. The primary factors driving the increase in net income were:

Increase in net unrealized gains on investments of \$80.2 million; and

Increased foreign exchange gains of \$7.5 million due to an increase in the value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency which resulted in foreign exchange gains of \$8.4 million for the three months ended June 30, 2009, as compared gains of \$0.9 million for the three months ended June 30, 2008.

The items above were partially offset by the following factors:

Transaction expenses of \$15.9 million in relation to the proposed acquisition of and amalgamation agreement with IPC; and

Decrease in net investment income of \$9.5 million due to increased balances of cash and cash equivalents and lower returns on cash and fixed income investments; and

Gain on repurchase of debentures of \$8.8 million realized during the three months ended June 30, 2008. No such gain was realized during the three months ended June 30, 2009.

The change in net income for the three months ended June 30, 2009 of \$61.6 million is described in the following table:

|                                              | <b>Three months ended June 30, 2009</b>                         |               |                                                          |              |
|----------------------------------------------|-----------------------------------------------------------------|---------------|----------------------------------------------------------|--------------|
|                                              | <b>Increase (decrease) over the three months ended June 30,</b> |               |                                                          |              |
|                                              | <b>2008</b>                                                     |               |                                                          |              |
| <b>(Dollars in thousands)</b>                | <b>Validus Re</b>                                               | <b>Talbot</b> | <b>Corporate<br/>and other<br/>reconciling<br/>items</b> | <b>Total</b> |
| Underwriting income                          | \$ (815)                                                        | \$ 1,007      | \$ 2,380                                                 | \$ 2,572     |
| Net investment income                        | (4,942)                                                         | (4,033)       | (497)                                                    | (9,472)      |
| Other income                                 | 878                                                             | (551)         | (772)                                                    | (445)        |
| Finance expenses                             | (389)                                                           | 2,061         | 338                                                      | 2,010        |
|                                              | (5,268)                                                         | (1,516)       | 1,449                                                    | (5,335)      |
| Taxes                                        | (8)                                                             | 4,061         |                                                          | 4,053        |
|                                              | (5,276)                                                         | 2,545         | 1,449                                                    | (1,282)      |
| Realized gain on repurchase of debentures    |                                                                 |               | (8,752)                                                  | (8,752)      |
| Net realized (losses) gains on investments   | 1,120                                                           | (1,345)       |                                                          | (225)        |
| Net unrealized gains (losses) on investments | 59,852                                                          | 20,379        |                                                          | 80,231       |
| Foreign exchange (losses) gains              | 2,230                                                           | 5,235         | 56                                                       | 7,521        |

|                      |    |        |    |          |    |          |    |        |
|----------------------|----|--------|----|----------|----|----------|----|--------|
| Transaction expenses |    |        |    | (15,851) |    | (15,851) |    |        |
| <b>Net income</b>    | \$ | 57,926 | \$ | 26,814   | \$ | (23,098) | \$ | 61,642 |

**Gross Premiums Written**

Gross premiums written for the three months ended June 30, 2009 were \$425.0 million compared to \$379.9 million for the three months ended June 30, 2008, an increase of \$45.1 million or 11.9%. The increase in gross premiums written was driven primarily by the property and marine lines which increased by \$38.7 million and \$5.4 million, respectively. Details of gross premiums written by line of business are provided below.

| <u>(Dollars in thousands)</u> | <b>Gross premiums written</b> |         | <b>Gross premiums written</b> |    | <b>%<br/>Change</b> |        |       |
|-------------------------------|-------------------------------|---------|-------------------------------|----|---------------------|--------|-------|
|                               | <b>Three months ended</b>     |         | <b>Three months ended</b>     |    |                     |        |       |
|                               | <b>June 30, 2009</b>          |         | <b>June 30, 2008</b>          |    |                     |        |       |
| Property                      | \$                            | 255,442 | 60.1%                         | \$ | 216,764             | 57.1%  | 17.8% |
| Marine                        |                               | 84,431  | 19.9%                         |    | 79,041              | 20.8%  | 6.8%  |
| Specialty                     |                               | 85,159  | 20.0%                         |    | 84,114              | 22.1%  | 1.2%  |
| <b>Total</b>                  | \$                            | 425,032 | 100.0%                        | \$ | 379,919             | 100.0% | 11.9% |

**Table of Contents**

*Validus Re.* Validus Re gross premiums written for the three months ended June 30, 2009 were \$199.6 million compared to \$187.8 million for the three months ended June 30, 2008, an increase of \$11.7 million or 6.3%. Details of Validus Re gross premiums written by line of business are provided below.

| <u>(Dollars in thousands)</u> | Gross premiums written              |               |                                     |               |             |
|-------------------------------|-------------------------------------|---------------|-------------------------------------|---------------|-------------|
|                               | Three months ended<br>June 30, 2009 |               | Three months ended<br>June 30, 2008 |               | % Change    |
| Property                      | \$ 183,898                          | 92.1%         | \$ 171,308                          | 91.2%         |             |
| Marine                        | 3,957                               | 2.0%          | 8,750                               | 4.7%          | (54.8)%     |
| Specialty                     | 11,705                              | 5.9%          | 7,762                               | 4.1%          | 50.8%       |
| <b>Total</b>                  | <b>\$ 199,560</b>                   | <b>100.0%</b> | <b>\$ 187,820</b>                   | <b>100.0%</b> | <b>6.3%</b> |

The increase in Validus Re gross premiums written was driven by increases in the property and specialty lines of \$12.6 million and \$3.9 million, respectively. The increase in the property line was due primarily to the delayed 2009 renewal of a \$7.0 million proportional contract during the three months ended June 30 where the 2008 renewal occurred during the three months ended March 31. In addition, \$5.1 million of additional gross premiums were written by AlphaCat Re, a Class 3 Bermuda insurance company that began writing premiums in 2009. These increases were offset by a \$4.8 million decrease in the marine line due primarily to reduced gross premiums written on Gulf of Mexico exposures and fewer reinstatement premiums as compared to the three months ended June 30, 2008. Gross premiums written under the quota share and surplus treaty contracts with Talbot increased by \$4.5 million as compared to the three months ended June 30, 2008. The quota share and surplus treaty contracts with Talbot are eliminated upon consolidation.

*Talbot.* Talbot gross premiums written for the three months ended June 30, 2009 were \$235.1 million compared to \$197.2 million for the three months ended June 30, 2008, an increase of \$37.8 million or 19.2%. The \$235.1 million of gross premiums written translated at second quarter 2008 rates of exchange would have been \$249.5 million during the three months ended June 30, 2009, an increase of \$52.3 million or 26.5%. Details of Talbot gross premiums written by line of business are provided below.

| <u>(Dollars in thousands)</u> | Gross premiums written              |               |                                     |               |              |
|-------------------------------|-------------------------------------|---------------|-------------------------------------|---------------|--------------|
|                               | Three months ended<br>June 30, 2009 |               | Three months ended<br>June 30, 2008 |               | % Change     |
| Property                      | \$ 78,769                           | 33.5%         | \$ 47,423                           | 24.0%         |              |
| Marine                        | 82,657                              | 35.2%         | 73,126                              | 37.1%         | 13.0%        |
| Specialty                     | 73,687                              | 31.3%         | 76,686                              | 38.9%         | (3.9)%       |
| <b>Total</b>                  | <b>\$ 235,113</b>                   | <b>100.0%</b> | <b>\$ 197,235</b>                   | <b>100.0%</b> | <b>19.2%</b> |

The increase in the property lines was due primarily to \$31.2 million of gross premiums written on the Onshore Energy lines. The increase in the marine lines was due primarily to a \$6.8 million increase on the Energy lines as a result of more favorable rates.

**Reinsurance Premiums Ceded**

Reinsurance premiums ceded for the three months ended June 30, 2009 were \$62.3 million compared to \$1.4 million for the three months ended June 30, 2008, an increase of \$60.9 million. The increase was due primarily to a \$55.2 million increase on the property lines retrocession as described below.

| <u>(Dollars in thousands)</u> | Reinsurance premiums ceded          |                                     |          |
|-------------------------------|-------------------------------------|-------------------------------------|----------|
|                               | Three months ended<br>June 30, 2009 | Three months ended<br>June 30, 2008 | % Change |
|                               |                                     |                                     |          |

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|              |                  |               |                 |               |           |
|--------------|------------------|---------------|-----------------|---------------|-----------|
| Property     | \$ 57,238        | 91.9%         | \$ 2,040        | 145.8%        | NM        |
| Marine       | 2,633            | 4.2%          | 793             | 56.7%         | 232.0%    |
| Specialty    | 2,420            | 3.9%          | (1,434)         | (102.5)%      | (268.8)%  |
| <b>Total</b> | <b>\$ 62,291</b> | <b>100.0%</b> | <b>\$ 1,399</b> | <b>100.0%</b> | <b>NM</b> |



**Table of Contents**

*Validus Re.* Validus Re reinsurance premiums ceded for the three months ended June 30, 2009 were \$43.1 million compared to \$1.2 million for the three months ended June 30, 2008, an increase of \$41.9 million.

| <u>(Dollars in thousands)</u> | Reinsurance premiums ceded          |               |                                     |               |           |
|-------------------------------|-------------------------------------|---------------|-------------------------------------|---------------|-----------|
|                               | Three months ended<br>June 30, 2009 |               | Three months ended<br>June 30, 2008 |               | % Change  |
| Property                      | \$ 42,705                           | 99.1%         | \$ (1,470)                          | (121.7)%      |           |
| Marine                        | 209                                 | 0.5%          | 2,678                               | 221.7%        | (92.2)%   |
| Specialty                     | 156                                 | 0.4%          |                                     | 0.0%          | NM        |
| <b>Total</b>                  | <b>\$ 43,070</b>                    | <b>100.0%</b> | <b>\$ 1,208</b>                     | <b>100.0%</b> | <b>NM</b> |

Reinsurance premiums ceded on the property lines increased by \$44.2 million, due primarily to the advanced renewal of retrocessional coverage via ultimate net loss agreements that incepted in 2008 during the three months ended September 30, 2008. These ultimate net loss agreements resulted in the recognition of \$37.0 million of reinsurance premiums ceded in the three months ended June 30, 2009. The purchased retrocessional coverage includes ultimate net loss coverage that attaches at \$200.0 million of onshore property losses.

*Talbot.* Talbot reinsurance premiums ceded for the three months ended June 30, 2009 were \$28.9 million compared to \$5.3 million for the three months ended June 30, 2008, an increase of \$23.5 million. The increase was due primarily to increased reinsurance premiums ceded on the property lines of business.

| <u>(Dollars in thousands)</u> | Reinsurance premiums ceded          |               |                                     |               |               |
|-------------------------------|-------------------------------------|---------------|-------------------------------------|---------------|---------------|
|                               | Three months ended<br>June 30, 2009 |               | Three months ended<br>June 30, 2008 |               | % Change      |
| Property                      | \$ 21,758                           | 75.3%         | \$ 5,477                            | 102.8%        |               |
| Marine                        | 4,607                               | 16.0%         | 950                                 | 17.8%         | 384.9%        |
| Specialty                     | 2,497                               | 8.7%          | (1,100)                             | (20.6)%       | (327.0)%      |
| <b>Total</b>                  | <b>\$ 28,862</b>                    | <b>100.0%</b> | <b>\$ 5,327</b>                     | <b>100.0%</b> | <b>441.8%</b> |

Reinsurance premiums ceded on the property lines increased by \$16.3 million, due primarily to \$16.5 million of reinsurance premiums ceded on the Onshore Energy lines, as discussed above. Reinsurance premiums ceded under third party quota share and surplus treaty contracts on the property and specialty lines increased by \$14.1 million and \$3.3 million, respectively, as compared to the three months ended June 30, 2008. Reinsurance premiums ceded under the quota share and surplus treaty contracts with Validus Re for the three months ended June 30, 2009 were \$9.6 million compared to \$5.1 million for the three months ended June 30, 2008, an increase of \$4.5 million. The quota share and surplus treaty contracts with Validus Re are eliminated upon consolidation.

**Net Premiums Written**

Net premiums written for the three months ended June 30, 2009 were \$362.7 million compared to \$378.5 million for the three months ended June 30, 2008, a decrease of \$15.8 million or 4.2%. The ratios of net premiums written to gross premiums written for the three months ended June 30, 2009 and 2008 were 85.3% and 99.6%, respectively. Details of net premiums written by line of business are provided below.

| <u>(Dollars in thousands)</u> | Net premiums written                |       |                                     |       |          |
|-------------------------------|-------------------------------------|-------|-------------------------------------|-------|----------|
|                               | Three months ended<br>June 30, 2009 |       | Three months ended<br>June 30, 2008 |       | % Change |
| Property                      | \$ 198,204                          | 54.7% | \$ 214,724                          | 56.7% |          |
| Marine                        | 81,798                              | 22.5% | 78,248                              | 20.7% | 4.5%     |
| Specialty                     | 82,739                              | 22.8% | 85,548                              | 22.6% | (3.3)%   |

|              |            |        |            |        |        |
|--------------|------------|--------|------------|--------|--------|
| <b>Total</b> | \$ 362,741 | 100.0% | \$ 378,520 | 100.0% | (4.2)% |
|--------------|------------|--------|------------|--------|--------|

*Validus Re.* Validus Re net premiums written for the three months ended June 30, 2009 were \$156.5 million compared to \$186.6 million for the three months ended June 30, 2008, a decrease of \$30.1 million or 16.1%. Details of net premiums written by line of business are provided below.

45

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**Table of Contents**

| <u>(Dollars in thousands)</u> | Net premiums written |               |                    |               |                |
|-------------------------------|----------------------|---------------|--------------------|---------------|----------------|
|                               | Three months ended   |               | Three months ended |               | % Change       |
|                               | June 30, 2009        |               | June 30, 2008      |               |                |
| Property                      | \$ 141,193           | 90.2%         | \$ 172,778         | 92.6%         | (18.3)%        |
| Marine                        | 3,748                | 2.4%          | 6,072              | 3.3%          | (38.3)%        |
| Specialty                     | 11,549               | 7.4%          | 7,762              | 4.1%          | 48.8%          |
| <b>Total</b>                  | <b>\$ 156,490</b>    | <b>100.0%</b> | <b>\$ 186,612</b>  | <b>100.0%</b> | <b>(16.1)%</b> |

The decrease in Validus Re net premiums written was driven by a decrease in the property lines of \$31.6 million. This decrease was a result primarily of the \$37.0 million of reinsurance premiums ceded on the advanced renewal of retrocessional coverage via ultimate net loss agreements, offset by the gross premiums written on the renewal of a \$7.0 million proportional contract, as discussed above. The ratios of net premiums written to gross premiums written were 78.4% and 99.4% for the three month periods ended June 30, 2009 and 2008, respectively.

*Talbot.* Talbot net premiums written for the three months ended June 30, 2009 were \$206.3 million compared to \$191.9 million for the three months ended June 30, 2008, an increase of \$14.3 million or 7.5%. Details of net premiums written by line of business are provided below:

| <u>(Dollars in thousands)</u> | Net premiums written |               |                    |               |             |
|-------------------------------|----------------------|---------------|--------------------|---------------|-------------|
|                               | Three months ended   |               | Three months ended |               | % Change    |
|                               | June 30, 2009        |               | June 30, 2008      |               |             |
| Property                      | \$ 57,011            | 27.6%         | \$ 41,946          | 21.9%         | 35.9%       |
| Marine                        | 78,050               | 37.9%         | 72,176             | 37.6%         | 8.1%        |
| Specialty                     | 71,190               | 34.5%         | 77,786             | 40.5%         | (8.5)%      |
| <b>Total</b>                  | <b>\$ 206,251</b>    | <b>100.0%</b> | <b>\$ 191,908</b>  | <b>100.0%</b> | <b>7.5%</b> |

The increase in net premiums written was driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded. The ratios of net premiums written to gross premiums written for the three month periods ended June 30, 2009 and 2008 were 87.7% and 97.3%, respectively. This decrease was due primarily to the 47.1% ratio of net premiums written to gross premiums written on the onshore energy lines for the three month period ended June 30, 2009.

**Change in Unearned Premiums**

Change in unearned premiums for the three months ended June 30, 2009 was \$34.5 million compared to \$69.2 million for the three months ended June 30, 2008, a decrease of \$34.7 million or 50.1%.

| <u>(Dollars in thousands)</u>         | Three months ended               |             | Three months ended |             | % Change     |
|---------------------------------------|----------------------------------|-------------|--------------------|-------------|--------------|
|                                       | June 30, 2009                    |             | June 30, 2008      |             |              |
|                                       | Change in gross unearned premium | \$ (57,819) |                    | \$ (43,830) |              |
| Change in prepaid reinsurance premium | 23,278                           |             | (25,392)           |             | 191.7%       |
| <b>Net change in unearned premium</b> | <b>\$ (34,541)</b>               |             | <b>\$ (69,222)</b> |             | <b>50.1%</b> |

*Validus Re.* Validus Re's change in unearned premiums for the three months ended June 30, 2009 was \$(7.2) million compared to \$22.5 million for the three months ended June 30, 2008, a decrease of

\$29.7 million or 132.0%.

|                                       | <b>Three months<br/>ended</b> | <b>Three months<br/>ended</b> | <b>%</b>      |
|---------------------------------------|-------------------------------|-------------------------------|---------------|
| <b><u>(Dollars in thousands)</u></b>  | <b>June 30, 2009</b>          | <b>June 30, 2008</b>          | <b>Change</b> |
| Change in gross unearned premium      | \$ (16,316)                   | \$ (12,169)                   | (34.1)%       |
| Change in prepaid reinsurance premium | 23,523                        | (10,331)                      | 327.7%        |
| <b>Net change in unearned premium</b> | <b>\$ 7,207</b>               | <b>\$ (22,500)</b>            | <b>132.0%</b> |

The difference in gross unearned premiums reflects the benefit of earning premiums on the increased gross premiums written during the six months ended June 30, 2009 as compared to the six months ended June 30, 2008. In respect of prepaid reinsurance premiums, the change was a result primarily of the advanced renewal of retrocessional coverage via ultimate net loss agreements, the majority of which is prepaid at June 30, 2009, as discussed above.

**Table of Contents**

*Talbot.* The Talbot change in unearned premiums for the three months ended June 30, 2009 was \$41.7 million compared to \$46.7 million for the three months ended June 30, 2008, a decrease of \$5.0 million, or 10.7%.

|                                       | <b>Three months<br/>ended</b> | <b>Three months<br/>ended</b> | <b>%<br/>Change</b> |
|---------------------------------------|-------------------------------|-------------------------------|---------------------|
| <b>(Dollars in thousands)</b>         | <b>June 30, 2009</b>          | <b>June 30, 2008</b>          |                     |
| Change in gross unearned premium      | \$ (41,503)                   | \$ (31,661)                   | (31.1)%             |
| Change in prepaid reinsurance premium | (245)                         | (15,061)                      | 98.4%               |
| <b>Net change in unearned premium</b> | <b>\$ (41,748)</b>            | <b>\$ (46,722)</b>            | <b>10.7%</b>        |

The difference in gross unearned premiums arose principally from the increased gross premiums written in the Property lines, specifically Onshore Energy exposures and premiums written by Validus Reaseguros, Inc., which acts as an approved Lloyd's coverholder for Syndicate 1183 on the property treaty lines, during the three months ended June 30, 2009, as compared to the three months ended June 30, 2008. The lower change in prepaid reinsurance premiums in the three months ended June 30, 2009 is reflective of the increased amounts of Onshore Energy exposures and premiums written by Validus Reaseguros, Inc., which have increased levels of ceded reinsurance. This results in less seasonality in the ceded reinsurance and hence a small change in prepaid reinsurance for the three months ended June 30, 2009.

**Net Premiums Earned**

Net premiums earned for the three months ended June 30, 2009 were \$328.2 million compared to \$309.3 million for the three months ended June 30, 2008, an increase of \$18.9 million or 6.1%. The increase in net premiums earned was driven by increased premiums earned at Talbot of \$19.3 million.

|                               | <b>Net premiums earned</b> |               |                           |               |                 |
|-------------------------------|----------------------------|---------------|---------------------------|---------------|-----------------|
| <b>(Dollars in thousands)</b> | <b>Three months ended</b>  |               | <b>Three months ended</b> |               | <b>% Change</b> |
|                               | <b>June 30, 2009</b>       |               | <b>June 30, 2008</b>      |               |                 |
| Property                      | \$ 143,843                 | 43.8%         | \$ 149,431                | 48.3%         | (3.7)%          |
| Marine                        | 100,953                    | 30.8%         | 86,794                    | 28.1%         | 16.3%           |
| Specialty                     | 83,404                     | 25.4%         | 73,073                    | 23.6%         | 14.1%           |
| <b>Total</b>                  | <b>\$ 328,200</b>          | <b>100.0%</b> | <b>\$ 309,298</b>         | <b>100.0%</b> | <b>6.1%</b>     |

*Validus Re.* Validus Re net premiums earned for the three months ended June 30, 2009 were \$163.7 million compared to \$164.1 million for the three months ended June 30, 2008, a decrease of \$0.4 million, or 0.3%.

|                               | <b>Net premiums earned</b> |               |                           |               |                 |
|-------------------------------|----------------------------|---------------|---------------------------|---------------|-----------------|
| <b>(Dollars in thousands)</b> | <b>Three months ended</b>  |               | <b>Three months ended</b> |               | <b>% Change</b> |
|                               | <b>June 30, 2009</b>       |               | <b>June 30, 2008</b>      |               |                 |
| Property                      | \$ 110,185                 | 67.3%         | \$ 120,916                | 73.7%         | (8.9)%          |
| Marine                        | 33,584                     | 20.5%         | 26,403                    | 16.1%         | 27.2%           |
| Specialty                     | 19,928                     | 12.2%         | 16,793                    | 10.2%         | 18.7%           |
| <b>Total</b>                  | <b>\$ 163,697</b>          | <b>100.0%</b> | <b>\$ 164,112</b>         | <b>100.0%</b> | <b>(0.3)%</b>   |

The decrease in Validus Re net premiums earned was driven by decreases in the property lines of \$10.7 million. \$6.2 million of this decrease was a result of the advanced renewal of retrocessional coverage via ultimate net loss agreements, as discussed above. This decrease was offset by an increase in the marine lines of \$7.2 million, due

partially to premium adjustments on proportional contracts.

*Talbot.* Talbot net premiums earned for the three months ended June 30, 2009 were \$164.5 million compared to \$145.2 million for the three months ended June 30, 2008, an increase of \$19.3 million or 13.3%.

| <u>(Dollars in thousands)</u> | Net premiums earned                 |        | Net premiums earned                 |        | % Change |
|-------------------------------|-------------------------------------|--------|-------------------------------------|--------|----------|
|                               | Three months ended<br>June 30, 2009 |        | Three months ended<br>June 30, 2008 |        |          |
| Property                      | \$ 33,658                           | 20.4%  | \$ 28,515                           | 19.6%  | 18.0%    |
| Marine                        | 67,369                              | 41.0%  | 60,391                              | 41.6%  | 11.6%    |
| Specialty                     | 63,476                              | 38.6%  | 56,280                              | 38.8%  | 12.8%    |
| <b>Total</b>                  | \$ 164,503                          | 100.0% | \$ 145,186                          | 100.0% | 13.3%    |

**Table of Contents**

The increase in net premiums earned is due primarily to the increased levels of net premiums written across all major business lines over the twelve months ended June 30, 2009, as compared with the twelve months ended June 30, 2008.

**Losses and Loss Expenses**

Losses and loss expenses for the three months ended June 30, 2009 were \$124.8 million compared to \$122.1 million for the three months ended June 30, 2008, an increase of \$2.7 million or 2.2%. The loss ratios, defined as losses and loss expenses divided by net premiums earned, for the three months ended June 30, 2009 and 2008 were 38.0% and 39.5%, respectively. Details of loss ratios by line of business are provided below.

|                  | <b>Three months ended<br/>June 30, 2009</b> | <b>Three months ended<br/>June 30, 2008</b> | <b>Percentage point<br/>change</b> |
|------------------|---------------------------------------------|---------------------------------------------|------------------------------------|
| Property         | 16.8%                                       | 33.0%                                       | (16.2)                             |
| Marine           | 48.6%                                       | 54.1%                                       | (5.5)                              |
| Specialty        | 61.8%                                       | 35.3%                                       | 26.5                               |
| <b>All lines</b> | <b>38.0%</b>                                | <b>39.5%</b>                                | <b>(1.5)</b>                       |

The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the three months ended June 30, 2009:

| <b>(Dollars in thousands)</b>                    | <b>Three months ended June 30, 2009</b> |               |                     |              |
|--------------------------------------------------|-----------------------------------------|---------------|---------------------|--------------|
|                                                  | <b>Validus Re</b>                       | <b>Talbot</b> | <b>Eliminations</b> | <b>Total</b> |
| Gross reserves at period beginning               | \$ 527,475                              | \$ 810,143    | \$ (18,886)         | \$ 1,318,732 |
| Losses recoverable at period beginning           | (78,687)                                | (144,396)     | 18,886              | (204,197)    |
| Net reserves at period beginning                 | 448,788                                 | 665,747       | -                   | 1,114,535    |
| Incurred losses - current year                   | 44,080                                  | 93,896        | -                   | 137,976      |
| Incurred losses - change in prior accident years | (2,959)                                 | (10,266)      | -                   | (13,225)     |
| Incurred losses                                  | 41,121                                  | 83,630        | -                   | 124,751      |
| Paid losses                                      | (65,440)                                | (59,946)      | -                   | (125,386)    |
| Foreign exchange                                 | 3,073                                   | 25,296        | -                   | 28,369       |
| Net reserves at period end                       | 427,542                                 | 714,727       | -                   | 1,142,269    |
| Losses recoverable at period end                 | 61,798                                  | 130,810       | (22,942)            | 169,666      |
| Gross reserves at period end                     | \$ 489,340                              | \$ 845,537    | \$ (22,942)         | \$ 1,311,935 |

The amount recorded represents management's best estimate of expected losses and loss expenses on premiums earned. Favorable loss development on prior years totaled \$13.2 million. The \$10.3 million favorable loss reserve development in the Talbot segment is due primarily to \$7.9 million and \$4.5 million of favorable development on the property and marine lines, respectively. Favorable loss reserve development benefitted the Company's loss ratio by 4.0 percentage points for the three months ended June 30, 2009. During the three months ended June 30, 2009, the Company incurred \$11.0 million of losses, or 3.4 percentage points of the loss ratio, attributable to a commercial flight loss. During the three months ended June 30, 2008, the Company incurred \$10.2 million of losses attributable to certain U.S. storm and flood loss events, which represented 3.3 percentage points of the loss ratio.

Management of insurance and reinsurance companies use significant judgment in the estimation of reserves for losses and loss expenses. Given the magnitude of recent loss events and other uncertainties inherent in loss estimation, meaningful uncertainty remains regarding the estimation of recent losses. The Company's actual ultimate net loss may vary materially from estimates.

At June 30, 2009 and 2008, gross and net reserves for losses and loss expenses were estimated using the methodology as outlined in the critical accounting policies and estimates as discussed in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on



**Table of Contents**

Form 10-K for the year ended December 31, 2008. The Company did not make any significant changes in the assumptions or methodology used in its reserving process during the three months ended June 30, 2009.

**At June 30, 2009**

| <b>(Dollars in thousands)</b> | <b>Gross case reserves</b> | <b>Gross IBNR</b> | <b>Total gross reserve for losses and loss expenses</b> |
|-------------------------------|----------------------------|-------------------|---------------------------------------------------------|
| Property                      | \$ 244,065                 | \$ 183,234        | \$ 427,299                                              |
| Marine                        | 365,388                    | 221,276           | 586,664                                                 |
| Specialty                     | 108,461                    | 189,511           | 297,972                                                 |
| <b>Total</b>                  | <b>\$ 717,914</b>          | <b>\$ 594,021</b> | <b>\$ 1,311,935</b>                                     |

**At June 30, 2009**

| <b>(Dollars in thousands)</b> | <b>Net case reserves</b> | <b>Net IBNR</b>   | <b>Total net reserve for losses and loss expenses</b> |
|-------------------------------|--------------------------|-------------------|-------------------------------------------------------|
| Property                      | \$ 241,625               | \$ 171,702        | \$ 413,327                                            |
| Marine                        | 264,169                  | 203,171           | 467,340                                               |
| Specialty                     | 98,292                   | 163,310           | 261,602                                               |
| <b>Total</b>                  | <b>\$ 604,086</b>        | <b>\$ 538,183</b> | <b>\$ 1,142,269</b>                                   |

*Validus Re.* Validus Re losses and loss expenses for the three months ended June 30, 2009 were \$41.1 million compared to \$48.7 million for the three months ended June 30, 2008, a decrease of \$7.6 million or 15.5%. Validus Re net paid losses for the three months ended June 30, 2009 were \$65.4 million compared to \$28.5 million for the three months ended June 30, 2008, an increase of \$36.9 million or 129.5%, primarily as a result of losses paid on Hurricane Ike. The loss ratio, defined as losses and loss expenses divided by net premiums earned, was 25.1% and 29.7% for the three months ended June 30, 2009 and 2008, respectively. During the three months ended June 30, 2009, Validus Re did not experience any notable loss events. During the three months ended June 30, 2008, Validus Re incurred \$10.2 million of losses attributable to certain U.S. storm and flood loss events, which represented 6.2 percentage points of the loss ratio. Details of loss ratios by line of business and period of incurrence are provided below.

**Three months ended June 30**

|                                           | <b>2009</b> | <b>2008</b> | <b>Percentage point change</b> |
|-------------------------------------------|-------------|-------------|--------------------------------|
| Property - current year                   | 21.2%       | 29.0%       | (7.8)                          |
| Property - change in prior accident years | (2.7)%      | (3.0)%      | 0.3                            |
| Property - loss ratio                     | 18.5%       | 26.0%       | (7.5)                          |
| Marine - current year                     | 39.7%       | 31.0%       | 8.7                            |
| Marine - change in prior accident years   | 0.0%        | 15.3%       | (15.3)                         |
| Marine - loss ratio                       | 39.7%       | 46.3%       | (6.6)                          |
| Specialty - current year                  | 37.1%       | 35.4%       | 1.7                            |

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|                                            |        |        |       |
|--------------------------------------------|--------|--------|-------|
| Specialty - change in prior accident years | 0.0%   | (5.1)% | 5.1   |
| Specialty - loss ratio                     | 37.1%  | 30.3%  | 6.8   |
| All lines - current year                   | 26.9%  | 30.0%  | (3.1) |
| All lines - change in prior accident years | (1.8)% | (0.3)% | (1.5) |
| <b>All lines - loss ratio</b>              | 25.1%  | 29.7%  | (4.6) |

For the three months ended June 30, 2009, the property lines include \$23.4 million related to current year losses and \$3.0 million of favorable development relating to prior accident years. During the three months ended June 30,

**Table of Contents**

2008, Validus Re's property lines incurred \$10.2 million of losses attributable to certain U.S. storm and flood loss events, which represented 8.4 percentage points of the property lines loss ratio. Validus Re property line loss ratios, excluding prior year development and loss events identified above, for the three months ended June 30, 2009 and 2008 were 21.2% and 20.6%, respectively.

For the three months ended June 30, 2009, the marine lines include \$13.3 million related to current year losses. Validus Re marine line loss ratios, excluding prior year development, for the three months ended June 30, 2009 and 2008 were 39.7% and 30.1%, respectively.

For the three months ended June 30, 2009, the specialty lines include \$7.4 million related to current year losses. Validus Re specialty lines loss ratios, excluding prior year development and the loss event identified above, for the three months ended June 30, 2009 and 2008 were 37.1% and 35.4%, respectively.

*Talbot.* Talbot losses and loss expenses for the three months ended June 30, 2009 were \$83.6 million compared to \$73.4 million for the three months ended June 30, 2008, an increase of \$10.2 million, or 13.9%. The loss ratio was 50.9% and 50.6% for the three months ended June 30, 2009 and 2008, respectively. During the three months ended June 30, 2009, Talbot incurred \$8.3 million, or 5.0 percentage points of the loss ratio, attributable to a commercial flight loss. During the three months ended June 30, 2009, \$93.9 million of losses and loss expenses related to current year losses and \$10.3 million related to favorable development of prior accident years. Details of loss ratios by line of business and calendar period are provided below.

|                               |                                | <b>Three months ended June<br/>30</b> |             | <b>Percentage<br/>point<br/>change</b> |
|-------------------------------|--------------------------------|---------------------------------------|-------------|----------------------------------------|
|                               |                                | <b>2009</b>                           | <b>2008</b> |                                        |
| Property                      | current year                   | 34.5%                                 | 61.8%       | (27.3)                                 |
| Property                      | change in prior accident years | (23.5)%                               | 1.2%        | (24.7)                                 |
| Property                      | loss ratio                     | 11.0%                                 | 63.0%       | (52.0)                                 |
| Marine                        | current year                   | 59.8%                                 | 63.4%       | (3.6)                                  |
| Marine                        | change in prior accident years | (6.7)%                                | (5.9)%      | (0.8)                                  |
| Marine                        | loss ratio                     | 53.1%                                 | 57.5%       | (4.4)                                  |
| Specialty                     | current year                   | 66.1%                                 | 49.9%       | 16.2                                   |
| Specialty                     | change in prior accident years | 3.5%                                  | (13.1)%     | 16.6                                   |
| Specialty                     | loss ratio                     | 69.6%                                 | 36.8%       | 32.8                                   |
| All lines                     | current year                   | 57.1%                                 | 57.9%       | (0.8)                                  |
| All lines                     | change in prior accident years | (6.2)%                                | (7.3)%      | 1.1                                    |
| <b>All lines - loss ratio</b> |                                | 50.9%                                 | 50.6%       | 0.3                                    |

For the three months ended June 30, 2009, the property lines include \$11.6 million related to current year losses and \$7.9 million of favorable development relating to prior accident years. This favorable development is primarily attributable to lower than expected claims development together with \$2.3 million of favorable development relating to Hurricane Katrina. Talbot property line loss ratio, excluding prior year development for the three months ended June 30, 2009 and 2008 were 34.5% and 61.8%, respectively. This decrease was due to significant number of non-catastrophe events in the three months ended June 30, 2008 compared to the same period in 2009.

For the three months ended June 30, 2009, the marine lines include \$40.3 million related to current year losses and \$4.5 million of favorable development relating to prior accident years. This favorable development is primarily

attributable to the Energy line. Talbot marine line loss ratios, excluding prior year development, for the three months ended June 30, 2009 and 2008 were 59.8% and 63.4%, respectively.

For the three months ended June 30, 2009, the specialty lines include \$42.0 million relating to current year losses and \$2.2 million due to adverse development on prior accident years. For the three months ended June 30, 2009, Talbot's specialty lines incurred \$8.3 million, or 13.1 percentage points of the specialty lines loss ratio, attributable to a commercial flight loss. Talbot specialty lines loss ratios, excluding prior year development and the

**Table of Contents**

loss events identified above, for the three months ended June 30, 2009 and 2008 were 53.1% and 49.9%, respectively.

**Policy Acquisition Costs**

Policy acquisition costs for the three months ended June 30, 2009 were \$64.4 million compared to \$56.4 million for the three months ended June 30, 2008, an increase of \$8.0 million or 14.2%. Policy acquisition costs as a percent of net premiums earned for the three months ended June 30, 2009 and 2008 were 19.6% and 18.2%, respectively.

| <u>(Dollars in thousands)</u> | Policy acquisition costs |               |                    |               |              |  |
|-------------------------------|--------------------------|---------------|--------------------|---------------|--------------|--|
|                               | Three months ended       |               | Three months ended |               | % Change     |  |
|                               | June 30, 2009            | June 30, 2008 | June 30, 2009      | June 30, 2008 |              |  |
| Property                      | \$ 22,796                | 35.4%         | \$ 24,623          | 43.6%         | (7.4)%       |  |
| Marine                        | 23,590                   | 36.6%         | 16,464             | 29.2%         | 43.3%        |  |
| Specialty                     | 18,052                   | 28.0%         | 15,332             | 27.2%         | 17.7%        |  |
| <b>Total</b>                  | <b>\$ 64,438</b>         | <b>100.0%</b> | <b>\$ 56,419</b>   | <b>100.0%</b> | <b>14.2%</b> |  |

*Validus Re.* Validus Re policy acquisition costs for the three months ended June 30, 2009 were \$29.1 million compared to \$25.3 million for the three months ended June 30, 2008, an increase of \$3.8 million or 15.1%.

| <u>(Dollars in thousands)</u> | Policy acquisition costs |               |                    |               |              |  |
|-------------------------------|--------------------------|---------------|--------------------|---------------|--------------|--|
|                               | Three months ended       |               | Three months ended |               | % Change     |  |
|                               | June 30, 2009            | June 30, 2008 | June 30, 2009      | June 30, 2008 |              |  |
| Property                      | \$ 18,052                | 62.0%         | \$ 19,430          | 76.7%         | (7.1)%       |  |
| Marine                        | 8,290                    | 28.5%         | 3,356              | 13.3%         | 147.0%       |  |
| Specialty                     | 2,778                    | 9.5%          | 2,523              | 10.0%         | 10.1%        |  |
| <b>Total</b>                  | <b>\$ 29,120</b>         | <b>100.0%</b> | <b>\$ 25,309</b>   | <b>100.0%</b> | <b>15.1%</b> |  |

Policy acquisition costs include brokerage, commission and excise tax and are generally driven by contract terms and are normally a set percentage of premiums and are also net of ceding commission income on retrocessions. Policy acquisition costs as a percent of net premiums earned for the three months ended June 30, 2009 and 2008 were 17.8% and 15.4%, respectively. The policy acquisition ratio increased largely due to a 12.0 percentage point increase on the marine policy acquisition ratio. The increase in the marine policy acquisition ratio was due to an increased portion of gross premiums written being earned on proportional contracts, which generally experience higher acquisition costs. *Talbot.* Talbot policy acquisition costs for the three months ended June 30, 2009 were \$36.1 million compared to \$31.1 million for the three months ended June 30, 2008, an increase of \$5.0 million or 16.0%.

| <u>(Dollars in thousands)</u> | Policy acquisition costs |               |                    |               |              |  |
|-------------------------------|--------------------------|---------------|--------------------|---------------|--------------|--|
|                               | Three months ended       |               | Three months ended |               | % Change     |  |
|                               | June 30, 2009            | June 30, 2008 | June 30, 2009      | June 30, 2008 |              |  |
| Property                      | \$ 5,540                 | 15.3%         | \$ 5,217           | 16.8%         | 6.2%         |  |
| Marine                        | 15,300                   | 42.4%         | 13,108             | 42.1%         | 16.7%        |  |
| Specialty                     | 15,274                   | 42.3%         | 12,809             | 41.1%         | 19.2%        |  |
| <b>Total</b>                  | <b>\$ 36,114</b>         | <b>100.0%</b> | <b>\$ 31,134</b>   | <b>100.0%</b> | <b>16.0%</b> |  |

Policy acquisition costs as a percent of net premiums earned were 22.0% and 21.4%, respectively, for the three month periods ended June 30, 2009 and 2008.

**General and Administrative Expenses**

General and administrative expenses for the three months ended June 30, 2009 were \$41.2 million compared to \$33.9 million for the three months ended June 30, 2008, an increase of \$7.3 million or 21.5%. The increase was a result of increased expenses in both the Validus Re and Talbot segments.

**Table of Contents**

| <u>(Dollars in thousands)</u> | <b>General and administrative expenses</b> |               |                      |                           |                 |  |
|-------------------------------|--------------------------------------------|---------------|----------------------|---------------------------|-----------------|--|
|                               | <b>Three months ended</b>                  |               |                      | <b>Three months ended</b> |                 |  |
|                               | <b>June 30, 2009</b>                       |               | <b>June 30, 2008</b> |                           | <b>% Change</b> |  |
| Validus Re                    | \$ 14,149                                  | 34.4%         | \$ 9,955             | 29.4%                     | 42.1%           |  |
| Talbot                        | 21,927                                     | 53.2%         | 19,787               | 58.3%                     | 10.8%           |  |
| Corporate & Eliminations      | 5,124                                      | 12.4%         | 4,170                | 12.3%                     | 22.9%           |  |
| <b>Total</b>                  | <b>\$ 41,200</b>                           | <b>100.0%</b> | <b>\$ 33,912</b>     | <b>100.0%</b>             | <b>21.5%</b>    |  |

General and administrative expense ratios for the three month periods ended June 30, 2009 and 2008 were 14.3% and 13.3%, respectively. General and administrative expense ratio is the sum of general and administrative expenses and share compensation expense divided by net premiums earned.

| <u>(Dollars in thousands)</u> | <b>Three months ended</b>          |                 | <b>Three months ended</b>          |                 |
|-------------------------------|------------------------------------|-----------------|------------------------------------|-----------------|
|                               | <b>June 30, 2009</b>               |                 | <b>June 30, 2008</b>               |                 |
|                               | <b>Expenses as % of Net Earned</b> |                 | <b>Expenses as % of Net Earned</b> |                 |
|                               | <b>Expenses</b>                    | <b>Premiums</b> | <b>Expenses</b>                    | <b>Premiums</b> |
| General and Administrative    | \$ 41,200                          | 12.6%           | \$ 33,912                          | 10.9%           |
| Share Compensation            | 5,632                              | 1.7%            | 7,271                              | 2.4%            |
| <b>Total</b>                  | <b>\$ 46,832</b>                   | <b>14.3%</b>    | <b>\$ 41,183</b>                   | <b>13.3%</b>    |

General and administrative expenses of \$41.2 million in the three months ended June 30, 2009 represents 12.6 percentage points of the expense ratio. Share compensation expense is discussed in the following section.

*Validus Re.* Validus Re general and administrative expenses for the three months ended June 30, 2009 were \$14.1 million compared to \$10.0 million for the three months ended June 30, 2008, an increase of \$4.2 million or 42.1%. General and administrative expenses have increased primarily as a result of the increase in staff to 105 at June 30, 2009 from 80 at June 30, 2008. General and administrative expenses are generally comprised of salaries and benefits, professional fees, rent and office expenses. Validus Re's general and administrative expenses as a percent of net premiums earned for the three month periods ended June 30, 2009 and 2008 were 8.7% and 6.1%, respectively.

*Talbot.* Talbot general and administrative expenses for the three months ended June 30, 2009 were \$21.9 million compared to \$19.8 million for the three months ended June 30, 2008, an increase of \$2.1 million or 10.8%. General and administrative expenses have increased primarily as a result of the increase in staff to 212 at June 30, 2009 from 167 at June 30, 2008 and expenses related to the new Onshore Energy and Aviation underwriting teams. Talbot's general and administrative expenses as a percent of net premiums earned for the three month periods ended June 30, 2009 and 2008 were 13.3% and 13.6%, respectively.

*Corporate & Eliminations.* Corporate general and administrative expenses for the three months ended June 30, 2009 were \$5.1 million compared to \$4.2 million for the three months ended June 30, 2008, an increase of \$1.0 million or 22.9%. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other cost relating to the Company as a whole.

**Share Compensation Expense**

Share compensation expense for the three months ended June 30, 2009 was \$5.6 million compared to \$7.3 million for the three months ended June 30, 2008, a decrease of \$1.6 million or 22.5%. This expense is non-cash and has no net effect on total shareholders' equity, as it is balanced by an increase in additional paid-in capital.

**Share compensation expense**

| <b>(Dollars in thousands)</b> | <b>Three months ended</b> |               | <b>Three months ended</b> |               | <b>% Change</b> |
|-------------------------------|---------------------------|---------------|---------------------------|---------------|-----------------|
|                               | <b>June 30, 2009</b>      |               | <b>June 30, 2008</b>      |               |                 |
| Validus Re                    | \$ 1,548                  | 27.4%         | \$ 1,597                  | 22.0%         | (3.1)%          |
| Talbot                        | 2,098                     | 37.3%         | 1,126                     | 15.5%         | 86.3%           |
| Corporate & Eliminations      | 1,986                     | 35.3%         | 4,548                     | 62.5%         | (56.3)%         |
| <b>Total</b>                  | <b>\$ 5,632</b>           | <b>100.0%</b> | <b>\$ 7,271</b>           | <b>100.0%</b> | <b>(22.5)%</b>  |



**Table of Contents**

Share compensation expense of \$5.6 million in the three months ended June 30, 2009 represents 1.7 percentage points of the general and administrative expense ratio.

*Validus Re.* Validus Re share compensation expense for the three months ended June 30, 2009 was \$1.5 million compared to \$1.6 million for the three months ended June 30, 2008. Share compensation expense as a percent of net premiums earned for the three month periods ended June 30, 2009 and 2008 were 0.9% and 1.0%, respectively.

*Talbot.* Talbot share compensation expense for the three months ended June 30, 2009 was \$2.1 million and \$1.1 million for the three months ended June 30, 2008. The increase was due to the impact of grants made during 2008. Share compensation expense as a percent of net premiums earned for the three month periods ended June 30, 2009 and June 30, 2008 was 1.3% and 0.8%, respectively.

*Corporate & Eliminations.* Corporate share compensation expense for the three months ended June 30, 2009 was \$2.0 million compared to \$4.5 million for the three months ended June 30, 2008, a decrease of \$2.6 million or 56.3%. This decrease was due primarily to several share award issuances with vesting periods greater than one year that vested during the year ended December 31, 2008 and therefore had no further amortization expense during the three months ended June 30, 2009.

**Selected Ratios**

The underwriting results of an insurance or reinsurance company are often measured by reference to its combined ratio, which is the sum of the loss ratio and the expense ratio. The net loss ratio is calculated by dividing losses and loss expenses incurred (including estimates for incurred but not reported losses) by net premiums earned. The expense ratio is calculated by dividing acquisition costs combined with general and administrative expenses by net premiums earned. The following table presents the losses and loss expenses ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the three months ended June 30, 2009 and 2008.

|                                             | <b>Three months<br/>ended</b> | <b>Three months<br/>ended</b> | <b>Percentage<br/>point<br/>change</b> |
|---------------------------------------------|-------------------------------|-------------------------------|----------------------------------------|
|                                             | <b>June 30, 2009</b>          | <b>June 30, 2008</b>          |                                        |
| Losses and loss expenses ratio              | 38.0%                         | 39.5%                         | (1.5)                                  |
| Policy acquisition cost ratio               | 19.6%                         | 18.2%                         | 1.4                                    |
| General and administrative expense ratio(1) | 14.3%                         | 13.3%                         | 1.0                                    |
| <br>Expense ratio                           | <br>33.9%                     | <br>31.5%                     | <br>2.4                                |
| <b>Combined ratio</b>                       | <b>71.9%</b>                  | <b>71.0%</b>                  | <b>0.9</b>                             |

(1) Includes general and administrative expense and share compensation expense

|                                | <b>Three months<br/>ended</b> | <b>Three months<br/>ended</b> | <b>Percentage<br/>point<br/>change</b> |
|--------------------------------|-------------------------------|-------------------------------|----------------------------------------|
|                                | <b>June 30, 2009</b>          | <b>June 30, 2008</b>          |                                        |
| <i>Validus Re</i>              |                               |                               |                                        |
| Losses and loss expenses ratio | 25.1%                         | 29.7%                         | (4.6)                                  |
| Policy acquisition cost ratio  | 17.8%                         | 15.4%                         | 2.4                                    |

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|                                          |              |              |            |
|------------------------------------------|--------------|--------------|------------|
| General and administrative expense ratio | 9.6%         | 7.0%         | 2.6        |
| Expense ratio                            | 27.4%        | 22.4%        | 5.0        |
| <b>Combined ratio</b>                    | <b>52.5%</b> | <b>52.1%</b> | <b>0.4</b> |

|                                          | <b>Three months<br/>ended</b> | <b>Three months<br/>ended</b> | <b>Percentage<br/>point<br/>change</b> |
|------------------------------------------|-------------------------------|-------------------------------|----------------------------------------|
| <i>Talbot</i>                            | <b>June 30, 2009</b>          | <b>June 30, 2008</b>          |                                        |
| Losses and loss expenses ratio           | 50.8%                         | 50.6%                         | 0.2                                    |
| Policy acquisition cost ratio            | 22.0%                         | 21.4%                         | 0.6                                    |
| General and administrative expense ratio | 14.6%                         | 14.4%                         | 0.2                                    |
| Expense ratio                            | 36.6%                         | 35.8%                         | 0.6                                    |
| <b>Combined ratio</b>                    | <b>87.4%</b>                  | <b>86.4%</b>                  | <b>1.0</b>                             |

**Table of Contents****Underwriting Income**

Underwriting income for the three months ended June 30, 2009 was \$92.2 million compared to income of \$89.6 million for the three months ended June 30, 2008, a change of \$2.6 million or 2.9%.

|                               | Three months ended |          | Three months ended |          |             |
|-------------------------------|--------------------|----------|--------------------|----------|-------------|
|                               |                    | % of Sub |                    | % of Sub | %           |
| <u>(Dollars in thousands)</u> | June 30, 2009      | total    | June 30, 2008      | total    | Change      |
| Validus Re                    | \$ 77,759          | 78.9%    | \$ 78,574          | 79.9%    | (1.0)%      |
| Talbot                        | 20,734             | 21.1%    | 19,727             | 20.1%    | 5.1%        |
| Sub total                     | 98,493             | 100.0%   | 98,301             | 100.0%   | 0.2%        |
| Corporate & Eliminations      | (6,314)            |          | (8,694)            |          | (27.4)%     |
| <b>Total</b>                  | <b>\$ 92,179</b>   |          | <b>\$ 89,607</b>   |          | <b>2.9%</b> |

The underwriting results of an insurance or reinsurance company are also often measured by reference to its underwriting income, which is a non-GAAP measure as previously defined. Underwriting income, as set out in the table below, is reconciled to net income (the most directly comparable GAAP financial measure) by the addition or subtraction of net investment income, other income, finance expenses, transaction expenses, realized gain on repurchase of debentures, net realized and unrealized gains (losses) on investments and foreign exchange gains (losses).

|                                              | Three months ended | Three months ended |
|----------------------------------------------|--------------------|--------------------|
| <u>(Dollars in thousands)</u>                | June 30, 2009      | June 30, 2008      |
| <b>Underwriting income</b>                   | \$ 92,179          | \$ 89,607          |
| Net investment income                        | 26,963             | 36,435             |
| Other income                                 | 1,017              | 1,462              |
| Finance expenses                             | (10,752)           | (12,762)           |
| Transaction expenses                         | (15,851)           |                    |
| Realized gain on repurchase of debentures    |                    | 8,752              |
| Net realized gains (losses) on investments   | (2,650)            | (2,425)            |
| Net unrealized gains (losses) on investments | 37,249             | (42,982)           |
| Foreign exchange gains (losses)              | 8,432              | 911                |
| <b>Net income before taxes</b>               | <b>\$ 136,587</b>  | <b>\$ 78,998</b>   |

Underwriting income indicates the performance of the Company's core underwriting function, excluding revenues and expenses such as the reconciling items in the table above. The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company's core insurance and reinsurance business. Underwriting profitability is influenced significantly by earned premium growth, adequacy of the Company's pricing and loss frequency and severity. Underwriting profitability over time is also influenced by the Company's underwriting discipline, which seeks to manage exposure to loss through favorable risk selection and diversification, its management of claims, its use of reinsurance and its ability to manage its expense ratio, which it accomplishes through its management of acquisition costs and other underwriting expenses. The Company believes that underwriting income provides investors with a valuable measure of profitability derived from underwriting activities.

The Company excludes the U.S. GAAP measures noted above, in particular net realized and unrealized gains and losses on investments, from its calculation of underwriting income because the amount of these gains and losses is heavily influenced by, and fluctuates in part, according to availability of investment market opportunities. The Company believes these amounts are largely independent of its underwriting business and including them distorts the analysis of trends in its operations. In addition to presenting net income determined in accordance with U.S. GAAP, the Company believes that showing underwriting income enables investors, analysts, rating agencies and other users of its financial information to more easily analyze the Company's results of operations in a manner similar to how management analyzes the Company's underlying business performance. The Company uses underwriting income as a primary measure of underwriting results in its analysis of historical financial information and when performing its budgeting and forecasting processes. Analysts, investors and rating agencies who follow the Company request this non-GAAP financial information on a regular basis. In addition, underwriting income is one of the factors considered by the compensation committee of our Board of Directors in determining the bonus component of the total annual incentive compensation.

**Table of Contents**

Underwriting income should not be viewed as a substitute for U.S. GAAP net income as there are inherent material limitations associated with the use of underwriting income as compared to using net income, which is the most directly comparable U.S. GAAP financial measure. The most significant limitation is the ability of users of the financial information to make comparable assessments of underwriting income with other companies, particularly as underwriting income may be defined or calculated differently by other companies. Therefore, the Company provides more prominence in this filing to the use of the most comparable U.S. GAAP financial measure, net income, which includes the reconciling items in the table above. The Company compensates for these limitations by providing both clear and transparent disclosure of net income and reconciliation of underwriting income to net income.

**Net Investment Income**

Net investment income for the three months ended June 30, 2009 was \$27.0 million compared to \$36.4 million for the three months ended June 30, 2008, a decrease of \$9.4 million or 26.0%. Net investment income decreased as a result of reduced market yields and higher quarterly average cash balances. Net investment income is comprised of accretion of premium or discount on fixed maturities, interest on coupon-paying bonds, short-term investments and cash and cash equivalents, partially offset by investment management fees. The components of net investment income for the three months ended June 30, 2009 and 2008 are as presented below.

|                                             | <b>Three months<br/>ended</b> | <b>Three months<br/>ended</b> | <b>%<br/>Change</b> |
|---------------------------------------------|-------------------------------|-------------------------------|---------------------|
| <b>(Dollars in thousands)</b>               | <b>June 30, 2009</b>          | <b>June 30, 2008</b>          |                     |
| Fixed maturities and short-term investments | \$ 26,395                     | \$ 34,519                     | (23.5)%             |
| Securities lending income                   | 173                           | 455                           | (62.0)%             |
| Cash and cash equivalents                   | 1,120                         | 2,378                         | (52.9)%             |
| Total investment income                     | 27,688                        | 37,352                        | (25.9)%             |
| Investment expenses                         | (726)                         | (917)                         | 20.8%               |
| <b>Net investment income</b>                | <b>\$ 26,962</b>              | <b>\$ 36,435</b>              | <b>(26.0)%</b>      |

Investment management fees incurred relate to BlackRock Financial Management, Inc. ( BlackRock ) and Goldman Sachs Asset Management L.P. and its affiliates ( GSAM ). Each of Merrill Lynch & Co, Inc. ( Merrill Lynch ), a wholly owned subsidiary of Bank of America Corp., and Goldman Sachs are major shareholders of the Company. BlackRock is considered a related party due to its merger in February 2006 with Merrill Lynch Investment Managers. Investment management fees earned by BlackRock for the three month periods ended June 30, 2009 and June 30, 2008 were \$0.5 million and \$0.5 million, respectively. Investment management fees earned by GSAM for the three month periods ended June 30, 2009 and June 30, 2008 were \$0.4 million and \$0.4 million, respectively. Management believes that the fees charged were consistent with those that would have been charged in arm s-length transactions with unrelated third parties.

Annualized effective investment yield is based on the weighted average investments held calculated on a simple period average and excludes net unrealized gains (losses), foreign exchange gains (losses) on investments and the foreign exchange effect of insurance balances. The Company s annualized effective investment yield was 3.08% and 4.50% for the three months ended June 30, 2009 and 2008, respectively, and the average duration at June 30, 2009 was 1.9 years (December 31, 2008 1.8 years).

**Finance Expenses**

Finance expenses for the three months ended June 30, 2009 were \$10.8 million compared to \$12.8 million for the three months ended June 30, 2008, a decrease of \$2.0 million or 15.7%. The decrease was primarily a result of a \$2.1 million decrease in Talbot third party FAL expense.

Finance expenses also include the amortization of debt offering costs and discounts and fees related to our credit facilities.



**Table of Contents**

| (Dollars in thousands)                           | Three months<br>ended | Three months<br>ended | % Change |
|--------------------------------------------------|-----------------------|-----------------------|----------|
|                                                  | June 30, 2009         | June 30, 2008         |          |
| 9.069% Junior Subordinated Deferrable Debentures | \$ 3,589              | \$ 3,589              | -        |
| 8.480% Junior Subordinated Deferrable Debentures | 3,348                 | 3,650                 | (8.3)%   |
| Credit facilities                                | 476                   | 123                   | 287.0%   |
| Talbot FAL facilities                            | 42                    | 62                    | (32.3)%  |
| Talbot other interest                            | -                     | (19)                  | NM       |
| Talbot third party FAL facility                  | 3,297                 | 5,357                 | (38.5)%  |
| Total                                            | \$ 10,752             | \$ 12,762             | (15.7)%  |

NM: Not Meaningful

Capital in Lloyd's entities, whether personal or corporate, is required to be set annually for the prospective year and held by Lloyd's in trust (Funds at Lloyd's or FAL). In underwriting years up to and including 2007, Talbot's FAL has been provided both by Talbot and by third parties, thereafter Talbot's FAL has been provided exclusively by the Company. Because the third party FAL providers remain on risk until each year of account that their support closes (normally after three years), Talbot must retain third party FAL even if a third party FAL provider has ceased to support the active underwriting year. This is achieved by placing such FAL in escrow outside Lloyd's. Thus the total FAL facility available to the Company is the total FAL for active and prior underwriting years, although the Company can only apply specific FAL against losses incurred by an underwriting year that such FAL is contracted to support.

For each year of account up to and including the 2007 year of account, between 30% and 40% of an amount equivalent to each underwriting year's profit is payable to Talbot third party FAL providers. However, some of these costs are fixed. There are no FAL finance charges related to the 2008 and 2009 years of account as there were no third party FAL providers in those periods.

The FAL finance charges relate to total syndicate profit (underwriting income, investment income and realized and unrealized capital gains and losses). FAL finance charges and total syndicate profits are analyzed by underwriting year of account as follows:

| Underwriting Year of Account<br>(Dollars in thousands) | Three months ended June 30 |          |           |           | FAL Finance Charges<br>as<br>% of Total Syndicate<br>Profit |          |
|--------------------------------------------------------|----------------------------|----------|-----------|-----------|-------------------------------------------------------------|----------|
|                                                        | FAL Finance Charges        |          | Profit    |           | 2009                                                        | 2008 (1) |
|                                                        | 2009                       | 2008     | 2009      | 2008      |                                                             |          |
| 2006 (1)                                               | \$ -                       | \$ 1,129 | \$ -      | \$ 3,384  | NM                                                          | 33.4%    |
| 2007                                                   | 3,297                      | 4,228    | 8,589     | 14,120    | 38.4%                                                       | 29.9%    |
| 2008                                                   | -                          | -        | 8,502     | (5,128)   | NM                                                          | NM       |
| 2009                                                   | -                          | -        | 3,524     | -         | NM                                                          | NM       |
| Total                                                  | \$ 3,297                   | \$ 5,357 | \$ 20,615 | \$ 12,376 | 16.0%                                                       | 43.3%    |
| Percentage excluding years in deficit                  |                            |          |           |           | 16.0%                                                       | 30.6%    |

(1) The earliest year of account includes the run-off of prior (closed) years of account.

NM: Not meaningful

FAL finance charges are based on syndicate profit but include fixed elements. FAL finance charges for the three months ended June 30, 2009 were \$3.3 million compared to \$5.4 million for the three months ended June 30, 2008, a decrease of \$2.1 million. This decrease was due to the absence of FAL finance charges related to the 2006 year of account, which is now closed.

Total syndicate profit, as set out in the table below, is reconciled to the Talbot segment net income by the addition or subtraction of items noted below.



**Table of Contents**

| <b>(Dollars in thousands)</b>                  | <b>Three months ended June 30</b> |                 |
|------------------------------------------------|-----------------------------------|-----------------|
|                                                | <b>2009</b>                       | <b>2008</b>     |
| <b>Total syndicate profit</b>                  | \$ 20,615                         | \$ 12,376       |
| FAL Finance expenses                           | (3,297)                           | (5,357)         |
| Managing agent's fee (1)                       | 2,342                             | 2,414           |
| Managing agent's profit commission (2)         | 2,961                             | 3,068           |
| Investment income (3)                          | 4,103                             | 2,589           |
| Other segment operating income (expenses), net | 9,909                             | (2,194)         |
| Share compensation (expenses)                  | (2,098)                           | (1,114)         |
| Intangible amortization (expenses)             | (1,041)                           | (1,041)         |
| Income tax benefit (expense)                   | 1,004                             | (3,057)         |
| <b>Talbot segment net income</b>               | <b>\$ 34,498</b>                  | <b>\$ 7,684</b> |

(1) 1.5% of syndicate capacity; corresponding syndicate expense reflected in total syndicate profit, above.

(2) 15.0% of syndicate profit; corresponding syndicate expense reflected in total syndicate profit, above.

(3) On FAL and on non-syndicate cash balances.

**Net Realized (Losses) Gains on Investments**

Net realized losses on investments for the three months ended June 30, 2009 were \$(2.7) million compared to losses of \$(2.4) million for the three months ended June 30, 2008.

**Net Unrealized Gains (Losses) on Investments**

Net unrealized gains on investments for the three months ended June 30, 2009 were \$37.2 million compared to losses of \$(43.0) million for the three months ended June 30, 2008. The net unrealized gains in the three months ended June 30, 2009 resulted primarily from unrealized gains in non-agency RMBS and corporate bond sectors, partially offset by unrealized losses in U.S. government and government agency securities.

The Company early adopted FAS 157 and the FAS 159 Fair Value Option on January 1, 2007 for its investment portfolio. As a result, for the three months ended June 30, 2009 and 2008, net unrealized gains on investments are

recorded as a component of net income. Talbot also adopted FAS 157 and the FAS 159 Fair Value Option for its investment portfolio upon acquisition by the Company on July 2, 2007. The Company adopted FSP FAS 157-3 during the year ended December 31, 2008 and FSP FAS 157-4 in the three months ended June 30, 2009. Consistent with these statements, certain market conditions allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable. Certain non-Agency RMBS securities were identified as trading in inactive markets. The change in fair value for the identified non-Agency RMBS securities was a \$5.4 million decrease in net unrealized loss on investments for the three months ended June 30, 2009. Further details are provided in the Investments section below.

**Other Income**

Other income for the three months ended June 30, 2009 was \$1.0 million compared to \$1.5 million for the three months ended June 30, 2008, a decrease of \$0.4 million or 30.4%.

**Foreign Exchange Gains (Losses)**

Foreign exchange gains for the three month period ended June 30, 2009 were \$8.4 million compared to \$0.9 million for the three months ended June 30, 2008, a change of \$7.5 million. The foreign exchange gains during the three months ended June 30, 2009 were due primarily to an increase in the value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency. The Talbot segment accounted for \$6.5 million of this gain. The British pound sterling to U.S. dollar exchange rates were 1.43 and 1.65 at March 31, 2009 and June 30, 2009, respectively. Certain premiums receivable and liabilities for losses incurred in currencies other than the U.S. dollar are exposed to the risk of changes in value resulting from fluctuations in foreign exchange rates and may affect financial results in the future.

At June 30, 2009, Talbot's balance sheet includes net unearned premiums and deferred acquisition costs denominated in foreign currencies of approximately \$110.0 million and \$23.0 million, respectively. These balances consisted of British pounds sterling and Canadian dollars of \$80.5 million and \$7.2 million, respectively. Net unearned premiums and deferred acquisition costs are classified as non-monetary items and are translated at historic

**Table of Contents**

exchange rates. All of Talbot's other balance sheet items are classified as monetary items and are translated at period end exchange rates. During the three months ended June 30, 2009, this translation process resulted in foreign exchange gains that will reverse in future periods as net unearned premiums and deferred acquisition costs are earned together with gains arising from the reversal of losses incurred in previous periods. Additional foreign exchange (losses) gains may be incurred on the translation of net unearned premiums and deferred acquisition costs arising from insurance and reinsurance premiums written in future periods.

**Transaction Expenses**

On July 9, 2009, the Company announced that the boards of directors of both the Company and IPC had approved a definitive amalgamation agreement. During the three months ended June 30, 2009, the Company incurred \$15.9 million in relation to the proposed acquisition of and amalgamation agreement with IPC. Transaction expenses are comprised of primarily legal, corporate advisory and audit related services.

**Income Tax Benefit (Expense)**

Income tax benefit for the three months ended June 30, 2009 was \$1.0 million compared to an expense of \$(3.1) million for the three months ended June 30, 2008, a change of \$4.1 million. The income tax benefit was due to U.K. taxable losses for six months ended June 30, 2009 offsetting taxation in prior periods. These taxable losses were due primarily to Syndicate 1183's 2008 and 2009 years of account, both of which have generated little or no profit commission revenue for Talbot's U.K. entities. On an inception to date basis, the 2009 year of account is in an overall deficit position while the 2008 year of account only moved into surplus during the second quarter of 2009.

**Table of Contents**

The following table presents results of operations for the three and six ended June 30, 2009 and 2008:

| <b>(Dollars in thousands)</b>                | <b>Three months<br/>ended<br/>June 30, 2009</b> | <b>Three months<br/>ended<br/>June 30, 2008</b> | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> |
|----------------------------------------------|-------------------------------------------------|-------------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| Gross premiums written                       | \$ 425,032                                      | \$ 379,919                                      | \$ 1,034,924                                  | \$ 901,513                                    |
| Reinsurance premiums ceded                   | (62,291)                                        | (1,399)                                         | (134,803)                                     | (86,299)                                      |
| Net premiums written                         | 362,741                                         | 378,520                                         | 900,121                                       | 815,214                                       |
| Change in unearned premiums                  | (34,541)                                        | (69,222)                                        | (253,162)                                     | (214,052)                                     |
| Net premiums earned                          | 328,200                                         | 309,298                                         | 646,959                                       | 601,162                                       |
| Losses and loss expenses                     | 124,751                                         | 122,089                                         | 256,585                                       | 262,113                                       |
| Policy acquisition costs                     | 64,438                                          | 56,419                                          | 125,887                                       | 113,120                                       |
| General and administrative expenses          | 41,200                                          | 33,912                                          | 79,279                                        | 71,019                                        |
| Share compensation expense                   | 5,632                                           | 7,271                                           | 12,986                                        | 13,806                                        |
| Total underwriting expenses                  | 236,021                                         | 219,691                                         | 474,737                                       | 460,058                                       |
| Underwriting income (1)                      | 92,179                                          | 89,607                                          | 172,222                                       | 141,104                                       |
| Net investment income                        | 26,963                                          | 36,435                                          | 53,735                                        | 72,478                                        |
| Other income                                 | 1,017                                           | 1,462                                           | 1,774                                         | 2,397                                         |
| Finance (expenses)                           | (10,752)                                        | (12,762)                                        | (18,475)                                      | (34,279)                                      |
| Operating income before taxes                | 109,407                                         | 114,742                                         | 209,256                                       | 181,700                                       |
| Income tax benefit (expense)                 | 976                                             | (3,077)                                         | 1,502                                         | (4,506)                                       |
| Operating income after tax                   | 110,383                                         | 111,665                                         | 210,758                                       | 177,194                                       |
| Net realized gains (losses) on investments   | (2,650)                                         | (2,425)                                         | (26,071)                                      | 5,319                                         |
| Net unrealized gains (losses) on investments | 37,249                                          | (42,982)                                        | 59,402                                        | (57,959)                                      |
| Realized gain on repurchase of debentures    |                                                 | 8,752                                           |                                               | 8,752                                         |
| Foreign exchange gains (losses)              | 8,432                                           | 911                                             | 4,232                                         | 9,090                                         |
| Transaction (expenses)                       | (15,851)                                        |                                                 | (15,851)                                      |                                               |
| <b>Net income after taxes</b>                | <b>\$ 137,563</b>                               | <b>\$ 75,921</b>                                | <b>\$ 232,470</b>                             | <b>\$ 142,396</b>                             |
| <b>Comprehensive income</b>                  |                                                 |                                                 |                                               |                                               |
| Foreign currency translation adjustments     | 3,993                                           | 10                                              | 3,797                                         | 77                                            |
| <b>Comprehensive income</b>                  | <b>\$ 141,556</b>                               | <b>\$ 75,931</b>                                | <b>\$ 236,267</b>                             | <b>\$ 142,473</b>                             |

**Selected ratios**

|                                              |       |       |       |       |
|----------------------------------------------|-------|-------|-------|-------|
| Net premiums written/ Gross premiums written | 85.3% | 99.6% | 87.0% | 90.4% |
| Losses and loss expenses ratio               | 38.0% | 39.5% | 39.7% | 43.6% |
| Policy acquisition cost ratio                | 19.6% | 18.2% | 19.5% | 18.8% |
| General and administrative expense ratio     | 14.3% | 13.3% | 14.3% | 14.1% |
| Expense ratio                                | 33.9% | 31.5% | 33.8% | 32.9% |
| Combined ratio                               | 71.9% | 71.0% | 73.5% | 76.5% |

(1) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income (loss) and operating income that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation underwriting income (loss) measure to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled Underwriting Income.

**Table of Contents**

|                                            | <b>Three months<br/>ended<br/>June 30, 2009</b> | <b>Three months<br/>ended<br/>June 30, 2008</b> | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> |
|--------------------------------------------|-------------------------------------------------|-------------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| <b>(Dollars in thousands)</b>              |                                                 |                                                 |                                               |                                               |
| <b><u>VALIDUS RE</u></b>                   |                                                 |                                                 |                                               |                                               |
| Gross premiums written                     | \$ 199,560                                      | \$ 187,820                                      | \$ 609,686                                    | \$ 518,869                                    |
| Reinsurance premiums ceded                 | (43,070)                                        | (1,208)                                         | (56,359)                                      | (24,951)                                      |
| Net premiums written                       | 156,490                                         | 186,612                                         | 553,327                                       | 493,918                                       |
| Change in unearned premiums                | 7,207                                           | (22,500)                                        | (215,183)                                     | (186,151)                                     |
| Net premiums earned                        | 163,697                                         | 164,112                                         | 338,144                                       | 307,767                                       |
| Losses and loss expenses                   | 41,121                                          | 48,677                                          | 96,583                                        | 107,591                                       |
| Policy acquisition costs                   | 29,120                                          | 25,309                                          | 57,697                                        | 45,712                                        |
| General and administrative expenses        | 14,149                                          | 9,955                                           | 27,941                                        | 19,334                                        |
| Share compensation expense                 | 1,548                                           | 1,597                                           | 3,220                                         | 2,823                                         |
| Total underwriting expenses                | 85,938                                          | 85,538                                          | 185,441                                       | 175,460                                       |
| Underwriting income (1)                    | 77,759                                          | 78,574                                          | 152,703                                       | 132,307                                       |
| <b><u>TALBOT</u></b>                       |                                                 |                                                 |                                               |                                               |
| Gross premiums written                     | \$ 235,113                                      | \$ 197,235                                      | \$ 463,033                                    | \$ 399,028                                    |
| Reinsurance premiums ceded                 | (28,862)                                        | (5,327)                                         | (116,239)                                     | (77,732)                                      |
| Net premiums written                       | 206,251                                         | 191,908                                         | 346,794                                       | 321,296                                       |
| Change in unearned premiums                | (41,748)                                        | (46,722)                                        | (37,979)                                      | (27,901)                                      |
| Net premiums earned                        | 164,503                                         | 145,186                                         | 308,815                                       | 293,395                                       |
| Losses and loss expenses                   | 83,630                                          | 73,412                                          | 160,002                                       | 154,522                                       |
| Policy acquisition costs                   | 36,114                                          | 31,134                                          | 69,271                                        | 67,432                                        |
| General and administrative expenses        | 21,927                                          | 19,787                                          | 42,141                                        | 40,710                                        |
| Share compensation expense                 | 2,098                                           | 1,126                                           | 4,433                                         | 2,102                                         |
| Total underwriting expenses                | 143,769                                         | 125,459                                         | 275,847                                       | 264,766                                       |
| Underwriting income (1)                    | 20,734                                          | 19,727                                          | 32,968                                        | 28,629                                        |
| <b><u>CORPORATE &amp; ELIMINATIONS</u></b> |                                                 |                                                 |                                               |                                               |
| Gross premiums written                     | \$ (9,641)                                      | \$ (5,136)                                      | \$ (37,795)                                   | \$ (16,384)                                   |
| Reinsurance premiums ceded                 | 9,641                                           | 5,136                                           | 37,795                                        | 16,384                                        |
| Net premiums written                       |                                                 |                                                 |                                               |                                               |
| Policy acquisition costs                   | (796)                                           | (24)                                            | (1,081)                                       | (24)                                          |
| General and administrative expenses        | 5,124                                           | 4,170                                           | 9,197                                         | 10,975                                        |

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|                                      |                  |                  |                   |                   |
|--------------------------------------|------------------|------------------|-------------------|-------------------|
| Share compensation                   | 1,986            | 4,548            | 5,333             | 8,881             |
| Total underwriting expenses          | 6,314            | 8,694            | 13,449            | 19,832            |
| Underwriting income (loss) (1)       | (6,314)          | (8,694)          | (13,449)          | (19,832)          |
| <b>Total underwriting income (1)</b> | <b>\$ 92,179</b> | <b>\$ 89,607</b> | <b>\$ 172,222</b> | <b>\$ 141,104</b> |

(1) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income (loss) that is not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation of this measure to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled Underwriting Income.

**Table of Contents****Six months ended June 30, 2009 compared to six months ended June 30, 2008**

Net income for the six months ended June 30, 2009 was \$232.5 million compared to net income of \$142.4 million for the six months ended June 30, 2008, an increase of \$90.1 million or 63.3%. The primary factors driving the increase in net income were:

Increase in net realized and unrealized gains on investments of \$86.0 million; and

Increase in underwriting income of \$31.1 million due primarily to increased net premiums earned of \$45.8 million, and increased net premiums written of \$84.9 million as a result of rate increases coupled with modest exposure growth; and

Reduced finance expenses of \$15.8 million due to reduced FAL costs.

The items above were partially offset by the following factors:

Decrease in net investment income of \$18.7 million due to increased balances of cash and cash equivalents and lower returns on cash and fixed income investments; and

Transaction expenses of \$15.9 million in relation to the proposed acquisition of and amalgamation agreement with IPC.

The change in net income for the six months ended June 30, 2009 of \$90.1 million is described in the following table:

|                                              | <b>Six months ended June 30, 2009</b>                              |                  |                                                          |                  |
|----------------------------------------------|--------------------------------------------------------------------|------------------|----------------------------------------------------------|------------------|
|                                              | <b>Increase (decrease) over the six months ended June 30, 2008</b> |                  |                                                          |                  |
| <b>(Dollars in thousands)</b>                | <b>Validus Re</b>                                                  | <b>Talbot</b>    | <b>Corporate<br/>and other<br/>reconciling<br/>items</b> | <b>Total</b>     |
| Underwriting income                          | \$ 20,396                                                          | \$ 4,339         | \$ 6,383                                                 | \$ 31,118        |
| Net investment income                        | (9,183)                                                            | (7,521)          | (2,039)                                                  | (18,743)         |
| Other income                                 | 1,163                                                              | (729)            | (1,057)                                                  | (623)            |
| Finance expenses                             | (398)                                                              | 14,858           | 1,344                                                    | 15,804           |
|                                              | 11,978                                                             | 10,947           | 4,631                                                    | 27,556           |
| Taxes                                        | (18)                                                               | 6,026            |                                                          | 6,008            |
|                                              | 11,960                                                             | 16,973           | 4,631                                                    | 33,564           |
| Realized gain on repurchase of debentures    |                                                                    |                  | (8,752)                                                  | (8,752)          |
| Net realized (losses) gains on investments   | (18,496)                                                           | (12,894)         |                                                          | (31,390)         |
| Net unrealized gains (losses) on investments | 97,471                                                             | 19,890           |                                                          | 117,361          |
| Foreign exchange (losses) gains              | (8,652)                                                            | 3,738            | 56                                                       | (4,858)          |
| Transaction expenses                         |                                                                    |                  | (15,851)                                                 | (15,851)         |
| <b>Net income</b>                            | <b>\$ 82,283</b>                                                   | <b>\$ 27,707</b> | <b>\$ (19,916)</b>                                       | <b>\$ 90,074</b> |



**Gross Premiums Written**

Gross premiums written for the six months ended June 30, 2009 were \$1,034.9 million compared to \$901.5 million for the six months ended June 30, 2008, an increase of \$133.4 million or 14.8%. The increase in gross premiums written was driven primarily by the property and marine lines which increased by \$83.6 million and \$37.9 million, respectively.

Details of gross premiums written by line of business are provided below.

**Table of Contents**

| (Dollars in thousands) | Gross premiums written |               |                   |               |              |
|------------------------|------------------------|---------------|-------------------|---------------|--------------|
|                        | Six months ended       |               | Six months ended  |               | % Change     |
|                        | June 30, 2009          |               | June 30, 2008     |               |              |
| Property               | \$ 537,726             | 51.9%         | \$ 454,145        | 50.4%         | 18.4%        |
| Marine                 | 290,531                | 28.1%         | 252,583           | 28.0%         | 15.0%        |
| Specialty              | 206,667                | 20.0%         | 194,785           | 21.6%         | 6.1%         |
| <b>Total</b>           | <b>\$ 1,034,924</b>    | <b>100.0%</b> | <b>\$ 901,513</b> | <b>100.0%</b> | <b>14.8%</b> |

*Validus Re.* Validus Re gross premiums written for the six months ended June 30, 2009 were \$609.7 million compared to \$518.9 million for the six months ended June 30, 2008, an increase of \$90.8 million or 17.5%. Details of Validus Re gross premiums written by line of business are provided below.

| (Dollars in thousands) | Gross premiums written |               |                   |               |              |
|------------------------|------------------------|---------------|-------------------|---------------|--------------|
|                        | Six months ended       |               | Six months ended  |               | % Change     |
|                        | June 30, 2009          |               | June 30, 2008     |               |              |
| Property               | \$ 418,564             | 68.6%         | \$ 374,418        | 72.1%         | 11.8%        |
| Marine                 | 125,505                | 20.6%         | 92,791            | 17.9%         | 35.3%        |
| Specialty              | 65,617                 | 10.8%         | 51,660            | 10.0%         | 27.0%        |
| <b>Total</b>           | <b>\$ 609,686</b>      | <b>100.0%</b> | <b>\$ 518,869</b> | <b>100.0%</b> | <b>17.5%</b> |

The increase in Validus Re gross premiums written was driven by increases in the property and marine lines of \$44.1 million and \$32.7 million, respectively. The increase in the property line was due primarily to gross premiums written on various new contracts where favorable changes in risk adjusted pricing met Validus Re's thresholds and rate increases on existing business. The increase in the marine line was due primarily to additional gross premiums written on proportional contracts where underlying insurance coverage terms have become more favorable. The gross and net amount of reinsurance limits exposed in the Gulf of Mexico have been reduced in 2009 despite the increased gross premiums written, due to more restrictive coverage terms and, in the case of gross limits, the non-renewal of the Company's collateralized quota share facility. The property and marine lines also benefited from \$12.3 million and \$5.7 million, respectively, of increased gross premiums written as a result of Talbot quota share and surplus treaty contracts. The quota share and surplus treaty contracts with Talbot are eliminated upon consolidation.

*Talbot.* Talbot gross premiums written for the six months ended June 30, 2009 were \$463.0 million compared to \$399.0 million for the six months ended June 30, 2008, an increase of \$64.0 million or 16.0%. The \$463.0 million of gross premiums written translated at second quarter 2008 rates of exchange would have been \$501.9 million during the six months ended June 30, 2009, an increase of \$102.9 million or 25.9%. Details of gross premiums written by line of business are provided below.

| (Dollars in thousands) | Gross premiums written |               |                   |               |              |
|------------------------|------------------------|---------------|-------------------|---------------|--------------|
|                        | Six months ended       |               | Six months ended  |               | % Change     |
|                        | June 30, 2009          |               | June 30, 2008     |               |              |
| Property               | \$ 139,495             | 30.1%         | \$ 87,790         | 22.0%         | 58.9%        |
| Marine                 | 175,067                | 37.8%         | 164,101           | 41.1%         | 6.7%         |
| Specialty              | 148,471                | 32.1%         | 147,137           | 36.9%         | 0.9%         |
| <b>Total</b>           | <b>\$ 463,033</b>      | <b>100.0%</b> | <b>\$ 399,028</b> | <b>100.0%</b> | <b>16.0%</b> |

The increase in the property line was due primarily to \$40.1 million of gross premiums written on the onshore energy lines and an \$11.3 million increase in gross premiums written by Validus Reaseguros, Inc., which acts as an approved Lloyd's coverholder for Syndicate 1183 targeting the Latin American and Caribbean markets, and commenced operations during 2008.

The increase in the marine line was due primarily to additional gross premiums written on proportional contracts where underlying insurance coverage terms have become more favorable.

**Table of Contents****Reinsurance Premiums Ceded**

Reinsurance premiums ceded for the six months ended June 30, 2009 were \$134.8 million compared to \$86.3 million for the six months ended June 30, 2008, an increase of \$48.5 million or 56.2%. The increase was due primarily to a \$60.8 million increase on the property lines retrocession as described below.

| (Dollars in thousands) | Reinsurance premiums ceded |               |                  |               |              |  |
|------------------------|----------------------------|---------------|------------------|---------------|--------------|--|
|                        | Six months ended           |               | Six months ended |               | % Change     |  |
|                        | June 30, 2009              | June 30, 2009 | June 30, 2008    | June 30, 2008 |              |  |
| Property               | \$ 80,654                  | 59.8%         | \$ 19,897        | 23.0%         | 305.4%       |  |
| Marine                 | 21,592                     | 16.0%         | 31,639           | 36.7%         | (31.8)%      |  |
| Specialty              | 32,557                     | 24.2%         | 34,763           | 40.3%         | (6.3)%       |  |
| <b>Total</b>           | <b>\$ 134,803</b>          | <b>100.0%</b> | <b>\$ 86,299</b> | <b>100.0%</b> | <b>56.2%</b> |  |

*Validus Re.* Validus Re reinsurance premiums ceded for the six months ended June 30, 2009 were \$56.4 million compared to \$25.0 million for the six months ended June 30, 2008, an increase of \$31.4 million or 125.9%.

| (Dollars in thousands) | Reinsurance premiums ceded |               |                  |               |               |  |
|------------------------|----------------------------|---------------|------------------|---------------|---------------|--|
|                        | Six months ended           |               | Six months ended |               | % Change      |  |
|                        | June 30, 2009              | June 30, 2009 | June 30, 2008    | June 30, 2008 |               |  |
| Property               | \$ 46,024                  | 81.6%         | \$ 4,893         | 19.6%         | 840.6%        |  |
| Marine                 | 8,766                      | 15.6%         | 19,655           | 78.8%         | (55.4)%       |  |
| Specialty              | 1,569                      | 2.8%          | 403              | 1.6%          | 289.3%        |  |
| <b>Total</b>           | <b>\$ 56,359</b>           | <b>100.0%</b> | <b>\$ 24,951</b> | <b>100.0%</b> | <b>125.9%</b> |  |

Reinsurance premiums ceded on the property lines increased by \$41.1 million, due primarily to the advanced renewal of retrocessional coverage via ultimate net loss agreements that inceptioned in 2008 during the three months ended September 30, 2008. These ultimate net loss agreements resulted in the recognition of \$37.0 million of reinsurance premiums ceded in the six months ended June 30, 2009. The purchased retrocessional coverage includes ultimate net loss coverage that attaches at \$200.0 million of U.S. onshore property losses. The decrease in the marine line was due primarily to the nonrenewal of a collateralized quota share retrocession treaty to which Validus Re ceded \$14.6 million during the six months ended June 30, 2008.

*Talbot.* Talbot reinsurance premiums ceded for the six months ended June 30, 2009 were \$116.2 million compared to \$77.7 million for the six months ended June 30, 2008, an increase of \$38.5 million. The increase is primarily due to reinsurance premiums ceded on the onshore energy lines, as discussed above, and increased reinsurance premiums ceded under the quota share and surplus treaty contracts with Validus Re.

| (Dollars in thousands) | Reinsurance premiums ceded |               |                  |               |              |  |
|------------------------|----------------------------|---------------|------------------|---------------|--------------|--|
|                        | Six months ended           |               | Six months ended |               | % Change     |  |
|                        | June 30, 2009              | June 30, 2009 | June 30, 2008    | June 30, 2008 |              |  |
| Property               | \$ 54,963                  | 47.3%         | \$ 23,066        | 29.6%         | 138.3%       |  |
| Marine                 | 22,867                     | 19.7%         | 16,293           | 21.0%         | 40.3%        |  |
| Specialty              | 38,409                     | 33.0%         | 38,373           | 49.4%         | 0.1%         |  |
| <b>Total</b>           | <b>\$ 116,239</b>          | <b>100.0%</b> | <b>\$ 77,732</b> | <b>100.0%</b> | <b>49.5%</b> |  |

Property reinsurance premiums ceded on the onshore energy lines were \$26.4 million, 17.0% of these premiums were ceded to Validus Re. Reinsurance premiums ceded under the quota share and surplus treaty contracts with

Validus Re for the six months ended June 30, 2009 were \$37.8 million compared to \$16.4 million for the six months ended June 30, 2008, an increase of \$21.4 million. Reinsurance premiums ceded under the quota share and surplus treaty contracts with Validus Re on the property and marine lines increased by \$12.3 million and \$5.7 million, respectively, as compared to the six months ended June 30, 2008. The quota share and surplus treaty contracts with Validus Re are eliminated upon consolidation.

**Net Premiums Written**

Net premiums written for the six months ended June 30, 2009 were \$900.1 million compared to \$815.2 million for the six months ended June 30, 2008, an increase of \$84.9 million or 10.4%. The ratios of net premiums written to

**Table of Contents**

gross premiums written for the six months ended June 30, 2009 and 2008 were 87.0% and 90.4%, respectively. Details of net premiums written by line of business are provided below.

| (Dollars in thousands) | Net premiums written |               |                   |               |              |
|------------------------|----------------------|---------------|-------------------|---------------|--------------|
|                        | Six months ended     |               | Six months ended  |               | % Change     |
|                        | June 30, 2009        |               | June 30, 2008     |               |              |
| Property               | \$ 457,072           | 50.8%         | \$ 434,249        | 53.3%         | 5.3%         |
| Marine                 | 268,939              | 29.9%         | 220,944           | 27.1%         | 21.7%        |
| Specialty              | 174,110              | 19.3%         | 160,021           | 19.6%         | 8.8%         |
| <b>Total</b>           | <b>\$ 900,121</b>    | <b>100.0%</b> | <b>\$ 815,214</b> | <b>100.0%</b> | <b>10.4%</b> |

Premium rates in most lines have increased during the six months ended June 30, 2009 as compared to the same period in 2008. As a result of the Company's strategy to grow premiums written only when returns meet or exceed internal requirements, net premiums written have increased compared with the six month period ended June 30, 2008. *Validus Re*. *Validus Re* net premiums written for the six months ended June 30, 2009 were \$553.3 million compared to \$493.9 million for the six months ended June 30, 2008, an increase of \$59.4 million or 12.0%. Details of net premiums written by line of business are provided below.

| (Dollars in thousands) | Net premiums written |               |                   |               |              |
|------------------------|----------------------|---------------|-------------------|---------------|--------------|
|                        | Six months ended     |               | Six months ended  |               | % Change     |
|                        | June 30, 2009        |               | June 30, 2008     |               |              |
| Property               | \$ 372,540           | 67.3%         | \$ 369,525        | 74.8%         | 0.8%         |
| Marine                 | 116,739              | 21.1%         | 73,136            | 14.8%         | 59.6%        |
| Specialty              | 64,048               | 11.6%         | 51,257            | 10.4%         | 25.0%        |
| <b>Total</b>           | <b>\$ 553,327</b>    | <b>100.0%</b> | <b>\$ 493,918</b> | <b>100.0%</b> | <b>12.0%</b> |

The increase in *Validus Re* net premiums written was driven by an increase in the marine line of \$43.6 million. This increase was a result of increased gross premiums written and decreased reinsurance premium ceded in the marine line, as discussed above. The ratios of net premiums written to gross premiums written were 90.8% and 95.2% for the six month periods ended June 30, 2009 and 2008, respectively. This increase was attributable to the advanced renewal of a retrocessional coverage via an ultimate net loss agreement, as discussed above.

*Talbot*. *Talbot* net premiums written for the six months ended June 30, 2009 were \$346.8 million compared to \$321.3 million for the six months ended June 30, 2008, an increase of \$25.5 million or 7.9%. Details of net premiums written by line of business are provided below:

| (Dollars in thousands) | Net premiums written |               |                   |               |             |
|------------------------|----------------------|---------------|-------------------|---------------|-------------|
|                        | Six months ended     |               | Six months ended  |               | % Change    |
|                        | June 30, 2009        |               | June 30, 2008     |               |             |
| Property               | \$ 84,532            | 24.4%         | \$ 64,724         | 20.1%         | 30.6%       |
| Marine                 | 152,200              | 43.9%         | 147,808           | 46.0%         | 3.0%        |
| Specialty              | 110,062              | 31.7%         | 108,764           | 33.9%         | 1.2%        |
| <b>Total</b>           | <b>\$ 346,794</b>    | <b>100.0%</b> | <b>\$ 321,296</b> | <b>100.0%</b> | <b>7.9%</b> |

The increase in net premiums written was driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded. The ratios of net premiums written to gross premiums written for the six month periods ended June 30, 2009 and 2008 were 74.9% and 80.5%, respectively. This decrease was due primarily to

the 34.2% ratio of net premiums written to gross premiums written on the Onshore Energy lines for the six month periods ended June 30, 2009.

**Change in Unearned Premiums**

Change in unearned premiums for the six months ended June 30, 2009 was \$253.2 million compared to \$214.1 million for the six months ended June 30, 2008, an increase of \$39.1 million or 18.3%.

**Table of Contents**

| <b>(Dollars in thousands)</b>         | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> | <b>% Change</b> |
|---------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------|
| Change in gross unearned premium      | \$ (331,840)                                  | \$ (246,715)                                  | (34.5)%         |
| Change in prepaid reinsurance premium | 78,678                                        | 32,663                                        | 140.9%          |
| <b>Net change in unearned premium</b> | <b>\$ (253,162)</b>                           | <b>\$ (214,052)</b>                           | <b>(18.3)%</b>  |

*Validus Re.* Validus Re's change in unearned premiums for the six months ended June 30, 2009 was \$215.2 million compared to \$186.2 million for the six months ended June 30, 2008, an increase of \$29.0 million or 15.6%.

| <b>(Dollars in thousands)</b>         | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> | <b>%<br/>Change</b> |
|---------------------------------------|-----------------------------------------------|-----------------------------------------------|---------------------|
| Change in gross unearned premium      | \$ (238,624)                                  | \$ (184,663)                                  | (29.2)%             |
| Change in prepaid reinsurance premium | 23,441                                        | (1,488)                                       | NM                  |
| <b>Net change in unearned premium</b> | <b>\$ (215,183)</b>                           | <b>\$ (186,151)</b>                           | <b>(15.6)%</b>      |

NM: Not Meaningful

The difference in gross unearned premiums reflects the benefit of earning premiums on the increased gross premiums written of \$90.8 million, or 17.5%, from \$518.9 million for the six months ended June 30, 2008 to \$609.7 million for the six months ended June 30, 2009. In respect of prepaid reinsurance premiums, the change is a result primarily of the advanced renewal of retrocessional coverage via ultimate net loss agreements, the majority of which is prepaid at June 30, 2009, as discussed above.

*Talbot.* The Talbot change in unearned premiums for the six months ended June 30, 2009 was \$38.0 million compared to \$27.9 million for the six months ended June 30, 2008, an increase of \$10.1 million, or 36.1%.

| <b>(Dollars in thousands)</b>         | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> | <b>% Change</b> |
|---------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------|
| Change in gross unearned premium      | \$ (93,216)                                   | \$ (62,051)                                   | (50.2)%         |
| Change in prepaid reinsurance premium | 55,237                                        | 34,150                                        | 61.7%           |
| <b>Net change in unearned premium</b> | <b>\$ (37,979)</b>                            | <b>\$ (27,901)</b>                            | <b>(36.1)%</b>  |

The difference in gross unearned premiums arises principally from the increased gross premiums written in the property lines, specifically onshore energy exposures and premiums written by Validus Reaseguros, Inc. on the property treaty lines, for the six months ended June 30, 2009, as compared to the six months ended June 30, 2008. The increase in the change in prepaid reinsurance is reflective of the higher levels of ceded reinsurance, principally in the property line for the six months ended June 30, 2009, as compared to the six months ended June 30, 2008.

**Net Premiums Earned**

Net premiums earned for the six months ended June 30, 2009 were \$647.0 million compared to \$601.2 million for the six months ended June 30, 2008, an increase of \$45.8 million or 7.6%. The increase in net premiums earned was driven primarily by increased premiums earned at Validus Re of \$30.4 million.

**Net premiums earned**



| (Dollars in thousands) | Six months ended  |               | Six months ended  |               | % Change    |
|------------------------|-------------------|---------------|-------------------|---------------|-------------|
|                        | June 30, 2009     |               | June 30, 2008     |               |             |
| Property               | \$ 293,959        | 45.4%         | \$ 287,626        | 47.8%         | 2.2%        |
| Marine                 | 189,254           | 29.3%         | 173,000           | 28.8%         | 9.4%        |
| Specialty              | 163,746           | 25.3%         | 140,536           | 23.4%         | 16.5%       |
| <b>Total</b>           | <b>\$ 646,959</b> | <b>100.0%</b> | <b>\$ 601,162</b> | <b>100.0%</b> | <b>7.6%</b> |

*Validus Re.* Validus Re net premiums earned for the six months ended June 30, 2009 were \$338.1 million compared to \$307.8 million for the six months ended June 30, 2008, an increase of \$30.4 million or 9.9%.

**Table of Contents**

| (Dollars in thousands) | Net premiums earned |               |                   |               |             |
|------------------------|---------------------|---------------|-------------------|---------------|-------------|
|                        | Six months ended    |               | Six months ended  |               | % Change    |
|                        | June 30, 2009       |               | June 30, 2008     |               |             |
| Property               | \$ 232,649          | 68.8%         | \$ 228,719        | 74.3%         | 1.7%        |
| Marine                 | 58,988              | 17.4%         | 45,129            | 14.7%         | 30.7%       |
| Specialty              | 46,507              | 13.8%         | 33,919            | 11.0%         | 37.1%       |
| <b>Total</b>           | <b>\$ 338,144</b>   | <b>100.0%</b> | <b>\$ 307,767</b> | <b>100.0%</b> | <b>9.9%</b> |

The increase in net premiums earned is due primarily to increased gross premiums written of \$90.8 million, or 17.5%, from \$518.9 million for the six months ended June 30, 2008 to \$609.7 million for the six months ended June 30, 2009. Contracts written on a risks-attaching basis are generally earned over twenty four months and therefore have less immediate effect on premiums earned than contracts written on a losses-occurring basis which are generally earned on a twelve month basis.

*Talbot.* Talbot net premiums earned for the six months ended June 30, 2009 were \$308.8 million compared to \$293.4 million for the six months ended June 30, 2008, an increase of \$15.4 million or 5.3%.

| (Dollars in thousands) | Net premiums earned |               |                   |               |             |
|------------------------|---------------------|---------------|-------------------|---------------|-------------|
|                        | Six months ended    |               | Six months ended  |               | % Change    |
|                        | June 30, 2009       |               | June 30, 2008     |               |             |
| Property               | \$ 61,310           | 19.8%         | \$ 58,907         | 20.1%         | 4.1%        |
| Marine                 | 130,266             | 42.2%         | 127,871           | 43.6%         | 1.9%        |
| Specialty              | 117,239             | 38.0%         | 106,617           | 36.3%         | 10.0%       |
| <b>Total</b>           | <b>\$ 308,815</b>   | <b>100.0%</b> | <b>\$ 293,395</b> | <b>100.0%</b> | <b>5.3%</b> |

The increase in net premiums earned is due primarily to the increased levels of net premiums written across all major business lines over the 12 months ended June 30, 2009, as compared with the twelve months ended June 30, 2008.

**Losses and Loss Expenses**

Losses and loss expenses for the six months ended June 30, 2009 were \$256.6 million compared to \$262.1 million for the six months ended June 30, 2008, a decrease of \$5.5 million or 2.1%. The loss ratios, defined as losses and loss expenses divided by net premiums earned, for the six months ended June 30, 2009 and 2008 were 39.7% and 43.6%, respectively. Details of loss ratios by line of business are provided below.

|                  | Six months ended | Six months ended | Percentage point |
|------------------|------------------|------------------|------------------|
|                  | June 30, 2009    | June 30, 2008    | change           |
| Property         | 20.0%            | 37.5%            | (17.5)           |
| Marine           | 60.0%            | 60.5%            | (0.5)            |
| Specialty        | 51.4%            | 35.3%            | 16.1             |
| <b>All lines</b> | <b>39.7%</b>     | <b>43.6%</b>     | <b>(3.9)</b>     |

The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the six months ended June 30, 2009.

| (Dollars in thousands)             | Six months ended June 30, 2009 |            |              |              |
|------------------------------------|--------------------------------|------------|--------------|--------------|
|                                    | Validus Re                     | Talbot     | Eliminations | Total        |
| Gross reserves at period beginning | \$ 535,888                     | \$ 790,199 | \$ (20,784)  | \$ 1,305,303 |
|                                    | (84,523)                       | (145,057)  | 20,784       | (208,796)    |

Losses recoverable at period  
beginning

|                                                     |            |            |             |              |
|-----------------------------------------------------|------------|------------|-------------|--------------|
| Net reserves at period beginning                    | 451,365    | 645,142    | -           | 1,096,507    |
| Incurred losses - current year                      | 101,404    | 176,485    | -           | 277,889      |
| Incurred losses - change in prior<br>accident years | (4,821)    | (16,483)   | -           | (21,304)     |
| Incurred losses                                     | 96,583     | 160,002    | -           | 256,585      |
| Paid losses                                         | (122,990)  | (114,267)  | -           | (237,257)    |
| Foreign exchange                                    | 2,584      | 23,850     | -           | 26,434       |
| Net reserves at period end                          | 427,542    | 714,727    |             | 1,142,269    |
| Losses recoverable at period end                    | 61,798     | 130,810    | (22,942)    | 169,666      |
| Gross reserves at period end                        | \$ 489,340 | \$ 845,537 | \$ (22,942) | \$ 1,311,935 |

**Table of Contents**

The amount of recorded reserves represents management's best estimate of expected losses and loss expenses on premiums earned. Favorable loss development on prior years totaled \$21.3 million. Favorable loss reserve development benefitted the Company's loss ratio by 3.3 percentage points for the six months ended June 30, 2009. During the six months ended June 30, 2009 the Company incurred \$12.0 million, \$11.0 million and \$5.3 million of losses attributable to windstorm Klaus, a commercial flight loss and Australian wildfires, respectively, which represent 1.9, 1.7 and 0.8 percentage points of the loss ratio, respectively. During the six months ended June 30, 2008 the Company incurred \$10.2 million of losses attributable to certain U.S. storm and flood loss events which represent 1.7 percentage points of the loss ratio. In addition, Item 2 of the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses \$41.5 million of losses attributable to separately identified losses, which, for the six months ended June 30, 2008, represented 7.3 percentage points of the loss ratio.

Management of insurance and reinsurance companies use significant judgment in the estimation of reserves for losses and loss expenses. Given the magnitude of recent loss events and other uncertainties inherent in loss estimation, meaningful uncertainty remains regarding the estimation of recent losses. The Company's actual ultimate net loss may vary materially from estimates.

At June 30, 2009 and 2008, gross and net reserves for losses and loss expenses were estimated using the methodology as outlined in the critical accounting policies and estimates as discussed in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The Company did not make any significant changes in the assumptions or methodology used in its reserving process during the six months ended June 30, 2009.

**At June 30, 2009**

| <b>(Dollars in thousands)</b> | <b>Gross case reserves</b> | <b>Gross IBNR</b> | <b>Total gross reserve for losses and loss expenses</b> |
|-------------------------------|----------------------------|-------------------|---------------------------------------------------------|
| Property                      | \$ 244,065                 | \$ 183,234        | \$ 427,299                                              |
| Marine                        | 365,388                    | 221,276           | 586,664                                                 |
| Specialty                     | 108,461                    | 189,511           | 297,972                                                 |
| <b>Total</b>                  | <b>\$ 717,914</b>          | <b>\$ 594,021</b> | <b>\$ 1,311,935</b>                                     |

**At June 30, 2009**

| <b>(Dollars in thousands)</b> | <b>Net case reserves</b> | <b>Net IBNR</b>   | <b>Total net reserve for losses and loss expenses</b> |
|-------------------------------|--------------------------|-------------------|-------------------------------------------------------|
| Property                      | \$ 241,625               | \$ 171,702        | \$ 413,327                                            |
| Marine                        | 264,169                  | 203,171           | 467,340                                               |
| Specialty                     | 98,292                   | 163,310           | 261,602                                               |
| <b>Total</b>                  | <b>\$ 604,086</b>        | <b>\$ 538,183</b> | <b>\$ 1,142,269</b>                                   |

*Validus Re.* Validus Re losses and loss expenses for the six months ended June 30, 2009 were \$96.6 million compared to \$107.6 million for the six months ended June 30, 2008, a decrease of \$11.0 million or 10.2%. Validus Re net paid losses for the six months ended June 30, 2009 were \$123.0 million compared to \$41.3 million for the six months ended June 30, 2008, an increase of \$81.7 million or 197.8% primarily as a result of losses paid on Hurricane Ike. The loss ratio, defined as losses and loss expenses divided by net premiums earned, was 28.6% and 35.0% for the six months ended June 30, 2009 and 2008, respectively. During the six months ended June 30, 2009, Validus Re incurred \$11.7 million and \$5.0 million of losses attributable to windstorm Klaus and Australian wildfires, respectively, which

represent 3.4 and 1.5 percentage points of the segment loss ratio, respectively. During the six months ended June 30, 2008, Validus Re incurred \$10.2 million of losses attributable to certain U.S. storm and flood loss events which represent 3.3 percentage points of the segment loss ratio. In addition, Item 2 of the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses \$30.2 million of

**Table of Contents**

Validus Re losses attributable to separately identified losses, which, for the six months ended June 30, 2008, represented 10.5 percentage points of the loss ratio.

|                                            | <b>Six months ended June 30</b> |              | <b>Percentage</b>   |
|--------------------------------------------|---------------------------------|--------------|---------------------|
|                                            | <b>2009</b>                     | <b>2008</b>  | <b>point change</b> |
| Property - current year                    | 23.6%                           | 35.9%        | (12.3)              |
| Property - change in prior accident years  | (3.4)%                          | (3.5)%       | 0.1                 |
| Property - loss ratio                      | 20.2%                           | 32.4%        | (12.2)              |
| Marine - current year                      | 56.9%                           | 39.2%        | 17.7                |
| Marine - change in prior accident years    | 8.4%                            | 6.4%         | 2.0                 |
| Marine - loss ratio                        | 65.3%                           | 45.6%        | 19.7                |
| Specialty - current year                   | 27.6%                           | 39.0%        | (11.4)              |
| Specialty - change in prior accident years | (3.9)%                          | (1.1)%       | (2.8)               |
| Specialty - loss ratio                     | 23.7%                           | 37.9%        | (14.2)              |
| All lines - current year                   | 30.0%                           | 36.8%        | (6.8)               |
| All lines - change in prior accident years | (1.4)%                          | (1.8)%       | 0.4                 |
| <b>All lines - loss ratio</b>              | <b>28.6%</b>                    | <b>35.0%</b> | <b>(6.4)</b>        |

For the six months ended June 30, 2009, the property lines include \$55.0 million related to current year losses and \$8.0 million of favorable development relating to prior accident years. During the six months ended June 30, 2009, Validus Re's property lines incurred \$11.7 million, or 5.0 percentage points of the property lines loss ratio, attributable to windstorm Klaus and \$5.0 million of loss expense, or 2.1 percentage points of the property lines loss ratio, attributable to Australian wildfires. The favorable development is primarily attributable to the reclassification of losses from onshore energy exposures during the 2007 California wildfires to the marine line and a reduced loss estimate for the June 2008 Midwest flood event. During the six months ended June 30, 2008, Validus Re's property lines incurred \$10.2 million of losses attributable to certain U.S. storm and flood loss events which represent 4.4 percentage points of the property lines loss ratio. In addition, Item 2 of the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses \$30.2 million of Validus Re's property lines losses attributable to separately identified losses, which, for the six months ended June 30, 2008, represented 14.1 percentage points of the loss ratio. Validus Re property line loss ratios, excluding prior year development and loss events identified above, for the six months ended June 30, 2009 and 2008 were 16.5% and 17.4%, respectively.

For the six months ended June 30, 2009, the marine lines include \$33.6 million related to current year losses and \$5.0 million of adverse development relating to prior accident years due primarily to the reclassification of losses from onshore energy exposures during the 2007 California wildfires from the property line. Validus Re marine line loss ratios, excluding prior year development, for the six months ended June 30, 2009 and 2008 were 56.9% and 39.2%, respectively.

For the six months ended June 30, 2009, the specialty lines include \$12.9 million related to current year losses and \$1.8 million of favorable development relating to prior accident years. Validus Re specialty lines loss ratios, excluding prior year development, for the six months ended June 30, 2009 and 2008 were 27.6% and 39.0%, respectively. *Talbot*. Talbot losses and loss expenses for the six months ended June 30, 2009 were \$160.0 million compared to \$154.5 million for the six months ended June 30, 2008, an increase of \$5.5 million, or 3.5%. The loss ratio was 51.8% and 52.7% for the six months ended June 30, 2009 and 2008, respectively. During the six months ended June 30,

2009, Talbot incurred \$8.3 million of loss expense attributable to a commercial flight loss, which represents 2.7 percentage points of the segment loss ratio. During the six months ended June 30, 2009, \$176.5 million of losses and loss expenses related to current year losses and \$16.5 million related to favorable development primarily on the property lines of business. In addition, Item 2 of the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses \$11.3 million of losses attributable to separately identified losses, which, for the six

**Table of Contents**

months ended June 30, 2008, represented 3.9 percentage points of the segment loss ratio. Details of loss ratios by line of business and calendar period are provided below.

|                  |                                | <b>Six months ended June 30</b> |             | <b>Percentage<br/>point<br/>change</b> |
|------------------|--------------------------------|---------------------------------|-------------|----------------------------------------|
|                  |                                | <b>2009</b>                     | <b>2008</b> |                                        |
| Property         | current year                   | 45.8%                           | 67.8%       | (22.0)                                 |
| Property         | change in prior accident years | (26.6)%                         | (11.0)%     | (15.6)                                 |
| Property         | loss ratio                     | 19.2%                           | 56.8%       | (37.6)                                 |
| Marine           | current year                   | 60.6%                           | 61.9%       | (1.3)                                  |
| Marine           | change in prior accident years | (2.9)%                          | 4.0%        | (6.9)                                  |
| Marine           | loss ratio                     | 57.7%                           | 65.9%       | (8.2)                                  |
| Specialty        | current year                   | 59.3%                           | 50.6%       | 8.7                                    |
| Specialty        | change in prior accident years | 3.1%                            | (16.1)%     | 19.2                                   |
| Specialty        | loss ratio                     | 62.4%                           | 34.5%       | 27.9                                   |
| All lines        | current year                   | 57.1%                           | 59.0%       | (1.9)                                  |
| All lines        | change in prior accident years | (5.3)%                          | (6.3)%      | 1.0                                    |
| <b>All lines</b> | <b>loss ratio</b>              | 51.8%                           | 52.7%       | (0.9)                                  |

For the six months ended June 30, 2009, the property lines include \$28.1 million related to current year losses and \$16.3 million of favorable loss development relating to prior accident years. This favorable development is primarily attributable to lower than expected claims development together with \$1.2 million and \$2.3 million of favorable development relating to Hurricane Ike and Hurricane Katrina, respectively. Item 2 of the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses \$11.3 million of losses attributable to separately identified losses, which, for the six months ended June 30, 2008, represented 19.5 percentage points of Talbot's property lines loss ratio. Talbot property line loss ratio, excluding prior year development for the six months ended June 30, 2009 and 2008 were 45.8% and 48.3%, respectively.

For the six months ended June 30, 2009, the marine lines include \$78.9 million related to current year losses and \$3.8 million of favorable development relating to prior accident years. Talbot marine line loss ratios, excluding prior year development, for the six months ended June 30, 2009 and 2008 were 60.6% and 61.9%, respectively.

For the six months ended June 30, 2009, the specialty lines include \$69.5 million relating to current year losses and \$3.6 million due to adverse development on prior accident years. During the six months ended June 30, 2009, Talbot's specialty lines incurred \$8.3 million of losses, or 7.1 percentage points of the specialty lines loss ratio, attributable to a commercial flight loss. Talbot specialty lines loss ratios, excluding prior year development and the loss events identified above, for the six months ended June 30, 2009 and 2008 were 52.2% and 50.6%, respectively.

**Policy Acquisition Costs**

Policy acquisition costs for the six months ended June 30, 2009 were \$125.9 million compared to \$113.1 million for the six months ended June 30, 2008, an increase of \$12.8 million or 11.3%. Policy acquisition costs as a percent of net premiums earned for the six months ended June 30, 2009 and 2008 were 19.5% and 18.8%, respectively.

| <b>(Dollars in thousands)</b> | <b>Policy acquisition costs</b>           |                                           | <b>% Change</b> |
|-------------------------------|-------------------------------------------|-------------------------------------------|-----------------|
|                               | <b>Six months ended<br/>June 30, 2009</b> | <b>Six months ended<br/>June 30, 2008</b> |                 |



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|              |                   |               |                   |               |              |
|--------------|-------------------|---------------|-------------------|---------------|--------------|
| Property     | \$ 48,299         | 38.4%         | \$ 46,958         | 41.5%         | 2.9%         |
| Marine       | 42,929            | 34.1%         | 35,145            | 31.1%         | 22.1%        |
| Specialty    | 34,659            | 27.5%         | 31,017            | 27.4%         | 11.7%        |
| <b>Total</b> | <b>\$ 125,887</b> | <b>100.0%</b> | <b>\$ 113,120</b> | <b>100.0%</b> | <b>11.3%</b> |

*Validus Re.* Validus Re policy acquisition costs for the six months ended June 30, 2009 were \$57.7 million compared to \$45.7 million for the six months ended June 30, 2008, an increase of \$12.0 million or 26.2%.

**Table of Contents**

| (Dollars in thousands) | Policy acquisition costs |               |   |                  |               |   |              |
|------------------------|--------------------------|---------------|---|------------------|---------------|---|--------------|
|                        | Six months ended         |               |   | Six months ended |               |   |              |
|                        | June 30, 2009            |               |   | June 30, 2008    |               |   |              |
|                        | \$                       |               | % | \$               |               | % | % Change     |
| Property               | 38,241                   | 66.3%         |   | 35,410           | 77.5%         |   | 8.0%         |
| Marine                 | 13,662                   | 23.7%         |   | 5,506            | 12.0%         |   | 148.1%       |
| Specialty              | 5,794                    | 10.0%         |   | 4,796            | 10.5%         |   | 20.8%        |
| <b>Total</b>           | <b>\$ 57,697</b>         | <b>100.0%</b> |   | <b>\$ 45,712</b> | <b>100.0%</b> |   | <b>26.2%</b> |

Policy acquisition costs include brokerage, commission and excise tax and are generally driven by contract terms and are normally a set percentage of premiums and are also net of ceding commission income on retrocessions. Policy acquisition costs as a percent of net premiums earned for the six months ended June 30, 2009 and 2008 were 17.1% and 14.9%, respectively. The policy acquisition ratio increased largely due to an 11.0 percentage point increase on the marine policy acquisition ratio. The increase in the marine policy acquisition ratio was due to an increased portion of gross premiums written being earned on proportional contracts, which generally experience higher acquisition costs. *Talbot*. *Talbot* policy acquisition costs for the six months ended June 30, 2009 were \$69.3 million compared to \$67.4 million for the six months ended June 30, 2008, a decrease of \$1.8 million or 2.7%.

| (Dollars in thousands) | Policy acquisition costs |               |   |                  |               |   |             |
|------------------------|--------------------------|---------------|---|------------------|---------------|---|-------------|
|                        | Six months ended         |               |   | Six months ended |               |   |             |
|                        | June 30, 2009            |               |   | June 30, 2008    |               |   |             |
|                        | \$                       |               | % | \$               |               | % | % Change    |
| Property               | 11,139                   | 16.0%         |   | 11,572           | 17.2%         |   | (3.7)%      |
| Marine                 | 29,267                   | 42.3%         |   | 29,639           | 43.9%         |   | (1.3)%      |
| Specialty              | 28,865                   | 41.7%         |   | 26,221           | 38.9%         |   | 10.1%       |
| <b>Total</b>           | <b>\$ 69,271</b>         | <b>100.0%</b> |   | <b>\$ 67,432</b> | <b>100.0%</b> |   | <b>2.7%</b> |

Policy acquisition costs as a percent of net premiums earned were 22.4% and 23.0%, respectively, for the six month periods ended June 30, 2009 and 2008.

**General and Administrative Expenses**

General and administrative expenses for the six months ended June 30, 2009 were \$79.3 million compared to \$71.0 million for the six months ended June 30, 2008, an increase of \$8.3 million or 11.6%. The increase was primarily a result of increased Validus Re expenses partially offset by decreases in the Corporate segment.

| (Dollars in thousands)   | General and administrative expenses |               |   |                  |               |   |              |
|--------------------------|-------------------------------------|---------------|---|------------------|---------------|---|--------------|
|                          | Six months ended                    |               |   | Six months ended |               |   |              |
|                          | June 30, 2009                       |               |   | June 30, 2008    |               |   |              |
|                          | \$                                  |               | % | \$               |               | % | % Change     |
| Validus Re               | 27,941                              | 35.2%         |   | 19,334           | 27.2%         |   | 44.5%        |
| Talbot                   | 42,141                              | 53.2%         |   | 40,710           | 57.3%         |   | 3.5%         |
| Corporate & Eliminations | 9,197                               | 11.6%         |   | 10,975           | 15.5%         |   | (16.2)%      |
| <b>Total</b>             | <b>\$ 79,279</b>                    | <b>100.0%</b> |   | <b>\$ 71,019</b> | <b>100.0%</b> |   | <b>11.6%</b> |

General and administrative expense ratios for the six month periods ended June 30, 2009 and 2008 were 14.3% and 14.1%, respectively. General and administrative expense ratio is the sum of general and administrative expenses and share compensation expense divided by net premiums earned.

Six months ended

Six months ended

| (Dollars in thousands)     | June 30, 2009    |                                | June 30, 2008    |                                |
|----------------------------|------------------|--------------------------------|------------------|--------------------------------|
|                            | Expenses         | Expenses as %<br>of Net Earned | Expenses         | Expenses as %<br>of Net Earned |
| General and Administrative | \$ 79,279        | 12.3%                          | \$ 71,019        | 11.8%                          |
| Share Compensation         | 12,986           | 2.0%                           | 13,806           | 2.3%                           |
| <b>Total</b>               | <b>\$ 92,265</b> | <b>14.3%</b>                   | <b>\$ 84,825</b> | <b>14.1%</b>                   |

**Table of Contents**

General and administrative expenses of \$79.3 million in the six months ended June 30, 2009 represents 12.3 percentage points of the expense ratio. Share compensation expense is discussed in the following section.

*Validus Re.* Validus Re general and administrative expenses for the six months ended June 30, 2009 were \$27.9 million compared to \$19.3 million for the six months ended June 30, 2008, an increase of \$8.6 million or 44.5%. General and administrative expenses have increased primarily as a result of the increase in staff to 105 at June 30, 2009 from 80 at June 30, 2008. General and administrative expenses are generally comprised of salaries and benefits, professional fees, rent and office expenses. Validus Re's general and administrative expenses as a percent of net premiums earned for the six month periods ended June 30, 2009 and 2008 were 8.2% and 6.2%, respectively.

*Talbot.* Talbot general and administrative expenses for the six months ended June 30, 2009 were \$42.1 million compared to \$40.7 million for the six months ended June 30, 2008, an increase of \$1.4 million or 3.5%. General and administrative expenses have increased primarily as a result of the increase in staff to 212 at June 30, 2009 from 167 at June 30, 2008 and expenses related to the new onshore energy and aviation underwriting teams. Talbot's general and administrative expenses as a percent of net premiums earned for the six month periods ended June 30, 2009 and 2008 were 13.7% and 13.9%, respectively.

*Corporate & Eliminations.* Corporate general and administrative expenses for the six months ended June 30, 2009 were \$9.2 million compared to \$11.0 million for the six months ended June 30, 2008, a decrease of \$1.8 million or 16.2%. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other cost relating to the Company as a whole.

**Share Compensation Expense**

Share compensation expense for the six months ended June 30, 2009 was \$13.0 million compared to \$13.8 million for the six months ended June 30, 2008, a decrease of \$0.8 million or 5.9%. This expense is non-cash and has no net effect on total shareholders' equity, as it is balanced by an increase in additional paid-in capital.

| (Dollars in thousands)   | Share compensation expense        |               |                                   |               |               |  |
|--------------------------|-----------------------------------|---------------|-----------------------------------|---------------|---------------|--|
|                          | Six months ended<br>June 30, 2009 |               | Six months ended<br>June 30, 2008 |               | % Change      |  |
| Validus Re               | \$ 3,220                          | 24.8%         | \$ 2,823                          | 20.5%         | 14.1%         |  |
| Talbot                   | 4,433                             | 34.1%         | 2,102                             | 15.2%         | 110.9%        |  |
| Corporate & Eliminations | 5,333                             | 41.1%         | 8,881                             | 64.3%         | (40.0)%       |  |
| <b>Total</b>             | <b>\$ 12,986</b>                  | <b>100.0%</b> | <b>\$ 13,806</b>                  | <b>100.0%</b> | <b>(5.9)%</b> |  |

Share compensation expense of \$13.0 million in the six months ended June 30, 2009 represents 2.0 percentage points of the general and administrative expense ratio.

*Validus Re.* Validus Re share compensation expense for the six months ended June 30, 2009 was \$3.2 million compared to \$2.8 million for the six months ended June 30, 2008, an increase of \$0.4 million or 14.1%. The increase was due to the impact of grants made during 2008. Share compensation expense as a percent of net premiums earned for the six month periods ended June 30, 2009 and 2008 were 1.0% and 0.9%, respectively.

*Talbot.* Talbot share compensation expense for the six months ended June 30, 2009 was \$4.4 million compared to \$2.1 million for the six months ended June 30, 2008. The increase was due to the impact of grants made during 2008. Share compensation expense as a percent of net premiums earned for the six month periods ended June 30, 2009 and 2008 were 1.4% and 0.7%, respectively.

*Corporate & Eliminations.* Corporate share compensation expense for the six months ended June 30, 2009 was \$5.3 million compared to \$8.9 million for the six months ended June 30, 2008, a decrease of \$3.5 million or 40.0%. This decrease was due primarily to several share award issuances with vesting periods greater than one year that vested during the year ended December 31, 2008 and therefore had no further amortization expense during the six months ended June 30, 2009.

**Selected Ratios**



**Table of Contents**

The underwriting results of an insurance or reinsurance company are often measured by reference to its combined ratio, which is the sum of the loss ratio and the expense ratio. The net loss ratio is calculated by dividing losses and loss expenses incurred (including estimates for incurred but not reported losses) by net premiums earned. The expense ratio is calculated by dividing acquisition costs combined with general and administrative expenses by net premiums earned. The following table presents the losses and loss expenses ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the six months ended June 30, 2009 and 2008.

|                                             | Six months<br>ended | Six months<br>ended | Percentage<br>point<br>change |
|---------------------------------------------|---------------------|---------------------|-------------------------------|
|                                             | June 30, 2009       | June 30, 2008       |                               |
| Losses and loss expenses ratio              | 39.7%               | 43.6%               | (3.9)                         |
| Policy acquisition cost ratio               | 19.5%               | 18.8%               | 0.7                           |
| General and administrative expense ratio(1) | 14.3%               | 14.1%               | 0.2                           |
| Expense ratio                               | 33.8%               | 32.9%               | 0.9                           |
| <b>Combined ratio</b>                       | <b>73.5%</b>        | <b>76.5%</b>        | <b>(3.0)</b>                  |

(1) Includes general and administrative expense and share compensation expense

|                                          | Six months<br>ended | Six months<br>ended | Percentage<br>point<br>change |
|------------------------------------------|---------------------|---------------------|-------------------------------|
|                                          | June 30, 2009       | June 30, 2008       |                               |
| <i>Validus Re</i>                        |                     |                     |                               |
| Losses and loss expenses ratio           | 28.6%               | 35.0%               | (6.4)                         |
| Policy acquisition cost ratio            | 17.1%               | 14.9%               | 2.2                           |
| General and administrative expense ratio | 9.2%                | 7.1%                | 2.1                           |
| Expense ratio                            | 26.3%               | 22.0%               | 4.3                           |
| <b>Combined ratio</b>                    | <b>54.9%</b>        | <b>57.0%</b>        | <b>(2.1)</b>                  |

|                                          | Six months<br>ended | Six months<br>ended | Percentage<br>point<br>change |
|------------------------------------------|---------------------|---------------------|-------------------------------|
|                                          | June 30, 2009       | June 30, 2008       |                               |
| <i>Talbot</i>                            |                     |                     |                               |
| Losses and loss expenses ratio           | 51.8%               | 52.7%               | (0.9)                         |
| Policy acquisition cost ratio            | 22.4%               | 23.0%               | (0.6)                         |
| General and administrative expense ratio | 15.1%               | 14.6%               | 0.5                           |

|                       |              |              |              |
|-----------------------|--------------|--------------|--------------|
| Expense ratio         | 37.5%        | 37.6%        | (0.1)        |
| <b>Combined ratio</b> | <b>89.3%</b> | <b>90.3%</b> | <b>(1.0)</b> |

**Underwriting Income**

Underwriting income for the six months ended June 30, 2009 was \$172.2 million compared to \$141.1 million for the six months ended June 30, 2008, a change of \$31.1 million or 22.1%.

| <u>(Dollars in thousands)</u> | <b>Six months ended<br/>June 30, 2009</b> | <b>% of Sub<br/>total</b> | <b>Six months ended<br/>June 30, 2008</b> | <b>% of Sub<br/>total</b> | <b>% Change</b> |
|-------------------------------|-------------------------------------------|---------------------------|-------------------------------------------|---------------------------|-----------------|
| Validus Re                    | \$ 152,703                                | 82.2%                     | \$ 132,307                                | 82.2%                     | 15.4%           |
| Talbot                        | 32,968                                    | 17.8%                     | 28,629                                    | 17.8%                     | 15.2%           |
| Sub total                     | 185,671                                   | 100.0%                    | 160,936                                   | 100.0%                    | 15.4%           |
| Corporate & Eliminations      | (13,449)                                  |                           | (19,832)                                  |                           | 47.7%           |
| <b>Total</b>                  | <b>\$ 172,222</b>                         |                           | <b>\$ 141,104</b>                         |                           | <b>22.1%</b>    |

The underwriting results of an insurance or reinsurance company are also often measured by reference to its underwriting income, which is a non-GAAP measure as previously defined. Underwriting income, as set out in the table below, is reconciled to net income (the most directly comparable GAAP financial measure) by the addition or subtraction of net investment income, other income, finance expenses, transaction expenses, realized gain on repurchase of debentures, net realized and unrealized gains (losses) on investments and foreign exchange gains (losses).

**Table of Contents**

| <b>(Dollars in thousands)</b>                | <b>Six months ended<br/>June 30, 2009</b> | <b>Six months ended<br/>June 30, 2008</b> |
|----------------------------------------------|-------------------------------------------|-------------------------------------------|
| <b>Underwriting income</b>                   | \$ 172,222                                | \$ 141,104                                |
| Net investment income                        | 53,735                                    | 72,478                                    |
| Other income                                 | 1,774                                     | 2,397                                     |
| Finance expenses                             | (18,475)                                  | (34,279)                                  |
| Transaction expenses                         | (15,851)                                  |                                           |
| Realized gain on repurchase of debentures    |                                           | 8,752                                     |
| Net realized gains (losses) on investments   | (26,071)                                  | 5,319                                     |
| Net unrealized gains (losses) on investments | 59,402                                    | (57,959)                                  |
| Foreign exchange gains (losses)              | 4,232                                     | 9,090                                     |
| <b>Net income before taxes</b>               | <b>\$ 230,968</b>                         | <b>\$ 146,902</b>                         |

Underwriting income indicates the performance of the Company's core underwriting function, excluding revenues and expenses such as the reconciling items in the table above. The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company's core insurance and reinsurance business. Underwriting profitability is influenced significantly by earned premium growth, adequacy of the Company's pricing and loss frequency and severity. Underwriting profitability over time is also influenced by the Company's underwriting discipline, which seeks to manage exposure to loss through favorable risk selection and diversification, its management of claims, its use of reinsurance and its ability to manage its expense ratio, which it accomplishes through its management of acquisition costs and other underwriting expenses. The Company believes that underwriting income provides investors with a valuable measure of profitability derived from underwriting activities.

The Company excludes the U.S. GAAP measures noted above, in particular net realized and unrealized gains and losses on investments, from its calculation of underwriting income because the amount of these gains and losses is heavily influenced by, and fluctuates in part, according to availability of investment market opportunities. The Company believes these amounts are largely independent of its underwriting business and including them distorts the analysis of trends in its operations. In addition to presenting net income determined in accordance with U.S. GAAP, the Company believes that showing underwriting income enables investors, analysts, rating agencies and other users of its financial information to more easily analyze the Company's results of operations in a manner similar to how management analyzes the Company's underlying business performance. The Company uses underwriting income as a primary measure of underwriting results in its analysis of historical financial information and when performing its budgeting and forecasting processes. Analysts, investors and rating agencies who follow the Company request this non-GAAP financial information on a regular basis. In addition, underwriting income is one of the factors considered by the compensation committee of our Board of Directors in determining the bonus component of the total annual incentive compensation.

Underwriting (loss) income should not be viewed as a substitute for U.S. GAAP net income as there are inherent material limitations associated with the use of underwriting income as compared to using net income, which is the most directly comparable U.S. GAAP financial measure. The most significant limitation is the ability of users of the financial information to make comparable assessments of underwriting income with other companies, particularly as underwriting income may be defined or calculated differently by other companies. Therefore, the Company provides more prominence in this filing to the use of the most comparable U.S. GAAP financial measure, net income, which includes the reconciling items in the table above. The Company compensates for these limitations by providing both clear and transparent disclosure of net income and reconciliation of underwriting income to net income.

**Net Investment Income**

Net investment income for the six months ended June 30, 2009 was \$53.7 million compared to \$72.5 million for the six months ended June 30, 2008, a decrease of \$18.8 million or 25.9%. Net investment income decreased as a



result of reduced market yields and higher quarterly average cash balances. Net investment income is comprised of accretion of premium or discount on fixed maturities, interest on coupon-paying bonds, short-term investments and cash and cash equivalents, partially offset by investment management fees. The components of net investment income for the six months ended June 30, 2009 and 2008 are as presented below.

**Table of Contents**

| <b>(Dollars in thousands)</b>               | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> | <b>% Change</b> |
|---------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------|
| Fixed maturities and short-term investments | \$ 52,914                                     | \$ 66,210                                     | (20.0)%         |
| Securities lending income                   | 512                                           | 890                                           | (42.5)%         |
| Cash and cash equivalents                   | 1,881                                         | 7,216                                         | (74.0)%         |
| <br>                                        |                                               |                                               |                 |
| Total investment income                     | 55,307                                        | 74,316                                        | (25.6)%         |
| Investment expenses                         | (1,571)                                       | (1,838)                                       | 14.5%           |
| <br>                                        |                                               |                                               |                 |
| <b>Net investment income</b>                | <b>\$ 53,736</b>                              | <b>\$ 72,478</b>                              | <b>(25.9)%</b>  |

Investment management fees incurred relate to BlackRock Financial Management, Inc. ( BlackRock ) and Goldman Sachs Asset Management L.P. and its affiliates ( GSAM ). Each of Merrill Lynch & Co, Inc. ( Merrill Lynch ), a wholly owned subsidiary of Bank of America Corp., and Goldman Sachs are major shareholders of the Company. BlackRock is considered a related party due to its merger in February 2006 with Merrill Lynch Investment Managers. Investment management fees earned by BlackRock for the six month periods ended June 30, 2009 and June 30, 2008 were \$1.0 million and \$0.9 million, respectively. Investment management fees earned by GSAM for the six month periods ended June 30, 2009 and June 30, 2008 were \$0.7 million and \$0.7 million, respectively. Management believes that the fees charged were consistent with those that would have been charged in arm s-length transactions with unrelated third parties.

Annualized effective investment yield is based on the weighted average investments held calculated on a simple period average and excludes net unrealized gains (losses), foreign exchange gains (losses) on investments and the foreign exchange effect of insurance balances. The Company s annualized effective investment yield was 3.08% and 4.50% for the six months ended June 30, 2009 and 2008, respectively, and the average duration at June 30, 2009 was 1.9 years (December 31, 2008 1.8 years).

**Finance Expenses**

Finance expenses for the six months ended June 30, 2009 were \$18.5 million compared to \$34.3 million for the six months ended June 30, 2008, a decrease of \$15.8 million or 46.1%. The decrease was primarily a result of a \$14.7 million decrease on Talbot third party FAL facility.

Finance expenses also include the amortization of debt offering costs and discounts and fees related to our credit facilities.

| <b>(Dollars in thousands)</b>                    | <b>Six months<br/>ended<br/>June 30, 2009</b> | <b>Six months<br/>ended<br/>June 30, 2008</b> | <b>% Change</b> |
|--------------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------|
| 9.069% Junior Subordinated Deferrable Debentures | \$ 7,177                                      | \$ 7,177                                      | NM              |
| 8.480% Junior Subordinated Deferrable Debentures | 6,696                                         | 8,008                                         | (16.4)%         |
| Credit facilities                                | 840                                           | 474                                           | 77.2%           |
| Talbot FAL facilities                            | 105                                           | 125                                           | (16.0)%         |
| Talbot other interest                            | -                                             | 112                                           | NM              |
| Talbot third party FAL facility                  | 3,657                                         | 18,383                                        | (80.1)%         |
| <br>                                             |                                               |                                               |                 |
| Total                                            | \$ 18,475                                     | \$ 34,279                                     | (46.1)%         |

NM: Not Meaningful

Capital in Lloyd's entities, whether personal or corporate, is required to be set annually for the prospective year and held by Lloyd's in trust ( Funds at Lloyd's or FAL ). In underwriting years up to and including 2007, Talbot's FAL has been provided both by Talbot and by third parties, thereafter Talbot's FAL has been provided exclusively by the Company. Because the third party FAL providers remain on risk until each year of account that their support closes (normally after six years). Talbot must retain third party FAL even if a third party FAL provider has ceased to support the active underwriting year. This is achieved by placing such FAL in escrow outside Lloyd's. Thus the total FAL facility available to the Company is the total FAL for active and prior underwriting years, although the Company can only apply specific FAL against losses incurred by an underwriting year that such FAL is contracted to support.

For each year of account up to and including the 2007 year of account, between 30% and 40% of an amount equivalent to each underwriting years' profit is payable to Talbot third party FAL providers. However, some of these

**Table of Contents**

costs are fixed. There are no FAL finance charges related to the 2008 and 2009 years of account as there were no third party FAL providers in those periods.

The FAL finance charges relate to total syndicate profit (underwriting income, investment income and realized and unrealized capital gains and losses). FAL finance charges and total syndicate profits are analyzed by underwriting year of account as follows:

| <b>Underwriting Year of Account</b><br><b>(Dollars in thousands)</b> | <b>Six months ended June 30</b> |                  |                               |                  |                                                           |                 |
|----------------------------------------------------------------------|---------------------------------|------------------|-------------------------------|------------------|-----------------------------------------------------------|-----------------|
|                                                                      | <b>FAL Finance Charges</b>      |                  | <b>Total Syndicate Profit</b> |                  | <b>FAL Finance Charges as % of Total Syndicate Profit</b> |                 |
|                                                                      | <b>2009</b>                     | <b>2008</b>      | <b>2009</b>                   | <b>2008</b>      | <b>2009</b>                                               | <b>2008 (1)</b> |
| 2006 (1)                                                             | \$ -                            | 9,487            | \$ -                          | 27,466           | NM                                                        | 34.5%           |
| 2007                                                                 | 3,657                           | 8,896            | 9,915                         | 30,031           | 36.9%                                                     | 29.6%           |
| 2008                                                                 | -                               | -                | 32,861                        | (20,168)         | NM                                                        | NM              |
| 2009                                                                 | -                               | -                | (11,204)                      | -                | NM                                                        | NM              |
| <b>Total</b>                                                         | <b>\$ 3,657</b>                 | <b>\$ 18,383</b> | <b>\$ 31,572</b>              | <b>\$ 37,329</b> | <b>11.6%</b>                                              | <b>49.2%</b>    |
| Percentage excluding years in deficit                                |                                 |                  |                               |                  | 8.6%                                                      | 32.0%           |

- (1) The earliest year of account includes the run-off of prior (closed) years of account.

NM: Not meaningful

FAL finance charges are based on syndicate profit but include fixed elements. FAL finance charges for the six months ended June 30, 2009 were \$3.6 million compared to \$18.4 million for the six months ended June 30, 2008, a decrease of \$14.7 million. This decrease was due to the absence of FAL finance charges related to the 2006 year of account, which has now closed.

Total syndicate profit, as set out in the table below, is reconciled to the Talbot segment net income by the addition or subtraction of items noted below.

| <b>(Dollars in thousands)</b>                  | <b>Six months ended June 30</b> |                  |
|------------------------------------------------|---------------------------------|------------------|
|                                                | <b>2009</b>                     | <b>2008</b>      |
| <b>Total syndicate profit</b>                  | <b>\$ 31,572</b>                | <b>\$ 37,329</b> |
| FAL Finance expenses                           | (3,657)                         | (18,383)         |
| Managing agent's fee (1)                       | 4,502                           | 4,828            |
| Managing agent's profit commission (2)         | 3,174                           | 10,153           |
| Investment income (3)                          | 8,924                           | 5,288            |
| Other segment operating income (expenses), net | 11,826                          | (6,898)          |
| Share compensation (expenses)                  | (4,433)                         | (2,090)          |
| Intangible amortization (expenses)             | (2,081)                         | (2,081)          |
| Income tax benefit (expense)                   | 1,568                           | (4,458)          |

|                                  |           |           |
|----------------------------------|-----------|-----------|
| <b>Talbot segment net income</b> | \$ 51,395 | \$ 23,688 |
|----------------------------------|-----------|-----------|

- (1) 1.5% of syndicate capacity; corresponding syndicate expense reflected in total syndicate profit, above.
- (2) 15.0% of syndicate profit; corresponding syndicate expense reflected in total syndicate profit, above.
- (3) On FAL and on non-syndicate cash balances.

**Net Realized (Losses) Gains on Investments**

Net realized (losses) on investments for the six months ended June 30, 2009 were \$(26.1) million compared to gains of \$5.3 million for the six months ended June 30, 2008. Net realized losses resulted primarily from the sale of \$98.6 million of CMBS with relatively long weighted average lives, resulting in realized losses of \$19.5 million, which resulted in a corresponding offset in net unrealized gains (losses). The decision to reduce the Company's exposure to CMBS was made in light of deteriorating fundamentals in the sector.

**Table of Contents****Net Unrealized Gains (Losses) on Investments**

Net unrealized gains on investments for the six months ended June 30, 2009 were \$59.4 million compared to losses of \$(58.0) million for the six months ended June 30, 2008. The net unrealized gains in the six months ended June 30, 2009 resulted from unrealized gains in non-agency RMBS and corporate bond sectors, partially offset by unrealized losses in U.S. government and government agency securities and the \$19.5 million realized (losses) arising from the sale of \$98.6 million in CMBS, which had the effect of reducing the unrealized (loss) on the investment portfolio by an equal and offsetting amount.

The Company early adopted FAS 157 and the FAS 159 Fair Value Option on January 1, 2007 for its investment portfolio. As a result, for the three months ended June 30, 2009 and 2008, net unrealized gains on investments are recorded as a component of net income. Talbot also adopted FAS 157 and the FAS 159 Fair Value Option for its investment portfolio upon acquisition by the Company on July 2, 2007. During the year ended December 31, 2008, the Company adopted FSP FAS 157-3. Consistent with this statement, certain market conditions allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable. Certain non-Agency RMBS securities were identified as trading in inactive markets. The change in fair value for the identified non-Agency RMBS securities was \$1.5 million increase in net unrealized loss on investments for the six months ended June 30, 2009. Further details are provided in the Investments section below.

**Other Income**

Other income for the six months ended June 30, 2009 was \$1.8 million compared to \$2.4 million for the six months ended June 30, 2008, a decrease of \$0.6 million or 26.0%.

**Foreign Exchange Gains (Losses)**

Foreign exchange gains for the six month period ended June 30, 2009 were \$4.2 million compared to gains of \$9.1 million for the six months ended June 30, 2008, a decrease of \$4.9 million. The foreign exchange gains during the six months ended June 30, 2009 were due to an increase in the value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency. The British pound sterling to U.S. dollar exchange rates were 1.44 and 1.65 at December 31, 2008 and June 30, 2009, respectively. Certain premiums receivable and liabilities for losses incurred in currencies other than the U.S. dollar are exposed to the risk of changes in value resulting from fluctuations in foreign exchange rates and may affect financial results in the future.

At June 30, 2009, Talbot's balance sheet includes net unearned premiums and deferred acquisition costs denominated in foreign currencies of approximately \$110.0 million and \$23.0 million, respectively. These balances consisted of British pounds sterling and Canadian dollars of \$80.5 million and \$7.2 million, respectively. Net unearned premiums and deferred acquisition costs are classified as non-monetary items and are translated at historic exchange rates. All of Talbot's other balance sheet items are classified as monetary items and are translated at period end exchange rates. During the six months ended June 30, 2009, this translation process resulted in foreign exchange gains that will reverse in future periods as net unearned premiums and deferred acquisition costs are earned together with gains arising from the reversal of losses incurred in previous periods. Additional foreign exchange (losses) gains may be incurred on the translation of net unearned premiums and deferred acquisition costs arising from insurance and reinsurance premiums written in future periods.

**Transaction Expenses**

On July 9, 2009, the Company announced that the boards of directors of both the Company and IPC had approved a definitive amalgamation agreement. During the six months ended June 30, 2009, the Company incurred \$15.9 million in relation to the proposed acquisition and amalgamation agreement with IPC. Transaction expenses are comprised of primarily legal, corporate advisory and audit related services.

**Table of Contents****Income Tax Benefit (Expense)**

Income tax benefit for the six months ended June 30, 2009 was \$1.5 million compared to an expense of \$4.5 million for the six months ended June 30, 2008, a change of \$6.0 million. The income tax benefit was due to U.K. taxable losses for six months ended June 30, 2009 offsetting taxation in prior periods. These taxable losses were due primarily to Syndicate 1183's 2008 and 2009 years of account, both of which have generated little or no profit commission revenue for Talbot's U.K. entities. On an inception to date basis, the 2009 year of account is in an overall deficit position while the 2008 year of account only moved into surplus during the second quarter of 2009.

**Other Non-GAAP Financial Measures**

In presenting the Company's results, management has included and discussed certain schedules containing net operating income (loss), underwriting income, annualized return on average equity and diluted book value per common share that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. The calculation of annualized return on average equity is discussed in the section above entitled Financial Measures. A reconciliation of underwriting income to net income, the most comparable U.S. GAAP financial measure, is presented above in the section entitled Underwriting Income. A reconciliation of diluted book value per share to book value per share, the most comparable U.S. GAAP financial measure, is presented below. Operating income is calculated based on net income (loss) excluding net realized gains (losses), net unrealized gains (losses) on investments, gains (losses) arising from translation of non-US\$ denominated balances and non-recurring items. A reconciliation of operating income to net income, the most comparable U.S. GAAP financial measure, is embedded in the table presenting results of operations for the six months ended June 30, 2009 and 2008 in the section above entitled Results of Operations. Realized gains (losses) from the sale of investments are driven by the timing of the disposition of investments, not by our operating performance. Gains (losses) arising from translation of non-US\$ denominated balances are unrelated to our underlying business.

The following tables present reconciliations of diluted book value per share to book value per share, the most comparable U.S. GAAP financial measure, at June 30, 2009 and December 31, 2008.

|                                            | <b>At June 30, 2009</b>  |                   |                           |                                 |
|--------------------------------------------|--------------------------|-------------------|---------------------------|---------------------------------|
|                                            | <b>Equity<br/>amount</b> | <b>Shares</b>     | <b>Exercise<br/>Price</b> | <b>Book value<br/>per share</b> |
| <b>Book value per common share</b>         |                          |                   |                           |                                 |
| Total shareholders' equity                 | \$ 2,151,969             | 76,151,473        |                           | \$ 28.26                        |
| <b>Diluted book value per common share</b> |                          |                   |                           |                                 |
| Total shareholders' equity                 | \$ 2,151,969             | 76,151,473        |                           |                                 |
| Assumed exercise of outstanding warrants   | 139,576                  | 7,952,138         | \$ 17.55                  |                                 |
| Assumed exercise of outstanding options    | 50,924                   | 2,793,402         | \$ 18.23                  |                                 |
| Unvested restricted shares                 |                          | 2,928,813         |                           |                                 |
| <b>Diluted book value per common share</b> | <b>\$ 2,342,469</b>      | <b>89,825,826</b> |                           | <b>\$ 26.08</b>                 |

**At December 31, 2008****Exercise Book value**

|                                            | <b>Equity<br/>amount</b> | <b>Shares</b>     | <b>Price</b> | <b>per share</b> |
|--------------------------------------------|--------------------------|-------------------|--------------|------------------|
| <b>Book value per common share</b>         |                          |                   |              |                  |
| Total shareholders equity                  | \$ 1,938,734             | 75,624,697        |              | \$ 25.64         |
| <b>Diluted book value per common share</b> |                          |                   |              |                  |
| Total shareholders equity                  | \$ 1,938,734             | 75,624,697        |              |                  |
| Assumed exercise of outstanding warrants   | 152,316                  | 8,680,149         | \$ 17.55     |                  |
| Assumed exercise of outstanding options    | 51,043                   | 2,799,938         | \$ 18.23     |                  |
| Unvested restricted shares                 | -                        | 2,986,619         |              |                  |
| <b>Diluted book value per common share</b> | <b>\$ 2,142,093</b>      | <b>90,091,403</b> |              | <b>\$ 23.78</b>  |



**Table of Contents****Financial Condition and Liquidity**

Validus Holdings, Ltd. is a holding company and conducts no operations of its own. The Company relies primarily on cash dividends and other permitted payments from Validus Re and Talbot to pay finance expenses and other holding company expenses. There are restrictions on the payment of dividends from Validus Re and Talbot to the Company. Please refer to Part II, Item 5, Market for Registrants, Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 for further discussion of the Company's dividend policy.

Three main sources provide cash flows for the Company: operating activities, investing activities and financing activities. Cash flow from operating activities is derived primarily from the net receipt of premiums less claims and expenses related to underwriting activities. Cash flow from investing activities is derived primarily from the receipt of net proceeds on the Company's total investment portfolio. Cash flow from financing activities is derived primarily from the issuance of common shares and debentures payable. The movement in net cash provided by operating activities, net cash (used in) provided by investing activities, net cash (used in) provided by financing activities and the effect of foreign currency rate changes on cash and cash equivalents for the six months ended June 30, 2009 and 2008 is described in the following table.

| <b>(Dollars in thousands)</b>                                        | <b>Six months ended</b> |                  | <b>%<br/>Change</b> |
|----------------------------------------------------------------------|-------------------------|------------------|---------------------|
|                                                                      | <b>2009</b>             | <b>2008</b>      |                     |
| Net cash provided by operating activities                            | \$ 209,811              | \$ 247,407       | (15.2)%             |
| Net cash used in investing activities                                | (310,974)               | (176,716)        | (76.0)%             |
| Net cash provided by (used in) financing activities                  | 28,080                  | (34,435)         | 181.5%              |
| Effect of foreign currency rate changes on cash and cash equivalents | 13,325                  | 6,306            | 111.3%              |
| <b>Net (decrease) increase in cash</b>                               | <b>\$ (59,758)</b>      | <b>\$ 42,562</b> | <b>(240.4)%</b>     |

During the six months ended June 30, 2009, net cash provided by operating activities was driven primarily by net income of \$232.5 million. Cash provided by operating activities, as compared to the six months ended June 30, 2008, was impacted by the relative movement in change in reserves for losses and loss expenses for the six months ended June 30, 2009, due primarily to the settlement 2008 loss reserves. Net cash used in investing activities was driven primarily by the investment of operating surpluses. Net cash provided by (used in) financing activities was driven primarily by aggregate quarterly dividend payments of \$34.4 million and a \$63.2 million decrease in securities lending payable. Net cash provided by (used in) financing activities, as compared to the six months ended June 30, 2008, was impacted by the absence of a debenture repurchase during the six months ended June 30, 2009.

During the six months ended June 30, 2008, net cash provided by operating activities was driven primarily by net income of \$142.4 million, a \$208.4 million increase in premiums receivable, a \$104.3 million increase in reserve for losses and loss expense and a \$236.2 million increase in unearned premiums. Net cash used in investing activities was driven primarily by the investment of operating surpluses. Net cash provided by (used in) financing activities was driven primarily by a \$36.9 million debenture repurchase, aggregate quarterly dividend payments of \$33.6 million and a \$35.6 million decrease in securities lending payable.

The Company's portfolio is all fixed income including cash, short-term investments, agency securities and sovereign securities amounting to \$2,390.2 million or 67.7% of total cash and investments. Details of the Company's debt and financing arrangements at June 30, 2009 are provided below.

| <b>(Dollars in thousands)</b>                    | <b>Maturity Date /<br/>Term</b> | <b>In Use /<br/>Outstanding</b> |
|--------------------------------------------------|---------------------------------|---------------------------------|
| 9.069% Junior Subordinated Deferrable Debentures | June 15, 2036                   | \$ 150,000                      |
| 8.480% Junior Subordinated Deferrable Debentures | June 15, 2037                   | 154,300                         |

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|                                               |                      |                   |
|-----------------------------------------------|----------------------|-------------------|
| \$200,000 unsecured letter of credit facility | March 12, 2010       | -                 |
| \$500,000 secured letter of credit facility   | March 12, 2012       | 276,955           |
| Talbot FAL facility                           | December 31,<br>2009 | 100,000           |
| Talbot third party FAL facility               | December 31,<br>2009 | 121,515           |
| <b>Total</b>                                  |                      | <b>\$ 802,770</b> |

**Table of Contents**

The capital and credit markets have been experiencing extreme volatility and disruption for more than one year. In some cases, the markets have exerted downward pressure on the availability of liquidity and credit capacity for certain issuers. However, management believes that liquidity is not a key constraint for the Company due to its highly liquid investment portfolio and the maturity dates of debt and facilities reflected in the table above. Management's belief is based on the following considerations:

The Talbot third party FAL facility represents cash, investments and undrawn letters of credit provided by various third parties for the 2007 year of account. These third party funds have been replaced by the Company effective January 1, 2008;

The Talbot FAL facility is a facility currently secured by assets of Validus Reinsurance, Ltd. and the Company could choose to provide FAL in the form of cash should the Talbot FAL facility not be renewed;

The \$200 million unsecured letter of credit facility is not utilized by the Company currently and has been used in the past only as part of the Talbot acquisition.

Under the terms of the Amalgamation Agreement, each outstanding IPC common share (including any shares held by IPC shareholders that do not vote in favor of the amalgamation, but excluding any shares as to which appraisal rights have been exercised pursuant to Bermuda law), will be cancelled and converted into the right to receive 0.9727 common shares of Validus, \$7.50 in cash, less any applicable withholding tax and without interest, and cash in lieu of fractional shares upon closing of the amalgamation. The amalgamation will result in the payment of cash and cash equivalents of approximately \$424 million to IPC shareholders.

**Capital Resources**

Shareholders' equity at June 30, 2009 was \$2,152.0 million.

On July 28, 2009, the Company announced a quarterly cash dividend of \$0.20 per each common share and \$0.20 per common share equivalent, for which each outstanding warrant is then exercisable, payable on September 30, 2009 to holders of record on August 20, 2009. During 2009, the Company paid quarterly cash dividends of \$0.20 per each common share and \$0.20 per common share equivalent, for which each outstanding warrant is then exercisable, on March 31, and June 30, to holders of record on March 16 and June 15, respectively. The timing and amount of any future cash dividends, however, will be at the discretion of our Board of Directors and will depend upon our results of operations and cash flows, our financial position and capital requirements, general business conditions, legal, tax, regulatory, rating agency and contractual constraints or restrictions and any other factors that our Board of Directors deems relevant.

On August 7, 2008, the Company filed a shelf registration statement on Form S-3 (No. 333-152856) with the U.S. Securities Exchange Committee in which we may offer from time to time common shares, preference shares, depository shares representing common shares or preference shares, senior or subordinated debt securities, warrants to purchase common shares, preference shares and debt securities, share purchase contracts, share purchase units and units which may consist of any combination of the securities listed above. In addition, the shelf registration statement will provide for secondary sales of common shares sold by the Company's shareholders. The registration statement is intended to provide the Company with additional flexibility to access capital markets for general corporate purposes, subject to market conditions and the company's capital needs.

On July 9, 2009, the Company announced that the boards of directors of both the Company and IPC Holdings, Ltd. (IPC) had approved a definitive amalgamation agreement under the terms of which, IPC shareholders will receive \$7.50 in cash and 0.9727 of the Company's voting common shares for each IPC common share.

**Table of Contents**

Completion of the transaction, which is expected to take place in the three months ended September 30, 2009, is subject to customary closing conditions, including the Company and IPC shareholders' approvals. The Company's special general meeting of shareholders will be held on September 4, 2009. Aquiline Capital Partners LLC, Vestar Capital Partners, and New Mountain Capital, LLC, which collectively owned approximately 38% of the Company's outstanding voting common shares as of July 27, 2009, have agreed to vote in favor of the issuance of the Company's shares in connection with the transaction. Upon closing of the transaction, the Company's current shareholders will own approximately 62% of the combined company on a fully diluted basis, with IPC shareholders owning approximately 38%.

In connection with the signing of the Amalgamation Agreement, the Company has withdrawn and terminated its previously announced Exchange Offer for all of the outstanding common shares of IPC and has instructed BNY Mellon Shareowner Services to promptly return all IPC common shares previously tendered to the Company. Additionally, the Company has terminated its solicitation efforts in connection with its other previously announced alternative steps to complete a transaction with IPC, including a scheme of arrangement and calling of a special meeting of IPC shareholders.

The Company may from time to time repurchase its securities, including common shares and Junior Subordinated Deferrable Debentures, subject to board approval.

Please refer to the discussion of capital resources in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. There have been no other material changes to this discussion.

**Recent accounting pronouncements**

Please refer to Note 2 to the consolidated financial statements (Part I, Item I) for further discussion of relevant recent accounting pronouncements.

**Debt and Financing Arrangements**

The following table details the Company's borrowings and credit facilities as at June 30, 2009:

| <b>(Dollars in thousands)</b>                    | <b>Commitment</b>   | <b>Outstanding</b> |
|--------------------------------------------------|---------------------|--------------------|
| 9.069% Junior Subordinated Deferrable Debentures | \$ 150,000          | \$ 150,000         |
| 8.480% Junior Subordinated Deferrable Debentures | 200,000             | 154,300            |
| \$200,000 unsecured letter of credit facility    | 200,000             |                    |
| \$500,000 secured letter of credit facility      | 500,000             | 276,955            |
| Talbot FAL facility                              | 100,000             | 100,000            |
| Talbot third party FAL facility (1)              | 121,515             | 121,515            |
| <b>Total</b>                                     | <b>\$ 1,271,515</b> | <b>\$ 802,770</b>  |

(1) The third party FAL facility comprises \$144.0 million which supports the 2007 and prior underwriting years. These funds have now been withdrawn from Lloyd's and placed in

escrow but  
remain available  
to pay losses.

On July 24, 2009, the Company announced that it has entered into the Second Amendment to each of its \$500,000 five-year secured letter of credit facility and \$200,000 three-year unsecured facility, and the First Amendment to its \$100,000 Talbot FAL facility to amend a specific investment restriction clause to permit the completion of the IPC amalgamation agreement. The amendment also modifies and updates certain pricing and covenant terms.

Please refer to Note 7 to the consolidated financial statements (Part I, Item I) for further discussion of the Company's debt and financing arrangements.

**Table of Contents****Ratings**

On July 9, 2009, following the announcement that the Company entered into the Amalgamation Agreement, A.M. Best placed the Company's bbb- issuer credit and indicative senior debt ratings as well as the bb+ subordinated debt and bb preferred stock ratings under review with negative implications. In addition, the A- financial strength and a- issuer credit ratings of subsidiary unit Validus Reinsurance, Ltd. were placed under review with negative implications. According to A.M. Best, the new status reflects uncertainties surrounding the Company's recently executed definitive Amalgamation Agreement with IPC.

On July 10, 2009, Standard & Poor's Ratings Services revised its outlook on the Company to positive from stable and affirmed the counterparty credit rating of BBB-. According to Standard & Poor's, the Company's ratings are based on the group's good and expanding competitive position; strong capitalization; strong risk controls around exposure management, underwriting and modeling; and very strong operating performance since its inception, partially offset by the potential integration risk related to the expected IPC transaction. Standard & Poor's Ratings Services may raise the Company's rating by one notch over the next 12-18 months.

On July 13, 2009, Moody's said that it will maintain its negative rating outlook, assigned on April 2, 2009, on the Company and subsidiary unit Validus Reinsurance Ltd. following the Amalgamation Agreement with IPC. The rating agency affirmed the Company's long-term issuer rating at Baa2 and the insurance financial strength rating for Validus Reinsurance, Ltd. at A3 with a negative outlook.

**Investments**

A significant portion of contracts written provide short-tail reinsurance coverage for losses resulting mainly from natural and man-made catastrophes, which could result in a significant amount of losses on short notice. Accordingly, the Company's investment portfolio is structured to provide significant liquidity and preserve capital, which means the investment portfolio contains a significant amount of relatively short-term fixed maturity investments, such as U.S. government securities, U.S. government-sponsored enterprises securities, corporate debt securities and mortgage-backed and asset-backed securities.

Substantially all of the fixed maturity investments held at June 30, 2009 were publicly traded. At June 30, 2009, the average duration of the Company's fixed maturity portfolio was 1.9 years (December 31, 2008: 1.8 years) and the average rating of the portfolio was AA+ (December 31, 2008: AAA). At June 30, 2009, the total fixed maturity portfolio was \$2,816.5 million (December 31, 2008: \$2,454.5 million), of which \$1,971.8 million (December 31, 2008: \$1,941.3 million) were rated AAA. At June 30, 2009, fair value measurements of certain non-Agency RMBS securities, representing 2.0% of the Company's total assets, have primarily unobservable inputs (December 31, 2008: 2.6%).

The Company's investment guidelines require that investments be rated A- or higher at the time of purchase. During the quarterly period ended June 30, 2009, Moody's downgraded a substantial number of non-agency mortgage backed securities issues, including several securities held by the Company. The Company reports the ratings of its investment portfolio securities at the lower of Moody's or Standard & Poor's rating for each investment security and, as a result, the Company's investment portfolio now has \$81.9 million of non-agency mortgage backed securities rated less than investment grade. The Company expects that Standard & Poor's may take similar actions in respect of their ratings of non-agency mortgage backed securities. The other components of less than investment grade securities held by the Company at June 30, 2009 were \$18.8 million of catastrophe bonds and \$2.9 million of corporate bonds.

Cash and cash equivalents and investments in Talbot of \$1,093.2 million at June 30, 2009 were held in trust for the benefit of cedants and policyholders, and to facilitate the accreditation as an alien insurer/reinsurer by certain regulators (December 31, 2008: \$1,032.3 million). Total cash and cash equivalents and investments in Talbot were \$1,237.3 million at June 30, 2009 (December 31, 2008: \$1,142.0 million).

**Table of Contents**

As of June 30, 2009, the Company had approximately \$4.1 million of asset-backed securities with sub-prime collateral (December 31, 2008: \$6.4 million) and \$94.7 million of Alt-A RMBS (December 31, 2008: \$103.8 million).

As described more fully under the *Critical Accounting Policies and Estimates* in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, the Company identified certain non-Agency RMBS securities trading in inactive markets. During the three months ended June 30, 2009, the change in fair value for the identified RMBS securities resulted in a \$5.4 million decrease in net unrealized gain on investments. This decrease in net unrealized losses on investments resulted in a \$5.4 million increase in shareholders' equity as at June 30, 2009.

**Cash Flows**

During the three months ended June 30, 2009 and 2008, the Company generated net cash from operating activities of \$116.8 million and \$111.7 million, respectively. During the six months ended June 30, 2009 and 2008, the Company generated net cash from operating activities of \$202.6 million and \$247.4 million, respectively. Cash flows from operations generally represent premiums collected, investment earnings realized and investment gains realized less losses and loss expenses paid and underwriting and other expenses paid. Cash flows from operations may differ substantially, however, from net income.

Sources of funds consist primarily of the receipt of premiums written, investment income and proceeds from sales and redemptions of investments. In addition, cash will also be received from financing activities. Cash is used to pay primarily losses and loss expenses, brokerage commissions, excise taxes, general and administrative expenses, purchase new investments, payment of premiums retroceded and payment of dividends. The Company has had sufficient resources to meet its liquidity requirements.

As of June 30, 2009 and December 31, 2008, the Company had cash and cash equivalents of \$390.1 million and \$449.9 million, respectively.

The Company has written certain business that has loss experience generally characterized as having low frequency and high severity. This results in volatility in both results and operational cash flows. The potential for large claims or a series of claims under one or more reinsurance contracts means that substantial and unpredictable payments may be required within relatively short periods of time. As a result, cash flows from operating activities may fluctuate, perhaps significantly, between individual quarters and years. Management believes the Company's unused credit facility amounts and highly liquid investment portfolio are sufficient to support any potential operating cash flow deficiencies. Please refer to the table detailing the Company's borrowings and credit facilities as at June 30, 2009, presented above.

In addition to relying on premiums received and investment income from the investment portfolio, the Company intends to meet these cash flow demands by carrying a substantial amount of short and medium term investments that would mature, or possibly be sold, prior to the settlement of expected liabilities. The Company cannot provide assurance, however, that it will successfully match the structure of its investments with its liabilities due to uncertainty related to the timing and severity of loss events.

**Table of Contents**

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

The Private Securities Litigation Reform Act of 1995 ( PSLRA ) provides a safe harbor for forward-looking statements. Any prospectus, prospectus supplement, the Company's Annual Report to shareholders, any proxy statement, any other Form 10-K, Form 10-Q or Form 8-K of the Company or any other written or oral statements made by or on behalf of the Company may include forward-looking statements that reflect the Company's current views with respect to future events and financial performance. Such statements include forward-looking statements both with respect to the Company in general, and to the insurance and reinsurance sectors in particular. Statements that include the words expect , intend , plan , believe , project , anticipate , will , may , and similar statements of a forward-looking nature identify forward-looking statements for purposes of the PSLRA or otherwise. All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements and, therefore, you should not place undue reliance on any such statement.

We believe that these factors include, but are not limited to, the following:

uncertainty as to whether the Company and IPC will be able to complete the proposed Amalgamation because, among other reasons, conditions to the proposed Amalgamation may not be satisfied or waived;

uncertainty as to the actual premium that will be realized by IPC shareholders in connection with the proposed Amalgamation;

uncertainty as to the long term value of the Company's common shares;

unpredictability and severity of catastrophic events;

our ability to obtain and maintain ratings, which may be affected by our ability to raise additional equity or debt financings, as well as other factors described herein;

adequacy of the Company's and IPC's risk management and loss limitation methods;

cyclicality of demand and pricing in the insurance and reinsurance markets;

the Company's limited operating history;

the Company's ability to implement its business strategy during soft as well as hard markets;

adequacy of the Company's loss reserves;

continued availability of capital and financing;

the Company's ability to identify, hire and retain, on a timely and unimpeded basis and on anticipated economic and other terms, experienced and capable senior management, as well as underwriters, claims professionals and support staff;

acceptance of our business strategy, security and financial condition by rating agencies and regulators, as well as by brokers and (re)insureds;

competition, including increased competition, on the basis of pricing, capacity, coverage terms or other factors;

potential loss of business from one or more major insurance or reinsurance brokers;





**Table of Contents**

the Company's or IPC's ability to implement, successfully and on a timely basis, complex infrastructure, distribution capabilities, systems, procedures and internal controls, and to develop accurate actuarial data to support the business and regulatory and reporting requirements;

general economic and market conditions (including inflation, volatility in the credit and capital markets, interest rates and foreign currency exchange rates) and conditions specific to the insurance and reinsurance markets in which we expect to operate;

the integration of Talbot Holdings, Ltd., IPC, or other businesses we may acquire or new business ventures we may start;

accuracy of those estimates and judgments used in the preparation of our financial statements, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables, investment valuations, intangible assets, bad debts, income taxes, contingencies, litigation and any determination to use the deposit method of accounting, which, for a relatively new insurance and reinsurance company like our company, are even more difficult to make than those made in a mature company because of limited historical information;

the effect on the Company's or IPC's investment portfolio of changing financial market conditions including inflation, interest rates, liquidity and other factors;

acts of terrorism, political unrest, outbreak of war and other hostilities or other non-forecasted and unpredictable events;

availability and cost of reinsurance and retrocession coverage;

the failure of reinsurers, retrocessionaires, producers or others to meet their obligations to us;

the timing of loss payments being faster or the receipt of reinsurance recoverables being slower than anticipated by us;

changes in domestic or foreign laws or regulations, or their interpretations;

changes in accounting principles or the application of such principles by regulators;

statutory or regulatory or rating agency developments, including as to tax policy and matters and reinsurance and other regulatory matters such as the adoption of proposed legislation that would affect Bermuda-headquartered companies and/or Bermuda-based insurers or reinsurers;

failure to realize the anticipated benefits of the proposed Amalgamation, including as a result of failure or delay in integrating the businesses of the Company and IPC;

the outcome of any legal proceedings to the extent initiated against the Company, IPC or others following the announcement of the proposed Amalgamation; and

the other factors set forth herein under Part II Item 1A "Risk Factors" and under Part I Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the other sections of this Quarterly Report on Form 10-Q and the Company's Annual Report on Form 10-K for the year ended December 31, 2008, as well as the risk and other factors set forth in the Company's other filings with the SEC as well as management's response to any of the aforementioned factors.

In addition, other general factors could affect our results, including: (a) developments in the world's financial and capital markets and our access to such markets; (b) changes in regulations or tax laws applicable to us, including, without limitation, any such changes resulting from the recent investigations relating to the insurance

**Table of Contents**

industry and any attendant litigation; and (c) the effects of business disruption or economic contraction due to terrorism or other hostilities.

The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included herein or elsewhere. Any forward-looking statements made in this report are qualified by these cautionary statements, and there can be no assurance that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, us or our business or operations. We undertake no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future developments or otherwise.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We believe we are principally exposed to five types of market risk:

interest rate risk;

foreign currency risk;

credit risk;

liquidity risk; and

effects of inflation.

*Interest Rate Risk:* The Company's primary market risk exposure is to changes in interest rates. The Company's fixed maturity portfolio is exposed to interest rate risk. Fluctuations in interest rates have a direct impact on the market valuation of these investments. As interest rates rise, the market value of the Company's fixed maturity portfolio falls and the Company has the risk that cash outflows will have to be funded by selling assets, which will be trading at depreciated values. As interest rates decline, the market value of the Company's fixed income portfolio increases and the Company has reinvestment risk, as funds reinvested will earn less than is necessary to match anticipated liabilities. We manage interest rate risk by selecting investments with characteristics such as duration, yield, currency and liquidity tailored to the anticipated cash outflow characteristics of the insurance and reinsurance liabilities the Company assumes.

As at June 30, 2009, the impact on the Company's fixed maturity and short-term investments from an immediate 100 basis point increase in market interest rates (based on U.S. treasury yield) would have resulted in an estimated decrease in market value of 1.9%, or approximately \$59.9 million. As at June 30, 2009, the impact on the Company's fixed maturity portfolio from an immediate 100 basis point decrease in market interest rates would have resulted in an estimated increase in market value of 1.8% or approximately \$55.3 million.

As at June 30, 2008, the impact on the Company's fixed maturity and short-term investments from an immediate 100 basis point increase in market interest rates would have resulted in an estimated decrease in market value of 2.4%, or approximately \$65.0 million. As at June 30, 2008, the impact on the Company's fixed maturity portfolio from an immediate 100 basis point decrease in market interest rates would have resulted in an estimated increase in market value of 2.3% or approximately \$63.9 million.

As at June 30, 2009, the Company held \$866.7 million (December 31, 2008: \$994.1 million), or 30.8% (December 31, 2008: 40.5%), of the Company's fixed maturity portfolio in asset-backed and mortgage-backed securities. These assets are exposed to prepayment risk, which occurs when holders of underlying loans increase the frequency with which they prepay the outstanding principal before the maturity date and refinance at a lower interest rate cost. The adverse impact of prepayment is more evident in a declining interest rate environment. As a result, the Company will be exposed to reinvestment risk, as cash flows received by the Company will be accelerated and will be reinvested at the prevailing interest rates.

*Foreign Currency Risk:* Certain of the Company's reinsurance contracts provide that ultimate losses may be payable in foreign currencies depending on the country of original loss. Foreign currency exchange rate risk exists to

**Table of Contents**

the extent that there is an increase in the exchange rate of the foreign currency in which losses are ultimately owed. Therefore, we attempt to manage our foreign currency risk by seeking to match our liabilities under insurance and reinsurance policies that are payable in foreign currencies with cash and investments that are denominated in such currencies. As of June 30, 2009, \$432.0 million, or 8.7% of our total assets and \$410.8 million, or 14.5% of our total liabilities was held in foreign currencies. As of June 30, 2009, \$94.1 million, or 3.3% of our total net liabilities held in foreign currencies was non-monetary items which do not require revaluation at each reporting date. As of June 30, 2008, \$266.4 million, or 9.7% of our total assets and \$217.7 million, or 24.2% of our total liabilities was held in foreign currencies. As of June 30, 2008, \$92.2 million, or 3.7% of our total net liabilities held in foreign currencies was non-monetary items which do not require revaluation at each reporting date. The Company does not transact in foreign exchange markets to hedge its foreign currency exposure. To the extent foreign currency exposure is not hedged, the Company may experience exchange losses, which in turn would adversely affect the results of operations and financial condition.

*Credit Risk:* We are exposed to credit risk primarily from the possibility that counterparties may default on their obligations to us. We attempt to limit our credit exposure by purchasing high quality fixed income investments to maintain an average portfolio credit quality of AA- or higher with mortgage and commercial mortgage-backed issues having an aggregate weighted average credit quality of AAA. In addition, we have limited our exposure to any single issuer to 3.0% or less of total investments, excluding treasury and agency securities. The minimum credit rating of any security purchased is A-/A3 and where investments are downgraded below A-/A3, we permit our investment managers to hold up to 2.0% in aggregate market value, or up to 10.0% with written authorization of the Company. At June 30, 2009, 4.3% of the portfolio was below A-/A3 and we did not have an aggregate exposure to any single issuer of more than 1.6% of total investments, other than with respect to government securities.

The amount of the maximum exposure to credit risk is indicated by the carrying value of the Company's financial assets. The Company's primary credit risks reside in investment in U.S. corporate bonds and recoverables from reinsurers at the Talbot segment. 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 S & P or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. 100.0% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) at June 30, 2009 were from reinsurers rated A-, (December 31, 2008 rated A- or better) or from reinsurers posting full collateral. Validus Re does not have any reinsurance recoverable balances that are not fully collateralized.

*Liquidity risk:* Certain of the Company's investments may become illiquid. The current disruption in the credit markets may materially affect the liquidity of the Company's investments, including residential mortgage-backed securities which represent 20.5% (December 31, 2008: 20.3%) of total cash and investments. If the Company requires significant amounts of cash on short notice in excess of normal cash requirements (which could include claims on a major catastrophic event) in a period of market illiquidity, the investments may be difficult to sell in a timely manner and may have to be disposed of for less than what may otherwise have been possible under other conditions. At June 30, 2009, the Company had \$1,278.1 million of unrestricted, liquid assets, defined as unpledged cash and cash equivalents, short term investments, government and government agency securities. Details of the Company's debt and financing arrangements at June 30, 2009 are provided below.

| <b>(Dollars in thousands)</b>                    | <b>Maturity Date /<br/>Term</b> | <b>Outstanding</b> |
|--------------------------------------------------|---------------------------------|--------------------|
| 9.069% Junior Subordinated Deferrable Debentures | June 15, 2036                   | \$ 150,000         |
| 8.480% Junior Subordinated Deferrable Debentures | June 15, 2037                   | 154,300            |
| \$200,000 unsecured letter of credit facility    | March 12, 2010                  | -                  |
| \$500,000 secured letter of credit facility      | March 12, 2012                  | 276,955            |
| Talbot FAL facility                              | December 31, 2009               | 100,000            |
| Talbot third party FAL facility                  | December 31, 2009               | 121,515            |

**Total**

\$ 802,770

86

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**Table of Contents**

*Effects of Inflation:* We do not believe that inflation has had or will have a material effect on our combined results of operations, except insofar as (a) inflation may affect interest rates, and (b) losses and loss expenses may be affected by inflation.

**ITEM 4. CONTROLS AND PROCEDURES**

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of disclosure controls and procedures pursuant to Rules 13a-15 and 15d-15 promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective to provide reasonable assurance that all material information relating to the Company required to be filed in this report has been made known to them in a timely fashion.

**Changes in Internal Control Over Financial Reporting**

There have been no changes in internal control over financial reporting identified in connection with the Company's evaluation required pursuant to Rules 13a-15 and 15d-15 promulgated under the Securities Exchange Act of 1934, as amended, that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

Prior to entering into the Amalgamation Agreement with IPC, on April 28, 2009, the Company filed a claim in the Supreme Court of Bermuda against IPC, IPC Limited and Max Capital Ltd. ( Max ) ( Bermuda claim ). On March 1, 2009, IPC and Max entered into an amalgamation agreement (the Max Amalgamation Agreement ) providing for the amalgamation of Max with IPC Limited. The Bermuda claim challenges the validity of the termination fee in the Max Amalgamation Agreement and provisions which restricted the ability of IPC to discuss competing proposals with third parties (the no-talk provisions ) in the Max Amalgamation Agreement. Further, the Bermuda claim alleges that by entering into the Max Amalgamation Agreement containing the Max termination fee and no talk provisions and by continuing to act in accordance with the terms of these provisions, the directors of IPC acted in breach of their fiduciary duty and not in accordance with the constitution of IPC.

On May 1, 2009, the Company filed an application to expedite the trial of the Bermuda claim. The Company requested that the Supreme Court of Bermuda set a schedule permitting a trial to be conducted commencing on an earlier date than any date on which IPC sought to hold its annual general meeting to consider the proposals related to the Proposed Max Amalgamation. The application to expedite the trial was denied by the Supreme Court of Bermuda on May 11, 2009. The Bermuda claim is still pending in the Supreme Court of Bermuda, however, the proceedings have been stayed by consent of the parties.

Also prior to entering into the Amalgamation Agreement, the Company had re-filed an application on June 29, 2009, initially filed on May 14, 2009, to the Supreme Court of Bermuda to convene a court-ordered meeting of the IPC s shareholders in order for IPC s shareholders to approve a scheme of arrangement (the Scheme of Arrangement ) under Part VII of The Companies Act 1981 of Bermuda, as amended. In order to implement the Scheme of Arrangement, IPC s shareholders would have had to approve the Scheme of Arrangement at a court-ordered meeting of IPC s shareholders, IPC would have had to separately approve the Scheme of Arrangement, IPC s shareholders would have had to approve certain proposals put forth by the Company at a special general meeting of shareholders of IPC (including, if necessary, to provide for IPC s separate approval of the Scheme of Arrangement) and the Scheme of Arrangement would have had to be sanctioned by the Supreme Court of Bermuda. On July 9, 2009, the Company announced that it would terminate its solicitation efforts in connection with its previously announced alternative steps to complete a non-consensual transaction with IPC, including the Scheme of Arrangement; therefore these proceedings have been adjourned.

We anticipate that, similar to the rest of the insurance and reinsurance industry, we will be subject to litigation and arbitration in the ordinary course of business.

**ITEM 1A. RISK FACTORS**

In addition to the risk factors set forth below, you should read and consider other risk factors specific to each of the Company s and IPC businesses that will also affect the Company s after consummation of the Amalgamation, described in Part I, Item 1A of each company s Annual Report on Form 10-K for the year ended December 31, 2008 and other documents that have been filed with the SEC and all of which are incorporated by reference into Amendment No. 5 to the joint proxy statement/prospectus on Form S-4, filed with the SEC on July 16, 2009. If any of the risks described below or in the reports incorporated by reference into Amendment No. 5 to the joint proxy statement/prospectus on Form S-4, filed with the SEC on July 16, 2009 occurs, the respective businesses, financial results, financial conditions, operating results or share prices of the Company or IPC could be materially adversely affected.

**Risk Factors Relating to the Amalgamation**

*The value of the Company s Shares that the IPC shareholders receive in the Amalgamation will vary as a result of the fixed exchange ratio and possible fluctuations in the price of the Company s Shares.*



**Table of Contents**

Upon consummation of the Amalgamation each IPC Share (other than IPC Shares held by dissenting IPC shareholders or by the Company and its subsidiaries) will be exchanged into 0.9727 common shares, par value \$0.175 per share of the Company (the Shares), \$7.50 in cash (less any applicable withholding taxes and without interest) and cash in lieu of fractional shares. Because the exchange ratio is fixed at 0.9727 of the Company's Shares for each IPC Share, the market value of the Company's Shares issued in exchange for IPC Shares will depend upon the market price of the Company's Shares at the date the Amalgamation is consummated. If the price of the Company's Shares declines, IPC shareholders could receive less value for their shares upon the consummation of the Amalgamation than the value calculated pursuant to the exchange ratio on the date the Amalgamation was announced or as of the date of the filing of this joint proxy statement/prospectus. Share price changes may result from a variety of factors that are beyond the companies' control, including general market conditions, changes in business prospects, catastrophic events, both natural and man-made, and regulatory considerations.

In connection with the Amalgamation, the Company estimates that it will need to issue approximately 54,959,648 of the Company's Shares. The increase in the number of the Company's outstanding Shares may lead to sales of such shares or the perception that such sales may occur, either of which may adversely affect the market for, and the market price of, the Company's Shares.

***The Amalgamation remains subject to conditions and failure to complete the Amalgamation could negatively impact the Company and IPC.***

The Amalgamation Agreement contains a number of conditions precedent that must be satisfied or waived prior to the consummation of the Amalgamation. In addition, the Amalgamation Agreement may be terminated under certain circumstances.

If the Amalgamation is not completed, the ongoing business of the Company may be adversely affected as follows: the attention of management of the Company will have been diverted to the Amalgamation instead of being directed solely to the Company's own operations and pursuit of other opportunities that could have been beneficial to the Company;

the Company will have to pay certain costs relating to the Amalgamation, including certain legal, accounting and financial advisory fees;

the Company may be required, in certain circumstances, to pay a termination fee of \$16 million to IPC; and

the Company may not have a right to be reimbursed the \$50 million it advanced to IPC in respect of the Max Termination Fee upon the execution of the Amalgamation Agreement.

***Termination of, or failure to renew reinsurance agreements by IPC's clients or failure to obtain effective consents of the Company's lenders to the Amalgamation could materially adversely affect the Amalgamation or the business of the Company.***

With regards to IPC's reinsurance arrangements, many in-force reinsurance contracts contain change of control provisions. In addition, many of these reinsurance contracts are annually renewable and whether or not they may be terminated in a change of control, reinsurance cedants may choose not to renew these contracts with the combined entity. Termination and failure to renew reinsurance agreements by contractual counterparties could result in a material adverse effect on the combined entity's business, financial condition and operating results, as well as on the market value of the combined entity's common shares. In addition, if the Company is unable to obtain the consent of the lenders under its credit facilities to the Amalgamation, the Company may be required to pay down the outstanding obligations. If the conditions to the effectiveness of the lenders' consents are not met, or the Company is required to pay down any obligations, the Company may be forced to find alternative sources of liquidity, which may not be available, or if available, may be on unfavorable terms.

**Table of Contents*****Potential payments made to dissenting IPC shareholders in respect of their rights to appraisal of their shares could exceed the amount of consideration otherwise due to them under the terms of the Amalgamation Agreement.***

Any IPC shareholder may apply, within one month after the date of notice convening the IPC special meeting, for an appraisal of the fair value of its IPC Shares. The Company may be required to pay the fair value appraised by the court to such dissenting shareholder which could be less than, equal to or more than the amalgamation consideration. Any such payments may have a material adverse effect on the Company's business, financial condition and operating results, as well as the market price of the Company's Shares.

***The financial analyses and forecasts considered by the Company and IPC and their respective financial advisors may not be realized, which may adversely affect the market price of the Company's Shares following the Amalgamation.***

In performing their financial analyses and rendering their opinions regarding the fairness from a financial perspective of the consideration in the Amalgamation, each of the respective financial advisors to the Company and IPC independently reviewed and relied on, among other things, internal stand-alone and pro forma financial analyses and forecasts as separately provided to each respective financial advisor by the Company or IPC. These analyses and forecasts were prepared by, or as directed by, the managements of the Company and IPC and were also considered by the Company and IPC's boards of directors. None of these analyses or forecasts were prepared with a view towards public disclosure or compliance with the published guidelines of the SEC or the American Institute of Certified Public Accountants regarding projections and forecasts. These projections are inherently based on various estimates and assumptions that are subject to the judgment of those preparing them. These projections are also subject to significant economic, competitive, industry and other uncertainties and contingencies, all of which are difficult or impossible to predict and many of which are beyond the control of the Company and IPC. Accordingly, there can be no assurance that the Company's or IPC's financial condition or results of operations will not be significantly worse than those set forth in such analyses and forecasts. Significantly worse financial results could have a material adverse effect on the market price of the Company's Shares following the Amalgamation.

**Risk Factors Relating to the Company Following the Amalgamation*****The Company may experience difficulties integrating IPC's businesses, which could cause the Company to fail to realize the anticipated benefits of the Amalgamation.***

If the Amalgamation is consummated, achieving the anticipated benefits of the Amalgamation will depend in part upon whether the two companies integrate their businesses in an effective and efficient manner. The Company may not be able to accomplish this integration process smoothly or successfully. The integration of certain operations following the Amalgamation will take time and will require the dedication of significant management resources, which may temporarily distract management's attention from the routine business of the combined entity.

Any delay or inability of management to successfully integrate the operations of the two companies could compromise the combined entity's potential to achieve the anticipated long-term strategic benefits of the Amalgamation and could have a material adverse effect on the business, financial condition, operating results and market value of the Company's Shares after the Amalgamation.

***The Amalgamation may result in ratings downgrades of one or more of the Company's insurance or reinsurance subsidiaries (including the newly acquired IPC insurance and reinsurance operating companies) which may adversely affect the Company's business, financial condition and operating results, as well as the market price of the Company's Shares.***

Ratings with respect to claims paying ability and financial strength are important factors in maintaining customer confidence in the Company and its ability to market insurance and reinsurance products and compete with other insurance and reinsurance companies. Rating organizations regularly analyze the financial performance and condition of insurers and reinsurers and will likely reevaluate the ratings of the Company and its reinsurance subsidiaries following the consummation of the Amalgamation, if applicable. Following the announcement of the

**Table of Contents**

Amalgamation Agreement, Standard & Poor's revised its outlook on the Company to positive from stable, and affirmed its BBB- counterparty credit rating on the Company and A.M. Best changed the outlook to negative with respect to the A- financial strength rating and a- issuer credit rating of the Company's reinsurance subsidiary, Validus Reinsurance, Ltd. ( Validus Re ), and the bbb- issuer credit rating of the Company. In addition, Moody's affirmed its outlook of negative with respect to the A3 insurance financial strength rating of Validus Re and the Baa2 long-term issuer rating of the Company. Additionally, following the announcement of the Amalgamation Agreement, A.M. Best downgraded the financial strength ratings to A- (Excellent) from A (Excellent) and issuer credit ratings to a- from a for the reinsurance subsidiaries of IPC (including IPCRe and IPCRe Europe Limited) and also downgraded the issuer credit rating to bbb- from bbb for IPC and indicated that these ratings continue to be under review with negative implications. Following the Amalgamation, any ratings downgrades, or the potential for ratings downgrades, of the Company or its subsidiaries (including the newly acquired IPC operating companies) could adversely affect the Company's ability to market and distribute products and services and successfully compete in the marketplace, which could have a material adverse effect on its business, financial condition and operating results, as well as the market price for the Company's Shares.

*The occurrence of severe catastrophic events after the completion of the Amalgamation could cause the Company's net income to be more volatile than if the Amalgamation did not take place.*

For the year ended December 31, 2008, the Company's gross premiums (excluding reinstatement premiums) written on property catastrophe business were \$328.2 million or 24.1% of total gross premiums written. For the year ended December 31, 2008, 93% of IPC's gross premiums written covered property catastrophe reinsurance risks. For the year ended December 31, 2008, after giving effect to the Amalgamation as if it had been consummated on December 31, 2008, gross premiums written on property catastrophe business would have been \$661.9 million or 37.5% of total gross premiums of the Company on a pro forma basis. Because the Company after the Amalgamation will, among other things, have larger aggregate exposures to natural and man-made disasters than it does today, the Company's aggregate loss experience could have a significant influence on the Company's net income.

**Risks Relating to Lloyd's*****Lloyd's 1992 and prior liabilities.***

Notwithstanding the firebreak introduced when Lloyd's implemented the Reconstruction and Renewal Plan in 1996, Lloyd's members, including Talbot subsidiaries, remain indirectly exposed in a number of ways to 1992 and prior business then reinsured by Equitas, including through the application of overseas deposits and the central fund.

Lloyd's currently has a number of contingent liabilities in respect of risks under certain policies allocated to 1992 or prior years of account. Notwithstanding the statutory transfer of 1992 and prior non-life business from Names to Equitas Insurance Limited, if the limit of retrocessional cover from National Indemnity Company in respect of that business proves to be insufficient and as a consequence Equitas is unable to pay the 1992 and prior liabilities in full, Lloyd's will be liable to meet any shortfall arising in respect of certain policies. The central fund, which Lloyd's can replenish, subject to its byelaws, by issuing calls on current underwriting members of Lloyd's (which will include Talbot subsidiaries), may be applied for these purposes. Lloyd's also has contingent liabilities under indemnities in respect of claims against certain persons.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

There were no stock repurchases for the quarter ended June 30, 2009.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS****Annual General Meeting of Shareholders**

(a) The annual general meeting of shareholders (the Annual General Meeting ) of the Company was held on May 6, 2009.

(b) Proxies for the Annual General Meeting were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934. There was no solicitation in opposition to management's nominees as listed in the Company's proxy statement, dated March 25, 2009 (the Proxy Statement ).

(c) The shareholders of the Company (1) elected Class II Directors for terms to expire in 2012, (2) approved the appointment of PricewaterhouseCoopers as Independent Auditor for the Company for the fiscal year ending December 31, 2009 and (3) elected designated company directors of the Company's non-U.S. subsidiaries. Set forth below are the voting results for these proposals:

**Table of Contents****Election of Class I Directors of the Company**

|                       | <b>For</b> | <b>Withheld</b> |
|-----------------------|------------|-----------------|
| Sander M. Levy        | 50,366,452 | 307,053         |
| George P. Reeth       | 49,575,252 | 1,098,253       |
| Alok Singh            | 50,365,518 | 307,987         |
| Christopher E. Watson | 47,593,068 | 3,080,437       |

**Approval of Selection of PricewaterhouseCoopers as Independent Auditor**

|        | <b>For</b> | <b>Against</b> | <b>Abstain</b> |
|--------|------------|----------------|----------------|
| Total: | 50,585,283 | 86,382         | 1,840          |

**Election of Designated Company Directors of Subsidiaries**

|                            | <b>For</b> | <b>Withheld</b> |
|----------------------------|------------|-----------------|
| Edward J. Noonan           | 50,365,910 | 307,595         |
| C.N. Rupert Atkin          | 50,363,027 | 310,478         |
| Patrick G. Barry           | 50,366,473 | 307,032         |
| Julian P. Bosworth         | 50,366,473 | 307,032         |
| Michael E.A. Carpenter     | 50,365,973 | 307,532         |
| Jane S. Clouting           | 50,363,590 | 309,915         |
| Joseph E. (Jeff) Consolino | 50,365,910 | 307,595         |
| C. Jerome Dill             | 50,365,973 | 307,532         |
| Kerry A. Emanuel           | 50,366,452 | 307,053         |
| Jonathan D. Ewington       | 50,363,590 | 309,915         |
| Nicholas Hales             | 50,366,473 | 307,032         |
| Mark S. Johnson            | 50,366,473 | 307,032         |
| Anthony J. Keys            | 50,366,473 | 307,032         |
| Gillian S. Langford        | 50,366,473 | 307,032         |
| Stuart W. Mercer           | 50,365,973 | 307,532         |
| Paul J. Miller             | 50,363,590 | 309,915         |
| George P. Reeth            | 50,366,473 | 307,032         |
| Julian G. Ross             | 50,366,452 | 307,053         |
| Verner G. Southey          | 50,363,590 | 309,915         |
| Guiseppe Venesiani         | 50,366,473 | 307,032         |
| Nigel D. Wachman           | 50,366,452 | 307,053         |
| Conan M. Ward              | 50,363,090 | 310,415         |
| Lixin Zeng                 | 50,366,452 | 307,053         |

**Special Meeting of Shareholders**

(a) The special meeting of shareholders (the "Special Meeting") of the Company was held on June 25, 2009.

(b) Proxies for the Special Meeting were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934. There was no solicitation in opposition to the proposals as listed in the Company's proxy statement, dated May 26, 2009 (the "Special Meeting Proxy Statement").

(c) The shareholders of the Company (1) approved the issuance of stock in connection with the acquisition of all of the outstanding common shares of IPC (the "Acquisition") and (2) approved the adjournment of the meeting. Set forth below are the voting results for these proposals:

**Approval of the Issuance of Stock in Connection with the Acquisition**

|        | <b>For</b> | <b>Against</b> | <b>Abstain</b> |
|--------|------------|----------------|----------------|
| Total: | 50,921,168 | 658,361        | 304,922        |



**Table of Contents**

**Approved the Adjournment of the Meeting**

|        | <b>For</b> | <b>Against</b> | <b>Abstain</b> |
|--------|------------|----------------|----------------|
| Total: | 49,280,938 | 2,207,566      | 395,947        |

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

| <b>Exhibit</b> | <b>Description</b>                                                                                                                                                                                                                         |
|----------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Exhibit 10.1   | Agreement and Plan of Amalgamation, dated as of July 9, 2009, among IPC Holdings, Ltd., Validus Holdings, Ltd. and Validus Ltd. (Incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on July 9, 2009) |

93

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**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**VALIDUS HOLDINGS, LTD.**

(Registrant)

Date: August 7, 2009

/s/ Edward J. Noonan  
Edward J. Noonan  
Chief Executive Officer

Date: August 7, 2009

/s/ Joseph E. (Jeff) Consolino  
Joseph E. (Jeff) Consolino  
Chief Financial Officer and Executive Vice  
President

94