

VALIDUS HOLDINGS LTD

Form 10-Q

November 07, 2014

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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Form 10-Q

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

For the quarterly period ended September 30, 2014

Commission file number 001-33606

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VALIDUS HOLDINGS, LTD.

(Exact name of registrant as specified in its charter)

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BERMUDA

(State or other jurisdiction of  
incorporation or organization)

29 Richmond Road, Pembroke, Bermuda HM 08  
(Address of principal executive offices and zip code)  
(441) 278-9000

(Registrant's telephone number, including area code)

98-0501001

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  No

As of November 5, 2014 there were 87,376,871 outstanding Common Shares, \$0.175 par value per share, of the registrant.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Validus Holdings, Ltd.

Consolidated Balance Sheets

As at September 30, 2014 (unaudited) and December 31, 2013

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

	September 30, 2014 (unaudited)	December 31, 2013
<b>Assets</b>		
Fixed maturities, at fair value (amortized cost: 2014—\$4,668,585; 2013—\$5,522,853)	\$4,670,173	\$5,542,258
Short-term investments, at fair value (amortized cost: 2014—\$1,684,997; 2013—\$751,734)	1,684,982	751,778
Other investments, at fair value (cost: 2014—\$714,508; 2013—\$637,728)	718,633	618,316
Cash and cash equivalents	843,747	1,056,346
Total investments and cash	7,917,535	7,968,698
Investments in affiliates	217,612	141,243
Premiums receivable	936,306	697,233
Deferred acquisition costs	186,277	134,269
Prepaid reinsurance premiums	129,809	103,251
Securities lending collateral	9,056	3,392
Loss reserves recoverable	298,502	370,154
Paid losses recoverable	62,991	80,080
Intangible assets	103,287	106,407
Goodwill	20,393	20,393
Accrued investment income	15,415	18,876
Other assets	155,867	202,436
Total assets	\$10,053,050	\$9,846,432
<b>Liabilities</b>		
Reserve for losses and loss expenses	\$2,752,168	\$3,030,399
Unearned premiums	1,158,429	824,496
Reinsurance balances payable	141,482	154,874
Securities lending payable	9,522	3,858
Deferred income taxes	11,687	19,086
Net payable for investments purchased	54,735	19,383
Accounts payable and accrued expenses	186,649	278,187
Notes payable to operating affiliates	655,976	439,272
Senior notes payable	247,279	247,198
Debentures payable	539,953	541,416
Total liabilities	\$5,757,880	\$5,558,169
<b>Commitments and contingent liabilities</b>		
Redeemable noncontrolling interest	70,473	86,512
<b>Shareholders' equity</b>		

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Common shares, 571,428,571 authorized, par value \$0.175 (Issued: 2014—155,253,556; 2013—154,488,497; Outstanding: 2014—89,112,271; 2013—96,044,312)	\$27,169	\$27,036
Treasury shares (2014—66,141,285; 2013—58,444,185)	(11,575	) (10,228 )
Additional paid-in-capital	1,413,145	1,677,894
Accumulated other comprehensive loss	(2,738	) (617 )
Retained earnings	2,276,409	2,010,009
Total shareholders' equity available to Validus	3,702,410	3,704,094
Noncontrolling interest	522,287	497,657
Total shareholders' equity	\$4,224,697	\$4,201,751
Total liabilities, noncontrolling interests and shareholders' equity	\$10,053,050	\$9,846,432

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

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Validus Holdings, Ltd.

Consolidated Statements of Comprehensive Income

For the Three and Nine Months Ended September 30, 2014 and 2013 (unaudited)

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

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2014	2013	2014	2013
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Revenues</b>				
Gross premiums written	\$358,974	\$ 356,760	\$2,026,639	\$ 2,163,833
Reinsurance premiums ceded	(30,137 )	(39,415 )	(275,610 )	(348,027 )
Net premiums written	328,837	317,345	1,751,029	1,815,806
Change in unearned premiums	165,859	213,943	(307,373 )	(205,999 )
Net premiums earned	494,696	531,288	1,443,656	1,609,807
Net investment income	25,261	20,009	69,909	71,868
Net realized gains (losses) on investments	4,595	(6,320 )	16,193	(1,190 )
Change in net unrealized (losses) gains on investments	(84,974 )	69,967	16,146	(78,618 )
Income from investment affiliate	1,754	1,044	7,881	4,274
Other (loss) income	(4,080 )	(2,806 )	14,985	4,297
Foreign exchange (losses) gains	(11,441 )	6,036	(14,761 )	4,735
Total revenues	425,811	619,218	1,554,009	1,615,173
<b>Expenses</b>				
Losses and loss expenses	224,125	177,965	545,541	587,780
Policy acquisition costs	86,404	94,900	251,006	275,663
General and administrative expenses	83,319	81,089	231,606	232,335
Share compensation expenses	8,764	10,527	24,252	19,483
Finance expenses	15,354	15,317	47,380	47,252
Transaction expenses	149	—	3,401	—
Total expenses	418,115	379,798	1,103,186	1,162,513
Income before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	7,696	239,420	450,823	452,660
Tax benefit (expense)	953	(5 )	(398 )	220
Income from operating affiliates	3,761	1,463	13,580	8,779
(Income) attributable to operating affiliate investors	(25,807 )	(11,815 )	(82,833 )	(42,156 )
Net (loss) income	\$(13,397 )	\$ 229,063	\$381,172	\$ 419,503
Net loss (income) attributable to noncontrolling interest	53,069	(45,694 )	(25,745 )	17,831
Net income available to Validus	\$39,672	\$ 183,369	\$355,427	\$ 437,334
<b>Other comprehensive (loss) income</b>				
Foreign currency translation adjustments	(5,198 )	4,390	(2,121 )	(5,209 )
Other comprehensive (loss) income	\$(5,198 )	\$ 4,390	\$(2,121 )	\$(5,209 )
Comprehensive income available to Validus	\$34,474	\$ 187,759	\$353,306	\$ 432,125

Earnings per share

Weighted average number of common shares and common  
share equivalents outstanding

Basic	90,593,329	99,834,563	91,665,950	103,451,396
Diluted	91,939,610	103,613,766	95,937,641	105,264,913

Basic earnings per share available to common shareholders	\$0.42	\$ 1.82	\$3.83	\$ 4.06
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Earnings per diluted share available to common shareholders	\$0.41	\$ 1.77	\$3.70	\$ 3.99
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Cash dividends declared per share	\$0.30	\$ 0.30	\$0.90	\$ 2.90
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The accompanying notes are an integral part of these consolidated financial statements (unaudited).

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Validus Holdings, Ltd.

Consolidated Statements of Shareholders' Equity

For the Nine Months Ended September 30, 2014 and 2013 (unaudited)

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

	September 30, 2014 (unaudited)	September 30, 2013 (unaudited)
Common shares		
Balance - Beginning of period	\$27,036	\$26,722
Common shares issued, net	133	296
Balance - End of period	\$27,169	\$27,018
Treasury shares		
Balance - Beginning of period	\$(10,228	) \$(7,836
Repurchase of common shares	(1,347	) (1,699
Balance - End of period	\$(11,575	) \$(9,535
Additional paid-in capital		
Balance - Beginning of period	\$1,677,894	\$2,160,478
Common shares redeemed, net	(3,822	) (134
Repurchase of common shares	(285,179	) (355,485
Share compensation expenses	24,252	19,483
Balance - End of period	\$1,413,145	\$1,824,342
Accumulated other comprehensive loss		
Balance - Beginning of period	\$(617	) \$(2,953
Amounts reclassified to retained earnings	—	4,290
Other comprehensive loss	(2,121	) (5,209
Balance - End of period	\$(2,738	) \$(3,872
Retained earnings		
Balance - Beginning of period	\$2,010,009	\$1,844,416
Dividends	(89,027	) (331,251
Net income	381,172	419,503
Net (income) loss attributable to noncontrolling interest	(25,745	) 17,831
Amounts reclassified from accumulated other comprehensive loss	—	(4,290
Balance - End of period	\$2,276,409	\$1,946,209
Total shareholders' equity available to Validus	\$3,702,410	\$3,784,162
Noncontrolling interest	\$522,287	\$471,933
Total shareholders' equity	\$4,224,697	\$4,256,095

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





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Validus Holdings, Ltd.

Consolidated Statements of Cash Flows

For the Nine Months Ended September 30, 2014 and 2013 (unaudited)

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

	September 30, 2014 (unaudited)	September 30, 2013 (unaudited)
Cash flows provided by (used in) operating activities		
Net income	\$381,172	\$419,503
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	24,252	19,483
Gain on sale of subsidiary	(709	) —
Gain on deconsolidation of subsidiary	(1,372	) —
Amortization of discount on senior notes	81	81
Income from investment affiliate	(7,881	) (4,274
Net realized (gains) losses on investments	(16,193	) 1,190
Change in net unrealized (gains) losses on investments	(16,146	) 78,618
Amortization of intangible assets	3,120	3,120
Income from operating affiliates	(13,580	) (8,779
Foreign exchange losses included in net income	10,841	4,927
Amortization of premium on fixed maturities	11,922	14,870
Change in:		
Premiums receivable	(241,175	) (226,154
Deferred acquisition costs	(52,008	) (19,951
Prepaid reinsurance premiums	(26,558	) (69,469
Loss reserves recoverable	70,444	20,411
Paid losses recoverable	17,245	16,218
Income taxes recoverable	—	(3,099
Accrued investment income	3,431	3,466
Other assets	30,125	(11,214
Reserve for losses and loss expenses	(271,063	) (293,673
Unearned premiums	333,933	275,468
Reinsurance balances payable	(12,836	) (634
Deferred income taxes	(7,385	) 2,565
Accounts payable and accrued expenses	(70,809	) (17,783
Net cash provided by operating activities	148,851	204,890
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	3,587,124	3,598,080
Proceeds on maturities of investments	466,872	406,079
Purchases of fixed maturities	(3,161,908	) (4,414,320
(Purchases) sales of short-term investments, net	(961,264	) 348,554
Purchases of other investments, net	(69,932	) (21,793
Increase in securities lending collateral	(5,664	) (796
Redemption of investment in operating affiliates	58,547	86,657

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Purchase of investment in investment affiliate	—	(13,089	)
Proceeds on sale of subsidiary	16,459	—	
Net cash used in investing activities	(69,766	) (10,628	)
Cash flows provided by (used in) financing activities			
Net proceeds on issuance of notes payable to operating affiliates	43,175	418,299	
(Redemption) issuance of common shares, net	(3,689	) 162	
Purchases of common shares under share repurchase program	(286,526	) (357,184	)
Dividends paid	(89,719	) (329,201	)
Increase in securities lending payable	5,664	796	
Investment in third party redeemable noncontrolling interest	50,704	62,790	
Investment in third party noncontrolling interest	—	58,500	
Net cash used in financing activities	(280,391	) (145,838	)
Effect of foreign currency rate changes on cash and cash equivalents	(11,293	) (13,185	)
Net (decrease) increase in cash	(212,599	) 35,239	
Cash and cash equivalents - beginning of period	\$1,056,346	\$1,219,379	
Cash and cash equivalents - end of period	\$843,747	\$1,254,618	
Taxes paid during the period	\$7,286	\$5,325	
Interest paid during the period	\$46,421	\$44,112	

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

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

1. Basis of preparation and consolidation

These unaudited Consolidated Financial Statements (the "Consolidated Financial Statements") include Validus Holdings, Ltd. and its wholly and majority owned subsidiaries (together the "Company") and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 in Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. This Quarterly Report on Form 10-Q should be read in conjunction with the financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the U.S. Securities and Exchange Commission (the "SEC").

In the opinion of management, these Consolidated Financial Statements reflect all adjustments (including normal recurring adjustments) 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. To facilitate comparison of information, certain amounts in prior periods have been reclassified to conform to current period presentation. The consolidated statement of cash flows for the nine months ended September 30, 2013 includes a reclassification of \$19,400 that increased net cash flows used in financing activities and net cash flows provided by operating activities to revise the presentation of subscriptions received in advance from third party investors. For the three and nine months ended September 30, 2013, \$11,815 and \$42,156 respectively, have been reclassified into income attributable to operating affiliate investors from finance expenses to conform to current period presentation. All significant intercompany accounts and transactions have been eliminated. The results of operations for any interim period are not necessarily indicative of the results for a full year.

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

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

The term "ASC" used in these notes refers to Accounting Standard Codification issued by the U.S. Financial Accounting Standards Board ("FASB").

2. Recent accounting pronouncements

Adoption of New Accounting Standards

Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity

In March 2013, the FASB issued Accounting Standard Update No. 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity" (ASU 2013-05). The objective of this Update is to resolve the diversity in practice about whether Subtopic 810-10, Consolidation-Overall, or Subtopic 830-30, Foreign Currency Matters-Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent

either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary within a foreign entity. The amendments became effective for the Company on January 1, 2014. Adoption of this guidance did not have a material impact on the Company's Consolidated Financial Statements.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

**Financial Services - Investment Companies - Amendments to the Scope, Measurement, and Disclosure Requirements**  
In June 2013, the FASB issued Accounting Standard Update No. 2013-08, "Financial Services - Investment Companies - Amendments to the Scope, Measurement, and Disclosure Requirements" (ASU 2013-08). The amendments in this Update change the assessment of whether an entity is an investment company by developing a new two-tiered approach for that assessment, which requires an entity to possess certain fundamental characteristics while allowing judgment in assessing other typical characteristics. The new approach requires an entity to assess all of the characteristics of an investment company and consider its purpose and determine whether it is an investment company. The amendments became effective for the Company on January 1, 2014. The Company performed an assessment and has concluded that the AlphaCat ILS funds meet the characteristics outlined in this Update and therefore will continue to be treated as investment companies.

**Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists**

In July 2013, the FASB issued Accounting Standard Update No. 2013-11 "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" (ASU 2013-11). This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward is not available to settle any additional income taxes that would result from the disallowance of a tax position at the reporting date, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The amendments became effective for the Company on January 1, 2014. Adoption of this guidance did not have a material impact on the Company's Consolidated Financial Statements.

**Recently Issued Accounting Standards Not Yet Adopted**

In May 2014, the FASB issued Accounting Standard Update No. 2014-09, "Revenue from Contracts with Customers" (ASU 2014-09). The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in this Update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Earlier adoption is not permitted. The Company is currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

In June 2014, the FASB issued Accounting Standard Update No. 2014-12, "Compensation - Stock Compensation (Topic 718) - Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period" (ASU 2014-12). The amendments in this Update apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target (for example, an initial public offering or a profitability target) could be achieved and still be eligible to vest in the award if and when the performance target is achieved. The amendments in this Update are effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Earlier adoption is permitted. The Company is currently evaluating the impact of this guidance; however, it is not expected to have a material impact on the Company's Consolidated Financial Statements.

In August 2014, the FASB issued Accounting Standard Update 2014-13, "Consolidation (Topic 810) - Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity" (ASU 2014-13). The fair value of the financial assets of a collateralized financing entity, as determined under GAAP, may differ from the fair value of its financial liabilities even when the financial liabilities have recourse only to the financial assets. The amendments in this Update provide an alternative to Topic 820 for measuring the financial assets and the financial liabilities of a consolidated collateralized financing entity to eliminate that difference. The amendments in this Update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted as of the beginning of an annual period. The Company is currently evaluating the impact of this guidance on the Company's Consolidated Financial Statements.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

In August 2014, the FASB issued Accounting Standard Update 2014-15, "Presentation of Financial Statements - Going Concern - Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern" (ASU 2014-15). The amendments in this Update require management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company is currently evaluating the impact of this guidance; however, it will not have a material impact on the Company's Consolidated Financial Statements.

## 3. Investments

## (a) Fixed maturity, short-term and other investments

The Company's investments in fixed maturities, short-term investments and other investments are classified as trading and carried at fair value, with related changes in net unrealized gains or losses included in earnings.

The amortized cost (or cost), gross unrealized gains and (losses) and estimated fair value of investments at September 30, 2014 were as follows:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	\$ 786,318	\$1,735	\$(1,798)	) \$786,255
Non-U.S. government and government agency	383,378	1,775	(3,956)	) 381,197
U.S. states, municipalities and political subdivisions	73,996	557	(188)	) 74,365
Agency residential mortgage-backed securities	368,646	7,877	(1,296)	) 375,227
Non-agency residential mortgage-backed securities	17,370	238	(409)	) 17,199
U.S. corporate	1,168,304	5,601	(4,987)	) 1,168,918
Non-U.S. corporate	593,619	4,071	(3,055)	) 594,635
Bank loans	488,904	616	(5,732)	) 483,788
Catastrophe bonds	47,574	1,305	(541)	) 48,338
Asset-backed securities	566,135	981	(664)	) 566,452
Commercial mortgage-backed securities	174,341	48	(590)	) 173,799
Total fixed maturities	4,668,585	24,804	(23,216)	) 4,670,173
Total short-term investments (b)	1,684,997	4	(19)	) 1,684,982
Other investments				
Fund of hedge funds	2,802	162	(921)	) 2,043
Hedge funds (a)	570,372	101,610	(104,142)	) 567,840
Private equity investments	11,295	3,832	(108)	) 15,019
Investment funds	123,840	350	—	) 124,190
Mutual funds	6,199	3,342	—	) 9,541
Total other investments	714,508	109,296	(105,171)	) 718,633
Total investments including noncontrolling interests	\$ 7,068,090	\$134,104	\$(128,406)	) \$7,073,788
Noncontrolling interest (a)	\$ (502,830)	) \$(86,263)	) \$93,728	) \$(495,365)
Redeemable noncontrolling interest (b)	\$ (11,637)	) \$—	) \$—	) \$(11,637)
Total investments excluding noncontrolling interests	\$ 6,553,623	\$47,841	\$(34,678)	) \$6,566,786

Included in the hedge funds balance are investments held by PaCRE in which the Company has an equity interest of (a) 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

(b)



Included in the short-term investments balance are investments held by one AlphaCat ILS fund which is consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

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The amortized cost (or cost), gross unrealized gains and (losses) and estimated fair value of investments at December 31, 2013 were as follows:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	\$ 1,368,826	\$2,589	\$(6,736)	) \$1,364,679
Non-U.S. government and government agency	454,578	6,511	(2,021)	) 459,068
U.S. states, municipalities and political subdivisions	42,978	459	(317)	) 43,120
Agency residential mortgage-backed securities	305,450	8,310	(2,261)	) 311,499
Non-agency residential mortgage-backed securities	16,530	143	(914)	) 15,759
U.S. corporate	1,328,960	9,208	(5,684)	) 1,332,484
Non-U.S. corporate	711,581	5,917	(3,173)	) 714,325
Bank loans	712,859	5,659	(1,402)	) 717,116
Catastrophe bonds	72,000	2,551	—	) 74,551
Asset-backed securities	509,091	1,409	(843)	) 509,657
Total fixed maturities	5,522,853	42,756	(23,351)	) 5,542,258
Total short-term investments (b)	751,734	45	(1)	) 751,778
Other investments				
Fund of hedge funds	3,141	83	(921)	) 2,303
Hedge funds (a)	584,518	71,641	(95,076)	) 561,083
Private equity investments	12,333	1,410	(258)	) 13,485
Investment funds	31,537	92	—	) 31,629
Mutual funds	6,199	3,617	—	) 9,816
Total other investments	637,728	76,843	(96,255)	) 618,316
Total investments including noncontrolling interests	\$ 6,912,315	\$119,644	\$(119,607)	) \$6,912,352
Noncontrolling interest (a)	(512,121)	) (62,850)	) 85,569	(489,402)
Redeemable noncontrolling interest (b)	\$ (18,365)	) \$—	\$—	) \$(18,365)
Total investments excluding noncontrolling interests	\$ 6,381,829	\$56,794	\$(34,038)	) \$6,404,585

Included in the hedge funds balance are investments held by PaCRE in which the Company has an equity interest of (a) 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

Included in the short-term investments balance are investments held by two AlphaCat ILS funds which are (b) consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

As of June 30, 2014, the Company changed the methodology of assigning investment ratings to its fixed maturities portfolio. In prior periods, investment ratings were the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. As of June 30, 2014, investment ratings are the median of Moody's, Standard & Poor's and Fitch, presented in Standard & Poor's equivalent rating. For investments where only two ratings are available, the lower of the two ratings shall apply, 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. The December 31, 2013 comparative data was restated as a result, to conform to current period presentation.



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The following table sets forth certain information regarding the investment ratings of the Company's fixed maturities portfolio as at September 30, 2014 and December 31, 2013.

	September 30, 2014		December 31, 2013		
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total	
AAA	\$2,174,861	46.6	% \$2,510,781	45.3	%
AA	594,858	12.7	% 696,998	12.6	%
A	960,153	20.6	% 1,233,716	22.3	%
BBB	363,626	7.8	% 323,085	5.8	%
Total investment-grade fixed maturities	4,093,498	87.7	% 4,764,580	86.0	%
BB	283,954	6.1	% 354,992	6.4	%
B	269,380	5.8	% 383,639	6.9	%
CCC	1,341	—	% 2,453	—	%
CC	2,330	—	% 2,496	0.1	%
C	146	—	% 235	—	%
D/NR	19,524	0.4	% 33,863	0.6	%
Total non-investment grade fixed maturities	576,675	12.3	% 777,678	14.0	%
Total fixed maturities	\$4,670,173	100.0	% \$5,542,258	100.0	%

The amortized cost and estimated fair value amounts for fixed maturities held at September 30, 2014 and December 31, 2013 are shown below by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

	September 30, 2014		December 31, 2013	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$277,213	\$278,507	\$688,855	\$692,768
Due after one year through five years	2,678,792	2,679,938	3,603,459	3,613,847
Due after five years through ten years	496,922	491,364	396,389	395,633
Due after ten years	89,166	87,687	3,079	3,095
	3,542,093	3,537,496	4,691,782	4,705,343
Asset-backed and mortgage-backed securities	1,126,492	1,132,677	831,071	836,915
Total fixed maturities	\$4,668,585	\$4,670,173	\$5,522,853	\$5,542,258

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Fixed maturities and short-term investments	\$22,544	\$20,936	\$68,048	\$74,618
Other investments	2,879	—	2,879	—
Cash and cash equivalents	1,581	1,079	4,534	3,241
Securities lending income	1	3	5	3
Total gross investment income	27,005	22,018	75,466	77,862
Investment expenses	(1,744	) (2,009	) (5,557	) (5,994

Total net investment income	\$25,261	\$20,009	\$69,909	\$71,868
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Net investment income from other investments includes distributed and undistributed net income from certain investment funds.

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

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

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

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Fixed maturities, short-term and other investments				
Gross realized gains (a)	\$8,075	\$7,706	\$23,184	\$25,578
Gross realized (losses)	(3,480)	(14,026)	(6,991)	(26,768)
Net realized gains (losses) on investments	4,595	(6,320)	16,193	(1,190)
Change in net unrealized (losses) gains on investments (a)	(84,974)	69,967	16,146	(78,618)
Total net realized gains (losses) and change in net unrealized (losses) gains on investments including noncontrolling interest	(80,379)	63,647	32,339	(79,808)
Noncontrolling interest (a)	52,595	(42,579)	(22,613)	25,766
Total net realized gains (losses) and change in net unrealized (losses) gains on investments excluding noncontrolling interest	\$(27,784)	\$21,068	\$9,726	\$(54,042)

Includes change in net unrealized gains (losses) and realized gains on investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors and is included in the Consolidated Statements of Comprehensive Income as net loss (income) attributable to noncontrolling interest.

(d) Pledged investments

The following tables outline investments pledged as collateral under the Company's credit facilities. For further details on the credit facilities, please refer to Note 12: "Debt and financing arrangements."

Description	September 30, 2014		
	Commitment	Issued and Outstanding	Investments and cash pledged as collateral
\$400,000 syndicated unsecured letter of credit facility	\$400,000	\$—	\$—
\$525,000 syndicated secured letter of credit facility	525,000	301,340	393,720
\$200,000 secured bi-lateral letter of credit facility	200,000	19,743	35,414
Talbot FAL facility	25,000	25,000	31,054
PaCRe senior secured letter of credit facility	10,000	294	—
AlphaCat Re secured letter of credit facility	30,000	30,000	30,059
IPC bi-lateral facility	40,000	16,975	96,633
\$375,000 Flagstone bi-lateral facility	375,000	288,739	456,458
Total	\$1,605,000	\$682,091	\$1,043,338

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Description	December 31, 2013		
	Commitment	Issued and Outstanding	Investments and cash pledged as collateral
\$400,000 syndicated unsecured letter of credit facility	\$400,000	\$—	\$—
\$525,000 syndicated secured letter of credit facility	525,000	358,567	507,620
\$200,000 secured bi-lateral letter of credit facility	200,000	16,726	130,256
Talbot FAL facility	25,000	25,000	30,801
PaCRe senior secured letter of credit facility	10,000	294	—
AlphaCat Re secured letter of credit facility	24,800	24,800	24,806
IPC bi-lateral facility	40,000	20,177	98,465
\$375,000 Flagstone bi-lateral facility	375,000	305,686	454,458
Total	\$1,599,800	\$751,250	\$1,246,406

In addition, \$3,035,784 of cash and cash equivalents, short-term investments and fixed maturities were pledged during the normal course of business as at September 30, 2014 (December 31, 2013: \$2,947,475). Of those, \$3,030,932 were held in trust (December 31, 2013: \$2,942,508). Pledged assets are generally for the benefit of the Company's cedants and policyholders, to support AlphaCat's fully collateralized reinsurance transactions and to facilitate the accreditation of Talbot as an alien insurer/reinsurer by certain regulators.

## 4. Fair value measurements

## (a) Classification within the fair value hierarchy

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

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

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

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

Level 3 - Fair values are measured based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect the Company's own judgments about assumptions where there is little, if any, market activity for that asset or liability that market participants might use.

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

Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This may lead the Company to change the selection of our valuation technique (for example, from

market to cash flow approach) or to use multiple valuation techniques to estimate the fair value of a financial instrument. These circumstances could cause an instrument to be reclassified between levels within the fair value hierarchy.

There have been no material changes in the Company's valuation techniques during the period, or periods, represented by these Consolidated Financial Statements. The following methods and assumptions were used in estimating the fair value of each class of financial instrument recorded in the Consolidated Balance Sheets.



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Validus Holdings, Ltd.

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At September 30, 2014, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. government and government agency	\$—	\$786,255	\$—	\$786,255
Non-U.S. government and government agency	—	381,197	—	381,197
U.S. states, municipalities and political subdivisions	—	74,365	—	74,365
Agency residential mortgage-backed securities	—	375,227	—	375,227
Non-agency residential mortgage-backed securities	—	17,199	—	17,199
U.S. corporate	—	1,168,918	—	1,168,918
Non-U.S. corporate	—	594,635	—	594,635
Bank loans	—	483,788	—	483,788
Catastrophe bonds	—	43,337	5,001	48,338
Asset-backed securities	—	566,452	—	566,452
Commercial mortgage-backed securities	—	173,799	—	173,799
Total fixed maturities	—	4,665,172	5,001	4,670,173
Total short-term investments (b)	1,671,911	13,071	—	1,684,982
Other investments				
Fund of hedge funds	—	—	2,043	2,043
Hedge funds (a)	—	—	567,840	567,840
Private equity investments	—	—	15,019	15,019
Investment funds	—	21,310	102,880	124,190
Mutual funds	—	9,541	—	9,541
Total other investments	—	30,851	687,782	718,633
Total investments including noncontrolling interests	\$1,671,911	\$4,709,094	\$692,783	\$7,073,788
Noncontrolling interest (a)	\$—	\$—	\$(495,365)	\$(495,365)
Redeemable noncontrolling interest (b)	\$(11,637)	\$—	\$—	\$(11,637)
Total investments excluding noncontrolling interests	\$1,660,274	\$4,709,094	\$197,418	\$6,566,786

Included in the hedge funds balance are investments held by PaCRE in which the Company has an equity interest of (a) 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

Included in the short-term investments balance are investments held by one AlphaCat ILS fund which is (b) consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

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At December 31, 2013, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. government and government agency	\$—	\$1,364,679	\$—	\$1,364,679
Non-U.S. government and government agency	—	459,068	—	459,068
U.S. states, municipalities and political subdivisions	—	43,120	—	43,120
Agency residential mortgage-backed securities	—	311,499	—	311,499
Non-agency residential mortgage-backed securities	—	15,759	—	15,759
U.S. corporate	—	1,332,484	—	1,332,484
Non-U.S. corporate	—	714,325	—	714,325
Bank loans	—	717,116	—	717,116
Catastrophe bonds	—	74,551	—	74,551
Asset-backed securities	—	509,657	—	509,657
Total fixed maturities	—	5,542,258	—	5,542,258
Total short-term investments (b)	747,215	4,563	—	751,778
Other investments				
Fund of hedge funds	—	—	2,303	2,303
Hedge funds (a)	—	—	561,083	561,083
Private equity investments	—	—	13,485	13,485
Investment fund	—	31,629	—	31,629
Mutual funds	—	9,816	—	9,816
Total other investments	—	41,445	576,871	618,316
Total investments including noncontrolling interests	\$747,215	\$5,588,266	\$576,871	\$6,912,352
Noncontrolling interest (a)	\$—	\$—	\$(489,402)	\$(489,402)
Redeemable noncontrolling interest (b)	\$(18,365)	\$—	\$—	\$(18,365)
Total investments excluding noncontrolling interests	\$728,850	\$5,588,266	\$87,469	\$6,404,585

Included in the hedge funds balance are investments held by PaCRE in which the Company has an equity interest of (a) 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

Included in the short-term investments balance are investments held by two AlphaCat ILS funds which are consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining (b) interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

At September 30, 2014, Level 3 investments excluding the noncontrolling interests totaled \$197,418 (December 31, 2013: \$87,469), representing 3.0% (December 31, 2013: 1.4%) of total investments, excluding noncontrolling interests, measured at fair value on a recurring basis.

(b) Level 1 assets measured at fair value

Short term investments

Short term investments categorized as Level 1 consist primarily of highly liquid securities, all with maturities less than one year from the date of purchase. The fair value of the Company's portfolio of short term investments are generally determined using amortized cost which approximates fair value. The Company has determined that certain of its short-term investments, held in highly liquid money market-type funds, should be included in Level 1 as their fair values are based on quoted market prices in active markets.



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(c) Level 2 assets measured at fair value

Fixed maturity investments

Fixed maturity investments included in Level 2 include U.S. government and government agency, non-U.S. government and government agency, U.S. states, municipalities and political subdivisions, agency residential mortgage-backed securities, non-agency residential mortgage-backed securities, U.S. corporate, non-U.S. corporate, bank loans, catastrophe bonds, asset-backed securities and commercial mortgage-backed securities.

In general, valuation of the Company's fixed maturity investment portfolios is provided by pricing services, such as index providers and pricing vendors, as well as broker quotations. The pricing vendors provide valuations for a high volume of liquid securities that are actively traded. For securities that do not trade on an exchange, the pricing services generally utilize market data and other observable inputs in matrix pricing models to determine month end prices. Prices are generally verified using third party data. Securities which are priced by an index provider are generally included in the index.

In general, broker-dealers value securities through their trading desks based on observable inputs. The methodologies include mapping securities based on trade data, bids or offers, observed spreads, and performance on newly issued securities. Broker-dealers also determine valuations by observing secondary trading of similar securities. Prices obtained from broker quotations are considered non-binding, however they are based on observable inputs and by observing secondary trading of similar securities obtained from active, non-distressed markets.

The Company considers these Level 2 inputs as they are corroborated with other market observable inputs. The techniques generally used to determine the fair value of the Company's fixed maturity investments are detailed below by asset class.

U.S. government and government agency

U.S. government and government agency securities consist primarily of debt securities issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association. Fixed maturity investments included in U.S. government and government agency securities are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources and integrate other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The fair value of each security is individually computed using analytical models which incorporate option adjusted spreads and other daily interest rate data.

Non-U.S. government and government agency

Non-U.S. government and government agency securities consist of debt securities issued by non-U.S. governments and their agencies along with supranational organizations (also known as sovereign debt securities). Securities held in these sectors are primarily priced by pricing services who employ proprietary discounted cash flow models to value the securities. Key quantitative inputs for these models are daily observed benchmark curves for treasury, swap and high issuance credits. The pricing services then apply a credit spread for each security which is developed by in-depth and real time market analysis. For securities in which trade volume is low, the pricing services utilize data from more frequently traded securities with similar attributes. These models may also be supplemented by daily market and credit research for international markets.

U.S. states, municipalities and political subdivisions

The Company's U.S. states, municipalities and political subdivisions portfolio contains debt securities issued by U.S. domiciled state and municipal entities. These securities are generally priced by independent pricing services using the techniques described for U.S. government and government agency securities described above.

Agency residential mortgage-backed securities

The Company's agency residential mortgage-backed investments are primarily priced by pricing services using a mortgage pool specific model which utilizes daily inputs from the active to be announced ("TBA") market which is very liquid, as well as the U.S. treasury market. The model also utilizes additional information, such as the weighted average maturity, weighted average coupon and other available pool level data which is provided by the sponsoring agency. Valuations are also corroborated with daily active market quotes.

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Non-agency residential mortgage-backed securities

The Company's non-agency mortgage-backed investments include non-agency prime residential mortgage-backed fixed maturity investments. The Company has no fixed maturity investments classified as sub-prime held in its fixed maturity investments portfolio. Securities held in these sectors are primarily priced by pricing services using an option adjusted spread model or other relevant models, which principally utilize inputs including benchmark yields, available trade information or broker quotes, and issuer spreads. The pricing services also review collateral prepayment speeds, loss severity and delinquencies among other collateral performance indicators for the securities valuation, when applicable.

U.S. corporate

Corporate debt securities consist primarily of investment-grade debt of a wide variety of U.S. corporate issuers and industries. The Company's corporate fixed maturity investments are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources regarding the issuer of the security and obtain credit data, as well as other observations, from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing services also consider the specific terms and conditions of the securities, including any specific features which may influence risk. In certain instances, securities are individually evaluated using a spread which is added to the U.S. treasury curve or a security specific swap curve as appropriate.

Non-U.S. corporate

Non-U.S. corporate debt securities consist primarily of investment-grade debt of a wide variety of non-U.S. corporate issuers and industries. The Company's non-U.S. corporate fixed maturity investments are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources regarding the issuer of the security and obtain credit data, as well as other observations, from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing services also consider the specific terms and conditions of the securities, including any specific features which may influence risk.

Bank loans

The Company's bank loan investments consist primarily of below-investment-grade debt of a wide variety of corporate issuers and industries. The Company's bank loans are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources regarding the issuer of the security and obtain credit data, as well as other observations, from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing services also consider the specific terms and conditions of the securities, including any specific features which may influence risk.

Catastrophe bonds

Catastrophe bonds are based on broker or underwriter bid indications. To the extent that these indications are based on significant unobservable inputs, the relevant bonds will be classified as a Level 3 asset.

Asset-backed securities

Asset backed securities include mostly investment-grade debt securities backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, student loans, credit card receivables, and collateralized loan obligations originated by a variety of financial institutions. Securities held in these sectors are primarily priced by pricing services. The pricing services apply dealer quotes and other available trade information such as bids and offers, prepayment speeds which may be adjusted for the underlying collateral or current price data, the U.S. treasury curve and swap curve as well as cash settlement. The pricing services determine the expected cash flows for each security held in this sector using historical prepayment and default projections for the underlying collateral and current

market data. In addition, a spread is applied to the relevant benchmark and used to discount the cash flows noted above to determine the fair value of the securities held in this sector.

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Commercial mortgage-backed securities

Commercial mortgage backed securities are investment-grade debt primarily priced by pricing services. The pricing services apply dealer quotes and other available trade information such as bids and offers, prepayment speeds which may be adjusted for the underlying collateral or current price data, the U.S. treasury curve and swap curve as well as cash settlement. The pricing services determine the expected cash flows for each security held in this sector using historical prepayment and default projections for the underlying collateral and current market data. In addition, a spread is applied to the relevant benchmark and used to discount the cash flows noted above to determine the fair value of the securities held in this sector.

Short term investments

Short term investments consist primarily of highly liquid securities, all with maturities less than one year from the date of purchase. The fair value of the Company's portfolio of short term investments is generally determined using amortized cost which approximates fair value. The Company has determined that, other than highly liquid money market-type funds, the remaining securities are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their amortized cost approximates fair value.

Investment funds

Investment funds classified as Level 2 assets consists of one pooled investment which is invested in fixed income securities with high credit ratings. The investment fund is only open to Lloyd' Trust Fund participants. The fair value of units in the investment fund is based on the net asset value of the fund as reported by Lloyd's Treasury & Investment Management.

Mutual funds

Mutual funds consist of two investment funds which are invested in various quoted investments. The fair value of units in the mutual funds is based on the net asset value of the fund as reported by the fund manager.

(d)Level 3 assets measured at fair value

Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. The Company's hedge funds, a fund of hedge funds, private equity investments, an investment fund and certain catastrophe bonds are the only financial instruments in this category as at September 30, 2014. For each respective hedge fund investment, the Company obtains and reviews the valuation methodology used by the fund administrators and investment managers to ensure that the hedge fund investments are following fair value principles consistent with U.S. GAAP in determining the net asset value ("NAV").

Within the hedge fund industry, there is a general lack of transparency necessary to facilitate a detailed independent assessment of the values placed on the securities underlying the NAV provided by the fund manager or fund administrator. To address this, on a quarterly basis, we perform a number of monitoring procedures designed to assist in the assessment of the quality of the information provided by managers and administrators. These procedures include, but are not limited to, regular review and discussion of each fund's performance with its manager and regular evaluation of fund performance against applicable benchmarks.

Fund of hedge funds

The fund of hedge funds includes a side pocket. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is unknown. The fund's administrator provides a monthly reported NAV with a one-month delay in its valuation. As a result, the fund administrator's August 31, 2014 NAV was used as a basis for fair value measurement in the Company's September 30, 2014 Consolidated Balance Sheet. The fund manager has provided an estimate of the fund NAV at September 30, 2014 based on the estimated performance provided from the underlying funds. To determine the reasonableness of the estimated NAV, the Company compares the one-month delayed fund administrator's NAV to the fund manager's estimated NAV that incorporates relevant valuation sources



on a timely basis. Material variances are recorded in the current reporting period while immaterial variances are recorded in the following reporting period. As this valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset.

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

Hedge funds

The hedge funds were valued at \$567,840 at September 30, 2014 (December 31, 2013: \$561,083). The hedge funds consist of investments in five Paulson & Co. managed funds (the "Paulson hedge funds") and one hedge fund assumed in the acquisition of Flagstone Reinsurance Holdings, S.A. (the "Flagstone Acquisition") (the "Flagstone hedge fund").

The Paulson hedge funds' administrator provides monthly reported NAVs with a one-month delay in its valuation. As a result, the funds' administrator's August 31, 2014 NAV was used as a partial basis for fair value measurement in the Company's September 30, 2014 Consolidated Balance Sheet. The fund manager provides an estimate of the NAV at September 30, 2014 based on estimated performance. The Company adjusts fair value to the fund manager's estimated NAV that incorporates relevant valuation sources on a timely basis. To determine the reasonableness of the estimated NAV, the Company assesses the variance between the fund manager's estimated NAV and the fund administrator's NAV. Material variances are recorded in the current reporting period while immaterial variances are recorded in the following reporting period. Historically, the Company's valuation estimates have not materially differed from the subsequent NAVs.

The Flagstone hedge fund's administrator provides quarterly NAVs with a three-month delay in valuation. As a result, the June 30, 2014 NAV was used as a basis for fair value measurement in the Company's September 30, 2014 Consolidated Balance Sheet.

As these valuation techniques incorporate both observable and significant unobservable inputs, both the Paulson hedge funds and the Flagstone hedge fund are classified as Level 3 assets. The Paulson hedge funds are subject to quarterly liquidity.

Private equity investments

Private equity investments consist of investments in five private equity funds. The private equity funds' respective fund administrators provide quarterly or semi-annual NAVs with a three-month or six-month delay in valuation as well as audited NAVs as at December 31. As a result, the June 30, 2014 or March 31, 2014 NAV was used as a basis for fair value measurement in the Company's September 30, 2014 Consolidated Balance Sheet. As this valuation technique incorporates both observable and significant unobservable inputs, the private equity investments are classified as Level 3 assets.

Investment funds

Investment funds classified as Level 3 assets consists of one structured securities fund that invests across asset backed securities, residential mortgage backed securities and commercial mortgage backed securities. The fair value of units in the investment fund is based on the NAV of the fund as reported by the independent fund administrator. The fund's administrator provides a monthly reported NAV with a one-month delay in its valuation. As a result, the fund administrator's August 31, 2014 NAV was used as a basis for fair value measurement in the Company's September 30, 2014 Consolidated Balance Sheet. As this valuation technique incorporates both observable and significant unobservable inputs, the investment fund investment is classified as a Level 3 asset.

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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 during the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Level 3 investments - Beginning of period	\$746,396	\$505,158	\$576,871	\$556,234
Purchases	25,784	33,154	125,784	98,669
Sales	(24,175 )	(35,264 )	(49,508 )	(80,095 )
Settlements	—	—	(1,500 )	—
Net realized gains	2,554	4,503	8,198	4,843
Change in net unrealized gains (losses)	(57,776 )	42,917	26,235	(29,183 )
Transfers into Level 3	—	—	6,703	—
Level 3 investments - End of period	\$692,783	\$550,468	\$692,783	\$550,468
Noncontrolling interest (a)	(495,365 )	(465,472 )	(495,365 )	(465,472 )
Level 3 investments excluding noncontrolling interest	\$197,418	\$84,996	\$197,418	\$84,996

Includes Level 3 investments held by PaCRE in which the Company has an equity interest of 10%. The remaining (a)90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

There have not been any transfers into or out of Levels 1, 2 and 3 during the three months ended September 30, 2014 or 2013. During the nine months ended September 30, 2014 there was a transfer of investments from Level 2 into Level 3 of the fair value hierarchy. This transfer was due to a reassessment of the extent of unobservable inputs used in establishing the fair value of certain catastrophe bonds. There were no transfers into or out of Level 3 during the nine months ended September 30, 2013.

## 5. Investments in affiliates

The following table presents the Company's investments in affiliates as at September 30, 2014 and December 31, 2013:

	September 30, 2014	December 31, 2013
Investment affiliate	\$42,381	\$34,500
Operating affiliates	175,231	106,743
Investments in affiliates	\$217,612	\$141,243

## (a)Investment affiliate

Aquiline Financial Services Fund II L.P.

On December 20, 2011, the Company entered into an Assignment and Assumption Agreement (the "Agreement") with Aquiline Capital Partners LLC, a Delaware limited liability company (the "Assignor") and Aquiline Capital Partners II GP (Offshore) Ltd., a Cayman Islands company limited by shares (the "General Partner") pursuant to which the Company has assumed 100% of the Assignor's interest in Aquiline Financial Services Fund II L.P. (the "Partnership") representing a total capital commitment of \$50,000 (the "Commitment"), as a limited partner in the Partnership (the "Transferred Interest"). The Transferred Interest is governed by the terms of an Amended and Restated Exempted Limited Partnership Agreement dated as of July 2, 2010 (the "Limited Partnership Agreement"). Pursuant to the terms of the Limited Partnership Agreement, the Commitment will expire on July 2, 2015.

The Partnership provides quarterly capital account statements with a three-month delay in its valuation. As a result, the Partnership's June 30, 2014 capital account statement was used as the basis for calculating the Company's share of Partnership income for the period.



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The following table presents a reconciliation of the beginning and ending investment in the Company's investment affiliate balance for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Investment affiliate, beginning of period	\$40,627	\$25,352	\$34,500	\$15,218
Capital contributions	—	6,185	—	13,089
Income from investment affiliate	1,754	1,044	7,881	4,274
Investment affiliate, end of period	\$42,381	\$32,581	\$42,381	\$32,581

The following table presents the Company's investment in the Partnership as at September 30, 2014:

	Investment in investment affiliate			
	Investment at cost	Voting ownership %	Equity Ownership	Carrying Value
Aquiline Financial Services Fund II L.P.	\$32,110	—	% 6.7	% \$42,381

The following table presents the Company's investment in the Partnership as at December 31, 2013:

	Investment in investment affiliate			
	Investment at cost	Voting ownership %	Equity Ownership	Carrying Value
Aquiline Financial Services Fund II L.P.	\$32,110	—	% 6.7	% \$34,500

(b) Operating affiliates

AlphaCat Re 2011 Ltd.

On May 25, 2011, the Company joined with other investors in capitalizing AlphaCat Re 2011 Ltd. ("AlphaCat Re 2011"), a special purpose reinsurer formed for the purpose of writing collateralized reinsurance and retrocessional reinsurance. AlphaCat Re 2011 was a market facing entity and the Company's investment in AlphaCat Re 2011 has been treated as an equity method investment.

AlphaCat Re 2011 is now considered "off-risk" as the risk periods for all reinsurance contracts written have expired. As a result, partial returns of investment have been made to the investors of AlphaCat Re 2011. The Company's portion of the returns made during the three and nine months ended September 30, 2014 and 2013 are included in the tables below.

AlphaCat Re 2012 Ltd.

On May 29, 2012, the Company joined with other investors in capitalizing AlphaCat Re 2012 Ltd. ("AlphaCat Re 2012"), a special purpose reinsurer formed for the purpose of writing collateralized reinsurance with a particular focus on windstorm risks for Florida domiciled insurance companies. AlphaCat Re 2012 was a market facing entity and the Company's investment in AlphaCat Re 2012 has been treated as an equity method investment.

AlphaCat Re 2012 is now considered "off-risk" as the risk periods for all reinsurance contracts written have expired. As a result, partial returns of investment have been made to the investors of AlphaCat Re 2012. The Company's portion of the returns made during the three and nine months ended September 30, 2014 and 2013 are included in the tables below.

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AlphaCat 2013, Ltd.

On December 17, 2012, the Company joined with other investors in capitalizing AlphaCat 2013, Ltd. ("AlphaCat 2013"), an entity formed for the purpose of investing in collateralized reinsurance and retrocession on a worldwide basis. AlphaCat 2013 deployed its capital through transactions entered into by AlphaCat Reinsurance Ltd. ("AlphaCat Re") and the Company's investment in AlphaCat 2013 has been treated as an equity method investment.

AlphaCat 2013 is now considered "off-risk" as the risk periods for all risk-linked instruments have expired. As a result, partial returns of investment have been made to the investors of AlphaCat 2013. The Company's portion of the returns made during the three and nine months ended September 30, 2014 and 2013 are included in the tables below.

AlphaCat 2014, Ltd.

On December 20, 2013, the Company joined with other investors in capitalizing AlphaCat 2014, Ltd. ("AlphaCat 2014"), an entity formed for the purpose of investing in collateralized reinsurance and retrocessional contracts for the January 1, 2014 renewal season. AlphaCat 2014 deploys its capital through transactions entered into by AlphaCat Re and the Company's investment in AlphaCat 2014 has been treated as an equity method investment.

AlphaCat ILS funds

The AlphaCat ILS funds invest in instruments with returns linked to property catastrophe reinsurance, retrocession and insurance linked securities ("ILS") contracts. AlphaCat ILS funds all deploy their capital through the AlphaCat Master Fund Ltd. (the "Master Fund") and AlphaCat Re. All three funds are variable interest entities, with one being consolidated by the Company as the primary beneficiary and one being accounted for as an equity method investment because the Company holds an equity interest of 7.9% and has significant influence. The third fund had been consolidated by the Company as the primary beneficiary from its formation through to December 31, 2013. However, on January 1, 2014 the fund received \$35,000 in additional third party subscriptions, resulting in a reduction of the Company's equity interest below 50%. Since the Company retains significant influence, this fund has been deconsolidated and accounted for as an equity method investment from January 1, 2014. The fair value of the retained interest, based on the fair value of the underlying instruments in Master Fund and AlphaCat Re, amounted to \$113,455 at January 1, 2014. The deconsolidation resulted in a gain of \$1,372 which is included in the Consolidated Statements of Comprehensive Income as other income for the nine months ended September 30, 2014. The Company's maximum exposure to any of the funds is the amount of capital invested at any given time.

AlphaCat Master Fund Ltd. and AlphaCat Reinsurance Ltd.

The Company utilizes Master Fund and AlphaCat Re for the purpose of investing in capital market products and writing collateralized reinsurance, respectively, on behalf of certain entities within the AlphaCat operating segment. Master Fund and AlphaCat Re are market facing entities which enter into transactions on behalf of AlphaCat 2013, AlphaCat 2014 and the AlphaCat ILS funds. The Company owns all of the voting equity interest in Master Fund and AlphaCat Re and, as a result, their financial statements are included in the Consolidated Financial Statements of the Company.

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The following tables present a reconciliation of the beginning and ending investment in operating affiliates for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30, 2014					
	AlphaCat Re 2011	AlphaCat Re 2012	AlphaCat 2013	AlphaCat 2014	AlphaCat ILS funds	Total
As at June 30, 2014	\$4,172	\$2,204	\$2,580	\$25,014	\$139,022	\$172,992
Return of investment	—	(1,516 )	(6 )	—	—	(1,522 )
(Loss) income from operating affiliates	(5 )	(9 )	7	1,367	2,401	3,761
As at September 30, 2014	\$4,167	\$679	\$2,581	\$26,381	\$141,423	\$175,231
	Three Months Ended September 30, 2013					
	AlphaCat Re 2011	AlphaCat Re 2012	AlphaCat 2013	AlphaCat 2014	AlphaCat ILS fund	Total
As at June 30, 2013	\$11,054	\$5,204	\$48,536	\$20,326	\$85,120	\$85,120
Return of investment	(2,800 )	(4,550 )	—	—	(7,350 )	(7,350 )
(Loss) income from operating affiliates	(270 )	(7 )	585	1,155	1,463	1,463
As at September 30, 2013	\$7,984	\$647	\$49,121	\$21,481	\$79,233	\$79,233
	Nine Months Ended September 30, 2014					
	AlphaCat Re 2011	AlphaCat Re 2012	AlphaCat 2013	AlphaCat 2014	AlphaCat ILS funds	Total
As at December 31, 2013	\$9,809	\$1,313	\$51,744	\$21,982	\$21,895	\$106,743
Return of investment	(5,825 )	(1,516 )	(51,206 )	—	—	(58,547 )
Fair value of retained interest on deconsolidation of AlphaCat ILS fund—	—	—	—	—	113,455	113,455
Income from operating affiliates	183	882	2,043	4,399	6,073	13,580
As at September 30, 2014	\$4,167	\$679	\$2,581	\$26,381	\$141,423	\$175,231
	Nine Months Ended September 30, 2013					
	AlphaCat Re 2011	AlphaCat Re 2012	AlphaCat 2013	AlphaCat 2014	AlphaCat ILS fund	Total
As at December 31, 2012	\$62,792	\$29,319	\$45,000	\$20,000	\$157,111	\$157,111
Return of investment	(54,914 )	(31,743 )	—	—	(86,657 )	(86,657 )
Income from operating affiliates	106	3,071	4,121	1,481	8,779	8,779
As at September 30, 2013	\$7,984	\$647	\$49,121	\$21,481	\$79,233	\$79,233

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The following table presents the Company's investments in AlphaCat Re 2011, AlphaCat Re 2012, AlphaCat 2013, AlphaCat 2014 and the AlphaCat ILS funds in the Consolidated Financial Statements as at September 30, 2014:

	Investment in operating affiliates			
	Cost	Voting ownership %	Equity ownership %	Carrying value
AlphaCat Re 2011	\$4,167	43.7	% 22.3	% \$4,167
AlphaCat Re 2012	679	49.0	% 37.9	% 679
AlphaCat 2013	2,581	40.9	% 19.7	% 2,581
AlphaCat 2014	22,000	42.3	% 19.6	% 26,381
AlphaCat ILS funds	133,455	n/a	(a)	141,423
Total	\$162,882			\$175,231

(a) Equity ownership in the two funds were 7.9% and 49.0% respectively as at September 30, 2014.

The following table presents the Company's investments in AlphaCat Re 2011, AlphaCat Re 2012, AlphaCat 2013, AlphaCat 2014 and the AlphaCat ILS fund in the Consolidated Financial Statements as at December 31, 2013:

	Investment in operating affiliates			
	Cost	Voting ownership %	Equity ownership %	Carrying value
AlphaCat Re 2011	\$9,882	43.7	% 22.3	% \$9,809
AlphaCat Re 2012	654	49.0	% 37.9	% 1,313
AlphaCat 2013	45,000	40.9	% 19.7	% 51,744
AlphaCat 2014	22,000	42.3	% 19.6	% 21,982
AlphaCat ILS fund	20,000	n/a	9.1	% 21,895
Total	\$97,536			\$106,743

(c) Notes payable and (income) attributable to operating affiliates

Notes are issued during the course of a year by Master Fund and AlphaCat Re to AlphaCat 2013, AlphaCat 2014 and the AlphaCat ILS funds (collectively the "feeder funds") in order to fund the purchase of capital market products and to write collateralized reinsurance on their behalf. The underlying capital market products and collateralized reinsurance typically have at least a twelve month duration; however, they do not have a stated maturity date. Since repayment is dependent on the settlement of the underlying transactions, the notes are subsequently redeemed as the underlying transactions are settled. The Company's investments in the feeder funds, together with investments made by third parties, are provided as consideration for these notes to Master Fund and AlphaCat Re, which are consolidated in the Company's Consolidated Financial Statements. The effective economic interest in Master Fund and AlphaCat Re that results from these transactions is represented on the Consolidated Balance Sheet as notes payable to operating affiliates. The subsequent income or loss generated by the relevant capital market products or collateralized reinsurance is transferred to the operating affiliates as (income) loss attributable to operating affiliate investors in the Company's Consolidated Statements of Comprehensive Income. The notes do not have any principal amount, since the final amount payable is dependent on the income or loss. To the extent that the (income) loss attributable to operating affiliate investors has not been returned to investors, it is included in accounts payable and accrued expenses in the Consolidated Balance Sheets.





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The following tables present a reconciliation of the beginning and ending notes payable to operating affiliates for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30, 2014			
	AlphaCat 2013	AlphaCat 2014	AlphaCat ILS funds	Total
As at June 30, 2014	\$—	\$157,992	\$464,958	\$622,950
Issuance of notes payable to operating affiliates	—	—	53,498	53,498
Redemption of notes payable to operating affiliates	—	—	(13,990)	(13,990)
Foreign exchange gain	—	(410)	(6,072)	(6,482)
As at September 30, 2014	\$—	\$157,582	\$498,394	\$655,976
	Three Months Ended September 30, 2013			
	AlphaCat 2013	AlphaCat 2013	AlphaCat ILS funds	Total
As at June 30, 2013		\$222,135	\$208,958	\$431,093
Issuance of notes payable to operating affiliates		—	6,733	6,733
Redemption of notes payable to operating affiliates		—	(3,553)	(3,553)
Foreign exchange loss		1,196	2,501	3,697
As at September 30, 2013		\$223,331	\$214,639	\$437,970
	Nine Months Ended September 30, 2014			
	AlphaCat 2013	AlphaCat 2014	AlphaCat ILS funds	Total
As at December 31, 2013	\$223,809	\$—	\$215,463	\$439,272
Notes payable to operating affiliates recognized on deconsolidation of AlphaCat ILS fund	—	—	178,837	178,837
Issuance of notes payable to operating affiliates	—	157,914	487,329	645,243
Redemption of notes payable to operating affiliates	(223,512)	—	(378,556)	(602,068)
Foreign exchange gain	(297)	(332)	(4,679)	(5,308)
As at September 30, 2014	\$—	\$157,582	\$498,394	\$655,976
	Nine Months Ended September 30, 2013			
	AlphaCat 2013	AlphaCat 2013	AlphaCat ILS funds	Total
As at December 31, 2012		\$—	\$—	\$—
Issuance of notes payable to operating affiliates		223,082	218,044	441,126
Redemption of notes payable to operating affiliates		—	(3,553)	(3,553)
Foreign exchange loss		249	148	397
As at September 30, 2013		\$223,331	\$214,639	\$437,970

The portion of notes payable to operating affiliates that were due to the Company, as an investor in the affiliates, and third party investors as at September 30, 2014 amounted to \$164,169 and \$491,807, respectively (December 31, 2013: \$63,654 and \$375,618).

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The following table presents the (income) attributable to operating affiliate investors for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
AlphaCat 2013	\$(98 )	\$(4,074 )	\$(14,218 )	\$(29,357 )
AlphaCat 2014	(11,309 )	—	(32,990 )	—
AlphaCat ILS funds	(14,400 )	(7,741 )	(35,625 )	(12,799 )
(Income) attributable to operating affiliate investors	\$(25,807 )	\$(11,815 )	\$(82,833 )	\$(42,156 )

The portion of income attributable to operating affiliate investors that was due to the Company, as an investor in the affiliates, and third party investors for the three months ended September 30, 2014 amounted to \$4,993 and \$20,814, respectively (2013: \$1,505 and \$10,310). The portion of income attributable to operating affiliate investors that was due to the Company, as an investor in the affiliates, and third party investors for the nine months ended September 30, 2014 amounted to \$16,552 and \$66,281, respectively (2013: \$7,114 and \$35,042).

## 6. Noncontrolling interest

On April 2, 2012, the Company joined with other investors in capitalizing PaCRe Ltd. ("PaCRe"), a Class 4 Bermuda reinsurer formed for the purpose of writing high excess property catastrophe reinsurance. The Company has an equity interest of 10% and the remaining 90% interest is held by third party investors. The Company has a majority voting equity interest in PaCRe and as a result, the financial statements of PaCRe are included in the Consolidated Financial Statements of the Company. The portion of PaCRe's earnings attributable to third party investors is recorded in the Consolidated Statements of Comprehensive Income as net (income) loss attributable to noncontrolling interest.

PaCRe's shareholder rights do not include redemption features within the control of the third party shareholders. The third party equity is recorded in the Company's Consolidated Balance Sheets as noncontrolling interest.

The portion of earnings from the one consolidated AlphaCat ILS fund attributable to third party investors is recorded in the Consolidated Statements of Comprehensive Income as net (income) loss attributable to noncontrolling interest.

The AlphaCat ILS funds have rights that enable shareholders, subject to certain limitations, to redeem their shares.

The third party equity is therefore recorded in the Company's Consolidated Balance Sheets as redeemable noncontrolling interest. When and if a redemption notice is received, the fair value of the redemption is reclassified to a liability.

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The following tables present a reconciliation of the beginning and ending balances of redeemable noncontrolling interest and noncontrolling interest for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30, 2014		
	Redeemable noncontrolling interest	Noncontrolling interest	Total
As at June 30, 2014	\$66,282	\$575,347	\$641,629
Issuance of shares	4,200	—	4,200
Loss attributable to noncontrolling interest	(9	) (53,060	) (53,069
As at September 30, 2014	\$70,473	\$522,287	\$592,760
	Three Months Ended September 30, 2013		
	Redeemable noncontrolling interest	Noncontrolling interest	Total
As at June 30, 2013	\$70,690	\$427,755	\$498,445
Issuance of shares	13,000	—	13,000
Income attributable to noncontrolling interest	1,516	44,178	45,694
Redemption of shares	(10,207	) —	(10,207
As at September 30, 2013	\$74,999	\$471,933	\$546,932
	Nine Months Ended September 30, 2014		
	Redeemable noncontrolling interest	Noncontrolling interest	Total
As at December 31, 2013	\$86,512	\$497,657	\$584,169
Issuance of shares	61,200	—	61,200
Income attributable to noncontrolling interest	1,115	24,630	25,745
Adjustment to noncontrolling interest as a result of deconsolidation	(78,354	) —	(78,354
As at September 30, 2014	\$70,473	\$522,287	\$592,760
	Nine Months Ended September 30, 2013		
	Redeemable noncontrolling interest	Noncontrolling interest	Total
As at December 31, 2012	\$—	\$434,280	\$434,280
Issuance of shares	82,190	58,500	140,690
Income (loss) attributable to noncontrolling interest	3,016	(20,847	) (17,831
Redemption of shares	(10,207	) —	(10,207
As at September 30, 2013	\$74,999	\$471,933	\$546,932

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## 7. Derivative instruments

The Company enters into derivative instruments for risk management purposes, specifically to hedge unmatched foreign currency exposures and interest rate exposures. As at September 30, 2014, the Company held foreign currency forward contracts to mitigate the risk of fluctuations in the U.S. dollar against a number of foreign currencies. As at September 30, 2014, the Company held two interest rate swaps to fix the payment of interest on the Company's 2006 and 2007 Junior Subordinated Deferrable Debentures, as well as three interest rate swaps and one cross-currency interest rate swap to fix the payment of interest and mitigate the foreign exchange rate impact on Flagstone's 2006 and 2007 Junior Subordinated Deferrable Debentures.

The following table summarizes information on the classification and amount of the fair value of derivatives designated as hedging instruments on the Consolidated Balance Sheets at September 30, 2014 and December 31, 2013:

Derivatives designated as hedging instruments:	As at September 30, 2014			As at December 31, 2013		
	Net Notional Exposure	Asset Derivative at Fair Value (a)	Liability Derivative at Fair Value (a)	Net Notional Exposure	Asset Derivative at Fair Value (a)	Liability Derivative at Fair Value (a)
Foreign currency forward contracts	\$246,638	\$592	\$16,672	\$163,576	\$1,167	\$2,313
Interest rate swap contracts	\$552,263	\$25	\$912	\$552,263	\$28	\$911

(a) Asset and liability derivatives are classified within other assets and accounts payable and accrued expenses respectively on the Consolidated Balance Sheets.

(a) Classification within the fair value hierarchy

As described in Note 4: "Fair value measurements" under U.S. GAAP, a company must determine the appropriate level in the fair value hierarchy for each fair value measurement. The assumptions used within the valuation of the Company's derivative instruments are observable in the marketplace, can be derived from observable data or are supported by observable levels at which other similar transactions are executed in the marketplace. Accordingly, these derivatives were classified within Level 2 of the fair value hierarchy.

(b) Derivative instruments designated as a fair value hedge

The Company designates its foreign currency derivative instruments as fair value hedges and formally and contemporaneously documents all relationships between the derivative instruments and hedged items and links the derivative instruments to specific assets and liabilities. The Company assesses the effectiveness of the hedges, both at inception and on an on-going basis and determines whether the hedges are highly effective in offsetting changes in fair value of the linked hedged items.

The following table provides the total impact on earnings, recognized in income within foreign exchange gains (losses), relating to the derivative instruments formally designated as fair value hedges along with the impact of the related hedged items for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Foreign currency forward contracts				
Amount of (loss) gain recognized in income on derivative	\$(14,817	) \$3,116	\$(9,979	) \$2,670
Amount of gain (loss) on hedged item recognized in income attributable to risk	\$14,817	\$(3,116	) \$9,979	\$(2,670

being hedged

Amount of gain (loss) recognized in income on derivative (ineffective portion)	\$—	\$—	\$—	\$—
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## (c) Derivative instruments designated as a cash flow hedge

The Company designates its interest rate derivative instruments as cash flow hedges and formally and contemporaneously documents all relationships between the hedging instruments and hedged items and links the derivative instruments to specific assets and liabilities. The Company assesses the effectiveness of the hedges, both at inception and on an on-going basis and determines whether the hedges are highly effective in offsetting changes in fair value of the linked hedged items. The Company currently applies the long haul method when assessing the hedge's effectiveness.

The following table provides the total impact on other comprehensive income (loss) and earnings relating to the derivative instruments formally designated as cash flow hedges along with the impact of the related hedged items for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Interest rate swap contracts				
Amount of effective portion recognized in other comprehensive income	\$3,302	\$3,268	\$9,762	\$7,838
Amount of effective portion subsequently reclassified to earnings	\$(3,302)	\$(3,268)	\$(9,762)	\$(7,838)
Amount of ineffective portion excluded from effectiveness testing	\$—	\$—	\$—	\$—

The above balances relate to interest payments and have therefore been classified as finance expenses in the Consolidated Statements of Comprehensive Income.

## (d) Balance sheet offsetting

There was no balance sheet offsetting activity as at September 30, 2014 or December 31, 2013.

The Company currently provides cash collateral as security for interest rate swap contracts. The Company does not provide cash collateral or financial instruments as security for foreign currency forward contracts. Our derivative instruments are generally traded under International Swaps and Derivatives Association master netting agreements, which establish terms that apply to all transactions. On a periodic basis, the amounts receivable from or payable to the counterparties are settled in cash.

The Company has not elected to settle multiple transactions with an individual counterparty on a net basis.

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## 8. Reserve for losses and loss expenses

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

The following table represents an analysis of paid and unpaid losses and loss expenses incurred and a reconciliation of the beginning and ending unpaid losses and loss expenses for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Reserve for losses and loss expenses, beginning of period	\$2,867,307	\$3,283,450	\$3,030,399	\$3,517,573
Losses and loss expenses recoverable	(338,734 )	(418,693 )	(370,154 )	(439,967 )
Net reserves for losses and loss expenses, beginning of period	2,528,573	2,864,757	2,660,245	3,077,606
Net reserves disposed	—	—	—	(18,591 )
Increase (decrease) in net reserves for losses and loss expenses in respect of losses occurring in:				
Current year	279,690	243,015	713,177	759,617
Prior years	(55,565 )	(65,050 )	(167,636 )	(171,837 )
Total incurred losses and loss expenses	224,125	177,965	545,541	587,780
Less net losses and loss expenses paid in respect of losses occurring in:				
Current year	(74,618 )	(59,701 )	(99,326 )	(95,535 )
Prior years	(183,697 )	(215,167 )	(633,048 )	(732,118 )
Total net paid losses	(258,315 )	(274,868 )	(732,374 )	(827,653 )
Foreign exchange	(40,717 )	34,363	(19,746 )	(16,925 )
Net reserve for losses and loss expenses, end of period	2,453,666	2,802,217	2,453,666	2,802,217
Losses and loss expenses recoverable	298,502	421,518	298,502	421,518
Reserve for losses and loss expenses, end of period	\$2,752,168	\$3,223,735	\$2,752,168	\$3,223,735
Incurred losses and loss expenses comprise:				
	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Gross losses and loss expenses	\$222,356	\$226,130	\$587,111	\$684,080
Reinsurance recoverable	1,769	(48,165 )	(41,570 )	(96,300 )
Net incurred losses and loss expenses	\$224,125	\$177,965	\$545,541	\$587,780





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## 9. 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.

## 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 as rated by Standard & Poor's or the equivalent with other rating agencies.

Exposure to a single reinsurer is also controlled with restrictions dependent on rating. At September 30, 2014, 97.3% (December 31, 2013: 96.7%) of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses and \$144,414 of total IBNR recoverable (December 31, 2013: \$196,840)) were fully collateralized or from reinsurers rated A- or better.

Reinsurance recoverables by reinsurer as at September 30, 2014 and December 31, 2013 are as follows:

	September 30, 2014		December 31, 2013		
	Reinsurance Recoverable	% of Total	Reinsurance Recoverable	% of Total	
Top 10 reinsurers	\$264,131	73.1	% \$340,253	75.6	%
Other reinsurers' balances > \$1 million	89,584	24.8	% 100,784	22.4	%
Other reinsurers' balances < \$1 million	7,778	2.1	% 9,197	2.0	%
Total	\$361,493	100.0	% \$450,234	100.0	%
			September 30, 2014		
Top 10 Reinsurers		Rating	Reinsurance Recoverable	% of Total	
Lloyd's Syndicates		A+	\$60,218	16.7	%
Everest Re		A+	46,765	12.9	%
Third Point Re		A-	34,180	9.5	%
Fully Collateralized		NR	33,770	9.3	%
Hannover Re		AA-	33,124	9.2	%
Swiss Re		AA-	13,849	3.8	%
Transatlantic Re		A+	11,649	3.2	%
XL Re		A+	10,334	2.9	%
Munich Re		AA-	10,232	2.8	%
Aioi Nissay Dowa Insurance		A+	10,010	2.8	%
Total			\$264,131	73.1	%
NR: Not rated					

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	December 31, 2013		
	Rating	Reinsurance Recoverable	% of Total
Top 10 Reinsurers			
Lloyd's Syndicates	A+	\$73,398	16.3
National Indemnity	AA+	51,037	11.3
Everest Re	A+	48,055	10.7
Hannover Re	AA-	41,483	9.2
Fully Collateralized	NR	36,683	8.1
Third Point Re	A-	30,428	6.8
Swiss Re	AA-	20,022	4.5
Transatlantic Re	A+	14,114	3.1
XL Re	A+	12,673	2.8
Munich Re	AA-	12,360	2.8
Total		\$340,253	75.6

NR: Not rated

At September 30, 2014 and December 31, 2013, the provision for uncollectible reinsurance relating to reinsurance recoverables was \$5,380 and \$5,794, respectively. To estimate the provision for uncollectible reinsurance, the reinsurance recoverable is first allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment is applied, especially in relation to ceded IBNR. The Company then uses default factors to determine the portion of a reinsurer's balance deemed to be uncollectible. Default factors require considerable judgment and are determined in part using the current rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions.

## 10. Share capital

## (a) Authorized and issued

The Company's authorized share capital is 571,428,571 common shares with a par value of \$0.175 per share. The holders of common shares are entitled to receive dividends. Holders of common shares 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 Company may from time to time repurchase its securities, including common shares, Junior Subordinated Deferrable Debentures and Senior Notes. On February 5, 2014, the Board of Directors of the Company approved an increase in the Company's common share purchase authorization to \$500,000. This amount is in addition to the \$1,774,436 of common shares repurchased by the Company through February 5, 2014 under its previously authorized share repurchase programs.

The Company has repurchased 64,502,410 common shares for an aggregate purchase price of \$2,006,875 from the inception of its share repurchase program to September 30, 2014. The Company had \$267,561 remaining under its authorized share repurchase program as of September 30, 2014.

The Company expects the purchases under its share repurchase program to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company's capital position relative to internal and rating agency targets, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of Directors at any time.

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

	Common Shares
Common shares issued, December 31, 2013	154,488,497
Restricted share awards vested, net of shares withheld	594,582
Restricted share units vested, net of shares withheld	10,265
Options exercised	133,385
Direct issuance of common stock	1,060
Performance share awards vested, net of shares withheld	25,767
Common shares issued, September 30, 2014	155,253,556
Treasury shares, September 30, 2014	(66,141,285 )
Common shares outstanding, September 30, 2014	89,112,271
	Common Shares
Common shares issued, December 31, 2012	152,698,191
Restricted share awards vested, net of shares withheld	768,889
Restricted share units vested, net of shares withheld	14,381
Options exercised	277,615
Warrants exercised	591,480
Direct issuance of common stock	928
Performance share awards vested, net of shares withheld	31,897
Deferred share units vested, net of shares withheld	2,935
Common shares issued, September 30, 2013	154,386,316
Treasury shares, September 30, 2013	(54,488,320 )
Common shares outstanding, September 30, 2013	99,897,996

## (b) Warrants

During the nine months ended September 30, 2014, no warrants were exercised. During the nine months ended September 30, 2013, 1,114,416 warrants were exercised which resulted in the issuance of 591,480 common shares. Holders of the outstanding warrants are entitled to exercise the warrants in whole or in part at any time until the expiration date. The total outstanding warrants at September 30, 2014 were 5,174,114 (December 31, 2013: 5,296,056). No further warrants are anticipated to be issued.

## (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. There were no outstanding deferred share units at September 30, 2014 (December 31, 2013: \$nil).

As of February 16, 2013, John Hendrickson became an employee director. As a result, his 5,039 deferred share units vested and 2,935 common shares were issued to him, net of shares withheld for taxes.

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## (d) Dividends

On July 29, 2014, the Company announced a quarterly cash dividend of \$0.30 (2013: \$0.30) per common share and \$0.30 per common share equivalent for which each outstanding warrant is exercisable. This dividend was paid on September 30, 2014 to holders of record on September 15, 2014.

On April 30, 2014, the Company announced a quarterly cash dividend of \$0.30 (2013: \$0.30) per common share and \$0.30 per common share equivalent for which each outstanding warrant is exercisable. This dividend was paid on June 30, 2014 to holders of record on June 13, 2014.

On February 5, 2014, the Company announced a quarterly cash dividend of \$0.30 (2013: \$0.30) per common share and \$0.30 per common share equivalent for which each outstanding warrant is exercisable. This dividend was paid on March 31, 2014 to holders of record on March 14, 2014.

On February 6, 2013, the Company announced a special dividend in the amount of \$2.00 per common share and \$2.00 per common share equivalent for which each outstanding warrant is exercisable (the "2013 Special Dividend"). The 2013 Special Dividend was paid on February 26, 2013 to shareholders and warrant holders of record as of February 19, 2013.

## 11. Stock plans

## (a) Long Term Incentive Plan and Short Term Incentive Plan

The Company's Amended and Restated 2005 Long Term Incentive Plan ("LTIP") provides for grants to employees of options, stock appreciation rights ("SARs"), restricted shares, restricted share units, performance shares, dividend equivalents or other share-based awards. In addition, the Company may issue restricted share awards or restricted share units in connection with awards issued under its annual Short Term Incentive Plan ("STIP"). The total number of shares reserved for issuance under the LTIP and STIP are 13,126,896 shares of which 1,018,998 shares are remaining. The LTIP and STIP are administered by the Compensation Committee of the Board of Directors. No SARs have been granted to date. Grant prices are established at the fair market value of the Company's common shares at the date of grant.

## i. Options

Options may be exercised for voting common shares upon vesting. Options have a life of 10 years and vest either pro rata or at the end of the required service period from the date of grant. Fair value of the option awards at the date of grant is determined using the Black-Scholes option-pricing model.

Expected volatility is based on stock price volatility of comparable publicly-traded companies. The Company used the simplified method consistent with U.S. GAAP authoritative guidance on stock compensation expenses to estimate expected lives for options granted during the period as historical exercise data was not available and the options met the requirement as set out in the guidance.

The Company has not granted any stock options since September 4, 2009.

There were no share compensation expenses in respect of options recognized for the three and nine months ended September 30, 2014 and 2013.

A modification event was triggered as a result of the 2013 Special Dividend. In accordance with the terms of the LTIP under which the options were issued, an adjustment was required to protect the holders of such stock options from changes in the value of the stock options following the declaration of the 2013 Special Dividend. The modification of the options included a decrease in the exercise price of each stock option and an increase in the number of shares underlying each stock option. The fair value of the options before and after the modification was unchanged.

Activity with respect to options for the nine months ended September 30, 2014 was as follows:

Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
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Options outstanding, December 31, 2013	1,572,713	\$6.66	\$18.88
Options exercised	(133,385	) 3.81	25.10
Options outstanding, September 30, 2014	1,439,328	\$6.93	\$18.30

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Activity with respect to options for the nine months ended September 30, 2013 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2012	1,823,947	\$6.52	\$20.69
Options regraded (modified)	1,833,414	6.76	19.02
Options exercised	(277,615	) 5.24	23.58
Options cancelled (modified)	(1,733,139	) 6.76	20.12
Options outstanding, September 30, 2013	1,646,607	\$6.75	\$18.94

At September 30, 2014 and 2013, there were no unrecognized share compensation expenses in respect of options.

## ii. Restricted share awards

Restricted shares granted under the LTIP and STIP vest either pro rata or at the end of the required service period and contain certain restrictions during the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. The Company recognized share compensation expenses during the three and nine months ended September 30, 2014 of \$8,180 (2013: \$10,041) and \$23,101 (2013: \$20,035), respectively. 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 awards for the nine months ended September 30, 2014 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2013	2,684,745	\$33.74
Restricted share awards granted	925,610	37.33
Restricted share awards vested	(769,971	) 31.47
Restricted share awards forfeited	(69,117	) 36.28
Restricted share awards outstanding, September 30, 2014	2,771,267	\$35.50

Activity with respect to unvested restricted share awards for the nine months ended September 30, 2013 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2012	2,170,547	\$29.24
Restricted share awards granted	1,580,117	36.06
Restricted share awards vested	(930,296	) 28.08
Restricted share awards forfeited	(110,912	) 28.34
Restricted share awards outstanding, September 30, 2013	2,709,456	\$33.65

At September 30, 2014, there were \$77,920 (December 31, 2013: \$69,219) of total unrecognized share compensation expenses in respect of restricted share awards that are expected to be recognized over a weighted-average period of 3.0 years (December 31, 2013: 3.2 years).

## iii. Restricted share units

Restricted share units under the LTIP and STIP vest either ratably or at the end of the required service period and contain certain restrictions during the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. The Company recognized share compensation expenses during the

three and nine months ended September 30, 2014 of \$269 (2013: \$168) and \$602 (2013: \$419), respectively. The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

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Activity with respect to unvested restricted share units for the nine months ended September 30, 2014 was as follows:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2013	66,518	\$33.74
Restricted share units granted	53,025	38.10
Restricted share units vested	(18,325	) 30.71
Restricted share units issued in lieu of cash dividends	1,479	34.19
Restricted share units outstanding, September 30, 2014	102,697	\$36.54

Activity with respect to unvested restricted share units for the nine months ended September 30, 2013 was as follows:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2012	47,238	\$29.61
Restricted share units granted	36,635	36.11
Restricted share units vested	(21,814	) 28.17
Restricted share units issued in lieu of cash dividends	3,924	30.29
Restricted share units outstanding, September 30, 2013	65,983	\$33.74

At September 30, 2014, there were \$3,038 (December 31, 2013: \$1,678) of total unrecognized share compensation expenses in respect of restricted share units that are expected to be recognized over a weighted-average period of 3.3 years (December 31, 2013: 3.4 years).

## iv. Performance share awards

The performance share awards contain a performance based component. The performance component relates to the compounded growth in the Dividend Adjusted Diluted Book Value per Share ("DBVPS") over a three year period relative to the Company's peer group. For performance share awards granted during the period, the grant date Diluted Book Value per Share is based on the DBVPS at the end of the most recent financial reporting year. The Dividend Adjusted Performance Period End DBVPS will be the DBVPS three years after the grant date DBVPS. The fair value estimate earns over the requisite attribution period and the estimate will be reassessed at the end of each performance period which will reflect any adjustments in the consolidated statements of comprehensive income in the period in which they are determined.

The Company recognized share compensation expenses during the three and nine months ended September 30, 2014 of \$315 (2013: \$318) and \$549 (2013: (\$971)), respectively. The negative expense is due to a reversal of expenses on unvested performance share awards based on a review of current and projected performance criteria.

Activity with respect to unvested performance share awards for the nine months ended September 30, 2014 was as follows:

	Performance Share Awards	Weighted Average Grant Date Fair Value
Performance share awards outstanding, December 31, 2013	101,820	\$33.56
Performance share awards granted	52,639	37.33
Performance share awards vested	(32,746	) 32.62
Performance share awards conversion adjustment	(15,344	) 31.38
Performance share awards outstanding, September 30, 2014	106,369	\$36.03



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Activity with respect to unvested performance share awards for the nine months ended September 30, 2013 was as follows:

	Performance Share Awards	Weighted Average Grant Date Fair Value
Performance share awards outstanding, December 31, 2012	220,845	\$31.81
Performance share awards granted	38,386	36.11
Performance share awards vested	(39,094	) 28.70
Performance share awards forfeited	(18,701	) 31.05
Performance share awards conversion adjustment	(99,616	) \$33.05
Performance share awards outstanding, September 30, 2013	101,820	\$33.56

At September 30, 2014, there were \$2,527 (December 31, 2013: \$1,642) of total unrecognized share compensation expenses in respect of performance share awards that are expected to be recognized over a weighted-average period of 2.3 years (December 31, 2013: 2.0 years).

(b) Total share compensation expenses

The breakdown of share compensation expenses by award type was as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Restricted share awards	8,180	10,041	23,101	20,035
Restricted share units	269	168	602	419
Performance share awards	315	318	549	(971
Total	\$8,764	\$10,527	\$24,252	\$19,483

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## 12. Debt and financing arrangements

## (a) Financing structure

The financing structure at September 30, 2014 was:

	Commitment	Issued and outstanding (a)	Drawn
2006 Junior Subordinated Deferrable Debentures	\$ 150,000	\$ 150,000	\$ 150,000
2007 Junior Subordinated Deferrable Debentures	200,000	139,800	139,800
Flagstone 2006 Junior Subordinated Deferrable Debentures	136,403	136,403	136,403
Flagstone 2007 Junior Subordinated Deferrable Debentures	113,750	113,750	113,750
Total debentures payable	600,153	539,953	539,953
2010 Senior Notes due 2040	250,000	250,000	247,279
Total debentures and senior notes payable	850,153	789,953	787,232
\$400,000 syndicated unsecured letter of credit facility	400,000	—	—
\$525,000 syndicated secured letter of credit facility	525,000	301,340	—
\$200,000 secured bi-lateral letter of credit facility	200,000	19,743	—
Talbot FAL facility	25,000	25,000	—
PaCRE senior secured letter of credit facility	10,000	294	—
AlphaCat Re secured letter of credit facility	30,000	30,000	—
IPC bi-lateral facility	40,000	16,975	—
\$375,000 Flagstone bi-lateral facility	375,000	288,739	—
Total credit and other facilities	1,605,000	682,091	—
Total debt and financing arrangements	\$ 2,455,153	\$ 1,472,044	\$ 787,232

The financing structure at December 31, 2013 was:

	Commitment	Issued and outstanding (a)	Drawn
2006 Junior Subordinated Deferrable Debentures	\$ 150,000	\$ 150,000	\$ 150,000
2007 Junior Subordinated Deferrable Debentures	200,000	139,800	139,800
Flagstone 2006 Junior Subordinated Deferrable Debentures	137,866	137,866	137,866
Flagstone 2007 Junior Subordinated Deferrable Debentures	113,750	113,750	113,750
Total debentures payable	601,616	541,416	541,416
2010 Senior Notes due 2040	250,000	250,000	247,198
Total debentures and senior notes payable	851,616	791,416	788,614
\$400,000 syndicated unsecured letter of credit facility	400,000	—	—
\$525,000 syndicated secured letter of credit facility	525,000	358,567	—
\$200,000 secured bi-lateral letter of credit facility	200,000	16,726	—
Talbot FAL facility	25,000	25,000	—
PaCRE senior secured letter of credit facility	10,000	294	—
AlphaCat Re secured letter of credit facility	24,800	24,800	—
IPC bi-lateral facility	40,000	20,177	—
\$375,000 Flagstone bi-lateral facility	375,000	305,686	—
Total credit and other facilities	1,599,800	751,250	—
Total debt and financing arrangements	\$ 2,451,416	\$ 1,542,666	\$ 788,614

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

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(b) Senior notes and junior subordinated deferrable debentures

The following table summarizes the key terms of the Company's senior notes and junior subordinated deferrable debentures as at the issuance date for each placement.

Description	Issuance date	Commitment	Maturity date	Fixed/Spread	Interest payments due
2006 Junior Subordinated Deferrable Debentures	June 15, 2006	\$ 150,000	June 15, 2036	9.069 % (a)	Quarterly
Flagstone 2006 Junior Subordinated Deferrable Debentures	August 23, 2006	\$ 136,403	September 15, 2036	3.540 % (b)	Quarterly
2007 Junior Subordinated Deferrable Debentures	June 21, 2007	\$ 200,000	June 15, 2037	8.480 % (a)	Quarterly
Flagstone 2007 Junior Subordinated Deferrable Debentures	June 8, 2007	\$ 88,750	July 30, 2037	3.000 % (b)	Quarterly
Flagstone 2007 Junior Subordinated Deferrable Debentures	September 20, 2007	\$ 25,000	September 15, 2037	3.100 % (b)	Quarterly
2010 Senior Notes due 2040	January 26, 2010	\$ 250,000	January 26, 2040	8.875 % (a)	Semi-annually in arrears

(a) Fixed interest rate.

(b) Variable interest rate is the three-month LIBOR, reset quarterly, plus spread as noted in the table.

The following table summarizes the key terms of the Company's senior notes and junior subordinated deferrable debentures as at September 30, 2014:

Description	Issuance date	Commitment	Maturity date	Fixed/Spread	Interest payments due
2006 Junior Subordinated Deferrable Debentures	June 15, 2006	\$ 150,000	June 15, 2036	5.831 % (b)	Quarterly
Flagstone 2006 Junior Subordinated Deferrable Debentures	August 23, 2006	\$ 136,403	September 15, 2036	6.463 % (b)	Quarterly
2007 Junior Subordinated Deferrable Debentures	June 21, 2007	\$ 200,000	June 15, 2037	5.180 % (b)	Quarterly
Flagstone 2007 Junior Subordinated Deferrable Debentures	June 8, 2007	\$ 88,750	July 30, 2037	5.900 % (b)	Quarterly
Flagstone 2007 Junior Subordinated Deferrable Debentures	September 20, 2007	\$ 25,000	September 15, 2037	5.983 % (b)	Quarterly
	January 26, 2010	\$ 250,000	January 26, 2040	8.875 % (a)	

2010 Senior Notes due  
2040

Semi-annually in  
arrears

(a) Fixed interest rate.

(b) Interest rate has been fixed as a result of interest rate swap contracts entered into by the Company.

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Senior Notes

The Senior Notes due 2040 (the “2010 Senior Notes”) were part of a registered public offering. The 2010 Senior Notes mature on January 26, 2040. The Company may redeem the notes, in whole at any time, or in part from time to time, at the Company’s option on not less than 30 nor more than 60 days’ notice, at a make-whole redemption price as described in “Description of the Notes - Optional Redemption” in the 2010 Senior Notes prospectus supplement. In addition, the Company may redeem the notes, in whole, but not in part, at any time upon the occurrence of certain tax events as described in “Description of the Notes - Redemption for Tax Purposes” in the prospectus supplement.

Debt issuance costs were deferred as an asset and are amortized over the life of the 2010 Senior Notes. There were no redemptions made during the three and nine months ended September 30, 2014 and 2013.

The 2010 Senior Notes are unsecured and unsubordinated obligations of the Company and rank equally in right of payment with all of the Company’s existing and future unsecured and unsubordinated indebtedness. The 2010 Senior Notes will be effectively junior to all of the Company’s future secured debt, to the extent of the value of the collateral securing such debt, and will rank senior to all our existing and future subordinated debt. The 2010 Senior Notes are structurally subordinated to all obligations of the Company’s subsidiaries.

Future payments of principal of \$250,000 on the 2010 Senior Notes are all expected to be after 2019.

Junior subordinated deferrable debentures

The Company participated in private placements of junior subordinated deferrable interest debentures due 2036 and 2037 (respectively, the “2006 Junior Subordinated Deferrable Debentures” and “2007 Junior Subordinated Deferrable Debentures”).

Debt issuance costs for the 2006 and 2007 Junior Subordinated Deferrable Debentures were deferred as an asset and were amortized to income over the five year optional redemption periods. They are redeemable at the Company’s option at par. There were no redemptions made during the three and nine months ended September 30, 2014 and 2013. As part of the acquisition of Flagstone, the Company assumed junior subordinated deferrable debentures due 2036 and 2037 (respectively, the “Flagstone 2006 Junior Subordinated Deferrable Debentures” and “Flagstone 2007 Junior Subordinated Deferrable Debentures”). These debentures are redeemable quarterly at par. There were no redemptions made during the three and nine months ended September 30, 2014 and 2013.

Future payments of principal of \$539,953 on the debentures discussed above are all expected to be after 2019.

(c) Credit facilities

i. \$400,000 syndicated unsecured letter of credit facility and \$525,000 syndicated secured letter of credit facility  
On March 9, 2012, the Company entered into a \$400,000 four-year unsecured credit facility with Deutsche Bank Securities Inc., as syndication agent, JPMorgan Chase Bank, N.A. as administrative agent, Lloyds Securities Inc. and Suntrust Bank, as co-documentation agents and the lenders party thereto, which provides for letter of credit and revolving credit availability for the Company (the “Four Year Unsecured Facility”) (the full \$400,000 of which is available for letters of credit and/or revolving loans). The Four Year Unsecured Facility was provided by a syndicate of commercial banks. Letters of credit under the Four Year Unsecured Facility are available to support obligations in connection with the insurance business of the Company and its subsidiaries. Loans under the Four Year Unsecured Facility are available for the general corporate and working capital purposes of the Company. The Company may request that existing lenders under the Four Year Unsecured Facility or prospective additional lenders agree to make available additional commitments from time to time so long as the aggregate commitments under the Four Year Unsecured Facility do not exceed \$500,000.

Also on March 9, 2012, the Company entered into a \$525,000 four-year secured credit facility, with the same parties, which provides for letter of credit availability for the Company (the “Four Year Secured Facility” and together with the Four Year Unsecured Facility, the “Credit Facilities”). The Four Year Secured Facility was also provided by a syndicate of commercial banks. Letters of credit under the Four Year Secured Facility will be available to support obligations in



connection with the insurance business of the Company. The Company may request that existing lenders under the Four Year Secured Facility or prospective additional lenders agree to make available additional commitments from time to time so long as the aggregate commitments under the Four Year Secured Facility do not exceed \$700,000. The obligations of the Company under the Four Year Secured Facility are secured by cash and securities deposited into cash collateral accounts from time to time with The Bank of New York Mellon.

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As of September 30, 2014, there were \$301,340 in outstanding letters of credit under the Four Year Secured Facility (December 31, 2013: \$358,567) and \$nil outstanding under the Four Year Unsecured Facility.

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 \$2,600,000 and, commencing with the end of the fiscal quarter ending March 31, 2012, to be increased quarterly by an amount equal to 50.0% of the Company's consolidated net income (if positive) for such quarter plus 50.0% of the aggregate increases in the consolidated shareholders' equity of the Company during such fiscal quarter by reason of the issuance and sale of common equity interests of the Company, including upon any conversion of debt securities of the Company into such equity interests, (ii) the requirement that the Company maintain at all times a consolidated total debt to consolidated total capital ratio not greater than 0.35:1.00, and (iii) the requirement that Validus Reinsurance, Ltd. and any other material insurance subsidiaries maintain a financial strength rating by A.M. Best of not less than "B++" (Fair). In addition, the Credit Facilities contain customary negative covenants applicable to the Company, including limitations on the ability to pay dividends and other payments in respect of equity interests at any time that the Company is otherwise in default with respect to certain provisions under the respective Credit Facilities, limitations on the ability to incur liens, sell assets, merge or consolidate with others, enter into transactions with affiliates, and limitations on the ability of its subsidiaries to incur indebtedness. The Credit Facilities also contain customary affirmative covenants, representations and warranties and events of default for credit facilities of its type. As of September 30, 2014, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Credit Facilities.

ii. \$25,000 Talbot FAL facility

Talbot holds a standby Letter of Credit facility (the "Talbot FAL facility") to provide Funds at Lloyd's to support the 2012, 2013, 2014 and 2015 underwriting years of account. As of September 30, 2014 the Company had \$25,000 (December 31, 2013: \$25,000) in outstanding letters of credit under the Talbot FAL facility.

The Talbot FAL facility contains affirmative covenants that include requirements for consolidated net worth and debt to capital ratios in line with those in place for the Credit Facilities and discussed above. The Talbot FAL facility also contains restrictions on the Company's ability to 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 Talbot FAL facility. As of September 30, 2014 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Talbot FAL facility.

iii. \$40,000 IPC bi-lateral facility

The Company assumed an existing evergreen letter of credit facility through the acquisition of IPC Holdings, Ltd. (the "IPC bi-lateral facility"). As of September 30, 2014, there were \$16,975 outstanding letters of credit issued under the IPC bi-lateral facility (December 31, 2013: \$20,177). As of September 30, 2014 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the IPC bi-lateral facility.

iv. \$200,000 secured bi-lateral letter of credit facility

The Company holds an uncommitted secured bi-lateral letter of credit facility with Citibank Europe plc (the "Secured bi-lateral letter of credit facility"). As of September 30, 2014, \$19,743 (December 31, 2013: \$16,726) of letters of credit were outstanding under the Secured bi-lateral letter of credit facility. The Secured bi-lateral letter of credit facility has no fixed termination date and as of September 30, 2014, and throughout the reporting periods presented, the Company is in compliance with all terms and covenants thereof.

v. \$10,000 PaCRe senior secured letter of credit facility

On May 11, 2012, PaCRe and its subsidiary, PaCRe Investments, Ltd. entered into a secured evergreen credit and letter of credit facility with JPMorgan Chase Bank, N.A. This facility provides for revolving borrowings by PaCRe

and for letters of credit issued by PaCRE to be used to support its reinsurance obligations in aggregate amount of \$10,000. As of September 30, 2014, \$294 (December 31, 2013: \$294) of letters of credit were outstanding under this facility. As of September 30, 2014, and throughout the reporting periods presented, PaCRE was in compliance with all covenants and restrictions thereof.

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## vi. \$30,000 AlphaCat Re secured letter of credit facility

On January 2, 2013, AlphaCat Re entered into a secured evergreen letter of credit facility with Comerica Bank. This facility provides for letters of credit issued by AlphaCat Re to be used to support its reinsurance obligations in the aggregate amount of \$24,800. During the period ended March 31, 2014 the size of the facility was increased to \$30,000 from \$24,800. As of September 30, 2014, \$30,000 (December 31, 2013: \$24,800) of letters of credit were outstanding under this facility. As of September 30, 2014, and throughout the reporting periods presented, AlphaCat Re was in compliance with all covenants and restrictions thereof.

## vii. \$375,000 Flagstone bi-lateral facility

As part of the Flagstone Acquisition, the Company assumed an evergreen Letters of Credit Master Agreement between Citibank Europe Plc and Flagstone Reassurance Suisse, S.A. (the "Flagstone Bi-Lateral Facility"). At September 30, 2014, the Flagstone Bi-Lateral Facility had \$288,739 (December 31, 2013: \$305,686) letters of credit issued and outstanding. As of September 30, 2014, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Flagstone Bi-Lateral Facility.

## (d) Finance expenses

Finance expenses consist of interest on the junior subordinated deferrable debentures and senior notes, the amortization of debt offering costs, credit facilities fees, bank charges, AlphaCat financing fees and Talbot FAL costs as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
2006 Junior Subordinated Deferrable Debentures	\$2,235	\$ 2,235	\$6,633	\$ 6,633
2007 Junior Subordinated Deferrable Debentures	1,848	1,848	5,492	5,492
Flagstone 2006 Junior Subordinated Deferrable Debentures	2,269	2,285	6,736	5,988
Flagstone 2007 Junior Subordinated Deferrable Debentures	1,807	1,807	5,335	4,426
2010 Senior Notes due 2040	5,597	5,597	16,791	16,791
Credit facilities	1,295	1,248	4,225	5,001
Bank charges	88	187	303	420
AlphaCat ILS funds fees (a)	384	78	2,030	2,406
Talbot FAL Facility	(169)	) 32	(165)	) 95
Total finance expenses	\$15,354	\$ 15,317	\$47,380	\$ 47,252

(a) Includes finance expenses incurred by AlphaCat Managers, Ltd. in relation to fund raising for the AlphaCat ILS funds, AlphaCat 2014 and AlphaCat 2013.

## 13. Accumulated other comprehensive (loss) income

The changes in accumulated other comprehensive (loss) income, by component for the three and nine months ended September 30, 2014 and 2013 is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Balance - Beginning of period	\$2,460	\$(8,262)	\$(617)	\$(2,953)
Amounts reclassified to retained earnings	—	—	—	4,290
Other comprehensive (loss) income	(5,198)	) 4,390	(2,121)	) (5,209)
Balance - End of period	\$(2,738)	\$(3,872)	\$(2,738)	\$(3,872)



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## 14. 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 a minimum weighted-average portfolio credit rating of A+. In addition, the portfolio limits the amount of "risk assets", such as non-investment grade debt and equity securities, to a maximum of 35% of shareholders' equity. The Company also limits its exposure to any single issuer to 3.5% of its investment portfolio or less, excluding government and agency securities, depending on the credit rating of the issuer. With the exception of the Company's bank loan portfolio, which represents 6.8% of the Company's total investments as at September 30, 2014, and certain capital securities issued by investment grade corporations, the minimum credit rating of any security purchased is Baa3/BBB-. In total, investments in below investment grade securities are limited to no more than 10% of the Company's investment portfolio. Excluding bank loans, 1.7% of the portfolio had a split rating below Baa3/BBB- as at September 30, 2014. The Company did not have an aggregate exposure to any single issuer of more than 0.9% of its investment portfolio, other than with respect to government and agency securities as at September 30, 2014.

## (b) Funds at Lloyd's

The amounts provided under the Talbot FAL Facility would become a liability of the Company in the event of Syndicate 1183 declaring a loss at a level which would call on this arrangement.

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 and 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 provided for each year of account as follows:

	2014	2013
	Underwriting	Underwriting
	Year	Year
Talbot FAL facility	\$25,000	\$25,000
Group funds	450,000	403,700
Total	\$475,000	\$428,700

The amounts which are provided as FAL are not available for distribution to the Company for the payment of dividends. Talbot's corporate member may also be required to maintain funds under the control of Lloyd's in excess of its capital requirement and such funds also may not be available for distribution to the Company for the payment of dividends. See Note 3 (d) for investments pledged as collateral.

## (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 2014 estimated premium income at Lloyd's of £625,000, at the September 30, 2014 exchange rate of £1 equals \$1.6195 and assuming the maximum 3% assessment, the Company would be assessed approximately \$30,366.

## (d) Aquiline commitment

As discussed in Note 5 "Investments in affiliates," the Company entered into an Assignment and Assumption Agreement with Aquiline Capital Partners LLC, pursuant to which it assumed a total capital commitment of \$50,000

which will expire on July 2, 2015. The Company's remaining commitment at September 30, 2014 was \$17,890 (December 31, 2013: \$17,890).

(e) Other investment commitments

At September 30, 2014, the Company had capital commitments to five other investments of \$105,000 (December 31, 2013: \$30,000). The Company's remaining commitment to these investments at September 30, 2014 was \$79,259 (December 31, 2013: \$5,045).

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15. Related party transactions

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

Aquiline Capital Partners, LLC and its related companies ("Aquiline"), which own 3,446,643 shares in the Company, hold warrants to purchase 2,756,088 shares, and have two employees on the Company's Board of Directors who do not receive compensation from the Company, are shareholders of Group Ark Insurance Holdings Ltd. ("Group Ark"). Christopher E. Watson, a director of the Company, serves as a director of Group Ark. Pursuant to reinsurance agreements with a subsidiary of Group Ark, the Company recognized gross premiums written during the three and nine months ended September 30, 2014 of \$246 (2013: \$nil) and \$2,190 (2013: \$2,848) respectively, with \$733 included in premiums receivable at September 30, 2014 (December 31, 2013: \$238). The Company also recognized reinsurance premiums ceded during the three and nine months ended September 30, 2014 of \$127 (2013: \$23) and had reinsurance balances payable of \$4 at September 30, 2014 (December 31, 2013: \$4). The Company recorded \$2,005 of loss reserves recoverable at September 30, 2014 (December 31, 2013: \$3,698). Earned premium adjustments of \$694 (2013: \$718) and \$1,653 (2013: \$2,147) were recorded during the three and nine months ended September 30, 2014, respectively.

On November 24, 2009, the Company entered into an Investment Management Agreement with Conning, Inc. ("Conning") to manage a portion of the Company's investment portfolio. Aquiline acquired Conning on June 16, 2009. Jeffrey W. Greenberg, a director of the Company, serves as a director of Conning Holdings Corp., the parent company of Conning. Investment management fees earned by Conning for the three and nine months ended September 30, 2014 were \$(7) (2013: \$165) and \$219 (2013: \$396) respectively, with \$239 included in accounts payable and accrued expenses at September 30, 2014 (December 31, 2013: \$283).

On December 20, 2011, the Company entered into an Assignment and Assumption Agreement (the "Agreement") with Aquiline Capital Partners LLC, a Delaware limited liability company (the "Assignor") and Aquiline Capital Partners II GP (Offshore) Ltd., a Cayman Islands company limited by shares (the "General Partner") pursuant to which the Company has assumed 100% of the Assignor's interest in Aquiline Financial Services Fund II L.P. (the "Partnership") representing a total capital commitment of \$50,000 (the "Commitment"), as a limited partner in the Partnership (the "Transferred Interest"). Messrs. Greenberg and Watson, directors of the Company, serve as managing principal and senior principal, respectively, of Aquiline Capital Partners LLC. For the three months ended September 30, 2014, the Company incurred \$nil (2013: \$505) in partnership fees and made capital contributions of \$nil (2013: \$6,185). For the nine months ended September 30, 2014, the Company incurred \$nil (2013: \$625) in partnership fees and made \$nil (2013: \$13,089) of capital contributions. There were no amounts included in accounts payable and accrued expenses at September 30, 2014 or December 31, 2013.

Certain shareholders of the Company and their affiliates, as well as employers of entities associated with directors or officers have purchased insurance and/or reinsurance from the Company in the ordinary course of business. The Company believes these transactions were settled for arm's length consideration.



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## 16. Earnings per share

The following table sets forth the computation of basic and earnings per diluted share for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Basic earnings per share				
Net (loss) income	\$(13,397	) \$229,063	\$381,172	\$419,503
Loss (income) attributable to noncontrolling interest	53,069	(45,694	) (25,745	) 17,831
Net income available to Validus	39,672	183,369	355,427	437,334
Less: Dividends and distributions declared on outstanding warrants	(1,552	) (1,552	) (4,656	) (17,662
Income available to common shareholders	\$38,120	\$181,817	\$350,771	\$419,672
Weighted average number of common shares outstanding	90,593,329	99,834,563	91,665,950	103,451,396
Basic earnings per share available to common shareholders	\$0.42	\$1.82	\$3.83	\$4.06
Earnings per diluted share				
Net (loss) income	\$(13,397	) \$229,063	\$381,172	\$419,503
Loss (income) attributable to noncontrolling interest	53,069	(45,694	) (25,745	) 17,831
Net income available to Validus	39,672	183,369	355,427	437,334
Less: Dividends and distributions declared on outstanding warrants	(1,552	) —	—	(17,662
Income available to common shareholders	\$38,120	\$183,369	\$355,427	\$419,672
Weighted average number of common shares outstanding	90,593,329	99,834,563	91,665,950	103,451,396
Share equivalents:				
Warrants	—	2,606,669	2,747,399	—
Stock options	760,267	782,158	752,145	1,090,298
Unvested restricted shares	586,014	390,376	772,147	723,219
Weighted average number of diluted common shares outstanding	91,939,610	103,613,766	95,937,641	105,264,913
Earnings per diluted share available to common shareholders	\$0.41	\$1.77	\$3.70	\$3.99

Share equivalents that would result in the issuance of common shares of 4,712 (2013: 125,728) and 235,460 (2013: 464,516) were outstanding for the three and nine months ended September 30, 2014, respectively, but were not included in the computation of earnings per diluted share because the effect would be antidilutive.



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17. Segment information

The Company conducts its operations worldwide through three operating segments, which have been determined under U.S. GAAP segment reporting to be Validus Re, AlphaCat and Talbot. 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 segment requires different strategies.

Validus Re Segment

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 and aviation, financial lines of business, nuclear, terrorism, life, accident & health, workers' compensation, crisis management, contingency, motor, technical lines, composite and trade credit.

AlphaCat Segment

The AlphaCat segment manages strategic relationships that leverage the Company's underwriting and investment expertise and earns management, performance and underwriting fees primarily from the Company's operating affiliates, AlphaCat Re 2011, AlphaCat Re 2012, AlphaCat 2013 and AlphaCat 2014, as well as PaCRe and the AlphaCat ILS funds.

Talbot Segment

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

Corporate and eliminations

The Company has a corporate function ("corporate"), which includes the activities of the parent company, and which carries out certain functions for the group. Corporate includes 'non-core' underwriting expenses, predominantly general and administrative and stock compensation expenses. Corporate also denotes the activities of certain key executives such as the Chief Executive Officer and Chief Financial Officer. For internal reporting purposes, corporate is reflected separately, however corporate is not considered an operating segment under these circumstances. Other reconciling items include, but are not limited to, the elimination of inter segment revenues and expenses and unusual items that are not allocated to segments.

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The following tables summarize the results of our operating segments and "Corporate":

Three Months Ended September 30, 2014	Validus Re Segment	AlphaCat Segment	Talbot Segment	Corporate & Eliminations	Total
<b>Underwriting income</b>					
Gross premiums written	\$ 114,897	\$ 6,936	\$ 245,685	\$(8,544)	\$ 358,974
Reinsurance premiums ceded	(10,899)	(648)	(27,134)	8,544	(30,137)
Net premiums written	103,998	6,288	218,551	—	328,837
Change in unearned premiums	122,712	28,850	14,297	—	165,859
Net premiums earned	226,710	35,138	232,848	—	494,696
<b>Underwriting deductions</b>					
Losses and loss expenses	102,005	3,738	118,382	—	224,125
Policy acquisition costs	36,177	3,378	47,862	(1,013)	86,404
General and administrative expenses	18,522	7,719	37,709	19,369	83,319
Share compensation expenses	2,582	179	2,990	3,013	8,764
Total underwriting deductions	159,286	15,014	206,943	21,369	402,612
Underwriting income (loss)	\$ 67,424	\$ 20,124	\$ 25,905	\$(21,369)	\$ 92,084
Net investment income	20,762	837	4,965	(1,303)	25,261
Other (loss) income	(6,827)	5,980	109	(3,342)	(4,080)
Finance expenses	(3,622)	(385)	162	(11,509)	(15,354)
Operating income (loss) before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	77,737	26,556	31,141	(37,523)	97,911
Tax benefit (expense)	1,058	—	332	(437)	953
Income from operating affiliates	—	3,761	—	—	3,761
(Income) attributable to operating affiliate investors	—	(25,807)	—	—	(25,807)
Net operating income (loss)	\$ 78,795	\$ 4,510	\$ 31,473	\$(37,960)	\$ 76,818
Net realized gains on investments	1,641	2,563	391	—	4,595
Change in net unrealized (losses) on investments	(20,149)	(60,253)	(3,097)	(1,475)	(84,974)
Income from investment affiliate	1,754	—	—	—	1,754
Foreign exchange (losses) gains	(6,056)	(51)	(7,114)	1,780	(11,441)
Transaction expenses (b)	—	—	—	(149)	(149)
Net income (loss)	\$ 55,985	\$(53,231)	\$ 21,653	\$(37,804)	\$(13,397)
Net loss attributable to noncontrolling interest	—	53,069	—	—	53,069
Net income (loss) available (attributable) to Validus	\$ 55,985	\$(162)	\$ 21,653	\$(37,804)	\$ 39,672

## Selected ratios (a):

Net premiums written / Gross premiums written	90.5	% 90.7	% 89.0	%	91.6	%
Losses and loss expenses	45.0	% 10.6	% 50.8	%	45.3	%
Policy acquisition costs	16.0	% 9.6	% 20.6	%	17.5	%
General and administrative expenses (c)	9.3	% 22.5	% 17.5	%	18.6	%
Expense ratio	25.3	% 32.1	% 38.1	%	36.1	%
Combined ratio	70.3	% 42.7	% 88.9	%	81.4	%
Total assets	\$4,716,426	\$1,688,191	\$2,898,755	\$749,678	\$10,053,050	

(a) Ratios are based on net premiums earned.

The transaction expenses relate to costs incurred in connection with the acquisition of Western World, which was completed on October 2, 2014. Western World results have not been included in the Company's consolidated results for the three months ended September 30, 2014. Transaction expenses are primarily comprised of legal, financial advisory and audit related services.

(c) The general and administrative expense ratio includes share compensation expenses.

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Three Months Ended September 30, 2013	Validus Re Segment	AlphaCat Segment	Talbot Segment	Corporate & Eliminations	Total
Underwriting income					
Gross premiums written	\$ 130,925	\$ 3,481	\$ 246,468	\$(24,114)	\$ 356,760
Reinsurance premiums ceded	(13,006)	(525)	(49,998)	24,114	(39,415)
Net premiums written	117,919	2,956	196,470	—	317,345
Change in unearned premiums	157,873	34,210	21,860	—	213,943
Net premiums earned	275,792	37,166	218,330	—	531,288
Underwriting deductions					
Losses and loss expenses	62,250	15,615	100,100	—	177,965
Policy acquisition costs	47,662	3,787	44,899	(1,448)	94,900
General and administrative expenses	19,785	5,728	37,402	18,174	81,089
Share compensation expenses	2,479	152	2,992	4,904	10,527
Total underwriting deductions	132,176	25,282	185,393	21,630	364,481
Underwriting income (loss)	\$ 143,616	\$ 11,884	\$ 32,937	\$(21,630)	\$ 166,807
Net investment income	15,628	967	4,395	(981)	20,009
Other (loss) income	(1,892)	3,791	73	(4,778)	(2,806)
Finance expenses	(3,640)	(80)	(107)	(11,490)	(15,317)
Operating income (loss) before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	153,712	16,562	37,298	(38,879)	168,693
Tax benefit (expense)	143	—	(513)	365	(5)
Income from operating affiliates (Income) attributable to operating affiliate investors	—	1,463	—	—	1,463
Net operating income (loss)	\$ 153,855	\$ 6,210	\$ 36,785	\$(38,514)	\$ 158,336
Net realized (losses) gains on investments	(10,137)	4,084	(267)	—	(6,320)
Change in net unrealized gains on investments	23,144	44,145	2,678	—	69,967
Income from investment affiliate	1,044	—	—	—	1,044
Foreign exchange gains (losses)	2,168	388	4,238	(758)	6,036
Net income (loss)	\$ 170,074	\$ 54,827	\$ 43,434	\$(39,272)	\$ 229,063
Net income attributable to noncontrolling interest	—	(45,694)	—	—	(45,694)
Net income (loss) available (attributable) to Validus	\$ 170,074	\$ 9,133	\$ 43,434	\$(39,272)	\$ 183,369

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Selected ratios (a):

Net premiums written / Gross premiums written	90.1	% 84.9	% 79.7	%	89.0	%
Losses and loss expenses	22.6	% 42.0	% 45.8	%	33.5	%
Policy acquisition costs	17.3	% 10.2	% 20.6	%	17.9	%
General and administrative expenses (b)	8.1	% 15.8	% 18.5	%	17.2	%
Expense ratio	25.4	% 26.0	% 39.1	%	35.1	%
Combined ratio	48.0	% 68.0	% 84.9	%	68.6	%
Total assets	\$5,854,354	\$1,446,941	\$2,892,477	\$123,596	\$10,317,368	

(a) Ratios are based on net premiums earned.

(b) The general and administrative expense ratio includes share compensation expenses.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

Nine Months Ended September 30, 2014	Validus Re Segment	AlphaCat Segment	Talbot Segment	Corporate & Eliminations	Total
Underwriting income					
Gross premiums written	\$1,104,169	\$135,073	\$854,324	\$(66,927)	\$2,026,639
Reinsurance premiums ceded	(184,074)	(4,348)	(154,115)	66,927	(275,610)
Net premiums written	920,095	130,725	700,209	—	1,751,029
Change in unearned premiums	(233,271)	(32,444)	(41,658)	—	(307,373)
Net premiums earned	686,824	98,281	658,551	—	1,443,656
Underwriting deductions					
Losses and loss expenses	247,848	(7,155)	304,848	—	545,541
Policy acquisition costs	106,547	9,414	138,383	(3,338)	251,006
General and administrative expenses	53,757	15,627	107,031	55,191	231,606
Share compensation expenses	7,126	330	8,434	8,362	24,252
Total underwriting deductions	415,278	18,216	558,696	60,215	1,052,405
Underwriting income (loss)	\$271,546	\$80,065	\$99,855	\$(60,215)	\$391,251
Net investment income	56,285	2,546	14,322	(3,244)	69,909
Other income (loss)	912	21,482	384	(7,793)	14,985
Finance expenses	(11,131)	(2,039)	68	(34,278)	(47,380)
Operating income (loss) before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	317,612	102,054	114,629	(105,530)	428,765
Tax benefit (expense)	1,176	—	(902)	(672)	(398)
Income from operating affiliates	—	13,580	—	—	13,580
(Income) attributable to operating affiliate investors	—	(82,833)	—	—	(82,833)
Net operating income (loss)	\$318,788	\$32,801	\$113,727	\$(106,202)	\$359,114
Net realized gains on investments	5,411	10,230	552	—	16,193
Change in net unrealized gains (losses) on investments	5,279	15,706	2,159	(6,998)	16,146
Income from investment affiliate	7,881	—	—	—	7,881
Foreign exchange (losses) gains	(9,384)	(204)	(5,897)	724	(14,761)
Transaction expenses (b)	—	—	—	(3,401)	(3,401)
Net income (loss)	\$327,975	\$58,533	\$110,541	\$(115,877)	\$381,172
Net (income) attributable to noncontrolling interest	—	(25,745)	—	—	(25,745)
Net income (loss) available (attributable) to Validus	\$327,975	\$32,788	\$110,541	\$(115,877)	\$355,427



## Selected ratios (a):

Net premiums written / Gross premiums written	83.3	% 96.8	% 82.0	%	86.4	%
Losses and loss expenses	36.1	% (7.3	)% 46.3	%	37.8	%
Policy acquisition costs	15.5	% 9.6	% 21.0	%	17.4	%
General and administrative expenses (c)	8.9	% 16.2	% 17.5	%	17.7	%
Expense ratio	24.4	% 25.8	% 38.5	%	35.1	%
Combined ratio	60.5	% 18.5	% 84.8	%	72.9	%
Total assets	\$4,716,426	\$1,688,191	\$2,898,755	\$749,678	\$10,053,050	

(a) Ratios are based on net premiums earned.

The transaction expenses relate to costs incurred in connection with the acquisition of Western World, which was completed on October 2, 2014. Western World results have not been included in the Company's consolidated results for the nine months ended September 30, 2014. Transaction expenses are primarily comprised of legal, financial advisory and audit related services.

(c) The general and administrative expense ratio includes share compensation expenses.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

Nine Months Ended September 30, 2013	Validus Re Segment	AlphaCat Segment	Talbot Segment	Corporate & Eliminations	Total
Underwriting income					
Gross premiums written	\$1,232,272	\$146,757	\$855,516	\$(70,712)	\$2,163,833
Reinsurance premiums ceded	(226,292)	(525)	(191,922)	70,712	(348,027)
Net premiums written	1,005,980	146,232	663,594	—	1,815,806
Change in unearned premiums	(122,303)	(46,459)	(37,237)	—	(205,999)
Net premiums earned	883,677	99,773	626,357	—	1,609,807
Underwriting deductions					
Losses and loss expenses	319,298	16,928	251,554	—	587,780
Policy acquisition costs	142,195	10,011	127,092	(3,635)	275,663
General and administrative expenses	69,649	13,757	100,506	48,423	232,335
Share compensation expenses	5,421	314	6,754	6,994	19,483
Total underwriting deductions	536,563	41,010	485,906	51,782	1,115,261
Underwriting income (loss)	\$347,114	\$58,763	\$140,451	\$(51,782)	\$494,546
Net investment income	61,770	2,821	13,496	(6,219)	71,868
Other income (loss)	11,237	17,439	564	(24,943)	4,297
Finance expenses	(12,133)	(4,273)	(256)	(30,590)	(47,252)
Operating income (loss) before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	407,988	74,750	154,255	(113,534)	523,459
Tax benefit (expense)	1,755	—	(1,184)	(351)	220
Income from operating affiliates (Income) attributable to operating affiliate investors	—	8,779	—	—	8,779
Net operating income (loss)	\$409,743	\$41,373	\$153,071	\$(113,885)	\$490,302
Net realized (losses) gains on investments	(5,790)	4,084	516	—	(1,190)
Change in net unrealized losses on investments	(36,883)	(31,029)	(10,706)	—	(78,618)
Income from investment affiliate	4,274	—	—	—	4,274
Foreign exchange gains (losses)	7,448	(663)	(1,877)	(173)	4,735
Net income (loss)	\$378,792	\$13,765	\$141,004	\$(114,058)	\$419,503
Net loss attributable to noncontrolling interest	—	17,831	—	—	17,831
Net income (loss) available (attributable) to Validus	\$378,792	\$31,596	\$141,004	\$(114,058)	\$437,334

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Selected ratios (a):

Net premiums written / Gross premiums written	81.6	% 99.6	% 77.6	%	83.9	%
Losses and loss expenses	36.1	% 17.0	% 40.2	%	36.5	%
Policy acquisition costs	16.1	% 10.0	% 20.3	%	17.2	%
General and administrative expenses (b)	8.5	% 14.1	% 17.1	%	15.6	%
Expense ratio	24.6	% 24.1	% 37.4	%	32.8	%
Combined ratio	60.7	% 41.1	% 77.6	%	69.3	%
Total assets	\$5,854,354	\$1,446,941	\$2,892,477	\$123,596	\$10,317,368	

(a) Ratios are based on net premiums earned.

(b) The general and administrative expense ratio includes share compensation expenses.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

The 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:

Three Months Ended September 30, 2014							
Gross Premiums Written							
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%	
United States	\$28,665	\$2,206	\$17,003	\$(874)	\$47,000	13.1	%
Worldwide excluding United States (a)	10,639	(81)	29,781	(973)	39,366	10.9	%
Australia and New Zealand	610	—	3,312	(139)	3,783	1.1	%
Europe	8,560	312	9,821	(311)	18,382	5.1	%
Latin America and Caribbean	12,945	—	24,740	(819)	36,866	10.3	%
Japan	1,664	22	1,274	(73)	2,887	0.8	%
Canada	188	—	2,430	(80)	2,538	0.7	%
Rest of the world (b)	1,527	—	27,145	(1,073)	27,599	7.7	%
Sub-total, non United States	36,133	253	98,503	(3,468)	131,421	36.6	%
Worldwide including United States (a)	28,747	4,477	18,611	(560)	51,275	14.3	%
Other location non-specific (c)	21,352	—	111,568	(3,642)	129,278	36.0	%
Total	\$114,897	\$6,936	\$245,685	\$(8,544)	\$358,974	100.0	%
Three Months Ended September 30, 2013							
Gross Premiums Written							
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%	
United States	\$38,881	\$2,546	\$21,573	\$(2,105)	\$60,895	17.0	%
Worldwide excluding United States (a)	16,973	—	34,751	(4,138)	47,586	13.3	%
Australia and New Zealand	(9,482)	33	2,905	(236)	(6,780)	(1.9)	%
Europe	4,252	377	9,778	(986)	13,421	3.8	%
Latin America and Caribbean	5,902	—	38,084	(3,353)	40,633	11.4	%
Japan	(2,637)	—	1,066	(117)	(1,688)	(0.5)	%
Canada	1,469	500	2,749	(740)	3,978	1.1	%
Rest of the world (b)	5,641	—	22,167	(1,830)	25,978	7.3	%
Sub-total, non United States	22,118	910	111,500	(11,400)	123,128	34.5	%
Worldwide including United States (a)	29,611	25	18,246	(1,665)	46,217	13.0	%
Other location non-specific (c)	40,315	—	95,149	(8,944)	126,520	35.5	%
Total	\$130,925	\$3,481	\$246,468	\$(24,114)	\$356,760	100.0	%

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

	Nine Months Ended September 30, 2014						
	Gross Premiums Written						
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%	
United States	\$452,470	\$31,160	\$85,465	\$(10,662)	\$558,433	27.5	%
Worldwide excluding United States (a)	80,671	7,331	105,397	(6,741)	186,658	9.2	%
Australia and New Zealand	20,025	1,019	7,615	(391)	28,268	1.4	%
Europe	57,884	3,005	36,110	(4,157)	92,842	4.6	%
Latin America and Caribbean	22,167	—	86,111	(4,418)	103,860	5.1	%
Japan	41,137	608	3,404	(784)	44,365	2.2	%
Canada	3,508	215	8,325	(641)	11,407	0.6	%
Rest of the world (b)	23,870	—	70,702	(3,627)	90,945	4.5	%
Sub-total, non United States	249,262	12,178	317,664	(20,759)	558,345	27.6	%
Worldwide including United States (a)	168,337	91,735	71,147	(11,365)	319,854	15.8	%
Other location non-specific (c)	234,100	—	380,048	(24,141)	590,007	29.1	%
Total	\$1,104,169	\$135,073	\$854,324	\$(66,927)	\$2,026,639	100.0	%
	Nine Months Ended September 30, 2013						
	Gross Premiums Written						
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%	
United States	\$542,692	\$50,935	\$77,630	\$(10,599)	\$660,658	30.6	%
Worldwide excluding United States (a)	69,482	14,801	109,562	(9,065)	184,780	8.4	%
Australia and New Zealand	21,116	2,216	7,930	(467)	30,795	1.4	%
Europe	64,986	2,514	41,523	(3,892)	105,131	4.9	%
Latin America and Caribbean	5,885	—	124,120	(7,312)	122,693	5.7	%
Japan	41,939	653	5,258	(963)	46,887	2.2	%
Canada	4,503	818	8,790	(1,336)	12,775	0.6	%
Rest of the world (b)	29,211	—	62,803	(3,700)	88,314	4.1	%
Sub-total, non United States	237,122	21,002	359,986	(26,735)	591,375	27.3	%
Worldwide including United States (a)	180,621	74,820	63,998	(10,214)	309,225	14.3	%
Other location non-specific (c)	271,837	—	353,902	(23,164)	602,575	27.8	%
Total	\$1,232,272	\$146,757	\$855,516	\$(70,712)	\$2,163,833	100.0	%

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

(b) Represents risks in one geographic zone.

The other locations non-specific category refers to business for which an analysis of exposure by geographic zone (c) is not applicable, such as marine and aerospace risks, since these exposures can span multiple geographic areas and, in some instances, are not fixed locations.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

18. Subsequent events

Western World Insurance Group acquisition

On June 23, 2014, the Company entered into a stock purchase agreement to acquire all of the issued and outstanding capital stock of Western World Insurance Group, Inc. ("Western World"), a specialty excess and surplus lines insurance company. On October 2, 2014, the Company completed its acquisition of Western World for an aggregate purchase price of \$690,000 in cash, subject to adjustment based on pre-closing payments to shareholders, transaction expenses and the timing of closing as further described in the stock purchase agreement. The results of Western World have not been included in the Company's Consolidated Financial Statements as at September 30, 2014.

Quarterly Dividend

On November 5, 2014, the Company announced a quarterly cash dividend of \$0.30 per each common share and \$0.30 per common share equivalent for which each outstanding warrant is exercisable, payable on December 31, 2014 to holders of record on December 15, 2014.

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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 nine months ended September 30, 2014 and 2013 and the Company's consolidated financial condition, liquidity and capital resources as at September 30, 2014 and December 31, 2013. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and notes thereto included in this filing and the audited consolidated financial statements and related notes for the fiscal year ended December 31, 2013, the discussions of critical accounting policies and the qualitative and quantitative disclosure about market risk, as well as management's discussion and analysis of financial condition and results of operations contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

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 Part I Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013 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 conducts its operations worldwide through three operating segments which have been determined under U.S. GAAP segment reporting to be Validus Re, AlphaCat and Talbot. Validus Re is a Bermuda-based reinsurance segment focused on short tail lines of reinsurance. AlphaCat is a Bermuda-based investment adviser, managing capital from third parties and the Company in insurance linked securities and other investments in the property catastrophe reinsurance space. Talbot is a specialty insurance segment, operating within the Lloyd's insurance market through Syndicate 1183.

The Company's strategy is to concentrate primarily on short-tail risks, which has been an area where management believes 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 November 30, 2012, the Company acquired all of the outstanding shares of Flagstone Reinsurance Holdings, S.A. ("Flagstone"). As part of this acquisition, the Company acquired Flagstone Reassurance Suisse, S.A. and renamed it Validus Reinsurance (Switzerland) Ltd. ("Validus Re Swiss"). Validus Re Swiss is based in Zurich, Switzerland and forms part of the Validus Re segment.

On April 25, 2013, the Company acquired Longhorn Re, Ltd. (renamed Validus Re Americas, Ltd.), a single contract Bermuda-domiciled crop reinsurer.

On December 20, 2013, the Company joined with other investors in capitalizing AlphaCat 2014, a special purpose vehicle formed for the purpose of investing in collateralized reinsurance and retrocessional contracts. The Company has an equity interest and voting rights in AlphaCat 2014 which are below 50%, therefore the investment in AlphaCat 2014 is included as an equity method investment in the Consolidated Financial Statements of the Company.

On June 23, 2014, the Company entered into a stock purchase agreement to acquire all of the issued and outstanding capital stock of Western World Insurance Group, Inc. ("Western World"), a specialty excess and surplus lines insurance company. On October 2, 2014, the Company completed its acquisition of Western World for an aggregate purchase price of \$690.0 million in cash, subject to adjustment based on pre-closing payments to shareholders, transaction expenses and the timing of closing as further described in the stock purchase agreement. The results of Western World have not been included in the Company's Consolidated Financial Statements as at September 30, 2014.





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## Business Outlook and Trends

We underwrite global property insurance and reinsurance and have large aggregate exposures to natural and man-made disasters. The occurrence of claims from catastrophic events results in substantial volatility, and can have material adverse effects on the Company's financial condition and results and its ability to write new business. This volatility affects results for the period in which the loss occurs because U.S. accounting principles do not permit reinsurers to reserve for such catastrophic events until they occur. Catastrophic events of significant magnitude historically have been relatively infrequent, although management believes the property catastrophe reinsurance market has experienced a higher level of worldwide catastrophic losses in terms of both frequency and severity in the period from 1992 to the present. We also expect that increases in the values and concentrations of insured property will increase the severity of such occurrences in the future. The Company seeks to reflect these types of trends when pricing contracts.

Property and other reinsurance premiums have historically risen in the aftermath of significant catastrophic losses. As loss reserves are established, industry surplus is depleted and the industry's capacity to write new business diminishes. At the same time, management believes that there is a heightened awareness of exposure to natural catastrophes on the part of cedants, rating agencies and catastrophe modeling firms, resulting in an increase in the demand for reinsurance protection. The global property and casualty insurance and reinsurance industry has historically been highly cyclical. Since 2007, increased capital provided by new entrants or by the commitment of capital by existing insurers and reinsurers increased the supply of insurance and reinsurance which resulted in a softening of rates on most lines. During 2010 and 2011, there was an increased level of catastrophe activity, principally the Chilean earthquake, Deepwater Horizon, Tohoku and New Zealand earthquake events, but the Company continues to see increased competition and decreased premium rates in most classes of business.

During the January 2013 renewal season, the Validus Re and AlphaCat segments underwrote \$655.7 million in gross premiums written, an increase of 12.7% from the prior year period. This increase was driven primarily by an increase in gross premiums written in the specialty lines. This renewal data does not include Talbot's operations as its business is distributed relatively evenly throughout the year. During the mid-year 2013 renewal period, the Validus Re segment experienced rate softening across U.S. and international property lines. The Talbot segment experienced relatively flat rate price movements in the year ended December 31, 2013 with increases being generated by the onshore energy, marine treaty and marine liability accounts offset by decreases generated by aviation accounts and the remainder of the treaty portfolio.

During the January 2014 renewal season, the Validus Re and AlphaCat segments underwrote \$575.2 million in gross premiums written, a decrease of 3.2% from the prior period, excluding the impact of the agriculture business of \$61.4 million and \$150.6 million for 2014 and 2013, respectively. This decrease was primarily driven by a challenging rate environment in the Company's U.S. property catastrophe business, which experienced a reduction in rates of approximately 12.5%. During the mid-year 2014 renewal period, the Validus Re segment experienced rate softening across U.S. and international property lines. In particular, although limits placed from the Florida market increased, the availability of capacity resulted in overall pricing reductions within this range for Florida property catastrophe business. The Talbot segment experienced a whole account rate decrease of 3.7% through September 30, 2014.

## Financial Measures

The Company believes that the primary financial indicator for evaluating performance and measuring the overall growth in value generated for shareholders is book value per diluted common share. Book value per diluted common share plus accumulated dividends, together with other important financial indicators, is shown below:

As at, or for the

Three Months Ended September 30,		Nine Months Ended September 30,		Year Ended December 31,
2014	2013	2014	2013	2013

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Book value per diluted common share plus accumulated dividends	\$47.28	\$43.05	\$47.28	\$43.05	\$43.91
Book value per diluted common share	38.70	35.67	38.70	35.67	36.23
Underwriting income	92,084	166,807	391,251	494,546	604,908
Net operating income attributable to Validus	77,256	155,237	355,954	482,303	578,672
Annualized return on average equity	4.2%	19.8%	12.8%	15.2%	17.7%

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Book value per diluted common share plus accumulated dividends is considered by management to be the primary indicator of financial performance, as we believe growth in book value on a diluted basis, plus the dividends that have accumulated, ultimately translates into the return that a shareholder will receive. Book value per diluted common share plus accumulated dividends increased by \$3.37, or 7.7%, from \$43.91 at December 31, 2013 to \$47.28 at September 30, 2014. Book value per diluted common share plus accumulated dividends increased by \$0.45, or 1.0%, from \$46.83 at June 30, 2014 to \$47.28 at September 30, 2014. Cash dividends per common share are an integral part of the value created for shareholders. The Company paid quarterly cash dividends of \$0.30 per common share and common share equivalent during the three and nine months ended September 30, 2014. On November 5, 2014, the Company announced a quarterly cash dividend of \$0.30 per common share and \$0.30 per common share equivalent for which each outstanding warrant is exercisable, payable on December 31, 2014 to holders of record on December 15, 2014. Book value per diluted common share plus accumulated dividends 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 and options and warrants outstanding (assuming their exercise), plus accumulated dividends. Book value per diluted common share plus accumulated dividends is a non-GAAP financial measure, as described in more detail in the section entitled "Non-GAAP Financial Measures."

Book value per diluted common share is considered by management to be a measure of returns to common shareholders, as we believe growth in book value on a diluted basis ultimately translates into growth in stock price. Book value per diluted common share after dividends paid, increased by \$2.47, or 6.8%, from \$36.23 at December 31, 2013 to \$38.70 at September 30, 2014. Book value per diluted common share after dividends paid, increased by \$0.15, or 0.4%, from \$38.55 at June 30, 2014 to \$38.70 at September 30, 2014. Book value per diluted common share is a non-GAAP financial measure, as described in more detail in the section entitled "Non-GAAP Financial Measures."

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 change in net unrealized gains (losses) on investments, foreign exchange gains (losses) and non-recurring items. The Company believes the reporting of underwriting income enhances the understanding of results by highlighting the underlying profitability of the Company's core insurance and reinsurance operations. Underwriting income for the three months ended September 30, 2014 and 2013 was \$92.1 million and \$166.8 million, respectively, and for the nine months ended September 30, 2014 and 2013 was \$391.3 million and \$494.5 million, respectively. Underwriting income is a non-GAAP financial measure, as described in more detail in the section entitled "Non-GAAP Financial Measures."

Net operating income available to Validus is defined as net income excluding net realized and change in net unrealized gains (losses) on investments, income (loss) from investment affiliate, foreign exchange gains (losses), non-recurring items and operating income (loss) (attributable) to noncontrolling interest. This measure focuses on the underlying fundamentals of the Company's operations without the influence of gains (losses) from the sale of investments, translation of non-U.S. dollar currencies and non-recurring items. Net operating income available to Validus for the three months ended September 30, 2014 and 2013 was \$77.3 million and \$155.2 million, respectively, and for the nine months ended September 30, 2014 and 2013 was \$356.0 million and \$482.3 million, respectively. Net operating income is a non-GAAP financial measure, as described in more detail in the section entitled "Non-GAAP Financial Measures."

Annualized return on average equity represents the return generated on common shareholders' capital during the period. Return on average equity is calculated by dividing the net income available to Validus for the period by the average shareholders' equity available to Validus during the period. Average shareholders' equity is the average of the beginning, ending and intervening quarter end shareholders' equity balances. The Company's objective is to generate superior returns on capital that appropriately rewards shareholders for the risks assumed. The annualized return on average equity for the three months ended September 30, 2014 and 2013 was 4.2% and 19.8%, respectively, and for the nine months ended September 30, 2014 and 2013 was 12.8% and 15.2%, respectively.



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## Third Quarter 2014 Summarized Consolidated Results of Operations

Gross premiums written for the three months ended September 30, 2014 were \$359.0 million compared to \$356.8 million for the three months ended September 30, 2013, an increase of \$2.2 million, or 0.6%.

Net premiums earned for the three months ended September 30, 2014 were \$494.7 million compared to \$531.3 million for the three months ended September 30, 2013, a decrease of \$36.6 million, or 6.9%.

Underwriting income for the three months ended September 30, 2014 was \$92.1 million compared to \$166.8 million for the three months ended September 30, 2013, a decrease of \$74.7 million, or 44.8%.

Combined ratio for the three months ended September 30, 2014 of 81.4% which included \$55.6 million of favorable loss reserve development on prior accident years, benefiting the loss ratio by 11.2 percentage points compared to a combined ratio for the three months ended September 30, 2013 of 68.6% which included \$65.1 million of favorable loss reserve development on prior accident years, benefiting the loss ratio by 12.2 percentage points. The favorable loss reserve development was primarily due to lower development on attritional losses. Included within the incurred losses for the three months ended September 30, 2014 of \$224.1 million, was \$61.4 million of non-notable loss events.

Loss ratio for the three months ended September 30, 2014 of 45.3% compared to 33.5% for the three months ended September 30, 2013 an increase of 11.8 percentage points.

Loss ratios by line of business are as follows:

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Percentage Point Change
Property	19.0	% 18.2	% 0.8
Marine	36.2	% 43.3	% (7.1)
Specialty	86.8	% 50.0	% 36.8
All lines	45.3	% 33.5	% 11.8

Losses and loss expenses from notable loss events for the three months ended September 30, 2014 and 2013 were \$nil.

Net investment income for the three months ended September 30, 2014 was \$25.3 million compared to \$20.0 million for the three months ended September 30, 2013, an increase of \$5.3 million, or 26.2%.

Net operating income available to Validus for the three months ended September 30, 2014 was \$77.3 million compared to \$155.2 million for the three months ended September 30, 2013, a decrease of \$78.0 million, or 50.2%.

Net income available to Validus for the three months ended September 30, 2014 was \$39.7 million, or \$0.41 per diluted common share compared to \$183.4 million or \$1.77 per diluted common share for the three months ended September 30, 2013.

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Overview of the Results of Operations for the Three Months Ended September 30, 2014 compared to the Three Months Ended September 30, 2013.

The change in net operating income available to Validus for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 is described in the following table:

	Increase (decrease) to net operating income available to Validus over the three months ended September 30 2014 compared to 2013	
(Dollars in thousands)		
Net premiums earned	\$(36,592	)
Notable loss events (a)	—	
Incurred current year losses, excluding notable loss events	(36,675	)
Prior period loss development	(9,485	)
Other underwriting deductions (b)	8,029	
Underwriting income (c)	(74,723	)
(Income) attributable to operating affiliate investors	(13,992	)
Other operating expenses and income, net (d)	7,197	
Net operating income (c)	(81,518	)
Net operating (income) loss attributable to noncontrolling interest	3,537	
Net operating income available to Validus (c)	\$(77,981	)

(a) There were no notable loss events for the three months ended September 30, 2014 and 2013.

(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.

(c) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income and operating income 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

(d) Other operating expenses and income, net, consists of net investment income, other income, finance expenses, taxes and income (loss) from operating affiliates.

Net operating income available to Validus for the three months ended September 30, 2014 was \$77.3 million compared to \$155.2 million for the three months ended September 30, 2013, a decrease of \$78.0 million or 50.2%.

The primary factors driving the decrease in net operating income available to Validus were:

• A decrease in net premiums earned of \$36.6 million, primarily within the Validus Re segment, due to a reduction in gross premiums written;

• An increase in losses and loss expenses of \$46.2 million primarily due to current quarter non-notable loss events and a decrease in favorable prior period loss development of \$9.5 million; and

• An increase in income attributable to operating affiliate investors of \$14.0 million; offset by,

• A decrease in policy acquisition costs of \$8.5 million.

#### Segment Reporting

Management has determined that the Company operates in three reportable segments - Validus Re, AlphaCat and Talbot.



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## Third Quarter 2014 Results of Operations - Validus Re Segment

The following table presents results of operations for the three months ended September 30, 2014 and 2013, respectively:

(Dollars in thousands)	Three Months Ended September 30,		
	2014	2013	
Underwriting income			
Gross premiums written	\$ 114,897	\$ 130,925	
Reinsurance premiums ceded	(10,899 )	(13,006 )	
Net premiums written	103,998	117,919	
Change in unearned premiums	122,712	157,873	
Net premiums earned	226,710	275,792	
Underwriting deductions			
Losses and loss expenses	102,005	62,250	
Policy acquisition costs	36,177	47,662	
General and administrative expenses	18,522	19,785	
Share compensation expenses	2,582	2,479	
Total underwriting deductions	159,286	132,176	
Underwriting income (a)	67,424	143,616	
Net investment income	20,762	15,628	
Other loss	(6,827 )	(1,892 )	
Finance expenses	(3,622 )	(3,640 )	
Operating income before taxes	77,737	153,712	
Tax benefit	1,058	143	
Net operating income (a)	\$ 78,795	\$ 153,855	
Selected ratios:			
Net premiums written / Gross premiums written	90.5	% 90.1	%
Losses and loss expenses	45.0	% 22.6	%
Policy acquisition costs	16.0	% 17.3	%
General and administrative expenses (b)	9.3	% 8.1	%
Expense ratio	25.3	% 25.4	%
Combined ratio	70.3	% 48.0	%

Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income and net operating income that are not calculated under standards or rules that comprise U.S.

(a) 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

(b) The general and administrative expense ratio includes share compensation expenses.





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The change in net operating income for the three months ended September 30, 2014 compared to the three months ended September 30, 2013, respectively, is described in the following table:

	Increase (decrease) to net operating income over the three months ended September 30 2014 compared to 2013	
(Dollars in thousands)		
Net premiums earned	\$(49,082	)
Notable loss events (a)	—	
Incurred current year losses, excluding notable loss events	(29,002	)
Prior period loss development	(10,753	)
Other underwriting deductions (b)	12,645	
Underwriting income (d)	(76,192	)
Other operating income and expenses, net (c)	1,132	
Net operating income (d)	\$(75,060	)

(a) There were no notable loss events for the three months ended September 30, 2014 and 2013.

(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.

(c) Other operating income and expenses, net, consists of net investment income, other income, finance expenses and taxes.

(d) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

## Gross Premiums Written

(Dollars in thousands)	Gross Premiums Written Three Months Ended September 30,			
	2014	2013	Change	
Property	\$70,595	\$96,481	\$(25,886	)
Marine	22,960	21,851	1,109	
Specialty	21,342	12,593	8,749	
Total	\$114,897	\$130,925	\$(16,028	)

The decrease in gross premiums written in the property lines of \$25.9 million was primarily due to reductions in business written in the catastrophe excess of loss, per risk and proportional lines of \$13.2 million, \$1.4 million and \$1.3 million, respectively. These decreases were as a result of current market conditions resulting in a number of non-renewals due to unfavorable pricing. In addition, variances in premium adjustments experienced on prior business led to a decrease of \$5.3 million and a further decrease of \$5.0 million was due to variances in intercompany cessions. The increase in gross premiums written of \$8.7 million in the specialty lines was primarily due to an increase in quota share premiums and renewals occurring later in 2014 than 2013.

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## Business Mix - Ratio of Gross Premiums Written by Line of Business to Total Gross Premiums Written

(Dollars in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)	
Property	\$70,595	61.4	% \$96,481	73.7	%
Marine	22,960	20.0	% 21,851	16.7	%
Specialty	21,342	18.6	% 12,593	9.6	%
Total	\$114,897	100.0	% \$130,925	100.0	%

The changes in mix of business are consistent with the changes in gross premiums written discussed above.

## Reinsurance Premiums Ceded

(Dollars in thousands)	Reinsurance Premiums Ceded			
	Three Months Ended September 30,			
	2014	2013	Change	
Property	\$3,505	\$2,337	\$1,168	
Marine	7,070	10,666	(3,596)	)
Specialty	324	3	321	
Total	\$10,899	\$13,006	\$(2,107)	)

Reinsurance premiums ceded in the marine lines decreased by \$3.6 million as a result of a reinsurance purchase occurring in the third quarter of 2013 that did not reoccur in 2014.

## Net Premiums Written

(Dollars in thousands)	Net Premiums Written			
	Three Months Ended September 30,			
	2014	2013	Change	
Property	\$67,090	\$94,144	\$(27,054)	)
Marine	15,890	11,185	4,705	
Specialty	21,018	12,590	8,428	
Total	\$103,998	\$117,919	\$(13,921)	)

The decrease in net premiums written was driven by factors highlighted above in respect of gross premiums written and reinsurance premiums ceded.

## Net Retention - Ratio of Net Premiums Written to Gross Premiums Written

(Dollars in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		
	Net Premiums Written	% of Gross Premiums Written	Net Premiums Written	% of Gross Premiums Written	
Property	\$67,090	95.0	% \$94,144	97.6	%
Marine	15,890	69.2	% 11,185	51.2	%
Specialty	21,018	98.5	% 12,590	100.0	%
Total	\$103,998	90.5	% \$117,919	90.1	%

The marine ratio increased by 18.0 percentage points due to a decrease in reinsurance premiums ceded as a result of the factors mentioned above.



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## Net Premiums Earned

(Dollars in thousands)	Net Premiums Earned Three Months Ended September 30,		
	2014	2013	Change
Property	\$114,414	\$159,454	\$(45,040 )
Marine	35,826	46,482	(10,656 )
Specialty	76,470	69,856	6,614
Total	\$226,710	\$275,792	\$(49,082 )

The decreases in the property and marine lines net premiums earned were as a result of lower gross premiums written over the past year. The increase in the specialty lines net premiums earned was due primarily to various adjustments on existing business.

## Losses and Loss Expenses

	Losses and Loss Expense Ratio - All Lines			
	Three Months Ended September 30,			
	2014	2013		
All lines—current period—notable loss events	0.0	% 0.0		%
All lines—change in prior accident years	(8.9	)% (11.2)		%
All lines—current period excluding items above	53.9	% 33.8		%
All lines—loss ratio	45.0	% 22.6		%

(Dollars in thousands)	Losses and Loss Expenses - All Lines Three Months Ended September 30,		
	2014	2013	Change
All lines—current period—notable loss events	\$—	\$—	\$—
All lines—change in prior accident years	(20,140	) (30,893	) 10,753
All lines—current period excluding items above	122,145	93,143	29,002
All lines—losses and loss expenses	\$102,005	\$62,250	\$39,755

## Notable Loss Events

There were no notable loss events for the three months ended September 30, 2014 and 2013.

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## Losses and Loss Expenses by Line of Business

	Losses and Loss Expense Ratio - Property Lines			
	Three Months Ended September 30,			
	2014	2013		
Property—current period—notable loss events	0.0	% 0.0		%
Property—change in prior accident years	(14.3)	% (11.0)		%
Property—current period excluding items above	26.2	% 11.7		%
Property—loss ratio	11.9	% 0.7		%

Losses and Loss Expenses - Property Lines  
Three Months Ended September 30,

(Dollars in thousands)	2014	2013	Change
Property—current period—notable loss events	\$—	\$—	\$—
Property—change in prior accident years	(16,384	) (17,595	) 1,211
Property—current period excluding items above	29,934	18,726	11,208
Property—losses and loss expenses	\$13,550	\$1,131	\$12,419

The property lines current quarter loss ratio, excluding the impact of notable loss events, was higher by 14.5 percentage points, representing a higher level of attritional claims experienced during the current quarter.

	Losses and Loss Expense Ratio - Marine Lines			
	Three Months Ended September 30,			
	2014	2013		
Marine—current period—notable loss events	0.0	% 0.0		%
Marine—change in prior accident years	(7.9	)% (23.7	)%	%
Marine—current period excluding items above	49.2	% 50.5		%
Marine—loss ratio	41.3	% 26.8		%

Losses and Loss Expenses - Marine Lines  
Three Months Ended September 30,

(Dollars in thousands)	2014	2013	Change
Marine—current period—notable loss events	\$—	\$—	\$—
Marine—change in prior accident years	(2,843	) (10,995	) 8,152
Marine—current period excluding items above	17,637	23,472	(5,835
Marine—losses and loss expenses	\$14,794	\$12,477	\$2,317

The marine lines experienced \$8.2 million lower favorable loss reserve development during the three months ended September 30, 2014, primarily due to lower favorable development on attritional losses. The current quarter loss ratio, excluding the impact of notable loss events, decreased by 1.3 percentage points as a result of lower attritional losses in the quarter.

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	Losses and Loss Expense Ratio - Specialty Lines			
	Three Months Ended September 30, 2014		2013	
Specialty—current period—notable loss events	0.0	%	0.0	%
Specialty—change in prior accident years	(1.2	)%	(3.3	)%
Specialty—current period excluding items above	97.5	%	72.9	%
Specialty—loss ratio	96.3	%	69.6	%

Losses and Loss Expenses - Specialty Lines  
Three Months Ended September 30,

(Dollars in thousands)	2014	2013	Change
Specialty—current period—notable loss events	\$—	\$—	\$—
Specialty—change in prior accident years	(913	) (2,303	) 1,390
Specialty—current period excluding items above	74,574	50,945	23,629
Specialty—losses and loss expenses	\$73,661	\$48,642	\$25,019

The specialty lines current quarter loss ratio, excluding the impact of notable loss events, was higher by 24.6 percentage points, due to non-notable loss events during the current quarter.

## Policy Acquisition Costs

(Dollars in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013	
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned
Property	\$19,868	17.4 %	\$28,173	17.7 %
Marine	5,966	16.7 %	9,241	19.9 %
Specialty	10,343	13.5 %	10,248	14.7 %
Total	\$36,177	16.0 %	\$47,662	17.3 %

The policy acquisition cost ratio for the marine lines decreased 3.2 percentage points primarily due to adjustments to estimates on proportional lines in the respective quarters.

## General and Administrative and Share Compensation Expenses

(Dollars in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013	
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned
General and administrative expenses	\$18,522	8.2 %	\$19,785	7.2 %
Share compensation expenses	2,582	1.1 %	2,479	0.9 %
Total	\$21,104	9.3 %	\$22,264	8.1 %

The decrease in general and administrative expenses of \$1.3 million or 6.4% was due primarily to the reduction in professional fees associated with the wind-up of certain Flagstone entities.

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## Selected Underwriting 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 losses and loss expense ratio and the expense ratio. The losses and loss expense ratio is calculated by dividing losses and loss expense 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 expense ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the three months ended September 30, 2014 and 2013.

	Three Months Ended September 30,		
	2014	2013	
Losses and loss expense ratio	45.0	% 22.6	%
Policy acquisition cost ratio	16.0	% 17.3	%
General and administrative expense ratio (a)	9.3	% 8.1	%
Expense ratio	25.3	% 25.4	%
Combined ratio	70.3	% 48.0	%

(a) Includes general and administrative expenses and share compensation expenses.

The increase in the combined ratio for the three months ended September 30, 2014 of 22.3 percentage points compared to the three months ended September 30, 2013 was due to the movement in the underlying ratios as discussed above.

## Net Investment Income

(Dollars in thousands)	Net Investment Income Three Months Ended September 30,		
	2014	2013	Change
Fixed maturities and short-term investments	\$17,538	\$16,171	\$1,367
Other investments	3,371	492	2,879
Cash and cash equivalents	1,202	627	575
Securities lending income	1	3	(2)
Total gross investment income	22,112	17,293	4,819
Investment expenses	(1,350)	(1,665)	315
Total	\$20,762	\$15,628	\$5,134

The increase in net investment income for the three months ended September 30, 2014 was \$5.1 million or 32.9% primarily due to modest asset allocation changes to diversify risk and improve portfolio yield. Net investment income from other investments includes distributed and undistributed net income from certain investments.

## Other Loss

(Dollars in thousands)	Other Loss Three Months Ended September 30,		
	2014	2013	Change
Other loss	\$(6,827)	\$(1,892)	\$(4,935)

Other loss for the three months ended September 30, 2014 resulted primarily from an adjustment of \$7.7 million to the carrying value of long-lived assets held by a Flagstone entity.



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Finance Expenses

(Dollars in thousands)	Finance Expenses		
	Three Months Ended September 30,		
	2014	2013	Change
Finance expenses	\$3,622	\$3,640	\$(18 )

Finance expenses for the three months ended September 30, 2014 and 2013 were comparable.

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## Third Quarter 2014 Results of Operations - AlphaCat Segment

The following table presents results of operations for the three months ended September 30, 2014 and 2013, respectively:

(Dollars in thousands)	Three Months Ended September 30,			
	2014	2013		
Underwriting income				
Gross premiums written	\$6,936	\$3,481		
Reinsurance premiums ceded	(648	) (525	)	)
Net premiums written	6,288	2,956		
Change in unearned premiums	28,850	34,210		
Net premiums earned	35,138	37,166		
Underwriting deductions				
Losses and loss expenses	3,738	15,615		
Policy acquisition costs	3,378	3,787		
General and administrative expenses	7,719	5,728		
Share compensation expenses	179	152		
Total underwriting deductions	15,014	25,282		
Underwriting income (a)	20,124	11,884		
Net investment income	837	967		
Other income	5,980	3,791		
Finance expenses	(385	) (80	)	)
Operating income before income from operating affiliates and (income) attributable to operating affiliate investors	26,556	16,562		
Income from operating affiliates	3,761	1,463		
(Income) attributable to operating affiliate investors	(25,807	) (11,815	)	)
Net operating income (a)	4,510	6,210		
Net operating (income) attributable to noncontrolling interest	438	(3,099	)	)
Net operating income available to Validus (a)	\$4,948	\$3,111		
Selected ratios:				
Net premiums written / Gross premiums written	90.7	% 84.9		%
Losses and loss expenses	10.6	% 42.0		%
Policy acquisition costs	9.6	% 10.2		%
General and administrative expenses (b)	22.5	% 15.8		%
Expense ratio	32.1	% 26.0		%
Combined ratio	42.7	% 68.0		%

(a) Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income and net 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. Further discussion of these measures is presented in the section entitled “Non-GAAP Financial Measures.”

(b) The general and administrative expense ratio includes share compensation expenses.

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The change in net operating income for the three months ended September 30, 2014 compared to the three months ended September 30, 2013, respectively, is described in the following table:

	Increase (decrease) to net operating income available to Validus over the three months ended September 30 2014 compared to 2013	
(Dollars in thousands)		
Net premiums earned	\$(2,028)	)
Notable loss events (a)	—	
Incurred current year losses, excluding notable loss events	11,877	
Prior period loss development	—	
Other underwriting deductions (b)	(1,609)	)
Underwriting income (d)	8,240	
(Income) attributable to operating affiliate investors	(13,992)	)
Other operating income and expenses, net (c)	4,052	
Net operating income (d)	(1,700)	)
Net operating loss (income) attributable to noncontrolling interest	3,537	
Net operating income available to Validus (d)	\$1,837	

(a) There were no notable loss events for the three months ended September 30, 2014 and 2013.

(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.

(c) Other operating income and expenses, net, consists of net investment income, other income, finance expenses, taxes and income (loss) from operating affiliates.

(d) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

## Gross Premiums Written

(Dollars in thousands)	Gross Premiums Written		
	Three Months Ended September 30,		
	2014	2013	Change
Property	\$6,936	\$3,481	\$3,455

The increase in gross premiums written in the property lines of \$3.5 million was primarily due to an increase in the capital base of the AlphaCat ILS funds for the three months ended September 30, 2014 compared to the three months ended September 30, 2013.

## Reinsurance Premiums Ceded

AlphaCat reinsurance premiums ceded for the three months ended September 30, 2014 and 2013 were \$0.6 million and \$0.5 million, respectively.

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## Net Premiums Written

(Dollars in thousands)	Net Premiums Written Three Months Ended September 30,		
	2014	2013	Change
Property	\$6,288	\$2,956	\$3,332

The increase in AlphaCat net premiums written was driven by factors highlighted above in respect of gross premiums written and reinsurance premiums ceded. The ratios of net premiums written to gross premiums written were 90.7% and 84.9% for the three months ended September 30, 2014 and 2013.

## Net Premiums Earned

(Dollars in thousands)	Net Premiums Earned Three Months Ended September 30,		
	2014	2013	Change
Property	\$35,138	\$37,166	\$(2,028)

The decrease in net premiums earned in the property lines was primarily due to the earnings patterns of gross premiums written.

## Losses and Loss Expenses

	Losses and Loss Expense Ratio - Property Lines			
	Three Months Ended September 30,			
	2014		2013	
Property—current period—notable loss events	0.0	%	0.0	%
Property—change in prior accident years	0.0	%	0.0	%
Property—current period excluding items above	10.6	%	42.0	%
Property—loss ratio	10.6	%	42.0	%

(Dollars in thousands)	Losses and Loss Expenses - Property Lines Three Months Ended September 30,		
	2014	2013	Change
Property—current period—notable loss events	\$—	\$—	\$—
Property—change in prior accident years	—	—	—
Property—current period excluding items above	3,738	15,615	(11,877)
Property—losses and loss expenses	\$3,738	\$15,615	\$(11,877)

The property lines current quarter loss ratio, excluding the impact of notable loss events, was lower by 31.4 percentage points, representing a lower level of attritional claims experienced during the current quarter.

## Notable Loss Events

There were no notable loss events for the three months ended September 30, 2014 and 2013.

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## Policy Acquisition Costs

(Dollars in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
Property	\$3,378	9.6	% \$3,787	10.2	%

The policy acquisition cost ratios for the three months ended September 30, 2014 and 2013 were comparable.

## General and Administrative and Share Compensation Expenses

(Dollars in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
General and administrative expenses	\$7,719	22.0	% \$5,728	15.4	%
Share compensation expenses	179	0.5	% 152	0.4	%
Total	\$7,898	22.5	% \$5,880	15.8	%

The increase in general and administrative expenses of \$2.0 million or 34.8% was due primarily to an increase in professional fees of \$1.7 million relating to PaCRe.

## Selected Underwriting Ratios

The following table presents the losses and loss expense ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the three months ended September 30, 2014 and 2013.

	Three Months Ended September 30,		
	2014	2013	
Losses and loss expense ratio	10.6	% 42.0	%
Policy acquisition cost ratio	9.6	% 10.2	%
General and administrative expense ratio (a)	22.5	% 15.8	%
Expense ratio	32.1	% 26.0	%
Combined ratio	42.7	% 68.0	%

(a) Includes general and administrative expenses and share compensation expenses.

The decrease in the combined ratio for the three months ended September 30, 2014 of 25.3 percentage points compared to the three months ended September 30, 2013 was due to the movement in the underlying ratios as discussed above.

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## Net Investment Income

(Dollars in thousands)	Net Investment Income Three Months Ended September 30,		
	2014	2013	Change
Fixed maturities and short-term investments	\$818	\$958	\$(140 )
Cash and cash equivalents	19	9	10
Total net investment income	\$837	\$967	\$(130 )

Net investment income for the three months ended September 30, 2014 and 2013 was comparable.

## Other Income

(Dollars in thousands)	Other Income Three Months Ended September 30,		
	2014	2013	Change
Other income	\$5,980	\$3,791	\$2,189

The increase in other income of \$2.2 million, or 57.7%, is primarily due to a reduction in performance fees in the prior year quarter as a result of a loss incurred by AlphaCat 2013 in the third quarter of 2013.

## Finance Expenses

(Dollars in thousands)	Finance Expenses Three Months Ended September 30,		
	2014	2013	Change
Finance expenses	\$385	\$80	\$305

Finance expenses for the three months ended September 30, 2014 and 2013 were comparable.

## Income From Operating Affiliates

(Dollars in thousands)	Income from Operating Affiliates Three Months Ended September 30,		
	2014	2013	Change
AlphaCat Re 2011	\$(5 )	\$(270 )	\$265
AlphaCat Re 2012	(9 )	(7 )	(2 )
AlphaCat 2013	7	585	(578 )
AlphaCat 2014	1,367	—	1,367
AlphaCat ILS funds	2,401	1,155	1,246
Total	\$3,761	\$1,463	\$2,298

For details of voting and equity ownership interests of the above entities, refer to Note 5 to the Consolidated Financial Statements in Part I. The increase in income from operating affiliates for the three months ended September 30, 2014 was due to additional income as a result of the deconsolidation of one of the AlphaCat ILS funds in the first quarter of 2014.

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## (Income) Attributable To Operating Affiliate Investors

(Dollars in thousands)	(Income) Attributable to Operating Affiliate Investors		
	Three Months Ended September 30,		
	2014	2013	Change
(Income) attributable to operating affiliate investors	\$(25,807	) \$(11,815	) \$(13,992

Income attributable to operating affiliate investors for the three months ended September 30, 2014 was \$25.8 million compared to \$11.8 million for the three months ended September 30, 2013, reflecting the increased transfer of economics as a result of the deconsolidation of one of the AlphaCat ILS funds in the first quarter of 2014. This balance represents the transfer of investors' economic interest in the non-consolidated affiliated entities and includes both the Company's and third-party investors' share.

## Net Operating Loss (Income) Attributable to Noncontrolling Interest

(Dollars in thousands)	Net Operating (Income) Loss Attributable to Noncontrolling Interest		
	Three Months Ended September 30,		
	2014	2013	Change
Net operating loss (income) attributable to noncontrolling interest	\$438	\$(3,099	) \$3,537

For the three months ended September 30, 2014, the net operating loss attributable to noncontrolling interest was \$0.4 million, which comprised \$0.4 million relating to 90% of the net operating income in PaCRE for the current quarter and \$nil of net operating income relating to the consolidated AlphaCat ILS fund.



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## Third Quarter 2014 Results of Operations - Talbot Segment

The following table presents results of operations for the three months ended September 30, 2014 and 2013, respectively:

(Dollars in thousands)	Three Months Ended September 30,	
	2014	2013
Underwriting income		
Gross premiums written	\$245,685	\$246,468
Reinsurance premiums ceded	(27,134	) (49,998
Net premiums written	218,551	196,470
Change in unearned premiums	14,297	21,860
Net premiums earned	232,848	218,330
Underwriting deductions		
Losses and loss expenses	118,382	100,100
Policy acquisition costs	47,862	44,899
General and administrative expenses	37,709	37,402
Share compensation expenses	2,990	2,992
Total underwriting deductions	206,943	185,393
Underwriting income (a)	25,905	32,937
Net investment income	4,965	4,395
Other income	109	73
Finance expenses	162	(107
Operating income before taxes	31,141	37,298
Tax benefit (expense)	332	(513
Net operating income (a)	\$31,473	\$36,785
Selected ratios:		
Net premiums written / Gross premiums written	89.0	% 79.7
Losses and loss expenses	50.8	% 45.8
Policy acquisition costs	20.6	% 20.6
General and administrative expenses (b)	17.5	% 18.5
Expense ratio	38.1	% 39.1
Combined ratio	88.9	% 84.9

Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income and net operating income that are not calculated under standards or rules that comprise U.S.

(a) 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

(b) The general and administrative expense ratio includes share compensation expenses.



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The change in net operating income for the three months ended September 30, 2014 compared to the three months ended September 30, 2013, respectively, is described in the following table:

(Dollars in thousands)	Increase (decrease) to net operating income over the three months ended September 30 2014 compared to 2013
Net premiums earned	\$14,518
Notable loss events (a)	—
Incurred current year losses, excluding notable loss events	(19,550 )
Prior period loss development	1,268
Other underwriting deductions (b)	(3,268 )
Underwriting income (d)	(7,032 )
Other operating income and expenses, net (c)	1,720
Net operating income (d)	\$(5,312 )

(a) There were no notable loss events for the three months ended September 30, 2014 and 2013.

(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.

(c) Other operating income and expenses, net, consists of net investment income, other income, finance expenses and taxes.

(d) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

## Gross Premiums Written

(Dollars in thousands)	Gross Premiums Written Three Months Ended September 30,		
	2014	2013	Change
Property	\$67,043	\$82,806	\$(15,763 )
Marine	90,794	75,837	14,957
Specialty	87,848	87,825	23
Total	\$245,685	\$246,468	\$(783 )

The decrease in gross premiums written in the property lines of \$15.8 million was primarily due to decreases in the property treaty lines of \$15.7 million related to Latin American business being written directly through Validus Re Swiss. This business was previously written by Talbot and ceded to Validus Re. The increase in gross premiums written in the marine lines of \$15.0 million was due primarily to an increase in the energy and marine energy and liability lines of \$6.4 million and \$3.8 million, respectively. These increases were due primarily to new business being written and renewals incepting in the third quarter of 2014 compared to the fourth quarter of 2013.

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## Business Mix - Ratio of Gross Premiums Written by Line of Business to Total Gross Premiums Written

(Dollars in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)	
Property	\$67,043	27.3	% \$82,806	33.6	%
Marine	90,794	37.0	% 75,837	30.8	%
Specialty	87,848	35.8	% 87,825	35.6	%
Total	\$245,685	100.0	% \$246,468	100.0	%

The changes in mix of business were consistent with the changes in gross premiums written discussed above.

## Reinsurance Premiums Ceded

(Dollars in thousands)	Reinsurance Premiums Ceded		
	Three Months Ended September 30,		
	2014	2013	Change
Property	\$17,235	\$34,964	\$(17,729)
Marine	(1,355)	1,635	(2,990)
Specialty	11,254	13,399	(2,145)
Total	\$27,134	\$49,998	\$(22,864)

The decrease in reinsurance premiums ceded in the property lines of \$17.7 million was due primarily to decreases in the property treaty and direct property lines of \$12.3 million and \$2.1 million, respectively due to lower quota share premiums as a result of business being written directly through Validus Re Swiss. This business was previously written by Talbot and ceded to Validus Re.

## Net Premiums Written

(Dollars in thousands)	Net Premiums Written		
	Three Months Ended September 30,		
	2014	2013	Change
Property	\$49,808	\$47,842	\$1,966
Marine	92,149	74,202	17,947
Specialty	76,594	74,426	2,168
Total	\$218,551	\$196,470	\$22,081

The increase in Talbot net premiums written was driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded.

## Net Retention - Ratio of Net Premiums Written to Gross Premiums Written

(Dollars in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		
	Net Premiums Written	% of Gross Premiums Written	Net Premiums Written	% of Gross Premiums Written	
Property	\$49,808	74.3	% \$47,842	57.8	%
Marine	92,149	101.5	% 74,202	97.8	%
Specialty	76,594	87.2	% 74,426	84.7	%
Total	\$218,551	89.0	% \$196,470	79.7	%

The property ratio increased by 16.5 percentage points due to the Latin American business being written directly through Validus Re Swiss. This business was previously written by Talbot and ceded to Validus Re.

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## Net Premiums Earned

(Dollars in thousands)	Net Premiums Earned Three Months Ended September 30,		
	2014	2013	Change
Property	\$52,130	\$49,935	\$2,195
Marine	99,774	92,514	7,260
Specialty	80,944	75,881	5,063
Total	\$232,848	\$218,330	\$14,518

The changes in net premiums earned were consistent with the pattern of net premiums written influencing the earned premiums for the three months ended September 30, 2014 compared to the three months ended September 30, 2013.

## Losses and Loss Expenses

	Losses and Loss Expense Ratio - All Lines			
	Three Months Ended September 30, 2014		2013	
All lines—current period—notable loss events	0.0	%	0.0	%
All lines—change in prior accident years	(15.2)	%	(15.7)	%
All lines—current period excluding items above	66.0	%	61.5	%
All lines—loss ratio	50.8	%	45.8	%

(Dollars in thousands)	Losses and Loss Expenses - All Lines Three Months Ended September 30,		
	2014	2013	Change
All lines—current period—notable loss events	\$—	\$—	\$—
All lines—change in prior accident years	(35,425	) (34,157	) (1,268
All lines—current period excluding items above	153,807	134,257	19,550
All lines - losses and loss expenses	\$118,382	\$100,100	\$18,282

## Notable Loss Events

There were no notable loss events for the three months ended September 30, 2014 and 2013.

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## Losses and Loss Expenses by Line of Business

	Losses and Loss Expense Ratio - Property Lines			
	Three Months Ended September 30,			
	2014	2013		
Property—current period—notable loss events	0.0	% 0.0		%
Property—change in prior accident years	(25.5)	% (3.9)		%
Property—current period excluding items above	65.9	% 60.3		%
Property—loss ratio	40.4	% 56.4		%

Losses and Loss Expenses - Property Lines  
Three Months Ended September 30,

(Dollars in thousands)	2014	2013	Change	
Property—current period—notable loss events	\$—	\$—	\$—	
Property—change in prior accident years	(13,285	) (1,953	) (11,332	)
Property—current period excluding items above	34,340	30,137	4,203	
Property—losses and loss expenses	\$21,055	\$28,184	\$(7,129	)

The property lines experienced \$11.3 million higher favorable loss reserve development in the current quarter, primarily due to higher favorable development on non-notable loss events. The property lines current quarter loss ratio, excluding the impact of notable loss events was higher by 5.6 percentage points, representing a higher level of non-notable loss events experienced during the current quarter.

	Losses and Loss Expense Ratio - Marine Lines			
	Three Months Ended September 30,			
	2014	2013		
Marine—current period—notable loss events	0.0	% 0.0		%
Marine—change in prior accident years	(12.0	)% (13.2	)%	)%
Marine—current period excluding items above	46.4	% 64.7		%
Marine—loss ratio	34.4	% 51.5		%

Losses and Loss Expenses - Marine Lines  
Three Months Ended September 30,

(Dollars in thousands)	2014	2013	Change	
Marine—current period—notable loss events	\$—	\$—	\$—	
Marine—change in prior accident years	(11,922	) (12,216	) 294	
Marine—current period excluding items above	46,278	59,875	(13,597	)
Marine—losses and loss expenses	\$34,356	\$47,659	\$(13,303	)

The marine lines current quarter loss ratio, excluding the impact of notable loss events, decreased by 18.3 percentage points primarily due to a lower level of non-notable loss events experienced during the current quarter.

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	Losses and Loss Expense Ratio - Specialty Lines			
	Three Months Ended September 30,			
	2014		2013	
Specialty—current period—notable loss events	0.0	%	0.0	%
Specialty—change in prior accident years	(12.6	)%	(26.3)	%
Specialty—current period excluding items above	90.4	%	58.3	%
Specialty—loss ratio	77.8	%	32.0	%

	Losses and Loss Expenses - Specialty Lines			
	Three Months Ended September 30,			
(Dollars in thousands)	2014	2013	Change	
Specialty—current period—notable loss events	\$—	\$—	\$—	
Specialty—change in prior accident years	(10,218	)	(19,988	) 9,770
Specialty—current period excluding items above	73,189	44,245	28,944	
Specialty—losses and loss expenses	\$62,971	\$24,257	\$38,714	

The specialty lines experienced \$9.8 million lower favorable loss reserve development in the current quarter, primarily as a result of lower favorable development on attritional losses. The current quarter loss ratio, excluding the impact of notable loss events, increased by 32.1 percentage points, representing a higher level of non-notable loss events experienced during the current quarter.

## Policy Acquisition Costs

	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		
(Dollars in thousands)	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
Property	\$6,930	13.3	% \$6,373	12.8	%
Marine	22,846	22.9	% 21,279	23.0	%
Specialty	18,086	22.3	% 17,247	22.7	%
Total	\$47,862	20.6	% \$44,899	20.6	%

The property acquisition cost ratios were comparable for the three months ended September 30, 2014 and 2013.

## General and Administrative and Share Compensation Expenses

	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		
(Dollars in thousands)	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
General and administrative expenses	37,709	16.2	% 37,402	17.1	%
Share compensation expenses	2,990	1.3	% 2,992	1.4	%
Total	\$40,699	17.5	% \$40,394	18.5	%

General and administrative and share compensation expenses were comparable for the three months ended September 30, 2014 and 2013.



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## Selected Underwriting Ratios

The following table presents the losses and loss expense ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the three months ended September 30, 2014 and 2013.

	Three Months Ended September 30,		
	2014	2013	
Losses and loss expense ratio	50.8	% 45.8	%
Policy acquisition cost ratio	20.6	% 20.6	%
General and administrative expense ratio (a)	17.5	% 18.5	%
Expense ratio	38.1	% 39.1	%
Combined ratio	88.9	% 84.9	%

(a) Includes general and administrative expenses and share compensation expenses.

The increase in the combined ratio for the three months ended September 30, 2014 of 4.0 percentage points compared to the three months ended September 30, 2013 was due to the movement in the underlying ratios as discussed above.

## Net Investment Income

(Dollars in thousands)	Investment Income		
	Three Months Ended September 30,		
	2014	2013	Change
Fixed maturities and short-term investments	\$4,999	\$4,296	\$703
Cash and cash equivalents	360	443	(83)
Total gross investment income	5,359	4,739	620
Investment expenses	(394)	(344)	(50)
Total	\$4,965	\$4,395	\$570

Net investment income for the three months ended September 30, 2014 and 2013 was comparable.

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## Third Quarter Non-Segment Discussion

## Corporate Expenses

Corporate general and administrative expenses for the three months ended September 30, 2014, net of eliminations related to the operating segments, were \$19.4 million compared to \$18.2 million for the three months ended September 30, 2013, an increase of \$1.2 million or 6.6%. General and administrative expenses have increased primarily due to an increase in headcount and the performance bonus accrual; offset by, a decrease in severance expenses relating to the departure of employees in the prior year quarter. Also, contributing to the increase was an increase in information technology expenses during the quarter. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other costs relating to the Company as a whole.

Corporate share compensation expenses for the three months ended September 30, 2014 were \$3.0 million compared to \$4.9 million for the three months ended September 30, 2013, a decrease of \$1.9 million or 38.6%. The decrease of \$1.9 million was primarily due to non-recurring expenses in 2013 from the acceleration of unvested awards in the prior year quarter relating to the departure of employees.

Corporate finance expenses for the three months ended September 30, 2014, net of eliminations related to the operating segments, were \$11.5 million compared to \$11.5 million for the three months ended September 30, 2013, an increase of \$nil.

Transaction expenses for the three months ended September 30, 2014 were \$0.1 million compared to \$nil for the three months ended September 30, 2013, an increase of \$0.1 million. The transaction expenses relate to costs incurred in connection with the acquisition of Western World, which was completed on October 2, 2014. The Company incurred an additional \$4.0 million of transaction expenses which will be recognized in the fourth quarter of 2014. Western World results have not been included in the Company's consolidated results for the three months ended September 30, 2014. Transaction expenses are primarily comprised of legal, financial advisory and audit related services.

## Third Quarter Non-Operating Income and Expenses

The following non-operating income and expense items are discussed on a consolidated basis, since the Company does not include these items when assessing the results of its operating segments.

## Net Realized and Change in Net Unrealized (Losses) Gains on Investments

(Dollars in thousands)	Net Realized and Change in Net Unrealized (Losses) Gains on Investments Three Months Ended September 30,		
	2014	2013	Change
Net realized gains (losses) on investments	\$4,595	\$(6,320)	) \$10,915
Change in net unrealized (losses) gains on investments	(84,974	) 69,967	(154,941 )
Net realized and change in net unrealized (losses) gains on investments	\$(80,379	) \$63,647	\$(144,026 )

The movement in the net realized and change in net unrealized (losses) gains on investments of \$(144.0) million was due to an unfavorable movement in net realized and unrealized (losses) gains on fixed maturity and short term investments of \$(38.0) million and an unfavorable movement in net realized and unrealized (losses) gains on other investments of \$(106.0) million.

The unfavorable movement on fixed maturity and short term investments was primarily as a result of an upward shift in the two-to-seven year portion of the yield curve during the current quarter. The unfavorable movement on other investments was primarily due to the change in net unrealized (losses) of \$(104.3) million on the Paulson hedge funds held by PaCRE. This is offset by a 90% noncontrolling interest of \$93.9 million.

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## Income From Investment Affiliate

(Dollars in thousands)	Income From Investment Affiliate Three Months Ended September 30,		
	2014	2013	Change
Income from investment affiliate	\$1,754	\$1,044	\$710

The income from investment affiliate relates to the income earned from the Company's investment in the Aquiline Financial Services Fund II L.P. which is recorded on a three-month lag and therefore reflects the underlying performance of that fund for the previous quarter.

## Foreign Exchange (Losses) Gains

The Company's reporting currency is the U.S. dollar. As a significant portion of the Company's operations are transacted in currencies other than the U.S. dollar, fluctuations in foreign exchange rates may affect period-to-period comparisons. The Company's largest foreign currency fluctuation exposures are to the following currencies, with the movement in each currency against the U.S. dollar shown in the table below:

U.S. dollar strengthened (weakened) against:	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013
British Pound sterling	5.6	% (6.0 )%
Euro	8.5	% (3.7 )%
Canadian dollar	5.1	% (1.8 )%
Swiss franc	7.8	% (4.1 )%
Australian dollar	8.5	% (1.6 )%
New Zealand dollar	12.7	% (6.3 )%
Singapore dollar	2.5	% (1.0 )%
Japanese yen	8.3	% (0.8 )%

(Dollars in thousands)	Foreign Exchange (Losses) Gains Three Months Ended September 30,		
	2014	2013	Change
Foreign exchange (losses) gains	\$(11,441 )	\$6,036	\$(17,477 )

Foreign exchange losses for the three months ended September 30, 2014 were (\$11.4) million compared to foreign exchange gains of \$6.0 million for the three months ended September 30, 2013, a decrease of \$17.5 million, or 289.5%, due primarily to the U.S. dollar strengthening against the Australian and New Zealand dollars as well as the Japanese yen.

## Net Loss (Income) Attributable to Noncontrolling Interest

(Dollars in thousands)	Net Loss (Income) Attributable to Noncontrolling Interest Three Months Ended September 30,		
	2014	2013	Change
Net loss (income) attributable to noncontrolling interest	\$53,069	\$(45,694 )	\$98,763

For the three months ended September 30, 2014, the net loss attributable to noncontrolling interest was \$53.1 million, which was comprised of an operating loss of \$0.4 million, as discussed in the AlphaCat Segment Results of Operations, and a non-operating loss of \$52.6 million, primarily on the investment portfolio within PaCRe.

For the three months ended September 30, 2013, net income attributable to noncontrolling interest was \$45.7 million, which was comprised of operating income of \$3.1 million, as discussed in the AlphaCat Segment Results of Operations, and non-operating income of \$42.6 million, primarily on the investment portfolio within PaCRe.



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## Year to Date 2014 Summarized Consolidated Results of Operations

Gross premiums written for the nine months ended September 30, 2014 were \$2,026.6 million compared to \$2,163.8 million for the nine months ended September 30, 2013, a decrease of \$137.2 million, or 6.3%.

Net premiums earned for the nine months ended September 30, 2014 were \$1,443.7 million compared to \$1,609.8 million for the nine months ended September 30, 2013, a decrease of \$166.2 million, or 10.3%.

Underwriting income for the nine months ended September 30, 2014 was \$391.3 million compared to \$494.5 million for the nine months ended September 30, 2013, a decrease of \$103.3 million, or 20.9%.

Combined ratio for the nine months ended September 30, 2014 of 72.9% which included \$167.6 million of favorable loss reserve development on prior accident years, benefiting the loss ratio by 11.6 percentage points compared to a combined ratio for the nine months ended September 30, 2013 of 69.3% which included \$171.8 million of favorable loss reserve development on prior accident years, benefiting the loss ratio by 10.7 percentage points.

Loss ratio for the nine months ended September 30, 2014 of 37.8% compared to 36.5% for the nine months ended September 30, 2013, an increase of 1.3 percentage points.

Loss ratios by line of business are as follows:

	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		Percentage Point Change
Property	14.4	%	18.9	%	(4.5 )
Marine	44.8	%	49.5	%	(4.7 )
Specialty	63.5	%	55.3	%	8.2
All lines	37.8	%	36.5	%	1.3

Losses and loss expenses from notable loss events for the nine months ended September 30, 2014 and September 30, 2013 were \$nil and \$62.7 million, respectively. The prior year notable loss event was the European floods.

Net investment income for the nine months ended September 30, 2014 was \$69.9 million compared to \$71.9 million for the nine months ended September 30, 2013, a decrease of \$2.0 million, or 2.7%.

Net operating income available to Validus for the nine months ended September 30, 2014 was \$356.0 million compared to \$482.3 million for the nine months ended September 30, 2013, a decrease of \$126.3 million, or 26.2%.

Net income available to Validus for the nine months ended September 30, 2014 was \$355.4 million, or \$3.70 per diluted common share compared to \$437.3 million or \$3.99 per diluted common share for the nine months ended September 30, 2013.

Transaction expenses for the nine months ended September 30, 2014 were \$3.4 million compared to \$nil for the nine months ended September 30, 2013, an increase of \$3.4 million. The transaction expenses relate to costs incurred in connection with the acquisition of Western World, which was completed on October 2, 2014. Western World results have not been included in the Company's consolidated results for the nine months ended September 30, 2014.

Transaction expenses are primarily comprised of legal, financial advisory and audit related services.

Investment yield for the nine months ended September 30, 2014 was 1.28% compared to 1.30% for the nine months ended September 30, 2013.

Annualized return on average equity and annualized net operating return on average equity for the nine months ended September 30, 2014 were 12.8% and 12.8%, respectively, compared to 15.2% and 16.8% for the nine months ended September 30, 2013.

Total investments and cash as at September 30, 2014 was \$7.9 billion compared to \$8.0 billion at December 31, 2013.

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Overview of the Results of Operations for the Nine Months Ended September 30, 2014 compared to the Nine Months Ended September 30, 2013.

The change in net operating income available to Validus for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013 is described in the following table:

	Increase (decrease) to net operating income available to Validus over the nine months ended September 30, 2014 compared to 2013	
(Dollars in thousands)		
Net premiums earned	\$(166,151	)
Notable loss events (a)	62,731	
Incurred current year losses, excluding notable loss events	(16,291	)
Prior period loss development	(4,201	)
Other underwriting deductions (b)	20,617	
Underwriting income (c)	(103,295	)
(Income) attributable to operating affiliate investors	(40,677	)
Other operating expenses and income, net (d)	12,784	
Net operating income (c)	(131,188	)
Net operating (income) loss attributable to noncontrolling interest	4,839	
Net operating income available to Validus (c)	\$(126,349	)

(a) There were no notable loss events for the nine months ended September 30, 2014. The notable loss event for the nine months ended September 30, 2013 was the European Floods.

(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.

Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income and operating income 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

(d) Other operating expenses and income, net, consists of net investment income, other income, finance expenses, taxes and income (loss) from operating affiliates.

Net operating income available to Validus for the nine months ended September 30, 2014 was \$356.0 million compared to \$482.3 million for the nine months ended September 30, 2013, a decrease of \$126.3 million or 26.2%.

The primary factors driving the decrease in net operating income were:

A decrease in net premiums earned of \$166.2 million, primarily within the Validus Re segment, due to a reduction in gross premiums written, the timing of the purchase of retrocessional coverage and the effect of the Flagstone run-off business; and

• An increase in income attributable to operating affiliate investors of \$40.7 million; offset by,

- A decrease in losses and loss expenses of \$42.2 million primarily due to a reduction in notable loss events of \$62.7 million; offset by an increase in current year losses, excluding notable loss events, of \$16.3 million and a decrease in favorable prior period development of \$4.2 million; and

• A decrease in policy acquisition costs of \$24.7 million.

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## Year To Date 2014 Results of Operations - Validus Re Segment

The following table presents results of operations for the nine months ended September 30, 2014 and 2013, respectively:

(Dollars in thousands)	Nine Months Ended September 30,		
	2014	2013	
Underwriting income			
Gross premiums written	\$ 1,104,169	\$ 1,232,272	
Reinsurance premiums ceded	(184,074 )	(226,292 )	
Net premiums written	920,095	1,005,980	
Change in unearned premiums	(233,271 )	(122,303 )	
Net premiums earned	686,824	883,677	
Underwriting deductions			
Losses and loss expenses	247,848	319,298	
Policy acquisition costs	106,547	142,195	
General and administrative expenses	53,757	69,649	
Share compensation expenses	7,126	5,421	
Total underwriting deductions	415,278	536,563	
Underwriting income (a)	271,546	347,114	
Net investment income	56,285	61,770	
Other income	912	11,237	
Finance expenses	(11,131 )	(12,133 )	
Operating income before taxes	317,612	407,988	
Tax benefit	1,176	1,755	
Net operating income (a)	\$ 318,788	\$ 409,743	
Selected ratios:			
Net premiums written / Gross premiums written	83.3	% 81.6	%
Losses and loss expenses	36.1	% 36.1	%
Policy acquisition costs	15.5	% 16.1	%
General and administrative expenses (b)	8.9	% 8.5	%
Expense ratio	24.4	% 24.6	%
Combined ratio	60.5	% 60.7	%

Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income and net operating income that are not calculated under standards or rules that comprise U.S.

(a) 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

(b) The general and administrative expense ratio includes share compensation expenses.





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The change in net operating income for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013, respectively, is described in the following table:

	Increase (decrease) to net operating income over the nine months ended September 30, 2014 compared to 2013	
(Dollars in thousands)		
Net premiums earned	\$(196,853	)
Notable loss events (a)	55,316	
Incurred current year losses, excluding notable loss events	21,988	
Prior period loss development	(5,854	)
Other underwriting deductions (b)	49,835	
Underwriting income (d)	(75,568	)
Other operating income and expenses, net (c)	(15,387	)
Net operating income (d)	\$(90,955	)

(a) There were no notable loss events for the nine months ended September 30, 2014. The notable loss event for the nine months ended September 30, 2013 was the European Floods.

(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.

(c) Other operating income and expenses, net, consists of net investment income, other income, finance expenses and taxes.

(d) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

## Gross Premiums Written

(Dollars in thousands)	Gross Premiums Written			
	Nine Months Ended September 30,			
	2014	2013	Change	
Property	\$617,023	\$727,404	\$(110,381	)
Marine	175,706	194,047	(18,341	)
Specialty	311,440	310,821	619	
Total	\$1,104,169	\$1,232,272	\$(128,103	)

The decrease in gross premiums written in the property lines of \$110.4 million was primarily due to reductions in business written in the catastrophe excess of loss and per risk lines of \$102.6 million and \$7.7 million, respectively. These decreases were as a result of current market conditions, the impact of a program that was withdrawn and a number of non-renewals due to both unfavorable pricing and the proposed inclusion of terror exposure on some programs without an appropriate premium for the additional risk. The decrease in gross premiums written of \$18.3 million in the marine lines was primarily due to non-renewals and some business historically written in marine lines being renewed in specialty lines. The increase in gross premiums written of \$0.6 million in the specialty lines was primarily due to new composite and trade credit business of \$20.3 million and \$16.1 million, respectively; offset by a \$39.6 million reduction in agricultural business as a result of reduced participation in a number of quota share agreements.



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## Business Mix - Ratio of Gross Premiums Written by Line of Business to Total Gross Premiums Written

(Dollars in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)	
Property	\$617,023	55.9	% \$727,404	59.1	%
Marine	175,706	15.9	% 194,047	15.7	%
Specialty	311,440	28.2	% 310,821	25.2	%
Total	\$1,104,169	100.0	% \$1,232,272	100.0	%

The changes in mix of business were consistent with the changes in gross premiums written discussed above.

## Reinsurance Premiums Ceded

(Dollars in thousands)	Reinsurance Premiums Ceded Nine Months Ended September 30,		
	2014	2013	Change
Property	\$153,896	\$171,382	\$(17,486)
Marine	21,002	15,831	5,171
Specialty	9,176	39,079	(29,903)
Total	\$184,074	\$226,292	\$(42,218)

Reinsurance premiums ceded in the property lines decreased by \$17.5 million, due to significant restructuring of retrocessional coverage purchased, reflecting more favorable market conditions in the current nine months. The increase in reinsurance premiums in the marine lines of \$5.2 million was primarily due to additional quota share coverage purchased in the first quarter of 2014 as a result of price reductions and broader coverage and terms available in the market. The decrease in reinsurance premiums ceded in the specialty lines of \$29.9 million was due primarily to the non-renewal of proportional coverage that was purchased in the first quarter of 2013 related to the agriculture business.

## Net Premiums Written

(Dollars in thousands)	Net Premiums Written Nine Months Ended September 30,		
	2014	2013	Change
Property	\$463,127	\$556,022	\$(92,895)
Marine	154,704	178,216	(23,512)
Specialty	302,264	271,742	30,522
Total	\$920,095	\$1,005,980	\$(85,885)

The changes in Validus Re net premiums written were driven by factors highlighted above in respect of gross premiums written and reinsurance premiums ceded.

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(Dollars in thousands)	Net Retention - Ratio of Net Premiums Written to Gross Premiums Written					
	Nine Months Ended September 30, 2014			Nine Months Ended September 30, 2013		
	Net Premiums Written	% of Gross Premiums Written		Net Premiums Written	% of Gross Premiums Written	
Property	\$463,127	75.1	%	\$556,022	76.4	%
Marine	154,704	88.0	%	178,216	91.8	%
Specialty	302,264	97.1	%	271,742	87.4	%
Total	\$920,095	83.3	%	\$1,005,980	81.6	%

The marine ratio has decreased by 3.8 percentage points due to an increase in ceded premiums as a result of the factors mentioned above. The specialty ratio has increased by 9.7 percentage points due to the decrease in reinsurance coverage purchased on the agriculture business.

## Net Premiums Earned

(Dollars in thousands)	Net Premiums Earned		
	Nine Months Ended September 30, 2014	2013	Change
Property	\$354,061	\$520,576	\$(166,515 )
Marine	117,521	155,461	(37,940 )
Specialty	215,242	207,640	7,602
Total	\$686,824	\$883,677	\$(196,853 )

The decreases in the property and marine lines net premiums earned were as a result of lower gross premiums written and the tail of the Flagstone run-off as premiums were earned in the first nine months of 2013 with no comparative amounts for the nine months ended September 30, 2014. The increase in the specialty lines net premiums earned was due primarily to various adjustments on existing business.

## Losses and Loss Expenses

	Losses and Loss Expense Ratio - All Lines			
	Nine Months Ended September 30, 2014		2013	
		%		%
All lines—current period—notable loss events	0.0	%	6.3	%
All lines—change in prior accident years	(8.3	)%	(7.1	)%
All lines—current period excluding items above	44.4	%	36.9	%
All lines—loss ratio	36.1	%	36.1	%

(Dollars in thousands)	Losses and Loss Expenses - All Lines		
	Nine Months Ended September 30, 2014	2013	Change
All lines—current period—notable loss events	\$—	\$55,316	\$(55,316 )
All lines—change in prior accident years	(56,836 )	(62,690 )	5,854
All lines—current period excluding items above	304,684	326,672	(21,988 )
All lines—losses and loss expenses	\$247,848	\$319,298	\$(71,450 )

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## Notable Loss Events

There were no notable loss events for the nine months ended September 30, 2014. In comparison, notable loss events incurred in the nine months ended September 30, 2013 of \$55.3 million were from a single notable loss event, the European Floods, which represented 6.3 percentage points of the loss ratio. Net of \$5.0 million of reinstatement premiums, the effect of this event on net operating income was a \$50.4 million reduction.

## Losses and Loss Expenses by Line of Business

	Losses and Loss Expense Ratio - Property Lines			
	Nine Months Ended September 30,			
	2014		2013	
Property—current period—notable loss event	0.0	%	10.6	%
Property—change in prior accident years	(14.3	)%	(19.0	)%
Property—current period excluding items above	23.8	%	22.5	%
Property—loss ratio	9.5	%	14.1	%

Losses and Loss Expenses - Property Lines  
Nine Months Ended September 30,

(Dollars in thousands)	2014	2013	Change		
Property—current period—notable loss event	\$—	\$55,316	\$(55,316	)	
Property—change in prior accident years	(50,598	)	(99,186	)	48,588
Property—current period excluding items above	84,261	117,082	(32,821	)	
Property—losses and loss expenses	\$33,663	\$73,212	\$(39,549	)	

The property lines experienced \$48.6 million lower favorable loss reserve development, due to lower favorable emergence of notable loss events and lower favorable development on attritional losses during the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. In addition, there was favorable development on a number of notable loss events in the nine months ended September 30, 2013, primarily the Chilean earthquake, Hurricane Isaac and Cat 67. The current period loss ratio, excluding the impact of notable loss events, was comparable for the nine months ended September 30, 2014 and 2013.

	Losses and Loss Expense Ratio - Marine Lines			
	Nine Months Ended September 30,			
	2014		2013	
Marine—current period—notable loss events	0.0	%	0.0	%
Marine—change in prior accident years	(4.4	)%	23.6	%
Marine—current period excluding items above	46.9	%	40.9	%
Marine—loss ratio	42.5	%	64.5	%

Losses and Loss Expenses - Marine Lines  
Nine Months Ended September 30,

(Dollars in thousands)	2014	2013	Change		
Marine—current period—notable loss events	\$—	\$—	\$—		
Marine—change in prior accident years	(5,213	)	36,761	(41,974	)
Marine—current period excluding items above	55,131	63,518	(8,387	)	
Marine—losses and loss expenses	\$49,918	\$100,279	\$(50,361	)	

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The marine lines experienced \$5.2 million of favorable loss reserve development during the nine months ended September 30, 2014 due to favorable development on the Gryphon Alpha mooring failure, partially offset by adverse development on Costa Concordia. This is compared to unfavorable loss reserve development of \$36.8 million during the nine months ended September 30, 2013, due primarily to adverse development on both Costa Concordia and Deepwater Horizon. The current nine months loss ratio, excluding the impact of notable loss events, increased by 6.0 percentage points as a result of higher attritional losses in the current nine months.

	Losses and Loss Expense Ratio - Specialty Lines			
	Nine Months Ended September 30, 2014		2013	
Specialty—current period—notable loss events	0.0	%	0.0	%
Specialty—change in prior accident years	(0.5	)%	(0.1	)%
Specialty—current period excluding items above	76.8	%	70.3	%
Specialty—loss ratio	76.3	%	70.2	%

(Dollars in thousands)	Losses and Loss Expenses - Specialty Lines			
	2014	2013	Change	
Specialty—current period—notable loss events	\$—	\$—	\$—	
Specialty—change in prior accident years	(1,025	)	(265	)
Specialty—current period excluding items above	165,292	146,072	19,220	
Specialty—losses and loss expenses	\$164,267	\$145,807	\$18,460	

The specialty lines current nine months loss ratio, excluding the impact of notable loss events, was higher by 6.5% percentage points, due to non-notable loss events during the current nine months.

## Policy Acquisition Costs

(Dollars in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
Property	\$59,665	16.9	% \$82,580	15.9	%
Marine	19,825	16.9	% 29,995	19.3	%
Specialty	27,057	12.6	% 29,620	14.3	%
Total	\$106,547	15.5	% \$142,195	16.1	%

The acquisition cost ratio for the property lines increased by 1.0 percentage points primarily due to the impact of the restructured retrocessional coverage discussed above. The acquisition cost ratio for the marine lines decreased 2.4 percentage points primarily due to adjustments to estimates on proportional lines in the respective nine months. The acquisition cost ratio for the specialty lines has decreased by 1.7 percentage points due to changes on some of the renewed agricultural policies.

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## General and Administrative and Share Compensation Expenses

(Dollars in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
General and administrative expenses	\$53,757	7.8	% \$69,649	7.9	%
Share compensation expenses	7,126	1.1	% 5,421	0.6	%
Total	\$60,883	8.9	% \$75,070	8.5	%

The decrease in general and administrative expenses of \$15.9 million or 22.8% was primarily due to a reduction in office and infrastructure costs related to entities that are no longer in use as a result of efficiencies achieved through rationalization of historical Flagstone entities. Also contributing to the decrease was a reduction in professional fees associated with the wind-up of certain Flagstone entities. This was partially offset by an increase in staff costs related to underwriting operations in Dublin, Ireland and Zurich, Switzerland compared to the nine months ended September 30, 2013.

## Selected Underwriting 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 losses and loss expense ratio and the expense ratio. The losses and loss expense 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 expense ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the nine months ended September 30, 2014 and 2013.

	Nine Months Ended September 30,	
	2014	2013
Losses and loss expense ratio	36.1	% 36.1
Policy acquisition cost ratio	15.5	% 16.1
General and administrative expense ratio (a)	8.9	% 8.5
Expense ratio	24.4	% 24.6
Combined ratio	60.5	% 60.7

(a) Includes general and administrative expenses and share compensation expenses.

The decrease in the combined ratio for the nine months ended September 30, 2014 of 0.2 percentage points compared to the nine months ended September 30, 2013 was due to the movement in the underlying ratios as discussed above.

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## Net Investment Income

(Dollars in thousands)	Net Investment Income Nine Months Ended September 30,		
	2014	2013	Change
Fixed maturities and short-term investments	\$52,871	\$60,288	\$(7,417 )
Other investments	4,354	4,753	(399 )
Cash and cash equivalents	3,465	1,712	1,753
Securities lending income	5	3	2
Total gross investment income	60,695	66,756	(6,061 )
Investment expenses	(4,410 )	(4,986 )	576
Total	\$56,285	\$61,770	\$(5,485 )

The decrease in net investment income for the nine months ended September 30, 2014 was \$5.5 million or 8.9% primarily due to a decrease in the overall yields on fixed maturity investments and a lower balance of such investments. Net investment income from other investments includes distributed and undistributed net income from certain investments.

## Other Income

(Dollars in thousands)	Other Income Nine Months Ended September 30,		
	2014	2013	Change
Other income	\$912	\$11,237	\$(10,325 )

Other income for the nine months ended September 30, 2014 decreased primarily due to an adjustment of \$7.7 million to the carrying value of long-lived assets held by a Flagstone entity.

## Finance Expenses

(Dollars in thousands)	Finance Expenses Nine Months Ended September 30,		
	2014	2013	Change
Finance expenses	\$11,131	\$12,133	\$(1,002 )

Finance expenses for the nine months ended September 30, 2014 and 2013 were comparable.



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## Year to Date 2014 Results of Operations - AlphaCat Segment

The following table presents results of operations for the nine months ended September 30, 2014 and 2013, respectively:

(Dollars in thousands)	Nine Months Ended September 30,		
	2014		2013
Underwriting income			
Gross premiums written	\$ 135,073		\$ 146,757
Reinsurance premiums ceded	(4,348	)	(525
Net premiums written	130,725		146,232
Change in unearned premiums	(32,444	)	(46,459
Net premiums earned	98,281		99,773
Underwriting deductions			
Losses and loss expenses	(7,155	)	16,928
Policy acquisition costs	9,414		10,011
General and administrative expenses	15,627		13,757
Share compensation expenses	330		314
Total underwriting deductions	18,216		41,010
Underwriting income (a)	80,065		58,763
Net investment income	2,546		2,821
Other income	21,482		17,439
Finance expenses	(2,039	)	(4,273
Operating income before income from operating affiliates and (income) attributable to operating affiliate investors	102,054		74,750
Income from operating affiliates	13,580		8,779
(Income) attributable to operating affiliate investors	(82,833	)	(42,156
Net operating income (a)	32,801		41,373
Net operating (income) attributable to noncontrolling interest	(3,160	)	(7,999
Net operating income available to Validus (a)	\$ 29,641		\$ 33,374
Selected ratios:			
Net premiums written / Gross premiums written	96.8	%	99.6
Losses and loss expenses	(7.3	)%	17.0
Policy acquisition costs	9.6	%	10.0
General and administrative expenses (b)	16.2	%	14.1
Expense ratio	25.8	%	24.1
Combined ratio	18.5	%	41.1

(a) Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income and net 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. Further discussion of these measures is presented in the section entitled “Non-GAAP Financial Measures.”

(b) The general and administrative expense ratio includes share compensation expenses.

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The change in net operating income for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013, respectively, is described in the following table:

	Increase (decrease) to net operating income available to Validus over the nine months ended September 30, 2014 compared to 2013	
(Dollars in thousands)		
Net premiums earned	\$(1,492)	)
Notable loss events (a)	975	
Incurred current year losses, excluding notable loss events	11,500	
Prior period loss development	11,608	
Other underwriting deductions (b)	(1,289)	)
Underwriting income (d)	21,302	
(Income) attributable to operating affiliate investors	(40,677)	)
Other operating income and expenses, net (c)	10,803	
Net operating income (d)	(8,572)	)
Net operating income attributable to noncontrolling interest	4,839	
Net operating income available to Validus (d)	\$(3,733)	)

(a) There were no notable loss events for the nine months ended September 30, 2014. The notable loss event for the nine months ended September 30, 2013 was the European Floods.

(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.

(c) Other operating income and expenses, net, consists of net investment income, other income, finance expenses, taxes and income (loss) from operating affiliates.

(d) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

## Gross Premiums Written

(Dollars in thousands)	Gross Premiums Written		
	Nine Months Ended September 30,		
	2014	2013	Change
Property	\$135,073	\$146,757	\$(11,684)

The decrease in gross premiums written in the property lines of \$11.7 million was as a result of AlphaCat 2014 having a smaller capital base than AlphaCat 2013. Partially offsetting this was an increase in the capital base of the AlphaCat ILS funds for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013.

Business written into the AlphaCat ILS funds typically has a lower rate on line than business written into AlphaCat 2014 or AlphaCat 2013. As a result, the impact on gross premiums written from a change in capital base between AlphaCat 2014 and AlphaCat 2013 will be proportionately higher than from a change in the capital base of the AlphaCat ILS funds.

## Reinsurance Premiums Ceded

AlphaCat reinsurance premiums ceded for the nine months ended September 30, 2014 were \$4.3 million compared to \$0.5 million for the nine months ended September 30, 2013. The reinsurance was purchased due to the availability of attractively priced coverage.



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## Net Premiums Written

(Dollars in thousands)	Net Premiums Written Nine Months Ended September 30,		
	2014	2013	Change
Property	\$130,725	\$146,232	\$(15,507 )

The decrease in AlphaCat net premiums written was driven by factors highlighted above in respect of gross premiums written and reinsurance premiums ceded. The ratios of net premiums written to gross premiums written were 96.8% and 99.6% for the nine months ended September 30, 2014 and 2013, respectively.

## Net Premiums Earned

(Dollars in thousands)	Net Premiums Earned Nine Months Ended September 30,		
	2014	2013	Change
Property	\$98,281	\$99,773	\$(1,492 )

The decrease in net premiums earned in the property lines was due to lower mid-year renewals in 2014 compared to 2013.

## Losses and Loss Expenses

	Losses and Loss Expense Ratio - Property Lines Nine Months Ended September 30,			
	2014	2013	2014	2013
Property - current period - notable loss events	0.0	% 1.0		%
Property - change in prior accident years	(11.8	)% 0.0		%
Property - current period excluding items above	4.5	% 16.0		%
Property—loss ratio	(7.3	)% 17.0		%

(Dollars in thousands)	Losses and Loss Expenses - Property Lines Nine Months Ended September 30,		
	2014	2013	Change
Property - current period—notable loss events	\$—	\$975	\$(975 )
Property - change in prior accident years	(11,608 )	—	(11,608 )
Property - current period excluding items above	4,453	15,953	(11,500 )
Property - losses and loss expenses	\$(7,155 )	\$16,928	\$(24,083 )

The property lines experienced \$11.6 million higher favorable loss reserve development compared to the nine months ended September 30, 2013, due to the partial release of reserves originally established in the third quarter of 2013 on an aggregate excess of loss contract. The current nine months loss ratio, excluding the impact of notable loss events, was lower by 11.5 percentage points, representing a lower level of attritional claims experienced during the current nine months.

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## Notable Loss Events

There were no notable loss events for the nine months ended September 30, 2014. In comparison, notable loss events incurred in the nine months ended September 30, 2013 of \$1.0 million were from a single notable loss event, the European Floods, which represented 1.0 percentage point of the loss ratio.

## Policy Acquisition Costs

(Dollars in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
Property	\$9,414	9.6	% \$10,011	10.0	%

The acquisition cost ratios for the nine months ended September 30, 2014 and 2013 were comparable.

## General and Administrative and Share Compensation Expenses

(Dollars in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
General and administrative expenses	\$15,627	15.9	% \$13,757	13.8	%
Share compensation expenses	330	0.3	% 314	0.3	%
Total	\$15,957	16.2	% \$14,071	14.1	%

The increase in general and administrative expenses of \$1.9 million or 13.6% was due primarily to an increase in professional fees of \$1.7 million relating to PaCRe.

## Selected Underwriting Ratios

The following table presents the losses and loss expense ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the nine months ended September 30, 2014 and 2013.

	Nine Months Ended September 30,	
	2014	2013
Losses and loss expense ratio	(7.3	)% 17.0
Policy acquisition cost ratio	9.6	% 10.0
General and administrative expense ratio (a)	16.2	% 14.1
Expense ratio	25.8	% 24.1
Combined ratio	18.5	% 41.1

(a) Includes general and administrative expenses and share compensation expenses.

The decrease in the combined ratio for the nine months ended September 30, 2014 of 22.6 percentage points compared to the nine months ended September 30, 2013 was due to the movement in the underlying ratios as discussed above.

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## Net Investment Income

(Dollars in thousands)	Net Investment Income Nine Months Ended September 30,		
	2014	2013	Change
Fixed maturities and short-term investments	\$2,493	\$2,796	\$(303 )
Cash and cash equivalents	53	25	28
Total net investment income	\$2,546	\$2,821	\$(275 )

Net investment income for the nine months ended September 30, 2014 and 2013 was comparable.

## Other Income

(Dollars in thousands)	Other Income Nine Months Ended September 30,		
	2014	2013	Change
Other income	\$21,482	\$17,439	\$4,043

The increase in other income of \$4.0 million or 23.2% was primarily due to a gain resulting from the deconsolidation of one of the AlphaCat ILS funds during the first quarter of 2014 and a reduction in performance fees in the third quarter of 2013 as a result of a loss incurred by AlphaCat 2013.

## Finance Expenses

(Dollars in thousands)	Finance Expenses Nine Months Ended September 30,		
	2014	2013	Change
Finance expenses	\$2,039	\$4,273	\$(2,234 )

The decrease in finance expenses of \$2.2 million or 52.3% was as a result of lower costs incurred in structuring AlphaCat 2014 compared to AlphaCat 2013.

## Income From Operating Affiliates

(Dollars in thousands)	Income from Operating Affiliates Nine Months Ended September 30,		
	2014	2013	Change
AlphaCat Re 2011	\$183	\$106	\$77
AlphaCat Re 2012	882	3,071	(2,189 )
AlphaCat 2013	2,043	4,121	(2,078 )
AlphaCat 2014	4,399	—	4,399
AlphaCat ILS funds	6,073	1,481	4,592
Total	\$13,580	\$8,779	\$4,801

For details of voting and equity ownership interests of the above entities, refer to Note 5 to the Consolidated Financial Statements in Part I. The increase in income from operating affiliates for the nine months ended September 30, 2014 was due to the deconsolidation of one of the AlphaCat ILS funds in the first quarter of 2014.

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## (Income) Attributable To Operating Affiliate Investors

## (Income) Attributable to Operating Affiliate Investors

Nine Months Ended September 30,

(Dollars in thousands)

2014

2013

Change

(Income) attributable to operating affiliate investors

\$ (82,833 ) \$ (42,156 ) \$ (40,677 )

Income attributable to operating affiliate investors was \$40.7 million higher, reflecting the increased transfer of economics as a result of the deconsolidation of one of the AlphaCat ILS funds in the first quarter of 2014. This balance represents the transfer of investors' economic interest in the non-consolidated affiliated entities and includes both the Company's and third-party investors' share.

## Net Operating (Income) Attributable to Noncontrolling Interest

## Net Operating (Income) Loss Attributable to Noncontrolling Interest

Nine Months Ended September 30,

(Dollars in thousands)

2014

2013

Change

Net operating (income) attributable to noncontrolling interest

\$ (3,160 ) \$ (7,999 ) \$ 4,839

For the nine months ended September 30, 2014, the net operating income attributable to noncontrolling interest was \$3.2 million, which comprised \$2.0 million relating to 90% of the net operating income in PaCRe for the quarter and \$1.1 million of net operating income relating to the consolidated AlphaCat ILS funds.



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## Year To Date 2014 Results of Operations - Talbot Segment

The following table presents results of operations for the nine months ended September 30, 2014 and 2013, respectively:

(Dollars in thousands)	Nine Months Ended September 30,		
	2014		2013
Underwriting income			
Gross premiums written	\$854,324		\$855,516
Reinsurance premiums ceded	(154,115	)	(191,922
Net premiums written	700,209		663,594
Change in unearned premiums	(41,658	)	(37,237
Net premiums earned	658,551		626,357
Underwriting deductions			
Losses and loss expenses	304,848		251,554
Policy acquisition costs	138,383		127,092
General and administrative expenses	107,031		100,506
Share compensation expenses	8,434		6,754
Total underwriting deductions	558,696		485,906
Underwriting income (a)	99,855		140,451
Net investment income	14,322		13,496
Other income	384		564
Finance expenses	68		(256
			)
Operating income before taxes	114,629		154,255
Tax expense	(902	)	(1,184
Net operating income (a)	\$113,727		\$153,071
Selected ratios:			
Net premiums written / Gross premiums written	82.0	%	77.6
			%
Losses and loss expenses	46.3	%	40.2
			%
Policy acquisition costs	21.0	%	20.3
			%
General and administrative expenses (b)	17.5	%	17.1
			%
Expense ratio	38.5	%	37.4
			%
Combined ratio	84.8	%	77.6
			%

Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income and net operating income that are not calculated under standards or rules that comprise U.S.

(a) 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

(b) The general and administrative expense ratio includes share compensation expenses.



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The change in net operating income for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013, respectively, is described in the following table:

	Increase (decrease) to net operating income over the nine months ended September 30, 2014 compared to 2013	
(Dollars in thousands)		
Net premiums earned	\$32,194	
Notable loss events (a)	6,440	
Incurred current year losses, excluding notable loss events	(49,779	)
Prior period loss development	(9,955	)
Other underwriting deductions (b)	(19,496	)
Underwriting income (d)	(40,596	)
Other operating income and expenses, net (c)	1,252	
Net operating income (d)	\$(39,344	)

(a) There were no notable loss events for the nine months ended September 30, 2014. The notable loss event for the nine months ended September 30, 2013 was the European Floods.

(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.

(c) Other operating income and expenses, net, consists of net investment income, other income, finance expenses and taxes.

(d) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting 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. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."

## Gross Premiums Written

(Dollars in thousands)	Gross Premiums Written			
	Nine Months Ended September 30,			
	2014	2013	Change	
Property	\$261,100	\$284,980	\$(23,880	)
Marine	319,805	306,093	13,712	
Specialty	273,419	264,443	8,976	
Total	\$854,324	\$855,516	\$(1,192	)

The decrease in gross premiums written in the property lines of \$23.9 million was primarily due to a decrease in the property treaty lines of \$35.4 million, of which \$29.7 million related to the Latin American business now being written directly through Validus Re Swiss. This business was previously written by Talbot and ceded to Validus Re. The remaining decrease on the property treaty lines was primarily due to non-renewals. This decrease was partially offset by an increase in the direct property lines due to new business and premium adjustments of \$16.3 million. The increase in gross premiums written in the marine lines of \$13.7 million was due primarily to an increase in the energy lines of \$6.7 million as a result of new business and increased premium on renewals. Also contributing to the increase in the marine lines was an increase in the cargo lines of \$6.1 million as a result of an increase to the rate on line and additional premium signings. The increase in gross premiums written in the specialty lines of \$9.0 million was partially due to an increase on political risk lines of \$7.2 million. In particular, the political risk lines increase was in part due to the expanding crisis management book and the employment of two new underwriters. The aviation treaty lines have also seen an increase of \$5.4 million; offset by, a decrease in the political violence lines of \$4.9 million.



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## Business Mix - Ratio of Gross Premiums Written by Line of Business to Total Gross Premiums Written

(Dollars in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013			
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)		
Property	\$261,100	30.6	% \$284,980	33.3	%	
Marine	319,805	37.4	% 306,093	35.8	%	
Specialty	273,419	32.0	% 264,443	30.9	%	
Total	\$854,324	100.0	% \$855,516	100.0	%	

The changes in mix of business were consistent with the changes in gross premiums written discussed above.

## Reinsurance Premiums Ceded

(Dollars in thousands)	Reinsurance Premiums Ceded Nine Months Ended September 30,			
	2014	2013	Change	
Property	\$91,332	\$122,002	\$(30,670)	)
Marine	20,621	23,137	(2,516)	)
Specialty	42,162	46,783	(4,621)	)
Total	\$154,115	\$191,922	\$(37,807)	)

The decrease in reinsurance premiums ceded in the property lines of \$30.7 million was due primarily to a decrease in the property treaty lines of \$23.4 million due to lower quota share premiums as a result of underlying Latin American business now being written directly through Validus Re Swiss. This business was previously written by Talbot and ceded to Validus Re. Also contributing to the decrease was a reduction in the energy onshore lines of \$7.5 million due to lower quota share premiums and changes in the excess of loss program and structure. The decrease in the specialty lines of \$4.6 million was primarily due to a decrease in the aviation direct lines of \$3.3 million.

## Net Premiums Written

(Dollars in thousands)	Net Premiums Written Nine Months Ended September 30,			
	2014	2013	Change	
Property	\$169,768	\$162,978	\$6,790	
Marine	299,184	282,956	16,228	
Specialty	231,257	217,660	13,597	
Total	\$700,209	\$663,594	\$36,615	

The changes in Talbot net premiums written were driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded.

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(Dollars in thousands)	Net Retention - Ratio of Net Premiums Written to Gross Premiums Written				
	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		
	Net Premiums Written	% of Gross Premiums Written	Net Premiums Written	% of Gross Premiums Written	
Property	\$169,768	65.0	% \$162,978	57.2	%
Marine	299,184	93.6	% 282,956	92.4	%
Specialty	231,257	84.6	% 217,660	82.3	%
Total	\$700,209	82.0	% \$663,594	77.6	%

The property ratio increased by 7.8 percentage points due to the Latin American business being written directly through Validus Re Swiss. This business was previously written through Talbot and ceded to Validus Re.

## Net Premiums Earned

(Dollars in thousands)	Net Premiums Earned		
	Nine Months Ended September 30, 2014	2013	Change
Property	\$153,766	\$142,940	\$10,826
Marine	275,793	264,455	11,338
Specialty	228,992	218,962	10,030
Total	\$658,551	\$626,357	\$32,194

The changes in the net premiums earned were consistent with the pattern of net premiums written influencing the earned premiums for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013.

## Losses and Loss Expenses

	Losses and Loss Expense Ratio - All Lines			
	Nine Months Ended September 30, 2014		2013	
All lines—current period—notable loss events	0.0	%	1.0	%
All lines—change in prior accident years	(15.1	)%	(17.4	)%
All lines—current period excluding items above	61.4	%	56.6	%
All lines—loss ratio	46.3	%	40.2	%

(Dollars in thousands)	Losses and Loss Expenses - All Lines			
	Nine Months Ended September 30, 2014	2013	Change	
All lines—current period—notable loss events	\$—	\$6,440	\$(6,440)	
All lines—change in prior accident years	(99,192	)	(109,147	) 9,955
All lines—current period excluding items above	404,040	354,261	49,779	
All lines - losses and loss expenses	\$304,848	\$251,554	\$53,294	

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## Notable Loss Events

There were no notable loss events for the nine months ended September 30, 2014. In comparison, notable loss events incurred in the six months ended September 30, 2013 of \$6.4 million were from a single notable loss event, the European Floods, which represented 1.0 percentage point of the loss ratio. Net of \$0.3 million of reinstatement premiums, the effect of this event on net operating income was a \$6.1 million reduction.

## Losses and Loss Expenses by Line of Business

	Losses and Loss Expense Ratio - Property Lines		
	Nine Months Ended September 30,		
	2014	2013	
Property—current period—notable loss events	0.0	% 3.1	%
Property—change in prior accident years	(28.6)	% (24.5)	%
Property—current period excluding items above	68.0	% 59.0	%
Property—loss ratio	39.4	% 37.6	%

Losses and Loss Expenses - Property Lines  
Nine Months Ended September 30,

(Dollars in thousands)	2014	2013	Change	
Property - current period—notable loss events	\$—	\$4,440	\$(4,440)	)
Property - change in prior accident years	(43,905)	(35,056)	(8,849)	)
Property—current period excluding items above	104,525	84,392	20,133	
Property - losses and loss expenses	\$60,620	\$53,776	\$6,844	

The property lines experienced favorable loss reserve development in both periods, due to a combination of favorable development on notable loss events, primarily the Tohoku earthquake, and lower development on both non-notable loss events and attritional losses in 2013 and predominantly lower non-notable loss event development in 2014. The current nine months loss ratio, excluding the impact of notable loss events, was higher by 9.0 percentage points, representing a higher level of attritional claims experienced compared to the prior year nine months, including a construction fire loss of \$8.3 million.

	Losses and Loss Expense Ratio - Marine Lines		
	Nine Months Ended September 30,		
	2014	2013	
Marine—current period—notable loss events	0.0	% 0.8	%
Marine—change in prior accident years	(6.6)	% (12.9)	%
Marine—current period excluding items above	52.4	% 52.8	%
Marine—loss ratio	45.8	% 40.7	%

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## Losses and Loss Expenses - Marine Lines

Nine Months Ended September 30,

(Dollars in thousands)	2014	2013	Change
Marine - current period—notable loss events	\$—	\$2,000	\$(2,000)
Marine—change in prior accident years	(18,191)	(34,031)	15,840
Marine—current period excluding items above	144,539	139,741	4,798
Marine - losses and loss expenses	\$126,348	\$107,710	\$18,638

The marine lines experienced \$15.8 million lower favorable loss reserve development compared to the prior year nine months due to lower favorable development on attritional claims in the current nine months.

## Losses and Loss Expense Ratio -

Specialty Lines

Nine Months Ended September 30,

	2014	2013	
Specialty—current period—notable loss events	0.0	% 0.0	%
Specialty—change in prior accident years	(16.2)	% (18.3)	%
Specialty—current period excluding items above	67.7	% 59.4	%
Specialty—loss ratio	51.5	% 41.1	%

## Losses and Loss Expenses - Specialty Lines

Nine Months Ended September 30,

(Dollars in thousands)	2014	2013	Change
Specialty - current period—notable loss events	\$—	\$—	\$—
Specialty—change in prior accident years	(37,096)	(40,060)	2,964
Specialty—current period excluding items above	154,976	130,128	24,848
Specialty - losses and loss expenses	\$117,880	\$90,068	\$27,812

The specialty lines experienced \$3.0 million of lower favorable loss reserve development, primarily related to lower development on attritional claims during the current nine months. The current nine months loss ratio, excluding the impact of notable loss events, was higher by 8.3 percentage points, representing a higher level of attritional and non-notable loss events experienced compared to the prior year nine months.

## Policy Acquisition Costs

(Dollars in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
Property	\$20,028	13.0	% \$16,300	11.4	%
Marine	65,568	23.8	% 59,182	22.4	%
Specialty	52,787	23.1	% 51,610	23.6	%
Total	\$138,383	21.0	% \$127,092	20.3	%

The property acquisition cost ratio increased by 1.6 percentage points due to lower ceded acquisition costs on quota share premiums as a result of the Latin American business being written directly through Validus Re Swiss. This business was previously written through Talbot and ceded to Validus Re. The increase in the marine acquisition cost ratio of 1.4 percentage points was due to profit commission adjustments that reduced costs for the nine months ended September 30, 2013.



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## General and Administrative and Share Compensation Expenses

(Dollars in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		
	Expenses	% of Net Premiums Earned	Expenses	% of Net Premiums Earned	
General and administrative expenses	\$107,031	16.2	% \$100,506	16.0	%
Share compensation expenses	8,434	1.3	% 6,754	1.1	%
Total	\$115,465	17.5	% \$107,260	17.1	%

General and administrative expenses increased by \$6.5 million due to salary increases, an increase in overall headcount and a strengthening of the British pound against the U.S. dollar compared to the prior year nine months.

## Selected Underwriting Ratios

The following table presents the losses and loss expense ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the nine months ended September 30, 2014 and 2013.

	Nine Months Ended September 30,	
	2014	2013
Losses and loss expense ratio	46.3	% 40.2
Policy acquisition cost ratio	21.0	% 20.3
General and administrative expense ratio (a)	17.5	% 17.1
Expense ratio	38.5	% 37.4
Combined ratio	84.8	% 77.6

(a) Includes general and administrative expenses and share compensation expenses.

The increase in the combined ratio for the nine months ended September 30, 2014 of 7.2 percentage points compared to the nine months ended September 30, 2013 was due to the movement in the underlying ratios as discussed above.

## Net Investment Income

(Dollars in thousands)	Investment Income		
	Nine Months Ended September 30,		
	2014	2013	Change
Fixed maturities and short-term investments	\$14,453	\$13,000	\$1,453
Cash and cash equivalents	1,016	1,504	(488)
Total gross investment income	15,469	14,504	965
Investment expenses	(1,147)	(1,008)	(139)
Total	\$14,322	\$13,496	\$826

Net investment income for the nine months ended September 30, 2014 and 2013 was comparable.

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## Year To Date Non-Segment Discussion

## Corporate Expenses

Corporate general and administrative expenses for the nine months ended September 30, 2014, net of eliminations related to the operating segments, were \$55.2 million compared to \$48.4 million for the nine months ended September 30, 2013, an increase of \$6.8 million or 14.0%. General and administrative expenses have increased primarily due to an increase in headcount offset by a decrease in severance expenses relating to the departure of employees in the prior nine months. Also, contributing to the increase was an increase in information technology expenses during the current nine months. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other costs relating to the Company as a whole.

Corporate share compensation expenses for the nine months ended September 30, 2014 were \$8.4 million compared to \$7.0 million for the nine months ended September 30, 2013, an increase of \$1.4 million or 19.6%. The increase of \$1.4 million was primarily due to a higher level of awards being issued in 2013 compared to earlier years.

Corporate finance expenses for the nine months ended September 30, 2014, net of eliminations related to the operating segments, were \$34.3 million compared to \$30.6 million for the nine months ended September 30, 2013, an increase of \$3.7 million or 12.1%.

Transaction expenses for the nine months ended September 30, 2014 were \$3.4 million compared to \$nil for the nine months ended September 30, 2013. The transaction expenses relate to costs incurred in connection with the acquisition of Western World, which was completed on October 2, 2014. The Company incurred an additional \$4.0 million of transaction expenses which will be recognized in the fourth quarter of 2014. Western World results have not been included in the Company's consolidated results for the nine months ended September 30, 2014. Transaction expenses are primarily comprised of legal, financial advisory and audit related services.

## Year to Date Non-Operating Income and Expenses

The following non-operating income and expense items are discussed on a consolidated basis, since the Company does not include these items when assessing the results of its operating segments.

## Net Realized and Change in Net Unrealized Gains (Losses) on Investments

(Dollars in thousands)	Net Realized and Change in Net Unrealized (Losses) Gains on Investments Nine Months Ended September 30,		
	2014	2013	Change
Net realized gains (losses) on investments	\$ 16,193	\$(1,190)	) \$ 17,383
Change in net unrealized gains (losses) on investments	16,146	(78,618)	) 94,764
Net realized and change in net unrealized gains (losses) on investments	\$ 32,339	\$(79,808)	) \$ 112,147

The movement in the net realized and change in net unrealized gains (losses) on investments of \$112.1 million was due to a favorable movement in net realized and unrealized gains (losses) on fixed maturity and short term investments of \$56.9 million and a favorable movement in net realized and unrealized gains (losses) on other investments of \$55.2 million.

The favorable movement on fixed maturity and short term investments was primarily as a result of a shift in the yield curve and a tightening of corporate bond spreads. The favorable movement on other investments was primarily due to the change in net unrealized gains of \$49.6 million on the Paulson hedge funds held by PaCRE. This is offset by a 90% noncontrolling interest of \$44.6 million.

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## Income From Investment Affiliate

(Dollars in thousands)	Income From Investment Affiliate Nine Months Ended September 30,		
	2014	2013	Change
Income from investment affiliate	\$7,881	\$4,274	\$3,607

Income from investment affiliate for the nine months ended September 30, 2014 was \$3.6 million higher than the nine months ended September 30, 2013. The income from investment affiliate relates to the income earned from the Company's investment in the Aquiline Financial Services Fund II L.P. which is recorded on a three-month lag and therefore reflects the underlying performance of that fund for the nine months ended June 30, 2014 and 2013, respectively.

## Foreign Exchange (Losses) Gains

The Company's reporting currency is the U.S. dollar. As a significant portion of the Company's operations are transacted in currencies other than the U.S. dollar, fluctuations in foreign exchange rates may affect period-to-period comparisons. The Company's largest foreign currency fluctuation exposures are to the following currencies, with the movement in each currency against the U.S. dollar shown in the table below:

U.S. dollar strengthened (weakened) against:	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
		%		%
British Pound sterling	2.3	%	0.3	%
Euro	8.9	%	(2.5)	)%
Canadian dollar	5.5	%	3.8	%
Swiss franc	7.0	%	(1.0)	)%
Australian dollar	2.5	%	11.5	%
New Zealand dollar	5.7	%	(0.3)	)%
Singapore dollar	1.1	%	2.8	%
Japanese yen	4.3	%	13.5	%

(Dollars in thousands)	Foreign Exchange Nine Months Ended September 30,		
	2014	2013	Change
Foreign exchange losses	\$(14,761 )	\$4,735	\$(19,496 )

Foreign exchange losses for the nine months ended September 30, 2014 were \$(14.8) million compared to gains of \$4.7 million for the nine months ended September 30, 2013, an unfavorable movement of \$19.5 million, or 411.7%, due primarily to the U.S. dollar strengthening against the Australian and New Zealand dollars, the Euro, the Swiss Franc and the Japanese yen.

The Company currently hedges foreign currency exposure by substantively balancing assets (primarily cash, investments and premium receivables) with liabilities (primarily case reserves and event IBNR) for certain major non-U.S. dollar currencies, or by entering into forward foreign currency contracts. Consequently, the Company attempts to have a limited exposure to foreign exchange fluctuations.

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## Net (Income) Loss Attributable to Noncontrolling Interest

## Net (Income) Loss Attributable to Noncontrolling Interest

Nine Months Ended September 30,

(Dollars in thousands)	2014	2013	Change
Net (income) loss attributable to noncontrolling interest	\$(25,745 )	\$17,831	\$(43,576 )

For the nine months ended September 30, 2014, net income attributable to noncontrolling interest was \$25.7 million, which was comprised of operating income of \$3.2 million, as discussed in the AlphaCat Segment Results of Operations, and a non-operating gain of \$22.6 million, primarily on the investment portfolio within PaCRe. For the nine months ended September 30, 2013, net loss attributable to noncontrolling interest was \$17.8 million, which was comprised of operating income of \$8.0 million, as discussed in the AlphaCat Segment Results of Operations, and a non-operating loss of \$25.8 million, primarily on the investment portfolio within PaCRe.

## Other Non-GAAP Financial Measures

The operating results of an insurance or reinsurance company are also often measured by reference to its net operating income, which is a non-GAAP financial measure. Net operating 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 certain Consolidated Statement of Comprehensive Income (Loss) line items, as illustrated below.

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Net operating income	76,818	158,336	359,114	490,302
Net realized gains on investments	4,595	(6,320 )	16,193	(1,190 )
Change in net unrealized gains (losses) on investments	(84,974 )	69,967	16,146	(78,618 )
Income from investment affiliate	1,754	1,044	7,881	4,274
Transaction expenses	(149 )	—	(3,401 )	—
Foreign exchange gains (losses)	(11,441 )	6,036	(14,761 )	4,735
Net income	\$(13,397 )	\$229,063	\$381,172	\$419,503

Operating 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 operating income enhances the understanding of results by highlighting the underlying profitability of the Company's core insurance and reinsurance business. This profitability is influenced significantly by earned premium growth, adequacy of the Company's pricing and loss frequency and severity. Over time it 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 excludes the U.S. GAAP measures noted above, in particular net realized and unrealized gains and losses on investments, from its calculation of operating 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 core underwriting activities 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 operating income provides investors with a valuable measure of profitability and 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.



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Operating 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 operating 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 operating income with other companies, particularly as operating income may be defined or calculated differently by other companies. Therefore, the Company provides 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 operating income to net income.

The Company also 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 total annual incentive compensation.

In presenting the Company's results, management has also included and discussed certain schedules containing book value per diluted common share and book value per diluted common share plus accumulated dividends that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP and 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 following tables present reconciliations of diluted book value per share to book value per share, the most comparable U.S. GAAP financial measure, at September 30, 2014 and December 31, 2013.

(Dollars in thousands, except share and per share amounts)	As at September 30, 2014		
	Equity Amount	Shares	Exercise Price
Book value per common share			
Total shareholders' equity available to Validus	\$3,702,410	89,112,271	\$ 41.55
Book value per diluted common share			
Total shareholders' equity available to Validus	3,702,410	89,112,271	
Assumed exercise of outstanding warrants	90,950	5,174,114	\$ 17.58
Assumed exercise of outstanding stock options	26,340	1,439,328	\$ 18.30
Unvested restricted shares	—	2,980,333	
Book value per diluted common share	\$3,819,700	98,706,046	\$ 38.70
Adjustment for accumulated dividends			\$ 8.58
Book value per diluted common share plus accumulated dividends			\$ 47.28
(Dollars in thousands, except share and per share amounts)	As at December 31, 2013		
	Equity Amount	Shares	Exercise Price
Book value per common share			
Total shareholders' equity available to Validus	\$3,704,094	96,044,312	\$ 38.57
Book value per diluted common share			
Total shareholders' equity available to Validus	3,704,094	96,044,312	
Assumed exercise of outstanding warrants	98,513	5,296,056	\$ 18.60
Assumed exercise of outstanding stock options	29,688	1,572,713	\$ 18.88
Unvested restricted shares	—	2,853,083	

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Book value per diluted common share	\$3,832,295	105,766,164	\$ 36.23
Adjustment for accumulated dividends			\$ 7.68
Book value per diluted common share plus accumulated dividends			\$ 43.91

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## Liquidity and Capital Resources

## Investments

At September 30, 2014, the Company held investments totaling \$7,073.8 million, compared to \$6,912.4 million at December 31, 2013, an increase of \$161.4 million, or 2.3%, primarily as a result of a reduction of cash and cash equivalents. A significant portion of (re)insurance contracts written by the Company provide short-tail reinsurance coverage for losses resulting mainly from natural and man-made catastrophes, which could result in payment of a substantial amount of losses at short notice. Accordingly, the Company's investment portfolio is primarily structured to provide liquidity, which means the investment portfolio contains a significant amount of relatively short-term fixed maturity investments. The Company's investment policies specifically require certain minimum thresholds of cash, short-term investments, and highly-rated fixed maturity securities relative to our consolidated net reserves and estimates of probable maximum loss exposures to provide necessary liquidity in a wide range of reasonable scenarios. At September 30, 2014, the average duration of the Company's fixed maturity and short term investment portfolio was 1.56 years (December 31, 2013: 1.60 years). This duration is reviewed regularly based on changes in the duration of the Company's liabilities and in general market conditions.

The Company's investment portfolio is also structured to preserve capital. The Company's investment policies require certain minimum credit quality standards, including a minimum weighted average portfolio rating of A+. Further limits on securities rated BBB and below are also mandated. In addition, the Company stress-tests the downside risks within its asset portfolio using internal and external inputs and stochastic modeling processes to help define and limit asset risks to acceptable levels that are consistent with our overall enterprise-risk framework. At September 30, 2014, the Company's total investment portfolio had an average credit quality rating of A+ (December 31, 2013 : AA-) and an effective yield of 1.28% for the nine months then ended (2013 : 1.30%). The estimated fair value of investment grade fixed maturities, as at September 30, 2014 was \$4,093.5 million, or 87.7% of the fixed maturity portfolio, compared to \$4,764.6 million as at December 31, 2013, or 86.0%, a decrease of \$671.1 million, or 14.1%. The estimated fair value of non-investment grade fixed maturities, excluding bank loans, as at September 30, 2014 was \$107.3 million compared to \$92.8 million as at December 31, 2013, an increase of \$14.5 million, or 15.6%.

The Company also has an allocation to other investments, primarily hedge funds and investment funds. At September 30, 2014, these other investments, excluding noncontrolling interests, totaled \$223.3 million, or 3.4%, of total investments, excluding noncontrolling interest (December 31, 2013: \$128.9 million or 2.0%). For further details related to the investment portfolio, including the extent of investments with fair values measured using unobservable inputs, see Notes 3 and 4 to the Consolidated Financial Statements in Part I, Item 1.

The value of the Company's fixed maturity portfolio will fluctuate with, among other factors, changes in the interest rate environment and in overall economic conditions. Additionally, the structure of the investment portfolio exposes the Company to other risks, including insolvency or reduced credit quality of corporate debt securities, and prepayment, default and structural risks on asset-backed securities, mortgage-backed securities and bank loans.



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The estimated fair value of investments at September 30, 2014 and December 31, 2013 was as follows:

(Dollars in thousands)	September 30, 2014		December 31, 2013		
	Estimated Fair Value	% of Total Investments	Estimated Fair Value	% of Total Investments	
U.S. government and government agency	\$786,255	12.0	% \$1,364,679	21.1	%
Non-U.S. government and government agency	381,197	5.8	% 459,068	7.2	%
U.S. states, municipalities and political subdivision	74,365	1.1	% 43,120	0.7	%
Agency residential mortgage-backed securities	375,227	5.7	% 311,499	4.9	%
Non-agency residential mortgage-backed securities	17,199	0.3	% 15,759	0.2	%
U.S. corporate	1,168,918	17.8	% 1,332,484	20.8	%
Non-U.S. corporate	594,635	9.1	% 714,325	11.2	%
Bank loans	483,788	7.4	% 717,116	11.2	%
Catastrophe bonds	48,338	0.7	% 74,551	1.2	%
Asset-backed securities	566,452	8.6	% 509,657	8.0	%
Commercial mortgage-backed securities	173,799	2.7	% —	—	%
Total fixed maturities	4,670,173	71.1	% 5,542,258	86.5	%
Total short-term investments (a) (b)	1,684,982	25.7	% 751,778	11.7	%
Total other investments	718,633	10.9	% 618,316	9.7	%
Total investments	7,073,788	107.6	% 6,912,352	107.9	%
Noncontrolling interest (a)	(495,365 )	(7.5 )	)% (489,402 )	(7.6 )	)%
Redeemable noncontrolling interest (b)	(11,637 )	(0.2 )	)% (18,365 )	(0.3 )	)%
Total investments excluding noncontrolling interest	\$6,566,786	100.0	% \$6,404,585	100.0	%

Included in the other investments balance are investments held by PaCRE in which the Company has an equity (a) interest of 10%. The remaining 90% interest is held by third party investors and included in the Consolidated Balance Sheets as noncontrolling interest.

Included in the short-term investments balance are investments held by one AlphaCat ILS fund which is (b) consolidated by the Company but in which the Company has an equity interest of less than 100%. The remaining interests are held by third party investors and included in the Consolidated Balance Sheets as redeemable noncontrolling interest.

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As part of the ongoing risk management process, the Company monitors the aggregation of country or jurisdiction risk exposure. Jurisdiction risk exposure is the risk that events within a jurisdiction, such as currency crises, regulatory changes and other political events, will adversely affect the ability of obligors within the jurisdiction to honor their obligations. The following table provides a breakdown of the fair value of jurisdiction risk exposures outside the United States within the Company's fixed maturity portfolio:

(Dollars in thousands)	September 30, 2014		December 31, 2013		
	Fair Value	% of Total	Fair Value	% of Total	
United Kingdom	\$140,473	14.4	% \$153,248	13.1	%
Supranational	49,876	5.1	% 74,834	6.4	%
Germany	47,364	4.9	% 59,274	5.1	%
Province of Ontario	22,939	2.4	% 29,395	2.5	%
Netherlands	21,744	2.2	% 24,340	2.1	%
France	19,169	2.0	% 24,097	2.1	%
Norway	17,705	1.8	% 22,430	1.9	%
Other (individual jurisdictions below \$20,000)	61,927	6.3	% 71,450	5.9	%
Total Non-U.S. Government Securities	381,197	39.1	% 459,068	39.1	%
European Non-U.S. Corporate Securities	220,002	22.5	% 248,613	21.2	%
United Kingdom Non-U.S. Corporate Securities	160,078	16.4	% 165,845	14.1	%
Other Non-U.S. Corporate Securities	214,555	22.0	% 299,867	25.6	%
Total Non-U.S. Fixed Income Portfolio	\$975,832	100.0	% \$1,173,393	100.0	%

The Company manages its corporate debt securities by limiting its exposure to any single issuer, excluding government and agency securities, to 3% or less of its total investments and cash. At September 30, 2014, the Company did not have an aggregate exposure to any single issuer of more than 0.9%, other than with respect to government and government agency securities. The top ten exposures to fixed income corporate issuers at September 30, 2014 are as follows:

(Dollars in thousands)	September 30, 2014			
	Fair Value (b)	S&P Rating (c)	% of Total Cash and Investments	
Issuer (a)				
JPMorgan Chase & Co	67,603	A-	0.9	%
Bank of America Corp	50,677	BBB+	0.6	%
HSBC Holdings Plc	45,393	A+	0.6	%
Bank of New York Mellon Corp	45,163	A+	0.6	%
Goldman Sachs Group Inc	43,276	BBB+	0.5	%
Wells Fargo & Company	41,296	A	0.5	%
General Electric Co	35,881	A+	0.5	%
Morgan Stanley	35,042	BBB+	0.4	%
Anheuser-Busch Inbev SA	32,418	A	0.4	%
Verizon Communications Inc	31,725	BBB+	0.4	%
Total	428,474		5.4	%

(a) Issuers exclude government-backed government-sponsored enterprises and cash and cash equivalents.

(b) Credit exposures represent only direct exposure to fixed maturities and short-term investments of the parent issuer and its major subsidiaries. These exposures exclude asset and mortgage backed securities that were issued, sponsored or serviced by the parent.

(c)

Investment ratings are the median of Moody's, Standard & Poor's and Fitch, presented in Standard & Poor's equivalent rating. For investments where three ratings are unavailable, the lower of the ratings shall apply, presented in Standard & Poor's equivalent rating.

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The tables below show the Company's investments in affiliates, accounted for under the equity method:

(Dollars in thousands)	September 30, 2014			
	Investment at cost	Voting ownership	Equity ownership	Carrying value
AlphaCat Re 2011	\$4,167	43.7	% 22.3	% \$4,167
AlphaCat Re 2012	679	49.0	% 37.9	% 679
AlphaCat 2013	2,581	40.9	% 19.7	% 2,581
AlphaCat 2014	22,000	42.3	% 19.6	% 26,381
AlphaCat ILS funds	133,455	n/a	(a)	141,423
Aquiline Financial Services Fund II L.P.	32,110	n/a	6.7	% 42,381
Total	\$194,992			\$217,612

(a) Equity ownership in the two funds were 7.9% and 49.0%, respectively as at September 30, 2014.

(Dollars in thousands)	December 31, 2013			
	Investment at cost	Voting ownership	Equity ownership	Carrying value
AlphaCat Re 2011	\$9,882	43.7	% 22.3	% \$9,809
AlphaCat Re 2012	654	49.0	% 37.9	% 1,313
AlphaCat 2013	45,000	40.9	% 19.7	% 51,744
AlphaCat 2014	22,000	42.3	% 19.6	% 21,982
AlphaCat ILS fund	20,000	n/a	9.1	% 21,895
Aquiline Financial Services Fund II L.P.	32,110	n/a	6.7	% 34,500
Total	\$129,646			\$141,243

During the first nine months of 2014, the Company received partial returns of investment from AlphaCat Re 2011, AlphaCat 2012 and AlphaCat 2013 of \$5.8 million, \$1.5 million and \$51.2 million, respectively. The Company expects to receive further returns of investment during the year from AlphaCat Re 2011, AlphaCat Re 2012 and AlphaCat 2013.

## Reserves for Losses and Loss Expenses

At September 30, 2014, gross and net reserves for losses and loss expenses were estimated using the methodology as outlined in the Critical Accounting Policies and Estimates section below. The following tables indicate the breakdown of gross and net reserves for losses and loss expenses between lines of business and between case reserves and IBNR.

As at September 30, 2014

(Dollars in thousands)	Gross Case Reserves	Gross IBNR	Total Gross Reserve for Losses and Loss Expenses
Property	\$692,699	\$474,687	\$ 1,167,386
Marine	441,910	393,670	835,580
Specialty	264,653	484,549	749,202
Total	\$1,399,262	\$1,352,906	\$ 2,752,168

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(Dollars in thousands)	As at September 30, 2014		Total Net Reserve for Losses and Loss Expenses
	Net Case Reserves	Net IBNR	
Property	\$599,391	\$400,421	\$ 999,812
Marine	413,004	369,484	782,488
Specialty	232,779	438,587	671,366
Total	\$1,245,174	\$1,208,492	\$ 2,453,666

The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the three months ended September 30, 2014.

(Dollars in thousands)	Three Months Ended September 30, 2014				
	Validus Re Segment	AlphaCat Segment	Talbot Segment	Eliminations	Total
Reserve for losses and loss expenses, beginning of period	\$1,555,946	\$6,194	\$1,384,877	\$(79,710)	\$2,867,307
Losses and loss expenses recoverable	(89,952)	—	(328,492)	79,710	(338,734)
Net reserves for losses and loss expenses, beginning of period	1,465,994	6,194	1,056,385	—	2,528,573
Increase (decrease) in net reserves for losses and loss expenses in respect of losses occurring in:					
Current year	122,145	3,738	153,807	—	279,690
Prior years	(20,140)	—	(35,425)	—	(55,565)
Total incurred losses and loss expenses	102,005	3,738	118,382	—	224,125
Net paid losses	(151,378)	(468)	(106,469)	—	(258,315)
Foreign exchange	(27,184)	(67)	(13,466)	—	(40,717)
Net reserve for losses and loss expenses, end of period	1,389,437	9,397	1,054,832	—	2,453,666
Losses and loss expenses recoverable	82,234	—	295,274	(79,006)	298,502
Reserve for losses and loss expenses, end of period	\$1,471,671	\$9,397	\$1,350,106	\$(79,006)	\$2,752,168

The amount of recorded reserves represents management's best estimate of expected losses and loss expenses on premiums earned. For the three months ended September 30, 2014, favorable loss reserve development on prior accident years was \$55.6 million of which \$20.1 million related to the Validus Re segment, \$nil related to the AlphaCat segment and \$35.4 million related to the Talbot segment.

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The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the nine months ended September 30, 2014.

(Dollars in thousands)	Nine Months Ended September 30, 2014				
	Validus Re Segment	AlphaCat Segment	Talbot Segment	Eliminations	Total
Reserve for losses and loss expenses, beginning of period	\$1,723,465	\$17,612	\$1,362,574	\$(73,252)	\$3,030,399
Losses and loss expenses recoverable	(105,601)	—	(337,805)	73,252	(370,154)
Net reserves for losses and loss expenses, beginning of period	1,617,864	17,612	1,024,769	—	2,660,245
Increase (decrease) in net reserves for losses and loss expenses in respect of losses occurring in:					
Current year	304,684	4,453	404,040	—	713,177
Prior years	(56,836)	(11,608)	(99,192)	—	(167,636)
Total incurred losses and loss expenses	247,848	(7,155)	304,848	—	545,541
Net paid losses	(462,542)	(981)	(268,851)	—	(732,374)
Foreign exchange	(13,733)	(79)	(5,934)	—	(19,746)
Net reserve for losses and loss expenses, end of period	1,389,437	9,397	1,054,832	—	2,453,666
Losses and loss expenses recoverable	82,234	—	295,274	(79,006)	298,502
Reserve for losses and loss expenses, end of period	\$1,471,671	\$9,397	\$1,350,106	\$(79,006)	\$2,752,168

The amount of recorded reserves represents management's best estimate of expected losses and loss expenses on premiums earned. For the nine months ended September 30, 2014, favorable loss reserve development on prior accident years was \$167.6 million of which \$56.8 million related to the Validus Re segment, \$11.6 million related to the AlphaCat segment and \$99.2 million related to the Talbot segment.

The management of insurance and reinsurance companies use significant judgment in the estimation of reserves for losses and loss expenses. Given the magnitude of some notable loss events and other uncertainties inherent in loss estimation, meaningful uncertainty remains regarding the estimation for these events. The Company's actual ultimate net loss may vary materially from these estimates. Ultimate losses for notable loss events are estimated through detailed review of contracts which are identified by the Company as potentially exposed to the specific notable loss event. However, there can be no assurance that the ultimate loss amount estimated for a specific contract will be accurate, or that all contracts with exposure to a specific notable loss event will be identified in a timely manner. Potential losses in excess of the estimated ultimate loss assigned to a contract on the basis of a specific review, or loss amounts from contracts not specifically included in the detailed review may be reserved for in the reserve for potential development on notable loss events. Any reserve for potential development on notable loss events (or "RDE") is included as part of the Company's overall reserve as defined and disclosed in the Critical Accounting Policies and Estimates section.

For disclosure purposes, only those notable loss events which had an initial ultimate loss estimate above \$30.0 million are disclosed separately and included in the reserves for notable loss event roll forward table. To the extent that there are complexity and volatility factors relating to notable loss events in the aggregate, additions to the RDE may be established for a specific accident year. The Company increased the threshold for disclosure for notable loss events effective January 1, 2013 from \$15.0 million to \$30.0 million.

The reserves for notable loss events table below does not disclose 2010 or 2011 notable loss events. Deepwater Horizon, a 2010 event, had closing reserves of \$64.9 million at September 30, 2014, excluding reserves assumed as part of the Flagstone acquisition. The New Zealand earthquakes of 2010 and 2011, had total closing reserves of \$98.2 million at September 30, 2014, excluding reserves assumed as part of the Flagstone acquisition.

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## RESERVES FOR NOTABLE LOSS EVENTS - USD (000's)

2012 NOTABLE LOSS EVENTS	Year Ended December 31, 2012			Year Ended December 31, 2013			Nine Months Ended September 30, 2014		
	Initial Estimate (a)	Development (Favorable) / Allocations Unfavorable of RDE (b)	Closing Estimate (c) December 31, 2012	Development (Favorable) / Allocations Unfavorable of RDE (b)	Closing Estimate (c) December 31, 2013	Development (Favorable) / Allocations Unfavorable of RDE (b)	Closing Estimate (c) September 30, 2014		
Hurricane Sandy	\$361,036	\$—	\$361,036	\$(2,009)	\$359,027	(4,158)	\$354,869		
Costa Concordia Cat 67	76,197	(2,061)	74,136	39,567	113,703	16,100	129,803		
U.S. Drought	22,713	5,377	28,090	(8,817)	19,273	(999)	18,274		
Hurricane Isaac	22,021	—	22,021	4,619	26,640	100	26,740		
Total 2012 Notable Loss Events	15,209	67	15,276	(9,374)	5,902	(20)	5,882		
	\$497,176	\$3,383	\$500,559	\$23,986	\$524,545	\$11,023	\$535,568		

Notable Loss Event	Year Ended December 31, 2012		Year Ended December 31, 2013		Nine Months Ended September 30, 2014	
	Paid Loss (Recovery)	Closing Reserve (d) December 31, 2012	Paid Loss (Recovery)	Closing Reserve (d) December 31, 2013	Paid Loss (Recovery)	Closing Reserve (d) September 30, 2014
Hurricane Sandy	\$38,515	\$322,521	\$134,978	\$185,534	\$40,180	\$141,196
Costa Concordia Cat 67	13,040	61,096	36,456	64,207	34,861	45,446
U.S. Drought	13,432	14,658	2,332	3,509	203	2,307
Hurricane Isaac	12,346	9,675	14,294	—	14	86
Total 2012 Notable Loss Events	313	14,963	3,727	1,862	641	1,201
	\$77,646	\$422,913	\$191,787	\$255,112	\$75,899	\$190,236

2013 NOTABLE LOSS EVENTS	Year Ended December 31, 2013		Nine Months Ended September 30, 2014	
	Development	Closing	Development	Closing



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	Initial Estimate (a)	(Favorable) / Unfavorable Allocations of RDE (b)	Estimate (c) December 31, 2013	(Favorable) / Unfavorable Allocations of RDE (b)	Estimate (c) September 30, 2014
Notable Loss Event European Floods	\$77,587	\$(16,762) —	\$60,825	\$(24,438) —	\$36,387
Total 2013 Notable Loss Events	\$77,587	\$(16,762) \$—	\$60,825	\$(24,438) \$—	\$36,387

	Year Ended December 31, 2013		Nine Months Ended September 30, 2014	
	Paid Loss (Recovery) (d)	Closing Reserve December 31, 2013	Paid Loss (Recovery) (d)	Closing Reserve September 30, 2014
Notable Loss Event European Floods	\$8,006	\$52,819	\$10,941	\$17,440
Total 2013 Notable Loss Events	\$8,006	\$52,819	\$10,941	\$17,440

(a) Includes paid losses, case reserves and IBNR reserves.

(b) Development other than allocation of RDE.

(c) Excludes impact of movements in foreign exchange rates.

(d) Closing Reserve for the period equals Closing Estimate for the period less cumulative Paid Losses.

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## Sources of Liquidity

## Holding Company 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 operating subsidiaries within the Validus Re, AlphaCat and Talbot segments to pay dividends, finance expenses and other holding company expenses. There are restrictions on the payment of dividends from most operating subsidiaries, primarily due to regulatory requirements in the jurisdictions in which the operating subsidiaries are domiciled. The Company believes the dividend/distribution capacity of the Company's subsidiaries will provide the Company with sufficient liquidity for the foreseeable future. The Company continues to generate substantial cash from operating activities and remains in a strong financial position, with resources available for reinvestment in existing businesses, strategic acquisitions and managing capital structure to meet short and long-term objectives.

The following table details the capital resources of certain subsidiaries of the Company on an unconsolidated basis.

	Capital at	
(Dollars in thousands)	September 30, 2014	
Validus Reinsurance, Ltd. (consolidated)	3,730,617	
Noncontrolling interest in PacRe, Ltd.	522,287	
Redeemable noncontrolling interest in AlphaCat ILS fund	70,473	
Talbot Holdings, Ltd. (consolidated)	783,919	
Other subsidiaries, net	79,322	
Other, net (a)	(104,216	)
Total consolidated capitalization	5,082,402	
Senior notes payable	(247,279	)
Debentures payable	(539,953	)
Redeemable noncontrolling interest in AlphaCat ILS fund	(70,473	)
Total shareholders' equity	\$4,224,697	

(a) Other, net includes balances arising from transactions between Validus Holdings, Ltd. and its subsidiaries.

## Sources and Uses of Cash

The Company has written certain (re)insurance 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.

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.

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There are three main sources of cash flows for the Company: operating activities, investing activities and financing activities. The movement in net cash provided by or used in operating, investing and financing activities and the effect of foreign currency rate changes on cash and cash equivalents for the nine months ended September 30, 2014 and 2013 is provided in the following table.

(Dollars in thousands)	Nine Months Ended September 30,		
	2014	2013	Change
Net cash provided by operating activities	\$ 148,851	\$ 204,890	\$(56,039 )
Net cash used in investing activities	(69,766 )	(10,628 )	(59,138 )
Net cash used in financing activities	(280,391 )	(145,838 )	(134,553 )
Effect of foreign currency rate changes on cash and cash equivalents	(11,293 )	(13,185 )	1,892
Net (decrease) increase in cash	\$(212,599 )	\$ 35,239	\$(247,838 )

**Operating Activities**

Cash flow from operating activities is derived primarily from the receipt of premiums less the payment of losses and loss expenses related to underwriting activities.

Net cash provided by operating activities during the nine months ended September 30, 2014 was \$148.9 million compared to \$204.9 million for nine months ended September 30, 2013, an unfavorable movement of \$56.0 million. This unfavorable movement reflects the lower level of business written in the current year and returns on investments made to third party investors in operating affiliates.

We anticipate that cash flows from operations will continue to be sufficient to cover cash outflows under the Company's contractual commitments as well as most loss scenarios through the foreseeable future.

**Investing Activities**

Cash flow from investing activities is derived primarily from the receipt of net proceeds on the Company's investment portfolio. As at September 30, 2014, the Company's portfolio was composed of fixed income investments, short-term and other investments amounting to \$7,073.8 million or 89.3% of total cash and investments.

Net cash used in investing activities during the nine months ended September 30, 2014 was \$69.8 million compared to \$10.6 million for the nine months ended September 30, 2013, an unfavorable movement of \$59.1 million. This unfavorable movement was due primarily to a net increase of \$1,309.8 million in the purchase of short-term investments, offset by a reduction of \$1,252.4 million in the purchase of fixed maturity securities.

**Financing Activities**

Cash flow from financing activities is derived primarily from the issuance and purchase of shares in the Company and its subsidiaries, and the issuance and repayment of notes to operating affiliates.

Net cash used in financing activities during the nine months ended September 30, 2014 was \$280.4 million compared to \$145.8 million during the nine months ended September 30, 2013, an unfavorable movement of \$134.6 million.

This unfavorable movement was driven primarily by a decrease in the net issuance and repayment of notes payable to operating affiliates of \$375.1 million, offset by a decrease in dividends paid of \$239.5 million as a result of the special dividend that was paid in the first quarter of 2013, with no comparative dividend in the nine months ended September 30, 2014.

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## Capital Resources

The following table details the Company's capital position as at September 30, 2014 and December 31, 2013.

Capitalization (Dollars in thousands)	September 30, 2014	December 31, 2013		
Senior Notes (a)	\$247,279	\$247,198		
Junior Subordinated Deferrable Debentures (JSDs) (b)	289,800	289,800		
Flagstone Junior Subordinated Deferrable Debentures (JSDs) (c)	250,153	251,616		
Total debt	787,232	788,614		
Redeemable noncontrolling interest	70,473	86,512		
Ordinary shares, capital and surplus available to Validus	3,705,148	3,704,711		
Accumulated other comprehensive income (loss)	(2,738	) (617	)	)
Noncontrolling interest	522,287	497,657		
Total shareholders' equity (d)	4,224,697	4,201,751		
Total capitalization (d) (f)	5,082,402	5,076,877		
Total capitalization available to Validus (e) (f)	\$4,489,642	\$4,492,708		
Debt to total capitalization	15.5	% 15.5		%
Debt (excluding JSDs) to total capitalization	4.9	% 4.9		%

## Notes

(a) On January 21, 2010, the Company offered and sold \$250.0 million of Senior Notes due 2040 (the "2010 Senior Notes") in a registered public offering. The 2010 Senior Notes mature on January 26, 2040, and are redeemable at the Company's option in whole any time or in part from time to time at a make-whole redemption price. The net proceeds of \$244.0 million from the sale of the 2010 Senior Notes, after the deduction of commissions paid to the underwriters in the transaction and other expenses, was used by the Company for general corporate purposes, which included the repurchase of our outstanding capital stock and dividends to our shareholders.

(b) \$150.0 million of Junior Subordinated Deferrable Debentures (the "2006 Junior Subordinated Deferrable Debentures") were issued on June 15, 2006, mature on June 15, 2036 and have been redeemable at the Company's option at par since June 15, 2011. \$200.0 million of Junior Subordinated Deferrable Debentures ("2007 Junior Subordinated Deferrable Debentures") were issued on June 21, 2007, mature on June 15, 2037 and have been redeemable at the Company's option at par since June 15, 2012. During 2008 and 2009, the Company repurchased \$60.2 million principal amount of its 2007 Junior Subordinated Deferrable Debentures due 2037 from an unaffiliated financial institution.

(c) As part of the acquisition of Flagstone Reinsurance Holdings, S.A., the Company assumed \$137.2 million of junior subordinated deferrable interest debentures due 2036 (the "Flagstone 2006 Junior Subordinated Deferrable Debentures"). The Flagstone 2006 Junior Subordinated Deferrable Debentures mature on September 15, 2036 and have been redeemable at the Company's option at par since September 15, 2011. In addition, the Company assumed \$113.7 million of junior subordinated deferrable interest debentures due 2037 (the "Flagstone 2007 Junior Subordinated Deferrable Debentures"). \$88.8 million of the Flagstone 2007 Junior Subordinated Deferrable Debentures mature on July 30, 2037 and have been redeemable at the Company's option at par since July 30, 2012. \$25.0 million of the Flagstone 2007 Junior Subordinated Deferrable Debentures mature on September 15, 2037 and have been redeemable at the Company's option at par since September 15, 2012.

(d) Total capitalization equals total shareholders' equity plus redeemable noncontrolling interest, Senior Notes and Junior Subordinated Deferrable Debentures.

(e) Total capitalization available to Validus equals total shareholder's equity less noncontrolling interest plus Senior Notes and Junior Subordinated Deferrable Debentures.

(f) The Company does not include notes payable to operating affiliate investors within total capitalization, since these are issued to some of the Company's operating affiliates specifically for the purpose of purchasing capital market products and writing collateralized reinsurance.

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## Shareholders' Equity

Shareholders' equity available to Validus at September 30, 2014 was \$3,702.4 million.

On November 5, 2014, the Company announced a quarterly cash dividend of \$0.30 per common share and \$0.30 per common share equivalent for which each outstanding warrant is exercisable, which is payable on December 31, 2014 to shareholders and warrant holders of record on December 15, 2014. The timing and amount of any future cash dividends, however, will be at the discretion of the Board and will depend upon results of operations and cash flows, the Company's financial position and capital requirements, general business conditions, legal, tax, regulatory, rating agency and contractual constraints or restrictions and any other factors that the Board deems relevant.

On February 6, 2013, the Company approved a special dividend in the amount of \$2.00 per common share and common share equivalent. The dividend was paid on February 26, 2013 to shareholders and warrant holders of record on February 19, 2013. On the same date the Board also approved an increase in the Company's regular quarterly dividend to \$0.30 from \$0.25 per common share and common share equivalent for which each outstanding warrant is exercisable.

The Company may from time to time repurchase its securities, including common shares, Junior Subordinated Deferrable Debentures and Senior Notes. On February 5 and October 31, 2013, the Board of Directors of the Company approved increases in its common share repurchase authorization to \$500.0 million and \$500.0 million, respectively. On February 5, 2014, the Board of Directors of the Company approved a further increase to the Company's common share repurchase authorization to \$500.0 million. This amount is in addition to the \$1,774.4 million of common shares repurchased by the Company through February 5, 2014 under its previously authorized share repurchase programs.

The Company expects the purchases under its share repurchase program to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company's capital position relative to internal and rating agency targets, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of Directors at any time.

## Debt and Financing Arrangements

The following table details the Company's borrowings and credit facilities as at September 30, 2014.

(Dollars in thousands)	Maturity Date / Term	Commitments	Issued and Outstanding (a)
2006 Junior Subordinated Deferrable Debentures	June 15, 2036	\$ 150,000	\$ 150,000
2007 Junior Subordinated Deferrable Debentures	June 15, 2037	200,000	139,800
2010 Senior Notes due 2040	January 26, 2040	250,000	250,000
\$400,000 syndicated unsecured letter of credit facility	March 9, 2016	400,000	—
\$525,000 syndicated secured letter of credit facility	March 9, 2016	525,000	301,340
\$200,000 secured bi-lateral letter of credit facility	Evergreen	200,000	19,743
Talbot FAL Facility	December 31, 2015	25,000	25,000
PaCRe senior secured letter of credit facility	Evergreen	10,000	294
AlphaCat Re secured letter of credit facility	Evergreen	30,000	30,000
IPC Bi-Lateral Facility	Evergreen	40,000	16,975
\$375,000 Flagstone bi-lateral facility	Evergreen	375,000	288,739
Flagstone 2006 Junior Subordinated Deferrable Debentures	September 15, 2036	136,403	136,403
Flagstone 2007 Junior Subordinated Deferrable Debentures	September 15, 2037	113,750	113,750
Total		\$2,455,153	\$1,472,044

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

Please refer to Note 12 to the Consolidated Financial Statements (Part I, Item 1) for further discussion of the Company's debt and financing arrangements.

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## Ratings

The following table summarizes the financial strength ratings of the Company and its principal reinsurance and insurance subsidiaries from internationally recognized rating agencies as of November 7, 2014:

	A.M. Best (a)	S&P (b)	Moody's (c)	Fitch (d)
Validus Holdings, Ltd.				
Issuer credit rating	bbb	BBB+	Baa2	A-
Senior debt	bbb	BBB+	Baa2	BBB-
Subordinated debt	bbb-	BBB	Baa3	—
Preferred stock	bb+	BBB-	Ba1	—
Outlook on ratings	Stable	Stable	Positive	Stable
Validus Reinsurance, Ltd.				
Financial strength rating	A	A	A3	A
Outlook on ratings	Stable	Stable	Positive	Stable
Lloyd's of London				
Financial strength rating applicable to all Lloyd's syndicates	A	A+	—	AA-
Outlook on ratings	Positive	Stable	—	Stable
Talbot Syndicate 1183				
Financial strength rating	A	—	—	—
Outlook on ratings	Positive	—	—	—
Validus Reinsurance (Switzerland), Ltd.				
Financial strength rating	A	A-	—	—
Outlook on ratings	Stable	Stable	—	—

The A.M. Best ratings were most recently affirmed on February 25, 2014 for Validus Holdings, Ltd, Validus (a) Reinsurance, Ltd and Validus Reinsurance (Switzerland), Ltd. The A.M. Best rating for Lloyd's was most recently affirmed on July 24, 2014. The A.M. Best rating for Talbot Syndicate 1183 was assigned on June 18, 2014.

The S&P ratings were most recently affirmed on August 23, 2012 for Validus Holdings, Ltd and Validus (b) Reinsurance, Ltd. The S&P rating for Validus Reinsurance (Switzerland), Ltd. was issued on December 11, 2013.

On October 13, 2014, the S&P rating for Lloyd's was affirmed and the outlook was revised from positive to stable.

The Moody's ratings were most recently affirmed on June 25, 2014 for Validus Holdings, Ltd and Validus (c) Reinsurance, Ltd.

The Fitch ratings were most recently affirmed on August 19, 2014 for Validus Holdings, Ltd. and Validus (d) Reinsurance, Ltd. The Fitch rating for Lloyds was upgraded on June 10, 2014.

## Recent accounting pronouncements

Please refer to Note 2 to the Consolidated Financial Statements (Part I, Item 1) for discussion of relevant recent accounting pronouncements.



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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 the Company's Consolidated Financial Statements:

- 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 premiums ceded and reinsurance recoverable balances including the provision for uncollectible amounts; and
- Investment valuation of financial assets.

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, 2013.

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 future or 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:

- unpredictability and severity of catastrophic events;
- our ability to obtain and maintain ratings, which may affect our ability to raise additional equity or debt financings, as well as other factors described herein;
- adequacy of the Company's risk management and loss limitation methods;
- cyclical nature of demand and pricing in the insurance and reinsurance markets;
- 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;
- the Company'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;



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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 operate;

the integration of businesses we may acquire or new business ventures, including overseas offices, we may start and the risk associated with implementing our business strategies and initiatives with respect to the new business ventures; 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, 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 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 the Company;

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

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 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; and

the other factors set forth under Part I Item 1A "Risk Factors" and under Part II Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the other sections of the Company's Annual Report on Form 10-K for the year ended December 31, 2013, 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 the Company, 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 the Company will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company, the business or operations. The Company undertakes no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future developments or otherwise.

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

We are principally exposed to five types of market risk:

- interest rate risk;
- foreign currency risk;
- credit risk;
- liquidity risk; and
- inflation risk.

**Interest Rate Risk:** 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 and credit spreads widen, 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 and credit spreads tighten, the market value of the Company's fixed income portfolio increases and the Company has reinvestment risk, as funds reinvested may 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 September 30, 2014 and December 31, 2013, 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 been an estimated decrease in market value of 1.9% and 1.6%, or approximately \$98.6 million and \$106.0 million, respectively. As at September 30, 2014 and December 31, 2013, the impact on the Company's fixed maturity portfolio from an immediate 100 basis point decrease in market interest rates would have been an estimated increase in market value of 1.9% and 1.5% or approximately \$96.8 million and \$98.1 million, respectively.

As at September 30, 2014, the Company held \$1,132.7 million (December 31, 2013: \$836.9 million), or 24.3% (December 31, 2013: 15.1%), 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 would be exposed to reinvestment risk, as cash flows received by the Company could be accelerated and would be reinvested at the prevailing interest rates.

**Foreign Currency Risk:** Certain of the Company's (re)insurance 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 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 these contracts with cash and investments that are denominated in such currencies. As of September 30, 2014, approximately \$719.4 million, or 7.2% of our total assets and \$781.3 million, or 13.6% of our total liabilities were denominated in foreign currencies. As of September 30, 2014, approximately \$109.7 million, or 1.9% of our total liabilities denominated in foreign currencies were non-monetary items which do not require revaluation at each reporting date. As of December 31, 2013, \$877.4 million, or 9.0% of our total assets and \$912.8 million, or 16.7% of our total liabilities were denominated in foreign currencies. As of December 31, 2013, \$133.4 million, or 2.4% of our total liabilities denominated in foreign currencies were non-monetary items which do not require revaluation at each reporting date. When necessary, we may also use derivatives to economically hedge un-matched foreign currency exposures, specifically forward contracts. Foreign currency forward contracts do not eliminate fluctuations in the value of our assets and liabilities denominated in foreign currencies but rather allow us to establish a rate of exchange for a future point in time. For further information on the accounting treatment of our foreign currency derivatives, refer to Note 7 of Part I, Item 1 - Consolidated Financial Statements. To the extent foreign currency exposure is not hedged or otherwise matched, the Company may experience exchange losses, which in turn would adversely affect the results of operations and financial condition.



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**Credit Risk:** The Company's exposed to credit risk from the possibility that counterparties may default on their obligations. The Company's primary credit risks reside in investment in U.S. and non-U.S. corporate bonds and amounts recoverable from reinsurers. The Company attempts to limit its credit exposure by purchasing high quality fixed income investments to maintain a minimum weighted-average portfolio credit rating of A+. In addition, the portfolio limits the amount of "risk assets", such as non-investment grade debt and equity securities, to a maximum of 35% of shareholders' equity. In addition, the Company limits its exposure to any single issuer to 3.5% of its investment portfolio or less, excluding government and agency securities, depending on the credit rating of the issuer. With the exception of the bank loan portfolio and certain capital securities issued by investment grade corporations, the minimum credit rating of any security purchased is Baa3/BBB-. In total, investments in below investment grade securities are limited to no more than 10% of the Company's investment portfolio. At September 30, 2014, 1.7% of the portfolio, excluding bank loans, was below BBB-/Baa3 and there was no aggregate exposure to any single issuer of more than 0.9% of total investments, other than with respect to government and agency securities.

The amount of the maximum exposure to credit risk is indicated by the carrying value of the Company's financial assets. 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. At September 30, 2014, 97.3% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A- or above, (December 31, 2013: 96.7%, rated A-) or from reinsurers posting full collateral.

**Liquidity risk:** Certain of the Company's investments may become illiquid. Disruptions in the credit markets may materially affect the liquidity of the Company's investments, including non-agency residential mortgage-backed securities and bank loans which represent 6.3% (December 31, 2013: 9.2%) of total cash and investments at September 30, 2014. 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 September 30, 2014, the Company had \$1,615.1 million of unrestricted, liquid assets, defined as unpledged cash and cash equivalents, short term investments and government and government agency securities. Details of the Company's debt and financing arrangements at September 30, 2014 are provided below.

(Dollars in thousands)	Maturity Date / Term	In Use / Outstanding
2006 Junior Subordinated Deferrable Debentures	June 15, 2036	\$150,000
2007 Junior Subordinated Deferrable Debentures	June 15, 2037	139,800
2010 Senior Notes due 2040	January 26, 2040	250,000
\$400,000 syndicated unsecured letter of credit facility	March 9, 2016	—
\$525,000 syndicated secured letter of credit facility	March 9, 2016	301,340
\$200,000 secured bi-lateral letter of credit facility	Evergreen	19,743
Talbot FAL facility	December 31, 2015	25,000
PaCRe senior secured letter of credit facility	Evergreen	294
AlphaCat Re secured letter of credit facility	Evergreen	30,000
IPC Bi-Lateral Facility	Evergreen	16,975
\$375,000 Flagstone bi-lateral facility	Evergreen	288,739
Flagstone 2006 Junior Subordinated Deferrable Debentures	September 15, 2036	136,403
Flagstone 2007 Junior Subordinated Deferrable Debentures	September 15, 2037	113,750
Total		\$1,472,044

**Inflation Risk:** We do not believe that inflation has had or will have a material effect on the Company's combined results of operations, except insofar as (a) inflation may affect interest rates, and (b) losses and loss expenses may be

affected by inflation.

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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 recorded, processed, summarized and reported when required and the information is accumulated and communicated, as appropriate, to allow timely decisions regarding required disclosures.

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.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

During the normal course of business, the Company and its subsidiaries are subject to litigation and arbitration. Legal proceedings such as claims litigation are common in the insurance and reinsurance industry in general. The Company and its subsidiaries may be subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on reinsurance treaties or contracts or insurance policies.

Litigation typically can include, but is not limited to, allegations of underwriting errors or misconduct, employment claims, regulatory activity, shareholder disputes or disputes arising from business ventures. These events are difficult, if not impossible, to predict with certainty. It is Company policy to dispute all allegations against the Company and/or its subsidiaries that management believes are without merit.

As at September 30, 2014, the Company was not a party to, or involved in any litigation or arbitration that it believes could have a material adverse effect on the financial condition, results of operations or liquidity of the Company.

ITEM 1A. RISK FACTORS

Please refer to the discussion of Risk Factors in Part 1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

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

The Company has repurchased approximately 66.3 million common shares for an aggregate purchase price of \$2,078.0 million from the inception of the share repurchase program to November 5, 2014.

The Company expects the purchases under its share repurchase program to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company's capital position relative to internal and rating agency targets, legal requirements and other factors.

On February 5, 2014, the Board of Directors of the Company approved an increase to the Company's common share repurchase authorization to \$500.0 million. This amount is in addition to the \$1,774.4 million of common shares repurchased by the Company through February 5, 2014 under its previously authorized share repurchase programs. The repurchase program may be modified, extended or terminated by the Board of Directors at any time. The remaining amount available under the current share repurchase authorization was \$196.4 million as of November 5, 2014.

Share repurchases include repurchases by the Company of shares, from time to time, from employees in order to facilitate the payment of withholding taxes on restricted shares that have vested. We repurchase these shares at their



fair market value, as determined by reference to the closing price of our common shares on the day the restricted shares vested.

Share Repurchase Activity  
(Expressed in thousands of U.S. dollars except for share and per share information)  
As at June 30,  
2014

	(cumulative)	July	August	September	Quarter ended September 30, 2014
Effect of share repurchases:					
Aggregate purchase price (a)	\$1,917,688	\$6,887	\$40,929	\$41,371	\$89,187
Shares repurchased	62,171,982	\$187,661	\$1,082,445	\$1,060,322	\$2,330,428
Average price (a)	\$30.84	\$36.70	\$37.81	\$39.02	\$38.27
Estimated cumulative net accretive (dilutive) impact on:					
Diluted BV per common share (b)					\$3.00
Diluted EPS - Quarter (c)					\$0.12

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Effect of share repurchases:	Share Repurchase Activity				
	(Expressed in thousands of U.S. dollars except for share and per share information)				
	As at September 30, 2014 (cumulative)	October	November	As at November 5, 2014	Cumulative to Date Effect
Aggregate purchase price (a)	\$2,006,875	\$65,633	\$5,523	\$71,156	\$2,078,031
Shares repurchased	64,502,410	1,663,577	139,558	1,803,135	66,305,545
Average price (a)	\$31.11	\$39.45	\$39.57	\$39.46	\$31.34

- (a) Share transactions are on a trade date basis through November 5, 2014 and are inclusive of commissions.  
Average share price is rounded to two decimal places.

As the average price per share repurchased during the periods from 2009 at the inception of the share repurchase (b) program through to 2013 was lower than the book value per common share, the repurchase of shares increased the ending book value per share.

- The estimated impact on earnings per diluted share was calculated by comparing reported results versus i) net income per share plus an estimate of lost net investment income on the cumulative share repurchases divided by ii) (c) weighted average diluted shares outstanding excluding the weighted average impact of cumulative share repurchases. The impact of cumulative share repurchases was accretive to earnings per diluted share.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit	Description
Exhibit 10.1	Stock Purchase Agreement, dated as of June 23, 2014, by and among Western World Insurance Group, Inc., the shareholders of Western World Insurance Group, Inc., Validus Specialty, Inc., Validus Holdings, Ltd. (solely for purposes of Article I, Section 5.08, Section 6.08, Section 9.03 and Article XI), and Andrew S. Frazier (in his capacity as the Sellers' Representative)(Incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on June 27, 2014).
Exhibit 31.1*	Certification of Chief Executive Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
Exhibit 31.2*	Certification of Chief Financial Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
Exhibit 32*	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
Exhibit 101.1 INS*	XBRL Instance Document
Exhibit 101.SCH*	XBRL Taxonomy Extension Schema Document
Exhibit 101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
Exhibit 101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
Exhibit 101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document
Exhibit 101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document

\*Filed herewith

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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: November 7, 2014

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

Date: November 7, 2014

/s/ Jeffrey D. Sangster  
Jeffrey D. Sangster  
Executive Vice President and Chief Financial Officer