VALIDUS HOLDINGS LTD
Form 10-Q
May 06, 2013

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

Form 10-Q

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

For the quarterly period ended March 31, 2013

Commission file number 001-33606

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

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

29 Richmond Road, Pembroke, Bermuda HM 08
(Address of principal executive offices and zip code)
(441) 278-9000
(Registrant's telephone number, including area code)

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

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 x No o

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

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

As of May 1, 2013 there were 104,353,625 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 March 31, 2013 (unaudited) and December 31, 2012
(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2013 (unaudited)	December 31, 2012
Assets		
Fixed maturities, at fair value (amortized cost: 2013—$5,616,693; 2012—$5,008,514)	$5,676,552	$5,085,334
Short-term investments, at fair value (amortized cost: 2013—$368,404; 2012—$1,112,929)	367,619	1,114,250
Other investments, at fair value (amortized cost: 2013—$552,233; 2012—$583,068)	532,786	564,448
Cash and cash equivalents	1,369,224	1,219,379
Total investments and cash	7,946,181	7,983,411
Investments in affiliates	128,448	172,329
Premiums receivable	1,195,430	802,159
Deferred acquisition costs	219,504	146,588
Prepaid reinsurance premiums	200,577	99,593
Securities lending collateral	1,914	225
Loss reserves recoverable	429,252	439,967
Paid losses recoverable	15,831	46,435
Income taxes recoverable	2,203	—
Intangible assets	109,529	110,569
Goodwill	20,393	20,393
Accrued investment income	19,708	21,321
Other assets	275,430	177,274
Total assets	$10,564,400	$10,020,264
Liabilities		
Reserve for losses and loss expenses	$3,357,691	$3,517,573
Unearned premiums	1,381,829	894,362
Reinsurance balances payable	187,048	138,550
Securities lending payable	2,380	691
Deferred income taxes	21,800	20,259
Net payable for investments purchased	33,101	38,346
Accounts payable and accrued expenses	111,323	167,577
AlphaCat variable funding notes	290,588	—
Senior notes payable	247,117	247,090
Debentures payable	540,212	540,709
Total liabilities	$6,173,089	$5,565,157
Commitments and contingent liabilities		
Shareholders' equity		
	$26,769	$26,722

Common shares, 571,428,571 authorized, par value $0.175 (Issued: 2013—152,963,762; 2012—152,698,191; Outstanding: 2013—106,282,441; 2012—107,921,259)		
Treasury shares (2013—46,681,321; 2012—44,776,932)	(8,169)	(7,836)
Additional paid-in-capital	2,096,512	2,160,478
Accumulated other comprehensive (loss)	(12,738)	(2,953)
Retained earnings	1,801,516	1,844,416
Total shareholders' equity available to Validus	3,903,890	4,020,827
Noncontrolling interest	487,421	434,280
Total shareholders' equity	$4,391,311	$4,455,107
Total liabilities and shareholders' equity	$10,564,400	$10,020,264

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

Validus Holdings, Ltd.
Consolidated Statements of Comprehensive Income
For the Three Months Ended March 31, 2013 and 2012 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Three Months Ended	
	March 31, 2013 (unaudited)	March 31, 2012 (unaudited)
Revenues		
Gross premiums written	$1,104,760	$837,289
Reinsurance premiums ceded	(187,216)	(107,052)
Net premiums written	917,544	730,237
Change in unearned premiums	(386,483)	(279,038)
Net premiums earned	531,061	451,199
Net investment income	25,649	27,760
Net realized gains on investments	1,721	7,532
Net unrealized (losses) gains on investments	(7,237)	20,671
Income from investment affiliate	1,477	—
Other income	2,685	8,891
Foreign exchange gains	6,922	3,166
Total revenues	562,278	519,219
Expenses		
Losses and loss expenses	144,771	231,989
Policy acquisition costs	93,611	78,132
General and administrative expenses	80,279	66,375
Share compensation expenses	2,318	5,438
Finance expenses	24,446	16,279
Total expenses	345,425	398,213
Net income before taxes and income from operating affiliates	216,853	121,006
Tax benefit (expense)	318	(139)
Income from operating affiliates	3,523	3,367
Net income	$220,694	$124,234
Net loss attributable to noncontrolling interest	2,549	—
Net income available to Validus	$223,243	$124,234
Other comprehensive (loss) income		
Foreign currency translation adjustments	(9,785)	1,393
Other comprehensive (loss) income	$(9,785)	$1,393
Comprehensive income available to Validus	$213,458	$125,627
Earnings per share		
Weighted average number of common shares and common share equivalents outstanding		
Basic	107,386,438	99,425,140

Diluted	110,052,999	105,096,090
Basic earnings per share available to common shareholders	$1.94	$1.23
Diluted earnings per share available to common shareholders	$1.90	$1.18
Cash dividends declared per share	$2.30	$0.25

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 Three Months Ended March 31, 2013 and 2012 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2013 (unaudited)	March 31, 2012 (unaudited)
Common shares		
Balance - Beginning of period	$26,722	$23,538
Common shares issued, net	47	42
Balance - End of period	$26,769	$23,580
Treasury shares		
Balance - Beginning of period	$(7,836)	$(6,131)
Repurchase of common shares	(333)	(65)
Balance - End of period	$(8,169)	$(6,196)
Additional paid-in capital		
Balance - Beginning of period	$2,160,478	$1,893,890
Common shares issued (redeemed), net	3,074	(1,309)
Repurchase of common shares	(69,358)	(11,243)
Share compensation expenses	2,318	5,438
Balance - End of period	$2,096,512	$1,886,776
Accumulated other comprehensive (loss)		
Balance - Beginning of period	$(2,953)	$(6,601)
Other comprehensive (loss) income	(9,785)	1,393
Balance - End of period	$(12,738)	$(5,208)
Retained earnings		
Balance - Beginning of period	$1,844,416	$1,543,729
Dividends	(266,143)	(27,404)
Net income	220,694	124,234
Net loss attributable to noncontrolling interest	2,549	—
Balance - End of period	$1,801,516	$1,640,559
Total shareholders' equity available to Validus	$3,903,890	$3,539,511
Noncontrolling interest	$487,421	$—
Total shareholders' equity	$4,391,311	$3,539,511

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 Three Months Ended March 31, 2013 and 2012 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2013 (unaudited)	March 31, 2012 (unaudited)
Cash flows provided by (used in) operating activities		
Net income	$220,694	$124,234
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	2,318	5,438
Amortization of discount on senior notes	27	27
(Income) from investment affiliate	(1,477)	—
Net realized (gains) on investments	(1,721)	(7,532)
Net unrealized losses (gains) on investments	7,237	(20,671)
Amortization of intangible assets	1,040	1,040
(Income) from operating affiliates	(3,523)	(3,367)
Foreign exchange losses (gains) included in net income	18,906	(13,070)
Amortization of premium on fixed maturities	5,059	7,517
Change in:		
Premiums receivable	(400,153)	(246,039)
Deferred acquisition costs	(72,916)	(49,217)
Prepaid reinsurance premiums	(100,984)	(34,026)
Loss reserves recoverable	6,447	22,916
Paid losses recoverable	30,438	42,903
Income taxes recoverable	(2,132)	(1,004)
Accrued investment income	1,532	1,565
Other assets	8,020	(10,880)
Reserve for losses and loss expenses	(138,633)	8,702
Unearned premiums	487,467	313,064
Reinsurance balances payable	51,300	31,701
Deferred income taxes	1,250	1,029
Accounts payable and accrued expenses	(59,513)	(9,425)
Net cash provided by operating activities	60,683	164,905
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	1,410,509	939,646
Proceeds on maturities of investments	125,841	108,360
Purchases of fixed maturities	(2,140,447)	(1,080,442)
Sales (purchases) of short-term investments, net	744,518	(23,943)
Sales (purchases) of other investments	31,121	(947)
(Increase) decrease in securities lending collateral	(1,689)	7,354
Redemption from investment in operating affiliates	50,222	—
Purchase of investment in investment affiliate	(1,341)	—
Net cash provided by (used in) investing activities	218,734	(49,972)
Cash flows provided by (used in) financing activities		

Net proceeds on issuance of AlphaCat variable funding notes	175,637	—
Issuance (redemption) of common shares, net	3,121	(1,267)
Purchases of common shares under share repurchase program	(69,691)	(11,308)
Dividends paid	(262,232)	(26,997)
Increase (decrease) in securities lending payable	1,689	(7,354)
Third party investment in noncontrolling interest	55,690	—
Net cash (used in) financing activities	(95,786)	(46,926)
Effect of foreign currency rate changes on cash and cash equivalents	(33,786)	16,545
Net increase in cash	149,845	84,552
Cash and cash equivalents - beginning of period	$1,219,379	$832,844
Cash and cash equivalents - end of period	$1,369,224	$917,396
Taxes paid during the period	$693	$3,194
Interest paid during the period	$17,819	$15,611

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 include Validus Holdings, Ltd. and its 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 should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2012, as filed with the U.S. Securities and Exchange Commission (the "SEC").
In the opinion of management, these unaudited consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position and results of operations as at the end of and for the periods presented. Certain amounts in prior periods have been reclassified to conform to current period presentation. All significant intercompany accounts and transactions have been eliminated.
The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The significant estimates reflected in the Company's consolidated financial statements include the reserve for losses and loss expenses, premium estimates for business written on a line slip or proportional basis, the valuation of goodwill and intangible assets, reinsurance premiums ceded and reinsurance recoverable balances including the provision for unrecoverable reinsurance recoverable balances and investment valuation. Actual results could differ from those estimates. The results of operations for any interim period are not necessarily indicative of the results for a full year. The term "ASC" used in these notes refers to Accounting Standard Codifications issued by the United States Financial Accounting Standards Board ("FASB").
On November 30, 2012, the Company acquired all of the outstanding common shares of Flagstone Reinsurance Holdings, S.A. ("Flagstone") in exchange for 0.1935 Company common shares and $2.00 cash per Flagstone common share (the "Flagstone Acquisition"). For segmental reporting purposes, the results of Flagstone’s operations since the acquisition date have been included within the Validus Re segment in the consolidated financial statements.

2. Recent accounting pronouncements

(a) Adoption of new accounting standards

Disclosures about Offsetting Assets and Liabilities

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, "Disclosures about Offsetting Assets and Liabilities" ("ASU 2011-11"). The objective of ASU 2011-11 is to enhance disclosures by requiring improved information about financial instruments and derivative instruments in relation to netting arrangements.
In January 2013, the FASB issued Accounting Standards Update No. 2013-01, “Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities” (“ASU 2013-01”). The objective of ASU 2013-01 is to address implementation issues about the scope of ASU 2011-11, Disclosures about Offsetting Assets and Liabilities. The amendments clarify that the scope of ASU 2011-11 applies to derivatives, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are

either or subject to an enforceable master netting arrangement or similar agreement. Entities with other types of financial assets and financial liabilities subject to a master netting arrangement or similar agreement also are affected because these amendments make them no longer subject to the disclosure requirements in ASU 2011-11. ASU 2011-11 and 2013-01 became effective for fiscal periods beginning on or after January 1, 2013, and as a result, the Company adopted ASU 2011-11 and 2013-01 effective January 1, 2013. The adoption of these new accounting standards impacts disclosures only; therefore they did not have an impact on the Company's consolidated financial statements. Please refer to Note 7: "Derivative instruments used in hedging activities."

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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)

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued Accounting Standard Update No. 2013-02, “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income” (“ASU 2013-02”). The objective of this update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. The amendments became effective for reporting periods beginning after December 15, 2012, and as a result, the Company adopted ASU 2013-02 effective January 1, 2013. The adoption of this new accounting standard did not have an impact on the Company's consolidated financial statements.

(b) Recently issued accounting standards not yet adopted

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 in this Update are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. Early 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.

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Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

3. Investments

(a) Trading Securities

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

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	$ 1,417,884	$ 7,150	$ (65)	$ 1,424,969
Non-U.S. government and government agency	396,948	4,314	(5,061)	396,201
States, municipalities, political subdivision	36,933	816	(18)	37,731
Agency residential mortgage-backed securities	372,469	12,311	(284)	384,496
Non-agency residential mortgage-backed securities	27,010	177	(903)	26,284
U.S. corporate	1,466,941	17,990	(753)	1,484,178
Non-U.S. corporate	632,880	9,027	(915)	640,992
Bank loans	718,427	13,617	(233)	731,811
Catastrophe bonds	47,006	748	(182)	47,572
Asset-backed securities	500,195	2,750	(627)	502,318
Total fixed maturities	5,616,693	68,900	(9,041)	5,676,552
Total short-term investments	368,404	60	(845)	367,619
Other investments				
Fund of hedge funds	4,192	273	(465)	4,000
Private equity investments	12,968	258	(301)	12,925
Hedge funds (a)	528,874	45,037	(67,143)	506,768
Mutual funds	6,199	2,894	—	9,093
Total other investments	552,233	48,462	(67,909)	532,786
Total	$ 6,537,330	$ 117,422	$ (77,795)	$ 6,576,957
Noncontrolling interest (a)	$ (450,000)	$ (38,441)	$ 60,354	$ (428,087)
Total investments excluding noncontrolling interest	$ 6,087,330	$ 78,981	$ (17,441)	$ 6,148,870

(a) Included in the Hedge funds balance are investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

The amortized cost, gross unrealized gains and (losses) and estimated fair value of investments at December 31, 2012 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	$ 1,091,357	$ 7,957	$ (84)	$ 1,099,230
Non-U.S. government and government agency	295,602	6,904	(227)	302,279
States, municipalities, political subdivision	41,286	800	(23)	42,063
Agency residential mortgage-backed securities	375,368	13,708	(202)	388,874
Non-agency residential mortgage-backed securities	106,536	1,266	(1,346)	106,456
U.S. corporate	1,189,173	21,681	(681)	1,210,173
Non-U.S. corporate	582,115	11,373	(223)	593,265
Bank loans	663,217	10,593	(427)	673,383
Catastrophe bonds	56,757	481	(291)	56,947
Asset-backed securities	607,103	5,767	(206)	612,664
Total fixed maturities	5,008,514	80,530	(3,710)	5,085,334
Total short-term investments	1,112,929	1,349	(28)	1,114,250
Other investments				
Fund of hedge funds	4,677	299	(219)	4,757
Private equity investments	12,857	94	—	12,951
Hedge funds (a)	559,335	21,814	(42,623)	538,526
Mutual funds	6,199	2,015	—	8,214
Total other investments	583,068	24,222	(42,842)	564,448
Total	$ 6,704,511	$ 106,101	$ (46,580)	$ 6,764,032
Noncontrolling interest (a)	(450,000)	(19,427)	36,690	(432,737)
Total investments excluding noncontrolling interest	$ 6,254,511	$ 86,674	$ (9,890)	$ 6,331,295

(a) Included in the Hedge funds balance are investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

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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 following table sets forth certain information regarding the investment ratings of the Company’s fixed maturities portfolio as at March 31, 2013 and December 31, 2012. Investment ratings are the lower of Moody’s or Standard & Poor’s rating for each investment security, presented in Standard & Poor’s equivalent rating. For investments where Moody’s and Standard & Poor’s ratings are not available, Fitch ratings are used and presented in Standard & Poor’s equivalent rating.

	March 31, 2013			December 31, 2012		
	Estimated Fair Value	% of Total		Estimated Fair Value	% of Total	
AAA	$820,687	14.5	%	$1,062,794	20.9	%
AA	2,338,976	41.2	%	1,862,322	36.6	%
A	1,285,519	22.6	%	1,049,969	20.6	%
BBB	447,761	7.9	%	374,447	7.4	%
Investment grade	4,892,943	86.2	%	4,349,532	85.5	%
BB	355,124	6.3	%	373,907	7.4	%
B	397,877	7.0	%	330,416	6.5	%
CCC	4,374	0.1	%	4,483	0.1	%
CC	3,261	—	%	3,259	0.1	%
D/NR	22,973	0.4	%	23,737	0.4	%
Non-Investment grade	783,609	13.8	%	735,802	14.5	%
Total Fixed Maturities	$5,676,552	100.0	%	$5,085,334	100.0	%

The amortized cost and estimated fair value amounts for fixed maturity securities held at March 31, 2013 and December 31, 2012 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.

	March 31, 2013		December 31, 2012	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$719,492	$725,393	$526,529	$530,499
Due after one year through five years	3,626,561	3,661,494	2,971,118	3,018,544
Due after five years through ten years	367,885	373,504	418,377	424,304
Due after ten years	3,081	3,063	3,483	3,993
	4,717,019	4,763,454	3,919,507	3,977,340
Asset-backed and mortgage-backed securities	899,674	913,098	1,089,007	1,107,994
Total	$5,616,693	$5,676,552	$5,008,514	$5,085,334

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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)

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended	
	March 31, 2013	March 31, 2012
Fixed maturities and short-term investments	$27,531	$27,276
Cash and cash equivalents	533	2,317
Securities lending income	—	5
Total gross investment income	28,064	29,598
Investment expenses	(2,415)	(1,838)
Net investment income	$25,649	$27,760

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

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

	Three Months Ended	
	March 31, 2013	March 31, 2012
Fixed maturities, short-term and other investments and cash equivalents		
Gross realized gains	$10,720	$10,008
Gross realized (losses)	(8,999)	(2,476)
Net realized gains on investments	1,721	7,532
Net unrealized gains on securities lending	—	37
Change in net unrealized (losses) gains on investments	(7,237)	20,634
Net change in unrealized (losses) gains on investments	$(7,237)	$20,671
Total net realized gains and change in net unrealized (losses) gains on investments	$(5,516)	$28,203
Noncontrolling interest (a)	4,651	—
Total net realized gains and change in net unrealized (losses) gains on investments excluding noncontrolling interest	$(865)	$28,203

(a) Includes change in net unrealized (losses) 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.

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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)

(d) Pledged investments

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

	March 31, 2013		
Description	Commitment	Issued and Outstanding	Investments pledged as collateral
$400,000 syndicated unsecured letter of credit facility	$400,000	$—	$—
$525,000 syndicated secured letter of credit facility	525,000	380,087	524,195
$500,000 secured bi-lateral letter of credit facility	500,000	89,511	126,146
Talbot FAL Facility	25,000	25,000	36,830
PaCRe senior secured letter of credit facility	10,000	258	—
IPC Bi-lateral facility	80,000	25,882	98,771
$550,000 Flagstone Bi-lateral facility	550,000	296,979	487,127
	$2,090,000	$817,717	$1,273,069

	December 31, 2012		
Description	Commitment	Issued and Outstanding	Investments pledged as collateral
$400,000 syndicated unsecured letter of credit facility	$400,000	$—	$—
$525,000 syndicated secured letter of credit facility	525,000	376,570	517,210
$500,000 secured bi-lateral letter of credit facility	500,000	92,402	125,991
Talbot FAL Facility	25,000	25,000	41,372
PaCRe senior secured letter of credit facility	10,000	219	—
IPC Bi-lateral facility	80,000	40,613	98,593
$550,000 Flagstone Bi-lateral facility	550,000	381,019	416,414
	$2,090,000	$915,823	$1,199,580

4. Fair Value Measurements

The Company has adopted all authoritative guidance in effect as of the balance sheet date regarding certain market conditions that allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable.

(a) Classification within the fair value hierarchy

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

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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 our 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 transaction. 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 us to change the selection of our valuation technique (from market to cash flow approach) or may cause us to use multiple valuation techniques to estimate the fair value of a financial instrument. This circumstance 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 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.

(b) Level 1 and Level 2 assets measured at fair value

Fixed maturity investments

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

In general, the Company's fixed maturity investment portfolios are priced using pricing services, such as index providers and pricing vendors, as well as broker quotations. The pricing vendors provide pricing 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

Level 2 - U.S. government and 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

Level 2 - 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.

States, municipalities, political subdivision

Level 2 - The Company's states, municipal and political subdivision 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

Level 2 - 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.

Non-agency residential mortgage-backed securities

Level 2 - 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 ("OAS") 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

Level 2 - Corporate debt securities consist primarily of investment-grade debt of a wide variety of 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.

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Non - U.S. corporate

Level 2 - 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

Level 2 - 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

Level 2 - Catastrophe bonds are recorded at fair value and are based on broker or underwriter bid indications.

Asset-backed securities

Level 2 - 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 CLO debt 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.

Short term investments

Level 1 & Level 2 - Short term investments consist primarily of highly liquid securities 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. These 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. The Company determined that certain of its short-term investments held in highly liquid money market-type funds would be included in Level 1 as their fair values are based on quoted market prices in active markets.

Mutual funds

Level 2 -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.

(c) Level 3 assets measured at fair value

Other investments

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 and private equity investments are the only financial instruments in this category as at March 31, 2013. For each respective hedge fund investment, the Company obtains and reviews the valuation methodology used by the fund administrators and investment managers

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to ensure that the hedge fund investments are following fair value principles consistent with U.S. GAAP in determining the net asset value (“NAV”).

Other investments in Level 3 consist of hedge funds, a fund of hedge funds and private equity investments. 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 us 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.

Hedge funds

The hedge funds were valued at $506,768 at March 31, 2013. The hedge funds consist of an investment in four Paulson & Co. managed funds (the "Paulson hedge funds") and three investment funds assumed from the Flagstone Acquisition (the "Flagstone investment funds"). The Paulson hedge funds' administrator provides monthly reported NAVs with a one-month delay in its valuation. As a result, the funds' administrator's February 28, 2013 NAV was used as a partial basis for fair value measurement in the Company's March 31, 2013 balance sheet. The fund manager provides an estimate of the NAV at March 31, 2013 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, our valuation estimates have not materially differed from the subsequent NAVs. The Flagstone investment fund administrators provide either monthly or quarterly reported NAVs with a one-month or one-quarter delay in its valuation, respectively. As a result, the February 28, 2013 NAV or the December 31, 2012 NAV was used as a basis for fair value measurement in the Company's March 31, 2013 balance sheet. As these valuation techniques incorporate both observable and significant unobservable inputs, both the Paulson hedge funds and the Flagstone investment funds are classified as Level 3 assets. The Paulson hedge funds noted above are subject to quarterly liquidity.

Private equity investments

Private equity investments consist of an investment in three private equity funds assumed from the Flagstone Acquisition. The private equity investments respective fund administrator provides either monthly or quarterly NAVs with a one-month or one-quarter delay in its valuation, respectively. As a result, the February 28, 2013 NAV or the December 31, 2012 NAV was used as a basis for fair value measurement in the Company's March 31, 2013 balance sheet. As this valuation technique incorporates both observable and significant unobservable inputs, the private equity investments are classified as Level 3 assets.

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 February 28, 2013 NAV was used as a basis for fair value measurement in the Company's March 31, 2013 balance sheet. The fund manager provides an estimate of the fund NAV at March 31, 2013 based on the estimated performance provided from the underlying third-party funds. To determine the reasonableness of the NAV, the Company compares the one-month delayed fund administrator's NAV to the fund manager's estimated NAV that incorporates relevant valuation sources on a timely basis. 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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At March 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	$—	$1,424,969	$—	$1,424,969
Non-U.S. government and government agency	—	396,201	—	396,201
States, municipalities, political subdivision	—	37,731	—	37,731
Agency residential mortgage-backed securities	—	384,496	—	384,496
Non-agency residential mortgage-backed securities	—	26,284	—	26,284
U.S. corporate	—	1,484,178	—	1,484,178
Non-U.S. corporate	—	640,992	—	640,992
Bank loans	—	731,811	—	731,811
Catastrophe bonds	—	47,572	—	47,572
Asset-backed securities	—	502,318	—	502,318
Total fixed maturities	—	5,676,552	—	5,676,552
Short-term investments	332,663	34,956	—	367,619
Other investments				
Fund of hedge funds	—	—	4,000	4,000
Private equity investments	—	—	12,925	12,925
Hedge funds (a)	—	—	506,768	506,768
Mutual funds	—	9,093	—	9,093
Total other investments	—	9,093	523,693	532,786
Total	$332,663	$5,720,601	$523,693	$6,576,957
Noncontrolling interest (a)	—	—	(428,087)	(428,087)
Total investments excluding noncontrolling interest	$332,663	$5,720,601	$95,606	$6,148,870

(a) Included in the Hedge funds balance are investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

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At December 31, 2012, 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	$—	$1,099,230	$—	$1,099,230
Non-U.S. government and government agency	—	302,279	—	302,279
States, municipalities, political subdivision	—	42,063	—	42,063
Agency residential mortgage-backed securities	—	388,874	—	388,874
Non-agency residential mortgage-backed securities	—	106,456	—	106,456
U.S. corporate	—	1,210,173	—	1,210,173
Non-U.S. corporate	—	593,265	—	593,265
Bank loans	—	673,383	—	673,383
Catastrophe bonds	—	56,947	—	56,947
Asset-backed securities	—	612,664	—	612,664
Total fixed maturities	—	5,085,334	—	5,085,334
Short-term investments	1,063,175	51,075	—	1,114,250
Other investments				
Fund of hedge funds	—	—	4,757	4,757
Private equity investments	—	—	12,951	12,951
Hedge funds (a)	—	—	538,526	538,526
Mutual funds	—	8,214	—	8,214
Total other investments	—	8,214	556,234	564,448
Total	$1,063,175	$5,144,623	$556,234	$6,764,032
Noncontrolling interest (a)			(432,737)	(432,737)
Total investments excluding noncontrolling interest	$1,063,175	$5,144,623	$123,497	$6,331,295

(a) Included in the Hedge funds balance are investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

At March 31, 2013, Level 3 investments excluding the noncontrolling interest totaled $95,606 (December 31, 2012: $123,497), representing 1.6% (December 31, 2012: 2.0%) of total investments, excluding noncontrolling interest, measured at fair value on a recurring basis.

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The following tables present a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31, 2013	
	Other Investments	Estimated Fair Value
Level 3 investments - Beginning of period	$ 556,234	$ 556,234
Purchases	459	459
Sales	(31,334)	(31,334)
Realized gains	40	40
Unrealized (losses)	(1,706)	(1,706)
Level 3 investments - End of period	$ 523,693	$ 523,693
Noncontrolling interest (a)	(428,087)	(428,087)
Level 3 investments excluding noncontrolling interest	$ 95,606	$ 95,606

	Three Months Ended March 31, 2012	
	Other Investments	Estimated Fair Value
Level 3 investments - Beginning of period	$ 8,880	$ 8,880
Purchases	1,529	1,529
Sales	(620)	(620)
Realized gains	28	28
Unrealized (losses)	(1,492)	(1,492)
Level 3 investments - End of period	$ 8,325	$ 8,325

(a) Includes Level 3 investments held by PaCRe in which the Company has an equity interest of 10%. The remaining 90% interest is held by third party investors.

There have not been any transfers between Levels 1 and 2 during the three months ended March 31, 2013 or 2012. There have not been any transfers into or out of Level 3 during the three months ended March 31, 2013 or 2012.

5. Investments in affiliates

(a) 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. At the time of formation, Validus Reinsurance, Ltd. ("Validus Re"), a wholly owned subsidiary of the Company, had a majority voting equity interest in AlphaCat Re 2011 and as a result the financial statements of

AlphaCat Re 2011 were included in the consolidated financial statements of the Company.

On December 23, 2011, AlphaCat Re 2011 completed a secondary offering of its common shares to third party investors, along with a partial sale of Validus Re's common shares to one of the third party investors.

As a result of these transactions, Validus Re maintained an equity interest in AlphaCat Re 2011, however its share of AlphaCat Re 2011's outstanding voting rights decreased to 43.7%. As a result of the Company's voting interest falling below 50%, the individual assets and liabilities and corresponding noncontrolling interest of AlphaCat Re 2011 were derecognized from the

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consolidated balance sheet of the Company as at December 31, 2011 and the remaining investment in AlphaCat Re 2011 has been treated as an equity method investment effective December 31, 2011.

AlphaCat Re 2011 is now considered "off-risk" as all reinsurance contracts written by the company have expired. As a result, on January 4, 2013 and January 23, 2013, a partial return of investment was made to the investors of AlphaCat Re 2011. Validus Re's corresponding portion of the return of investment was $46,436.

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. The Company holds an equity interest of 37.9% and a voting interest of 49.0% in AlphaCat Re 2012, therefore the investment has been treated as an equity method investment as at March 31, 2013.

On February 22, 2013, a partial return of investment was made to the investors of AlphaCat Re 2012. Validus Re's corresponding portion of the return of investment was $3,786.

AlphaCat 2013, Ltd.

On December 17, 2012, the Company joined with other investors in capitalizing AlphaCat 2013, Ltd. ("AlphaCat 2013"), a special purpose vehicle formed for the purpose of investing in collateralized reinsurance. The Company holds an equity interest of 19.7% and a voting interest of 40.9% in AlphaCat 2013, therefore the investment has been treated as an equity method investment as at March 31, 2013.

The following table presents a reconciliation of the beginning and ending investment in operating affiliates balances for the three months ended March 31, 2013:

	Three Months Ended March 31, 2013			
	Investment in operating affiliate (AlphaCat Re 2011)	Investment in operating affiliate (AlphaCat Re 2012)	Investment in operating affiliate (AlphaCat 2013)	Total
As at December 31, 2012	$62,792	$29,319	$45,000	$137,111
Return of investment	(46,436)	(3,786)	—	(50,222)
Income from operating affiliates	449	1,825	1,100	3,374
As at March 31, 2013	$16,805	$27,358	$46,100	$90,263

The following table presents a reconciliation of the beginning and ending investment in operating affiliate balances for the three months ended March 31, 2012:

	Three Months Ended March 31, 2012	
	Investment in operating affiliate	Total

	(AlphaCat Re 2011)	
As at December 31, 2011	$53,031	$53,031
Income from operating affiliates	3,367	3,367
As at March 31, 2012	$56,398	$56,398

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The following table presents the Company's investments in AlphaCat Re 2011, AlphaCat Re 2012 and AlphaCat 2013 as at March 31, 2013:

	Investment in operating affiliates			
	Investment at cost	Voting ownership %	Equity ownership %	Carrying value
AlphaCat Re 2011	$16,355	43.7 %	22.3 %	$16,805
AlphaCat Re 2012	25,533	49.0 %	37.9 %	27,358
AlphaCat 2013	45,000	40.9 %	19.7 %	46,100
Total	$86,888			$90,263

(b) Investment in Insurance Linked Securities ("ILS")
The Company received $219,400 of third party subscriptions in three of the AlphaCat ILS funds as of December 31, 2012. The AlphaCat ILS funds invest in instruments with returns linked to property catastrophe reinsurance, retrocession and ILS contracts. Two of the funds are variable interest entities and are consolidated by the Company as Validus Re is deemed to be the primary beneficiary. The third fund is also a variable interest entity, however, it is not consolidated by the Company as Validus Re is not deemed to be the primary beneficiary. As a result, the investment in this fund is included in "Investments in affiliates" as at March 31, 2013. Income from this ILS fund was $149 for the three months ended March 31, 2013. The Company's investment in this fund amounted to $20,149 as at March 31, 2013. The Company's maximum exposure to loss with respect to this investment is limited to the investment carrying amount reported in the Company's Consolidated Balance Sheet.

(c) Investment affiliate

Aquiline Financial Services Fund II L.P.

On December 20, 2011, Validus Re 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 Validus Re 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 private equity limited partnership provides quarterly capital account statements with a three-month delay in its valuation. As a result, the limited partnership's December 31, 2012 capital account statement was used as a basis for calculation of the Company's share of partnership income for the period.

The following table presents a reconciliation of the beginning and ending investment in the Company's investment affiliate balance for the three months ended March 31, 2013:

	Three Months Ended March 31, 2013 Investment in limited partnership (Aquiline Financial Services Fund II L.P) (a)
As at December 31, 2012	$ 15,218
Capital contributions	1,341
Income from investment affiliate	1,477
As at March 31, 2013	$ 18,036

(a) As at March 31, 2012, this investment was included in "Other investments" as a Level 3 investment in the fair value hierarchy.

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The following table presents the Company's investment in the Aquiline Financial Services Fund II L.P. as at March 31, 2013:

	Investment in non-consolidated affiliate			
	Investment at cost	Voting ownership %	Equity Ownership	Carrying Value
Aquiline Financial Services Fund II L.P	$ 18,959	— %	6.7 %	$ 18,036

6. Noncontrolling interest

On April 2, 2012, the Company joined with other investors in capitalizing PaCRe a new Class 4 Bermuda reinsurer formed for the purpose of writing high excess property catastrophe reinsurance. Validus Re 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 for the three months ended March 31, 2013 is recorded in the Consolidated Statements of Comprehensive Income as net loss attributable to noncontrolling interest. The Company has an equity interest of 10% and the remaining 90% interest is held by third party investors.

The Company received $219,400 of third party subscriptions in three of the AlphaCat ILS funds as of December 31, 2012. The AlphaCat ILS funds invest in instruments with returns linked to property catastrophe reinsurance, retrocession and ILS contracts. Two of the funds are variable interest entities and are consolidated by the Company as Validus Re is deemed to be the primary beneficiary. Validus Re has a majority participating interest in these funds and as a result, the financial statements of these funds are included in the consolidated financial statements of the Company. The portion of the AlphaCat ILS funds' earnings attributable to third party investors for the three months ended March 31, 2013 is recorded in the Consolidated Statements of Comprehensive Income within net loss/income attributable to noncontrolling interest.

The following table presents a reconciliation of the beginning and ending balances of noncontrolling interest for the three months ended March 31, 2013:

	Three Months Ended March 31, 2013		
	PaCRe	AlphaCat ILS Funds	Total
As at December 31, 2012	$ 434,280	$ —	$ 434,280
Purchase of shares by noncontrolling interest	—	55,690	55,690
Net (loss) income attributable to noncontrolling interest	(3,135)	586	(2,549)
As at March 31, 2013	$ 431,145	$ 56,276	$ 487,421

There was no noncontrolling interest activity for the three months ended March 31, 2012.

7. Derivative instruments used in hedging activities

The Company enters into derivative instruments for risk management purposes, specifically to hedge unmatched foreign currency exposures and interest rate exposures. As at March 31, 2013 the Company held a foreign currency forward contract to mitigate the risk of foreign currency exposure of unpaid losses denominated in Chilean Pesos

(CLP) as well as foreign currency forward contracts to mitigate the risk of fluctuations in the Euro to U.S. dollar exchange rates. As at March 31, 2013, the Company held two interest rate swap contracts to mitigate the risk of interest rate exposure on 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 mitigate the risk of interest rate and foreign exchange rate exposure on the payment of interest on the Flagstone's 2006 and 2007 Junior Subordinated Deferrable Interest Notes.

As part of the Flagstone Acquisition, the Company assumed foreign currency forward contracts which are not designated as hedging instruments.

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The following table summarizes information on the location and amount of the fair value of derivatives not designated as hedging instruments on the consolidated balance sheet at March 31, 2013:

		Asset derivatives		Liability derivatives	
Derivatives not designated as hedging instruments:	Notional amount	Balance Sheet location	Fair value	Balance Sheet location	Fair value
Foreign currency forward contracts	$147,398	Other assets	$266	Accounts payable and accrued expenses	$2,646

The following table summarizes information on the location and amount of the fair value of derivatives designated as hedging instruments on the consolidated balance sheet at March 31, 2013:

		Asset derivatives		Liability derivatives	
Derivatives designated as hedging instruments:	Notional amount	Balance Sheet location	Fair value	Balance Sheet location	Fair value
Foreign currency forward contracts	$55,450	Other assets	$701	Accounts payable and accrued expenses	$—
Interest rate swap contracts	$452,263	Other assets	$—	Accounts payable and accrued expenses	$447

The following table summarizes information on the location and amount of the fair value of derivatives not designated as hedging instruments on the consolidated balance sheet at December 31, 2012:

		Asset derivatives		Liability derivatives	
Derivatives not designated as hedging instruments:	Notional amount	Balance Sheet location	Fair value	Balance Sheet location	Fair value
Currency swaps	$17,153	Other assets	$—	Accounts payable and accrued expenses	$772
Foreign currency forward contracts	$310,541	Other assets	$—	Accounts payable and accrued expenses	$394

The following table summarizes information on the location and amount of the fair value of derivatives designated as hedging instruments on the consolidated balance sheet at December 31, 2012:

		Asset derivatives		Liability derivatives	
Derivatives designated as hedging instruments:	Notional amount	Balance Sheet location	Fair value	Balance Sheet location	Fair value
Foreign currency forward contracts	$35,976	Other assets	$—	Accounts payable and accrued expenses	$223
Interest rate swap contracts	$289,800	Other assets	$—	Accounts payable and accrued expenses	$220

(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 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 derivative instruments as fair value hedges and formally and contemporaneously documents all relationships between the hedging instruments and hedged items and links the hedging derivatives to specific assets and liabilities.

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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 relating to the derivative instruments formally designated as fair value hedges along with the impact of the related hedged items for the three months ended March 31, 2013 and 2012:

		Three Months Ended March 31, 2013		
Derivatives designated as fair value hedges and related hedged item:	Location of gain (loss) recognized in income	Amount of gain (loss) recognized in income on derivative	Amount of gain (loss) on hedged item recognized in income attributable to risk being hedged	Amount of gain (loss) recognized in income on derivative (ineffective portion)
Foreign currency forward contracts	Foreign exchange gains (losses)	$ 1,261	$ (1,261)	$ —

		Three Months Ended March 31, 2012		
Derivatives designated as fair value hedges and related hedged item:	Location of gain (loss) recognized in income	Amount of gain (loss) recognized in income on derivative	Amount of gain (loss) on hedged item recognized in income attributable to risk being hedged	Amount of gain (loss) recognized in income on derivative (ineffective portion)
Foreign currency forward contracts	Foreign exchange gains (losses)	$ (3,319)	$ 3,319	$ —

(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 hedging derivatives to specific assets and liabilities. The Company assesses the effectiveness of the hedges, both at inception and on an on-going basis (as required) 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 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 months ended March 31, 2013:

		Three Months Ended March 31, 2013			
Derivatives designated as cash flow hedges and related hedged item:	Location of the effective portion recognized in other comprehensive (loss) recognized in	Location of the effective portion subsequently reclassified to earnings and the	Amount of effective portion recognized in other comprehensive	Amount of effective portion subsequently reclassified to	Amount of ineffective portion excluded from

	income	ineffective portion excluded from effectiveness testing	income	earnings	effectiveness testing
Interest rate swap contracts	Other comprehensive income	Finance expenses	$ 1,608	$(1,608)	$—

There was no interest rate swap contract activity for the three months ended March 31, 2012.

(d) Balance sheet offsetting

There was no balance sheet offsetting activity as at March 31, 2013 or December 31, 2012.

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 losses reported from brokers, insureds and ceding companies. The Company also uses statistical and actuarial methods to estimate ultimate expected losses and loss expenses. The period of time from the occurrence of a loss, the reporting of a loss to the Company and 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, case 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 the total reserves.

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 months ended March 31, 2013 and 2012:

	Three Months Ended	
	March 31, 2013	March 31, 2012
Reserve for losses and loss expenses, beginning of period	$3,517,573	$2,631,143
Losses and loss expenses recoverable	(439,967)	(372,485)
Net reserves for losses and loss expenses, beginning of period	3,077,606	2,258,658
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:		
Current year	210,569	262,413
Prior years	(65,798)	(30,424)
Total incurred losses and loss expenses	144,771	231,989
Total net paid losses	(260,112)	(204,223)
Foreign exchange	(33,826)	11,894
Net reserve for losses and loss expenses, end of period	2,928,439	2,298,318
Losses and loss expenses recoverable	429,252	351,292
Reserve for losses and loss expenses, end of period	$3,357,691	$2,649,610

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 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 March 31, 2013, 97.9% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A- or better and included $181,163 of IBNR recoverable (December 31, 2012: $185,255). Reinsurance recoverables by reinsurer are as follows:

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	March 31, 2013			December 31, 2012		
	Reinsurance Recoverable	% of Total		Reinsurance Recoverable	% of Total	
Top 10 reinsurers	$339,061	76.2	%	$360,234	74.1	%
Other reinsurers’ balances > $1 million	97,409	21.9	%	115,262	23.7	%
Other reinsurers’ balances < $1 million	8,613	1.9	%	10,906	2.2	%
Total	$445,083	100.0	%	$486,402	100.0	%

	March 31, 2013			
Top 10 Reinsurers	Rating	Reinsurance Recoverable	% of Total	
Lloyd’s Syndicates	A+	$69,769	20.6	%
National Indemnity	AA+	64,667	19.1	%
Everest Re	A+	52,863	15.6	%
Hannover Re	AA-	42,431	12.5	%
Fully Collateralized	NR	29,906	8.8	%
Transatlantic Re	A+	20,584	6.1	%
Swiss Re	AA-	17,574	5.2	%
XL Re	A	15,350	4.5	%
Tokio Millennium	AA+	13,439	4.0	%
Munich Re	AA-	12,478	3.6	%
Total		$339,061	100.0	%

	December 31, 2012			
Top 10 Reinsurers	Rating	Reinsurance Recoverable	% of Total	
Lloyd’s Syndicates	A+	$71,469	19.9	%
National Indemnity	AA+	59,941	16.6	%
Everest Re	A+	51,340	14.3	%
Fully Collateralized	NR	47,445	13.2	%
Hannover Re	AA-	40,552	11.3	%
Munich Re	AA-	20,954	5.8	%
Transatlantic Re	A+	20,320	5.6	%
Swiss Re	AA-	16,992	4.7	%
Allianz	AA-	16,367	4.5	%
XL Re	A	14,854	4.1	%
Total		$360,234	100.0	%

NR: Not rated

At March 31, 2013 and December 31, 2012, the provision for uncollectible reinsurance relating to losses recoverable was $6,046 and $6,602, respectively. To estimate the provision for uncollectible reinsurance recoverable, 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. As part of this process, ceded IBNR is allocated by reinsurer. Of the $445,083 reinsurance recoverable at March 31, 2013 (December 31, 2012: $486,402), $29,906 was fully collateralized (December 31, 2012: $47,445).

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

10. Share capital

(a) Authorized and issued

The Company's authorized share capital is 571,428,571 voting common shares with a par value of $0.175 per share. The holders of voting common shares are entitled to receive dividends. Holders of voting 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, Junior Subordinated Deferrable Interest Notes and Senior Notes. On February 6, 2013, the Board of Directors of the Company announced an increase in the Company's common share purchase authorization to $500,000. This amount is in addition to the $1,206,845 of common shares repurchased by the Company through February 6, 2013 under its previously authorized share repurchase programs.

The Company has repurchased approximately 45,042,446 common shares for an aggregate purchase price of $1,276,536 from the inception of its share repurchase program to March 31, 2013. The Company had $430,309 remaining under its authorized share repurchase program as of March 31, 2013.

On November 30, 2012, the Company acquired all of the outstanding shares of Flagstone from a group of institutional and other investors. Pursuant to the Merger Agreement, the Company acquired all of Flagstone's outstanding common shares in exchange for the Company's common shares and cash. The Company issued 14,202,664 common shares, net of 87,725 shares withheld for income taxes, valued at $34.87 per share as partial consideration for the acquisition. In addition, 1,638,875 common shares recorded in treasury are owned by Flagstone (Bermuda) Holdings Limited, a wholly-owned subsidiary of Validus Holdings, Ltd. As part of the Flagstone Acquisition, warrants to acquire Flagstone shares were converted into 121,942 warrants to acquire the Company's common shares. In accordance with the merger agreement, these warrants have a $62.02 strike price and expire on December 31, 2013.

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.

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

	Common Shares
Common shares issued, December 31, 2012	152,698,191
Restricted share awards vested, net of shares withheld	130,637

Restricted share units vested, net of shares withheld	3,796
Options exercised	128,020
Direct issuance of common stock	183
Deferred share units vested, net of shares withheld	2,935
Common shares issued, March 31, 2013	152,963,762
Shares repurchased, March 31, 2013	(46,681,321)
Common shares outstanding, March 31, 2013	106,282,441

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	Common Shares
Common shares issued, December 31, 2011	134,503,065
Restricted share awards vested, net of shares withheld	229,688
Restricted share units vested, net of shares withheld	5,101
Options exercised	7,149
Common shares issued, March 31, 2012	134,745,003
Shares repurchased, March 31, 2012	(35,404,545)
Common shares outstanding, March 31, 2012	99,340,458

(b) Warrants

During the three months ended March 31, 2013 and 2012, no warrants were exercised. No further warrants are anticipated to be issued. Holders of the outstanding warrants are entitled to exercise the warrants in whole or in part at any time until the expiration date.

(c) Deferred share units

Under the terms of the Company’s Director Stock Compensation Plan, non-management directors may elect to receive their director fees in deferred share units rather than cash. The number of share units distributed in case of election under the plan is equal to the amount of the annual retainer fee otherwise payable to the director on such payment date divided by 100% of the fair market value of a share on such payment date. Additional deferred share units are issued in lieu of dividends that accrue on these deferred share units. The total outstanding deferred share units at March 31, 2013 were nil (December 31, 2012: 5,001).

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.

(d) Dividends

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.

In addition, the Company announced a quarterly cash dividend of $0.30 (2012: $0.25) per common share and $0.30 per common share equivalent for which each outstanding warrant is exercisable. This dividend was paid on March 29, 2013 to holders of record on March 15, 2013.

11. Stock plans

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 3,016,246 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 ratably 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.

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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 awards since September 4, 2009.

Share compensation expenses in respect of options of $nil were recorded for the three months ended March 31, 2013 (2012: $135). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

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 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 three months ended March 31, 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 regranted (repriced)	1,833,414	6.76	19.02
Options granted	—	—	—
Options exercised	(128,020)	3.40	28.98
Options cancelled (repriced)	(1,733,139)	6.76	20.12
Options forfeited	—	—	—
Options outstanding, March 31, 2013	1,796,202	$6.75	$18.95
Options exercisable, March 31, 2013	1,796,202	$6.75	$18.95

Activity with respect to options for the three months ended March 31, 2012 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2011	2,263,012	$6.69	$20.12
Options granted	—	—	—
Options exercised	(7,149)	6.90	24.69
Options forfeited	—	—	—
Options outstanding, March 31, 2012	2,255,863	$6.69	$20.10
Options exercisable, March 31, 2012	2,227,043	$6.64	$20.08

At March 31, 2013, there were $nil (December 31, 2012: $nil) of total unrecognized share compensation expenses in respect of options that are expected to be recognized over a weighted-average period of 0.0 years (December 31, 2012: 0.0 years).

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ii.Restricted share awards

Restricted shares granted 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. Share compensation expenses of $4,061 were recorded for the three months ended March 31, 2013 (2012: $5,940). 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 three months ended March 31, 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	22,005		35.63
Restricted share awards vested	(148,304	)	25.97
Restricted share awards forfeited	(93,993	)	28.42
Restricted share awards outstanding, March 31, 2013	1,950,255		$29.60

Activity with respect to unvested restricted share awards for the three months ended March 31, 2012 was as follows:

	Restricted Share Awards		Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2011	3,003,547		$25.77
Restricted share awards granted	4,500		30.49
Restricted share awards vested	(259,017	)	25.52
Restricted share awards forfeited	(20,371	)	27.96
Restricted share awards outstanding, March 31, 2012	2,728,659		$25.78

At March 31, 2013, there were $38,226 (December 31, 2012: $43,952) of total unrecognized share compensation expenses in respect of restricted share awards that are expected to be recognized over a weighted-average period of 2.5 years (December 31, 2012: 2.6 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. Share compensation expenses of $121 were recorded for the three months ended March 31, 2013 (2012: $120). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested restricted share units for the three months ended March 31, 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 vested	(5,468)	25.27
Restricted share units issued in lieu of cash dividends	3,020	29.69
Restricted share units outstanding, March 31, 2013	44,790	$30.15

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Activity with respect to unvested restricted share units for the three months ended March 31, 2012 was as follows:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2011	53,312	$27.60
Restricted share units vested	(7,314)	24.27
Restricted share units issued in lieu of cash dividends	408	27.90
Restricted share units outstanding, March 31, 2012	46,406	$28.13

At March 31, 2013, there were $861 (December 31, 2012: $978) of total unrecognized share compensation expenses in respect of restricted share units that are expected to be recognized over a weighted-average period of 2.5 years (December 31, 2012: 2.6 years).

iv.Performance share awards

The Performance Share Awards ("PSAs") contain a performance based component. The performance component relates to the compounded growth in the Dividend Adjusted Diluted Book Value per Share over a three year period. For PSAs granted during the period, the grant date Diluted Book Value per Share ("DBVPS") 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 income in the period in which they are determined.

Share compensation expenses of ($1,864) were recorded for the three months ended March 31, 2013 (2012: ($757)). 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 three months ended March 31, 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 forfeited	(128,667)	32.41
Performance share awards outstanding, March 31, 2013	92,178	$30.99

Activity with respect to unvested performance share awards for the three months ended March 31, 2012 was as follows:

	Performance Share Awards	Weighted Average Grant Date Fair Value
Performance share awards outstanding, December 31, 2011	279,019	$30.77
Performance share awards forfeited	(99,302)	28.70
Performance share awards outstanding, March 31, 2012	179,717	$31.91

At March 31, 2013, there were $1,148 (December 31, 2012: $3,328) of total unrecognized share compensation expenses in respect of PSAs that are expected to be recognized over a weighted-average period of 1.7 years (December 31, 2012: 1.7 years).

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Total share compensation expenses

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

	Three Months Ended	
	March 31, 2013	March 31, 2012
Options	$—	$135
Restricted share awards	4,061	5,940
Restricted share units	121	120
Performance share awards	(1,864)	(757)
Total	$2,318	$5,438

12. Debt and financing arrangements

(a) Financing structure and finance expenses

The financing structure at March 31, 2013 was:

	Commitment	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
2010 Senior Notes due 2040	250,000	250,000	247,117
$400,000 syndicated unsecured letter of credit facility	400,000	—	—
$525,000 syndicated secured letter of credit facility	525,000	380,087	—
$500,000 bi-lateral secured letter of credit facility	500,000	89,511	—
Talbot FAL Facility (b)	25,000	25,000	—
PaCRe senior secured letter of credit facility	10,000	258	—
IPC Bi-Lateral Facility	80,000	25,882	—
$550,000 Flagstone Bi-Lateral Facility	550,000	296,979	—
Flagstone 2006 Junior Subordinated Deferrable Interest Notes	136,662	136,662	136,662
Flagstone 2007 Junior Subordinated Deferrable Interest Notes	113,750	113,750	113,750
Total	$2,940,412	$1,607,929	$787,329

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The financing structure at December 31, 2012 was:

	Commitment	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
2010 Senior Notes due 2040	250,000	250,000	247,090
$400,000 syndicated unsecured letter of credit facility	400,000	—	—
$525,000 syndicated secured letter of credit facility	525,000	376,570	—
$500,000 secured letter of credit facility	500,000	92,402	—
Talbot FAL Facility (b)	25,000	25,000	—
PaCRe senior secured letter of credit facility	10,000	219	—
IPC Bi-Lateral Facility	80,000	40,613	—
$550,000 Flagstone Bi-Lateral Facility	550,000	381,019	—
Flagstone 2006 Junior Subordinated Deferrable Interest Notes	137,159	137,159	137,159
Flagstone 2007 Junior Subordinated Deferrable Interest Notes	113,750	113,750	113,750
Total	$2,940,909	$1,706,532	$787,799

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

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

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

	Three Months Ended	
	March 31, 2013	March 31, 2012
2006 Junior Subordinated Deferrable Debentures	$2,187	$1,549
2007 Junior Subordinated Deferrable Debentures	1,809	3,029
2010 Senior Notes due 2040	5,597	5,597
AlphaCat Variable Funding Notes (a)	11,191	—
Flagstone 2006 Junior Subordinated Deferrable Interest Notes	1,472	—
Flagstone 2007 Junior Subordinated Deferrable Interest Notes	1,072	—
Credit facilities	954	6,016
Bank charges	133	57
Talbot FAL Facility	31	31
Total	$24,446	$16,279

(a) Refer to Note 13: "AlphaCat variable funding notes" for further details.

(b) $250,000 2010 Senior Notes due 2040

On January 21, 2010, the Company offered and sold $250,000 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 Company may redeem the notes in whole, but not in part, at any time upon the occurrence of certain tax events as described in the prospectus supplement of the 2010 Senior Notes. The 2010 Senior Notes bear interest at the rate of 8.875% per annum from January 26, 2010 to maturity or early redemption. Interest on the 2010 Senior Notes is payable semi-annually in arrears on January 26 and July 26 of each year, commencing on

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July 26, 2010. The net proceeds of $243,967 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 its outstanding capital stock and payment of dividends to shareholders. Debt issuance costs of $2,808 were deferred as an asset and amortized over the life of the 2010 Senior Notes. There were no redemptions made during the three months ended March 31, 2013 and 2012.

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 expected payments of principal on the 2010 Senior Notes are as follows:

2013	$—
2014	—
2015	—
2016	—
2017 and thereafter	250,000
Total minimum future payments	$250,000

(c) Junior subordinated deferrable debentures and Junior subordinated deferrable interest notes

On June 15, 2006, the Company participated in a private placement of $150,000 of junior subordinated deferrable interest debentures due 2036 (the "2006 Junior Subordinated Deferrable Debentures"). The 2006 Junior Subordinated Deferrable Debentures mature on June 15, 2036, are redeemable at the Company's option at par beginning June 15, 2011, and require quarterly interest payments by the Company to the holders of the 2006 Junior Subordinated Deferrable Debentures. Interest was payable at 9.069% per annum through June 15, 2011, and thereafter at a floating rate of three-month LIBOR plus 355 basis points, reset quarterly. The proceeds of $150,000 from the sale of the 2006 Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, were used by the Company to fund Validus Re segment operations and for general working capital purposes. Debt issuance costs of $3,750 were deferred as an asset and were amortized to income over the five year optional redemption period. There were no redemptions made during the three months ended March 31, 2013 and 2012.

On June 21, 2007, the Company participated in a private placement of $200,000 of junior subordinated deferrable interest debentures due 2037 (the "2007 Junior Subordinated Deferrable Debentures"). The 2007 Junior Subordinated Deferrable Debentures mature on June 15, 2037, are redeemable at the Company's option at par beginning June 15, 2012, and require quarterly interest payments by the Company to the holders of the 2007 Junior Subordinated Deferrable Debentures. Interest was payable at 8.480% per annum through June 15, 2012, and thereafter at a floating rate of three-month LIBOR plus 295 basis points, reset quarterly. The proceeds of $200,000 from the sale of the 2007 Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, were used by the Company to fund the purchase of Talbot Holdings Ltd. Debt issuance costs of $2,000 were deferred as an asset and were amortized to income over the five year optional redemption period. There were no redemptions made during the three months ended March 31, 2013 and 2012.

As part of the acquisition of Flagstone, the Company assumed $136,662 of junior subordinated deferrable interest notes due 2036 (the “Flagstone 2006 Junior Subordinated Deferrable Interest Notes”). The Flagstone 2006 Junior Subordinated Deferrable Interest Notes mature on September 15, 2036, are redeemable at the Company's option at par beginning as of September 15, 2011, and require quarterly interest payments by the Company to the holders of the Flagstone 2006 Junior Subordinated Deferrable Interest Notes. Interest is payable at a floating rate of three-month LIBOR plus 354 basis points, reset quarterly. There were no redemptions made during the three months ended March 31, 2013 and 2012.

As part of the acquisition of Flagstone, the Company assumed $113,750 of junior subordinated deferrable interest notes due 2037 (the “Flagstone 2007 Junior Subordinated Deferrable Interest Notes”). Of these, $88,750 of the Flagstone 2007 Junior Subordinated Deferrable Interest Notes mature on July 30, 2037, are redeemable at the Company's option at par as of July 30,

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2012, and require quarterly interest payments by the Company to the holders of the Flagstone 2007 Junior Subordinated Deferrable Interest Notes. Interest is payable at a floating rate of three-month LIBOR plus 300 basis points, reset quarterly. The remaining $25,000 of the Flagstone 2007 Junior Subordinated Deferrable Interest Notes mature on September 15, 2037, are redeemable at the Company's option at par as of September 15, 2012, and require quarterly interest payments by the Company to the holders of the Flagstone 2007 Junior Subordinated Deferrable Interest Notes. Interest is payable at a floating rate of three-month LIBOR plus 310 basis points, reset quarterly. There were no redemptions made during the three months ended March 31, 2013 and 2012.
Future expected payments of principal on the 2006 and 2007 Junior Subordinated Deferrable Debentures and Flagstone 2006 and 2007 Junior Subordinated Deferrable Interest Notes are as follows:

2013	$—
2014	—
2015	—
2016	—
2017 and thereafter	540,709
Total minimum future payments	$540,709

(d) 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, Validus Re Americas, Ltd. ("Validus Re Americas"), PaCRe and Validus Re 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 availability for the Company and certain designated subsidiaries of the Company 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 arranged by J.P. Morgan Securities LLC, Deutsche Bank Securities Inc., Lloyds Securities Inc. and SunTrust Robinson Humphrey, Inc. 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. Letter of credit fees are payable on account of each letter of credit issued under the Four Year Unsecured Facility at a rate per annum equal to an applicable rate. Borrowings under the Four Year Unsecured Facility bear interest, at the option of the Company, at the base rate (the higher of the prime rate announced by JPMorgan Chase Bank, N.A., the federal funds effective rate plus 0.5%, and the adjusted LIBOR rate plus 1.0%) or the adjusted LIBOR rate applicable to such loans, plus an applicable rate.

Also on March 9, 2012, the Company, Validus Re Americas and Validus Re entered into a $525,000 four-year secured 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 availability for the Company and certain designated subsidiaries of the

Company (the "Four Year Secured Facility" and together with the Four Year Unsecured Facility, the "Credit Facilities"). The Four Year Secured Facility was provided by a syndicate of commercial banks arranged by J.P. Morgan Securities LLC, Deutsche Bank Securities Inc., Lloyds Securities Inc. and SunTrust Robinson Humphrey, Inc. Letters of credit under the Four Year Secured Facility will be available to support obligations in connection with the insurance business of the Company and its subsidiaries. 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 and its designated subsidiaries 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. Letter of credit fees are payable on account of each letter of credit issued under the Four Year Secured Facility at a rate per annum equal to an applicable rate. Borrowings under the Four Year Secured Facility bear interest at the base rate (the higher of the prime rate announced by JPMorgan Chase Bank, N.A., the federal funds effective rate plus 0.5%, and the adjusted LIBOR rate plus 1.0%).

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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, 2013, 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 Re 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 and its subsidiaries, 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 March 31, 2013, there was $380,087 in outstanding letters of credit under the Four Year Secured Facility (December 31, 2012: $376,570) and $nil outstanding under the Four Year Unsecured Facility (December 31, 2012: $nil).

As of March 31, 2013, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Credit Facilities.
On March 9, 2012, upon entering into the Credit Facilities, the Company terminated its (a) three-year bi-lateral $60,000 unsecured revolving credit facility, dated March 12, 2010 with Lloyds TSB Bank plc, (b) $340,000 three-year unsecured credit facility, dated March 12, 2010 with Deutsche Bank Securities Inc., as syndication agent and JPMorgan Chase Bank, N.A. as administrative agent and (c) $500,000 five-year secured credit facility, dated March 12, 2007 with Deutsche Bank Securities Inc., as syndication agent and JPMorgan Chase Bank, N.A. as administrative agent. No early termination penalties were incurred.

(ii) Talbot FAL Facility

On November 28, 2007, Talbot entered into a $100,000 standby Letter of Credit facility (the “Talbot FAL Facility”) to provide Funds at Lloyd’s for the 2008 and 2009 underwriting years of account; this facility is guaranteed by the Company and is secured against the assets of Validus Re. The Talbot FAL Facility was provided by a syndicate of commercial banks arranged by Lloyds TSB Bank plc and ING Bank N.V., London Branch.

On November 19, 2009, the Company entered into an Amendment and Restatement of the Talbot FAL Facility to reduce the commitment from $100,000 to $25,000, and to extend the support to the 2010 and 2011 underwriting years of account. On November 18, 2011, the Company entered into an Amendment and Restatement of the Talbot FAL Facility to extend the support to the 2012 and 2013 underwriting years of account.

As amended, the Talbot FAL Facility contains affirmative covenants that include, among other things, (i) the requirement that the Company initially maintain a minimum level of consolidated net worth of at least $2,589,615, and commencing with the end of the fiscal quarter ended December 31, 2011 to be increased quarterly by an amount equal to 50% of our consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, and (ii) the requirement that we maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00.

The Talbot FAL Facility also contains restrictions on our ability to 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 March 31, 2013, the Company had $25,000 (December 31, 2012: $25,000) in outstanding letters of credit under this facility.

As of March 31, 2013, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Talbot FAL Facility.

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(iii) IPC Syndicated Facility and IPC Bi-Lateral Facility

IPC obtained letters of credit through the IPC Syndicated Facility and the IPC Bi-Lateral Facility. In July 2009, certain terms of these facilities were amended including suspending IPC's ability to increase existing letters of credit or to issue new letters of credit. Effective March 31, 2010, the IPC Syndicated Facility was closed. As of March 31, 2013, $25,882 of outstanding letters of credit were issued under the IPC Bi-Lateral Facility (December 31, 2012: $40,613).

As of March 31, 2013, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the IPC Bi-Lateral Facility.

(iv) $500,000 secured bi-lateral letter of credit facility

On August 10, 2009, Validus Re entered into an uncommitted $500,000 secured bi-lateral letter of credit facility with Citibank Europe plc (the "Secured Bi-Lateral Letter of Credit Facility"). Letters of credit were first issued under the Secured Bi-Lateral Letter of Credit Facility during the first quarter of 2012. As of March 31, 2013, $89,511 of letters of credit were outstanding under the Secured Bi-Lateral Letter of Credit Facility (December 31, 2012: $92,402). The Secured Bi-Lateral Letter of Credit Facility has no fixed termination date and as of March 31, 2013, Validus Re is in compliance with all terms and covenants thereof.

(v) $10,000 PaCRe Senior secured letter of credit facility

On May 11, 2012, PaCRe (as Borrower) and its subsidiary, PaCRe Investments, Ltd. (as Guarantor) entered into a 364-Day secured revolving credit and letter of credit facility with JPMorgan Chase Bank, N.A. This facility provides for revolving borrowings by the Borrower and for letters of credit issued by the Borrower to be used to support its reinsurance obligations in aggregate amount of $10,000. As of March 31, 2013, $258 of letters of credit were outstanding under this facility (December 31, 2012: $219).

As of March 31, 2013, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the PaCRe Senior secured letter of credit facility.

(vi) $550,000 Flagstone Bi-Lateral Facility

As part of the Flagstone Acquisition, the Company assumed a Letters of Credit Master Agreement between Citibank Europe Plc and Flagstone Reassurance Suisse, S.A. (the "Flagstone Bi-Lateral Facility"). At March 31, 2013, the Flagstone Bi-Lateral Facility had $296,979 letters of credit issued and outstanding (December 31, 2012: $381,019).

As of March 31, 2013, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Flagstone Bi-Lateral Facility.

13. AlphaCat variable funding notes

AlphaCat Master Fund Ltd. ("Master Fund"), a Bermuda registered exempt mutual fund company and AlphaCat Reinsurance Ltd. ("AlphaCat Re"), a Bermuda Class 3 licensed insurance company, issued Variable Funding Notes

(“VFNs”) to the AlphaCat ILS Funds ("ILS Funds") and AlphaCat 2013.

The purpose of the VFNs is to enable the ILS Funds to invest in specific contracts or cat bonds through the market facing entities. The economic benefit of the investments is transferred to the ILS Funds and AlphaCat 2013 by way of interim payments, which accrue to the ILS Funds and sidecars according to the earnings in AlphaCat Re and Master Fund.

The following table presents a summary of the AlphaCat VFNs on the balance sheet as at March 31, 2013:

	March 31, 2013
AlphaCat 2013	$161,439
AlphaCat ILS Funds	129,149
Total	$290,588

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For details on the AlphaCat VFNs interest expense which is included in the Company's Consolidated Statements of Comprehensive Income, refer to Note 12: "Debt and financing arrangements."

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 an average portfolio, excluding bank loans, credit quality of AA- or higher, with mortgage and commercial mortgage-backed issues having an aggregate weighted average credit quality of AAA. In addition, the Company limits its exposure to any single issuer to 3% or less, excluding government and agency securities. With the exception of the Company's bank loan portfolio, which represents 11.1% of the Company's total investments as at March 31, 2013, the minimum credit rating of any security purchased is Baa3/BBB- and where investments are downgraded, the Company permits a holding of up to 2% in aggregate market value, or 10% with written pre-authorization. At March 31, 2013, 1.1% of the portfolio, excluding bank loans, had a split rating below Baa3/BBB- and the Company did not have an aggregate exposure to any single issuer of more than 0.7% of its investment portfolio, other than with respect to government and agency securities.

(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 between $403,700 and $428,700 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, reserving environment together with input arising from Lloyd's discussions with, inter alia, regulatory and rating agencies. Such capital, called Funds at Lloyd's (“FAL”), comprises: cash, investments and undrawn letters of credit provided by various banks. The amounts of cash, investments and letters of credit at March 31, 2013 amounted to $428,700 (December 31, 2012: $428,700) of which $25,000 is provided under the Talbot FAL Facility (December 31, 2012: $25,000).

The amounts which the Company provides 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.

(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 2013 estimated premium income at Lloyd's of £620,000, the March 31, 2013 exchange rate of £1 equals $1.5187 and assuming the maximum 3% assessment, the Company would be assessed approximately $28,248.

(d) Aquiline Commitment

On December 20, 2011, Validus Re 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 Validus Re 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 Company's remaining commitment at March 31, 2013 was $31,041.

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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 6,255,943 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, also 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 months ended March 31, 2013 of $1,795 (2012: $297) of which $198 was included in premiums receivable at March 31, 2013 (December 31, 2012: $251). The Company also recognized reinsurance premiums ceded during the three months ended March 31, 2013 of $4 (2012: $nil) and recorded $4,417 of loss reserves recoverable at March 31, 2013 (December 31, 2012: $3,694). Earned premium adjustments of $719 (2012: $362) were recorded during the three months ended March 31, 2013.
Aquiline was previously a shareholder of Tiger Risk Partners LLC (“Tiger Risk”). Christopher E. Watson, a director of the Company serves as a director of Tiger Risk. As of March 31, 2013, Tiger Risk was no longer a related party due to Aquiline's disposal of its investment. Pursuant to certain reinsurance contracts, the Company recognized brokerage expenses paid to Tiger Risk for the three months ended March 31, 2012 of $290 of which $964 was included in accounts payable and accrued expenses at December 31, 2012.

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 and Michael Carpenter, the Chairman of Talbot Holdings Ltd. and a director of the Company, serves as a director of a subsidiary company of Conning Holdings Corp. Investment management fees earned by Conning for the three months ended March 31, 2013 were $191 (2012: $203) of which $196 was included in accounts payable and accrued expenses at March 31, 2013 (December 31, 2012: $201).
On December 20, 2011, Validus Re 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 Validus Re 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 March 31, 2013, the Company incurred $120 (2012: $1,436) in partnership fees and made $1,341 (2012: $1,529) of capital contributions respectively, of which $nil were included in accounts payable and accrued expenses at March 31, 2013 (December 31, 2012: $nil).
Certain shareholders of the Company and their affiliates, as well as the employers of or entities otherwise associated with certain directors and officers or their affiliates, have purchased insurance and/or reinsurance from the Company in the ordinary course of business on terms the Company believes were no more favorable to these (re)insureds than those made available to other customers.

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16. Earnings per share

The following table sets forth the computation of basic and diluted earnings per share for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Basic earnings per share		
Net income	$220,694	$124,234
Loss attributable to noncontrolling interest	2,549	—
Net income available to Validus	223,243	124,234
Less: Dividends and distributions declared on outstanding warrants	(14,464)	(1,729)
Income available to common shareholders	$208,779	$122,505
Weighted average number of common shares outstanding	107,386,438	99,425,140
Basic earnings per share available to common shareholders	$1.94	$1.23
Diluted earnings per share		
Net income	$220,694	$124,234
Loss attributable to noncontrolling interest	2,549	—
Net income available to Validus	223,243	124,234
Less: Dividends and distributions declared on outstanding warrants	(14,464)	—
Income available to common shareholders	$208,779	$124,234
Weighted average number of common shares outstanding	107,386,438	99,425,140
Share equivalents:		
Warrants	—	3,022,971
Stock options	1,631,556	813,863
Unvested restricted shares	1,035,005	1,834,116
Weighted average number of diluted common shares outstanding	110,052,999	105,096,090
Diluted earnings per share available to common shareholders	$1.90	$1.18

Share equivalents that would result in the issuance of common shares of 104,405 (2012: 16,660) were outstanding for the three months ended March 31, 2013, but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

17. Segment information

The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. and Talbot Holdings Ltd. from which three operating segments have been determined under U.S. GAAP segment reporting. During the first quarter of 2012, to better align the Company's operating and reporting structure with its current strategy, there was a change in the segment structure. This change included the AlphaCat group of companies as a separate operating segment. "AlphaCat segment" was included as an additional segment and includes the Company's investments in AlphaCat Re 2011, AlphaCat Re 2012, AlphaCat 2013, PaCRe and the AlphaCat ILS funds. The Company's operating segments are strategic business units that offer different products and services. They are managed and have capital allocated separately because each business requires different strategies.

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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 and composite.

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 and AlphaCat 2013 as well as investments in 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 other reconciling items

The Company has a "Corporate" function, 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 intersegment 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 March 31, 2013	Validus Re Segment	AlphaCat Segment	Talbot Segment	Corporate & Eliminations	Total
Underwriting income					
Gross premiums written	$747,963	$96,516	$293,530	$(33,249)	$1,104,760
Reinsurance premiums ceded	(125,728)	—	(94,737)	33,249	(187,216)
Net premiums written	622,235	96,516	198,793	—	917,544
Change in unearned premiums	(319,101)	(68,899)	1,517	—	(386,483)
Net premiums earned	303,134	27,617	200,310	—	531,061
Underwriting deductions					
Losses and loss expenses	73,402	—	71,369	—	144,771
Policy acquisition costs	51,744	2,638	40,526	(1,297)	93,611
General and administrative expenses	29,441	4,037	30,912	15,889	80,279
Share compensation expenses	1,413	77	1,405	(577)	2,318
Total underwriting deductions	156,000	6,752	144,212	14,015	320,979
Underwriting income (loss)	$147,134	$20,865	$56,098	$(14,015)	$210,082
Net investment income	23,193	881	4,718	(3,143)	25,649
Other income	13,490	6,633	—	(17,438)	2,685
Finance expenses	(3,252)	(11,325)	(74)	(9,795)	(24,446)
Operating income (loss) before taxes and income from operating affiliates	180,565	17,054	60,742	(44,391)	213,970
Tax benefit (expense)	1,757	—	(1,054)	(385)	318
Income from operating affiliates	—	3,523	—	—	3,523
Net operating income (loss)	$182,322	$20,577	$59,688	$(44,776)	$217,811
Net realized gains on investments	1,593	—	128	—	1,721
Net unrealized (losses) on investments	(2,193)	(4,788)	(256)	—	(7,237)
Income from investment affiliate	1,477	—	—	—	1,477
Foreign exchange gains (losses)	11,162	(1,187)	(3,918)	865	6,922
Net income (loss)	$194,361	$14,602	$55,642	$(43,911)	$220,694
Net loss attributable to noncontrolling interest	—	2,549	—	—	2,549
Net income (loss) available (attributable) to Validus	$194,361	$17,151	$55,642	$(43,911)	$223,243
Selected ratios (a):					
Net premiums written / Gross premiums written	83.2 %	100.0 %	67.7 %		83.1 %

Losses and loss expenses	24.2 %	0.0 %	35.6 %		27.3 %
Policy acquisition costs	17.1 %	9.6 %	20.2 %		17.6 %
General and administrative expenses (b)	10.2 %	14.9 %	16.1 %		15.6 %
Expense ratio	27.3 %	24.5 %	36.3 %		33.2 %
Combined ratio	51.5 %	24.5 %	71.9 %		60.5 %
Total assets	$6,299,481	$1,189,190	$3,043,312	$32,417	$10,564,400

(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.
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Three Months Ended March 31, 2012	Validus Re Segment	AlphaCat Segment	Talbot Segment	Corporate & Eliminations	Total
Underwriting income					
Gross premiums written	$566,866	$3,518	$293,253	$(26,348)	$837,289
Reinsurance premiums ceded	(30,001)	—	(103,399)	26,348	(107,052)
Net premiums written	536,865	3,518	189,854	—	730,237
Change in unearned premiums	(283,856)	(855)	5,673	—	(279,038)
Net premiums earned	253,009	2,663	195,527	—	451,199
Underwriting deductions					
Losses and loss expenses	124,206	—	107,783	—	231,989
Policy acquisition costs	38,790	256	38,738	348	78,132
General and administrative expenses	17,252	1,032	33,348	14,743	66,375
Share compensation expenses	1,872	52	1,348	2,166	5,438
Total underwriting deductions	182,120	1,340	181,217	17,257	381,934
Underwriting income (loss)	$70,889	$1,323	$14,310	$(17,257)	$69,265
Net investment income	23,577	659	5,790	(2,266)	27,760
Other income	2,219	7,974	1,026	(2,328)	8,891
Finance expenses	(3,694)	(2)	(31)	(12,552)	(16,279)
Operating income (loss) before taxes and income from operating affiliates	92,991	9,954	21,095	(34,403)	89,637
Tax (expense)	(7)	—	(132)	—	(139)
Income from operating affiliates	—	3,367	—	—	3,367
Net operating income (loss)	$92,984	$13,321	$20,963	$(34,403)	$92,865
Net realized gains on investments	6,242	—	1,290	—	7,532
Net unrealized gains (losses) on investments	19,865	(597)	1,403	—	20,671
Foreign exchange (losses) gains	(262)	(9)	3,623	(186)	3,166
Net income (loss)	$118,829	$12,715	$27,279	$(34,589)	$124,234
Net (income) attributable to noncontrolling interest	—	—	—	—	—
Net income (loss) available (attributable) to Validus	$118,829	$12,715	$27,279	$(34,589)	$124,234
Selected ratios (a):					
Net premiums written / Gross premiums written	94.7 %	100.0 %	64.7 %		87.2 %
Losses and loss expenses	49.1 %	0.0 %	55.1 %		51.4 %

Policy acquisition costs	15.3 %	9.6 %	19.8 %		17.3 %
General and administrative expenses (b)	7.6 %	40.7 %	17.7 %		15.9 %
Expense ratio	22.9 %	50.3 %	37.5 %		33.2 %
Combined ratio	72.0 %	50.3 %	92.6 %		84.6 %
Total assets	$4,940,727	$237,528	$2,929,817	$13,797	$8,121,869

(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.
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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 March 31, 2013					
	Gross Premiums Written					
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%
United States	$236,496	$17,489	$20,541	$(6,864)	$267,662	24.2 %
Worldwide excluding United States (a)	50,308	14,689	39,458	(4,508)	99,947	9.0 %
Australia and New Zealand	25,026	2,183	3,005	(230)	29,984	2.7 %
Europe	40,870	1,964	18,311	(2,848)	58,297	5.3 %
Latin America and Caribbean	8,418	—	42,000	(3,218)	47,200	4.3 %
Japan	737	—	654	(50)	1,341	0.1 %
Canada	2,642	318	2,706	(525)	5,141	0.5 %
Rest of the world (b)	19,079	—	18,314	(1,403)	35,990	3.3 %
Sub-total, non United States	147,080	19,154	124,448	(12,782)	277,900	25.2 %
Worldwide including United States (a)	100,540	59,873	19,156	(3,689)	175,880	15.9 %
Other location non-specific (c)	263,847	—	129,385	(9,914)	383,318	34.7 %
Total	$747,963	$96,516	$293,530	$(33,249)	$1,104,760	100.0 %

	Three Months Ended March 31, 2012					
	Gross Premiums Written					
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%
United States	$106,936	$1,326	$18,426	$(1,656)	$125,032	14.9 %
Worldwide excluding United States (a)	37,116	279	51,317	(4,611)	84,101	10.0 %
Australia and New Zealand	24,785	—	3,534	(316)	28,003	3.3 %
Europe	45,274	338	15,247	(1,370)	59,489	7.1 %
Latin America and Caribbean	3,789	—	40,570	(3,645)	40,714	4.9 %
Japan	(1,311)	—	660	(59)	(710)	(0.1)%
Canada	2,430	—	3,522	(318)	5,634	0.7 %
Rest of the world (b)	17,397	—	20,482	(1,840)	36,039	4.3 %
Sub-total, non United States	129,480	617	135,332	(12,159)	253,270	30.2 %
Worldwide including United States (a)	103,575	1,575	14,797	(1,329)	118,618	14.2 %
Other location non-specific (c)	226,875	—	124,698	(11,204)	340,369	40.7 %
Total	$566,866	$3,518	$293,253	$(26,348)	$837,289	100.0 %

(a) Represents risks in two or more geographic zones.
(b) Represents risks in one geographic zone.
(c) The Other location non-specific category refers to business for which an analysis of exposure by geographic zone is not applicable such as marine and aerospace risks and can span multiple geographic areas and are not fixed locations in some instances.

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Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (unaudited)
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18. Subsequent events

(a) Quarterly Dividend

On May 1, 2013, 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 June 28, 2013 to holders of record on June 14, 2013.

(b) Longhorn Re Acquisition

On April 25, 2013, the Company acquired Longhorn Re, Ltd., a single contract, Bermuda domiciled crop reinsurer.

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 months ended March 31, 2013 and 2012 and the Company's consolidated financial condition, liquidity and capital resources at March 31, 2013 and December 31, 2012. This discussion and analysis should be read in conjunction with the audited consolidated financial statements and related notes for the fiscal year ended December 31, 2012, the discussions of critical accounting policies and the qualitative and quantitative disclosure about market risk contained in the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2012.

For a variety of reasons, the Company's historical financial results may not accurately indicate future performance. See "Cautionary Note Regarding Forward-Looking Statements." The Risk Factors set forth in Item 1A of the Company's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2012 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, Validus Re, Talbot and AlphaCat. The Company, provides reinsurance, insurance and insurance linked securities ("ILS") fund management. Validus Re is a Bermuda based reinsurer focused on short tail lines of reinsurance. Talbot is the Bermuda parent of the specialty insurance group primarily operating within the Lloyd's insurance market through Syndicate 1183. AlphaCat is a Bermuda based investment adviser, managing third-party capital in insurance linked securities and other investments in the property catastrophe reinsurance space. The Company’s strategy has been to concentrate primarily on short-tail risks, which has been an area where management believes current prices and terms provide an attractive risk adjusted return and the management team has proven expertise. The Company’s profitability in any given period is based upon premium and investment revenues, less net losses and loss expenses, acquisition expenses and operating expenses. Financial results in the insurance and reinsurance industry are influenced by the frequency and/or severity of claims and losses, including as a result of catastrophic events, changes in interest rates, financial markets and general economic conditions, the supply of insurance and reinsurance capacity and changes in legal, regulatory and judicial environments.

On April 2, 2012, the Company capitalized PaCRe, a new Class 4 Bermuda reinsurer formed for the purpose of writing high excess property catastrophe reinsurance. PaCRe was funded with $500.0 million of contributed capital. Validus invested $50.0 million in PaCRe's common equity. The Company underwrites business for PaCRe, for which it paid a profit commission based on the company's underwriting results. As Validus Re holds a majority of PaCRe's outstanding voting rights, the financial statements of PaCRe are included in the consolidated financial statements for the Company. The portion of PaCRe's earnings attributable to third party investors for the three months ended March 31, 2013 is recorded in the consolidated Statements of Comprehensive Income (Loss) as "Net (income) loss attributable to noncontrolling interest."

On May 29, 2012, the Company announced that it has joined with other investors in capitalizing AlphaCat Re 2012. AlphaCat Re 2012 is 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 funded with $70.0 million of equity capital. The Company underwrites business for AlphaCat Re 2012, for which it is paid a commission for originating the business and a

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profit commission based on underwriting results. Validus Re has an equity interest and voting rights in AlphaCat Re 2012 which is below 50%, therefore the investment in AlphaCat Re 2012 is included as an equity method investment in the consolidated financial statements of the Company.

On February 22, 2013, a partial return of investment was made to the investors of AlphaCat Re 2012. Validus Re's corresponding portion of the return of investment was $3.8 million.
On November 30, 2012, the Company acquired all of the outstanding shares of Flagstone Reinsurance Holdings S.A. ("Flagstone"), strengthening the Company's leading property catastrophe reinsurance and short-tail specialty insurance platform. For segmental reporting purposes, the results of Flagstone’s operations since the acquisition date have been included within the Validus Re segment in the consolidated financial statements.
On December 17, 2012, the Company joined with other investors in capitalizing AlphaCat 2013, a special purpose vehicle formed for the purpose of investing in collateralized reinsurance. AlphaCat 2013 was funded with $230.0 million of contributed capital. Validus Re has an equity interest and voting rights in AlphaCat 2013 which is below 50%, therefore the investment in AlphaCat 2013 is included as an equity method investment in the consolidated financial statements of the Company.

On December 17, 2012, the Company also received $219.4 million of third party subscriptions for three AlphaCat ILS Funds. Validus Re holds a majority of participation rights in two of the funds, therefore the financial statements of these funds are included in the consolidated financial statements of the Company. The portion of the funds' earnings attributable to third party investors for the three months ended March 31, 2013 is recorded in the consolidated Statements of Comprehensive Income as "Net loss attributable to noncontrolling interest." The third fund is also a variable interest entity, however, it is not consolidated by the Company as Validus Re is not deemed to be the primary beneficiary. As a result, the investment in this fund is included in "Investments in affiliates" as at March 31, 2013. The Company's maximum exposure to loss with respect to this investment is limited to the investment carrying amount reported in the Company's Consolidated Balance Sheet.

AlphaCat Re 2011 is now considered "off-risk" as all reinsurance contracts written by the company have expired. As a result, on January 4, 2013 and January 23, 2013, a partial return of investment was made to the investors of AlphaCat Re 2011. Validus Re's corresponding portion of the return of investment was $46.4 million.

Business Outlook and Trends

We underwrite global specialty 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 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 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 on rates on most lines. During 2010 there was an increased level of catastrophe activity, principally the Chilean earthquake and the Deepwater Horizon events but the Company continued to see increased competition and decreased premium rates in most classes of business.

During the January 2012 renewal season, the Validus Re segment showed rate improvement relative to 2011. This improvement was largely due to the large catastrophe loss activity during 2011. During the first quarter of 2012, Talbot experienced rate increases in loss affected lines without seeing a systemic rise in rates across all lines. During the July 2012 renewal period, the Validus Re segment experienced rate improvements in the U.S. property lines while European and Latin American property rates were unchanged. The Talbot segment experienced a rate increase of 2.7% across the portfolio, with some lines performing in line with expectations and other lines either de-risking or reassessing the respective portfolio.

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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. Talbot experienced a rate increase of 1.9% across the portfolio, driven largely by the marine and energy liability, onshore energy international, financial institutions and marine treaty accounts.

Financial Measures

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

Annualized return on average equity represents the level of net income available to shareholders generated from the average shareholders’ equity during the period. Annualized 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 available to Validus is the average of the beginning, ending and intervening quarter end shareholders’ equity available to Validus balances. Percentages for the quarter and interim periods are annualized. The Company’s objective is to generate superior returns on capital that appropriately reward shareholders for the risks assumed and to grow premiums written only when returns meet or exceed internal requirements. Details of annualized return on average equity are provided below.

	Three Months Ended March 31,		Year Ended December 31,
	2013	2012	2012
Annualized return on average equity	22.5 %	14.2 %	11.3 %

The increase in annualized return on average equity for the three months ended March 31, 2013 was driven primarily by an increase in net income. Net income available to Validus for the three months ended March 31, 2013 increased by $99.0 million, or 79.7% compared to the three months ended March 31, 2012. The increase in net income for the three months ended March 31, 2013 was primarily due to an increase in underwriting income of $140.8 million, partially offset by an unfavorable movement of $27.9 million in net unrealized gains (losses) on investments.

Diluted book value per common share is considered by management to be an appropriate measure of our returns to common shareholders, as we believe growth in our book value on a diluted basis ultimately translates into growth of our stock price. Diluted book value per common share decreased by $0.43, or 1.2%, from $35.22 at December 31, 2012 to $34.79 at March 31, 2013, primarily due to the special dividend of $2.00 per share and an increase in the quarterly dividend from $0.25 to $0.30 per share which was paid during the three months ended March 31, 2013. Diluted book value per common share is a Non-GAAP financial measure. The most comparable U.S. GAAP financial measure is book value per common share. Diluted book value per common share is calculated based on total shareholders’ equity plus the assumed proceeds from the exercise of outstanding options and warrants, divided by the sum of common shares, unvested restricted shares, options and warrants outstanding (assuming their exercise). A reconciliation of diluted book value per common share to book value per common share is presented below in the section entitled “Other Non-GAAP Financial Measures.”

Cash dividends per common share are an integral part of the value created for shareholders. On May 1, 2013, 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 June 28, 2013 to holders of record on June 14, 2013.

Underwriting income measures the performance of the Company’s core underwriting function, excluding revenues and expenses such as net investment income (loss), other income, finance expenses, net realized and unrealized gains (losses) on investments and foreign exchange gains (losses). The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company’s core insurance and reinsurance operations. Underwriting income for the three months ended March 31, 2013 and 2012 was $210.1 million and $69.3 million, respectively. Underwriting income is a non-GAAP financial measure as described in detail and reconciled in the section below entitled “Underwriting Income.”

Managed gross premiums written, a non-GAAP financial measure, represents gross premiums written by the Company and its operating affiliates. Managed gross premiums written differs from total gross premiums written, which the Company believes is the most directly comparable GAAP measure, due to the inclusion of premiums written on behalf of the Company's operating affiliates, AlphaCat Re 2011 and AlphaCat Re 2012, which are accounted for under the equity method of accounting. A reconciliation

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of managed gross premiums written to gross premiums written, the most comparable U.S. GAAP financial measure, is presented in below in the section entitled "Other Non-GAAP Financial Measures."

Critical Accounting Policies and Estimates

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

- Reserve for losses and loss expenses;
- Premiums;
- Reinsurance premiums ceded and reinsurance recoverable; and
- Investment valuation.

Critical accounting policies and estimates are discussed further in Item 7, Management's Discussion and Analysis of Results of Operations and Financial Condition in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2012.

Segment Reporting

Management has determined that the Company operates in three reportable segments. These segments are its significant operating subsidiaries, Validus Re, AlphaCat and Talbot. For segmental reporting purposes, the results of Flagstone’s operations since the acquisition date have been included within the Validus Re segment in the consolidated financial statements.

Results of Operations

Validus Re commenced operations on December 16, 2005. The Company’s fiscal year ends on December 31. Financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information.

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The following table presents results of operations for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31,	
(Dollars in thousands)	2013	2012 (a)
Underwriting income		
Gross premiums written	$1,104,760	$837,289
Reinsurance premiums ceded	(187,216)	(107,052)
Net premiums written	917,544	730,237
Change in unearned premiums	(386,483)	(279,038)
Net premiums earned	531,061	451,199
Underwriting deductions		
Losses and loss expenses	144,771	231,989
Policy acquisition costs	93,611	78,132
General and administrative expenses	80,279	66,375
Share compensation expenses	2,318	5,438
Total underwriting deductions	320,979	381,934
Underwriting income (b)	210,082	69,265
Net investment income	25,649	27,760
Other income	2,685	8,891
Finance expenses	(24,446)	(16,279)
Operating income before taxes and income from operating affiliates (b)	213,970	89,637
Tax benefit (expense)	318	(139)
Income from operating affiliates	3,523	3,367
Net operating income (b)	217,811	92,865
Net realized gains on investments	1,721	7,532
Net unrealized (losses) gains on investments	(7,237)	20,671
Income from investment affiliate	1,477	—
Foreign exchange gains	6,922	3,166
Net income	220,694	124,234
Net loss attributable to noncontrolling interest	2,549	—
Net income available to Validus	$223,243	$124,234
Selected ratios:		
Net premiums written / Gross premiums written	83.1%	87.2%
Losses and loss expenses	27.3%	51.4%
Policy acquisition costs	17.6%	17.3%
General and administrative expenses (c)	15.6%	15.9%
Expense ratio	33.2%	33.2%
Combined ratio	60.5%	84.6%

a) The results of operations for Flagstone are consolidated only from the November 30, 2012 date of acquisition.

b) 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. A reconciliation of underwriting income to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled "Underwriting Income."

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

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	Three Months Ended March 31, 2013	2012 (a)
Validus Re		
Gross premiums written	$747,963	$566,866
Reinsurance premiums ceded	(125,728)	(30,001)
Net premiums written	622,235	536,865
Change in unearned premiums	(319,101)	(283,856)
Net premiums earned	303,134	253,009
Losses and loss expenses	73,402	124,206
Policy acquisition costs	51,744	38,790
General and administrative expenses	29,441	17,252
Share compensation expenses	1,413	1,872
Total underwriting deductions	156,000	182,120
Underwriting income (b)	$147,134	$70,889
AlphaCat		
Gross premiums written	$96,516	$3,518
Reinsurance premiums ceded	—	—
Net premiums written	96,516	3,518
Change in unearned premiums	(68,899)	(855)
Net premiums earned	27,617	2,663
Policy acquisition costs	2,638	256
General and administrative expenses	4,037	1,032
Share compensation expenses	77	52
Total underwriting deductions	6,752	1,340
Underwriting income (b)	$20,865	$1,323
Talbot		
Gross premiums written	$293,530	$293,253
Reinsurance premiums ceded	(94,737)	(103,399)
Net premiums written	198,793	189,854
Change in unearned premiums	1,517	5,673
Net premiums earned	200,310	195,527
Losses and loss expenses	71,369	107,783
Policy acquisition costs	40,526	38,738
General and administrative expenses	30,912	33,348
Share compensation expenses	1,405	1,348
Total underwriting deductions	144,212	181,217
Underwriting income (b)	$56,098	$14,310
Corporate & Eliminations		
Gross premiums written	$(33,249)	$(26,348)

Reinsurance premiums ceded	33,249	26,348
Net premiums written	—	—
Policy acquisition costs	(1,297)	348
General and administrative expenses	15,889	14,743
Share compensation expenses	(577)	2,166
Total underwriting deductions	14,015	17,257
Underwriting (loss) (b)	$(14,015)	$(17,257)
Total underwriting income (b)	$210,082	$69,265

a) The results of operations for Flagstone are consolidated only from the November 30, 2012 date of acquisition.

b) Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting 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. A reconciliation of this measure to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled "Underwriting Income."

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Three Months Ended March 31, 2013 compared to Three Months Ended March 31, 2012

Net income available to Validus for the three months ended March 31, 2013 was $223.2 million compared to $124.2 million for the three months ended March 31, 2012, an increase of $99.0 million or 79.7%. The primary factors driving the increase in net income were:

- Increase in underwriting income of $140.8 million primarily due to:

- An increase in net premiums earned of $79.9 million;

- A decrease in underwriting deductions of $61.0 million due primarily to a decrease in losses and loss expenses of $87.2 million, partially offset by an increase in policy acquisition costs of $15.5 million; and

- A favorable movement in foreign exchange gains of $3.8 million.

The above factors were partially offset by the following:

- An unfavorable movement of $27.9 million in net unrealized gains (losses) on investments, of which $4.7 million is attributable to noncontrolling interest; and

- An increase in finance expenses of $8.2 million.

The change in net income available to Validus for the three months ended March 31, 2013 of $99.0 million as compared to the three months ended March 31, 2012 is described in the following table:

	Three Months Ended March 31, 2013 Increase (Decrease) Over the Three Months Ended March 31, 2012				
(Dollars in thousands)	Validus Re	AlphaCat	Talbot	Corporate and Eliminations	Total
Notable losses - decrease in net loss and loss expenses (a)	$85,497	$—	$13,413	—	$98,910
Less: Notable losses - (decrease) increase in net reinstatement premiums (a)	(17,796)	—	3,424	—	(14,372)
Other underwriting income	8,544	19,542	24,951	3,242	56,279
Underwriting income (b)	76,245	19,542	41,788	3,242	140,817
Net investment income	(384)	222	(1,072)	(877)	(2,111)
Other income	11,271	(1,341)	(1,026)	(15,110)	(6,206)
Finance expenses	442	(11,323)	(43)	2,757	(8,167)
Operating income (loss) before taxes and income from operating affiliates	87,574	7,100	39,647	(9,988)	124,333
Tax benefit (expense)	1,764	—	(922)	(385)	457
Income from operating affiliates	—	156	—	—	156
Net operating income (loss)	89,338	7,256	38,725	(10,373)	124,946
Net realized (losses) on investments	(4,649)	—	(1,162)	—	(5,811)
Net unrealized (losses) on investments	(22,058)	(4,191)	(1,659)	—	(27,908)
Income from investment affilate	1,477	—	—	—	1,477
Foreign exchange gains (losses)	11,424	(1,178)	(7,541)	1,051	3,756

Net income (loss)	75,532	1,887	28,363	(9,322)	96,460
Net loss attributable to noncontrolling interest	—	2,549	—	—	2,549
Net income (loss) available to Validus	$75,532	$4,436	$28,363	$(9,322)	$99,009

(a) There were no notable losses for the three months ended March 31, 2013. Notable losses for the three months ended March 31, 2012 included: Costa Concordia and Cat 67. Excludes the reserve for potential development on 2012 notable loss events.

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

Gross Premiums Written

Gross premiums written for the three months ended March 31, 2013 were $1,104.8 million compared to $837.3 million for the three months ended March 31, 2012, an increase of $267.5 million or 31.9%. Details of gross premiums written by line of business are provided below.

	Three Months Ended March 31, 2013		Three Months Ended March 31, 2012 (a)		
(Dollars in thousands)	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)	% Change
Property	$471,526	42.7 %	$381,381	45.5 %	23.6 %
Marine	283,822	25.7 %	306,235	36.6 %	(7.3)%
Specialty	349,412	31.6 %	149,673	17.9 %	133.5 %
Total	$1,104,760	100.0 %	$837,289	100.0 %	31.9 %

a) The results of operations for Flagstone are consolidated only from the November 30, 2012 date of acquisition.

Validus Re. Validus Re gross premiums written for the three months ended March 31, 2013 were $748.0 million compared to $566.9 million for the three months ended March 31, 2012, an increase of $181.1 million or 31.9%. Details of Validus Re gross premiums written by line of business are provided below.

	Three Months Ended March 31, 2013		Three Months Ended March 31, 2012 (a)		
(Dollars in thousands)	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)	% Change
Property	$326,024	43.6 %	$318,485	56.2 %	2.4 %
Marine	161,432	21.6 %	198,427	35.0 %	(18.6)%
Specialty	260,507	34.8 %	49,954	8.8 %	421.5 %
Total	$747,963	100.0 %	$566,866	100.0 %	31.9 %

a) The results of operations for Flagstone are consolidated only from the November 30, 2012 date of acquisition.

The increase in gross premiums written in the property lines of $7.5 million was due primarily to an increase in catastrophe excess of loss treaties of $20.4 million and a $7.2 million increase in premiums relating to new business assumed through the Flagstone acquisition, offset by decreases in premiums assumed from Talbot of $4.0 million, proportional treaties of $4.8 million, per risk excess of loss treaties of $4.0 million and reinstatement premiums of $5.4 million. The decrease in gross premiums written of $37.0 million in the marine lines was due primarily to a $23.5

million decrease in proportional treaties due to the non-renewal of business that no longer met the Company's underwriting threshold and a $16.9 million decrease in reinstatement premiums primarily on Costa Concordia. The increase in gross premiums written in the specialty lines of $210.6 million was due primarily to an increase in proportional crop treaties of $187.2 million related to targeted growth in the agricultural class, as a result of the hiring of two experienced agriculture underwriters and an increase in catastrophe excess of loss treaties of $9.8 million.

Gross premiums written under the quota share, surplus treaty and excess of loss contracts with Talbot for the three months ended March 31, 2013 were $22.5 million compared to $26.3 million for the three months ended March 31, 2012, a decrease of $3.8 million on all lines, as compared to the three months ended March 31, 2012. These reinsurance agreements with Talbot are eliminated upon consolidation.

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