

VALIDUS HOLDINGS LTD

Form 10-K

February 27, 2009

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

Form 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008**

Commission file number 001-33606

VALIDUS HOLDINGS, LTD.

(Exact name of registrant as specified in its charter)

BERMUDA

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

98-0501001

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

19 Par-La-Ville Road, Hamilton, Bermuda HM 11

(Address of principal executive offices and zip code)

(441) 278-9000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:

Name of Each Exchange on Which Registered:

Common Shares, \$0.175 par value per share

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2008 was \$796.8 million computed upon the basis of the closing sales price of the Common Shares on June 30, 2008. For the purposes of this computation, shares held by directors and officers of the registrant have been excluded. Such exclusion is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

As of February 27, 2009, there were 75,717,528 outstanding Common Shares, \$0.175 par value per share, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates information from certain portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the fiscal year end of December 31, 2008.

Validus Holdings, Ltd.**2008 Form 10-K Annual Report****TABLE OF CONTENTS**

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This Annual Report on Form 10-K contains Forward-Looking Statements as defined in the Private Securities Litigation Reform Act of 1995. A non-exclusive list of the important factors that could cause actual results to differ materially from those in such Forward-Looking Statements is set forth herein under the caption Management's

Discussion and Analysis of Financial Condition and Results of Operations *Cautionary Note Regarding Forward-Looking Statements.*

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PART I

All amounts presented in this part are in U.S. dollars except as otherwise noted.

Item 1. Business

Overview

Validus Holdings, Ltd. (the Company) was incorporated under the laws of Bermuda on October 19, 2005. Our initial investor, which we refer to as our founding investor, is Aquiline Capital Partners LLC, a private equity firm dedicated to investing in financial services companies. Other sponsoring investors include private equity funds managed by Goldman Sachs Capital Partners, Vestar Capital Partners, New Mountain Capital and Merrill Lynch Global Private Equity. The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. (Validus Re) and Talbot Holdings Ltd. (Talbot). The Company, through its subsidiaries, provides reinsurance coverage in the Property, Marine and Specialty lines markets, effective January 1, 2006, and insurance coverage in the same markets effective July 2, 2007.

We seek to establish ourselves as a leader in the global insurance and reinsurance markets. Our principal operating objective is to use our capital efficiently by underwriting primarily short-tail insurance and reinsurance contracts with superior risk and return characteristics. Our primary underwriting objective is to construct a portfolio of short-tail insurance and reinsurance contracts which maximize our return on equity subject to prudent risk constraints on the amount of capital we expose to any single extreme event. We manage our risks through a variety of means, including contract terms, portfolio selection, diversification criteria, including geographic diversification criteria, and proprietary and commercially available third-party vendor models. We have assembled a senior management team with substantial industry expertise and longstanding industry relationships. We are well positioned to take advantage of current market conditions; we have also built our operations so that we may effectively take advantage of future market conditions as they develop.

Since our formation in 2005, we have been able to achieve substantial success in the development of our business. Selected examples of our accomplishments are as follows:

Assembling an executive management team with an average of 21 years of industry experience and senior expertise spanning multiple aspects of the global insurance and reinsurance business;

Building a risk analytics staff comprised of over 20 experts, many of whom have PhDs and Masters degrees in related fields;

Developing Validus Capital Allocation and Pricing System (VCAPS), a proprietary computer-based system for modeling, pricing, allocating capital and analyzing catastrophe-exposed risks;

Raising approximately \$1.0 billion of initial equity capital in December 2005;

Augmenting our equity through the placement of \$150.0 million of Junior Subordinated Deferrable Debentures in June 2006;

Underwriting \$362.0 million in gross premiums written for the January 1, 2007 renewal season in the Validus Re segment, representing an increase of \$144.6 million or 66.5% over the comparable period for 2006;

Issuing an additional \$200.0 million in aggregate principal amount of junior subordinated deferrable debentures due 2037 in June 2007;

Acquiring all of the outstanding shares of Talbot Holdings Ltd. on July 2, 2007;

Completing an initial public offering (IPO) on July 30, 2007;

Recording net income of \$402.9 million for the year ended December 31, 2007;

Underwriting \$291.0 million in gross premiums written for the January 1, 2008 renewal season in the Validus Re segment;

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Opening offices in Miami, Singapore City and New York City in 2008;

Increasing our shareholders' equity to \$1.94 billion in 2008 despite losses attributable to Hurricane Ike and turbulent credit market conditions; and

Underwriting \$366.7 million in gross premiums written for the January 2009 renewal season in the Validus Re segment, representing an increase of \$75.7 million or 26.0% over the January 2008 renewal season.

Our Operating Subsidiaries

The following chart shows how our Company and its principal operating subsidiaries are organized.

Our Segments

Validus Re: Validus Re, the Company's principal reinsurance operating subsidiary, operates as a Bermuda-based provider of short-tail reinsurance products on a global basis. Validus Re concentrates on first-party risks, which are property risks and other reinsurance lines commonly referred to as short-tail in nature due to the relatively brief period between the occurrence and payment of a claim.

Validus Re was registered as a Class 4 insurer under The Insurance Act 1978 of Bermuda, amendments thereto and related regulations (the Insurance Act) in November 2005. It commenced operations with approximately \$1.0 billion of equity capital and a balance sheet unencumbered by any historical losses relating to the 2005 hurricane season, the events of September 11, 2001, asbestos or other legacy exposures affecting our industry.

Validus Re entered the global reinsurance market in 2006 during a period of imbalance between the supply of underwriting capacity available for reinsurance on catastrophe-exposed property, marine and energy risks and demand for such reinsurance coverage.

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The following are the primary lines in which Validus Re conducts its business. Details of gross premiums written by line of business are provided below:

Line of Business (Dollars in thousands)	Year Ended December 31, 2008		Year Ended December 31, 2007		Year Ended December 31, 2006	
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)
Property	\$ 492,967	71.7%	\$ 498,375	71.0%	\$ 370,958	68.6%
Marine	117,744	17.1%	136,710	19.5%	104,584	19.3%
Specialty	77,060	11.2%	67,013	9.5%	65,247	12.1%
Total	\$ 687,771	100.0%	\$ 702,098	100.0%	\$ 540,789	100.0%

Property: Validus Re underwrites property catastrophe reinsurance, property per risk reinsurance and property pro rata reinsurance.

Property catastrophe: Property catastrophe provides reinsurance for insurance companies' exposures to an accumulation of property and related losses from separate policies, typically relating to natural disasters or other catastrophic events. Property catastrophe reinsurance is generally written on an excess of loss basis, which provides coverage to primary insurance companies when aggregate claims and claim expenses from a single occurrence from a covered peril exceed a certain amount specified in a particular contract. Under these contracts, the Company provides protection to an insurer for a portion of the total losses in excess of a specified loss amount, up to a maximum amount per loss specified in the contract. In the event of a loss, most contracts provide for coverage of a second occurrence following the payment of a premium to reinstate the coverage under the contract, which is referred to as a reinstatement premium. The coverage provided under excess of loss reinsurance contracts may be on a worldwide basis or limited in scope to specific regions or geographical areas. Coverage can also vary from all property perils, which is the most expansive form of coverage, to more limited coverage of specified perils such as windstorm-only coverage. Property catastrophe reinsurance contracts are typically all risk in nature, providing protection against losses from earthquakes and hurricanes, as well as other natural and man-made catastrophes such as floods, tornadoes, fires and storms. The predominant exposures covered are losses stemming from property damage and business interruption coverage resulting from a covered peril. Certain risks, such as war or nuclear contamination may be excluded, partially or wholly, from certain contracts. Gross premiums written on property catastrophe business during the year ended December 31, 2008 were \$328.2 million.

Property per risk: Property per risk provides reinsurance for insurance companies' excess retention on individual property and related risks, such as highly-valued buildings. Risk excess of loss reinsurance protects insurance companies on their primary insurance risks on a single risk basis. A risk in this context might mean the insurance coverage on one building or a group of buildings or the insurance coverage under a single policy which the reinsured treats as a single risk. Coverage is usually triggered by a large loss sustained by an individual risk rather than by smaller losses which fall below the specified retention of the reinsurance contract. Such property risk coverages are generally written on an excess of loss basis, which provides the reinsured protection beyond a specified amount up to the limit set within the reinsurance contract. Gross premiums written on property per risk business during the year ended December 31, 2008 were \$54.1 million.

Property pro rata: Property pro rata contracts require that the reinsurer share the premiums as well as the losses and expenses in an agreed proportion with the cedant. Gross premiums written on property pro rata business during the year ended December 31, 2008 were \$110.7 million.

Marine: Validus Re underwrites reinsurance on marine risks covering damage to or losses of marine vessels and cargo, third-party liability for marine accidents and physical loss and liability from principally offshore energy properties. Validus Re underwrites marine on an excess of loss basis, and to a lesser extent, on a pro rata basis. Gross premiums written on marine business during the year ended December 31, 2008 were \$117.7 million.

Specialty: Validus Re underwrites other lines of business depending on an evaluation of pricing and market conditions, which include aerospace, terrorism, life and accident & health, financial lines, and workers

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compensation catastrophe. The Company seeks to underwrite other specialty lines with very limited exposure correlation with its property, marine and energy portfolios. With the exception of the aerospace line of business, which has a meaningful portion of its gross premiums written volume on a proportional basis, the Company's other specialty lines are written on an excess of loss basis. Gross premiums written on specialty business during the year ended December 31, 2008 were \$77.1 million.

Talbot: On July 2, 2007, the Company acquired all of the outstanding shares of Talbot. Talbot is the Bermuda parent of a specialty insurance group primarily operating within the Lloyd's of London (Lloyd's) insurance market through Syndicate 1183. The acquisition of Talbot provides us with significant benefits in terms of product line and geographic diversification as well as offering us broader access to underwriting expertise. Similar to Validus Re, Talbot writes primarily short-tail lines of business but, as a complement to Validus Re, focuses mostly on insurance, as opposed to reinsurance, risks and on specialty lines where Validus Re currently has limited or no presence (e.g., war, financial institutions, contingency, bloodstock and livestock, accident and health). In addition, Talbot provides us with access to the Lloyd's marketplace where Validus Re does not operate. As a London-based insurer, Talbot also writes the majority of its premiums on risks outside the United States. Talbot's team of underwriters have, in many cases, spent most of their careers writing niche, short-tail business and bring their expertise to bear on expanding our short-tail insurance and reinsurance franchise.

The following are the primary lines in which Talbot conducts its business. Details of gross premiums written by line of business are provided below:

Line of Business (Dollars in thousands)	Year Ended December 31, 2008		Year Ended December 31, 2007(1)	
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)
Property	\$ 152,142	21.4%	\$ 151,245	22.0%
Marine	287,696	40.6%	264,008	38.4%
Specialty	269,158	38.0%	272,472	39.6%
Total	\$ 708,996	100.0%	\$ 687,725	100.0%

(1) Talbot was acquired on July 2, 2007. Talbot's gross premium written for the full year ended December 31, 2007 has been presented above for informational purposes only and is not included within the consolidated results for that period.

Property: The main sub-classes within property are international and North American direct and facultative contracts, lineslips and binding authorities together with a book of business written on a treaty reinsurance basis. The business written is mostly commercial and industrial insurance though there is a modest personal lines component. The business is short-tail with reinsurance risks substantially earned within 12 months, direct and facultative risks substantially earned after 18 months and lineslips and binding authorities earned within 24 months of the expiry of the contract. Gross premiums written on property business during the year ended December 31, 2008 were \$152.1 million, including \$51.0 million of treaty reinsurance.

Marine: The main types of business within marine are hull, cargo, energy, marine and energy liabilities, yachts and marinas and other treaty. Hull consists primarily of ocean going vessels and cargo and covers worldwide risks. Energy covers a variety of oil and gas industry risks. The marine and energy liability account provides cover for protection and indemnity clubs and a wide range of companies operating in the marine and energy sector. Yacht and marina policies are primarily written through Underwriting Risk Services Ltd., an underwriting agency that is a subsidiary of Talbot. Each of the sub-classes within marine has a different profile of contracts written – some, such as energy, derive up to 50% of their business through writing facultative contracts while others, such as cargo, only derive 15% of their business from this method. Each of the sub-classes also has a different geographical risk allocation. Most business written is short-tail which helps to establish confidence over profitability levels quickly; the marine and energy liability account, which makes up \$35.1 million of the \$287.7 million of gross premiums written during the year ended December 31, 2008, is the primary long-tail class in this line. The business written is

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mainly on a direct and facultative basis with a small element written on a reinsurance basis either as excess of loss reinsurance or proportional reinsurance. Gross premiums written on marine business during the year ended December 31, 2008 were \$287.7 million.

Specialty: This class consists of war (which comprises marine & aviation war, political risks and political violence), financial institutions, contingency, bloodstock and livestock, accident and health, and aviation. With the exception of aviation and other treaty, most of the business written under the specialty accounts is written on a direct or facultative basis or under a binding authority through a coverholder. Gross premiums written on specialty business during the year ended December 31, 2008 were \$269.2 million.

War. The marine & aviation war account covers physical damage to aircraft and marine vessels caused by acts of war and terrorism. The political risk account deals primarily with expropriation, contract frustration/trade credit, kidnap and ransom, and malicious and accidental product tamper. The political violence account mainly insures physical loss to property or goods anywhere in the world, caused by war, terrorism or civil unrest. This class is often written in conjunction with cargo, specie, property, energy, contingency and political risk. The period of the risks can extend up to 36 months and beyond, particularly with construction risks. The attritional losses on the account are traditionally low but the account can be affected by large individual losses. Talbot is a leader in the war and political violence classes. Gross premiums written for war business during the year ended December 31, 2008 were \$128.7 million.

Financial Institutions. Talbot's financial institutions team predominantly underwrites bankers blanket bond, professional indemnity and directors and officers coverage for various types of financial institutions and similar companies. Bankers blanket bond insurance products are specifically designed to protect against direct financial loss caused by fraud/criminal actions and mitigate the damage such activities may have on the asset base of these institutions. Professional indemnity insurance protects businesses in the event that legal action is taken against them by third parties claiming to have suffered a loss as a result of advice received. Directors and officers insurance protects directors and officers against personal liability for losses incurred by a third party due to negligent performance by the director or officer. Gross premiums written in financial institutions for the year ended December 31, 2008 were \$42.3 million, comprised of:

(Dollars in thousands)	Year Ended December 31, 2008	
	Gross Premiums Written	Gross Premiums Written (%)
Bankers blanket bond	\$ 26,597	62.9%
Professional indemnity	14,360	34.0%
Directors and Officers	1,285	3.0%
Other	21	0.1%
Total	\$ 42,263	100.0%

The risks covered in financial institutions are primarily fraud related and are principally written on an excess of loss basis. Talbot's financial institutions account is concentrated on non-U.S. based clients, with 41.2% of gross premiums written in 2008 generated in Europe, 20.3% from the U.S and 38.5% from other geographical regions. In addition, Talbot seeks to write regional accounts rather than global financial institutions with exposure in multiple jurisdictions and has only limited participation in exposures to publicly listed U.S. companies. The underwriters actively avoid writing U.S. directors and officers risks. The Company has identified no liability exposure to any U.S. domiciled

financial institution that has announced a write down related to the current credit crisis. As of December 31, 2008, the Company had gross reserves related to the financial institutions business of \$111.1 million, comprised of \$71.2 million, or 64.1% of IBNR and \$39.9 million, or 35.9% of case reserves.

Contingency. The main types of covers written under the contingency account are event cancellation and non-appearance business. Gross premiums written for contingency business during the year ended December 31, 2008 were \$22.9 million.

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Bloodstock and Livestock. The bloodstock and livestock account mainly insures bloodstock, livestock, agricultural, zoological, private and commercial risks. Gross premiums written for bloodstock and livestock business during the year ended December 31, 2008 were \$16.9 million.

Accident and Health. The accident and health account provides insurance in respect of individuals in both their personal and business activity together with corporations where they have an insurable interest relating to death or disability of employees or those under contract. Gross premiums written for accident and health business during the year ended December 31, 2008 were \$18.3 million.

Aviation. The aviation account insures major airlines, general aviation, aviation hull war and satellites. The coverage is mainly excess of loss treaty with medium to high attachment points. Gross premiums written for aviation business during the year ended December 31, 2008 were \$40.0 million.

Underwriting and Risk Management

We underwrite and manage risk by paying close attention to risk selection and analysis. Through a detailed examination of contract terms, diversification criteria, contract experience and exposure, we aim to outperform our peers. We strive to provide our experienced underwriters with technically sound and objective information. We believe a strong working relationship between the underwriting, catastrophe modeling and actuarial disciplines is critical to long-term success and solid decision-making.

A principal focus of the Company is to develop and apply sophisticated computer models and other analytical tools to assess the risks and aggregation of the risks that we underwrite and to optimize our portfolio of contracts. In particular, we devote a substantial amount of our efforts to the optimization of our catastrophe risk profile. In addition to using Probable Maximum Loss (PML) and other risk metrics, that measures the maximum amount of loss expected from our portfolio measured over various return periods or measured probabilistically, our approach to risk control imposes a limit on our net maximum potential loss for any single event in any one risk zone, which reduces the risks inherent in probabilistic modeling. Further, we recognize that the reliability and credibility of the models is contingent upon the accuracy, reliability and quality of the data that is used in modeling efforts.

The Company has chartered a Group Risk Management Committee (the GRMC) chaired by its Chief Risk Officer and composed of senior management of the Company. The GRMC was established as part of the Company s implementation of enterprise risk management (ERM). The GRMC is responsible for monitoring and managing risks in close coordination with risk management committees and personnel within our operating subsidiaries. The GRMC meets monthly to review and discuss key risks, make decisions to manage those risks and oversee implementation of those decisions. The GRMC also has oversight over the risk management organization, ensuring the availability of appropriate risk management resources.

Underwriting

All of the Company s underwriters are subject to a set of underwriting guidelines that are established by the Chief Underwriting Officer at Validus Re and the Chief Executive Officer at Talbot and are subject to review and approval by the Underwriting Committee of our Board of Directors. They are also issued letters of authority that more specifically address the limits of their underwriting authority and their referral criteria. The Company s current underwriting guidelines and letters of authority include:

lines of business that a particular underwriter is authorized to write;

exposure limits by line of business;

contractual exposures and limits requiring mandatory referrals to the Chief Underwriting Officer at Validus Re and the Chief Executive Officer at Talbot; and

level of analysis to be performed by lines of business.

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In general, our underwriting approach is to:

seek high quality clients who have demonstrated superior performance over an extended period;

evaluate our clients' exposures and make adjustments where their exposure is not adequately reflected;

apply the comprehensive knowledge and experience of our entire underwriting team to make progressive and cohesive decisions about the business they underwrite;

employ our well-founded and carefully maintained market contacts within the group to enhance our robust distribution capabilities; and

refer submissions to the Chief Underwriting Officer at Validus Re, the Chief Executive Officer at Talbot, Chief Executive Officer at Validus Re and the Underwriting Committee of our Board of Directors according to our underwriting guidelines.

The underwriting guidelines are subject to waiver or change by the Chief Underwriting Officer at Validus Re or the Chief Executive Officer at Talbot subject to their authority as overseen by their respective Underwriting Committees.

Our underwriters have the responsibility to analyze all submissions and determine if the related potential exposures meet with both the Company's risk profile line size and aggregate limitations. In order to ensure compliance, we run underwriting reports and conduct periodic audits. Further, our treaty reinsurance operation has the authority limits of individual underwriters built into VCAPS while Talbot maintains separate compliance procedures to ensure that the appropriate policies and guidelines are followed.

Validus Re: We have established a referral process whereby business exceeding set exposure or premium limits is referred to the Chief Underwriting Officer for review. As the reviewer of such potential business, the Chief Underwriting Officer has the ability to determine if the business meets the Company's overall desired risk profile. The Chief Underwriting Officer has defined underwriting authority for each underwriter, and risks outside of this authority must be referred to the Chief Underwriting Officer. The Underwriting Committee reviews business that is outside the authority of the Chief Underwriting Officer.

Talbot: Our risk review and control processes have been designed to ensure that all written risks comply with underwriting and risk control strategies. The various types of review are sequential in timing and emphasize the application of an appropriate level of scrutiny. A workflow system automates the referral of risks to relevant reviewers. These reviews are monitored and reports prepared on a regular basis.

Collectively, the various peer review procedures serve numerous objectives, including:

Validating that underwriting decisions are in accordance with risk appetite, authorities, agreed business plans and standards for type, quality and profitability of risk;

Providing an experienced and suitably qualified second review of individual risks;

Ensuring that risks identified as higher risks undergo the highest level of technical underwriting review;

Elevating technical underwriting queries and/or need for remedial actions on a timely basis; and

Improving database accuracy and coding for subsequent management reporting.

The principal elements of the underwriting review process are as follows:

Underwriter Review: The underwriter must evidence data entry review by confirming review and agreement on the workflow system within a specified number of working days of entry being completed by the contracted third party.

Peer Review: Risks are peer reviewed by a peer review underwriter within a specified number of working days of data entry being completed. There is an agreed matrix of peer review underwriters who are authorized to peer review. Endorsements that increase exposure are scanned into the workflow system and are subject to the current peer review procedures.

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Class of business review: Risks written into a class by an underwriter other than the nominated class underwriter generally are forwarded to and reviewed by the nominated class underwriter.

Exceptions review: Risks that exceed a set of pre-determined criteria will also be referred to the Active Underwriter or the Underwriting Risk Officer for review. Such risks are discussed by the underwriters at regular underwriting meetings in the presence of at least one of the above. In certain circumstances, some risks may be referred to the Insurance Management Committee or the Talbot Underwriting Ltd (TUL) Board for final approval. These reviews also commonly include reports of risks renewed where there has been a large loss ratio in the recent past.

Insurance Management Committee: At its regular meetings, the Committee reviews a range of key performance indicators including: premium income written versus plan; movements in syndicate cash and investments; and aggregate exposures in a number of accounts. The Committee also reviews claim movements over a financial threshold.

Expert Review Sub-committee (ERC): The ERC is a committee that meets regularly to review the underwriting activities of Syndicate 1183 and other related activities to provide assurance that the underwriting risks assumed are within the parameters of the business plan. This is achieved with the help of five expert reviewers who report their findings to the ERC.

The expert reviewers obtain and review a sample of risks underwritten in each class and report their findings to the quarterly meetings of the ERC. Findings range from general comments on approach and processes to specific points in respect of individual risks.

Risk Management

A pivotal factor in determining whether to found and fund the Company was the opportunity for differentiation based upon superior risk management expertise; specifically, managing catastrophe risk and optimizing our portfolio to generate attractive returns on capital while controlling our exposure to risk, and assembling a management team with the experience and expertise to do so. The Company's proprietary models are current with emerging scientific trends. This has enabled the Company to gain a competitive advantage over those reinsurers who rely exclusively on commercial models for pricing and portfolio management. The Company has made a significant investment in expertise in the risk modeling area to capitalize on this opportunity. The Company has assembled an experienced group of professional experts who operate in an environment designed to allow them to use their expertise as a competitive advantage. While the Company uses both proprietary and commercial probabilistic models, risk is ultimately subject to absolute aggregate limitations based on risk levels determined by the Underwriting Committee of our Board of Directors.

Vendor Models: The Company has global licenses for all three major vendor models (RMS, AIR and EQECAT) to assess the adequacy of risk pricing and to monitor our overall exposure to risk in correlated geographic zones. The Company models property exposures that could potentially lead to an over-aggregation of property risks (i.e., catastrophe-exposed business) using the vendor models. The vendor models enable us to aggregate exposures by correlated event loss scenarios, which are probability-weighted. This enables the generation of exceedance probability curves for the portfolio and major geographic areas. Once exposures are modeled using one of the vendor models, the two other models are used as a reasonability check and validation of the loss scenarios developed and reported by the first. The three commercial models each have unique strengths and weaknesses. It is necessary to impose changes to frequency and severity ahead of changes made by the model vendors.

The Company's view of market practice revealed a number of areas where quantitative expertise can be used to improve the reliability of the vendor model outputs:

Ceding companies may often report insufficient data and many reinsurers may not be sufficiently critical in their analysis of this data. The Company generally scrutinizes data for anomalies that may indicate insufficient data quality. These circumstances are addressed by either declining the program or, if the variances are manageable, by modifying the model output and pricing to reflect insufficient data quality;

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Prior to making overall adjustments for changes in climate variables, other variables are carefully examined (for example, demand surge, storm surge, and secondary uncertainty); and

Pricing individual contracts frequently requires further adjustments to the three vendor models. Examples include bias in damage curves for commercial structures and occupancies and frequency of specific perils.

In addition, many risks, such as second-event covers, aggregate excess of loss, or attritional loss components cannot be fully evaluated using the vendor models. In order to better evaluate and price these risks, the Company has developed proprietary analytical tools, such as VCAPS and other models and data sets.

Proprietary Models: In addition to making frequency and severity adjustments to the vendor model outputs, the Company has implemented a proprietary pricing and risk management tool, VCAPS, to assist in pricing submissions and monitoring risk aggregation.

To supplement the analysis performed using vendor models, VCAPS uses the gross loss output of catastrophe models to generate 100,000-year simulation set, which is used for both pricing and risk management. This approach allows more precise measurement and pricing of exposures. The two primary benefits of this approach are:

VCAPS takes into account annual limits, event/franchise/annual aggregate deductibles, and reinstatement premiums. This allows for more accurate evaluation of treaties with a broad range of features, including both common (reinstatement premium and annual limits) and complex features (second or third event coverage, aggregate excess of loss, attritional loss components covers with varying attachment across different geographical zones or lines of businesses and covers with complicated structures); and

VCAPS use of 100,000-year simulation enables robust pricing of catastrophe-exposed business. This is possible in real-time operation because the Company has designed a computing hardware platform and software environment to accommodate the significant computing needs.

In addition to VCAPS, the Company uses other proprietary models and other data in evaluating exposures. The Company cannot assure that the models and assumptions used by the software will accurately predict losses. Further, the Company cannot assure that the software is free of defects in the modeling logic or in the software code. In addition, the Company has not sought copyright or other legal protection for VCAPS.

Program Limits: Overall exposure to risk is controlled by limiting the amount of reinsurance underwritten in a particular program or contract. This helps to diversify within and across risk zones. The Underwriting Committee sets these limits, which may be exceeded only with its approval.

Geographic Diversification: The Company actively manages our aggregate exposures by geographic or risk zone (zones) to maintain a balanced and diverse portfolio of underlying risks. The coverage the Company is willing to provide for any risk located in a particular zone is limited to a predetermined level, thus limiting the net aggregate loss exposure from all contracts covering risks believed to be located in any zone. Contracts that have worldwide territorial limits have exposures in several geographic zones. Generally, if a proposed reinsurance program would cause the limit to be exceeded, the program would be declined, regardless of its desirability, unless the Company buys retrocessional coverage, thereby reducing the net aggregate exposure to the maximum limit permitted or less.

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Year Ended December 31, 2008
Gross Premiums Written

(Dollars in thousands)	Validus Re	Talbot	Eliminations	Total	%
United States	\$ 356,902	\$ 62,098	\$	\$ 419,000	30.8%
Worldwide excluding United States(1)	27,512	221,260	(20,870)	227,902	16.7%
Europe	44,079	57,132		101,211	7.4%
Latin America and Caribbean	18,404	46,721	(13,413)	51,712	3.8%
Japan	9,416	3,955		13,371	1.0%
Canada		9,630		9,630	0.7%
Sub-total, non United States	99,411	338,698	(34,283)	403,826	29.6%
Worldwide including United States(1)	74,391	58,079		132,470	9.7%
Marine and Aerospace(2)	157,067	250,121		407,188	29.9%
Total	\$ 687,771	\$ 708,996	\$ (34,283)	\$ 1,362,484	100.0%

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

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

The effectiveness of geographic zone limits in managing risk exposure depends on the degree to which an actual event is confined to the zone in question and on the Company's ability to determine the actual location of the risks believed to be covered under a particular reinsurance program. Accordingly, there can be no assurance that risk exposure in any particular zone will not exceed that zone's limits. Further diversification is achieved through guidelines covering the types and amount of business written in product classes and lines within a class.

Within Talbot, the TUL Board is responsible for creating the environment and structures for risk management to operate effectively. The Talbot Chief Executive is responsible for ensuring the risk management process is implemented.

The TUL Board has several committees responsible for monitoring risk. The TUL Board approves the risk appetite as part of the syndicate business plan process which sets targets for premium volume, pricing, line sizes, aggregate exposures and retention by class of business.

The TUL Executive Committee is responsible for establishing and maintaining a comprehensive risk register and key controls for TUL. It is responsible for formulating a risk appetite consistent with the Company's risk appetite, for approval by the TUL Board.

The key focuses of each committee are as follows:

The TUL Executive Committee manages key risks with regard to strategy and reserves;

The Talbot Insurance Management Committee manages insurance risks;

Operational Risk Committee manages risk related to people, processes, systems and external events; and

Financial Risk Committee manages credit risk associated with investments and reinsurance counterparties, capital markets risk and liquidity risk.

Performance against underwriting targets is measured regularly throughout the year. Risks written are subject to peer review, an internal quality control process. Pricing is controlled by the monitoring of rate movements and the comparison of technical prices to actual prices for certain classes of business. Controls over aggregation of claims exposures vary by class of business. They include limiting coastal risks, monitoring aggregation by county/region/blast zones and applying line size limits in all cases. Catastrophe modeling software and techniques are used to model expected loss outcomes for Lloyd's Realistic Disaster Scenario returns and in-house catastrophe event scenarios. Reserves are reviewed for adequacy on a quarterly basis. The syndicate also purchases reinsurance, with an appropriate number of reinstatements, to arrive at an acceptable net risk.

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Validus Re Retrocession: Validus Re monitors the opportunity to purchase retrocessional coverage on a continual basis and employs the VCAPS modeling system to evaluate the effectiveness of risk mitigation and exposure management relative to the cost. This coverage may be purchased on an indemnity basis as well as on an index basis (e.g., industry loss warranties (ILWs)). Validus Re also considers alternative retrocessional structures, including collateralized quota share (sidecar) and capital markets products (cat bonds).

When Validus Re buys retrocessional coverage on an indemnity basis, payment is for an agreed upon portion of the losses actually suffered. In contrast, when Validus Re buys an ILW cover, which is a reinsurance contract in which the payout is dependent on both the insured loss of the policy purchaser and the measure of the industry-wide loss, payment is made only if both Validus Re and the industry suffer a loss, as reported by one of a number of independent agencies, in excess of specified threshold amounts. With an ILW, Validus Re bears the risk of suffering a loss while receiving no payment under the ILW because the industry loss was less than the specified threshold amount.

Validus Re may use capital markets instruments for risk management in the future (e.g., catastrophe bonds, further sidecar facilities and other forms of risk securitization) where the pricing and terms are attractive.

Talbot Ceded Reinsurance: Talbot enters into reinsurance agreements in order to mitigate its accumulation of loss, reduce its liability on individual risks and enable it to underwrite policies with higher limits. The ceding of the insurance does not legally discharge Talbot from its primary liability for the full amount of the policies, and Talbot is required to pay the loss and bear collection risk if the reinsurer fails to meet its obligations under the reinsurance agreement.

The following describes the Talbot Group's process in the purchase and authorization of treaty reinsurance policies only. It does not cover the purchase of facultative business because these premiums are not significant.

Each July, before the start of each annual covered period, the in-force reinsurance program is reviewed by the Talbot Chief Executive Officer and modified to create a first draft of the reinsurance program for the following year (predominantly incepting on January 1). This exercise is repeated and refined with a second budgeting exercise in October, incorporating advice and analytical work from our brokers and actuarial team.

The review and modification is based upon the following:

- budgeted underwriting for the coming year;

- loss experience from prior years;

- loss information from the coming year's individual capital assessment calculations;

- changes to risk limits and aggregation limits expected and any other changes to Talbot's risk tolerance;

- scenario planning;

- changes to capital requirements; and

- Realistic Disaster Scenarios (RDSs) prescribed by Lloyd's.

The main type of reinsurance purchased is losses occurring; however, for a few lines of business, where the timing of the loss event is less easily verified or where such cover is available, risk attaching policies are purchased.

The type, quantity and cost of cover of the proposed reinsurance program is discussed and amended by the Insurance Management Committee, and ultimately authorized by the TUL Board.

Once this has occurred, the reinsurance program is purchased in the months prior to the beginning of the covered period. All reinsurance contracts arranged are authorized for purchase by the Talbot Chief Executive Officer. Slips are developed prior to inception to ensure the best possible cover is achieved. After purchase, cover notes are reviewed by the relevant class underwriters and presentations made to all underwriting staff to ensure they are aware of the boundaries of the cover.

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Although we conduct some business on a direct basis with our treaty and facultative reinsurance clients, most of our business is derived through insurance and reinsurance intermediaries (brokers), who access business from clients and coverholders. We are able to attract business through our recognized lead capability in most classes we underwrite, particularly in classes where such lead ability is rare.

Currently, our largest broker relationships, as measured by gross premiums written, are with Aon Benfield Group Ltd, Marsh & McLennan Companies, Inc./Guy Carpenter & Co., and Willis Group Holdings Ltd. The following table sets forth the Company's gross premiums written by broker:

(Dollars in thousands)	Year Ended December 31, 2008				
	Gross Premiums Written				
Name of broker	Validus Re	Talbot	Eliminations	Total	%
Aon Benfield Group Ltd.	263,255	93,136	(8,684)	347,707	25.5%
Marsh Inc./Guy Carpenter & Co.	\$ 204,526	\$ 94,766	\$ (2,011)	\$ 297,281	21.9%
Willis Group Holdings Ltd.	97,959	99,214	(8,894)	188,279	13.8%
Sub-total	565,740	287,116	(19,589)	833,267	61.2%
All Others	122,031	421,880	(14,694)	529,217	38.8%
Total	\$ 687,771	\$ 708,996	\$ (34,283)	\$ 1,362,484	100.0%

Reserve for losses and loss expenses

For insurance and reinsurance companies, a significant judgment made by management is the estimation of the reserve for losses and loss expenses. The Company establishes its reserve for losses and loss expenses to cover the estimated incurred liability for both reported and unreported claims.

The following tables show certain information with respect to the Company's reserves:

(Dollars in thousands)	At December 31, 2008		
	Gross Case Reserves	Gross IBNR	Total Gross Reserve for Losses and Loss Expenses
Property	\$ 287,903	\$ 183,291	\$ 471,194
Marine	344,998	250,511	595,509
Specialty	74,816	163,784	238,600
Total	\$ 707,717	\$ 597,586	\$ 1,305,303

(Dollars in thousands)	At December 31, 2008		
	Net Case Reserves	Net IBNR	Total Net Reserve for Losses and Loss Expenses
Property	\$ 282,755	\$ 175,886	\$ 458,641
Marine	220,090	211,020	431,110
Specialty	66,701	140,055	206,756
Total	\$ 569,546	\$ 526,961	\$ 1,096,507

Loss reserves are established due to the significant periods of time that may lapse between the occurrence, reporting and payment of a loss. To recognize liabilities for unpaid losses and loss expenses, the Company estimates future amounts needed to pay claims and related expenses with respect to insured events. The Company's reserving practices and the establishment of any particular reserve reflects management's judgment concerning sound

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financial practice and does not represent any admission of liability with respect to any claim. Unpaid losses and loss expense reserves are established for reported claims (case reserves) and incurred but not reported (IBNR) claims.

The nature of the Company's high excess of loss liability and catastrophe business can result in loss payments that are both irregular and significant. Such loss payments are part of the normal course of business for the Company. Adjustments to reserves for individual years can also be irregular and significant. Conditions and trends that have affected development of liabilities in the past may not necessarily occur in the future. Accordingly, it is inappropriate to extrapolate future redundancies or deficiencies based upon historical experience. See Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

The tables below present the development of the Company's unpaid losses and loss expense reserves on both a net and gross basis. The cumulative redundancy (deficiency) calculated on a net basis differs from that calculated on a gross basis. As different reinsurance programs cover different underwriting years, net and gross loss experience will not develop proportionately. The top line of the tables shows the estimated liability, net of reinsurance recoveries, as at the year end balance sheet date for each of the indicated years. This represents the estimated amounts of losses and loss expenses, including IBNR, arising in the current and all prior years that are unpaid at the year end balance sheet date of the indicated year. The tables also show the re-estimated amount of the previously recorded reserve liability based on experience as of the year end balance sheet date of each succeeding year. The estimate changes as more information becomes known about the frequency and severity of claims for individual years. The cumulative redundancy (deficiency) represents the aggregate change with respect to that liability originally estimated. The lower portion of the first table also reflects the cumulative paid losses relating to these reserves. Conditions and trends that have affected development of liabilities in the past may not necessarily occur in the future. Accordingly, it is not appropriate to extrapolate redundancies or deficiencies into the future, based on the tables below. See Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Cautionary Note Regarding Forward-Looking Statements.

Analysis of Losses and Loss Expense Reserve Development Net of Reinsurance Recoveries

(Dollars in thousands)	Year Ended December 31,		
	2006	2007	2008
Estimated liability for unpaid losses and loss expense, net of reinsurance recoverable	\$ 77,363	\$ 791,713	\$ 1,096,507
Liability estimated as of:			
One year later	60,106	722,010	
Two years later	54,302		
Cumulative redundancy (deficiency)(1)	23,061	69,702	
Cumulative paid losses, net of reinsurance recoveries, as of:			
One year later	\$ 27,180	\$ 216,469	\$
Two years later	34,935		

(1) See Part II Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion.

Table of Contents**Analysis of Losses and Loss Expense Reserve Development Gross of Reinsurance Recoveries**

(Dollars in thousands)	Year Ended December 31,		
	2006	2007	2008
Estimated gross liability for unpaid losses and loss expense	\$ 77,363	\$ 926,117	\$ 1,305,303
Liability estimated as of:			
One year later	60,106	846,863	
Two years later	54,302		
Cumulative redundancy (deficiency)(1)	23,061	79,253	
Cumulative paid losses, gross of reinsurance recoveries, as of:			
One year later	\$ 27,180	\$ 245,240	\$
Two years later	34,935		

The following table presents an analysis of the Company's paid, unpaid and incurred losses and loss expenses and a reconciliation of beginning and ending unpaid losses and loss expenses for the years indicated:

(Dollars in thousands)	Year Ended December 31,		
	2008	2007	2006
Gross reserves at beginning of year	\$ 926,117	\$ 77,363	\$
Losses recoverable at beginning of year	(134,404)		
Net loss reserves acquired in purchase of Talbot		588,068	
Net reserves at beginning of year	791,713	665,431	
Incurred losses - current year	841,856	351,850	91,323
Incurred losses - change in prior accident years	(69,702)	(67,857)	
Incurred losses	772,154	283,993	91,323
Paid losses	(406,469)	(156,872)	(13,960)
Foreign exchange	(60,891)	(839)	
Net reserves at year end	1,096,507	791,713	77,363
Losses recoverable at year end	208,796	134,404	
Gross reserves at year end	\$ 1,305,303	\$ 926,117	\$ 77,363

Validus Re: Validus Re's loss reserves are established based upon an estimate of the total cost of claims that have been incurred, including estimates of unpaid liability on known individual claims, the costs of additional case reserves on claims reported but not considered to be adequately reserved in such reporting (ACRs) and amounts that have been incurred but not yet reported. ACRs are used in certain cases and may be calculated based on management's estimate of the required case reserve on an individual claim less the case reserves reported by the client. The Executive Committee for Events follows material catastrophe event ultimate loss reserve estimation procedures for the investigation, analysis, estimation and approval of ultimate loss reserving resulting from any material catastrophe

event. U.S. GAAP does not permit the establishment of loss reserves until an event occurs that gives rise to a loss.

For reported losses, Validus Re establishes case reserves within the parameters of the coverage provided in the reinsurance contracts. Where there is a reported claim for which the reported case reserve is determined to be insufficient, Validus Re may book an ACR or individual claim IBNR estimate that is adjusted as claims notifications are received. Information may be obtained from various sources including brokers, proprietary and third party vendor models and internal data regarding reinsured exposures related to the geographic location of the event, as well as other sources. Validus Re uses generally accepted actuarial techniques in its IBNR estimation process. Validus Re also uses historical insurance industry loss emergence patterns, as well as estimates of future trends in claims severity, frequency and other factors, to aid it in establishing loss reserves.

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Loss reserves represent estimates, including actuarial and statistical projections at a given point in time, of the expectations of the ultimate settlement and administration costs of claims incurred. Such estimates are not precise in that, among other things, they are based on predictions of future developments and estimates of future trends in loss severity and frequency and other variable factors such as inflation, litigation and tort reform. This uncertainty is heightened by the short time in which Validus Re has operated, thereby providing limited claims loss emergence patterns that directly pertain to Validus Re's operations. This has necessitated the use of industry loss emergence patterns in deriving IBNR, which despite management's and our actuaries' care in selecting them, will differ from actual experience. Further, expected losses and loss ratios are typically developed using vendor and proprietary computer models and these expected loss ratios are a significant component in the calculation deriving IBNR. Finally, the uncertainty surrounding estimated costs is greater in cases where large, unique events have been reported and the associated claims are in early stages of resolution. As a result of these uncertainties, it is likely that the ultimate liability will differ from such estimates, perhaps significantly.

Loss reserves are reviewed regularly and adjustments to reserves, if any, will be recorded in earnings in the period in which they are determined. Even after such adjustments, the ultimate liability may exceed or be less than the revised estimates.

Talbot: Talbot's loss reserves are established based upon an estimate of the total cost of claims that have been incurred, including case reserves and IBNR. Talbot uses generally accepted actuarial techniques in its IBNR estimation process. ACRs are not generally used.

Talbot performs internal assessments of liabilities on a quarterly basis. Talbot's loss reserving process involves the assessment of actuarial estimates of gross ultimate losses on both an ultimate basis (i.e., ignoring the period during which premium earns) and an earned basis, split by underwriting year and class of business, and generally also between attritional, large and catastrophe losses. These estimates are made using a variety of generally accepted actuarial projection methodologies, as well as additional qualitative consideration of future trends in frequency, severity and other factors. The gross estimates are used to estimate ceded reinsurance recoveries, which are in turn used to calculate net ultimate premiums and ultimate losses as the difference between gross and ceded. These figures are subsequently used by Talbot's management to help it assess its best estimate of gross and net ultimate losses.

As with Validus Re, Talbot's loss reserves represent estimates, including actuarial and statistical projections at a given point in time, of the expectations of the ultimate settlement and administration costs of claims incurred. Such estimates are not precise in that, among other things, they are based on predictions of future developments and estimates of future trends in loss severity and frequency and other variable factors such as inflation, litigation and tort reform. The uncertainty surrounding estimated costs is also greater in cases where large, unique events have been reported and the associated claims are in the early stages of resolution. As a result of these uncertainties, it is likely that the ultimate liability will differ from such estimates, perhaps significantly.

Talbot's loss reserves are reviewed regularly and adjustments to reserves, if any, will be recorded in earnings in the period in which they are determined. Even after such adjustments, the ultimate liability may exceed or be less than the revised estimates. See Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Cautionary Note Regarding Forward-Looking Statements.

Claims Management

Claims management includes the receipt of initial loss notifications, generation of appropriate responses to claim reports, identification and handling of coverage issues, determination of whether further investigation is required and, where appropriate retention of legal representation, establishment of case reserves, approval of loss payments and notification to reinsurers.

Validus Re: The role of our claims department is to investigate, evaluate and pay claims efficiently. Our claims director has implemented claims handling guidelines, and reporting and control procedures. The primary objectives of the claims department are to ensure that each claim is addressed, evaluated, processed and appropriately documented in a timely and efficient manner and information relevant to the management of the claim is retained.

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Talbot: Where Talbot is a leading syndicate on business written, the claims adjusters will deal with the broker representing the insured. This may involve appointing attorneys, loss adjusters or other experts. The central Lloyd's market claims bureau will respond on behalf of syndicates other than the leading syndicate.

Where Talbot is not the lead underwriter on the business, the case reserves are established by the lead underwriter in conjunction with third party/bureau input who then advise regarding movements in loss reserves to all syndicates participating on the risk. Material claims and claims movements are subject to review by Talbot.

Investments

The Company manages its investment portfolio on a consolidated basis. As we provide short-tail insurance and reinsurance coverage, we could become liable to pay substantial claims on short notice. Accordingly, we follow a conservative investment strategy designed to emphasize the preservation of invested assets and provide sufficient liquidity for the prompt payment of claims. Our Board of Directors, led by our Finance Committee, oversees our investment strategy, and in consultation with BlackRock Financial Management, Inc. and Goldman Sachs Asset Management, our portfolio advisors, has established investment guidelines for us. The investment guidelines dictate the portfolio's overall objective, benchmark portfolio, eligible securities, duration, use of derivatives, inclusion of foreign securities, diversification requirements and average portfolio rating. Management and the Finance Committee periodically review these guidelines in light of our investment goals and consequently they may change at any time. We also have entered into a securities lending agreement under which we loan certain fixed income securities to third parties and receive collateral, primarily in the form of cash. The collateral received is reinvested and is reflected as a short-term investment.

Substantially all of the fixed maturity investments held at December 31, 2008 were publicly traded. At December 31, 2008, the average duration of the Company's fixed maturity portfolio was 1.82 years (December 31, 2007 and 2006: 2.00 and 0.90 years, respectively). Management emphasizes capital preservation for the portfolio and maintains a significant allocation of short-term investments. At December 31, 2008, the average rating of the portfolio was AAA (December 31, 2007 and 2006: AAA and AA+). At December 31, 2008, the total fixed maturity portfolio was \$2,454.5 million (December 31, 2007 and 2006: \$2,411.4 million and \$844.9 million, respectively), of which \$1,941.3 million or 79.2% (December 31, 2007 and 2006: \$2,029.6 million and \$644.1 million, respectively) were rated AAA.

Please refer to our Current Report on Form 8-K filed with the Securities and Exchange Commission (the SEC) on February 13, 2009 for additional disclosure with respect to the composition of our investment portfolio.

Financial Strength Ratings

Validus Re: Validus Re's ability to underwrite business is dependent upon the quality of its claims paying and financial strength ratings as evaluated by independent rating agencies. Validus Re was assigned a rating of A- (Excellent) with a stable outlook by A.M. Best Company in December 2005 (which was affirmed by A.M. Best on December 18, 2008). Ratings are not an evaluation directed to investors in the Company's securities or a recommendation to buy, sell or hold the Company's securities. Ratings may be revised or revoked at the sole discretion of A.M. Best, Standard & Poor's (S & P) or Fitch Ratings. In the normal course of business, the Company evaluates its capital needs to support the volume of business written in order to maintain its claims paying and financial strength ratings. Financial information is regularly provided to rating agencies to both maintain and enhance existing ratings. In the event of a downgrade below A- (Excellent), the Company believes its ability to write business would be materially adversely affected.

Syndicate 1183 at Lloyd's of London: All Lloyd's syndicates benefit from Lloyd's central resources, including the Lloyd's brand, its network of global licenses and the central fund. The central fund is available at the discretion of the Council of Lloyd's to meet any valid claim that cannot be met by the resources of any

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member. As all Lloyd's policies are ultimately backed by this common security, a single market rating can be applied. Lloyd's as a market is rated as follows:

AM Best	A	Excellent	Stable outlook
Fitch Ratings	A+	Strong	Stable outlook
S & P	A+	Strong	Stable outlook

The syndicate benefits from these ratings and the Company believes that ratings impairments below A- would materially impair the syndicate's ability to write business.

Competition

The insurance and reinsurance industries are highly competitive. We compete with major U.S., Bermuda, European and other international insurers and reinsurers and certain underwriting syndicates and insurers. We encounter competition in all of our classes of business but there is less competition in those of our lines where we are a specialist underwriter. The Company competes with insurance and reinsurance providers such as;

ACE Tempest Re, Allied World Assurance Company Holdings Limited, Arch Capital Group Limited, AXIS Capital Holdings Limited, Endurance Specialty Holdings Limited, Everest Re Group Limited, Flagstone Reinsurance Holdings Group Limited, IPC Holdings Limited, Munich Re, PartnerRe Ltd., Platinum Underwriters Holdings Ltd., Renaissance Reinsurance Holdings Ltd., Swiss Re and XL Re;
 Amlin plc, Aspen Insurance Holdings Limited, Catlin Group Limited, Hiscox and others in the Lloyd's market;
 Direct insurers who compete with Lloyd's on a worldwide basis;
 Various capital markets participants who access insurance and reinsurance business in securitized form, through special purpose entities or derivative transactions; and
 Government-sponsored insurers and reinsurers.

Competition varies depending on the type of business being insured or reinsured and whether the Company is in a leading or following position. Competition in the types of business that the Company underwrites is based on many factors, including: