

VALIDUS HOLDINGS LTD

Form 10-Q

August 06, 2010

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

**Form 10-Q**

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

**For the quarterly period ended June 30, 2010**  
**Commission file number 001-33606**

**VALIDUS HOLDINGS, LTD.**

*(Exact name of registrant as specified in its charter)*

**BERMUDA**

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

**98-0501001**

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

**29 Richmond Road, Pembroke, Bermuda HM 08**

*(Address of principal executive offices and zip code)*

**(441) 278-9000**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

**Yes ☒ No ☐**

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

**Yes ☐ No ☐**

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐  
(Do not check if a smaller  
reporting company)

Smaller reporting  
company ☐

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

**Yes ☐ No ☒**

As of August 6, 2010, there were 111,527,254 outstanding Common Shares, \$0.175 par value per share, of the registrant.

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Consolidated Balance Sheets

**As at June 30, 2010 (unaudited) and December 31, 2009**

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

|  | <b>June 30,<br/>2010<br/>(unaudited)</b> | <b>December<br/>31,<br/>2009</b> |
|--|--|----------------------------------|
| <b>Assets</b>  |  |                                  |
| Fixed maturities, at fair value (amortized cost: 2010 - \$4,924,447; 2009 - \$4,870,395)   | \$ 4,975,019                             | \$ 4,869,378                     |
| Short-term investments, at fair value (amortized cost: 2010 - \$269,782; 2009 - \$482,632) | 269,782                                  | 481,766                          |
| Other investments, at fair value (amortized cost: 2010 - \$24,948; 2009 - \$35,941)        | 26,068                                   | 37,615                           |
| Cash and cash equivalents  | 492,489                                  | 387,585                          |
| <br>Total investments and cash   | <br>5,763,358                            | <br>5,776,344                    |
| Premiums receivable  | 931,670                                  | 551,616                          |
| Deferred acquisition costs   | 165,957                                  | 112,329                          |
| Prepaid reinsurance premiums   | 185,771                                  | 73,164                           |
| Securities lending collateral  | 99,224                                   | 90,350                           |
| Loss reserves recoverable  | 193,604                                  | 181,765                          |
| Paid losses recoverable  | 24,133                                   | 14,782                           |
| Net receivable for investments sold  | 25,542                                   |                                  |
| Income taxes recoverable   | 1,171                                    | 2,043                            |
| Intangible assets  | 120,975                                  | 123,055                          |
| Goodwill   | 20,393                                   | 20,393                           |
| Accrued investment income  | 38,643                                   | 38,077                           |
| Other assets   | 44,182                                   | 35,222                           |
| <br><b>Total assets</b>  | <br><b>\$ 7,614,623</b>                  | <br><b>\$ 7,019,140</b>          |
| <br><b>Liabilities</b>   |  |                                  |
| Reserve for losses and loss expenses   | \$ 1,978,130                             | \$ 1,622,134                     |
| Unearned premiums  | 1,176,603                                | 724,104                          |
| Reinsurance balances payable   | 98,740                                   | 65,414                           |
| Securities lending payable   | 100,000                                  | 90,106                           |
| Deferred income taxes  | 26,200                                   | 24,508                           |
| Net payable for investments purchased  |  | 44,145                           |
| Accounts payable and accrued expenses  | 95,404                                   | 127,809                          |
| Senior notes payable   | 246,820                                  |                                  |
| Debentures payable   | 289,800                                  | 289,800                          |
| <br><b>Total liabilities</b>   | <br><b>4,011,697</b>                     | <br><b>2,988,020</b>             |

Commitments and contingent liabilities

**Shareholders equity**

Common shares, 571,428,571 authorized, par value \$0.175 Issued and outstanding (including treasury shares) (2010 - 111,407,993; 2009 -

|   |           |           |
|---|-----------|-----------|
| 128,459,478)  | 23,101    | 23,033    |
| Treasury shares (2010 - 20,598,594; 2009 - 3,156,871) | (3,605)   | (553)     |
| Additional paid-in-capital                            | 2,247,995 | 2,675,680 |
| Accumulated other comprehensive (loss)                | (6,726)   | (4,851)   |
| Retained earnings                                     | 1,342,161 | 1,337,811 |

|                                  |                  |                  |
|----------------------------------|------------------|------------------|
| <b>Total shareholders equity</b> | <b>3,602,926</b> | <b>4,031,120</b> |
|----------------------------------|------------------|------------------|

|  |                     |                     |
|--|---------------------|---------------------|
| <b>Total liabilities and shareholders equity</b> | <b>\$ 7,614,623</b> | <b>\$ 7,019,140</b> |
|--|---------------------|---------------------|

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

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

## Consolidated Statements of Operations and Comprehensive Income

**For the Three and Six Months Ended June 30, 2010 and 2009 (unaudited)**

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

|  | <b>Three Months Ended</b> |                    | <b>Six Months Ended</b> |                    |
|--|---------------------------|--------------------|-------------------------|--------------------|
|  | <b>June 30,</b>           | <b>June 30,</b>    | <b>June 30,</b>         | <b>June 30,</b>    |
|  | <b>2010</b>               | <b>2009</b>        | <b>2010</b>             | <b>2009</b>        |
|  | <b>(unaudited)</b>        | <b>(unaudited)</b> | <b>(unaudited)</b>      | <b>(unaudited)</b> |
| <b>Revenues</b>                            |                           |                    |                         |                    |
| Gross premiums written                     | \$ 516,861                | \$ 425,032         | \$ 1,387,795            | \$ 1,034,924       |
| Reinsurance premiums ceded                 | (67,726)                  | (62,291)           | (158,465)               | (134,803)          |
| Net premiums written                       | 449,135                   | 362,741            | 1,229,330               | 900,121            |
| Change in unearned premiums                | (11,191)                  | (34,541)           | (333,692)               | (253,162)          |
| Net premiums earned                        | 437,944                   | 328,200            | 895,638                 | 646,959            |
| Net investment income                      | 34,809                    | 26,963             | 69,108                  | 53,735             |
| Net realized gains (losses) on investments | 12,441                    | (2,650)            | 23,839                  | (26,071)           |
| Net unrealized gains on investments        | 41,640                    | 37,249             | 57,053                  | 59,402             |
| Other income                               | 2,697                     | 1,017              | 3,585                   | 1,774              |
| Foreign exchanges (losses) gains           | (4,099)                   | 8,432              | (12,863)                | 4,232              |
| <b>Total revenues</b>                      | <b>525,432</b>            | <b>399,211</b>     | <b>1,036,360</b>        | <b>740,031</b>     |
| <b>Expenses</b>                            |                           |                    |                         |                    |
| Losses and loss expenses                   | 194,894                   | 124,751            | 673,425                 | 256,585            |
| Policy acquisition costs                   | 74,126                    | 64,438             | 150,302                 | 125,887            |
| General and administrative expenses        | 52,379                    | 41,200             | 105,948                 | 79,279             |
| Share compensation expenses                | 6,846                     | 5,632              | 13,422                  | 12,986             |
| Finance expenses                           | 13,218                    | 10,752             | 28,369                  | 18,475             |
| Transaction expenses                       |                           | 15,851             |                         | 15,851             |
| <b>Total expenses</b>                      | <b>341,463</b>            | <b>262,624</b>     | <b>971,466</b>          | <b>509,063</b>     |
| <b>Net income before taxes</b>             | <b>183,969</b>            | <b>136,587</b>     | <b>64,894</b>           | <b>230,968</b>     |
| Tax (expense) benefit                      | (4,187)                   | 976                | (3,490)                 | 1,502              |
| <b>Net income</b>                          | <b>\$ 179,782</b>         | <b>\$ 137,563</b>  | <b>\$ 61,404</b>        | <b>\$ 232,470</b>  |
| <b>Comprehensive income</b>                |                           |                    |                         |                    |
| Foreign currency translation adjustments   | (68)                      | 3,993              | (1,875)                 | 3,797              |
| <b>Comprehensive income</b>                | <b>\$ 179,714</b>         | <b>\$ 141,556</b>  | <b>\$ 59,529</b>        | <b>\$ 236,267</b>  |

**Earnings per share**

Weighted average number of common  
shares and common share equivalents  
outstanding

|         |             |            |             |            |
|---------|-------------|------------|-------------|------------|
| Basic   | 121,009,553 | 76,138,038 | 123,821,415 | 75,941,308 |
| Diluted | 125,152,300 | 78,942,065 | 125,661,729 | 79,022,355 |

|                                 |    |      |    |      |    |      |    |      |
|---------------------------------|----|------|----|------|----|------|----|------|
| <b>Basic earnings per share</b> | \$ | 1.47 | \$ | 1.79 | \$ | 0.47 | \$ | 3.02 |
|---------------------------------|----|------|----|------|----|------|----|------|

|                                   |    |      |    |      |    |      |    |      |
|-----------------------------------|----|------|----|------|----|------|----|------|
| <b>Diluted earnings per share</b> | \$ | 1.44 | \$ | 1.74 | \$ | 0.46 | \$ | 2.94 |
|-----------------------------------|----|------|----|------|----|------|----|------|

|  |    |      |    |      |    |      |    |      |
|--|----|------|----|------|----|------|----|------|
| <b>Cash dividends declared per share</b> | \$ | 0.22 | \$ | 0.20 | \$ | 0.44 | \$ | 0.40 |
|--|----|------|----|------|----|------|----|------|

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

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Consolidated Statements of Shareholders' Equity

**For the Six Months Ended June 30, 2010 and 2009 (unaudited)**

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

|   | <b>June 30, 2010<br/>(unaudited)</b> | <b>June 30, 2009<br/>(unaudited)</b> |
|---|--------------------------------------|--------------------------------------|
| <b>Common shares</b>                          |                                      |                                      |
| Balance Beginning of period                   | \$ 23,033                            | \$ 13,235                            |
| Issue of common shares                        | 68                                   | 92                                   |
| Balance End of period                         | \$ 23,101                            | \$ 13,327                            |
| <b>Treasury shares</b>                        |                                      |                                      |
| Balance Beginning of period                   | \$ (553)                             | \$                                   |
| Repurchase of common shares                   | (3,052)                              |                                      |
| Balance End of period                         | \$ (3,605)                           | \$                                   |
| <b>Additional paid-in capital</b>             |                                      |                                      |
| Balance Beginning of period                   | \$ 2,675,680                         | \$ 1,412,635                         |
| Issue of common shares, net of expenses       | (80)                                 | (1,243)                              |
| Repurchase of common shares                   | (441,027)                            |                                      |
| Share compensation expenses                   | 13,422                               | 12,986                               |
| Balance End of period                         | \$ 2,247,995                         | \$ 1,424,378                         |
| <b>Accumulated other comprehensive (loss)</b> |                                      |                                      |
| Balance Beginning of period                   | \$ (4,851)                           | \$ (7,858)                           |
| Foreign currency translation adjustments      | (1,875)                              | 3,797                                |
| Balance End of period                         | \$ (6,726)                           | \$ (4,061)                           |
| <b>Retained earnings</b>                      |                                      |                                      |
| Balance Beginning of period                   | \$ 1,337,811                         | \$ 520,722                           |
| Dividends                                     | (57,054)                             | (34,867)                             |
| Net income                                    | 61,404                               | 232,470                              |
| Balance End of period                         | \$ 1,342,161                         | \$ 718,325                           |
| <b>Total shareholders' equity</b>             | <b>\$ 3,602,926</b>                  | <b>\$ 2,151,969</b>                  |

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





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## Consolidated Statements of Cash Flows

**For the Six Months Ended June 30, 2010 and 2009 (unaudited)**

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

|   | <b>June 30,<br/>2010<br/>(unaudited)</b> | <b>June 30,<br/>2009<br/>(unaudited)</b> |
|---|--|--|
| <b>Cash flows provided by (used in) operating activities</b>                            |  |  |
| Net income  | \$ 61,404                                | \$ 232,470                               |
| Adjustments to reconcile net income to cash provided by (used in) operating activities: |  |  |
| Share compensation expenses   | 13,422                                   | 12,986                                   |
| Discount on senior notes  | 27                                       |  |
| Net unrealized (gains) losses on investments  | (23,839)                                 | 26,071                                   |
| Net unrealized (gains) on investments   | (57,053)                                 | (59,402)                                 |
| Amortization of intangible assets   | 2,080                                    | 2,081                                    |
| Foreign exchange losses (gains) on cash and cash equivalents included in net income     | 17,129                                   | (9,593)                                  |
| Amortization of premium on fixed maturities   | 8,410                                    | 4,123                                    |
| Change in:  |  |  |
| Premiums receivable   | (383,671)                                | (264,194)                                |
| Deferred acquisition costs  | (53,628)                                 | (37,460)                                 |
| Prepaid reinsurance premiums  | (112,607)                                | (63,532)                                 |
| Loss reserves recoverable   | (13,488)                                 | 42,977                                   |
| Paid losses recoverable   | (9,364)                                  | (34,083)                                 |
| Income taxes recoverable  | 860                                      | (522)                                    |
| Accrued investment income   | (653)                                    | 680                                      |
| Other assets  | (11,550)                                 | 258                                      |
| Reserve for losses and loss expenses  | 367,779                                  | (18,001)                                 |
| Unearned premiums   | 452,499                                  | 316,689                                  |
| Reinsurance balances payable  | 35,240                                   | 66,957                                   |
| Deferred income taxes   | 1,452                                    | (2,504)                                  |
| Accounts payable and accrued expenses   | (30,867)                                 | (6,190)                                  |
| <b>Net cash provided by operating activities</b>  | <b>263,582</b>                           | <b>209,811</b>                           |
| <b>Cash flows provided by (used in) investing activities</b>                            |  |  |
| Proceeds on sales of investments  | 2,933,352                                | 1,509,773                                |
| Proceeds on maturities of investments   | 198,637                                  | 311,221                                  |
| Purchases of fixed maturities   | (3,244,072)                              | (2,122,514)                              |
| Sales of short-term investments, net  | 211,801                                  | 53,781                                   |
| Sales of other investments  | 11,610                                   |  |
| (Increase) in securities lending collateral   | (9,894)                                  | (63,235)                                 |
| <b>Net cash provided by (used in) investing activities</b>                              | <b>101,434</b>                           | <b>(310,974)</b>                         |

**Cash flows provided by (used in) financing activities**

|   |                   |                   |
|---|-------------------|-------------------|
| Net proceeds on issuance of senior notes                                    | 246,793           |                   |
| Issue of common shares, net of expenses                                     | (12)              | (1,182)           |
| Purchases of common shares under share repurchase program                   | (444,079)         |                   |
| Dividends paid  | (55,994)          | (33,973)          |
| Increase in securities lending payable                                      | 9,894             | 63,235            |
| <b>Net cash (used in) provided by financing activities</b>                  | <b>(243,398)</b>  | <b>28,080</b>     |
| <b>Effect of foreign currency rate changes on cash and cash equivalents</b> | <b>(16,714)</b>   | <b>13,325</b>     |
| <b>Net increase (decrease) in cash</b>                                      | <b>104,904</b>    | <b>(59,758)</b>   |
| <b>Cash and cash equivalents beginning of period</b>                        | <b>387,585</b>    | <b>449,848</b>    |
| <b>Cash and cash equivalents end of period</b>                              | <b>\$ 492,489</b> | <b>\$ 390,090</b> |
| <b>Taxes paid during the period</b>   | <b>\$ 1,335</b>   | <b>\$ 1,199</b>   |
| <b>Interest paid during the period</b>                                      | <b>\$ 12,729</b>  | <b>\$ 13,344</b>  |

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 wholly and majority owned subsidiaries (together, the Company) and have been prepared in accordance with generally accepted accounting principles 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 Company's Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the U.S. Securities and Exchange Commission (the SEC).

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

The consolidated financial statements include the results of operations and cash flows of IPC Holdings Ltd. (IPC), since the date of acquisition, September 4, 2009 and not any prior periods (including for comparative purposes) except where indicated Pro Forma financial information.

#### **2. Recent accounting pronouncements**

In June 2009, the FASB issued authoritative guidance on accounting for *Transfers and Servicing* (ASC 860). This update addresses practices that have developed that are not consistent with the original intent and key requirements and concerns that derecognized financial assets and related obligations should continue to be reported in the transferors' financial statements. This update is effective for financial asset transfers in the interim and annual periods beginning January 1, 2010. The adoption of this guidance has not had a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued authoritative guidance which amends the *Consolidation* guidance that applies to Variable Interest Entities (VIEs) (ASC 810). This update amends the guidance for the identification of VIEs and their primary beneficiaries and the financial statement disclosures required. This update is effective for interim and annual periods beginning January 1, 2010. The adoption of this update has not had a material impact on the Company's consolidated financial statements.

In January 2010, the FASB issued authoritative guidance on *Fair Value Measurements and Disclosures* (ASC 820). This update requires additional disclosures regarding (1) significant transfers in and out of Levels 1 and 2 and

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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 reasons that such transfers were made; (2) inputs and valuation techniques used to measure fair value for financial assets and liabilities that fall in either Level 2 or Level 3; (3) the activity within Level 3 fair value measurements, including information on a gross basis for purchases, sales, issuances, and settlements; and (4) disaggregation of financial assets and liabilities measured at fair value into classes of financial assets and liabilities. This guidance is effective for interim and annual reporting periods beginning January 1, 2010, except for Level 3 reconciliation disclosures which are effective for interim and annual periods beginning January 1, 2011. The adoption of this update has not had a material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued authoritative guidance which amends the *Subsequent Events* guidance (ASC 855). The guidance requires SEC filers to evaluate subsequent events through the date the financial statements are issued, and also exempts SEC filers from disclosing the date through which subsequent events have been evaluated. This update is effective immediately for financial statements that are (1) issued or available to be issued or (2) revised. The adoption of this update has not had a material impact on the Company's consolidated financial statements.

In March 2010, the FASB issued authoritative guidance which clarifies the *Embedded Derivatives* guidance (ASC 815). All entities that enter into contracts containing an embedded credit derivative feature related to the transfer of credit risk that is not only in the form of subordination of one financial instrument to another will be affected by the amendments. The amendments in this update are effective for interim periods beginning after June 15, 2010. The Company has evaluated the guidance and has concluded that it does not have a material impact on the Company's consolidated financial statements.

In April 2010, the FASB issued authoritative guidance which clarifies the *Stock Compensation* guidance (ASC 718). This guidance clarifies the accounting for certain employee share-based payment awards. Awards with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades would not be considered to contain a condition that is not a market, performance or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. This accounting guidance is effective for accounting periods beginning on or after December 15, 2010, with earlier application 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.

### **3. Investments**

The Company's investments in fixed maturities are classified as trading and carried at fair value, with related net unrealized gains or losses included in earnings. 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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### **Validus Holdings, Ltd.**

Notes to Consolidated Financial Statements (unaudited)

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

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

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

The Company's external investment advisors have noted illiquidity and dislocation in the non-Agency RMBS market during 2010 and 2009. During the period ended June 30, 2010 and 2009, the Company identified certain non-Agency RMBS securities in its portfolio trading in inactive markets (identified RMBS securities). In order to gauge market activity for the identified RMBS securities, management, with assistance from external investment advisors, reviewed the pricing sources for each security in the portfolio. The Company utilized various pricing vendors to obtain market pricing information for investment securities.

Consistent with U.S. GAAP, market approach fair value measurements for securities trading in inactive markets are not determinative. In weighing the fair value measurements resulting from market approach and income approach valuation techniques, the Company has placed less reliance on the market approach fair value measurements. The income approach valuation technique determines the fair value of each security on the basis of contractual cash flows, discounted using a risk-adjusted discount rate. As the proposed valuation technique incorporates both observable and significant unobservable inputs, these securities are included as Level 3 assets with respect to the fair value hierarchy. The foundation for the income approach is the amount and timing of future cash flows.

Other investments consist of an investment in a fund of hedge funds and a deferred compensation trust held in mutual funds. During the fourth quarter of 2009, a majority of the fund of hedge funds was redeemed. The remaining portion is a side pocket valued at \$19,130 at June 30, 2010. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is unknown. The fund investment manager provides monthly reported net asset values (NAV) with a one-month delay in its valuation. As a result, the fund investment manager's May 31, 2010 NAV was used as a partial basis for fair value measurement in the Company's June 30, 2010 balance sheet. The fund investment manager's NAV relies on an estimate of the performance of the fund based on the month end positions from the underlying third-party funds. The Company utilizes the fund investment manager's primary market approach estimated NAV that incorporates relevant valuation sources on a timely basis. As this valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset. To determine the reasonableness of the estimated NAV, the Company assesses

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the variance between the estimated NAV and the one-month delayed fund investment manager's NAV. Immaterial variances are recorded in the following reporting period.

At June 30, 2010, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

|   | <b>Level 1</b> | <b>Level 2</b>   | <b>Level 3</b> | <b>Total</b>     |
|---|----------------|------------------|----------------|------------------|
| U.S. Government and Government Agency             | \$             | \$ 1,751,516     | \$             | \$ 1,751,516     |
| Non-U.S. Government and Government Agency         |                | 662,062          |                | 662,062          |
| States, municipalities, political subdivision     |                | 27,210           |                | 27,210           |
| Agency residential mortgage-backed securities     |                | 500,018          |                | 500,018          |
| Non-Agency residential mortgage-backed securities |                | 51,744           | 75,578         | 127,322          |
| U.S. corporate                                    |                | 1,294,383        |                | 1,294,383        |
| Non-U.S. corporate                                |                | 432,711          |                | 432,711          |
| Catastrophe bonds                                 |                | 63,164           |                | 63,164           |
| Asset-backed securities                           |                | 88,270           |                | 88,270           |
| Commercial mortgage-backed securities             |                | 28,363           |                | 28,363           |
| <br>Total fixed maturities                        |                | <br>4,899,441    | <br>75,578     | <br>4,975,019    |
| Short-term investments                            | 269,216        | 566              |                | 269,782          |
| Hedge fund  |                |                  | 19,130         | 19,130           |
| Mutual funds                                      |                | 6,938            |                | 6,938            |
| <br><b>Total</b>                                  | <br>\$ 269,216 | <br>\$ 4,906,945 | <br>\$ 94,708  | <br>\$ 5,270,869 |

At December 31, 2009, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

|   | <b>Level 1</b> | <b>Level 2</b>   | <b>Level 3</b> | <b>Total</b>     |
|---|----------------|------------------|----------------|------------------|
| U.S. Government and Government Agency             | \$             | \$ 1,918,811     | \$             | \$ 1,918,811     |
| Non-U.S. Government and Government Agency         |                | 673,680          |                | 673,680          |
| States, municipalities, political subdivision     |                | 19,359           |                | 19,359           |
| Agency residential mortgage-backed securities     |                | 551,610          |                | 551,610          |
| Non-Agency residential mortgage-backed securities |                | 52,233           | 85,336         | 137,569          |
| U.S. corporate                                    |                | 1,027,225        |                | 1,027,225        |
| Non-U.S. corporate                                |                | 409,398          |                | 409,398          |
| Catastrophe bonds                                 |                | 52,351           |                | 52,351           |
| Asset-backed securities                           |                | 36,712           |                | 36,712           |
| Commercial mortgage-backed securities             |                | 42,663           |                | 42,663           |
| <br>Total fixed maturities                        |                | <br>4,784,042    | <br>85,336     | <br>4,869,378    |
| Short-term investments                            | 479,552        | 2,214            |                | 481,766          |
| Hedge fund  |                |                  | 25,670         | 25,670           |
| Mutual funds                                      |                | 11,945           |                | 11,945           |
| <br><b>Total</b>                                  | <br>\$ 479,552 | <br>\$ 4,798,201 | <br>\$ 111,006 | <br>\$ 5,388,759 |

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

At June 30, 2010, Level 3 investments totaled \$94,708, representing 1.8% of total investments measured at fair value on a recurring basis. At December 31, 2009, Level 3 investments totaled \$111,006, representing 2.1% of total investments measured at fair value on a recurring basis.

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs as at June 30, 2010 and December 31, 2009:

|   | <b>Six Months Ended June 30, 2010</b> |                    |                   |
|---|---------------------------------------|--------------------|-------------------|
|   | <b>Fixed</b>                          | <b>Other</b>       | <b>Total Fair</b> |
|   | <b>Maturity</b>                       |                    | <b>Market</b>     |
|   | <b>Investments</b>                    | <b>Investments</b> | <b>Value</b>      |
| Level 3 investments - Beginning of period | \$ 85,336                             | \$ 25,670          | \$ 111,006        |
| Payments and purchases                    |                                       |                    |                   |
| Sales and maturities                      |                                       | (7,094)            | (7,094)           |
| Realized gains                            |                                       | 344                | 344               |
| Unrealized (losses) gains                 | (1,634)                               | 210                | (1,424)           |
| Amortization                              | (8,124)                               |                    | (8,124)           |
| Transfers in                              |                                       |                    |                   |
| Level 3 investments End of period         | \$ 75,578                             | \$ 19,130          | \$ 94,708         |

|   | <b>Year Ended December 31, 2009</b> |                    |                   |
|---|-------------------------------------|--------------------|-------------------|
|   | <b>Fixed</b>                        | <b>Other</b>       | <b>Total Fair</b> |
|   | <b>Maturity</b>                     |                    | <b>Market</b>     |
|   | <b>Investments</b>                  | <b>Investments</b> | <b>Value</b>      |
| Level 3 investments - Beginning of period | \$ 111,318                          | \$                 | \$ 111,318        |
| Payments and purchases                    |                                     | 115,351            | 115,351           |
| Sales and maturities                      | (822)                               | (92,004)           | (92,826)          |
| Realized (losses) gains                   | (1,284)                             | 1,609              | 325               |
| Unrealized (losses) gains                 | (7,329)                             | 714                | (6,615)           |
| Amortization                              | (16,547)                            |                    | (16,547)          |
| Transfers in                              |                                     |                    |                   |
| Level 3 investments End of period         | \$ 85,336                           | \$ 25,670          | \$ 111,006        |

**(b) Net investment income**

Net investment income was derived from the following sources:

|   | <b>Three Months Ended</b> |                      | <b>Six Months Ended</b> |                      |
|---|---------------------------|----------------------|-------------------------|----------------------|
|   | <b>June 30, 2010</b>      | <b>June 30, 2009</b> | <b>June 30, 2010</b>    | <b>June 30, 2009</b> |
| Fixed maturities and short-term investments | \$ 36,346                 | \$ 26,396            | \$ 72,101               | \$ 52,914            |



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|                               |           |           |           |           |
|-------------------------------|-----------|-----------|-----------|-----------|
| Cash and cash equivalents     | 311       | 1,120     | 897       | 1,881     |
| Securities lending income     | 49        | 173       | 119       | 512       |
| Total gross investment income | 36,706    | 27,689    | 73,117    | 55,307    |
| Investment expenses           | (1,897)   | (726)     | (4,009)   | (1,572)   |
| Net investment income         | \$ 34,809 | \$ 26,963 | \$ 69,108 | \$ 53,735 |

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

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

|  | <b>Three Months Ended</b> |                      | <b>Six Months Ended</b> |                      |
|--|---------------------------|----------------------|-------------------------|----------------------|
|  | <b>June 30, 2010</b>      | <b>June 30, 2009</b> | <b>June 30, 2010</b>    | <b>June 30, 2009</b> |
| Fixed maturities, short-term and other investments and cash equivalents                    |                           |                      |                         |                      |
| Gross realized gains   | \$ 15,120                 | \$ 3,928             | \$ 27,885               | \$ 13,381            |
| Gross realized (losses)  | (2,679)                   | (6,578)              | (4,046)                 | (39,452)             |
| Net realized gains (losses) on investments   | 12,441                    | (2,650)              | 23,839                  | (26,071)             |
| Net unrealized (losses) gains on securities lending  | (6)                       | 3,214                | (1,020)                 | 4,306                |
| Change in net unrealized gains on investments  | 41,646                    | 34,035               | 58,073                  | 55,096               |
| <b>Total net realized gains (losses) and change in net unrealized gains on investments</b> | <b>\$ 54,081</b>          | <b>\$ 34,599</b>     | <b>\$ 80,892</b>        | <b>\$ 33,331</b>     |

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at June 30, 2010 were as follows:

|   | <b>Amortized Cost</b> | <b>Gross Unrealized Gains</b> | <b>Gross Unrealized Losses</b> | <b>Estimated Fair Value</b> |
|---|-----------------------|-------------------------------|--------------------------------|-----------------------------|
| U.S. Government and Government Agency             | \$ 1,718,214          | \$ 33,540                     | \$ (238)                       | \$ 1,751,516                |
| Non-U.S. Government and Government Agency         | 664,666               | 13,054                        | (15,658)                       | 662,062                     |
| States, municipalities, political subdivision     | 26,745                | 538                           | (73)                           | 27,210                      |
| Agency residential mortgage-backed securities     | 481,308               | 18,779                        | (69)                           | 500,018                     |
| Non-Agency residential mortgage-backed securities | 164,121               | 116                           | (36,915)                       | 127,322                     |
| U.S. corporate                                    | 1,258,345             | 37,164                        | (1,126)                        | 1,294,383                   |
| Non-U.S. corporate                                | 431,586               | 8,175                         | (7,050)                        | 432,711                     |
| Catastrophe bonds                                 | 62,924                | 1,366                         | (1,126)                        | 63,164                      |
| Asset-backed securities                           | 88,788                | 442                           | (960)                          | 88,270                      |
| Commercial mortgage-backed securities             | 27,750                | 617                           | (4)                            | 28,363                      |
| Total fixed maturities                            | 4,924,447             | 113,791                       | (63,219)                       | 4,975,019                   |
| Total short-term investments                      | 269,782               |                               |                                | 269,782                     |

|                         |                     |                   |                    |                     |
|-------------------------|---------------------|-------------------|--------------------|---------------------|
| Total other investments | 24,948              | 1,120             |                    | 26,068              |
| <b>Total</b>            | <b>\$ 5,219,177</b> | <b>\$ 114,911</b> | <b>\$ (63,219)</b> | <b>\$ 5,270,869</b> |

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at December 31, 2009 were as follows:

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|   | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Estimated Fair<br/>Value</b> |
|---|---------------------------|---------------------------------------|--|---------------------------------|
| U.S. Government and Government Agency             | \$ 1,912,081              | \$ 12,308                             | \$ (5,578)                             | \$ 1,918,811                    |
| Non-U.S. Government and Government Agency         | 678,555                   | 7,552                                 | (12,427)                               | 673,680                         |
| States, municipalities, political subdivision     | 19,310                    | 105                                   | (56)                                   | 19,359                          |
| Agency residential mortgage-backed securities     | 537,876                   | 14,643                                | (909)                                  | 551,610                         |
| Non-Agency residential mortgage-backed securities | 176,853                   | 481                                   | (39,765)                               | 137,569                         |
| U.S. corporate                                    | 1,004,464                 | 23,895                                | (1,134)                                | 1,027,225                       |
| Non-U.S. corporate                                | 411,499                   | 4,781                                 | (6,882)                                | 409,398                         |
| Catastrophe bonds                                 | 51,236                    | 1,244                                 | (129)                                  | 52,351                          |
| Asset-backed securities                           | 36,828                    | 411                                   | (527)                                  | 36,712                          |
| Commercial mortgage-backed securities             | 41,693                    | 971                                   | (1)                                    | 42,663                          |
| Total fixed maturities                            | 4,870,395                 | 66,391                                | (67,408)                               | 4,869,378                       |
| Total short-term investments                      | 482,632                   | 33                                    | (899)                                  | 481,766                         |
| Total other investments                           | 35,941                    | 1,674                                 |  | 37,615                          |
| <b>Total</b>                                      | <b>\$ 5,388,968</b>       | <b>\$ 68,098</b>                      | <b>\$ (68,307)</b>                     | <b>\$ 5,388,759</b>             |

The following table sets forth certain information regarding the investment ratings of the Company's fixed maturities portfolio as at June 30, 2010 and December 31, 2009. Investment ratings are the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. For investments where Moody's and Standard & Poor's ratings are not available, Fitch ratings are used and presented in Standard & Poor's equivalent rating.

|                  | <b>June 30, 2010</b>                |                       | <b>December 31, 2009</b>        |                       |
|------------------|-------------------------------------|-----------------------|---------------------------------|-----------------------|
|                  | <b>Estimated<br/>Fair<br/>Value</b> | <b>% of<br/>Total</b> | <b>Estimated<br/>Fair Value</b> | <b>% of<br/>Total</b> |
| AAA              | \$ 3,111,753                        | 62.5%                 | \$ 3,287,879                    | 67.5%                 |
| AA               | 490,443                             | 9.9%                  | 487,364                         | 10.0%                 |
| A                | 1,158,636                           | 23.3%                 | 925,532                         | 19.0%                 |
| BBB              | 49,042                              | 1.0%                  | 14,416                          | 0.3%                  |
| Investment grade | 4,809,874                           | 96.7%                 | 4,715,191                       | 96.8%                 |
| BB               | 52,701                              | 1.0%                  | 45,191                          | 0.9%                  |

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|                               |                     |               |                     |               |
|-------------------------------|---------------------|---------------|---------------------|---------------|
| B                             | 35,087              | 0.7%          | 59,116              | 1.2%          |
| CCC                           | 72,574              | 1.5%          | 45,194              | 1.0%          |
| D/NR                          | 4,783               | 0.1%          | 4,686               | 0.1%          |
| Non-Investment grade          | 165,145             | 3.3%          | 154,187             | 3.2%          |
| <b>Total Fixed Maturities</b> | <b>\$ 4,975,019</b> | <b>100.0%</b> | <b>\$ 4,869,378</b> | <b>100.0%</b> |

The amortized cost and estimated fair value amounts for fixed maturity securities held at June 30, 2010 and December 31, 2009 are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

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|   | <b>June 30, 2010</b>      |                                 | <b>December 31, 2009</b>  |                                 |
|---|---------------------------|---------------------------------|---------------------------|---------------------------------|
|   | <b>Amortized<br/>Cost</b> | <b>Estimated Fair<br/>Value</b> | <b>Amortized<br/>Cost</b> | <b>Estimated Fair<br/>Value</b> |
| Due in one year or less                     | \$ 453,392                | \$ 453,706                      | \$ 269,889                | \$ 270,688                      |
| Due after one year through five years       | 3,538,674                 | 3,602,572                       | 3,498,792                 | 3,521,167                       |
| Due after five years through ten years      | 170,314                   | 174,656                         | 306,065                   | 306,502                         |
| Due after ten years                         | 100                       | 112                             | 2,399                     | 2,467                           |
|   | 4,162,480                 | 4,231,046                       | 4,077,145                 | 4,100,824                       |
| Asset-backed and mortgage-backed securities | 761,967                   | 743,973                         | 793,250                   | 768,554                         |
| <b>Total</b>                                | <b>\$ 4,924,447</b>       | <b>\$ 4,975,019</b>             | <b>\$ 4,870,395</b>       | <b>\$ 4,869,378</b>             |

The Company has a five year, \$500,000 secured letter of credit facility provided by a syndicate of commercial banks. At June 30, 2010, approximately \$239,056 (December 31, 2009: \$225,823) of letters of credit were issued and outstanding under this facility for which \$321,018 of investments were pledged as collateral (December 31, 2009: \$314,857). In 2007, the Company entered into a \$100,000 standby letter of credit facility which provides Funds at Lloyd's (the Talbot FAL Facility). On November 19, 2009, the Company entered into a Second Amendment to the Talbot FAL Facility to reduce the commitment from \$100,000 to \$25,000. At June 30, 2010, \$25,000 (December 31, 2009: \$25,000) of letters of credit were issued and outstanding under the Talbot FAL Facility for which \$45,682 of investments were pledged as collateral (December 31, 2009: \$128,798). In addition, \$1,575,617 of investments were held in trust at June 30, 2010 (December 31, 2009: \$1,517,249). Of those, \$1,421,260 were held in trust for the benefit of Talbot's cedants and policyholders, and to facilitate the accreditation as an alien insurer/reinsurer by certain regulators (December 31, 2009: \$1,408,084).

The Company assumed two letters of credit facilities as part of the acquisition of IPC. A \$250,000 Credit Agreement between IPC Holdings, Ltd., IPCRe Limited, the Lenders party thereto and Wachovia Bank, National Association (the IPC Syndicated Facility) and a \$350,000 Letters of Credit Master Agreement between Citibank N.A. and IPCRe Limited (the IPC Bi-Lateral Facility). At March 31, 2010, the IPC Syndicated Facility was closed. At June 30, 2010, the IPC Bi-Lateral Facility had \$77,603 (December 31, 2009: \$96,047) letters of credit issued and outstanding for which \$103,526 (December 31, 2009: \$219,004) of investments were held in an associated collateral account.

**(d) Securities lending**

The Company participates in a securities lending program whereby certain securities from its portfolio are loaned to third parties for short periods of time through a lending agent. The Company retains all economic interest in the securities it lends and receives a fee from the borrower for the temporary use of the securities. Collateral in the form of cash, government securities and letters of credit is required at a rate of 102% of the market value of the loaned securities and is held by a third party. As at June 30, 2010, the Company had \$97,550 (December 31, 2009: \$88,146) in securities on loan. During the three months ended June 30, 2010, the Company recorded a \$6 unrealized loss on this collateral on its Statements of Operations (June 30, 2009: unrealized gain \$3,214). During the six months ended June 30, 2010, the Company recorded a \$1,020 unrealized loss on this collateral on its Statements of Operations (June 30, 2009: unrealized gain \$4,306).

Securities lending collateral reinvested is primarily comprised of corporate floating rate securities and overnight repo with an average reset period of 11.5 days (December 31, 2009: 26.1 days). As at June 30, 2010, the securities lending collateral reinvested by the Company in connection with its securities lending program was allocated between Levels 1, 2 and 3 as follows:

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|                        | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|------------------------|----------------|----------------|----------------|--------------|
| Corporate              | \$             | \$ 5,204       | \$             | \$ 5,204     |
| Agency                 |                |                |                |              |
| Short-term investments | 61,217         | 32,803         |                | 94,020       |
| <b>Total</b>           | \$ 61,217      | \$ 38,007      | \$             | \$ 99,224    |

As at December 31, 2009, the securities lending collateral reinvested lending by the Company in connection with its securities program was allocated between Levels 1, 2 and 3 as follows:

|                         | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|-------------------------|----------------|----------------|----------------|--------------|
| Corporate               | \$             | \$ 14,123      | \$             | \$ 14,123    |
| Agency                  |                | 9,363          |                | 9,363        |
| Asset-backed securities |                | 6,153          |                | 6,153        |
| Short-term investments  | 730            | 59,981         |                | 60,711       |
| <b>Total</b>            | \$ 730         | \$ 89,620      | \$             | \$ 90,350    |

The following table sets forth certain information regarding the investment ratings of the Company's securities lending collateral reinvested as at June 30, 2010 and December 31, 2009. Investment ratings are the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. For investments where Moody's and Standard & Poor's ratings are not available, Fitch ratings are used and presented in Standard & Poor's equivalent rating.

|                                | <b>June 30, 2010</b> |              | <b>December 31, 2009</b> |              |
|--------------------------------|----------------------|--------------|--------------------------|--------------|
|                                | <b>Estimated</b>     |              | <b>Estimated</b>         |              |
|                                | <b>Fair</b>          | <b>% of</b>  | <b>Fair</b>              | <b>% of</b>  |
|                                | <b>Value</b>         | <b>Total</b> | <b>Value</b>             | <b>Total</b> |
| AAA                            | \$ 14,009            | 14.1%        | \$ 33,501                | 37.1%        |
| AA+                            | 13,012               | 13.1%        | 12,011                   | 13.3%        |
| AA                             |                      | 0.0%         | 4,998                    | 5.5%         |
| AA-                            | 2,993                | 3.0%         | 19,910                   | 22.0%        |
| A+                             |                      | 0.0%         | 9,999                    | 11.1%        |
| A                              | 7,798                | 7.9%         | 9,006                    | 10.0%        |
| NR                             | 195                  | 0.2%         | 195                      | 0.2%         |
|                                | 38,007               | 38.3%        | 89,620                   | 99.2%        |
| NR- Short-term investments (1) | 61,217               | 61.7%        | 730                      | 0.8%         |
| <b>Total</b>                   | \$ 99,224            | 100.0%       | \$ 90,350                | 100.0%       |

(1) This amount  
relates to



short-term  
investments and  
is therefore not  
a rated security.

The amortized cost and estimated fair value amounts for securities lending collateral reinvested by the Company at June 30, 2010 and December 31, 2009 are shown by contractual maturity below. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

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|                                       | <b>June 30, 2010</b>      |                                 | <b>December 31, 2009</b>  |                                 |
|---------------------------------------|---------------------------|---------------------------------|---------------------------|---------------------------------|
|                                       | <b>Amortized<br/>Cost</b> | <b>Estimated Fair<br/>Value</b> | <b>Amortized<br/>Cost</b> | <b>Estimated Fair<br/>Value</b> |
| Due in one year or less               | \$ 97,000                 | \$ 97,029                       | \$ 68,895                 | \$ 70,074                       |
| Due after one year through five years | 3,000                     | 2,195                           | 21,211                    | 20,276                          |
| <b>Total</b>                          | <b>\$ 100,000</b>         | <b>\$ 99,224</b>                | <b>\$ 90,106</b>          | <b>\$ 90,350</b>                |

**4. 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 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 loss expenses as at June 30, 2010 and December 31, 2009:

|   | <b>Six Months<br/>Ended<br/>June 30,<br/>2010</b> | <b>Year ended<br/>December<br/>31,<br/>2009</b> |
|---|---|---|
| Reserve for losses and loss expenses, beginning of period                                       | \$ 1,622,134                                      | \$ 1,305,303                                    |
| Losses and loss expenses recoverable  | (181,765)   | (208,796)                                       |
| Net reserves for losses and loss expenses, beginning of period                                  | 1,440,369   | 1,096,507                                       |
| Net reserves acquired in purchase of IPC  |   | 304,957   |
| Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in: |   |   |
| Current year  | 749,717   | 625,810   |
| Prior years   | (76,292)  | (102,053)                                       |
| Total incurred losses and loss expenses   | 673,425   | 523,757   |
| Total net paid losses   | (306,084)   | (507,435)                                       |
| Foreign exchange  | (23,184)  | 22,583  |
| Net reserve for losses and loss expenses, end of period   | 1,784,526   | 1,440,369                                       |
| Losses and loss expenses recoverable  | 193,604   | 181,765   |
| Reserve for losses and loss expenses, end of period   | \$ 1,978,130                                      | \$ 1,622,134                                    |



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**5. Reinsurance**

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

**a) Credit risk**

The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- or better rated by Standard & Poor's or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. At June 30, 2010, 99.2% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A- or better and included \$84,216 of IBNR recoverable (December 31, 2009: \$99,587). Reinsurance recoverables by reinsurer are as follows:

|   | <b>June 30, 2010</b> |                   | <b>December 31, 2009</b> |                   |
|---|----------------------|-------------------|--------------------------|-------------------|
|   | <b>Reinsurance</b>   |                   | <b>Reinsurance</b>       |                   |
|   | <b>Recoverable</b>   | <b>% of Total</b> | <b>Recoverable</b>       | <b>% of Total</b> |
| Top 10 reinsurers                       | \$ 169,005           | 77.6%             | 170,810                  | 86.9%             |
| Other reinsurers balances > \$1 million | 38,635               | 17.8%             | 19,818                   | 10.1%             |
| Other reinsurers balances < \$1 million | 10,097               | 4.6%              | 5,919                    | 3.0%              |
| <b>Total</b>                            | <b>\$ 217,737</b>    | <b>100.0%</b>     | <b>196,547</b>           | <b>100.0%</b>     |

|                                 | <b>June 30, 2010</b> |                    |                   |
|---------------------------------|----------------------|--------------------|-------------------|
|                                 | <b>Reinsurance</b>   |                    |                   |
| <b>Top 10 Reinsurers</b>        | <b>Rating</b>        | <b>Recoverable</b> | <b>% of Total</b> |
| Fully collateralized reinsurers | NR                   | \$ 40,591          | 24.0%             |
| Lloyd's Syndicates              | A+                   | 37,641             | 22.3%             |
| Hannover Re                     | AA-                  | 14,973             | 8.9%              |
| Montpelier Re                   | A-                   | 15,000             | 8.9%              |
| Munich Re                       | AA-                  | 12,276             | 7.3%              |
| Tokio Millenium                 | AA                   | 10,000             | 5.9%              |
| Flagstone                       | A-                   | 9,745              | 5.8%              |
| Transatlantic Re                | A+                   | 9,711              | 5.7%              |
| Everest Re                      | A-                   | 9,695              | 5.7%              |
| Aspen                           | A                    | 9,373              | 5.5%              |
| <b>Total</b>                    |                      | <b>\$ 169,005</b>  | <b>100.0%</b>     |

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|                                 |        | December 31, 2009 |            |
|---------------------------------|--------|-------------------|------------|
|                                 |        | Reinsurance       |            |
| Top 10 Reinsurers               | Rating | recoverable       | % of Total |
| Fully collateralized reinsurers | NR     | \$ 50,840         | 29.8%      |
| Lloyd's Syndicates              | A+     | 33,103            | 19.4%      |
| Munich Re                       | AA-    | 19,921            | 11.7%      |
| Hannover Re                     | AA-    | 13,427            | 7.8%       |
| Aspen                           | A      | 11,417            | 6.7%       |
| Allianz                         | AA     | 9,645             | 5.6%       |
| Swiss Re                        | A+     | 8,995             | 5.3%       |
| Transatlantic Re                | A+     | 8,804             | 5.1%       |
| Brit Insurance Limited          | A      | 8,159             | 4.8%       |
| Platinum Underwriters           | A      | 6,499             | 3.8%       |
| Total                           |        | \$ 170,810        | 100.0%     |

At June 30, 2010 and December 31, 2009, the provision for uncollectible reinsurance relating to losses recoverable was \$5,505 and \$3,477, respectively. To estimate the provision for uncollectible reinsurance recoverable, the reinsurance recoverable must first be allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment must be applied. As part of this process, ceded IBNR is allocated by reinsurer. Of the \$217,737 reinsurance recoverable at June 30, 2010, \$40,591 was fully collateralized (December 31, 2009: \$50,840).

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.

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

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

The Company may from time to time repurchase its securities, including common shares and Junior Subordinated Deferrable Debentures. In November 2009, the Board of Directors of the Company authorized an initial \$400,000 share repurchase program. On February 17, 2010, the Board of Directors of the Company authorized the Company to return up to \$750,000 to shareholders. This amount is in addition to, and in excess of, the \$135,494 of common shares purchased by the Company through February 17, 2010 under its previously authorized \$400,000 share repurchase program. On May 6, 2010, the Board of Directors authorized a self tender offer pursuant to which the Company has repurchased \$300,000 in common shares.

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



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

|  | <b>Common<br/>Shares</b> |
|--|--------------------------|
| Common shares outstanding, December 31, 2009           | 128,459,478              |
| Restricted share awards vested, net of shares withheld | 281,512                  |
| Restricted share units vested, net of shares withheld  | 57,192                   |
| Employee seller shares vested, net of shares withheld  |                          |
| Options exercised                                      | 51,534                   |
| Warrants exercised                                     |                          |
| Shares repurchased                                     | (17,441,723)             |
| Common shares outstanding, June 30, 2010               | 111,407,993              |

|  | <b>Common<br/>Shares</b> |
|--|--------------------------|
| Common shares outstanding, December 31, 2008           | 75,624,697               |
| IPC acquisition issuance                               | 54,556,762               |
| Restricted share awards vested, net of shares withheld | 423,746                  |
| Restricted share units vested, net of shares withheld  | 360,383                  |
| Employee seller shares vested, net of shares withheld  | 248,085                  |
| Options exercised                                      | 164,834                  |
| Warrants exercised                                     | 237,842                  |
| Shares repurchased                                     | (3,156,871)              |
| Common shares outstanding, December 31, 2009           | 128,459,478              |

***b) Warrants***

During the three and six months ended June 30, 2010, no warrants were exercised. During the three and six months ended June 30, 2009, 728,010 warrants were exercised which resulted in the net share issuance of 237,842 common shares.

***c) Deferred share units***

Under the terms of the Company's Director Stock Compensation Plan, non-management directors may elect to receive their director fees in deferred share units rather than cash. The number of share units distributed in case of election under the plan is equal to the amount of the annual retainer fee otherwise payable to the director on such payment date divided by 100% of the fair market value of a share on such payment date. Additional deferred share units are issued in lieu of dividends that accrue on these deferred share units. The total outstanding deferred share units at June 30, 2010 were 4,655 (December 31, 2009: 4,577).

***d) Dividends***

On May 5, 2010, the Company announced a quarterly cash dividend of \$0.22 (2009: \$0.20) per common share and \$0.22 per common share equivalent for which each outstanding warrant is then exercisable, payable on June 30, 2010 to holders of record on June 15, 2010.

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**7. Stock plans****a) Long Term Incentive Plan and Short Term Incentive Plan**

The Company's Long Term Incentive Plan ( LTIP ) provides for grants to employees of options, stock appreciation rights ( SARs ), restricted shares, restricted share units, performance shares, performance units, 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 7,757,232 shares are remaining. The LTIP and STIP are administered by the Compensation Committee of the Board of Directors. No SARs or performance shares 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. All options granted in 2009 were as a result of the IPC Acquisition. Grant prices are established at the estimated fair value of the Company's common shares at the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used for all grants to date:

| <b>Year</b>          | <b>Weighted average risk free interest rate</b> | <b>Weighted average dividend yield</b> | <b>Expected life (years)</b> | <b>Expected volatility</b> |
|----------------------|---|--|------------------------------|----------------------------|
| 2007 and prior years | 4.5%  | 0.0%                                   | 7                            | 30.0%                      |
| 2008                 | 3.5%  | 3.2%                                   | 7                            | 30.0%                      |
| 2009                 | 3.9%  | 3.7%                                   | 2                            | 34.6%                      |

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.

Share compensation expenses of \$1,036 were recorded for the three months ended June 30, 2010 (2009: \$918). Share compensation expenses of \$2,074 were recorded for the six months ended June 30, 2010 (2009: \$1,975). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to the options for the six months ended June 30, 2010 was as follows:

|  | <b>Options</b> | <b>Weighted Average Grant Date Fair Value</b> | <b>Weighted Average Grant Date Exercise Price</b> |
|--|----------------|---|---|
| Options outstanding, December 31, 2009 | 3,278,015      | \$ 6.83                                       | \$ 19.88  |
| Options granted                        |                |   |   |
| Options exercised                      | (51,534)       | 5.72  | 22.34   |
| Options forfeited                      | (4,317)        | 10.30   | 20.39   |
| Options outstanding, June 30, 2010     | 3,222,164      | \$ 6.84                                       | \$ 19.84  |
| Options exercisable at June 30, 2010   | 2,549,805      | \$ 6.05                                       | \$ 20.10  |

Activity with respect to options for the six months ended June 30, 2009 was as follows:





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|  | <b>Options</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Exercise Price</b> |
|--|----------------|---|---|
| Options outstanding, December 31, 2008 | 2,799,938      | \$ 7.57   | \$ 18.23  |
| Options granted                        |                |   |   |
| Options exercised                      |                |   |   |
| Options forfeited                      | (6,536)        | 10.30   | 20.39   |
| Options outstanding, June 30, 2009     | 2,793,402      | \$ 7.56   | \$ 18.22  |
| Options exercisable at June 30, 2009   | 1,531,092      | \$ 7.52   | \$ 17.92  |

At June 30, 2010, there were \$2,610 (December 31, 2009: \$4,713) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.0 years (December 31, 2009: 1.3 years).

***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 for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of \$4,735 were recorded for the three months ended June 30, 2010 (2009: \$4,074). Share compensation expenses of \$9,061 were recorded for the six months ended June 30, 2010 (2009: \$8,386). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested restricted shares for the six months ended June 30, 2010 was as follows:

|  | <b>Restricted<br/>Share<br/>Awards</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|--|--|---|
| Restricted share awards outstanding, December 31, 2009 | 2,525,958                              | \$ 23.43  |
| Restricted share awards granted                        | 439,114                                | 26.17   |
| Restricted share awards vested                         | (323,520)                              | 23.91   |
| Restricted share awards forfeited                      | (22,609)                               | 23.07   |
| Restricted share awards outstanding, June 30, 2010     | 2,618,943                              | \$ 23.83  |

Activity with respect to unvested restricted share awards for the six months ended June 30, 2009 was as follows:

|  | <b>Restricted<br/>Share<br/>Awards</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|--|--|---|
| Restricted share awards outstanding, December 31, 2008 | 2,307,402                              | \$ 22.73  |
| Restricted share awards granted                        | 280,073                                | 24.70   |
| Restricted share awards vested                         | (291,328)                              | 22.00   |

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|  |           |    |       |
|--|-----------|----|-------|
| Restricted share awards forfeited                  | (3,989)   |    | 21.29 |
| Restricted share awards outstanding, June 30, 2009 | 2,292,158 | \$ | 23.06 |

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At June 30, 2010, there were \$38,750 (December 31, 2009: \$38,395) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.5 years (December 31, 2009: 2.8 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 for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of \$61 were recorded for the three months ended June 30, 2010 (2009: \$21) related to restricted share units. Share compensation expenses of \$234 were recorded for the six months ended June 30, 2010 (2009: \$37) related to restricted share units. The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested restricted share units for the six months ended June 30, 2010 was as follows:

|   | <b>Restricted<br/>Share<br/>Units</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|---|---------------------------------------|---|
| Restricted share units outstanding, December 31, 2009 | 78,591                                | \$ 24.84  |
| Restricted share units granted                        | 7,952                                 | 26.07   |
| Restricted share units vested                         | (59,019)                              | 24.76   |
| Restricted share units forfeited                      | (1,094)                               | 21.49   |
| Restricted share units outstanding, June 30, 2010     | 26,430                                | \$ 25.51  |

Activity with respect to unvested restricted share units for the six months ended June 30, 2009 was as follows:

|   | <b>Restricted<br/>Share<br/>Units</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|---|---------------------------------------|---|
| Restricted share units outstanding, December 31, 2008 | 11,853                                | \$ 25.28  |
| Restricted share units granted                        | 4,044                                 | 25.03   |
| Restricted share units vested                         | (1,569)                               | 24.84   |
| Restricted share units forfeited                      |                                       |   |
| Restricted share units outstanding, June 30, 2009     | 14,328                                | \$ 25.25  |

At June 30, 2010, there were \$541 (December 31, 2009: \$578) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.2 years (December 31, 2009: 2.5 years). Additional restricted share units are issued in lieu of accrued dividends for each unvested restricted share unit. As at June 30, 2010, unvested restricted share units issued in lieu of dividends were \$1,117 (December 31, 2009: 858).

**b) Employee seller shares**

Pursuant to the Share Sale Agreement for the purchase of Talbot Holdings, Ltd. ( Talbot ), the Company issued 1,209,741 restricted shares to Talbot employees (the employee seller shares ). Upon consummation of the



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acquisition, the employee seller shares were validly issued, fully-paid and non-assessable and entitled to vote and participate in distributions and dividends in accordance with the Company's By-laws. However, the employee seller shares are subject to a restricted period during which they are subject to forfeiture (as implemented by repurchase by the Company for a nominal amount). Forfeiture of employee seller shares will generally occur in the event that any such Talbot employee's employment terminates, with certain exceptions, prior to the end of the restricted period. The restricted period will end for 25% of the employee seller shares on each anniversary of the closing date of July 2, 2007 for all Talbot employees other than Talbot's Chairman, such that after four years forfeiture will be completely extinguished.

Share compensation expenses of \$1,014 were recorded for the three months ended June 30, 2010 (2009: \$619). Share compensation expenses of \$2,053 were recorded for the six months ended June 30, 2010 (2009: \$2,588). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested employee seller shares for the six months ended June 30, 2010 was as follows:

|   | <b>Employee<br/>Seller<br/>Shares</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|---|---------------------------------------|---|
| Employee seller shares outstanding, December 31, 2009 | 410,667                               | \$ 22.01  |
| Employee seller shares granted                        |                                       |   |
| Employee seller shares vested                         |                                       |   |
| Employee seller shares forfeited                      | (3,551)                               | (22.01)   |
| Employee seller shares outstanding, June 30, 2010     | 407,116                               | \$ 22.01  |

Activity with respect to unvested employee seller shares for the six months ended June 30, 2009 was as follows:

|   | <b>Employee<br/>Seller<br/>Shares</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|---|---------------------------------------|---|
| Employee seller shares outstanding, December 31, 2008 | 663,375                               | \$ 22.01  |
| Employee seller shares granted                        |                                       |   |
| Employee seller shares vested                         | (42,349)                              | 22.01   |
| Employee seller shares forfeited                      | (3,799)                               | 22.01   |
| Employee seller shares outstanding, June 30, 2009     | 617,227                               | \$ 22.01  |

At June 30, 2010, there were \$4,083 (December 31, 2009: \$6,135) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.0 years (December 31, 2009: 1.5 years).

***c) Total share compensation expenses***

The breakdown of share compensation expenses was as follows:

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|                         | <b>Three Months Ended</b> |                      | <b>Six Months Ended</b> |                      |
|-------------------------|---------------------------|----------------------|-------------------------|----------------------|
|                         | <b>June 30, 2010</b>      | <b>June 30, 2009</b> | <b>June 30, 2010</b>    | <b>June 30, 2009</b> |
| Options                 | \$ 1,036                  | \$ 918               | \$ 2,074                | \$ 1,975             |
| Restricted share awards | 4,735                     | 4,074                | 9,061                   | 8,386                |
| Restricted share units  | 61                        | 21                   | 234                     | 37                   |
| Employee seller shares  | 1,014                     | 619                  | 2,053                   | 2,588                |
| <b>Total</b>            | <b>\$ 6,846</b>           | <b>\$ 5,632</b>      | <b>\$ 13,422</b>        | <b>\$ 12,986</b>     |

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

The financing structure at June 30, 2010 was:

|  | <b>Commitment</b>   | <b>Outstanding (1)</b> | <b>Drawn</b>      |
|--|---------------------|------------------------|-------------------|
| 9.069% Junior Subordinated Deferrable Debentures         | \$ 150,000          | \$ 150,000             | \$ 150,000        |
| 8.480% Junior Subordinated Deferrable Debentures         | 200,000             | 139,800                | 139,800           |
| 8.875% Senior Notes due 2040                             | 250,000             | 250,000                | 246,820           |
| \$340,000 syndicated unsecured letter of credit facility | 340,000             |                        |                   |
| \$60,000 bilateral unsecured letter of credit facility   | 60,000              |                        |                   |
| \$500,000 secured letter of credit facility              | 500,000             | 239,056                |                   |
| Talbot FAL Facility (2)                                  | 25,000              | 25,000                 |                   |
| \$350,000 IPC Bi-Lateral Facility                        | 350,000             | 77,603                 |                   |
| <b>Total</b>   | <b>\$ 1,875,000</b> | <b>\$ 881,459</b>      | <b>\$ 536,620</b> |

The financing structure at December 31, 2009 was:

|  | <b>Commitment</b>   | <b>Outstanding (1)</b> | <b>Drawn</b>      |
|--|---------------------|------------------------|-------------------|
| 9.069% Junior Subordinated Deferrable Debentures | \$ 150,000          | \$ 150,000             | \$ 150,000        |
| 8.480% Junior Subordinated Deferrable Debentures | 200,000             | 139,800                | 139,800           |
| \$200,000 unsecured letter of credit facility    | 200,000             |                        |                   |
| \$500,000 secured letter of credit facility      | 500,000             | 225,823                |                   |
| Talbot FAL Facility (2)                          | 25,000              | 25,000                 |                   |
| \$250,000 IPC Syndicated Facility                | 16,537              | 16,537                 |                   |
| \$350,000 IPC Bi-Lateral Facility                | 350,000             | 96,047                 |                   |
| <b>Total</b>                                     | <b>\$ 1,441,537</b> | <b>\$ 653,207</b>      | <b>\$ 289,800</b> |

(1) Indicates  
utilization of

commitment  
amount, not  
drawn  
borrowings.

- (2) Talbot operates  
in Lloyd's  
through a  
corporate  
member, Talbot  
2002  
Underwriting  
Capital Ltd  
( T02 ), which is  
the sole  
participant in  
Syndicate 1183.  
Lloyd's sets  
T02's required  
capital annually  
based on  
syndicate 1183's  
business plan,  
rating  
environment,  
reserving  
environment  
together with  
input arising  
from



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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, the amortization of debt offering costs, fees relating to our credit facilities and the costs of FAL as follows:

|  | <b>Three Months Ended</b>    |                          | <b>Six Months Ended</b>      |                          |
|--|------------------------------|--------------------------|------------------------------|--------------------------|
|  | <b>June<br/>30,<br/>2010</b> | <b>June 30,<br/>2009</b> | <b>June<br/>30,<br/>2010</b> | <b>June 30,<br/>2009</b> |
| 9.069% Junior Subordinated Deferrable Debentures | \$ 3,589                     | \$ 3,589                 | 7,177                        | 7,177                    |
| 8.480% Junior Subordinated Deferrable Debentures | 3,028                        | 3,348                    | 6,057                        | 6,696                    |
| 8.875% Senior Notes due 2040                     | 5,597                        |                          | 9,575                        |                          |
| Credit facilities                                | 1,109                        | 476                      | 2,420                        | 840                      |
| Talbot FAL Facility                              | (89)                         | 42                       | 333                          | 105                      |
| Talbot other interest                            | (16)                         |                          | 59                           |                          |
| Talbot third party FAL facility                  |                              | 3,297                    | 2,748                        | 3,657                    |
| <b>Total</b>                                     | <b>\$ 13,218</b>             | <b>\$ 10,752</b>         | <b>\$ 28,369</b>             | <b>\$ 18,475</b>         |

***(b) \$250,000 8.875% Senior Notes due 2040***

On January 21, 2010, the Company offered and sold \$250,000 of Senior Notes due 2040 (the "8.875% Senior Notes") in a registered public offering. The 8.875% 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 notes prospectus supplement. The 8.875% Senior Notes bear interest at the rate of 8.875% per annum from January 26, 2010 to maturity or early redemption. Interest on the 8.875% Senior Notes is payable semi-annually in arrears on January 26 and July 26 of each year, commencing on July 26, 2010. The net proceeds of \$243,967 from the sale of the 8.875% 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 dividends to shareholders. Debt issuance costs of \$2,808 were deferred as an asset and amortized over the life of the 8.875% Senior Notes.

The 8.875% Senior Notes are unsecured and unsubordinated obligations and rank equally in right of payment with all of the Company's existing and future unsecured and unsubordinated indebtedness. The 8.875% 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 8.875% Senior Notes will be structurally subordinated to all obligations of the Company's subsidiaries.

Future expected payments of interest on the 8.875% Senior Notes are as follows:

|                                      |                   |
|--------------------------------------|-------------------|
| 2010                                 | \$ 11,094         |
| 2011                                 | 22,187            |
| 2012                                 | 22,187            |
| 2013                                 | 22,187            |
| 2014 and thereafter                  | 587,970           |
| <b>Total minimum future payments</b> | <b>\$ 665,625</b> |

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***(c) Junior  
subordinated  
deferrable  
debentures***

On June 15, 2006, the Company participated in a private placement of \$150,000 of junior subordinated deferrable interest debentures due 2036 (the 9.069% Junior Subordinated Deferrable Debentures). The 9.069% Junior Subordinated Deferrable Debentures mature on June 15, 2036, are redeemable at the Company's option at par beginning June 15, 2011, and require quarterly interest payments by the Company to the holders of the 9.069% Junior Subordinated Deferrable Debentures. Interest is 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 9.069% 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 are amortized to income over the five year optional redemption period.

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

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

On December 1, 2009, the Company repurchased from an unaffiliated financial institution \$14,500 principal amount of its 8.480% Junior Subordinated Deferrable Debentures due 2037 at an aggregate price of \$9,933, plus accrued and unpaid interest of \$246. The repurchase resulted in the recognition of a realized gain of \$4,444 for the year ended December 31, 2009.

Future expected payments of interest and principal on the 9.069% and 8.480% Junior Subordinated Deferrable Debentures are as follows:

|                                      |                   |
|--------------------------------------|-------------------|
| 2010                                 | \$ 12,729         |
| 2011                                 | 168,657           |
| 2012                                 | 145,727           |
| 2013 and thereafter                  |                   |
| <b>Total minimum future payments</b> | <b>\$ 327,113</b> |

***(d) Credit facilities***

***(i) \$340,000 syndicated unsecured letter of credit facility, \$60,000 bilateral unsecured letter of credit facility and \$500,000 secured letter of credit facility***

On March 12, 2007, the Company entered into a \$200,000 three-year unsecured facility, as subsequently amended on October 25, 2007 and September 4, 2009. The facility was refinanced at maturity on March 12, 2010 with a three-year \$340,000 syndicated unsecured letter of credit facility and a \$60,000 bilateral unsecured letter of credit facility which provides for letter of credit availability for Validus Re and our other subsidiaries and revolving credit

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availability for the Company (the Three Year Facilities ) (the full \$400,000 of which is available for letters of credit and/or revolving loans).

On March 12, 2007, the Company entered into a \$500,000 five-year secured letter of credit facility, as subsequently amended on October 25, 2007, July 24, 2009, and March 12, 2010, which provides for letter of credit availability for Validus Re and our other subsidiaries (the Five Year Facility and, together with the Three Year Facilities, the Credit Facilities ). The Credit Facilities were provided by a syndicate of commercial banks arranged by J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc. On October 25, 2007, the Company entered into the First Amendment to the Credit Facilities to provide for, among other things, additional capacity to incur up to \$100,000 under a new Funds at Lloyd's Letter of Credit Facility (as described below) to support underwriting capacity provided to Talbot 2002 Underwriting Ltd through Syndicate 1183 at Lloyd's of London for the 2008 and 2009 underwriting years of account. The amendment also modified certain provisions in the Credit Facilities in order to permit dividend payments on existing and future preferred and hybrid securities notwithstanding certain events of default.

On September 4, 2009, the Company announced that it had entered into Amendments to each of its \$500,000 five-year secured letter of credit facility; \$200,000 three-year unsecured facility and \$100,000 Talbot FAL facility to amend a specific investment restriction clause to permit the completion of the IPC Acquisition. The amendment also modified and updated certain pricing and covenant terms.

As amended, 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 70% of consolidated net worth (\$2,925,590) and, commencing with the end of the fiscal quarter ending December 31, 2009 to be increased quarterly by an amount equal to 50% of its consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, (ii) the requirement that the Company maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00, and (iii) the requirement that Validus Re and any other material insurance subsidiaries maintain a financial strength rating by A.M. Best of not less than B++ (Fair). For purposes of covenant compliance (i) net worth is calculated with investments carried at amortized cost and (ii) consolidated total debt does not include the Company's junior subordinated deferrable debentures. The credit facilities also contain restrictions on our ability to pay dividends and other payments in respect of equity interests at any time that we are otherwise in default with respect to certain provisions under the credit facilities, make investments, incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others.

As of June 30, 2010, there was \$239,056 in outstanding letters of credit under the Five Year Facility (December 31, 2009: \$225,823) and \$nil outstanding under the Three Year Facilities (December 31, 2009: \$nil).

As of June 30, 2010 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Credit Facilities.

#### ***(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.

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As amended, the Talbot FAL Facility contains affirmative covenants that include, among other things, (i) the requirement that we initially maintain a minimum level of consolidated net worth of at least 70% of consolidated net worth (\$2,607,219), and commencing with the end of the fiscal quarter ending September 30, 2009 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 Credit Facilities. As of June 30, 2010 the Company had \$25,000 in outstanding letters of credit under this facility.

As of June 30, 2010 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Talbot FAL Facility.

#### ***(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 (the IPC Facilities). In July, 2009, certain terms of these facilities were amended including suspending IPCRe's ability to increase existing letters of credit or to issue new letters of credit. With respect to the IPC Syndicated Facility, IPCRe provides the banks security by depositing cash in the amount of 103% of the aggregate letters of credit outstanding. Effective March 31, 2010, the IPC Syndicated Facility was closed. As of June 30, 2010, \$77,603 of outstanding letters of credit were issued from the IPC Bi-Lateral Facility.

As of June 30, 2010 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the IPC Facilities.

### **9. Commitments and contingencies**

#### ***a) Concentrations of credit risk***

The Company's investments are managed following prudent standards of diversification. The Company attempts to limit its credit exposure by purchasing high quality fixed income investments to maintain an average portfolio credit quality of AA- or higher with mortgage and commercial mortgage-backed issues having an aggregate weighted average credit quality of triple-A. In addition, the Company limits its exposure to any single issuer to 3% or less, excluding treasury and agency securities. The minimum credit rating of any security purchased is 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 June 30, 2010, 3.1% of the investment portfolio had a split rating below Baa3/BBB- and the Company did not have an aggregate exposure to any single issuer of more than 1.5% 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 the syndicate declaring a loss at a level which would call on this arrangement.

Talbot operates in Lloyd's through a corporate member, Talbot 2002 Underwriting Capital Ltd (T02), which is the sole participant in Syndicate 1183. Lloyd's sets T02's required capital annually based on syndicate 1183's business plan, rating environment, 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,

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investments and undrawn letters of credit provided by various banks. The amounts of cash, investments and letters of credit at June 30, 2010 amounted to \$452,000 (December 31, 2009: \$452,000) of which \$25,000 is provided under the Talbot FAL Facility (December 31, 2009: \$25,000).

#### ***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. This levy is affected by the split of sterling and US dollar business expected to be written by the syndicate. 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 2010 estimated underwriting capacity at Lloyd's of £600,000, the June 30, 2010 exchange rate of £1 equals \$1.5067 and assuming the maximum 3% assessment, the Company would be assessed approximately \$27,121.

### **10. Related party transactions**

a) On December 8, 2005, the Company entered into agreements with BlackRock Financial Management, Inc. (BlackRock) under which BlackRock provides investment management services for part of the Company's investment portfolio. Merrill Lynch is a shareholder of Blackrock. Merrill Lynch entities, which are now wholly-owned subsidiaries of Bank of America Corp, own 5,714,285 non-voting shares and 658,614 voting shares in the Company, hold warrants to purchase 1,067,187 shares and during a portion of 2009 had an employee on the Company's Board of Directors who did not receive compensation from the Company. For the three and six months ended June 30, 2010, BlackRock was no longer a related party. Investment management fees earned by Blackrock for the three and six months ended June 30, 2009 were \$527 and \$978.

b) On December 8, 2005, the Company entered into agreements with Goldman Sachs Asset Management and its affiliates (GSAM) under which GSAM provides investment management services for a portion of the Company's investment portfolio. Goldman Sachs entities, own 14,057,137 non-voting shares in the Company, hold warrants to purchase 1,604,410 non-voting shares, and have an employee on the Company's Board of Directors who does not receive compensation from the Company. Investment management fees earned by GSAM for the three and six months ended June 30, 2010 were \$241 (2009: \$368), and \$733 (2009: \$726), of which \$390 was included in accounts payable and accrued expenses at June 30, 2010 (December 31, 2009: \$371). Management believes that the fees charged were consistent with those that would have been charged in arm's-length transactions with unrelated third parties. Sumit Rajpal, a director of the Company, serves as Managing Director of Goldman, Sachs and Co., GSAM's parent company.

c) Vestar Capital entities own 8,571,427 shares in the Company, hold warrants to purchase 972,810 shares and have an employee on the Company's Board of Directors who does not receive compensation from the Company. During 2009, Vestar Capital entities were shareholders of PARIS RE Holdings, Limited (Paris Re). On July 4, 2009, PartnerRe Ltd. (PartnerRe) acquired the outstanding shares of Paris Re and subsequently Paris Re was not a related party of the Company during the three and six months ended June 30, 2010. However, for the three and six months ended June 30, 2009, pursuant to reinsurance agreements with Paris Re, the Company recognized gross premiums written of \$28 and \$6,634 and earned premium adjustments of \$1,710 and \$3,416. Sander M. Levy, a director of the Company, serves as Managing Director of Vestar Capital Partners.

d) Aquiline Capital Partners, LLC and its related companies (Aquiline), which own 6,886,342 shares in the Company, hold warrants to purchase 3,193,865 shares, and have three employees on the Board of Directors who do not receive compensation from the Company, are shareholders of Group Ark Insurance Holdings Ltd. (Group Ark). Pursuant to reinsurance agreements with a subsidiary of Group Ark, the Company recognized \$601 (2009: \$nil) and \$1,341 (2009: \$nil) of gross premiums written during the three and six months ended June 30, 2010, of which \$954 was included in premiums receivable at June 30, 2010 (December 31, 2009: \$nil). The Company also recognized \$606 (2009: \$nil) of reinsurance premiums ceded during the six months ended June 30, 2010, and \$213





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(2009: \$nil) and \$881 (2009: \$800) of earned premium adjustments during the three and six months ended June 30, 2010, of which \$333 was included in reinsurance balances payable at June 30, 2010 (December 31, 2009: \$nil).

Christopher E. Watson, a director of the Company, also serves as a director of Group Ark.

Aquiline is also a shareholder of Tiger Risk Partners LLC ( Tiger Risk ). Pursuant to certain reinsurance contracts, the Company recognized brokerage expenses paid to Tiger Risk of \$1,432 (2009: \$nil) and \$1,469 (2009: \$nil) during the three and six months ended June 30, 2010, of which \$1,366 was included in accounts payable and accrued expenses at June 30, 2010 (December 31, 2009: \$643). Christopher E. Watson, a director of the Company serves as a director of Tiger Risk.

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. John J. Hendrickson and Jeffrey W. Greenberg, directors of the Company, each serve as a director of Conning Holdings Corp., the parent company of Conning. Investment management fees earned by Conning for the three and six months ended June 30, 2010 were \$100 and \$186, of which \$100 was included in accounts payable and accrued expenses at June 30, 2010.

**11. Earnings per share**

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2010 and 2009:

|  | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|--|---------------------------|--------------------------|--------------------------|--------------------------|
|  | <b>June 30,<br/>2010</b>  | <b>June 30,<br/>2009</b> | <b>June 30,<br/>2010</b> | <b>June 30,<br/>2009</b> |
| <b>Basic earnings per share</b>                                    |                           |                          |                          |                          |
| Income   | \$ 179,782                | \$ 137,563               | \$ 61,404                | \$ 232,470               |
| less: Dividends and distributions declared on outstanding warrants | (1,749)                   | (1,590)                  | (3,498)                  | (3,326)                  |
| Income available to common shareholders                            | \$ 178,033                | \$ 135,973               | \$ 57,906                | \$ 229,144               |
| Weighted average number of common shares outstanding               | 121,009,553               | 76,138,038               | 123,821,415              | 75,941,308               |
| <b>Basic earnings per share</b>                                    | <b>\$ 1.47</b>            | <b>\$ 1.79</b>           | <b>\$ 0.47</b>           | <b>\$ 3.02</b>           |
| <b>Diluted earnings per share</b>                                  |                           |                          |                          |                          |
| Income   | \$ 179,782                | \$ 137,563               | \$ 61,404                | \$ 232,470               |
| less: Dividends and distributions declared on outstanding warrants |                           |                          | (3,498)                  |                          |
| Income available to common shareholders                            | \$ 179,782                | \$ 137,563               | \$ 57,906                | \$ 232,470               |

|  |             |            |             |            |
|--|-------------|------------|-------------|------------|
| Weighted average number of common shares outstanding | 121,009,553 | 76,138,038 | 123,821,415 | 75,941,308 |
| Share equivalents:                                   |             |            |             |            |
| Warrants   | 2,339,922   | 1,806,372  |             | 2,056,733  |
| Stock options  | 794,625     | 300,405    | 840,067     | 333,955    |
| Unvested restricted shares                           | 1,008,200   | 697,250    | 1,000,247   | 690,359    |

|  |             |            |             |            |
|--|-------------|------------|-------------|------------|
| Weighted average number of common shares outstanding | 125,152,300 | 78,942,065 | 125,661,729 | 79,022,355 |
|--|-------------|------------|-------------|------------|

|                                   |                |                |                |                |
|-----------------------------------|----------------|----------------|----------------|----------------|
| <b>Diluted earnings per share</b> | <b>\$ 1.44</b> | <b>\$ 1.74</b> | <b>\$ 0.46</b> | <b>\$ 2.94</b> |
|-----------------------------------|----------------|----------------|----------------|----------------|

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Share equivalents that would result in the issuance of common shares of 218,497 and 198,500 were outstanding for three months ended June 30, 2010 and 2009, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive. Share equivalents that would result in the issuance of common shares of 194,812 and 179,713 were outstanding for six months ended June 30, 2010 and 2009, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

**12. Subsequent events**

On August 4, 2010, the Company announced a quarterly cash dividend of \$0.22 per common share and \$0.22 per common share equivalent for which each outstanding warrant is then exercisable, payable on September 30, 2010 to shareholders and warrant holders of record as of September 15, 2010.

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**13. Segment information**

The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. and Talbot Holdings Ltd. from which two operating segments have been determined under U.S. GAAP segment reporting. The Company's operating segments are strategic business units that offer different products and services. They are managed and have capital allocated separately because each business requires different strategies.

**Validus Re**

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

**Talbot**

The Talbot segment focuses on a wide range of marine and energy, war, political violence, commercial property, financial institutions, contingency, bloodstock & livestock, accident & health and aerospace 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 underwriting results of our operating segments and corporate segment:

| <b>Three Months Ended June 30, 2010</b> | <b>Validus Re</b>   | <b>Talbot</b>       | <b>Corporate<br/>&amp;<br/>Eliminations</b> | <b>Total</b>        |
|---|---------------------|---------------------|---|---------------------|
| Gross premiums written                  | \$ 284,328          | \$ 253,710          | \$ (21,177)                                 | \$ 516,861          |
| Reinsurance premiums ceded              | (41,175)            | (47,728)            | 21,177                                      | (67,726)            |
| Net premiums written                    | 243,153             | 205,982             |   | 449,135             |
| Change in unearned premiums             | 18,888              | (30,079)            |   | (11,191)            |
| Net premiums earned                     | 262,041             | 175,903             |   | 437,944             |
| Losses and loss expenses                | 123,793             | 71,101              |   | 194,894             |
| Policy acquisition costs                | 37,979              | 38,647              | (2,500)                                     | 74,126              |
| General and administrative expenses     | 10,983              | 24,960              | 16,436                                      | 52,379              |
| Share compensation expenses             | 1,749               | 1,468               | 3,629                                       | 6,846               |
| <b>Underwriting income (loss)</b>       | <b>\$ 87,537</b>    | <b>\$ 39,727</b>    | <b>\$ (17,565)</b>                          | <b>\$ 109,699</b>   |
| Net investment income                   | 29,914              | 7,251               | (2,356)                                     | 34,809              |
| Net realized gains on investments       | 10,363              | 2,078               |   | 12,441              |
| Net unrealized gains on investments     | 35,697              | 5,943               |   | 41,640              |
| Foreign exchange (losses)               | (843)               | (3,243)             | (13)  | (4,099)             |
| Other income                            | 1,477               | 3,084               | (1,864)                                     | 2,697               |
| Finance expenses                        | (1,107)             | 105                 | (12,216)                                    | (13,218)            |
| <b>Net income (loss) before taxes</b>   | <b>163,038</b>      | <b>54,945</b>       | <b>(34,014)</b>                             | <b>183,969</b>      |
| Tax (expense) benefit                   | (94)                | (4,094)             | 1   | (4,187)             |
| <b>Net income (loss)</b>                | <b>\$ 162,944</b>   | <b>\$ 50,851</b>    | <b>\$ (34,011)</b>                          | <b>\$ 179,782</b>   |
| <b>Selected ratios (1)</b>              |                     |                     |   |                     |
| Losses and loss expenses                | 47.2%               | 40.4%               |   | 44.5%               |
| Policy acquisition costs                | 14.5%               | 22.0%               |   | 16.9%               |
| General and administrative expenses     | 4.9%                | 15.0%               |   | 13.5%               |
| Expense ratio                           | 19.4%               | 37.0%               |   | 30.4%               |
| <b>Combined ratio</b>                   | <b>66.6%</b>        | <b>77.4%</b>        |   | <b>74.9%</b>        |
| <b>Total assets</b>                     | <b>\$ 5,057,693</b> | <b>\$ 2,507,586</b> | <b>\$ 49,344</b>                            | <b>\$ 7,614,623</b> |

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

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|  |                     |                     | <b>Corporate<br/>&amp;<br/>Eliminations</b> |                     |
|--|---------------------|---------------------|---|---------------------|
| <b>Three months ended June 30, 2009</b>  | <b>Validus Re</b>   | <b>Talbot</b>       |   | <b>Total</b>        |
| Gross premiums written                   | \$ 199,560          | \$ 235,113          | \$ (9,641)                                  | \$ 425,032          |
| Reinsurance premiums ceded               | (43,070)            | (28,862)            | 9,641                                       | (62,291)            |
| Net premiums written                     | 156,490             | 206,251             |   | 362,741             |
| Change in unearned premiums              | 7,207               | (41,748)            |   | (34,541)            |
| Net premiums earned                      | 163,697             | 164,503             |   | 328,200             |
| Losses and loss expenses                 | 41,121              | 83,630              |   | 124,751             |
| Policy acquisition costs                 | 29,120              | 36,114              | (796)                                       | 64,438              |
| General and administrative expenses      | 14,149              | 21,927              | 5,124                                       | 41,200              |
| Share compensation expenses              | 1,548               | 2,098               | 1,986                                       | 5,632               |
| <b>Underwriting income (loss)</b>        | <b>\$ 77,759</b>    | <b>\$ 20,734</b>    | <b>\$ (6,314)</b>                           | <b>\$ 92,179</b>    |
| Net investment income                    | 20,783              | 7,693               | (1,513)                                     | 26,963              |
| Net realized (losses) on investments     | (2,140)             | (510)               |   | (2,650)             |
| Net unrealized gains on investments      | 35,793              | 1,456               |   | 37,249              |
| Foreign exchange gains                   | 1,827               | 6,549               | 56  | 8,432               |
| Other income                             | 902                 | 911                 | (796)                                       | 1,017               |
| Finance expenses                         | (477)               | (3,339)             | (6,936)                                     | (10,752)            |
| Transaction expenses                     |                     |                     | (15,851)                                    | (15,851)            |
| <b>Net income (loss) before taxes</b>    | <b>134,447</b>      | <b>33,494</b>       | <b>(31,354)</b>                             | <b>136,587</b>      |
| Income tax (expense) benefit             | (28)                | 1,004               |   | 976                 |
| <b>Net income (loss)</b>                 | <b>\$ 134,419</b>   | <b>\$ 34,498</b>    | <b>\$ (31,354)</b>                          | <b>\$ 137,563</b>   |
| <b>Selected ratios (1):</b>              |                     |                     |   |                     |
| Loss and loss expense ratio              | 25.1%               | 50.8%               |   | 38.0%               |
| Policy acquisition cost ratio            | 17.8%               | 22.0%               |   | 19.6%               |
| General and administrative expense ratio | 9.6%                | 14.6%               |   | 14.3%               |
| Expense ratio                            | 27.4%               | 36.6%               |   | 33.9%               |
| <b>Combined ratio</b>                    | <b>52.5%</b>        | <b>87.4%</b>        |   | <b>71.9%</b>        |
| <b>Total assets</b>                      | <b>\$ 3,013,433</b> | <b>\$ 1,988,037</b> | <b>\$ 6,980</b>                             | <b>\$ 5,008,450</b> |

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



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

Notes to Consolidated Financial Statements (unaudited)

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

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

| <b>Six months ended June 30, 2010</b> | <b>Validus Re</b>   | <b>Talbot</b>       | <b>Corporate<br/>&amp;<br/>Eliminations</b> | <b>Total</b>        |
|---------------------------------------|---------------------|---------------------|---|---------------------|
| Gross premiums written                | \$ 924,623          | \$ 524,251          | \$ (61,079)                                 | \$ 1,387,795        |
| Reinsurance premiums ceded            | (54,285)            | (165,259)           | 61,079                                      | (158,465)           |
| Net premiums written                  | 870,338             | 358,992             |   | 1,229,330           |
| Change in unearned premiums           | (324,376)           | (9,316)             |   | (333,692)           |
| Net premiums earned                   | 545,962             | 349,676             |   | 895,638             |
| Losses and loss expenses              | 472,713             | 200,712             |   | 673,425             |
| Policy acquisition costs              | 81,482              | 73,592              | (4,772)                                     | 150,302             |
| General and administrative expenses   | 27,295              | 50,508              | 28,145                                      | 105,948             |
| Share compensation expenses           | 3,378               | 3,027               | 7,017                                       | 13,422              |
| <b>Underwriting (loss) income</b>     | <b>\$ (38,906)</b>  | <b>\$ 21,837</b>    | <b>\$ (30,390)</b>                          | <b>\$ (47,459)</b>  |
| Net investment income                 | 59,159              | 14,571              | (4,622)                                     | 69,108              |
| Net realized gains on investments     | 20,142              | 3,697               |   | 23,839              |
| Net unrealized gains on investments   | 47,892              | 9,161               |   | 57,053              |
| Other income (loss)                   | 2,555               | 5,059               | (4,029)                                     | 3,585               |
| Finance expenses                      | (2,400)             | (3,140)             | (22,829)                                    | (28,369)            |
| Foreign exchange (losses)             | (5,982)             | (6,842)             | (39)  | (12,863)            |
| <b>Net income (loss) before taxes</b> | <b>82,460</b>       | <b>44,343</b>       | <b>(61,909)</b>                             | <b>64,894</b>       |
| Tax (expense)                         | (185)               | (3,299)             | (6)   | (3,490)             |
| <b>Net income (loss)</b>              | <b>\$ 82,275</b>    | <b>\$ 41,044</b>    | <b>\$ (61,915)</b>                          | <b>\$ 61,404</b>    |
| <b>Selected ratios (1)</b>            |                     |                     |   |                     |
| Losses and loss expenses              | 86.6%               | 57.4%               |   | 75.2%               |
| Policy acquisition costs              | 14.9%               | 21.0%               |   | 16.8%               |
| General and administrative expenses   | 5.6%                | 15.3%               |   | 13.3%               |
| Expense ratio                         | 20.5%               | 36.3%               |   | 30.1%               |
| <b>Combined ratio</b>                 | <b>107.1%</b>       | <b>93.7%</b>        |   | <b>105.3%</b>       |
| <b>Total assets</b>                   | <b>\$ 5,057,693</b> | <b>\$ 2,507,586</b> | <b>\$ 49,344</b>                            | <b>\$ 7,614,623</b> |

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

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

Notes to Consolidated Financial Statements (unaudited)

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

| <b>Six months ended June 30, 2009</b>    | <b>Validus Re</b>   | <b>Talbot</b>       | <b>Corporate<br/>&amp;<br/>Eliminations</b> | <b>Total</b>        |
|--|---------------------|---------------------|---|---------------------|
| Gross premiums written                   | \$ 609,686          | \$ 463,033          | \$ (37,795)                                 | \$ 1,034,924        |
| Reinsurance premiums ceded               | (56,359)            | (116,239)           | 37,795                                      | (134,803)           |
| Net premiums written                     | 553,327             | 346,794             |   | 900,121             |
| Change in unearned premiums              | (215,183)           | (37,979)            |   | (253,162)           |
| Net premiums earned                      | 338,144             | 308,815             |   | 646,959             |
| Losses and loss expenses                 | 96,583              | 160,002             |   | 256,585             |
| Policy acquisition costs                 | 57,697              | 69,271              | (1,081)                                     | 125,887             |
| General and administrative expenses      | 27,941              | 42,141              | 9,197                                       | 79,279              |
| Share compensation expenses              | 3,220               | 4,433               | 5,333                                       | 12,986              |
| <b>Underwriting income (loss)</b>        | <b>\$ 152,703</b>   | <b>\$ 32,968</b>    | <b>\$ (13,449)</b>                          | <b>\$ 172,222</b>   |
| Net investment income                    | 41,569              | 15,187              | (3,021)                                     | 53,735              |
| Net realized (losses) on investments     | (19,679)            | (6,392)             |   | (26,071)            |
| Net unrealized gains on investments      | 54,800              | 4,602               |   | 59,402              |
| Foreign exchange (losses) gains          | (1,380)             | 5,556               | 56  | 4,232               |
| Other income (loss)                      | 1,187               | 1,668               | (1,081)                                     | 1,774               |
| Finance expenses                         | (840)               | (3,762)             | (13,873)                                    | (18,475)            |
| Transaction expenses                     |                     |                     | (15,851)                                    | (15,851)            |
| <b>Net income (loss) before taxes</b>    | <b>228,360</b>      | <b>49,827</b>       | <b>(47,219)</b>                             | <b>230,968</b>      |
| Income tax (expense) benefit             | (66)                | 1,568               |   | 1,502               |
| <b>Net income (loss)</b>                 | <b>\$ 228,294</b>   | <b>\$ 51,395</b>    | <b>\$ (47,219)</b>                          | <b>\$ 232,470</b>   |
| <b>Selected ratios (1)</b>               |                     |                     |   |                     |
| Loss and loss expense ratio              | 28.6%               | 51.8%               |   | 39.7%               |
| Policy acquisition cost ratio            | 17.1%               | 22.4%               |   | 19.5%               |
| General and administrative expense ratio | 9.2%                | 15.1%               |   | 14.3%               |
| Expense ratio                            | 26.3%               | 37.5%               |   | 33.8%               |
| <b>Combined ratio</b>                    | <b>54.9%</b>        | <b>89.3%</b>        |   | <b>73.5%</b>        |
| <b>Total assets</b>                      | <b>\$ 3,013,433</b> | <b>\$ 1,988,037</b> | <b>\$ 6,980</b>                             | <b>\$ 5,008,450</b> |

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

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

Notes to Consolidated Financial Statements (unaudited)

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

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

**Three Months Ended June 30, 2010****Gross premiums written**

|  | <b>Validus<br/>Re</b> | <b>Talbot</b>     | <b>Eliminations</b> | <b>Total</b>      | <b>%</b>      |
|--|-----------------------|-------------------|---------------------|-------------------|---------------|
| United States  | \$ 186,653            | \$ 29,691         | \$ (2,020)          | \$ 214,324        | 41.5%         |
| Worldwide excluding United States (1)                              | 4,830                 | 58,806            | (2,086)             | 61,550            | 11.9%         |
| Europe   | 10,757                | 12,832            | (504)               | 23,085            | 4.4%          |
| Latin America and Caribbean  | 15,036                | 29,368            | (12,766)            | 31,638            | 6.1%          |
| Japan  | 19,250                | 2,901             | (72)                | 22,079            | 4.3%          |
| Canada   | 72                    | 3,367             | (72)                | 3,367             | 0.7%          |
| Rest of the world (2)  | 25,168                |                   |                     | 25,168            | 4.9%          |
| Sub-total, non United States Worldwide including United States (1) | 75,113                | 107,274           | (15,500)            | 166,887           | 32.3%         |
| Marine and Aerospace (3)   | 2,032                 | 15,911            | (504)               | 17,439            | 3.3%          |
|  | 20,530                | 100,834           | (3,153)             | 118,211           | 22.9%         |
| <b>Total</b>   | <b>\$ 284,328</b>     | <b>\$ 253,710</b> | <b>\$ (21,177)</b>  | <b>\$ 516,861</b> | <b>100.0%</b> |

**Three Months Ended June 30, 2009****Gross premiums written**

|  | <b>Validus<br/>Re</b> | <b>Talbot</b>     | <b>Eliminations</b> | <b>Total</b>      | <b>%</b>      |
|--|-----------------------|-------------------|---------------------|-------------------|---------------|
| United States  | \$ 132,788            | \$ 24,480         | \$ (259)            | \$ 157,009        | 36.9%         |
| Worldwide excluding United States (1)                              | 11,754                | 67,581            | (1,593)             | 77,742            | 18.3%         |
| Europe   | 7,357                 | 17,595            | (551)               | 24,401            | 5.8%          |
| Latin America and Caribbean  | 7,560                 | 15,646            | (6,631)             | 16,575            | 3.9%          |
| Japan  | 14,807                | 3,256             |                     | 18,063            | 4.2%          |
| Canada   | 112                   | 2,219             | (112)               | 2,219             | 0.5%          |
| Rest of the world (2)  | 8,660                 |                   |                     | 8,660             | 2.0%          |
| Sub-total, non United States Worldwide including United States (1) | 50,250                | 106,297           | (8,887)             | 147,660           | 34.7%         |
| Marine and Aerospace (3)   | 6,321                 | 16,461            | (393)               | 22,389            | 5.3%          |
|  | 10,201                | 87,875            | (102)               | 97,974            | 23.1%         |
| <b>Total</b>   | <b>\$ 199,560</b>     | <b>\$ 235,113</b> | <b>\$ (9,641)</b>   | <b>\$ 425,032</b> | <b>100.0%</b> |

(1)

Represents risks  
in two or more  
geographic  
zones.

(2) Represents risks  
in one  
geographic  
zone.

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

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Notes to Consolidated Financial Statements (unaudited)

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

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

**Six Months Ended June 30, 2010****Gross premiums written**

|  | <b>Validus<br/>Re</b> | <b>Talbot</b>     | <b>Eliminations</b> | <b>Total</b>        | <b>%</b>      |
|--|-----------------------|-------------------|---------------------|---------------------|---------------|
| United States  | \$ 420,220            | \$ 54,974         | \$ (5,491)          | \$ 469,703          | 33.8%         |
| Worldwide excluding United States (1)                              | 44,594                | 134,824           | (5,918)             | 173,500             | 12.5%         |
| Europe   | 91,233                | 28,370            | (961)               | 118,642             | 8.5%          |
| Latin America and Caribbean  | 43,775                | 46,595            | (28,553)            | 61,817              | 4.5%          |
| Japan  | 19,900                | 3,609             | (137)               | 23,372              | 1.7%          |
| Canada   | 137                   | 7,003             | (137)               | 7,003               | 0.5%          |
| Rest of the world (2)  | 25,168                |                   |                     | 25,168              | 1.8%          |
| Sub-total, non United States Worldwide including United States (1) | 224,807               | 220,401           | (35,706)            | 409,502             | 29.5%         |
| Marine and Aerospace (3)   | 78,267                | 28,687            | (2,234)             | 104,720             | 7.6%          |
|  | 201,329               | 220,189           | (17,648)            | 403,870             | 29.1%         |
| <b>Total</b>   | <b>\$ 924,623</b>     | <b>\$ 524,251</b> | <b>\$ (61,079)</b>  | <b>\$ 1,387,795</b> | <b>100.0%</b> |

**Six Months Ended June 30, 2009****Gross premiums written**

|  | <b>Validus<br/>Re</b> | <b>Talbot</b>     | <b>Eliminations</b> | <b>Total</b>        | <b>%</b>      |
|--|-----------------------|-------------------|---------------------|---------------------|---------------|
| United States  | \$ 297,999            | \$ 46,893         | \$ (5,087)          | \$ 339,805          | 32.8%         |
| Worldwide excluding United States (1)                              | 33,942                | 127,191           | (9,282)             | 151,851             | 14.7%         |
| Europe   | 46,582                | 37,908            | (3,213)             | 81,277              | 7.9%          |
| Latin America and Caribbean  | 18,456                | 32,596            | (14,893)            | 36,159              | 3.5%          |
| Japan  | 14,807                | 3,707             |                     | 18,514              | 1.8%          |
| Canada   | 652                   | 6,378             | (652)               | 6,378               | 0.6%          |
| Rest of the world (2)  | 20,875                |                   |                     | 20,875              | 2.0%          |
| Sub-total, non United States Worldwide including United States (1) | 135,314               | 207,780           | (28,040)            | 315,054             | 30.5%         |
| Marine and Aerospace (3)   | 36,706                | 31,062            | (2,287)             | 65,481              | 6.3%          |
|  | 139,667               | 177,298           | (2,381)             | 314,584             | 30.4%         |
| <b>Total</b>   | <b>\$ 609,686</b>     | <b>\$ 463,033</b> | <b>\$ (37,795)</b>  | <b>\$ 1,034,924</b> | <b>100.0%</b> |

(1)

Represents risks  
in two or more  
geographic  
zones.

(2) Represents risks  
in one  
geographic  
zone.

(3) Not classified as  
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as marine and  
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can span  
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areas and are  
not fixed  
locations in  
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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following is a discussion and analysis of the Company's consolidated results of operations for the three and six months ended June 30, 2010 and 2009 and the Company's consolidated financial condition, liquidity and capital resources at June 30, 2010 and December 31, 2009. 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, 2009, the discussions of critical accounting policies and the qualitative and quantitative disclosure about market risk contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

The Company was formed on October 19, 2005 and completed the acquisitions of Talbot Holdings Ltd. ( "Talbot" ) and IPC Holdings, Ltd. ( "IPC" ) on July 2, 2007 and September 4, 2009, respectively. 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 for the fiscal year ended December 31, 2009 present a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained herein.

**Executive Overview**

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

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

On September 4, 2009, the Company acquired all of the outstanding shares of IPC (the "IPC Acquisition" ) in exchange for common shares and cash. IPC's operations focused on short-tail lines of reinsurance. The primary lines in which IPC conducted business were property catastrophe reinsurance and, to a limited extent, property-per-risk excess, aviation (including satellite) and other short-tail reinsurance on a worldwide basis. The IPC Acquisition was undertaken to increase the Company's capital base and gain a strategic advantage in the current reinsurance market. This acquisition created a leading Bermuda carrier in the short-tail reinsurance market that facilitates stronger relationships with major reinsurance intermediaries.

**Business Outlook and Trends**

The Company was formed in October 2005 in response to the supply/demand imbalance resulting from the large industry losses in 2004 and 2005. In the aggregate, the Company observed substantial increases in premium rates in 2006 compared to 2005 levels. During the years ended December 31, 2007 and 2008, the Company experienced increased competition in most lines of business. Capital provided by new entrants or by the commitment of additional capital by existing insurers and reinsurers increased the supply of insurance and reinsurance which resulted in a softening of rates in most lines. However, during 2008, the insurance and reinsurance industry incurred material losses and capital declines due to Hurricanes Ike and Gustav and the global financial crisis. In the wake of these events, the January 2009 renewal season saw decreased competition and increased premium rates due to

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relatively scarce capital and increased demand. During 2009, the Company observed reinsurance demand stabilization and industry capital recovery from investment portfolio gains. In 2009, there were few notable large losses affecting the worldwide (re)insurance industry and no major hurricanes making landfall in the United States.

The January 2010 renewal period saw business being withdrawn from the market, notably catastrophe excess of loss, resulting in the Company writing less business in these lines and reducing the Company's aggregate loss exposure. Despite the elevated level of catastrophe activity during the first quarter of 2010, principally the Chilean earthquake which stands among the most costly industry losses in history outside of the United States, the Company continues to see increased competition and decreased premium rates in most classes of business. During the July 2010 renewal period, Validus Re experienced continued rate decreases in the U.S. The Talbot segment, has also experienced pricing pressures in most classes of business, with the exception of the property treaty, offshore energy, financial institution and political risk lines, which have been experiencing favorable renewal terms and conditions following recent losses.

**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 for the period by the average shareholders' equity during the period. Average shareholders' equity is the average of the beginning, ending and intervening quarter end shareholders' equity balances. 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.

|                                     | <b>Three Months Ended<br/>June 30,</b> |             |
|-------------------------------------|--|-------------|
|                                     | <b>2010</b>                            | <b>2009</b> |
| Annualized return on average equity | 19.5%                                  | 26.4%       |

The decrease in annualized return on average equity for the three months ended June 30, 2010 was driven primarily by an increase in notable loss events incurred. Notable loss events for the three months ended June 30, 2010 were \$70.5 million as compared to \$11.0 million for the three months ended June 30, 2009. Net income for the three months ended June 30, 2010 increased by \$42.2 million, or 30.7% compared to the three months ended June 30, 2009.

*Diluted book value per common share* is considered by management to be an appropriate measure of our returns to common shareholders, as we believe growth in our book value on a diluted basis ultimately translates into growth of our stock price. Diluted book value per common share increased by \$1.64, or 5.7%, from \$28.66 at March 31, 2010 to \$30.30 at June 30, 2010. The increase was substantially due to the earnings generated in the three months ended June 30, 2010, partially offset by dividends of \$0.22 per share and per share equivalent paid in the period. Diluted book value per common share is a Non-GAAP financial measure. The most comparable U.S. GAAP financial measure is book value per common share. Diluted book value per common share is calculated based on total shareholders equity plus the assumed proceeds from the exercise of outstanding options and warrants, divided by the sum of common shares, unvested restricted shares, options and warrants outstanding (assuming their exercise). A reconciliation of diluted book value per common share to book value per common share is presented below in the section entitled Non-GAAP Financial Measures.

*Cash dividends per common share* are an integral part of the value created for shareholders. The Company declared a quarterly cash dividend of \$0.22 per common share in the second quarter of 2010. On August 4, 2010, the Company announced a quarterly cash dividend of \$0.22 per each common share and \$0.22 per common share equivalent for which each outstanding warrant is then exercisable, payable on September 30, 2010 to holders of record on September 15, 2010.



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*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, foreign exchange gains (losses) and gain on bargain purchase, net of expenses. The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company's core insurance and reinsurance operations. Underwriting income for the three months ended June 30, 2010 and 2009 was \$109.7 million and \$92.2 million, respectively. The increase was primarily due to an increase in net premiums earned, partially offset by an increase in loss and loss expenses during the three months ended June 30, 2010. Underwriting income is a Non-GAAP financial measure as described in detail and reconciled in the section below entitled Underwriting Income.

### **Critical Accounting Policies and Estimates**

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

Reserve for losses and loss expenses;

Premiums;

Reinsurance premiums ceded and reinsurance recoverable; and

Investment valuation.

Critical accounting policies and estimates are discussed further in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

### **Segment Reporting**

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

### **Results of Operations**

Validus Re commenced operations on December 16, 2005. The Company's fiscal year ends on December 31. Financial statements are prepared in accordance with generally accepted accounting principles 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 and six months ended June 30, 2010 and 2009:

|   | <b>Three Months Ended June 30,</b> |                 |                 | <b>Six Months Ended June 30,</b> |                 |                 |
|---|------------------------------------|-----------------|-----------------|----------------------------------|-----------------|-----------------|
|   |                                    |                 | <b>Pro</b>      |                                  |                 | <b>Pro</b>      |
| <b>(Dollars in thousands)</b>                 | <b>2010</b>                        | <b>2009 (a)</b> | <b>2009 (c)</b> | <b>2010</b>                      | <b>2009 (a)</b> | <b>2009 (c)</b> |
| Gross premiums written                        | \$ 516,861                         | \$ 425,032      | \$ 552,581      | \$ 1,387,795                     | \$ 1,034,924    | \$ 1,396,818    |
| Reinsurance premiums ceded                    | (67,726)                           | (62,291)        | (64,486)        | (158,465)                        | (134,803)       | (138,467)       |
| Net premiums written                          | 449,135                            | 362,741         | 488,095         | 1,229,330                        | 900,121         | 1,258,351       |
| Change in unearned premiums                   | (11,191)                           | (34,541)        | (63,697)        | (333,692)                        | (253,162)       | (416,486)       |
| Net premiums earned                           | 437,944                            | 328,200         | 424,398         | 895,638                          | 646,959         | 841,865         |
| Losses and loss expenses                      | 194,894                            | 124,751         | 116,334         | 673,425                          | 256,585         | 287,277         |
| Policy acquisition costs                      | 74,126                             | 64,438          | 74,344          | 150,302                          | 125,887         | 145,631         |
| General and administrative expenses           | 52,379                             | 41,200          | 51,108          | 105,948                          | 79,279          | 99,341          |
| Share compensation expenses                   | 6,846                              | 5,632           | 8,107           | 13,422                           | 12,986          | 17,950          |
| Total underwriting deductions                 | 328,245                            | 236,021         | 249,893         | 943,097                          | 474,737         | 550,199         |
| Underwriting income (loss) (b)                | 109,699                            | 92,179          | 174,505         | (47,459)                         | 172,222         | 291,666         |
| Net investment income                         | 34,809                             | 26,963          | 44,540          | 69,108                           | 53,735          | 88,987          |
| Other income                                  | 2,697                              | 1,017           | 1,036           | 3,585                            | 1,774           | 1,800           |
| Finance expenses                              | (13,218)                           | (10,752)        | (10,752)        | (28,369)                         | (18,475)        | (18,858)        |
| Operating income (loss) before taxes (b)      | 133,987                            | 109,407         | 209,329         | (3,135)                          | 209,256         | 363,595         |
| Tax (expense) benefit                         | (4,187)                            | 976             | 976             | (3,490)                          | 1,502           | 1,502           |
| Net operating income (loss) (b)               | 129,800                            | 110,383         | 210,305         | (6,625)                          | 210,758         | 365,097         |
| Net realized gains (losses) on investments    | 12,441                             | (2,650)         | 2,430           | 23,839                           | (26,071)        | (24,909)        |
| Net unrealized gains on investments           | 41,640                             | 37,249          | 109,554         | 57,053                           | 59,402          | 100,053         |
| Foreign exchange (losses) gains               | (4,099)                            | 8,432           | 10,111          | (12,863)                         | 4,232           | 2,765           |
| Transaction expenses                          |                                    | (15,851)        |                 |                                  | (15,851)        |                 |
| Net income                                    | \$ 179,782                         | \$ 137,563      | \$ 332,400      | \$ 61,404                        | \$ 232,470      | \$ 443,006      |
| Selected ratios:                              |                                    |                 |                 |                                  |                 |                 |
| Net premiums written / Gross premiums written | 86.9%                              | 85.3%           | 88.3%           | 88.6%                            | 87.0%           | 90.1%           |
| Losses and loss expenses                      | 44.5%                              | 38.0%           | 27.4%           | 75.2%                            | 39.7%           | 34.1%           |
| Policy acquisition costs                      | 16.9%                              | 19.6%           | 17.5%           | 16.8%                            | 19.5%           | 17.3%           |
| General and administrative expenses (d)       | 13.5%                              | 14.3%           | 14.0%           | 13.3%                            | 14.3%           | 13.9%           |
| Expense ratio                                 | 30.4%                              | 33.9%           | 31.5%           | 30.1%                            | 33.8%           | 31.2%           |

|                |       |       |       |        |       |       |
|----------------|-------|-------|-------|--------|-------|-------|
| Combined ratio | 74.9% | 71.9% | 58.9% | 105.3% | 73.5% | 65.3% |
|----------------|-------|-------|-------|--------|-------|-------|

- a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.
- b) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income (loss) and operating income (loss) 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  
(loss) measure to  
net income, the  
most comparable  
U.S. GAAP  
financial  
measure, is  
presented in the  
section below  
entitled  
Underwriting  
Income.

- c) Pro Forma  
combined  
Validus  
Holdings, Ltd.  
and IPC  
Holdings Ltd.  
income  
statement for the  
three months  
and six months  
ended June 30,  
2009.
- d) The general and  
administrative  
ratio includes  
share  
compensation  
expenses.

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| (Dollars in thousands)              | Three Months Ended June 30, |            |                       | Six Months Ended June 30, |            |                       |
|-------------------------------------|-----------------------------|------------|-----------------------|---------------------------|------------|-----------------------|
|                                     | 2010                        | 2009 (a)   | Pro Forma<br>2009 (c) | 2010                      | 2009 (a)   | Pro Forma<br>2009 (c) |
| <b>Validus Re</b>                   |                             |            |                       |                           |            |                       |
| Gross premiums written              | \$ 284,328                  | \$ 199,560 | \$ 327,109            | \$ 924,623                | \$ 609,686 | \$ 971,580            |
| Reinsurance premiums ceded          | (41,175)                    | (43,070)   | (45,265)              | (54,285)                  | (56,359)   | (60,023)              |
| Net premiums written                | 243,153                     | 156,490    | 281,844               | 870,338                   | 553,327    | 911,557               |
| Change in unearned premiums         | 18,888                      | 7,207      | (21,949)              | (324,376)                 | (215,183)  | (378,507)             |
| Net premiums earned                 | 262,041                     | 163,697    | 259,895               | 545,962                   | 338,144    | 533,050               |
| Losses and loss expenses            | 123,793                     | 41,121     | 32,704                | 472,713                   | 96,583     | 127,275               |
| Policy acquisition costs            | 37,979                      | 29,120     | 39,026                | 81,482                    | 57,697     | 77,441                |
| General and administrative expenses | 10,983                      | 14,149     | 24,057                | 27,295                    | 27,941     | 48,003                |
| Share compensation expenses         | 1,749                       | 1,548      | 4,023                 | 3,378                     | 3,220      | 8,184                 |
| Total underwriting deductions       | 174,504                     | 85,938     | 99,810                | 584,868                   | 185,441    | 260,903               |
| Underwriting income (loss) (b)      | 87,537                      | 77,759     | 160,085               | (38,906)                  | 152,703    | 272,147               |
| <b>Talbot</b>                       |                             |            |                       |                           |            |                       |
| Gross premiums written              | \$ 253,710                  | \$ 235,113 | \$ 235,113            | \$ 524,251                | \$ 463,033 | \$ 463,033            |
| Reinsurance premiums ceded          | (47,728)                    | (28,862)   | (28,862)              | (165,259)                 | (116,239)  | (116,239)             |
| Net premiums written                | 205,982                     | 206,251    | 206,251               | 358,992                   | 346,794    | 346,794               |
| Change in unearned premiums         | (30,079)                    | (41,748)   | (41,748)              | (9,316)                   | (37,979)   | (37,979)              |
| Net premiums earned                 | 175,903                     | 164,503    | 164,503               | 349,676                   | 308,815    | 308,815               |
| Losses and loss expenses            | 71,101                      | 83,630     | 83,630                | 200,712                   | 160,002    | 160,002               |
| Policy acquisition costs            | 38,647                      | 36,114     | 36,114                | 73,592                    | 69,271     | 69,271                |
| General and administrative expenses | 24,960                      | 21,927     | 21,927                | 50,508                    | 42,141     | 42,141                |
| Share compensation expenses         | 1,468                       | 2,098      | 2,098                 | 3,027                     | 4,433      | 4,433                 |
| Total underwriting deductions       | 136,176                     | 143,769    | 143,769               | 327,839                   | 275,847    | 275,847               |



|                                      |             |            |            |             |             |             |
|--------------------------------------|-------------|------------|------------|-------------|-------------|-------------|
| Underwriting income (b)              | 39,727      | 20,734     | 20,734     | 21,837      | 32,968      | 32,968      |
| <b>Corporate &amp; Eliminations</b>  |             |            |            |             |             |             |
| Gross premiums written               | \$ (21,177) | \$ (9,641) | \$ (9,641) | \$ (61,079) | \$ (37,795) | \$ (37,795) |
| Reinsurance premiums ceded           | 21,177      | 9,641      | 9,641      | 61,079      | 37,795      | 37,795      |
| Net premiums written                 |             |            |            |             |             |             |
| Change in unearned premiums          |             |            |            |             |             |             |
| Net premiums earned                  |             |            |            |             |             |             |
| Losses and loss expenses             |             |            |            |             |             |             |
| Policy acquisition costs             | (2,500)     | (796)      | (796)      | (4,772)     | (1,081)     | (1,081)     |
| General and administrative expenses  | 16,436      | 5,124      | 5,124      | 28,145      | 9,197       | 9,197       |
| Share compensation expenses          | 3,629       | 1,986      | 1,986      | 7,017       | 5,333       | 5,333       |
| Total underwriting deductions        | 17,565      | 6,314      | 6,314      | 30,390      | 13,449      | 13,449      |
| Underwriting (loss) (b)              | (17,565)    | (6,314)    | (6,314)    | (30,390)    | (13,449)    | (13,449)    |
| Total underwriting income (loss) (b) | \$ 109,699  | \$ 92,179  | \$ 174,505 | \$ (47,459) | \$ 172,222  | \$ 291,666  |

a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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.

- c) Pro Forma  
combined  
Validus  
Holdings, Ltd.  
and IPC  
Holdings Ltd.  
income  
statement for the  
three and six  
months ended  
June 30, 2009.

**Table of Contents****Three Months Ended June 30, 2010 compared to Three Months Ended June 30, 2009**

Net income for the three months ended June 30, 2010 was \$179.8 million compared to net income of \$137.6 million for the three months ended June 30, 2009, an increase of \$42.2 million or 30.7%. The primary factors driving the increase in net income were:

Increase in underwriting income of \$17.5 million due primarily to an increase in net premiums earned of \$109.7 million primarily relating to the IPC Acquisition. This was partially offset by an increase in underwriting deductions of \$92.2 million including \$70.5 million of notable loss events included in loss and loss expenses. Underwriting deductions also include policy acquisition costs, general and administrative expenses and share compensation expenses;

Decrease in transaction expenses of \$15.9 million relating to the IPC Acquisition that were absent in the three months ended June 30, 2010;

Increase in net investment income and net realized gains on investments of \$7.8 million and \$15.1 million respectively, and;

Increase in net unrealized gains on investments of \$4.4 million.

The above items were partially offset by the following factor:

An adverse movement in foreign exchange of \$12.5 million.

The change in net income for the three months ended June 30, 2010 of \$42.2 million as compared to the three months ended June 30, 2009 is described in the following table:

**Three Months Ended June 30, 2010  
Increase (Decrease) Over the Three Months Ended June 30,  
2009**

|   | <b>Corporate<br/>and</b>  |                  |                     |                  |
|---|---------------------------|------------------|---------------------|------------------|
| <b>(Dollars in thousands)</b>                 | <b>Validus<br/>Re (a)</b> | <b>Talbot</b>    | <b>Eliminations</b> | <b>Total (a)</b> |
| Notable losses net loss and loss expenses (c) | \$ (59,571)               | \$ (10,920)      | \$                  | \$ (70,491)      |
| Notable losses net reinstatement premiums (c) | 7,721                     | (4,420)          |                     | 3,301            |
| Other underwriting income (loss)              | 61,628                    | 34,333           | (11,251)            | 84,710           |
| Underwriting income (loss) (b)                | 9,778                     | 18,993           | (11,251)            | 17,520           |
| Net investment income                         | 9,131                     | (442)            | (843)               | 7,846            |
| Other income                                  | 575                       | 2,173            | (1,068)             | 1,680            |
| Finance expenses                              | (630)                     | 3,444            | (5,280)             | (2,466)          |
|   | 18,854                    | 24,168           | (18,442)            | 24,580           |
| Taxes   | (66)                      | (5,098)          | 1                   | (5,163)          |
|   | 18,788                    | 19,070           | (18,441)            | 19,417           |
| Transaction expenses                          |                           |                  | 15,851              | 15,851           |
| Net realized gains (losses) on investments    | 12,503                    | 2,588            |                     | 15,091           |
| Net unrealized gains on investments           | (96)                      | 4,487            |                     | 4,391            |
| Foreign exchange (losses) gains               | (2,670)                   | (9,792)          | (69)                | (12,531)         |
| <b>Net income (loss)</b>                      | <b>\$ 28,525</b>          | <b>\$ 16,353</b> | <b>\$ (2,659)</b>   | <b>\$ 42,219</b> |

- (a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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(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.

(c)

Notable losses  
for the three  
months ended  
include:  
Deepwater  
Horizon, Aban  
Pearl, Bangkok  
riots, and Perth  
hailstorm.

### Gross Premiums Written

Gross premiums written for the three months ended June 30, 2010 were \$516.9 million compared to \$425.0 million for the three months ended June 30, 2009, an increase of \$91.8 million or 21.6%. The increase in gross premiums written was driven primarily by the impact of the IPC Acquisition. The property and marine lines increased by \$84.8 million and \$7.9 million, respectively, while the specialty lines decreased by \$1.0 million. Details of gross premiums written by line of business are provided below.

|                               | Three Months Ended<br>June 30, 2010 |                                     | Three Months Ended<br>June 30, 2009 (a) |                                     | %<br>Change  |
|-------------------------------|-------------------------------------|-------------------------------------|---|-------------------------------------|--------------|
|                               | Gross<br>Premiums<br>Written        | Gross<br>Premiums<br>Written<br>(%) | Gross<br>Premiums<br>Written            | Gross<br>Premiums<br>Written<br>(%) |              |
| <b>(Dollars in thousands)</b> |                                     |                                     |   |                                     |              |
| Property                      | \$ 340,289                          | 65.8%                               | \$ 255,442                              | 60.1%                               | 33.2%        |
| Marine                        | 92,380                              | 17.9%                               | 84,431                                  | 19.9%                               | 9.4%         |
| Specialty                     | 84,192                              | 16.3%                               | 85,159                                  | 20.0%                               | (1.1)%       |
| <b>Total</b>                  | <b>\$ 516,861</b>                   | <b>100.0%</b>                       | <b>\$ 425,032</b>                       | <b>100.0%</b>                       | <b>21.6%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Validus Re.* Validus Re gross premiums written for the three months ended June 30, 2010 were \$284.3 million compared to \$199.6 million for the three months ended June 30, 2009, an increase of \$84.8 million or 42.5%. Details of Validus Re gross premiums written by line of business are provided below.

|                               | Three Months Ended<br>June 30, 2010 |                                     | Three Months Ended<br>June 30, 2009 (a) |                                     | %<br>Change |
|-------------------------------|-------------------------------------|-------------------------------------|---|-------------------------------------|-------------|
|                               | Gross<br>Premiums<br>Written        | Gross<br>Premiums<br>Written<br>(%) | Gross<br>Premiums<br>Written            | Gross<br>Premiums<br>Written<br>(%) |             |
| <b>(Dollars in thousands)</b> |                                     |                                     |   |                                     |             |
| Property                      | \$ 261,568                          | 92.0%                               | \$ 183,898                              | 92.1%                               | 42.2%       |
| Marine                        | 15,410                              | 5.4%                                | 3,957                                   | 2.0%                                | 289.4%      |
| Specialty                     | 7,350                               | 2.6%                                | 11,705                                  | 5.9%                                | (37.2)%     |

|              |            |        |            |        |       |
|--------------|------------|--------|------------|--------|-------|
| <b>Total</b> | \$ 284,328 | 100.0% | \$ 199,560 | 100.0% | 42.5% |
|--------------|------------|--------|------------|--------|-------|

- (a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

The impact of the IPC Acquisition has been the primary driver for the increase in gross premiums written. The additional capacity was used to increase lines on renewing deals and to write new business totaling \$47.3 million. The Singapore branch of Validus Re commenced writing business in January 2010 and contributed an additional \$10.2 million in gross premiums written during the three months ended June 30, 2010.

The increase in gross premiums written in the property lines of \$77.7 million was due to primarily to a \$48.9 million increase in new and renewing business and the \$10.2 million in new premiums contributed by the Singapore branch, as described above. There was \$6.3 million increase in earned premium adjustments. The increase in gross premiums written of \$11.5 million in the marine lines was due primarily to a \$7.9 million increase in reinstatement premiums mainly relating to the Aban Pearl and Deepwater Horizon events. The decrease in gross premiums written in specialty lines of \$4.4 million was primarily due to a \$3.1 million decrease in premiums in new and renewing business.

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Gross premiums written under the quota share, surplus treaty and excess of loss contracts between Validus Re and Talbot increased by \$11.6 million on the property lines, \$0.2 million on the marine lines and decreased by \$0.3 million of the specialty lines as compared to the three months ended June 30, 2009. These reinsurance agreements with Talbot are eliminated upon consolidation.

*Talbot.* Talbot gross premiums written for the three months ended June 30, 2010 were \$253.7 million compared to \$235.1 million for the three months ended June 30, 2009, an increase of \$18.6 million or 7.9%. The \$253.7 million of gross premiums written translated at 2009 rates of exchange would have been \$255.7 million during the three months ended June 30, 2010, an increase of \$2.0 million. Details of Talbot gross premiums written by line of business are provided below.

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                              | Three Months Ended<br>June 30, 2009 |                              | %<br>Change |
|------------------------|-------------------------------------|------------------------------|-------------------------------------|------------------------------|-------------|
|                        | Gross<br>Premiums                   | Gross<br>Premiums<br>Written | Gross<br>Premiums                   | Gross<br>Premiums<br>Written |             |
|                        | Written                             | (%)                          | Written                             | (%)                          |             |
| Property               | \$ 97,529                           | 38.4%                        | \$ 78,769                           | 33.5%                        | 23.8%       |
| Marine                 | 79,355                              | 31.3%                        | 82,657                              | 35.2%                        | (4.0)%      |
| Specialty              | 76,826                              | 30.3%                        | 73,687                              | 31.3%                        | 4.3%        |
| <b>Total</b>           | <b>\$ 253,710</b>                   | <b>100.0%</b>                | <b>\$ 235,113</b>                   | <b>100.0%</b>                | <b>7.9%</b> |

The increase in gross premiums written in the property lines of \$18.8 million was primarily due to \$16.1 million of gross premiums written on the onshore energy lines. The onshore energy team starting writing business during the first quarter of 2009 which is the main reason for the increase over the three months ended June 30, 2009. In addition, there was a \$4.9 million increase in gross premiums written in the property treaty lines, most of which was written by Validus Reasegueros, Inc., which acts as an approved Lloyd's cover holder for Syndicate 1183 targeting the Latin American and Caribbean markets. This was offset by a reduction of \$2.6 million on the property direct lines.

**Reinsurance Premiums Ceded**

Reinsurance premiums ceded for the three months ended June 30, 2010 were \$67.7 million compared to \$62.3 million for the three months ended June 30, 2009, an increase of \$5.4 million or 8.7%. Reinsurance premiums ceded on the marine and specialty lines increased by \$8.3 million and \$0.6 million respectively, partially offset by a decrease in the property lines of \$3.4 million, as described below.

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                                  | Three Months Ended<br>June 30, 2009 (a) |                                  | %<br>Change |
|------------------------|-------------------------------------|----------------------------------|---|----------------------------------|-------------|
|                        | Reinsurance<br>Premiums             | Reinsurance<br>Premiums<br>Ceded | Reinsurance<br>Premiums                 | Reinsurance<br>Premiums<br>Ceded |             |
|                        | Ceded                               | (%)                              | Ceded                                   | (%)                              |             |
| Property               | \$ 53,828                           | 79.5%                            | \$ 57,238                               | 91.9%                            | (6.0)%      |
| Marine                 | 10,923                              | 16.1%                            | 2,633                                   | 4.2%                             | 314.8%      |
| Specialty              | 2,975                               | 4.4%                             | 2,420                                   | 3.9%                             | 22.9%       |
| <b>Total</b>           | <b>\$ 67,726</b>                    | <b>100.0%</b>                    | <b>\$ 62,291</b>                        | <b>100.0%</b>                    | <b>8.7%</b> |

(a)



The results of  
operations for  
IPC are  
consolidated  
only from the  
September 2009  
date of  
acquisition.

*Validus Re.* Validus Re reinsurance premiums ceded for the three months ended June 30, 2010 were \$41.2 million compared to \$43.1 million for the three months ended June 30, 2009, a decrease of \$1.9 million or 4.4%.

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|                        | Three Months Ended<br>June 30, 2010 |               | Three Months Ended<br>June 30, 2009 (a) |               |               |
|------------------------|-------------------------------------|---------------|---|---------------|---------------|
|                        | Reinsurance<br>Premiums<br>Ceded    |               | Reinsurance<br>Premiums<br>Ceded        |               |               |
| (Dollars in thousands) | Ceded                               | (%)           | Ceded                                   | (%)           | %<br>Change   |
| Property               | \$ 33,933                           | 82.4%         | \$ 42,705                               | 99.1%         | (20.5)%       |
| Marine                 | 7,242                               | 17.6%         | 209                                     | 0.5%          | NM            |
| Specialty              |                                     | 0.0%          | 156                                     | 0.4%          | (100.0)%      |
| <b>Total</b>           | <b>\$ 41,175</b>                    | <b>100.0%</b> | <b>\$ 43,070</b>                        | <b>100.0%</b> | <b>(4.4)%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

NM: Not meaningful

Reinsurance premiums ceded on the property lines decreased by \$8.8 million, primarily due to a reduction of \$11.2 million in U.S. property cover, offset by an increase of \$5.4 million in international property cover. Reinsurance premiums ceded on the marine lines increased by \$7.0 million, due to the purchase of \$6.3 million in industry loss warranties.

*Talbot.* Talbot reinsurance premiums ceded for the three months ended June 30, 2010 were \$47.7 million compared to \$28.9 million for the three months ended June 30, 2009, an increase of \$18.9 million or 65.4%. This increase was primarily due to an increase in quota share costs following the increase in premiums written under the energy-on shore lines, additional surplus and quota share costs following the increase in premiums written through Talbot's overseas offices.

|                        | Three Months Ended<br>June 30, 2010 |               | Three Months Ended<br>June 30, 2009 |               |              |
|------------------------|-------------------------------------|---------------|-------------------------------------|---------------|--------------|
|                        | Reinsurance<br>Premiums<br>Ceded    |               | Reinsurance<br>Premiums<br>Ceded    |               |              |
| (Dollars in thousands) | Ceded                               | (%)           | Ceded                               | (%)           | %<br>Change  |
| Property               | \$ 38,702                           | 81.1%         | \$ 21,758                           | 75.3%         | 77.9%        |
| Marine                 | 6,066                               | 12.7%         | 4,607                               | 16.0%         | 31.7%        |
| Specialty              | 2,960                               | 6.2%          | 2,497                               | 8.7%          | 18.5%        |
| <b>Total</b>           | <b>\$ 47,728</b>                    | <b>100.0%</b> | <b>\$ 28,862</b>                    | <b>100.0%</b> | <b>65.4%</b> |

Reinsurance premiums ceded on the property lines increased by \$16.9 million. The increase was due primarily to the increased premiums written under the onshore energy lines. In addition, reinsurance premiums ceded under third party

quota share, surplus treaty and excess of loss contracts on the property lines increased by \$5.4 million, as compared to the three months ended June 30, 2009. Reinsurance premiums ceded under the quota share, surplus treaty and excess of loss contracts with Validus Re for the three months ended June 30, 2010 were \$21.2 million compared to \$9.6 million for the three months ended June 30, 2009, an increase of \$11.6 million. These reinsurance agreements with Validus Re are eliminated upon consolidation.

#### Net Premiums Written

Net premiums written for the three months ended June 30, 2010 were \$449.1 million compared to \$362.7 million for the three months ended June 30, 2009, an increase of \$86.4 million, or 23.8%. The ratios of net premiums written to gross premiums written for the three months ended June 30, 2010 and 2009 were 86.9% and 85.3%, respectively. Details of net premiums written by line of business are provided below.

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                            | Three Months Ended<br>June 30, 2009 (a) |                            | %<br>Change  |
|------------------------|-------------------------------------|----------------------------|---|----------------------------|--------------|
|                        | Net<br>Premiums                     | Net<br>Premiums<br>Written | Net<br>Premiums                         | Net<br>Premiums<br>Written |              |
|                        | Written                             | (%)                        | Written                                 | (%)                        |              |
| Property               | \$ 286,463                          | 63.8%                      | \$ 198,204                              | 54.7%                      | 44.5%        |
| Marine                 | 81,455                              | 18.1%                      | 81,798                                  | 22.5%                      | (0.4)%       |
| Specialty              | 81,217                              | 18.1%                      | 82,739                                  | 22.8%                      | (1.8)%       |
| <b>Total</b>           | <b>\$ 449,135</b>                   | <b>100.0%</b>              | <b>\$ 362,741</b>                       | <b>100.0%</b>              | <b>23.8%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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*Validus Re.* Validus Re net premiums written for the three months ended June 30, 2010 were \$243.2 million compared to \$156.5 million for the three months ended June 30, 2009, an increase of \$86.7 million or 55.4%. Details of net premiums written by line of business are provided below.

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                            | Three Months Ended<br>June 30, 2009 (a) |                            | %<br>Change  |
|------------------------|-------------------------------------|----------------------------|---|----------------------------|--------------|
|                        | Net<br>Premiums                     | Net<br>Premiums<br>Written | Net<br>Premiums                         | Net<br>Premiums<br>Written |              |
|                        | Written                             | (%)                        | Written                                 | (%)                        |              |
| Property               | \$ 227,635                          | 93.6%                      | \$ 141,193                              | 90.2%                      | 61.2%        |
| Marine                 | 8,168                               | 3.4%                       | 3,748                                   | 2.4%                       | 117.9%       |
| Specialty              | 7,350                               | 3.0%                       | 11,549                                  | 7.4%                       | (36.4)%      |
| <b>Total</b>           | <b>\$ 243,153</b>                   | <b>100.0%</b>              | <b>\$ 156,490</b>                       | <b>100.0%</b>              | <b>55.4%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

The increase in Validus Re net premiums written was driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded. The ratios of net premiums written to gross premiums written were 85.5% and 78.4% for the three months ended June 30, 2010 and 2009, respectively, reflecting the increase in gross premiums written while reinsurance premiums ceded remained relatively stable.

*Talbot.* Talbot net premiums written for the three months ended June 30, 2010 were \$206.0 million compared to \$206.3 million for the three months ended June 30, 2009, a decrease of \$0.3 million or 0.1%. Details of net premiums written by line of business are provided below:

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                            | Three Months Ended<br>June 30, 2009 |                            | %<br>Change   |
|------------------------|-------------------------------------|----------------------------|-------------------------------------|----------------------------|---------------|
|                        | Net<br>Premiums                     | Net<br>Premiums<br>Written | Net<br>Premiums                     | Net<br>Premiums<br>Written |               |
|                        | Written                             | (%)                        | Written                             | (%)                        |               |
| Property               | \$ 58,827                           | 28.5%                      | \$ 57,011                           | 27.6%                      | 3.2%          |
| Marine                 | 73,289                              | 35.6%                      | 78,050                              | 37.9%                      | (6.1)%        |
| Specialty              | 73,866                              | 35.9%                      | 71,190                              | 34.5%                      | 3.8%          |
| <b>Total</b>           | <b>\$ 205,982</b>                   | <b>100.0%</b>              | <b>\$ 206,251</b>                   | <b>100.0%</b>              | <b>(0.1)%</b> |

The decrease in net premiums written was driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded, in particular the lower net premium resulting from the increase in reinsurance premiums. The ratios of net premiums written to gross premiums written for the three months ended June 30, 2010 and 2009 were 81.2% and 87.7%, respectively, reflecting the significant increase in quota share costs

on the onshore energy lines.

**Change in Unearned Premiums**

Change in unearned premiums for the three months ended June 30, 2010 was (\$11.2) million compared to (\$34.5) million for the three months ended June 30, 2009, a change of \$23.3 million or 67.6%.

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|                                       | <b>Three Months<br/>Ended<br/>June 30, 2010<br/>Change in<br/>Unearned</b> | <b>Three Months<br/>Ended<br/>June 30, 2009<br/>(a)<br/>Change in<br/>Unearned</b> | <b>%<br/>Change</b> |
|---------------------------------------|--|--|---------------------|
| <b>(Dollars in thousands)</b>         | <b>Premiums</b>  | <b>Premiums</b>  |                     |
| Change in gross unearned premium      | \$ (93,012)  | \$ (60,905)  | 52.7%               |
| Change in prepaid reinsurance premium | 81,821   | 26,364   | 210.4%              |
| <b>Net change in unearned premium</b> | <b>\$ (11,191)</b>   | <b>\$ (34,541)</b>   | <b>(67.6)%</b>      |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Validus Re.* Validus Re's net change in unearned premiums for the three months ended June 30, 2010 were \$18.9 million compared to \$7.2 million for the three months ended June 30, 2009, a change of \$11.7 million or 162.1%.

|                                       | <b>Three Months<br/>Ended<br/>June 30, 2010<br/>Change in<br/>Unearned</b> | <b>Three Months<br/>Ended<br/>June 30, 2009 (a)<br/>Change in<br/>Unearned</b> | <b>%<br/>Change</b> |
|---------------------------------------|--|--|---------------------|
| <b>(Dollars in thousands)</b>         | <b>Premiums</b>  | <b>Premiums</b>  |                     |
| Change in gross unearned premium      | \$ (75,680)  | \$ (19,410)  | 289.9%              |
| Change in prepaid reinsurance premium | 94,568   | 26,617   | 255.3%              |
| <b>Net change in unearned premium</b> | <b>\$ 18,888</b>   | <b>\$ 7,207</b>  | <b>162.1%</b>       |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

The Validus Re net change in unearned premium has increased for the three months ended June 30, 2010 primarily due to the earning effect from historical IPC gross premiums written.

*Talbot.* The Talbot net change in unearned premiums for the three months ended June 30, 2010 was (\$30.1) million compared to (\$41.7) million for the three months ended June 30, 2009, a change of \$11.7 million, or 28.0%.

|                                       | <b>Three Months<br/>Ended<br/>June 30, 2010</b> | <b>Three Months<br/>Ended<br/>June 30, 2009</b> |                     |
|---------------------------------------|---|---|---------------------|
|                                       | <b>Change in<br/>Unearned</b>                   | <b>Change in<br/>Unearned</b>                   |                     |
| <b>(Dollars in thousands)</b>         | <b>Premiums</b>                                 | <b>Premiums</b>                                 | <b>%<br/>Change</b> |
| Change in gross unearned premium      | \$ (17,332)                                     | \$ (41,495)                                     | (58.2)%             |
| Change in prepaid reinsurance premium | (12,747)  | (253)   | NM                  |
| <b>Net change in unearned premium</b> | <b>\$ (30,079)</b>                              | <b>\$ (41,748)</b>                              | <b>(28.0)%</b>      |

NM: Not meaningful

The Talbot net change in unearned premium has decreased for the three months ended June 30, 2010 primarily due to the seasonality of earnings of gross premiums written previously to the current quarter.

#### **Net Premiums Earned**

Net premiums earned for the three months ended June 30, 2010 were \$437.9 million compared to \$328.2 million for the three months ended June 30, 2009, an increase of \$109.7 million or 33.4%. The increase in net premiums earned was driven by increased premiums earned of \$98.3 million and \$11.4 million in the Validus Re and Talbot segments, respectively.

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| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                           | Three Months Ended<br>June 30, 2009 (a) |                           | %<br>Change  |
|------------------------|-------------------------------------|---------------------------|---|---------------------------|--------------|
|                        | Net<br>Premiums                     | Net<br>Premiums<br>Earned | Net<br>Premiums                         | Net<br>Premiums<br>Earned |              |
|                        | Earned                              | (%)                       | Earned                                  | (%)                       |              |
| Property               | \$ 223,597                          | 51.0%                     | \$ 143,843                              | 43.8%                     | 55.4%        |
| Marine                 | 111,565                             | 25.5%                     | 100,953                                 | 30.8%                     | 10.5%        |
| Specialty              | 102,782                             | 23.5%                     | 83,404                                  | 25.4%                     | 23.2%        |
| <b>Total</b>           | <b>\$ 437,944</b>                   | <b>100.0%</b>             | <b>\$ 328,200</b>                       | <b>100.0%</b>             | <b>33.4%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Validus Re.* Validus Re net premiums earned for the three months ended June 30, 2010 were \$262.0 million compared to \$163.7 million for the three months ended June 30, 2009, an increase of \$98.3 million or, 60.1%.

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                           | Three Months Ended<br>June 30, 2009 (a) |                           | %<br>Change  |
|------------------------|-------------------------------------|---------------------------|---|---------------------------|--------------|
|                        | Net<br>Premiums                     | Net<br>Premiums<br>Earned | Net<br>Premiums                         | Net<br>Premiums<br>Earned |              |
|                        | Earned                              | (%)                       | Earned                                  | (%)                       |              |
| Property               | \$ 186,444                          | 71.1%                     | \$ 110,185                              | 67.3%                     | 69.2%        |
| Marine                 | 48,154                              | 18.4%                     | 33,584                                  | 20.5%                     | 43.4%        |
| Specialty              | 27,443                              | 10.5%                     | 19,928                                  | 12.2%                     | 37.7%        |
| <b>Total</b>           | <b>\$ 262,041</b>                   | <b>100.0%</b>             | <b>\$ 163,697</b>                       | <b>100.0%</b>             | <b>60.1%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

The increase in net premiums earned was due primarily to \$18.8 million of historical IPC premiums earned from business in force at the time of the IPC Acquisition, and an increase of \$54.4 million of premiums earned on contracts incepting in the first quarter of the year which is consistent with the increase in new and renewing premiums



compared to the three months ended June 30, 2009. In addition, there was a \$8.3 million increase in reinstatement premiums earned, and a \$9.2 million increase in related party premiums earned through the Talbot quota share, surplus treaty and excess of loss.

*Talbot.* Talbot net premiums earned for the three months ended June 30, 2010 were \$175.9 million compared to \$164.5 million for the three months ended June 30, 2009, an increase of \$11.4 million or 6.9%.

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                           | Three Months Ended<br>June 30, 2009 |                           | %<br>Change |
|------------------------|-------------------------------------|---------------------------|-------------------------------------|---------------------------|-------------|
|                        | Net<br>Premiums                     | Net<br>Premiums<br>Earned | Net<br>Premiums                     | Net<br>Premiums<br>Earned |             |
|                        | Earned                              | (%)                       | Earned                              | (%)                       |             |
| Property               | \$ 37,152                           | 21.1%                     | \$ 33,658                           | 20.4%                     | 10.4%       |
| Marine                 | 63,413                              | 36.1%                     | 67,369                              | 41.0%                     | (5.9)%      |
| Specialty              | 75,338                              | 42.8%                     | 63,476                              | 38.6%                     | 18.7%       |
| <b>Total</b>           | <b>\$ 175,903</b>                   | <b>100.0%</b>             | <b>\$ 164,503</b>                   | <b>100.0%</b>             | <b>6.9%</b> |

The increase in net premiums earned is due primarily to the increased levels of gross premiums written by the onshore energy, aviation and other treaty classes over the three months ended June 30, 2010, as compared to the three months ended June 30, 2009, as discussed above.

#### Losses and Loss Expenses

Losses and loss expenses for the three months ended June 30, 2010 were \$194.9 million compared to \$124.8 million for the three months ended June 30, 2009, an increase of \$70.1 million or 56.2%. The loss ratios, defined as losses and loss expenses divided by net premiums earned, for the three months ended June 30, 2010 and 2009 were 44.5% and 38.0%, respectively. Details of loss ratios by line of business are provided below.

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|                  | <b>Three Months<br/>Ended</b> | <b>Three Months<br/>Ended</b> | <b>%</b>      |
|------------------|-------------------------------|-------------------------------|---------------|
|                  | <b>June 30, 2010</b>          | <b>June 30, 2009 (a)</b>      | <b>Change</b> |
| Property         | 31.3%                         | 16.8%                         | 14.5          |
| Marine           | 76.0%                         | 48.6%                         | 27.4          |
| Specialty        | 38.9%                         | 61.8%                         | (22.9)        |
| <b>All lines</b> | <b>44.5%</b>                  | <b>38.0%</b>                  | <b>6.5</b>    |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the three months ended June 30, 2010:

|   | <b>Three Months Ended June 30, 2010</b> |               |                     |              |
|---|---|---------------|---------------------|--------------|
| <b>(Dollars in thousands)</b>                   | <b>Validus</b>                          | <b>Talbot</b> | <b>Eliminations</b> | <b>Total</b> |
| Gross reserves at period beginning              | \$ 1,025,073                            | \$ 1,164,550  | \$ (212,734)        | \$ 1,976,889 |
| Losses recoverable at period beginning          | (57,480)                                | (354,210)     | 212,734             | (198,956)    |
| Net reserves at period beginning                | 967,593                                 | 810,340       |                     | 1,777,933    |
| Incurring losses current period                 | 141,670                                 | 102,787       |                     | 244,457      |
| Incurring losses change in prior accident years | (17,877)                                | (31,686)      |                     | (49,563)     |
| Incurring losses                                | 123,793                                 | 71,101        |                     | 194,894      |
| Paid losses                                     | (112,582)                               | (65,850)      |                     | (178,432)    |
| Foreign exchange                                | (9,471)                                 | (398)         |                     | (9,869)      |
| Net reserves at period end                      | 969,333                                 | 815,193       |                     | 1,784,526    |
| Losses recoverable                              | 60,145                                  | 327,522       | (194,063)           | 193,604      |
| Gross reserves at period end                    | 1,029,478                               | 1,142,715     | (194,063)           | 1,978,130    |

The amount of recorded reserves represents management's best estimate of expected losses and loss expenses on premiums earned. Favorable loss development on prior years totaled \$49.6 million. \$17.9 million of the favorable loss development on prior years related to the Validus Re segment and \$31.7 million related to the Talbot segment. Favorable loss reserve development benefitted the Company's loss ratio by 11.3 percentage points for the three months ended June 30, 2010. For the three months ended June 30, 2010, the Company incurred \$70.5 million from notable

loss events described below, which represented 16.1 percentage points of the loss ratio. During the three months ended June 30, 2010, the Company also incurred \$20.0 million for a reserve for potential development on 2010 events, which represented 4.6 percentage points on the loss ratio. For the three months ended June 30, 2009, the Company incurred \$11.0 million of losses attributable to a commercial flight loss, which represented 3.4 percentage points of the loss ratio. The Company's loss ratio, excluding prior year development and notable loss events for the three months ended June 30, 2010 and 2009 were 39.7% and 38.6%, respectively.

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

At June 30, 2010 and 2009, gross and net reserves for losses and loss expenses were estimated using the methodology as outlined in the critical accounting policies and estimates as discussed in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The Company did not make any significant changes in the assumptions or methodology used in its reserving process for the three months ended June 30, 2010.

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| (Dollars in thousands) | As at June 30, 2010 |                     |  |
|------------------------|---------------------|---------------------|--|
|                        | Gross Case Reserves | Gross IBNR          | Total Gross Reserve for Losses and Loss Expenses |
| Property               | \$ 487,032          | \$ 472,328          | \$ 959,360                                       |
| Marine                 | 314,443             | 295,970             | 610,413  |
| Specialty              | 150,746             | 257,611             | 408,357  |
| <b>Total</b>           | <b>\$ 952,221</b>   | <b>\$ 1,025,909</b> | <b>\$ 1,978,130</b>                              |

| (Dollars in thousands) | As at June 30, 2010 |                   |  |
|------------------------|---------------------|-------------------|--|
|                        | Net Case Reserves   | Net IBNR          | Total Net Reserve for Losses and Loss Expenses |
| Property               | \$ 457,214          | \$ 459,665        | \$ 916,879                                     |
| Marine                 | 256,096             | 266,363           | 522,459  |
| Specialty              | 129,523             | 215,665           | 345,188  |
| <b>Total</b>           | <b>\$ 842,833</b>   | <b>\$ 941,693</b> | <b>\$ 1,784,526</b>                            |

During the three months ended June 30, 2010, the Company incurred and estimated \$70.5 million of losses in connection with the notable loss events below, which represented 16.1 percentage points of the loss ratio. During the three months ended June 30, 2009, the Company incurred \$11.0 million in connection with notable events, which represented 3.4 percentage points of the loss ratio.

**Second Quarter 2010 Notable Loss Events (1)**

| (Dollars in thousands) |                   | Three months ended June 30, 2010 |              |                              |             |                              |              |
|------------------------|-------------------|----------------------------------|--------------|------------------------------|-------------|------------------------------|--------------|
|                        |                   | Validus Re                       |              | Talbot                       |             | Total                        |              |
| Description            |                   | Losses and Loss Expenses (2)     | % of NPE     | Losses and Loss Expenses (2) | % of NPE    | Losses and Loss Expenses (2) | % of NPE     |
|                        |                   |                                  |              |                              |             |                              |              |
| Deepwater Horizon      | Oil rig and spill | \$ 33,681                        | 12.9%        | \$ 10,420                    | 5.9%        | \$ 44,101                    | 10.1%        |
| Aban Pearl             | Oil rig           | 10,000                           | 3.8%         | 500                          | 0.3%        | 10,500                       | 2.4%         |
| Bangkok riots          | Terrorism         | 7,500                            | 2.9%         |                              |             | 7,500                        | 1.7%         |
| Perth hailstorm        | Hailstorm         | 8,390                            | 3.1%         |                              |             | 8,390                        | 1.9%         |
| <b>Total</b>           |                   | <b>\$ 59,571</b>                 | <b>22.7%</b> | <b>\$ 10,920</b>             | <b>6.2%</b> | <b>\$ 70,491</b>             | <b>16.1%</b> |

**Second Quarter 2009 Notable Loss Events**

|  |  | Three months ended June 30, 2009 |            |            |
|--|--|----------------------------------|------------|------------|
|  |  | Validus Re                       | Talbot     | Total      |
|  |  | Losses and                       | Losses and | Losses and |
|  |  |                                  |            |            |

| (Dollars in thousands) | Description    | Loss<br>Expenses<br>(2) | % of<br>NPE | Loss<br>Expenses<br>(2) | % of<br>NPE | Loss<br>Expenses<br>(2) | % of<br>NPE |
|------------------------|----------------|-------------------------|-------------|-------------------------|-------------|-------------------------|-------------|
| Commercial Flight      | Specialty loss | \$ 2,715                | 1.7%        | \$ 8,300                | 5.0%        | \$ 11,015               | 3.4%        |
| <b>Total</b>           |                | <b>\$ 2,715</b>         | <b>1.7%</b> | <b>\$ 8,300</b>         | <b>5.0%</b> | <b>\$ 11,015</b>        | <b>3.4%</b> |

(1) These 2010 notable loss event amounts are based on management's estimates following a review of the Company's potential exposure and discussions with certain clients and brokers. Given the magnitude and recent occurrence of these events, and other uncertainties inherent in loss estimation, meaningful uncertainty remains regarding losses from these events and the Company's actual ultimate net losses from these events may vary materially from these estimates.

(2) Net of reinsurance but not net of reinstatement premiums. Reinstatement

premiums were  
\$3.3 million for  
the three months  
ended June 30,  
2010.

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*Validus Re.* Validus Re losses and loss expenses for the three months ended June 30, 2010 were \$123.8 million compared to \$41.1 million for the three months ended June 30, 2009, an increase of \$82.7 million or 201.0%. The loss ratio, defined as losses and loss expenses divided by net premiums earned, was 47.2% and 25.1% for the three months ended June 30, 2010 and 2009, respectively. Favorable loss development on prior years totaled \$17.9 million and benefited the Validus Re loss ratio by 6.8 percentage points. For the three months ended June 30, 2010, Validus Re incurred notable loss events as identified above of \$59.6 million, which represented 22.7 percentage points of the loss ratio. For the three months ended June 30, 2009, Validus Re incurred \$2.7 million of notable losses, which represented 1.7 percentage points of the loss ratio. Validus Re segment loss ratios, excluding prior year development and notable loss events identified above, for the three months ended June 30, 2010 and 2009 were 31.4% and 25.2%, respectively. Details of loss ratios by line of business and period of incurrence are provided below.

|                  |                                | <b>Three Months Ended June 30,</b> |                 |                     |
|------------------|--------------------------------|------------------------------------|-----------------|---------------------|
|                  |                                | <b>2010</b>                        | <b>2009 (a)</b> | <b>%<br/>Change</b> |
| Property         | current year                   | 40.6%                              | 21.2%           | 19.4                |
| Property         | change in prior accident years | (7.3)%                             | (2.7)%          | (4.6)               |
| Property         | loss ratio                     | 33.3%                              | 18.5%           | 14.8                |
| Marine           | current year                   | 117.5%                             | 39.7%           | 77.8                |
| Marine           | change in prior accident years | (7.5)%                             | 0.0%            | (7.5)               |
| Marine           | loss ratio                     | 110.0%                             | 39.7%           | 70.3                |
| Specialty        | current year                   | 34.3%                              | 37.1%           | (2.8)               |
| Specialty        | change in prior accident years | (2.3)%                             | 0.0%            | (2.3)               |
| Specialty        | loss ratio                     | 32.0%                              | 37.1%           | (5.1)               |
| All lines        | current year                   | 54.1%                              | 26.9%           | 27.2                |
| All lines        | change in prior accident years | (6.9)%                             | (1.8)%          | (5.1)               |
| <b>All lines</b> | <b>loss ratio</b>              | <b>47.2%</b>                       | <b>25.1%</b>    | <b>22.1</b>         |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

For the three months ended June 30, 2010, Validus Re property lines include \$75.7 million related to current year losses and \$13.6 million of favorable development relating to prior accident years. This favorable development is attributable to reduced loss estimates for the U.K. flood loss and windstorm Kyrill, as well as lower expected claim development elsewhere. For the three months ended June 30, 2010, Validus Re's property lines incurred \$8.4 million of notable losses, which represented 4.5 percentage points of the property line loss ratio. For the three months ended June 30, 2009, Validus Re's property lines did not experience any notable loss events. Validus Re property lines loss

ratios, excluding prior year development and notable loss events identified above, for the three months ended June 30, 2010 and 2009 were 36.1% and 21.2%, respectively.

For the three months ended June 30, 2010, Validus Re marine lines include \$56.6 million related to current year losses and \$3.7 million of favorable development relating to prior accident years. For the three months ended June 30, 2010, Validus Re's marine lines incurred \$43.7 million of notable losses, which represented 90.7 percentage points of the marine lines loss ratio. For the three months ended June 30, 2009, Validus Re's marine lines did not experience any notable loss events. Validus Re marine line loss ratios, excluding prior year development and notable loss events identified above, for the three months ended June 30, 2010 and 2009 were 26.8 and 39.7%, respectively.



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For the three months ended June 30, 2010, Validus Re specialty lines include \$9.4 million related to current year losses and \$0.6 million of favorable development relating to prior accident years. For the three months ended June 30, 2010, Validus Re s specialty lines incurred \$7.5 million of notable losses, which represented 27.3 percentage points of the specialty line loss ratio. For the three months ended June 30, 2009, Validus Re s specialty lines incurred \$2.7 million of notable losses, which represented 13.6 percentage points of the specialty loss ratio. Validus Re specialty lines loss ratios, excluding prior year development and the loss events identified above, for the three months ended June 30, 2010 and 2009 were 7.0% and 23.5%, respectively.

*Talbot.* Talbot losses and loss expenses for the three months ended June 30, 2010 were \$71.1 million compared to \$83.6 million for the three months ended June 30, 2009, a decrease of \$12.5 million, or 15.0%. The loss ratio was 40.4% and 50.8% for the three months ended June 30, 2010 and 2009, respectively. For the three months ended June 30, 2010 Talbot incurred losses of \$102.8 million related to current year losses and \$31.7 million in favorable development relating to prior accident years. For the three months ended June 30, 2010, Talbot incurred \$10.9 million of notable losses, which represented 6.2 percentage points of the loss ratio. For the three months ended June 30, 2009, Talbot incurred \$8.3 million of notable losses, or 5.0 percentage points of the loss ratio. Talbot loss ratios, excluding prior year loss development and loss events identified above, for the three months ended June 30, 2010 and three months ended June 30, 2009 were 52.2% and 52.0% respectively. Details of loss ratios by line of business and calendar period are provided below.

|                  |                                | <b>Three Months Ended June 30,</b> |              |                     |
|------------------|--------------------------------|------------------------------------|--------------|---------------------|
|                  |                                | <b>2010</b>                        | <b>2009</b>  | <b>%<br/>Change</b> |
| Property         | current year                   | 48.0%                              | 34.5%        | 13.5                |
| Property         | change in prior accident years | (26.5)%                            | (23.5)%      | (3.0)               |
| Property         | loss ratio                     | 21.5%                              | 11.0%        | 10.5                |
| Marine           | current year                   | 67.3%                              | 59.8%        | 7.5                 |
| Marine           | change in prior accident years | (17.0)%                            | (6.7)%       | (10.3)              |
| Marine           | loss ratio                     | 50.3%                              | 53.1%        | (2.8)               |
| Specialty        | current year                   | 56.1%                              | 66.2%        | (10.1)              |
| Specialty        | change in prior accident years | (14.7)%                            | 3.4%         | (18.1)              |
| Specialty        | loss ratio                     | 41.4%                              | 69.6%        | (28.2)              |
| All lines        | current year                   | 58.4%                              | 57.0%        | 1.4                 |
| All lines        | change in prior accident years | (18.0)%                            | (6.2)%       | (11.8)              |
| <b>All lines</b> | <b>loss ratio</b>              | <b>40.4%</b>                       | <b>50.8%</b> | <b>(10.4)</b>       |

For the three months ended June 30, 2010, Talbot property lines include \$17.8 million related to current year losses and \$9.8 million of favorable development relating to prior accident years. The favorable development is attributable to lower than expected claim development on the property facultative and binder accounts, together with favorable development on hurricanes Katrina and Ike. Talbot property line loss ratio, excluding prior year development and loss events noted above for the three months ended June 30, 2010 and 2009 were 48.0% and 34.5%, respectively.

For the three months ended June 30, 2010, Talbot marine lines include \$42.7 million related to current year losses and \$10.8 million of favorable development relating to prior accident years. The prior year favorable development is primarily due to lower than expected loss development on the Hull lines. For the three months ended June 30, 2010,

Talbot's marine lines incurred \$10.9 million of notable losses, which represented 17.2 percentage points of the loss ratio. For the three months ended June 30, 2009, Talbot's marine lines did not experience any notable loss events. Talbot marine lines loss ratios, excluding prior year development and loss events noted above, for the three months ended June 30, 2010 and 2009 were 50.1% and 59.8%, respectively.

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For the three months ended June 30, 2010, Talbot specialty lines include \$42.3 million relating to current year losses and \$11.0 million due to favorable development on prior accident years. The favorable development is primarily due to lower than expected claims across most specialty sub classes. For the three months ended June 30, 2009, Talbot's specialty lines incurred \$8.3 million of losses attributable to a commercial flight loss, which represented 13.1 percentage points of the loss ratio. Talbot specialty lines loss ratios, excluding prior year development and the loss events identified above, for the three months ended June 30, 2010 and 2009 were 56.1% and 53.1%, respectively.

**Policy Acquisition Costs**

Policy acquisition costs for the three months ended June 30, 2010 were \$74.1 million compared to \$64.4 million for the three months ended June 30, 2009, an increase of \$9.7 million or 15.0%. Policy acquisition costs as a percent of net premiums earned for the three months ended June 30, 2010 and 2009 were 16.9% and 19.6%, respectively. The changes in policy acquisition costs are due to the factors described below.

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                       |                     | Three Months Ended<br>June 30, 2009 (a) |                       |                     | %<br>Change  |
|------------------------|-------------------------------------|-----------------------|---------------------|---|-----------------------|---------------------|--------------|
|                        | Policy<br>Acquisition               | Policy<br>Acquisition | Acquisition<br>Cost | Policy<br>Acquisition                   | Policy<br>Acquisition | Acquisition<br>Cost |              |
|                        | Costs                               | Costs<br>(%)          | Ratio               | Costs                                   | Costs<br>(%)          | Ratio               |              |
| Property               | \$ 30,614                           | 41.3%                 | 13.7%               | \$ 22,796                               | 35.4%                 | 15.8%               | 34.3%        |
| Marine                 | 22,982                              | 31.0%                 | 20.6%               | 23,590                                  | 36.6%                 | 23.4%               | (2.6)%       |
| Specialty              | 20,530                              | 27.7%                 | 20.0%               | 18,052                                  | 28.0%                 | 21.6%               | 13.7%        |
| <b>Total</b>           | <b>\$ 74,126</b>                    | <b>100.0%</b>         | <b>16.9%</b>        | <b>\$ 64,438</b>                        | <b>100.0%</b>         | <b>19.6%</b>        | <b>15.0%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Validus Re.* Validus Re policy acquisition costs for the three months ended June 30, 2010 were \$38.0 million compared to \$29.1 million for the three months ended June 30, 2009, an increase of \$8.9 million or 30.4%.

| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                       |                     | Three Months Ended<br>June 30, 2009 (a) |                       |                     | %<br>Change  |
|------------------------|-------------------------------------|-----------------------|---------------------|---|-----------------------|---------------------|--------------|
|                        | Policy<br>Acquisition               | Policy<br>Acquisition | Acquisition<br>Cost | Policy<br>Acquisition                   | Policy<br>Acquisition | Acquisition<br>Cost |              |
|                        | Costs                               | Costs<br>(%)          | Ratio               | Costs                                   | Costs<br>(%)          | Ratio               |              |
| Property               | \$ 27,182                           | 71.6%                 | 14.6%               | \$ 18,052                               | 62.0%                 | 16.4%               | 50.6%        |
| Marine                 | 7,707                               | 20.3%                 | 16.0%               | 8,290                                   | 28.5%                 | 24.7%               | (7.0)%       |
| Specialty              | 3,090                               | 8.1%                  | 11.3%               | 2,778                                   | 9.5%                  | 13.9%               | 11.2%        |
| <b>Total</b>           | <b>\$ 37,979</b>                    | <b>100.0%</b>         | <b>14.5%</b>        | <b>\$ 29,120</b>                        | <b>100.0%</b>         | <b>17.8%</b>        | <b>30.4%</b> |

- (a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

Policy acquisition costs include brokerage, commission and excise tax and are generally driven by contract terms and are normally a set percentage of premiums and are also net of ceding commission income on retrocessions. Validus Re policy acquisition costs as a percent of net premiums earned for the three months ended June 30, 2010 and 2009 were 14.5% and 17.8%, respectively. The Validus Re policy acquisition ratio decrease on the property and marine lines is primarily due to the effects of the earned premium adjustments and the impact of reinstatement premiums earned with lower related policy acquisition costs for three months ended June 30, 2010. The Validus Re policy acquisition cost ratio decreased on the specialty lines for three months ended June 30, 2010 due primarily to an adjustment to a profit commission in IPC related business.

*Talbot.* Talbot policy acquisition costs for the three months ended June 30, 2010 were \$38.6 million compared to \$36.1 million for the three months ended June 30, 2009, an increase of \$2.5 million or 7.0%.

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| (Dollars in thousands) | Three Months Ended<br>June 30, 2010 |                       |              | Three Months Ended<br>June 30, 2009 |                       |              | %<br>Change |
|------------------------|-------------------------------------|-----------------------|--------------|-------------------------------------|-----------------------|--------------|-------------|
|                        | Policy<br>Acquisition               | Policy<br>Acquisition | Acquisition  | Policy<br>Acquisition               | Policy<br>Acquisition | Acquisition  |             |
|                        | Costs                               | Costs                 | Cost         | Costs                               | Costs                 | Cost         |             |
|                        | (%)                                 | (%)                   | Ratio        | (%)                                 | (%)                   | Ratio        |             |
| Property               | \$ 5,824                            | 15.1%                 | 15.7%        | \$ 5,540                            | 15.3%                 | 16.5%        | 5.1%        |
| Marine                 | 15,314                              | 39.6%                 | 24.1%        | 15,300                              | 42.4%                 | 22.7%        | 0.1%        |
| Specialty              | 17,509                              | 45.3%                 | 23.2%        | 15,274                              | 42.3%                 | 24.1%        | 14.6%       |
| <b>Total</b>           | <b>\$ 38,647</b>                    | <b>100.0%</b>         | <b>22.0%</b> | <b>\$ 36,114</b>                    | <b>100.0%</b>         | <b>22.0%</b> | <b>7.0%</b> |

Policy acquisition costs as a percent of net premiums earned were 22.0% in each of the three months ended June 30, 2010 and 2009.

**General and Administrative Expenses**

General and administrative expenses for the three months ended June 30, 2010 were \$52.4 million compared to \$41.2 million for the three months ended June 30, 2009, an increase of \$11.2 million or 27.1%. The increase was a result of increased expenses in the Talbot and Corporate segments, offset by a decrease in the Validus Re segment.

| (Dollars in thousands)   | Three Months Ended<br>June 30, 2010 |                                  | Three Months Ended<br>June 30, 2009 (a) |                                  | %<br>Change  |
|--------------------------|-------------------------------------|----------------------------------|---|----------------------------------|--------------|
|                          | General<br>and<br>Administrative    | General<br>and<br>Administrative | General<br>and<br>Administrative        | General<br>and<br>Administrative |              |
|                          | Expenses                            | Expenses                         | Expenses                                | Expenses                         |              |
|                          | (%)                                 | (%)                              | (%)                                     | (%)                              |              |
| Validus Re               | \$ 10,983                           | 21.0%                            | \$ 14,149                               | 34.4%                            | (22.4)%      |
| Talbot                   | 24,960                              | 47.6%                            | 21,927                                  | 53.2%                            | 13.8%        |
| Corporate & Eliminations | 16,436                              | 31.4%                            | 5,124                                   | 12.4%                            | 220.8%       |
| <b>Total</b>             | <b>\$ 52,379</b>                    | <b>100.0%</b>                    | <b>\$ 41,200</b>                        | <b>100.0%</b>                    | <b>27.1%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

General and administrative expenses of \$52.4 million in the three months ended June 30, 2010 represents 12.0% percentage points of the expense ratio. Share compensation expense is discussed in the following section. *Validus Re*. Validus Re general and administrative expenses for the three months ended June 30, 2010 were \$11.0 million compared to \$14.1 million for the three months ended June 30, 2009, a decrease of \$3.2 million or 22.4%. General and administrative expenses have decreased primarily as a result of a decrease in salaries and benefits driven by the reallocation of staff into the Corporate segment from the Validus Re segment over the three months ended June 30, 2009. General and administrative expenses are generally comprised of salaries and benefits,

professional fees, rent and office expenses. Validus Re's general and administrative expenses as a percent of net premiums earned for the three months ended June 30, 2010 and 2009 were 4.2% and 8.6%, respectively.

*Talbot.* Talbot general and administrative expenses for the three months ended June 30, 2010 were \$25.0 million compared to \$21.9 million for the three months ended June 30, 2009, an increase of \$3.0 million or 13.8%. General and administrative expenses have increased primarily as a result of an increase of \$2.0 million in Talbot's syndicate costs, Lloyd's subscription and central fund costs due to higher gross premiums written. Talbot's general and administrative expenses as a percent of net premiums earned for the three months ended June 30, 2010 and 2009 were 14.2% and 13.3%, respectively.

*Corporate & Eliminations.* Corporate general and administrative expenses for the three months ended June 30, 2010 were \$16.4 million compared to \$5.1 million for the three months ended June 30, 2009, an increase of \$11.3 million or 220.8%. During the first quarter of 2010, to better align the Company's operating and reporting structure with its current strategy, there was a change in segment structure. This change was to allocate all non-core

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underwriting expenses, predominantly general and administration and stock compensation expenses to the Corporate segment. Prior periods have not been restated as the change is immaterial to the Consolidated Financial Statements. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other cost relating to the Company as a whole. In addition, general and administrative expenses have increased as a result of an increase in staff from 66 at June 30, 2009 to 89 at June 30, 2010. There was an increase of \$2.6 million in general legal and corporate expenses for the three months ended June 30, 2010.

**Share Compensation Expenses**

Share compensation expenses for the three months ended June 30, 2010 were \$6.8 million compared to \$5.6 million for the three months ended June 30, 2009, an increase of \$1.2 million or 21.6%. These expenses are non-cash and have no net effect on total shareholders' equity, as they are balanced by an increase in additional paid-in capital.

|                          | Three Months Ended<br>June 30, 2010 |               | Three Months Ended<br>June 30, 2009 (a) |               | %<br>Change  |
|--------------------------|-------------------------------------|---------------|---|---------------|--------------|
|                          | Share                               | Share         | Share                                   | Share         |              |
|                          | Compensation                        | Compensation  | Compensation                            | Compensation  |              |
| (Dollars in thousands)   | Expenses                            | Expenses (%)  | Expenses                                | Expenses (%)  |              |
| Validus Re               | \$ 1,749                            | 25.6%         | \$ 1,548                                | 27.4%         | 13.0%        |
| Talbot                   | 1,468                               | 21.4%         | 2,098                                   | 37.3%         | (30.0)%      |
| Corporate & Eliminations | 3,629                               | 53.0%         | 1,986                                   | 35.3%         | 82.7%        |
| <b>Total</b>             | <b>\$ 6,846</b>                     | <b>100.0%</b> | <b>\$ 5,632</b>                         | <b>100.0%</b> | <b>21.6%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

Share compensation expenses of \$6.8 million in the three months ended June 30, 2010 represent 1.5 percentage points of the general and administrative expense ratio.

*Validus Re.* Validus Re share compensation expenses for the three months ended June 30, 2010 were \$1.7 million compared to \$1.5 million for the three months ended June 30, 2009. Share compensation expenses as a percent of net premiums earned for the three months ended June 30, 2010 and 2009 were 0.7% and 0.9%, respectively.

*Talbot.* Talbot share compensation expenses for the three months ended June 30, 2010 were \$1.5 million compared to \$2.1 million for the three months ended June 30, 2009. The decrease from the prior year was due to the impact of accelerated vesting during 2009. Share compensation expenses as a percent of net premiums earned for the three months ended June 30, 2010 and 2009 were 0.8% and 1.3%, respectively.

*Corporate & Eliminations.* Corporate share compensation expenses for the three months ended June 30, 2010 were \$3.6 million compared to \$2.0 million for the three months ended June 30, 2009, an increase of \$1.6 million or 82.7%.

**Selected Ratios**

The underwriting results of an insurance or reinsurance company are often measured by reference to its combined ratio, which is the sum of the loss ratio and the expense ratio. The net loss ratio is calculated by dividing losses and loss expenses incurred (including estimates for incurred but not reported losses) by net premiums earned. The expense ratio is calculated by dividing acquisition costs combined with general and administrative expenses (including share

compensation expenses) by net premiums earned. The following table presents the losses and loss expenses ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the three months ended June 30, 2010 and 2009.

|   | <b>Three Months<br/>Ended<br/>June 30, 2010</b> | <b>Three Months<br/>Ended<br/>June 30, 2009<br/>(a)</b> | <b>%<br/>Change</b> |
|---|---|---|---------------------|
| Losses and loss expenses                | 44.5%   | 38.0%   | 6.5                 |
| Policy acquisition costs                | 16.9%   | 19.6%   | (2.7)               |
| General and administrative expenses (b) | 13.5%   | 14.3%   | (0.8)               |
| <b>Expense ratio</b>                    | 30.4%   | 33.9%   | (3.5)               |
| <b>Combined ratio</b>                   | 74.9%   | 71.9%   | 3.0                 |



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|   | <b>Three Months<br/>Ended<br/>June 30, 2010</b> | <b>Three Months<br/>Ended<br/>June 30, 2009<br/>(a)</b> | <b>%<br/>Change</b> |
|---|---|---|---------------------|
| <i>Validus Re</i>                       |   |   |                     |
| Losses and loss expenses                | 47.2%   | 25.1%   | 22.1                |
| Policy acquisition costs                | 14.5%   | 17.8%   | (3.3)               |
| General and administrative expenses (b) | 4.9%  | 9.6%  | (4.7)               |
| <b>Expense ratio</b>                    | 19.4%   | 27.4%   | (8.0)               |
| <b>Combined ratio</b>                   | 66.6%   | 52.5%   | 14.1                |

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|   | <b>Three Months<br/>Ended</b> | <b>Three Months<br/>Ended</b> | <b>%<br/>Change</b> |
|---|-------------------------------|-------------------------------|---------------------|
| <i>Talbot</i>                           | <b>June 30, 2010</b>          | <b>June 30, 2009</b>          |                     |
| Losses and loss expenses                | 40.4%                         | 50.8%                         | (10.4)              |
| Policy acquisition costs                | 22.0%                         | 22.0%                         |                     |
| General and administrative expenses (b) | 15.0%                         | 14.6%                         | 0.4                 |
| Expense ratio                           | 37.0%                         | 36.6%                         | 0.4                 |
| <b>Combined ratio</b>                   | <b>77.4%</b>                  | <b>87.4%</b>                  | <b>(10.0)</b>       |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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

General and administrative expense ratios for the three months ended June 30, 2010 and 2009 were 13.5% and 14.3%, respectively. General and administrative expense ratio is the sum of general and administrative expenses and share compensation expense divided by net premiums earned.

|                                     | <b>Three Months Ended<br/>June 30, 2010</b> |   | <b>Three Months Ended<br/>June 30, 2009 (a)</b> |   |
|-------------------------------------|---|---|---|---|
|                                     | <b>Expenses</b>                             | <b>Expenses as<br/>% of<br/>Net Earned<br/>Premiums</b> | <b>Expenses</b>                                 | <b>Expenses as<br/>% of<br/>Net Earned<br/>Premiums</b> |
| <b>(Dollars in thousands)</b>       |   |   |   |   |
| General and administrative expenses | \$ 52,379                                   | 12.0%   | \$ 41,200                                       | 12.6%   |
| Share compensation expenses         | 6,846                                       | 1.5%  | 5,632   | 1.7%  |
| <b>Total</b>                        | <b>\$ 59,225</b>                            | <b>13.5%</b>  | <b>\$ 46,832</b>                                | <b>14.3%</b>  |

(a) The results of operations for IPC are

consolidated  
only from the  
September 2009  
date of  
acquisition.

### Underwriting Income

Underwriting income for the three months ended June 30, 2010 was \$109.7 million compared to underwriting income of \$92.2 million for the three months ended June 30, 2009, an increase of \$17.5 million, or 19.0%.

|                               | Three Months Ended June 30, |              |                  |              |              |
|-------------------------------|-----------------------------|--------------|------------------|--------------|--------------|
|                               |                             | % of<br>Sub  |                  | % of<br>Sub  | %<br>Change  |
| <b>(Dollars in thousands)</b> | <b>2010</b>                 | <b>Total</b> | <b>2009 (a)</b>  | <b>Total</b> |              |
| Validus Re                    | \$ 87,537                   | 68.8%        | \$ 77,759        | 78.9%        | 12.6%        |
| Talbot                        | 39,727                      | 31.2%        | 20,734           | 21.1%        | 91.6%        |
| Sub-total                     | 127,264                     | 100.0%       | 98,493           | 100.0%       | 29.2%        |
| Corporate & Eliminations      | (17,565)                    |              | (6,314)          |              | 178.2%       |
| <b>Total</b>                  | <b>\$ 109,699</b>           |              | <b>\$ 92,179</b> |              | <b>19.0%</b> |

(a) The results of  
operations for  
IPC are  
consolidated  
only from the  
September 2009  
date of  
acquisition.

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The underwriting results of an insurance or reinsurance company are also often measured by reference to its underwriting income, which is a non-GAAP financial measure. Underwriting income, as set out in the table below, is reconciled to net income (the most directly comparable GAAP financial measure) by the addition or subtraction of certain Consolidated Statement of Operations and Comprehensive Income line items, as illustrated below.

| <b>(Dollars in thousands)</b>              | <b>Three Months<br/>Ended<br/>June 30, 2010</b> | <b>Three Months<br/>Ended<br/>June 30, 2009 (a)</b> |
|--|---|---|
| Underwriting income                        | \$ 109,699                                      | \$ 92,179   |
| Net investment income                      | 34,809  | 26,963  |
| Other income                               | 2,697   | 1,017   |
| Finance expenses                           | (13,218)  | (10,752)  |
| Transaction expenses                       |   | (15,851)  |
| Net realized gains (losses) on investments | 12,441  | (2,650)   |
| Net unrealized gains on investments        | 41,640  | 37,249  |
| Foreign exchange (losses) gains            | (4,099)   | 8,432   |
| <b>Net income before tax</b>               | <b>\$ 183,969</b>                               | <b>\$ 136,587</b>                                   |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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

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

by the compensation committee of our Board of Directors in determining the bonus component of the total annual incentive compensation.

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

**Net Investment Income**

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Net investment income for the three months ended June 30, 2010 was \$34.8 million compared to \$27.0 million for the three months ended June 30, 2009, an increase of \$7.8 million or 29.1%. Net investment income increased due primarily to a larger fixed maturity portfolio as a result of the IPC Acquisition. Net investment income is comprised of accretion of premium or discount on fixed maturities, interest on coupon-paying bonds, short-term investments and cash and cash equivalents, partially offset by investment management fees. The components of net investment income for the three months ended June 30, 2010 and 2009 are as presented below.

|   | Three Months<br>Ended<br>June 30, 2010 | Three Months<br>Ended<br>June 30, 2009<br>(a) | %<br>Change |
|---|--|---|-------------|
| <b>(Dollars in thousands)</b>               |  |   |             |
| Fixed maturities and short-term investments | \$ 36,346                              | \$ 26,396                                     | 37.7%       |
| Cash and cash equivalents                   | 311                                    | 1,120   | (72.2)%     |
| Securities lending income                   | 49                                     | 173   | (71.7)%     |
| Total gross investment income               | 36,706                                 | 27,689  | 32.6%       |
| Investment expenses                         | (1,897)                                | (726)   | 161.3%      |
| Net investment income                       | \$ 34,809                              | \$ 26,963                                     | 29.1%       |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

Annualized effective investment yield is based on the weighted average investments held calculated on a simple period average and excludes net unrealized gains (losses), foreign exchange gains (losses) on investments and the foreign exchange effect of insurance balances. The Company's annualized effective investment yield was 2.37% and 3.08% for the three months ended June 30, 2010 and 2009, respectively, and the average duration at June 30, 2010 was 2.2 years (December 31, 2009 2.2 years).

**Finance Expenses**

Finance expenses for the three months ended June 30, 2010 were \$13.2 million compared to \$10.8 million for the three months ended June 30, 2009, an increase of \$2.5 million or 22.9%. The increase was primarily driven by \$5.6 million in interest expense on the 8.875% Senior Notes due 2040 which were issued in the first quarter of 2010, partially offset by a \$3.3 million decrease in payments under the Talbot third party FAL facility.

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

|  | Three Months Ended June<br>30, |                 | %<br>Change |
|--|--------------------------------|-----------------|-------------|
| <b>(Dollars in thousands)</b>                    | <b>2010</b>                    | <b>2009 (a)</b> |             |
| 9.069% Junior Subordinated Deferrable Debentures | \$ 3,589                       | \$ 3,589        | 0.0%        |
| 8.480% Junior Subordinated Deferrable Debentures | 3,028                          | 3,348           | (9.6)%      |
| 8.875% Senior Notes due 2040                     | 5,597                          |                 | NM          |

|                                 |                  |                  |              |
|---------------------------------|------------------|------------------|--------------|
| Credit facilities               | 1,109            | 476              | 133.0%       |
| Talbot FAL facility             | (89)             | 42               | NM           |
| Talbot other interest           | (16)             |                  | NM           |
| Talbot third party FAL facility |                  | 3,297            | NM           |
| <b>Finance expenses</b>         | <b>\$ 13,218</b> | <b>\$ 10,752</b> | <b>22.9%</b> |

NM: Not Meaningful

- (a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

Capital in Lloyd's entities, whether personal or corporate, is required to be set annually for the prospective year and held by Lloyd's in trust ( Funds at Lloyd's or FAL ). In underwriting years up to and including 2007, Talbot's FAL has been provided both by Talbot and by third parties, thereafter Talbot's FAL has been provided exclusively by the Company. Because the third party FAL providers remain on risk until each year of account that their support closes (normally after three years). Talbot must retain third party FAL even if a third party FAL provider

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has ceased to support the active underwriting year. This is achieved by placing such FAL in escrow outside Lloyd's. Thus, the total FAL facility available to the Company is the total FAL for active and prior underwriting years, although the Company can only apply specific FAL against losses incurred by an underwriting year that such FAL is contracted to support. With effect from December 31, 2009, the last year of account supported by the Talbot third party FAL facility closed and all liability, ceased and all third party FAL was returned to its providers.

For each year of account up to and including the 2007 year of account, between 30% and 40% of an amount equivalent to each underwriting years' profit is payable to Talbot third party FAL providers. However, some of these costs are fixed. There are no FAL finance charges related to the 2008, 2009 and 2010 years of account as there were no third party FAL providers in those periods. The FAL finance charges relate to total syndicate profit (underwriting income, investment income and realized and unrealized capital gains and losses).

FAL finance charges are based on syndicate profit but include fixed elements. FAL finance charges for the three months ended June 30, 2010 were \$nil compared to \$3.3 million for the three months ended June 30, 2009, a decrease of \$3.3 million.

**Tax (Expense) Benefit**

Tax expense for the three months ended June 30, 2010 was (\$4.2) million compared to a benefit of \$1.0 million for the three months ended June 30, 2009, an increase of \$5.2 million. For the three months ended June 30, 2010, Talbot incurred higher UK taxable profits which increased the tax expense by \$0.9 million.

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

Net realized gains on investments for the three months ended June 30, 2010 were \$12.4 million compared to losses of (\$2.7) million for the three months ended June 30, 2009, an increase of \$15.1 million.

**Net Unrealized Gains on Investments**

Net unrealized gains on investments for the three months ended June 30, 2010 were \$41.6 million compared to gains of \$37.2 million for the three months ended June 30, 2009 an increase of \$4.4 million or 11.8%. The net unrealized gains in the three months ended June 30, 2010 resulted primarily from improved market conditions for fixed income securities.

Net unrealized gains on investments are recorded as a component of net income. The Company has adopted all authoritative guidance on U.S. GAAP fair value measurements in effect as of the balance sheet date. Consistent with these standards, certain market conditions allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable. Certain non-Agency RMBS securities were identified as trading in inactive markets. The change in fair value for the identified non-Agency RMBS securities was a \$2.6 million decrease in net unrealized loss on investments for the three months ended June 30, 2010. Further details are provided in the Investments section below.

**Transaction Expenses**

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

**Other Income**

Other income for the three months ended June 30, 2010 was \$2.7 million compared to \$1.0 million for the three months ended June 30, 2009, an increase of \$1.7 million or 165.2%.



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**Foreign Exchange (Losses) Gains**

Foreign exchange (losses) for the three months ended June 30, 2010 were (\$4.1) million compared to a gain of \$8.4 million for the three months ended June 30, 2009, an increase of \$12.5 million or 148.6%. The increase in foreign exchange (losses) was due primarily to the decreased value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency for the three months ended June 30, 2010, as compared to the three months ended June 30, 2009. For the three months ended June 30, 2010, Validus Re recognized foreign exchange (losses) of \$(0.8) million and Talbot recognized foreign exchange (losses) of (\$3.2) million.

For the three months ended June 30, 2010, Validus Re segment foreign exchange (losses) were (\$0.8) million compared to gains of \$1.8 million for the three months ended June 30, 2009, in foreign exchange of \$2.7 million. The increase in Validus Re segment foreign exchange (losses) was due to a net long position on premium receivable assets denominated in Euro and British pound sterling. The Euro to U.S. dollar exchange rates were 1.35 and 1.22 at March 31, 2010 and June 30, 2010, respectively, a depreciation of 9.6 percent, while the British pound sterling for the same period remained relatively constant.

For the three months ended June 30, 2010, Talbot segment foreign exchange (losses) were (\$3.2) million compared to gains of \$6.5 million for the three months ended June 30, 2009, (losses) of \$9.8 million or 149.5%. The increase in Talbot segment foreign exchange (losses) was due primarily to revaluation of Euro and overseas deposits. The Euro to U.S. dollar exchange rates were 1.35 and 1.22 at March 31, 2010 and June 30, 2010, respectively, or 9.6 percent depreciation. Certain premiums receivable and liabilities for losses incurred in currencies other than the U.S. dollar are exposed to the risk of changes in value resulting from fluctuations in foreign exchange rates and may affect financial results in the future.

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The following table presents results of operations for the three and six months ended June 30, 2010 and 2009:

|   | <b>Three Months Ended June 30,</b> |                 |                               | <b>Six Months Ended June 30,</b> |                 |                               |
|---|------------------------------------|-----------------|-------------------------------|----------------------------------|-----------------|-------------------------------|
|   |                                    |                 | <b>Pro<br/>Forma<br/>2009</b> |                                  |                 | <b>Pro<br/>Forma<br/>2009</b> |
| <b>(Dollars in thousands)</b>                 | <b>2010</b>                        | <b>2009 (a)</b> | <b>(c)</b>                    | <b>2010</b>                      | <b>2009 (a)</b> | <b>(c)</b>                    |
| Gross premiums written                        | \$ 516,861                         | \$ 425,032      | \$ 552,581                    | \$ 1,387,795                     | \$ 1,034,924    | \$ 1,396,818                  |
| Reinsurance premiums ceded                    | (67,726)                           | (62,291)        | (64,486)                      | (158,465)                        | (134,803)       | (138,467)                     |
| Net premiums written                          | 449,135                            | 362,741         | 488,095                       | 1,229,330                        | 900,121         | 1,258,351                     |
| Change in unearned premiums                   | (11,191)                           | (34,541)        | (63,697)                      | (333,692)                        | (253,162)       | (416,486)                     |
| Net premiums earned                           | 437,944                            | 328,200         | 424,398                       | 895,638                          | 646,959         | 841,865                       |
| Losses and loss expenses                      | 194,894                            | 124,751         | 116,334                       | 673,425                          | 256,585         | 287,277                       |
| Policy acquisition costs                      | 74,126                             | 64,438          | 74,344                        | 150,302                          | 125,887         | 145,631                       |
| General and administrative expenses           | 52,379                             | 41,200          | 51,108                        | 105,948                          | 79,279          | 99,341                        |
| Share compensation expenses                   | 6,846                              | 5,632           | 8,107                         | 13,422                           | 12,986          | 17,950                        |
| Total underwriting deductions                 | 328,245                            | 236,021         | 249,893                       | 943,097                          | 474,737         | 550,199                       |
| Underwriting income (loss) (b)                | 109,699                            | 92,179          | 174,505                       | (47,459)                         | 172,222         | 291,666                       |
| Net investment income                         | 34,809                             | 26,963          | 44,540                        | 69,108                           | 53,735          | 88,987                        |
| Other income                                  | 2,697                              | 1,017           | 1,036                         | 3,585                            | 1,774           | 1,800                         |
| Finance expenses                              | (13,218)                           | (10,752)        | (10,752)                      | (28,369)                         | (18,475)        | (18,858)                      |
| Operating income (loss) before taxes (b)      | 133,987                            | 109,407         | 209,329                       | (3,135)                          | 209,256         | 363,595                       |
| Tax (expense) benefit                         | (4,187)                            | 976             | 976                           | (3,490)                          | 1,502           | 1,502                         |
| Net operating income (loss) (b)               | 129,800                            | 110,383         | 210,305                       | (6,625)                          | 210,758         | 365,097                       |
| Net realized gains (losses) on investments    | 12,441                             | (2,650)         | 2,430                         | 23,839                           | (26,071)        | (24,909)                      |
| Net unrealized gains on investments           | 41,640                             | 37,249          | 109,554                       | 57,053                           | 59,402          | 100,053                       |
| Foreign exchange (losses) gains               | (4,099)                            | 8,432           | 10,111                        | (12,863)                         | 4,232           | 2,765                         |
| Transaction expenses                          |                                    | (15,851)        |                               |                                  | (15,851)        |                               |
| Net income                                    | \$ 179,782                         | \$ 137,563      | \$ 332,400                    | \$ 61,404                        | \$ 232,470      | \$ 443,006                    |
| Selected ratios:                              |                                    |                 |                               |                                  |                 |                               |
| Net premiums written / Gross premiums written | 86.9%                              | 85.3%           | 88.3%                         | 88.6%                            | 87.0%           | 90.1%                         |
| Losses and loss expenses                      | 44.5%                              | 38.0%           | 27.4%                         | 75.2%                            | 39.7%           | 34.1%                         |
| Policy acquisition costs                      | 16.9%                              | 19.6%           | 17.5%                         | 16.8%                            | 19.5%           | 17.3%                         |
| General and administrative expenses (d)       | 13.5%                              | 14.3%           | 14.0%                         | 13.3%                            | 14.3%           | 13.9%                         |

|                |       |       |       |        |       |       |
|----------------|-------|-------|-------|--------|-------|-------|
| Expense ratio  | 30.4% | 33.9% | 31.5% | 30.1%  | 33.8% | 31.2% |
| Combined ratio | 74.9% | 71.9% | 58.9% | 105.3% | 73.5% | 65.3% |

- a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.
- b) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income (loss) and operating income (loss) 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  
(loss) measure to  
net income, the  
most comparable  
U.S. GAAP  
financial  
measure, is  
presented in the  
section below  
entitled  
Underwriting  
Income.

- c) Pro Forma  
combined  
Validus  
Holdings, Ltd.  
and IPC  
Holdings Ltd.  
income  
statement for the  
three months  
and six months  
ended June 30,  
2009.
- d) The general and  
administrative  
ratio includes  
share  
compensation  
expenses.

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| (Dollars in thousands)              | Three Months Ended June 30, |            |                          | Six Months Ended June 30, |            |                          |
|-------------------------------------|-----------------------------|------------|--------------------------|---------------------------|------------|--------------------------|
|                                     | 2010                        | 2009 (a)   | Pro Forma<br>2009<br>(c) | 2010                      | 2009 (a)   | Pro Forma<br>2009<br>(c) |
| <b>Validus Re</b>                   |                             |            |                          |                           |            |                          |
| Gross premiums written              | \$ 284,328                  | \$ 199,560 | \$ 327,109               | \$ 924,623                | \$ 609,686 | \$ 971,580               |
| Reinsurance premiums ceded          | (41,175)                    | (43,070)   | (45,265)                 | (54,285)                  | (56,359)   | (60,023)                 |
| Net premiums written                | 243,153                     | 156,490    | 281,844                  | 870,338                   | 553,327    | 911,557                  |
| Change in unearned premiums         | 18,888                      | 7,207      | (21,949)                 | (324,376)                 | (215,183)  | (378,507)                |
| Net premiums earned                 | 262,041                     | 163,697    | 259,895                  | 545,962                   | 338,144    | 533,050                  |
| Losses and loss expenses            | 123,793                     | 41,121     | 32,704                   | 472,713                   | 96,583     | 127,275                  |
| Policy acquisition costs            | 37,979                      | 29,120     | 39,026                   | 81,482                    | 57,697     | 77,441                   |
| General and administrative expenses | 10,983                      | 14,149     | 24,057                   | 27,295                    | 27,941     | 48,003                   |
| Share compensation expenses         | 1,749                       | 1,548      | 4,023                    | 3,378                     | 3,220      | 8,184                    |
| Total underwriting deductions       | 174,504                     | 85,938     | 99,810                   | 584,868                   | 185,441    | 260,903                  |
| Underwriting income (loss) (b)      | 87,537                      | 77,759     | 160,085                  | (38,906)                  | 152,703    | 272,147                  |
| <b>Talbot</b>                       |                             |            |                          |                           |            |                          |
| Gross premiums written              | \$ 253,710                  | \$ 235,113 | \$ 235,113               | \$ 524,251                | \$ 463,033 | \$ 463,033               |
| Reinsurance premiums ceded          | (47,728)                    | (28,862)   | (28,862)                 | (165,259)                 | (116,239)  | (116,239)                |
| Net premiums written                | 205,982                     | 206,251    | 206,251                  | 358,992                   | 346,794    | 346,794                  |
| Change in unearned premiums         | (30,079)                    | (41,748)   | (41,748)                 | (9,316)                   | (37,979)   | (37,979)                 |
| Net premiums earned                 | 175,903                     | 164,503    | 164,503                  | 349,676                   | 308,815    | 308,815                  |
| Losses and loss expenses            | 71,101                      | 83,630     | 83,630                   | 200,712                   | 160,002    | 160,002                  |
| Policy acquisition costs            | 38,647                      | 36,114     | 36,114                   | 73,592                    | 69,271     | 69,271                   |
| General and administrative expenses | 24,960                      | 21,927     | 21,927                   | 50,508                    | 42,141     | 42,141                   |
| Share compensation expenses         | 1,468                       | 2,098      | 2,098                    | 3,027                     | 4,433      | 4,433                    |
| Total underwriting deductions       | 136,176                     | 143,769    | 143,769                  | 327,839                   | 275,847    | 275,847                  |

|                                      |             |            |            |             |             |             |
|--------------------------------------|-------------|------------|------------|-------------|-------------|-------------|
| Underwriting income (b)              | 39,727      | 20,734     | 20,734     | 21,837      | 32,968      | 32,968      |
| <b>Corporate &amp; Eliminations</b>  |             |            |            |             |             |             |
| Gross premiums written               | \$ (21,177) | \$ (9,641) | \$ (9,641) | \$ (61,079) | \$ (37,795) | \$ (37,795) |
| Reinsurance premiums ceded           | 21,177      | 9,641      | 9,641      | 61,079      | 37,795      | 37,795      |
| Net premiums written                 |             |            |            |             |             |             |
| Change in unearned premiums          |             |            |            |             |             |             |
| Net premiums earned                  |             |            |            |             |             |             |
| Losses and loss expenses             |             |            |            |             |             |             |
| Policy acquisition costs             | (2,500)     | (796)      | (796)      | (4,772)     | (1,081)     | (1,081)     |
| General and administrative expenses  | 16,436      | 5,124      | 5,124      | 28,145      | 9,197       | 9,197       |
| Share compensation expenses          | 3,629       | 1,986      | 1,986      | 7,017       | 5,333       | 5,333       |
| Total underwriting deductions        | 17,565      | 6,314      | 6,314      | 30,390      | 13,449      | 13,449      |
| Underwriting (loss) (b)              | (17,565)    | (6,314)    | (6,314)    | (30,390)    | (13,449)    | (13,449)    |
| Total underwriting income (loss) (b) | \$ 109,699  | \$ 92,179  | \$ 174,505 | \$ (47,459) | \$ 172,222  | \$ 291,666  |

a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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.

- c) Pro Forma  
combined  
Validus  
Holdings, Ltd.  
and IPC  
Holdings Ltd.  
income  
statement for the  
three and six  
months ended  
June 30, 2009.





**Table of Contents****Six Months Ended June 30, 2010 compared to six months ended June 30, 2009**

Net income for the six months ended June 30, 2010 was \$61.4 million compared to net income of \$232.5 million for the six months ended June 30, 2009, a decrease of \$171.1 million. The primary factors driving the decrease in net income were:

Decrease in underwriting income of \$219.7 million due primarily to increased notable loss events. For the six months ended June 30, 2010, the Company incurred a \$416.8 million increase in loss and loss expenses over the six months ended June 30, 2009. This was partially offset by a \$248.7 million increase in net premiums earned primarily relating to the IPC Acquisition;

An adverse movement in foreign exchange of \$17.1 million; and

Increase in finance expenses of \$9.9 million.

The items above were partially offset by the following factors:

Decrease in transaction expenses of \$15.9 million relating to the IPC Acquisition that were absent in the three months ended June 30, 2010; and

Increase in net investment income and net realized gains on investments of \$15.4 million and \$49.9 million respectively.

The change in net income for the six months ended June 30, 2010 of \$171.1 million is described in the following table:

**Six Months Ended June 30, 2010**  
**(Decrease) increase over the six months ended June 30, 2009**  
**(a)**

|   | <b>Validus</b> |               | <b>Corporate and other reconciling items</b> | <b>Total</b> |
|---|----------------|---------------|--|--------------|
| <b>(Dollars in thousands)</b>                   | <b>Re</b>      | <b>Talbot</b> |  |              |
| Notable losses net losses and loss expenses (c) | \$ (356,262)   | \$ (60,805)   | \$   | \$ (417,067) |
| Notable losses net reinstatement premiums (c)   | 27,662         | (3,802)       |  | 23,860       |
| Other underwriting income (loss)                | 136,991        | 53,476        | (16,941)                                     | 173,526      |
| Underwriting income (b)                         | (191,609)      | (11,131)      | (16,941)                                     | (219,681)    |
| Net investment income                           | 17,590         | (616)         | (1,601)                                      | 15,373       |
| Other income                                    | 1,368          | 3,391         | (2,948)                                      | 1,811        |
| Finance expenses                                | (1,560)        | 622           | (8,956)                                      | (9,894)      |
|   | (174,211)      | (7,734)       | (30,446)                                     | (212,391)    |
| Taxes   | (119)          | (4,867)       | (6)  | (4,992)      |
|   | (174,330)      | (12,601)      | (30,452)                                     | (217,383)    |
| Transaction expenses                            |                |               | 15,851                                       | 15,851       |
| Net realized gains on investments               | 39,821         | 10,089        |  | 49,910       |
| Net unrealized (losses) gains on investments    | (6,908)        | 4,559         |  | (2,349)      |

|                           |                     |                    |                    |                     |
|---------------------------|---------------------|--------------------|--------------------|---------------------|
| Foreign exchange (losses) | (4,602)             | (12,398)           | (95)               | (17,095)            |
| <b>Net income</b>         | <b>\$ (146,019)</b> | <b>\$ (10,351)</b> | <b>\$ (14,696)</b> | <b>\$ (171,066)</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

(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

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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.

- (c) Notable losses for the six months ended June 30, 2010 include: the Chilean earthquake, Melbourne hailstorm, windstorm Xynthia, Deepwater Horizon, Aban Pearl, Bangkok riots and the Perth hailstorm.

**Gross Premiums Written**

Gross premiums written for the six months ended June 30, 2010 were \$1,387.8 million compared to \$1,034.9 million for the six months ended June 30, 2009, an increase of \$352.9 million or 34.1%. The increase in gross premiums written was driven primarily by the impact of the IPC Acquisition and the increase in reinstatement premiums relating to the notable loss events for the six months ended June 30, 2010. The property, marine and specialty lines increased by \$273.6 million, \$62.5 million and \$16.8 million, respectively. Details of gross premiums written by line of business are provided below.

|                        | Six Months Ended<br>June 30, 2010 |                                     | Six Months Ended<br>June 30, 2009 (a) |                                     | %<br>Change |
|------------------------|-----------------------------------|-------------------------------------|---------------------------------------|-------------------------------------|-------------|
|                        | Gross<br>Premiums<br>Written      | Gross<br>Premiums<br>Written<br>(%) | Gross<br>Premiums<br>Written          | Gross<br>Premiums<br>Written<br>(%) |             |
| (Dollars in thousands) | Written                           | (%)                                 | Written                               | (%)                                 |             |

|              |                     |               |                     |               |              |
|--------------|---------------------|---------------|---------------------|---------------|--------------|
| Property     | \$ 817,426          | 58.9%         | \$ 543,808          | 52.5%         | 50.3%        |
| Marine       | 353,005             | 25.4%         | 290,531             | 28.1%         | 21.5%        |
| Specialty    | 217,364             | 15.7%         | 200,585             | 19.4%         | 8.4%         |
| <b>Total</b> | <b>\$ 1,387,795</b> | <b>100.0%</b> | <b>\$ 1,034,924</b> | <b>100.0%</b> | <b>34.1%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Validus Re.* Validus Re gross premiums written for the six months ended June 30, 2010 were \$924.6 million compared to \$609.7 million for the six months ended June 30, 2009, an increase of \$314.9 million or 51.7%. Details of Validus Re gross premiums written by line of business are provided below.

|                               | Six Months Ended<br>June 30, 2010 |                              | Six Months Ended<br>June 30, 2009 (a) |                              | %<br>Change  |
|-------------------------------|-----------------------------------|------------------------------|---------------------------------------|------------------------------|--------------|
|                               | Gross<br>Premiums                 | Gross<br>Premiums<br>Written | Gross<br>Premiums                     | Gross<br>Premiums<br>Written |              |
|                               | Written                           | (%)                          | Written                               | (%)                          |              |
| <b>(Dollars in thousands)</b> |                                   |                              |                                       |                              |              |
| Property                      | \$ 673,976                        | 72.9%                        | \$ 424,646                            | 69.6%                        | 58.7%        |
| Marine                        | 185,396                           | 20.0%                        | 125,505                               | 20.6%                        | 47.7%        |
| Specialty                     | 65,251                            | 7.1%                         | 59,535                                | 9.8%                         | 9.6%         |
| <b>Total</b>                  | <b>\$924,623</b>                  | <b>100.0%</b>                | <b>\$ 609,686</b>                     | <b>100.0%</b>                | <b>51.7%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

The impact of the IPC Acquisition was the primary driver for the increase in gross premiums written. The additional capacity was used to increase lines on renewing deals and to write new business totaling \$266.8 million for the six months ended June 30, 2010.

Validus Re gross premiums written increased across the property, marine and specialty lines by \$249.3 million, \$59.9 million and \$5.7 million, respectively. The increase in the Validus Re property line was due primarily to a \$200.3 million increase in new and renewing business and an increase of \$13.1 million contributed by the Validus Re Singapore branch, which commenced writing business in January 2010. In addition, there was an \$8.0 million increase in earned premium adjustments and a \$6.0 million increase in reinstatement premiums relating to the notable loss events for the six months ended June 30, 2010. The increase in gross premiums written in the Validus Re marine lines was due primarily to a \$54.3 million increase in new and renewing business. In addition, there was a \$12.9 million increase in reinstatement premiums relating to the notable loss events, offset by a \$12.4 million reduction in earned

premium adjustments for the six months ended June 30, 2010. The increase in gross premiums written in the Validus Re specialty lines was due primarily to a \$12.0 million increase in new and renewing business, partially offset by \$2.8 million in earned premium adjustments.

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Gross premiums written under the quota share, surplus treaty and excess of loss contracts with Talbot increased by \$19.6 million and \$4.6 million, respectively on the property and marine lines and decreased by \$0.9 million on the specialty lines for the six months ended June 30, 2010. These reinsurance contracts with Talbot are eliminated upon consolidation.

*Talbot.* Talbot gross premiums written for the six months ended June 30, 2010 were \$524.3 million compared to \$463.0 million for the six months ended June 30, 2009, an increase of \$61.2 million or 13.2%. The \$524.3 million of gross premiums written translated at 2009 rates of exchange would have been \$520.2 million during the six months ended June 30, 2010, a decrease of \$4.1 million. Details of Talbot gross premiums written by line of business are provided below.

| (Dollars in thousands) | Six Months Ended<br>June 30, 2010 |                              | Six Months Ended<br>June 30, 2009 |                              | %<br>Change  |
|------------------------|-----------------------------------|------------------------------|-----------------------------------|------------------------------|--------------|
|                        | Gross<br>Premiums                 | Gross<br>Premiums<br>Written | Gross<br>Premiums                 | Gross<br>Premiums<br>Written |              |
|                        | Written                           | (%)                          | Written                           | (%)                          |              |
| Property               | \$ 183,404                        | 34.9%                        | \$ 139,495                        | 30.1%                        | 31.5%        |
| Marine                 | 182,227                           | 34.8%                        | 175,067                           | 37.8%                        | 4.1%         |
| Specialty              | 158,620                           | 30.3%                        | 148,471                           | 32.1%                        | 6.8%         |
| <b>Total</b>           | <b>\$ 524,251</b>                 | <b>100.0%</b>                | <b>\$ 463,033</b>                 | <b>100.0%</b>                | <b>13.2%</b> |

Talbot gross premiums written increased across the property, marine and specialty lines by \$43.9 million, \$7.2 million and \$10.1 million, respectively. The increase in the Talbot property lines was due primarily to \$32.2 million of gross premiums written on the onshore energy lines. The onshore energy team had commenced writing business during the first quarter of 2009, which is the main reason for the increase over the six months ended June 30, 2009. In addition, there was a \$18.4 million increase in gross premiums written by Validus Reasegueros, Inc., which acts as an approved Lloyd's coverholder for Syndicate 1183 targeting the Latin American and Caribbean markets. This increase was partly driven by \$7.2 million of reinstatement premiums relating to the Chilean earthquake of which 85% are ceded to Validus Re. The increase in the Talbot marine lines of \$7.2 million was due primarily to additional gross premiums written on the marine treaty lines following an increased in client base and increased line sizes. The increase in the Talbot specialty lines was due primarily to \$18.5 million of additional gross premiums written by the new aviation team.

**Reinsurance Premiums Ceded**

Reinsurance premiums ceded for the six months ended June 30, 2010 were \$158.5 million compared to \$134.8 million for the six months ended June 30, 2009, an increase of \$23.7 million, or 17.6%. Reinsurance premiums ceded on the property, marine and specialty lines increased by \$14.8 million, \$5.0 million and \$3.9 million, respectively.

| (Dollars in thousands) | Six Months Ended<br>June 30, 2010 |                                  | Six Months Ended<br>June 30, 2009 (a) |                                  | %<br>Change |
|------------------------|-----------------------------------|----------------------------------|---------------------------------------|----------------------------------|-------------|
|                        | Reinsurance<br>Premiums           | Reinsurance<br>Premiums<br>Ceded | Reinsurance<br>Premiums               | Reinsurance<br>Premiums<br>Ceded |             |
|                        | Ceded                             | (%)                              | Ceded                                 | (%)                              |             |
| Property               | \$ 95,501                         | 60.2%                            | \$ 80,654                             | 59.8%                            | 18.4%       |
| Marine                 | 26,548                            | 16.8%                            | 21,592                                | 16.0%                            | 23.0%       |
| Specialty              | 36,416                            | 23.0%                            | 32,557                                | 24.2%                            | 11.9%       |

|              |            |        |            |        |       |
|--------------|------------|--------|------------|--------|-------|
| <b>Total</b> | \$ 158,465 | 100.0% | \$ 134,803 | 100.0% | 17.6% |
|--------------|------------|--------|------------|--------|-------|

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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*Validus Re.* Validus Re reinsurance premiums ceded for the six months ended June 30, 2010 were \$54.3 million compared to \$56.4 million for the six months ended June 30, 2009, a decrease of \$2.1 million, or 3.7%.

|                               | <b>Six Months Ended<br/>June 30, 2010</b> |   | <b>Six Months Ended<br/>June 30, 2009 (a)</b> |   |                     |
|-------------------------------|---|---|---|---|---------------------|
|                               | <b>Reinsurance<br/>Premiums</b>           | <b>Reinsurance<br/>Premiums<br/>Ceded</b> | <b>Reinsurance<br/>Premiums</b>               | <b>Reinsurance<br/>Premiums<br/>Ceded</b> | <b>%<br/>Change</b> |
| <b>(Dollars in thousands)</b> | <b>Ceded</b>                              | <b>(%)</b>                                | <b>Ceded</b>                                  | <b>(%)</b>                                |                     |
| Property                      | \$ 43,275                                 | 79.7%                                     | \$ 46,024                                     | 81.6%                                     | (6.0)%              |
| Marine                        | 11,293                                    | 20.8%                                     | 8,766   | 15.6%                                     | 28.8%               |
| Specialty                     | (283)                                     | (0.5)%                                    | 1,569   | 2.8%                                      | (118.0)%            |
| <b>Total</b>                  | <b>\$ 54,285</b>                          | <b>100.0%</b>                             | <b>\$ 56,359</b>                              | <b>100.0%</b>                             | <b>(3.7)%</b>       |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

Reinsurance premiums ceded on the Validus Re property lines decreased by \$2.7 million, due primarily to a reduction in U.S. property cover and rate reductions in the retro market for the six months ended June 30, 2010. Reinsurance premiums ceded on the Validus Re marine lines increased by \$2.5 million due primarily to the reinstatement premiums and purchase of industry loss warranties generated as a result of the Deepwater Horizon event. Reinsurance premiums ceded on the Validus Re specialty lines decreased by \$1.9 million six months ended June 30, 2010 due primarily to the non-renewal of specific satellite exposure coverage purchased in the prior period. *Talbot*. Talbot reinsurance premiums ceded for the six months ended June 30, 2010 were \$165.3 million compared to \$116.2 million for the six months ended June 30, 2009, an increase of \$49.0 million or 42.2%. The increase is primarily due to reinsurance premiums ceded on the onshore energy lines, as discussed above, additional surplus and quota share costs following the increase in premiums written through Talbot's overseas offices and reinstatement premiums relating to the Chilean earthquake and Deepwater Horizon losses.

|                               | <b>Six Months Ended<br/>June 30, 2010</b> |   | <b>Six Months Ended<br/>June 30, 2009</b> |   |                     |
|-------------------------------|---|---|---|---|---------------------|
|                               | <b>Reinsurance<br/>Premiums</b>           | <b>Reinsurance<br/>Premiums<br/>Ceded</b> | <b>Reinsurance<br/>Premiums</b>           | <b>Reinsurance<br/>Premiums<br/>Ceded</b> | <b>%<br/>Change</b> |
| <b>(Dollars in thousands)</b> | <b>Ceded</b>                              | <b>(%)</b>                                | <b>Ceded</b>                              | <b>(%)</b>                                |                     |
| Property                      | \$ 92,178                                 | 55.8%                                     | \$ 54,963                                 | 47.3%                                     | 67.7%               |
| Marine                        | 29,874                                    | 18.1%                                     | 22,867                                    | 19.7%                                     | 30.6%               |
| Specialty                     | 43,207                                    | 26.1%                                     | 38,409                                    | 33.0%                                     | 12.5%               |
| <b>Total</b>                  | <b>\$165,259</b>                          | <b>100.0%</b>                             | <b>\$ 116,239</b>                         | <b>100.0%</b>                             | <b>42.2%</b>        |



Reinsurance premiums ceded on the Talbot property lines increased by \$37.2 million for the six months ended June 30, 2010. The increase was primarily due to a \$16.8 million increase in premiums ceded on the onshore energy lines, a \$9.2 million increase in premiums ceded under the property quota share and surplus treaty and reinstatements of \$6.2 million relating to the Chilean earthquake. Reinsurance premiums ceded on the Talbot marine lines increased by \$7.0 million for the six months ended June 30, 2010 primarily due to \$5.9 million in additional quota share costs over the six months ended June 30, 2009. Reinsurance premiums ceded on the Talbot Specialty lines increased by \$4.8 million for the six months ended June 30, 2010 primarily due to a \$2.0 million increase in excess of loss costs relating to the political risk line. Talbot reinsurance premiums ceded under the quota share, surplus treaty and excess of loss contracts with Validus Re for the six months ended June 30, 2010 increased by \$17.6 million as compared to the six months ended June 30, 2009. The increase was primarily due to increased business written on the energy onshore lines. Reinsurance premiums ceded on the property and marine lines under the quota share, surplus treaty and excess of loss contracts with Validus Re increased by \$19.6 million and \$4.6 million, respectively, compared to the six months ended June 30, 2009. These agreements are eliminated upon consolidation.

**Table of Contents****Net Premiums Written**

Net premiums written for the six months ended June 30, 2010 were \$1,229.3 million compared to \$900.1 million for the six months ended June 30, 2009, an increase of \$329.2 million, or 36.6%. The ratios of net premiums written to gross premiums written for the six months ended June 30, 2010 and 2009 were 88.6% and 87.0%, respectively. Details of net premiums written by line of business are provided below.

|                               | Six Months Ended<br>June 30, 2010 |                                   | Six Months Ended<br>June 30, 2009 (a) |                                   | %<br>Change  |
|-------------------------------|-----------------------------------|-----------------------------------|---------------------------------------|-----------------------------------|--------------|
|                               | Net<br>Premiums<br>Written        | Net<br>Premiums<br>Written<br>(%) | Net<br>Premiums<br>Written            | Net<br>Premiums<br>Written<br>(%) |              |
| <b>(Dollars in thousands)</b> |                                   |                                   |                                       |                                   |              |
| Property                      | \$ 721,927                        | 58.7%                             | \$ 463,154                            | 51.4%                             | 55.9%        |
| Marine                        | 326,456                           | 26.6%                             | 268,939                               | 29.9%                             | 21.4%        |
| Specialty                     | 180,947                           | 14.7%                             | 168,028                               | 18.7%                             | 7.7%         |
| <b>Total</b>                  | <b>\$ 1,229,330</b>               | <b>100.0%</b>                     | <b>\$ 900,121</b>                     | <b>100.0%</b>                     | <b>36.6%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Validus Re.* Validus Re net premiums written for the six months ended June 30, 2010 were \$870.3 million compared to \$553.3 million for the six months ended June 30, 2009, an increase of \$317.0 million or 57.3%. Details of Validus Re net premiums written by line of business are provided below.

|                               | Six Months Ended<br>June 30, 2010 |                                   | Six Months Ended<br>June 30, 2009 (a) |                                   | %<br>Change  |
|-------------------------------|-----------------------------------|-----------------------------------|---------------------------------------|-----------------------------------|--------------|
|                               | Net<br>Premiums<br>Written        | Net<br>Premiums<br>Written<br>(%) | Net<br>Premiums<br>Written            | Net<br>Premiums<br>Written<br>(%) |              |
| <b>(Dollars in thousands)</b> |                                   |                                   |                                       |                                   |              |
| Property                      | \$ 630,701                        | 72.5%                             | \$ 378,622                            | 68.4%                             | 66.6%        |
| Marine                        | 174,103                           | 20.0%                             | 116,739                               | 21.1%                             | 49.1%        |
| Specialty                     | 65,534                            | 7.5%                              | 57,966                                | 10.5%                             | 13.1%        |
| <b>Total</b>                  | <b>\$ 870,338</b>                 | <b>100.0%</b>                     | <b>\$ 553,327</b>                     | <b>100.0%</b>                     | <b>57.3%</b> |

(a) The results of operations for IPC are consolidated only from the

September 2009  
date of  
acquisition.

The increase in Validus Re net premiums written was driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded. The ratios of net premiums written to gross premiums written were 94.1% and 90.8% for the six months ended June 30, 2010 and 2009, respectively. The increase in the ratio of net premiums written to gross premiums written is a result of the increase in gross premiums written following the IPC Acquisition while reinsurance premium ceded remained relatively constant.

*Talbot.* Talbot net premiums written for the six months ended June 30, 2010 were \$359.0 million compared to \$346.8 million for the six months ended June 30, 2009, an increase of \$12.2 million or 3.5%. Details of Talbot net premiums written by line of business are provided below.

|                               | Six Months Ended<br>June 30, 2010 |                                | Six Months Ended<br>June 30, 2009 |                                | %<br>Change |
|-------------------------------|-----------------------------------|--------------------------------|-----------------------------------|--------------------------------|-------------|
|                               | Net<br>Premiums<br>Written        | Net<br>Premiums<br>Written (%) | Net<br>Premiums<br>Written        | Net<br>Premiums<br>Written (%) |             |
| <b>(Dollars in thousands)</b> |                                   |                                |                                   |                                |             |
| Property                      | \$ 91,226                         | 25.4%                          | \$ 84,532                         | 24.4%                          | 7.9%        |
| Marine                        | 152,353                           | 42.4%                          | 152,200                           | 43.9%                          | 0.1%        |
| Specialty                     | 115,413                           | 32.2%                          | 110,062                           | 31.7%                          | 4.9%        |
| <b>Total</b>                  | <b>\$ 358,992</b>                 | <b>100.0%</b>                  | <b>\$ 346,794</b>                 | <b>100.0%</b>                  | <b>3.5%</b> |

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

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for the six months ended June 30, 2010 and 2009 were 68.5% and 74.9%, respectively. This decrease was due primarily to the increase in quota share costs on the onshore energy lines, marine treaty lines and reinstatement premiums following the Chilean earthquake and Deepwater Horizon losses.

**Change in Unearned Premiums**

Change in unearned premiums for the six months ended June 30, 2010 was (\$333.7) million compared to (\$253.2) million for the six months ended June 30, 2009, a change of (\$80.5) million or 31.8%.

|                                       | <b>Six Months<br/>Ended<br/>June 30, 2010<br/>Change in<br/>Unearned<br/>Premiums</b> | <b>Six Months<br/>Ended<br/>June 30, 2009<br/>(a)<br/>Change in<br/>Unearned<br/>Premiums</b> | <b>%<br/>Change</b> |
|---------------------------------------|---|---|---------------------|
| <b>(Dollars in thousands)</b>         |   |   |                     |
| Change in gross unearned premium      | \$ (460,166)  | \$ (331,840)  | 38.7%               |
| Change in prepaid reinsurance premium | 126,474   | 78,678  | 60.7%               |
| <b>Net change in unearned premium</b> | <b>\$ (333,692)</b>   | <b>\$ (253,162)</b>   | <b>31.8%</b>        |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Validus Re.* Validus Re's net change in unearned premiums for the six months ended June 30, 2010 was (\$324.4) million compared to (\$215.2) million for the six months ended June 30, 2009, a change of (\$109.2) million, or 50.7%. The rate of change in unearned premiums has increased due primarily to the earnings effect of the increased premiums written as a result of the IPC Acquisition.

|                                       | <b>Six Months<br/>Ended<br/>June 30, 2010<br/>Change in<br/>Unearned<br/>Premiums</b> | <b>Six Months<br/>Ended<br/>June 30, 2009<br/>(a)<br/>Change in<br/>Unearned<br/>Premiums</b> | <b>%<br/>Change</b> |
|---------------------------------------|---|---|---------------------|
| <b>(Dollars in thousands)</b>         |   |   |                     |
| Change in gross unearned premium      | \$ (407,280)  | \$ (238,624)  | 70.7%               |
| Change in prepaid reinsurance premium | 82,904  | 23,441  | 253.7%              |
| <b>Net change in unearned premium</b> | <b>\$ (324,376)</b>   | <b>\$ (215,183)</b>   | <b>50.7%</b>        |

(a)

The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Talbot.* The Talbot net change in unearned premiums for the six months ended June 30, 2010 was (\$9.3) million compared to (\$38.0) million for the six months ended June 30, 2009, a change of \$28.7 million, or 75.5%.

|                                       | <b>Six Months<br/>Ended<br/>June 30, 2010<br/>Change in<br/>Unearned</b> | <b>Six Months<br/>Ended<br/>June 30, 2009<br/>Change in<br/>Unearned</b> |                     |
|---------------------------------------|--|--|---------------------|
| <b>(Dollars in thousands)</b>         | <b>Premiums</b>  | <b>Premiums</b>  | <b>%<br/>Change</b> |
| Change in gross unearned premium      | \$ (52,886)  | \$ (93,216)  | (43.3)%             |
| Change in prepaid reinsurance premium | 43,570   | 55,237   | (21.1)%             |
| <b>Net change in unearned premium</b> | <b>\$ (9,316)</b>  | <b>\$ (37,979)</b>   | <b>(75.5)%</b>      |

The net change in unearned premium is largely driven by seasonality of earnings and also as a result of the increased gross premiums written in the property lines, specifically onshore energy exposures and premiums written by Validus Reaseguros, Inc. on the property treaty lines, for the six months ended June 30, 2010, as compared to the six months ended June 30, 2009.

**Table of Contents****Net Premiums Earned**

Net premiums earned for the six months ended June 30, 2010 were \$895.6 million compared to \$647.0 million for the six months ended June 30, 2009, an increase of \$248.7 million or 38.4%. The increase in net premiums earned was driven by increased premiums earned in the Validus Re segment of \$207.8 million and increased premiums earned in the Talbot segment of \$40.9 million.

| (Dollars in thousands) | Six Months Ended<br>June 30, 2010 |                           | Six Months Ended<br>June 30, 2009 (a) |                           | %<br>Change  |
|------------------------|-----------------------------------|---------------------------|---------------------------------------|---------------------------|--------------|
|                        | Net<br>Premiums                   | Net<br>Premiums<br>Earned | Net<br>Premiums                       | Net<br>Premiums<br>Earned |              |
|                        | Earned                            | (%)                       | Earned                                | (%)                       |              |
| Property               | \$ 473,082                        | 52.8%                     | \$ 293,959                            | 45.4%                     | 60.9%        |
| Marine                 | 215,818                           | 24.1%                     | 189,254                               | 29.3%                     | 14.0%        |
| Specialty              | 206,738                           | 23.1%                     | 163,746                               | 25.3%                     | 26.3%        |
| <b>Total</b>           | <b>\$ 895,638</b>                 | <b>100.0%</b>             | <b>\$ 646,959</b>                     | <b>100.0%</b>             | <b>38.4%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

*Validus Re.* Validus Re net premiums earned for the six months ended June 30, 2010 were \$546.0 million compared to \$338.1 million for the six months ended June 30, 2009, an increase of \$207.8 million or 61.5%. The increase in Validus Re net premiums earned was due primarily to the IPC Acquisition.

| (Dollars in thousands) | Six Months Ended<br>June 30, 2010 |                           | Six Months Ended<br>June 30, 2009 (a) |                           | %<br>Change  |
|------------------------|-----------------------------------|---------------------------|---------------------------------------|---------------------------|--------------|
|                        | Net<br>Premiums                   | Net<br>Premiums<br>Earned | Net<br>Premiums                       | Net<br>Premiums<br>Earned |              |
|                        | Earned                            | (%)                       | Earned                                | (%)                       |              |
| Property               | \$ 397,887                        | 72.9%                     | \$ 232,649                            | 68.8%                     | 71.0%        |
| Marine                 | 89,183                            | 16.3%                     | 58,988                                | 17.4%                     | 51.2%        |
| Specialty              | 58,892                            | 10.8%                     | 46,507                                | 13.8%                     | 26.6%        |
| <b>Total</b>           | <b>\$ 545,962</b>                 | <b>100.0%</b>             | <b>\$ 338,144</b>                     | <b>100.0%</b>             | <b>61.5%</b> |

(a) The results of operations for IPC are consolidated only from the

September 2009  
date of  
acquisition.

The increase in net premiums earned is due primarily to \$65.4 million of historical IPC premiums earned from business in force at the time of the IPC Acquisition and \$104.6 million increase in gross premiums earned on new and renewing premiums. In addition, there was a \$18.2 million increase in reinstatement premiums earned and a \$24.7 million increase in related party premiums earned through the Talbot quota share, surplus treaty and excess of loss contracts.

*Talbot.* Talbot net premiums earned for the six months ended June 30, 2010 were \$349.7 million compared to \$308.8 million for the six months ended June 30, 2009, an increase of \$40.9 million or 13.2%.

|                               | Six Months Ended<br>June 30, 2010 |                           | Six Months Ended<br>June 30, 2009 |                           | %<br>Change  |
|-------------------------------|-----------------------------------|---------------------------|-----------------------------------|---------------------------|--------------|
|                               | Net<br>Premiums                   | Net<br>Premiums<br>Earned | Net<br>Premiums                   | Net<br>Premiums<br>Earned |              |
|                               | Earned                            | (%)                       | Earned                            | (%)                       |              |
| <b>(Dollars in thousands)</b> |                                   |                           |                                   |                           |              |
| Property                      | \$ 75,195                         | 21.5%                     | \$ 61,310                         | 19.8%                     | 22.6%        |
| Marine                        | 126,635                           | 36.2%                     | 130,266                           | 42.2%                     | (2.8)%       |
| Specialty                     | 147,846                           | 42.3%                     | 117,239                           | 38.0%                     | 26.1%        |
| <b>Total</b>                  | <b>\$ 349,676</b>                 | <b>100.0%</b>             | <b>\$ 308,815</b>                 | <b>100.0%</b>             | <b>13.2%</b> |

The increase in Talbot net premiums earned is due primarily to the increased levels of net premiums written by the onshore energy, aviation and other treaty lines over the six

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months ended June 30, 2010 compared with the six months ended June 30, 2009 as discussed above, together with earnings generated in 2010 in respect of increases in premium written in 2009.

**Losses and Loss Expenses**

Losses and loss expenses for the six months ended June 30, 2010 were \$673.4 million compared to \$256.6 million for the six months ended June 30, 2009, an increase of \$416.8 million or 162.5%. The loss ratios, defined as losses and loss expenses divided by net premiums earned, for the six months ended June 30, 2010 and 2009 were 75.2% and 39.7%, respectively. Details of loss ratios by line of business are provided below.

|                  | <b>Six Months<br/>Ended<br/>June 30, 2010</b> | <b>Six Months<br/>Ended<br/>June 30, 2009<br/>(a)</b> | <b>Percentage<br/>point<br/>change</b> |
|------------------|---|---|--|
| Property         | 93.8%   | 20.0%   | 73.8                                   |
| Marine           | 66.0%   | 60.0%   | 6.0                                    |
| Specialty        | 42.2%   | 51.4%   | (9.2)                                  |
| <b>All lines</b> | <b>75.2%</b>                                  | <b>39.7%</b>  | <b>35.5</b>                            |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the six months ended June 30, 2010.

|  | <b>Six Months Ended June 30, 2010</b> |               |                     |              |
|--|---------------------------------------|---------------|---------------------|--------------|
| <b>(Dollars in thousands)</b>          | <b>Validus<br/>Re</b>                 | <b>Talbot</b> | <b>Eliminations</b> | <b>Total</b> |
| Gross reserves at period beginning     | \$ 742,510                            | \$ 903,986    | \$ (24,362)         | \$ 1,622,134 |
| Losses recoverable at period beginning | (49,808)                              | (156,319)     | 24,362              | (181,765)    |
| Net reserves at period beginning       | 692,702                               | 747,667       |                     | 1,440,369    |
| Incurred losses – current year         | 502,068                               | 247,649       |                     | 749,717      |
| Change in prior accident years         | (29,355)                              | (46,937)      |                     | (76,292)     |
| Incurred losses                        | 472,713                               | 200,712       |                     | 673,425      |
| Paid losses                            | (183,038)                             | (123,046)     |                     | (306,084)    |
| Foreign exchange                       | (13,044)                              | (10,140)      |                     | (23,184)     |
| Net reserves at period end             | 969,333                               | 815,193       |                     | 1,784,526    |
| Losses recoverable                     | 60,145                                | 327,522       | (194,063)           | 193,604      |



|                              |              |              |              |              |
|------------------------------|--------------|--------------|--------------|--------------|
| Gross reserves at period end | \$ 1,029,478 | \$ 1,142,715 | \$ (194,063) | \$ 1,978,130 |
|------------------------------|--------------|--------------|--------------|--------------|

The amount of recorded reserves represents management's best estimate of expected losses and loss expenses on premiums earned. Favorable loss reserve development on prior years totaled \$76.3 million. \$29.4 million of the favorable development related to the Validus Re segment and \$46.9 million related to the Talbot segment. This favorable loss reserve development benefitted the Company's loss ratio by 8.5 percentage points for the six months ended June 30, 2010. For the six months ended June 30, 2010, the Company incurred \$417.1 million of notable losses, which represented 46.6 percentage points of the loss ratio. During the six months ended June 30, 2010, the Company made a provision for loss and loss expenses of \$20.0 million for a reserve for potential development on 2010 events. This represented 2.2 percentage points on the loss ratio. For the six months ended June 30, 2009, the Company incurred \$28.3 million of notable losses which represented 4.4 percentage points of the loss ratio. The Company's loss ratios, excluding prior year development and notable loss events for the six months ended June 30, 2010 and 2009 were 37.1% and 38.6%, respectively.

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

At June 30, 2010 and 2009, gross and net reserves for losses and loss expenses were estimated using the methodology as outlined in the critical accounting policies and estimates as discussed in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The Company did not make any significant changes in the assumptions or methodology used in its reserving process for the six months ended June 30, 2010.

| (Dollars in thousands) | As at June 30, 2010 |                     |                          |
|------------------------|---------------------|---------------------|--------------------------|
|                        |                     |                     | Total Gross Reserve for  |
|                        | Gross Case Reserves | Gross IBNR          | Losses and Loss Expenses |
| Property               | \$ 487,032          | \$ 472,328          | \$ 959,360               |
| Marine                 | 314,443             | 295,970             | 610,413                  |
| Specialty              | 150,746             | 257,611             | 408,357                  |
| <b>Total</b>           | <b>\$ 952,221</b>   | <b>\$ 1,025,909</b> | <b>\$ 1,978,130</b>      |

| (Dollars in thousands) | As at June 30, 2010 |                   |                          |
|------------------------|---------------------|-------------------|--------------------------|
|                        |                     |                   | Total Net Reserve for    |
|                        | Net Case Reserves   | Net IBNR          | Losses and Loss Expenses |
| Property               | \$ 457,214          | \$ 459,665        | \$ 916,879               |
| Marine                 | 256,096             | 266,363           | 522,459                  |
| Specialty              | 129,523             | 215,665           | 345,188                  |
| <b>Total</b>           | <b>\$ 842,833</b>   | <b>\$ 941,693</b> | <b>\$ 1,784,526</b>      |

*Validus Re.* Validus Re losses and loss expenses for the six months ended June 30, 2010 were \$472.7 million compared to \$96.6 million for the six months ended June 30, 2009, an increase of \$376.1 million or 389.4%. The Validus Re loss ratio, defined as losses and loss expenses divided by net premiums earned, was 86.6% and 28.6% for the six months ended June 30, 2010 and 2009, respectively. For the six months ended June 30, 2010, Validus Re incurred \$356.3 million of notable losses, which represented 65.3 percentage points of the segment loss ratio. For the six months ended June 30, 2009, Validus Re incurred \$19.4 million of notable losses, which represented 5.7 percentage points of the segment loss ratio. Validus Re segment loss ratios, excluding prior year development and loss events identified above, for the six months ended June 30, 2010 and 2009 were 26.7% and 24.3%, respectively.

| Six Months Ended June 30, |                                |            | Percentage point change |
|---------------------------|--------------------------------|------------|-------------------------|
|                           |                                |            |                         |
| Property                  | current year                   | 2010 99.9% | 2009 (a) 23.6%          |
| Property                  | change in prior accident years | (5.5)%     | (3.4)%                  |
|                           |                                |            | (2.1)                   |

|                  |                                |              |              |             |
|------------------|--------------------------------|--------------|--------------|-------------|
| Property         | loss ratio                     | 94.4%        | 20.2%        | 74.2        |
| Marine           | current year                   | 94.1%        | 56.9%        | 37.2        |
| Marine           | change in prior accident years | (8.6)%       | 8.4%         | (17.0)      |
| Marine           | loss ratio                     | 85.5%        | 65.3%        | 20.2        |
| Specialty        | current year                   | 35.1%        | 27.7%        | 7.4         |
| Specialty        | change in prior accident years | 0.3%         | (3.9)%       | 4.2         |
| Specialty        | loss ratio                     | 35.4%        | 23.8%        | 11.6        |
| All lines        | current year                   | 92.0%        | 30.0%        | 62.0        |
| All lines        | change in prior accident years | (5.4)%       | (1.4)%       | (4.0)       |
| <b>All lines</b> | <b>loss ratio</b>              | <b>86.6%</b> | <b>28.6%</b> | <b>58.0</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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For the six months ended June 30, 2010, the Validus Re property lines includes \$397.5 million related to current year losses and \$21.9 million of favorable development relating to prior accident years. This favorable development is attributable to reduced loss estimated for the Dublin and U.K. flood events and windstorm Kyrill, as well as lower than expected claim development elsewhere. For the six months ended June 30, 2010, Validus Re's property lines incurred \$295.6 million of notable losses, which represented 74.3 percentage points of the property loss ratio. For the six months ended June 30, 2009, Validus Re's property lines incurred \$16.7 million of notable losses, which represented 7.1 percentage points of the property lines loss ratio. Validus Re property line loss ratios, excluding prior year development and loss events identified above, for the six months ended June 30, 2010 and 2009 were 25.6% and 16.5%, respectively.

For the six months ended June 30, 2010, the Validus Re marine lines includes \$83.9 million related to current year losses and \$7.6 million of favorable development relating to prior accident years. For the six months ended June 30, 2010, Validus Re marine lines incurred \$53.2 million of notable losses, which represented 59.7 percentage points of the marine loss ratio. For the six months ended June 30, 2009, the Validus Re marine lines did not experience any notable losses. Validus Re marine line loss ratios, excluding prior year development and loss events identified above, for the six months ended June 30, 2010 and 2009 were 34.4% and 56.9%, respectively.

For the six months ended June 30, 2010, the Validus Re specialty lines includes \$20.7 million related to current year losses and \$0.2 million of adverse development relating to prior accident years. For the six months ended June 30, 2010, Validus Re specialty lines incurred \$7.5 million of notable losses, which represented 12.7 percentage points of the specialty loss ratio. Validus Re specialty lines loss ratios, excluding prior year development and loss events identified above, for the six months ended June 30, 2010 and 2009 were 22.4% and 23.1%, respectively.

*Talbot.* Talbot losses and loss expenses for the six months ended June 30, 2010 were \$200.7 million compared to \$160.0 million for the six months ended June 30, 2009, an increase of \$40.7 million, or 25.4%. Talbot incurred \$247.6 million related to current year losses and \$46.9 million of favorable loss development relating to prior accident years. Favorable loss reserve development benefitted the segment loss ratio by 13.4 percentage points for the six months ended June 30, 2010. For the six months ended June 30, 2010, Talbot incurred \$60.8 million of notable losses, which represented 17.4 percentage points of the segment loss ratio. For the six months ended June 30, 2009, Talbot incurred \$8.9 million of notable losses, which represented 2.9 percentage points of the segment loss ratio. Talbot loss ratios, excluding prior year development and loss events identified above, for the six months ended June 30, 2010 and 2009 were 53.4% and 54.2%, respectively. Details of loss ratios by line of business and calendar period are provided below.

|           |                                | Six months ended June 30, |         |                         |
|-----------|--------------------------------|---------------------------|---------|-------------------------|
|           |                                | 2010                      | 2009    | Percentage point change |
| Property  | current year                   | 109.4%                    | 45.8%   | 63.6                    |
| Property  | change in prior accident years | (18.7)%                   | (26.6)% | 7.9                     |
| Property  | loss ratio                     | 90.7%                     | 19.2%   | 71.5                    |
| Marine    | current year                   | 67.6%                     | 60.6%   | 7.0                     |
| Marine    | change in prior accident years | (15.3)%                   | (2.9)%  | (12.4)                  |
| Marine    | loss ratio                     | 52.3%                     | 57.7%   | (5.4)                   |
| Specialty | current year                   | 54.0%                     | 59.3%   | (5.3)                   |
| Specialty | change in prior accident years | (9.2)%                    | 3.1%    | (12.3)                  |
| Specialty | loss ratio                     | 44.8%                     | 62.4%   | (17.6)                  |

|                  |                                |         |        |       |
|------------------|--------------------------------|---------|--------|-------|
| All lines        | current year                   | 70.8%   | 57.1%  | 13.7  |
| All lines        | change in prior accident years | (13.4)% | (5.3)% | (8.1) |
| <b>All lines</b> | <b>loss ratio</b>              | 57.4%   | 51.8%  | 5.6   |
|                  |                                | 73      |        |       |

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For the six months ended June 30, 2010, the Talbot property lines includes \$82.3 million related to current year losses and \$14.1 million of favorable loss development relating to prior accident years. The prior year favorable development is primarily due to lower than expected claim development on the property facultative and binder accounts, together with favorable development on hurricanes Katrina and Ike. For the six months ended June 30, 2010, the Talbot property lines incurred \$42.5 million of notable losses, which represented 56.5 percentage points of the property lines loss ratio. For the six months ended June 30, 2009, the Talbot property lines incurred \$0.6 million of notable losses, which represented 1.0 percentage points of the property loss ratio. Talbot property line loss ratio, excluding prior year development and the loss events identified above, for the six months ended June 30, 2010 and 2009 were 52.9% and 44.8%, respectively.

For the six months ended June 30, 2010, the Talbot marine lines includes \$85.6 million related to current year losses and \$19.4 million of favorable development relating to prior accident years. The prior year favorable development is due to lower than expected attritional loss development mainly on the Hull lines. For the six months ended June 30, 2010, the Talbot marine lines incurred \$17.0 million of notable losses, which represented 13.4 percentage points of the marine loss ratio. For the six months ended June 30, 2009, the Talbot marine lines did not experience any notable loss events. Talbot marine lines loss ratios, excluding prior year development and the loss events identified above, for the six months ended June 30, 2010 and 2009 were 54.2% and 60.6%, respectively.

For the six months ended June 30, 2010, the Talbot specialty lines includes \$79.8 million relating to current year losses and \$13.5 million due to favorable development on prior accident years. The prior year favorable development is primarily due to lower than expected claims across most of the specialty sub-classes. For the six months ended June 30, 2010, Talbot incurred \$1.3 million of notable losses, which represented 0.9 percentage points of the specialty loss ratio. For the six months ended June 30, 2009, the Talbot specialty lines incurred \$8.3 million of notable losses, which represented 7.1 percentage points of the loss ratio. Talbot specialty lines loss ratios, excluding prior year development and the loss events identified above, for the six months ended June 30, 2010 and 2009 were 53.1% and 52.2%, respectively.

**Policy Acquisition Costs**

Policy acquisition costs for the six months ended June 30, 2010 were \$150.3 million compared to \$125.9 million for the six months ended June 30, 2009, an increase of \$24.4 million or 19.4%. Policy acquisition costs as a percent of net premiums earned for the six months ended June 30, 2010 and 2009 were 16.8% and 19.5%, respectively.

|                        | Six Months Ended<br>June 30, 2010 |                                       |  | Six Months Ended<br>June 30, 2009 (a) |                                       |  | %<br>Change  |
|------------------------|-----------------------------------|---------------------------------------|--|---------------------------------------|---------------------------------------|--|--------------|
|                        | Policy<br>Acquisition<br>Costs    | Policy<br>Acquisition<br>Costs<br>(%) | Policy<br>Acquisition<br>Cost<br>Ratio | Policy<br>Acquisition<br>Costs        | Policy<br>Acquisition<br>Costs<br>(%) | Policy<br>Acquisition<br>Cost<br>Ratio |              |
| (Dollars in thousands) | Costs                             | (%)                                   | Ratio                                  | Costs                                 | (%)                                   | Ratio                                  |              |
| Property               | \$ 67,716                         | 45.0%                                 | 14.3%                                  | \$ 48,299                             | 38.4%                                 | 16.4%                                  | 40.2%        |
| Marine                 | 41,145                            | 27.4%                                 | 19.1%                                  | 42,929                                | 34.1%                                 | 22.7%                                  | (4.2)%       |
| Specialty              | 41,441                            | 27.6%                                 | 20.0%                                  | 34,659                                | 27.5%                                 | 21.2%                                  | 19.6%        |
| <b>Total</b>           | <b>\$ 150,302</b>                 | <b>100.0%</b>                         | <b>16.8%</b>                           | <b>\$ 125,887</b>                     | <b>100.0%</b>                         | <b>19.5%</b>                           | <b>19.4%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of

acquisition.

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*Validus Re.* Validus Re policy acquisition costs for the six months ended June 30, 2010 were \$81.5 million compared to \$57.7 million for the six months ended June 30, 2009, an increase of \$23.8 million or 41.2%.

|                        | Six Months Ended<br>June 30, 2010 |                                       |                              | Six Months Ended<br>June 30, 2009 (a) |                                       |                              | %<br>Change  |
|------------------------|-----------------------------------|---------------------------------------|------------------------------|---------------------------------------|---------------------------------------|------------------------------|--------------|
|                        | Policy<br>Acquisition<br>Costs    | Policy<br>Acquisition<br>Costs<br>(%) | Acquisition<br>Cost<br>Ratio | Policy<br>Acquisition<br>Costs        | Policy<br>Acquisition<br>Costs<br>(%) | Acquisition<br>Cost<br>Ratio |              |
| (Dollars in thousands) | Costs                             | (%)                                   | Ratio                        | Costs                                 | (%)                                   | Ratio                        |              |
| Property               | \$ 59,440                         | 73.0%                                 | 14.9%                        | \$ 38,241                             | 66.3%                                 | 16.4%                        | 55.4%        |
| Marine                 | 14,516                            | 17.8%                                 | 16.3%                        | 13,662                                | 23.7%                                 | 23.2%                        | 6.3%         |
| Specialty              | 7,526                             | 9.2%                                  | 12.8%                        | 5,794                                 | 10.0%                                 | 12.5%                        | 29.9%        |
| <b>Total</b>           | <b>\$ 81,482</b>                  | <b>100.0%</b>                         | <b>14.9%</b>                 | <b>\$ 57,697</b>                      | <b>100.0%</b>                         | <b>17.1%</b>                 | <b>41.2%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

Policy acquisition costs include brokerage, commission and excise tax and are generally driven by contract terms, are normally a set percentage of premiums and are also net of ceding commission income on retrocessions. Validus Re policy acquisition costs as a percent of net premiums earned for the six months ended June 30, 2010 and 2009 were 14.9% and 17.1%, respectively. The Validus Re policy acquisition ratio decreased largely due to a 6.9 percentage point decrease on the marine policy acquisition ratio. The decrease in the marine policy acquisition ratio was due to a combination of adjustments to earned commission rates on the 2007 underwriting years and an increased proportion of reinstatement premiums over the six months ended June 30, 2010 which generally experience lower acquisition costs. *Talbot.* Talbot policy acquisition costs for the six months ended June 30, 2010 were \$73.6 million compared to \$69.3 million for the six months ended June 30, 2009, an increase of \$4.3 million or 6.2%.

|                        | Six Months Ended<br>June 30, 2010 |                                       |                              | Six Months Ended<br>June 30, 2009 |                                       |                              | %<br>Change |
|------------------------|-----------------------------------|---------------------------------------|------------------------------|-----------------------------------|---------------------------------------|------------------------------|-------------|
|                        | Policy<br>Acquisition<br>Costs    | Policy<br>Acquisition<br>Costs<br>(%) | Acquisition<br>Cost<br>Ratio | Policy<br>Acquisition<br>Costs    | Policy<br>Acquisition<br>Costs<br>(%) | Acquisition<br>Cost<br>Ratio |             |
| (Dollars in thousands) | Costs                             | (%)                                   | Ratio                        | Costs                             | (%)                                   | Ratio                        |             |
| Property               | \$ 12,880                         | 17.5%                                 | 17.1%                        | \$ 11,139                         | 16.0%                                 | 18.2%                        | 15.6%       |
| Marine                 | 26,709                            | 36.3%                                 | 21.1%                        | 29,267                            | 42.3%                                 | 22.5%                        | (8.7)%      |
| Specialty              | 34,003                            | 46.2%                                 | 23.0%                        | 28,865                            | 41.7%                                 | 24.6%                        | 17.8%       |
| <b>Total</b>           | <b>\$ 73,592</b>                  | <b>100.0%</b>                         | <b>21.0%</b>                 | <b>\$ 69,271</b>                  | <b>100.0%</b>                         | <b>22.4%</b>                 | <b>6.2%</b> |

Talbot policy acquisition costs as a percent of net premiums earned were 21.0% and 22.4%, respectively, for the six months ended June 30, 2010 and 2009. The decrease in the acquisition cost ratio is primarily driven by the impact of reinsurance commissions.



**General and Administrative Expenses**

General and administrative expenses for the six months ended June 30, 2010 were \$105.9 million compared to \$79.3 million for the six months ended June 30, 2009, an increase of \$26.7 million or 33.6%. The increase was primarily a result of increased Corporate segment expenses of \$18.9 million and increased Talbot expenses of \$8.3 million.

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|                          | Six Months Ended<br>June 30, 2010            |   | Six Months Ended<br>June 30, 2009 (a)        |   | %<br>Change  |
|--------------------------|--|---|--|---|--------------|
|                          | General<br>and<br>Administrative<br>Expenses | General<br>and<br>Administrative<br>Expenses<br>(%) | General<br>and<br>Administrative<br>Expenses | General<br>and<br>Administrative<br>Expenses<br>(%) |              |
| (Dollars in thousands)   |  |   |  |   |              |
| Validus Re               | \$ 27,295                                    | 25.7%   | \$ 27,941                                    | 35.2%   | (2.3)%       |
| Talbot                   | 50,508                                       | 47.7%   | 42,141                                       | 53.2%   | 19.9%        |
| Corporate & Eliminations | 28,145                                       | 26.6%   | 9,197  | 11.6%   | 206.0%       |
| <b>Total</b>             | <b>\$ 105,948</b>                            | <b>100.0%</b>                                       | <b>\$ 79,279</b>                             | <b>100.0%</b>                                       | <b>33.6%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

General and administrative expenses of \$105.9 million in the six months ended June 30, 2010 represents 11.8 percentage points of the expense ratio. Share compensation expense is discussed in the following section. *Validus Re.* Validus Re general and administrative expenses for the six months ended June 30, 2010 were \$27.3 million compared to \$27.9 million for the six months ended June 30, 2009, a decrease of \$0.6 million or 2.3%. *Talbot.* Talbot general and administrative expenses for the six months ended June 30, 2010 were \$50.5 million compared to \$42.1 million for the six months ended June 30, 2009, an increase of \$8.4 million or 19.9%. Talbot general and administrative expenses have increased primarily as a result of the increase of \$3.5 million in Talbot's syndicate costs, Lloyd's subscription and central fund costs due to higher gross premiums written. Talbot's general and administrative expenses as a percent of net premiums earned for the six months ended June 30, 2010 and 2009 were 14.4% and 13.6%, respectively.

*Corporate & Eliminations.* Corporate general and administrative expenses for the six months ended June 30, 2010 were \$28.1 million compared to \$9.2 million for the six months ended June 30, 2009, an increase of \$18.9 million or 205.4%. During the first quarter of 2010, to better align the Company's operating and reporting structure with its current strategy, there was a change in segment structure. Prior periods have not been restated as the change is immaterial to the consolidated financial statements. This change was to allocate all non-core underwriting expenses, predominantly general and administration and stock compensation expenses to the corporate function. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other costs relating to the company as a whole. General and administrative expenses have increased as a result of an increase in headcount from 66 at June 30, 2009 to 89 at June 30, 2010. In addition, there was an increase of \$2.6 million in legal fees and other expenses for the six months ended June 30, 2010.

**Share Compensation Expenses**

Share compensation expenses for the six months ended June 30, 2010 were \$13.4 million compared to \$13.0 million for the six months ended June 30, 2009, an increase of \$0.4 million or 3.4%. These expenses are non-cash and have no net effect on total shareholders' equity, as they are balanced by an increase in additional paid-in capital.

|                          | Six Months Ended<br>June 30, 2010 |                                   | Six Months Ended<br>June 30, 2009 (a) |                                   | %<br>Change |
|--------------------------|-----------------------------------|-----------------------------------|---------------------------------------|-----------------------------------|-------------|
|                          | Share<br>Compensation             | Share<br>Compensation<br>Expenses | Share<br>Compensation                 | Share<br>Compensation<br>Expenses |             |
| (Dollars in thousands)   | Expenses                          | (%)                               | Expenses                              | (%)                               |             |
| Validus Re               | \$ 3,378                          | 25.1%                             | \$ 3,220                              | 24.8%                             | 4.9%        |
| Talbot                   | 3,027                             | 22.6%                             | 4,433                                 | 34.1%                             | (31.7)%     |
| Corporate & Eliminations | 7,017                             | 52.3%                             | 5,333                                 | 41.1%                             | 31.6%       |
| <b>Total</b>             | <b>\$ 13,422</b>                  | <b>100.0%</b>                     | <b>\$ 12,986</b>                      | <b>100.0%</b>                     | <b>3.4%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

Share compensation expenses of \$13.4 million in the six months ended June 30, 2010 represent 1.5 percentage points of the general and administrative expense ratio.

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*Validus Re.* Validus Re share compensation expenses for the six months ended June 30, 2010 were \$3.4 million compared to \$3.2 million for the six months ended June 30, 2009, an increase of \$0.2 million or 4.9%. Share compensation expenses as a percent of net premiums earned for the six months ended June 30, 2010 and 2009 were 0.6% and 1.0%, respectively.

*Talbot.* Talbot share compensation expenses for the six months ended June 30, 2010 were \$3.0 million compared to \$4.4 million for the six months ended June 30, 2009, a decrease of \$1.4 million or 31.7%. This decrease was due to lower costs in the six months ended June 30, 2010 as a result of accelerated vesting in the six months ended June 30, 2009. Share compensation expenses as a percent of net premiums earned for the six months ended June 30, 2010 and 2009 were 0.9% and 1.4%, respectively.

*Corporate & Eliminations.* Corporate share compensation expenses for the six months ended June 30, 2010 were \$7.0 million compared to \$5.3 million for the six months ended June 30, 2009, an increase of \$1.7 million or 31.6%.

**Selected Ratios**

The underwriting results of an insurance or reinsurance company are often measured by reference to its combined ratio, which is the sum of the loss ratio and the expense ratio. The net loss ratio is calculated by dividing losses and loss expenses incurred (including estimates for incurred but not reported losses) by net premiums earned. The expense ratio is calculated by dividing acquisition costs combined with general and administrative expenses by net premiums earned. The following table presents the losses and loss expenses ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the six months ended June 30, 2010 and 2009.

|   | <b>Six Months<br/>Ended<br/>June 30, 2010</b> | <b>Six Months<br/>Ended<br/>June 30, 2009<br/>(a)</b> | <b>Percentage<br/>point<br/>change</b> |
|---|---|---|--|
| Losses and loss expenses                | 75.2%   | 39.7%   | 35.5                                   |
| Policy acquisition costs                | 16.8%   | 19.5%   | (2.7)                                  |
| General and administrative expenses (b) | 13.3%   | 14.3%   | (1.0)                                  |
| <b>Expense ratio</b>                    | 30.1%   | 33.8%   | (3.7)                                  |
| <b>Combined ratio</b>                   | 105.3%  | 73.5%   | 31.8                                   |

|   | <b>Six Months<br/>Ended<br/>June 30, 2010</b> | <b>Six Months<br/>Ended<br/>June 30, 2009<br/>(a)</b> | <b>Percentage<br/>point<br/>change</b> |
|---|---|---|--|
| <i>Validus Re</i>                       |   |   |  |
| Losses and loss expenses                | 86.6%   | 28.6%   | 58.0                                   |
| Policy acquisition costs                | 14.9%   | 17.1%   | (2.2)                                  |
| General and administrative expenses (b) | 5.6%  | 9.2%  | (3.6)                                  |
| <b>Expense ratio</b>                    | 20.5%   | 26.3%   | (5.8)                                  |
| <b>Combined ratio</b>                   | 107.1%  | 54.9%   | 52.2                                   |

|               | <b>Six Months<br/>Ended<br/>June 30, 2010</b> | <b>Six Months<br/>Ended<br/>June 30, 2009</b> | <b>Percentage<br/>point<br/>change</b> |
|---------------|---|---|--|
| <i>Talbot</i> |   |   |  |

|   |              |              |              |
|---|--------------|--------------|--------------|
| Losses and loss expenses                | 57.4%        | 51.8%        | 5.6          |
| Policy acquisition costs                | 21.0%        | 22.4%        | (1.4)        |
| General and administrative expenses (b) | 15.3%        | 15.1%        | 0.2          |
| <b>Expense ratio</b>                    | <b>36.3%</b> | <b>37.5%</b> | <b>(1.2)</b> |
| <b>Combined ratio</b>                   | <b>93.7%</b> | <b>89.3%</b> | <b>4.4</b>   |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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

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General and administrative expense ratios for the six months ended June 30, 2010 and 2009 were 13.3% and 14.3%, respectively. General and administrative expense ratio is the sum of general and administrative expenses and share compensation expense divided by net premiums earned.

| (Dollars in thousands)              | Six Months Ended<br>June 30, 2010 |   | Six Months Ended<br>June 30, 2009 (a) |   |
|-------------------------------------|-----------------------------------|---|---------------------------------------|---|
|                                     | Expenses                          | Expenses as<br>% of<br>Net Earned<br>Premiums | Expenses                              | Expenses as<br>% of<br>Net Earned<br>Premiums |
| General and administrative expenses | \$ 105,948                        | 11.8%   | \$ 79,279                             | 12.3%   |
| Share compensation expenses         | 13,422                            | 1.5%  | 12,986                                | 2.0%  |
| <b>Total</b>                        | <b>\$ 119,370</b>                 | <b>13.3%</b>                                  | <b>\$ 92,265</b>                      | <b>14.3%</b>                                  |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

**Underwriting (Loss) Income**

Underwriting (loss) income for the six months ended June 30, 2010 was (\$47.5) million compared to \$172.2 million for the six months ended June 30, 2009, a decrease of \$219.7 million or 127.6%.

| (Dollars in thousands)   | Six Months ended June 30, |                      |                   |                      |                 |
|--------------------------|---------------------------|----------------------|-------------------|----------------------|-----------------|
|                          | 2010                      | % of<br>Sub<br>total | 2009 (a)          | % of<br>Sub<br>total | %<br>Change     |
| Validus Re               | \$ (38,906)               | 227.9%               | \$ 152,703        | 82.2%                | (125.5)%        |
| Talbot                   | 21,837                    | (127.9)%             | 32,968            | 17.8%                | (33.8)%         |
| Sub total                | (17,069)                  | 100.0%               | 185,671           | 100.0%               | (109.2)%        |
| Corporate & Eliminations | (30,390)                  |                      | (13,449)          |                      | (126.0)%        |
| <b>Total</b>             | <b>\$ (47,459)</b>        |                      | <b>\$ 172,222</b> |                      | <b>(127.6)%</b> |

(a) The results of operations for IPC are consolidated only from the September 2009

date of  
acquisition.

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

|  | Six Months<br>Ended<br>June 30, 2010 | Six Months<br>Ended<br>June 30, 2009<br>(a) |
|--|--------------------------------------|---|
| <b>(Dollars in thousands)</b>                |                                      |   |
| <b>Underwriting income (loss)</b>            | \$ (47,459)                          | \$ 172,222                                  |
| Net investment income                        | 69,108                               | 53,735                                      |
| Other income                                 | 3,585                                | 1,774                                       |
| Finance expenses                             | (28,369)                             | (18,475)                                    |
| Foreign exchange (losses) gains              | (12,863)                             | 4,232                                       |
| Gain on bargain purchase, net of expenses    |                                      | (15,851)                                    |
| Net realized gains (losses) on investments   | 23,839                               | (26,071)                                    |
| Net unrealized gains (losses) on investments | 57,053                               | 59,402                                      |
| <b>Net income before taxes</b>               | \$ 64,894                            | \$ 230,968                                  |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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

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

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

**Net Investment Income**

Net investment income for the six months ended June 30, 2010 was \$69.1 million compared to \$53.7 million for the six months ended June 30, 2009, an increase of \$15.4 million or 28.6%. Net investment income increased due primarily to a larger fixed maturity portfolio as a result of the IPC Acquisition. Net investment income is comprised of accretion of premium or discount on fixed maturities, interest on coupon-paying bonds, short-term investments and cash and cash equivalents, partially offset by investment management fees. The components of net investment income for the six months ended June 30, 2010 and 2009 are as presented below.

|   | Six Months<br>Ended | Six Months<br>Ended  | %       |
|---|---------------------|----------------------|---------|
| (Dollars in thousands)                      | June 30, 2010       | June 30, 2009<br>(a) | Change  |
| Fixed maturities and short-term investments | \$ 72,101           | \$ 52,914            | 36.3%   |
| Cash and cash equivalents                   | 897                 | 1,881                | (52.3)% |
| Securities lending income                   | 119                 | 512                  | (76.8)% |
| Total investment income                     | 73,117              | 55,307               | 32.2%   |
| Investment expenses                         | (4,009)             | (1,572)              | 155.0%  |



|                              |    |        |    |        |       |
|------------------------------|----|--------|----|--------|-------|
| <b>Net investment income</b> | \$ | 69,108 | \$ | 53,735 | 28.6% |
|------------------------------|----|--------|----|--------|-------|

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

Annualized effective investment yield is based on the weighted average investments held calculated on a simple period average and excludes net unrealized gains (losses), foreign exchange gains (losses) on investments and the

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foreign exchange effect of insurance balances. The Company's annualized effective investment yield was 2.36% and 3.14% for the six months ended June 30, 2010 and 2009, respectively and the average duration at June 30, 2010 was 2.2 years (December 31, 2009 - 2.2 years).

**Finance Expenses**

Finance expenses for the six months ended June 30, 2010 were \$28.4 million compared to \$18.5 million for the six months ended June 30, 2009, an increase of \$9.9 million or 53.6%. The increase was primarily driven by \$9.6 million in interest expense relating to the 8.875% Senior Notes due 2010 which were issued in the first quarter of 2010.

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

|  | <b>Six Months Ended June 30,</b> |                  |               |
|--|----------------------------------|------------------|---------------|
|  | <b>2010</b>                      |                  | <b>%</b>      |
| <b>(Dollars in thousands)</b>                    | <b>2010</b>                      | <b>2009 (a)</b>  | <b>Change</b> |
| 9.069% Junior Subordinated Deferrable Debentures | \$ 7,177                         | \$ 7,177         | 0.0%          |
| 8.480% Junior Subordinated Deferrable Debentures | 6,057                            | 6,696            | (9.5)%        |
| 8.875% Senior Notes due 2040                     | 9,575                            |                  | NM            |
| Credit facilities                                | 2,420                            | 840              | 188.1%        |
| Talbot FAL Facility                              | 333                              | 105              | 217.1%        |
| Talbot other interest                            | 59                               |                  | NM            |
| Talbot third party FAL facility                  | 2,748                            | 3,657            | (24.9)%       |
| <b>Finance expenses</b>                          | <b>\$ 28,369</b>                 | <b>\$ 18,475</b> | <b>53.6%</b>  |

NM: Not Meaningful

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

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

For each year of account up to and including the 2007 year of account, between 30% and 40% of an amount equivalent to each underwriting year's profit is payable to Talbot third party FAL providers. However, some of these costs are fixed. There are no FAL finance charges related to the 2008, 2009 and 2010 years of account as there were no third party FAL providers in those periods. The FAL finance charges relate to total syndicate profit (underwriting income, investment income and realized and unrealized capital gains and losses).

FAL finance charges are based on syndicate profit but include fixed elements. FAL finance charges for the six months ended June 30, 2010 were \$2.8 million compared to \$3.7 million for the six months ended June 30, 2009, a decrease of \$0.9 million. This decrease was due to the absence of FAL finance charges related to the 2006 year of account, which has now closed.

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

Net realized gains on investments for the six months ended June 30, 2010 were \$23.8 million compared to (losses) of (\$26.1) million for the six months ended June 30, 2009.

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

Net unrealized gains on investments for the six months ended June 30, 2010 were \$57.1 million compared to gains of \$59.4 million for the six months ended June 30, 2009. The net unrealized gains in the six months ended June 30, 2010 resulted from improved market conditions for fixed income securities.

Net unrealized gains on investments are recorded as a component of net income. The Company has adopted all authoritative guidance on U.S. GAAP fair value measurements in effect as of the balance sheet date. Consistent with these statements, certain market conditions allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable. Certain non-Agency RMBS securities were identified as trading in inactive markets. The change in fair value for the identified non-Agency RMBS securities was a \$1.6 million increase in net unrealized loss on investments for the six months ended June 30, 2010. Further details are provided in the Investments section below.

### **Other Income**

Other income for the six months ended June 30, 2010 was \$3.6 million compared to \$1.8 million for the six months ended June 30, 2009, an increase of \$1.8 million or 102.1%.

### **Foreign Exchange (Losses) Gains**

Foreign exchange (losses) for the six months ended June 30, 2010 were (\$12.9) million compared to gains of \$4.2 million for the six months ended June 30, 2009, an increase in foreign exchange (losses) of \$17.1 million. The increase in foreign exchange (losses) was due primarily to the increased value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency for the six months ended June 30, 2010, as compared to the six months ended June 30, 2009. For the six months ended June 30, 2010, Validus Re and Talbot recognized foreign exchange (losses) of (\$6.0) million and (\$6.8) million, respectively.

For the six months ended June 30, 2010, the Validus Re segment foreign exchange (losses) were (\$6.0) million compared to (losses) of (\$1.4) million for the six months ended June 30, 2009, an increase of (\$4.6) million. The increase in Validus Re foreign exchange (losses) was due to the net long position on premium receivable assets denominated in Euro and British pound sterling. During the six months ended June 30, 2010, the Euro and British pound sterling depreciated by 14.8 and 5.4 percent, respectively.

For the six months ended June 30, 2010, the Talbot segment foreign exchange (losses) were (\$6.8) million compared to gains of \$5.6 million for the six months ended June 30, 2009, an increase in foreign exchange (losses) of \$12.4 million. The adverse change in Talbot segment foreign exchange (losses) was due primarily to a weakening of the British pound sterling relative to the U.S. dollar for the six months ended June 30, 2010. The British pound sterling to U.S. Dollar exchange rates were 1.59 and 1.51 at December 31, 2009 and June 30, 2010, respectively. Certain premiums receivable and liabilities for losses incurred in currencies other than the U.S. dollar are exposed to the risk of changes in value resulting from fluctuations in foreign exchange rates and may affect financial results in the future.

### **Transaction Expenses**

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

**Table of Contents****Tax (Expenses) Benefit**

Tax expense for the six months ended June 30, 2010 was (\$3.5) million compared to a benefit of \$1.5 million for the six months ended June 30, 2009, a change of \$5.0 million. This was predominantly due to increased U.K. taxable profits in the Talbot segment. The income tax benefit for the six months ended June 30, 2009 was due to U.K. taxable losses, due primarily to syndicate 1183 s 2008 and 2009 years of account.

**Other Non-GAAP Financial Measures**

In presenting the Company's results, management has included and discussed certain schedules containing net operating income (loss), underwriting income, annualized return on average equity and diluted book value per common share that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. The calculation of annualized return on average equity is discussed in the section above entitled Financial Measures. A reconciliation of underwriting income to net income, the most comparable U.S. GAAP financial measure, is presented above in the section entitled Underwriting Income. A reconciliation of diluted book value per share to book value per share, the most comparable U.S. GAAP financial measure, is presented below. Operating income is calculated based on net income (loss) excluding net realized gains (losses), net unrealized gains (losses) on investments, gains (losses) arising from translation of non-US\$ denominated balances and non-recurring items. A reconciliation of operating income to net income, the most comparable U.S. GAAP financial measure, is embedded in the table presenting results of operations for the six months ended June 30, 2010 and 2009 in the section above entitled Results of Operations. Realized gains (losses) from the sale of investments are driven by the timing of the disposition of investments, not by our operating performance. Gains (losses) arising from translation of non-US\$ denominated balances are unrelated to our underlying business.

The following tables present reconciliations of diluted book value per share to book value per share, the most comparable U.S. GAAP financial measure, at June 30, 2010 and December 31, 2009.

| As at June 30, 2010                           |                  |             |                   | Book Value<br>Per<br>Share |
|---|------------------|-------------|-------------------|----------------------------|
|   | Equity<br>Amount | Shares      | Exercise<br>Price |                            |
| <b>Book value per common share</b>            |                  |             |                   |                            |
| Total shareholders' equity                    | \$ 3,602,926     | 111,407,993 |                   | \$ 32.34                   |
| <b>Diluted book value per common share</b>    |                  |             |                   |                            |
| Total shareholders' equity                    | 3,602,926        | 111,407,993 |                   |                            |
| Assumed exercise of outstanding warrants      | 139,576          | 7,952,138   | \$ 17.55          |                            |
| Assumed exercise of outstanding stock options | 63,920           | 3,222,164   | \$ 19.84          |                            |
| Unvested restricted shares                    |                  | 3,058,281   |                   |                            |
| <b>Diluted book value per common share</b>    | \$ 3,806,422     | 125,640,576 |                   | \$ 30.30                   |

| As at December 31, 2009 |                  |        |                   | Book Value<br>Per<br>Share |
|-------------------------|------------------|--------|-------------------|----------------------------|
|                         | Equity<br>Amount | Shares | Exercise<br>Price |                            |

**Book value per common share**

|                            |              |             |    |       |
|----------------------------|--------------|-------------|----|-------|
| Total shareholders' equity | \$ 4,031,120 | 128,459,478 | \$ | 31.38 |
|----------------------------|--------------|-------------|----|-------|

**Diluted book value per common share**

|   |                     |                    |           |              |
|---|---------------------|--------------------|-----------|--------------|
| Total shareholders' equity                    | 4,031,120           | 128,459,478        |           |              |
| Assumed exercise of outstanding warrants      | 139,576             | 7,952,138          | \$        | 17.55        |
| Assumed exercise of outstanding stock options | 65,159              | 3,278,015          | \$        | 19.88        |
| Unvested restricted shares                    |                     | 3,020,651          |           |              |
| <b>Diluted book value per common share</b>    | <b>\$ 4,235,855</b> | <b>142,710,282</b> | <b>\$</b> | <b>29.68</b> |

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

Validus Holdings, Ltd. is a holding company and conducts no operations of its own. The Company relies primarily on cash dividends and other permitted payments from Validus Re and Talbot to pay finance expenses and other holding company expenses. There are restrictions on the payment of dividends from Validus Re and Talbot to the Company. Please refer to Part II, Item 5, *Market for Registrants, Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities* in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 for further discussion of the Company's dividend policy.

Three main sources provide cash flows for the Company: operating activities, investing activities and financing activities. Cash flow from operating activities is derived primarily from the net receipt of premiums less claims and expenses related to underwriting activities. Cash flow from investing activities is derived primarily from the receipt of net proceeds on the Company's total investment portfolio. Cash flow from financing activities is derived primarily from the issuance of common shares and debentures payable. The movement in net cash provided by operating activities, net cash provided (used in) by investing activities, net cash (used in) provided by financing activities and the effect of foreign currency rate changes on cash and cash equivalents for the six months ended June 30, 2010 and 2009 is described in the following table.

|  | <b>Six Months Ended June 30,</b> |                    |                     |
|--|----------------------------------|--------------------|---------------------|
| <b>(Dollars in thousands)</b>  | <b>2010</b>                      | <b>2009 (a)</b>    | <b>%<br/>Change</b> |
| Net cash provided by operating activities                            | \$ 263,582                       | \$ 209,811         | 25.6%               |
| Net cash provided by (used in) investing activities                  | 101,434                          | (310,974)          | 132.6%              |
| Net cash (used in) provided by financing activities                  | (243,398)                        | 28,080             | 966.8%              |
| Effect of foreign currency rate changes on cash and cash equivalents | (16,714)                         | 13,325             | (225.4)%            |
| <b>Net increase (decrease) in cash</b>                               | <b>\$ 104,904</b>                | <b>\$ (59,758)</b> | <b>(275.5)%</b>     |

(a) The results of operations for IPC are consolidated only from the September 2009 date of acquisition.

During the six months ended June 30, 2010, net cash provided by operating activities of \$263.6 million was driven primarily by a \$452.5 million change in unearned premiums relating to increased premiums written following the IPC Acquisition. In addition, there was an increase of \$367.8 million in reserve for losses and loss expenses primarily due to the increase notable loss events in the six months ended June 30, 2010 and a \$61.4 million contribution from net income in the six months ended June 30, 2010. These amounts were partially offset by an increase of \$383.7 million in premiums receivable and a combined \$166.2 million decrease in deferred acquisition costs and prepaid reinsurance premiums. Net cash provided by investing activities of \$101.4 million was driven primarily by the net sales of short term investments. Net cash used in financing activities of \$243.4 million was driven primarily by the purchase of \$444.0 million of common shares under the share repurchase program and the payment of \$56.0 million in quarterly dividend, partially offset by the issuance \$246.8 million of 8.875% Senior Notes due 2040.

During the six months ended June 30, 2009, net cash provided by operating activities of \$209.8 million was driven primarily by net income of \$232.5 million. Cash provided by operating activities was impacted by the relative movement in change in reserves for losses and loss expenses for the six months ended June 30, 2009, due primarily to

the settlement of 2008 loss reserves. Net cash used in investing activities of was driven primarily by the investment of operating surpluses. Net cash provided by financing activities of \$28.1 million was driven primarily by an increase in securities lending payable of \$63.2 million, partially offset by quarterly dividend payments of \$34.0 million.



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As at June 30, 2010, the Company's portfolio was composed of fixed income investments including; cash, short-term investments, agency securities and sovereign securities amounting to \$5,270.9 million or 91.4% of total cash and investments. Details of the Company's debt and financing arrangements at June 30, 2010 are provided below.

| <b>(Dollars in thousands)</b>                            | <b>Maturity<br/>Date /<br/>Term</b> | <b>In Use/<br/>Outstanding</b> |
|--|-------------------------------------|--------------------------------|
| 9.069% Junior Subordinated Deferrable Debentures         | June 15, 2036                       | \$ 150,000                     |
| 8.480% Junior Subordinated Deferrable Debentures         | June 15, 2037                       | 139,800                        |
|  | January 26,<br>2040                 | 250,000                        |
| 8.875% Senior Notes due 2040                             |                                     |                                |
| \$340,000 syndicated unsecured letter of credit facility | March 12, 2012                      |                                |
| \$60,000 bilateral unsecured letter of credit facility   | March 12, 2012                      |                                |
| \$500,000 secured letter of credit facility              | March 12, 2012                      | 239,056                        |
| Talbot FAL facility                                      | April 13, 2011                      | 25,000                         |
|  | December 31,<br>2010                | 77,603                         |
| \$350,000 IPC Bi-Lateral Facility                        |                                     |                                |
| <b>Total</b>   |                                     | <b>\$ 881,459</b>              |

**Capital Resources**

Shareholders' equity at June 30, 2010 was \$3,602.9 million.

On February 17, 2010, the Company announced that its Board of Directors (the "Board") had increased the Company's annual dividend by 10% from \$0.80 to \$0.88 per common share and common share equivalent for which each outstanding warrant is exercisable. On May 5, 2010, the Company announced a quarterly cash dividend of \$0.22 per each common share and \$0.22 per common share equivalent, for which each outstanding warrant is then exercisable, payable on June 30, 2010 to holders of record on June 15, 2010. The timing and amount of any future cash dividends, however, will be at the discretion of the Board and will depend upon our results of operations and cash flows, our financial position and capital requirements, general business conditions, legal, tax, regulatory, rating agency and contractual constraints or restrictions and any other factors that the Board deems relevant.

On August 4, 2010, the Company announced a quarterly cash dividend of \$0.22 per each common share and \$0.22 per common share equivalent for which each outstanding warrant is exercisable, payable on September 30, 2010 to holders of record on September 15, 2010.

The Company may from time to time repurchase its securities, including common shares and Junior Subordinated Deferrable Debentures. On February 17, 2010, the Board authorized the Company to return up to \$750.0 million to shareholders. To this end, the Board expanded the Company's current share repurchase program authorizing the Company to repurchase up to \$750.0 million of common shares. This amount is in addition to, and in excess of, the \$135.5 million of common shares repurchased by the Company through February 17, 2010 under its previously authorized \$400.0 million share repurchase program announced in November 2009. This amount is in addition to the Company's previously authorized \$750.0 million share repurchase program. The Company expects the purchases 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 at any time. For the period November 4, 2009 through August 4, 2010 the Company repurchased 20,761,694 shares at a cost of \$532.4 million under the share repurchase program.

On August 7, 2008, the Company filed a shelf registration statement on Form S-3 (No. 333-152856) with the U.S. Securities Exchange Committee in which we may offer from time to time common shares, preference shares, depository shares representing common shares or preference shares, senior or subordinated debt securities, warrants to

purchase common shares, preference shares and debt securities, share purchase contracts, share purchase units and units which may consist of any combination of the securities listed above. In addition, the shelf registration statement will provide for secondary sales of common shares sold by the Company's shareholders. The registration

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statement is intended to provide the Company with additional flexibility to access capital markets for general corporate purposes, subject to market conditions and the Company's capital needs.

The following table details the capital resources of the Company's more significant subsidiaries on an unconsolidated basis.

| <b>(Dollars in thousands)</b>                                   | <b>Capital at<br/>June 30, 2010</b> |
|---|-------------------------------------|
| Validus Reinsurance, Ltd. (consolidated), excluding IPCRe, Ltd. | \$ 2,712,291                        |
| IPCRe, Ltd  | 776,602                             |
| <b>Total Validus Reinsurance, Ltd. (consolidated)</b>           | <b>3,488,893</b>                    |
| Talbot Holdings, Ltd  | 650,653                             |
| <b>Total consolidated capitalization</b>                        | <b>4,139,546</b>                    |
| Senior notes payable  | (246,820)                           |
| Debentures payable  | (289,800)                           |
| <b>Total shareholders' equity</b>                               | <b>\$ 3,602,926</b>                 |

Please refer to the discussion of capital resources in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. There have been no other material changes to this discussion.

**Recent accounting pronouncements**

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

**Debt and Financing Arrangements**

The following table details the Company's borrowings and credit facilities as at June 30, 2010.

| <b>(Dollars in thousands)</b>                            | <b>Commitments<br/>(1)</b> | <b>Outstanding</b> |
|--|----------------------------|--------------------|
| 9.069% Junior Subordinated Deferrable Debentures         | \$ 150,000                 | \$ 150,000         |
| 8.480% Junior Subordinated Deferrable Debentures         | 200,000                    | 139,800            |
| 8.875% Senior Notes due 2040                             | 250,000                    | 250,000            |
| \$340,000 syndicated unsecured letter of credit facility | 340,000                    |                    |
| \$60,000 bilateral unsecured letter of credit facility   | 60,000                     |                    |
| \$500,000 secured letter of credit facility              | 500,000                    | 239,056            |
| Talbot FAL Facility (2)                                  | 25,000                     | 25,000             |
| \$350,000 IPC Bi-Lateral Facility                        | 350,000                    | 77,603             |
| <b>Total</b>   | <b>\$ 1,875,000</b>        | <b>\$ 881,459</b>  |

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

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

Please refer to Note 8 to the consolidated financial statements (Part I, Item I) for further discussion of the Company's debt and financing arrangements.

#### **Ratings**

**A.M. Best** The ratings assigned by The A.M. Best Company (A.M. Best) were most recently affirmed on September 9, 2009. The ratings assigned by A.M. Best to the Company and its subsidiaries are as follows: Validus

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Holdings, Ltd. issuer credit rating of bbb- and the Company's indicative ratings for securities available under the shelf registration at bbb- on senior debt, bb+ on subordinated debt and bb on preferred stock. Financial strength ratings at A- and issuer credit ratings at a- for Validus Reinsurance Ltd., IPCRe and IPCRe Europe Ltd. The outlook is stable for all ratings assigned by A.M. Best.

On January 27, 2010, A.M. Best assigned a debt rating of bbb- to the Company's \$250.0 million 8.875% senior notes due 2040. The assigned outlook for the notes is stable.

**Standard & Poor's** On January 20, 2010, Standard & Poor's (S&P) assigned a BBB- rating to the Company's \$250.0 million 30 year senior notes due 2040. At the same time, S&P affirmed their BBB- counterparty credit rating on the Company. The outlook on the counterparty credit rating is Positive, having been revised from Stable on July 10, 2009. On September 8, 2009, S&P published a full credit analysis on Validus which confirmed the BBB- counterparty credit rating with a positive outlook.

**Moody's Investors Service** On January 20, 2010, Moody's Investors Service assigned a Baa2 rating to the 30 year senior unsecured debt of Validus. At the same time, Moody's affirmed the other ratings on the Company and its subsidiaries as follows. Validus Holdings, Ltd. long term issuer rating at Baa2. Validus Reinsurance, Ltd. insurance financial strength at A3. The outlook is stable for all ratings assigned by Moody's.

**Fitch Ratings** On May 13, 2010, Fitch Ratings (Fitch) initiated coverage on Validus by issuing an A- Insurer Financial Strength rating to Validus Reinsurance, Ltd., a BBB+ Issuer Default Rating to Validus Holdings, Ltd., and a BBB rating to Validus Holdings, Ltd.'s senior unsecured notes. All Fitch ratings were assigned with a stable outlook.

## **Investments**

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

Substantially all of the fixed maturity investments held at June 30, 2010 were publicly traded. At June 30, 2010, the average duration of the Company's fixed maturity portfolio was 2.2 years (December 31, 2009: 2.2 years) and the average rating of the portfolio was AA+ (December 31, 2009: AA+). At June 30, 2010, the total fixed maturity portfolio was \$4,975.0 million (December 31, 2009: \$4,869.4 million), of which \$3,111.8 million (December 31, 2009: \$3,287.9 million) were rated AAA. At June 30, 2010, fair value measurements of certain non-Agency RMBS securities, representing 1.0% of the Company's total assets, have primarily unobservable inputs (December 31, 2009: 1.2%).

On September 4, 2009, as part of the IPC Acquisition, the Company assumed IPCRe's investment portfolio containing \$1,820.9 million of corporate bonds, \$112.9 million of agency residential mortgage-backed securities, \$234.7 million of equity mutual funds, \$114.8 million fund of hedge funds and \$11.0 million of equity mutual funds contained within a deferred compensation trust. On September 9, 2009, the Company realized a gain of \$4.5 million on the disposition of \$234.7 million of equity mutual funds. A redemption request for the fund of hedge funds has been submitted for value as at October 31, 2009. The redemption amounted to \$89.4 million. As of June 30, 2010 the Company had received \$80.5 million and accordingly, a receivable of \$8.9 million with the full and final payment received during July 2010. As at June 30, 2010, the Company held a fund of hedge fund side pocket of \$19.1 million. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is indeterminable. During the six months ended June 30, 2010, \$7.1 million was received from the side pocket.

Company's investment guidelines require that investments be rated BBB- or higher at the time of purchase. During the three months ended March 31, 2010, Moody's downgraded a substantial number of non-agency mortgage backed securities issues, including several securities held by the Company. The Company reports the ratings of its investment portfolio securities at the lower of Moody's or Standard & Poor's rating for each investment security and, as a result, the Company's investment portfolio now has \$100.2 million of non-agency

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mortgage backed securities rated less than investment grade. The other components of less than investment grade securities held by the Company at June 30, 2010 were \$63.2 million of catastrophe bonds and \$1.7 million of corporate bonds.

Cash and cash equivalents and investments held by Talbot of \$1,421.3 million at June 30, 2010 were held in trust for the benefit of cedants and policyholders and to facilitate the accreditation as an alien insurer/reinsurer by certain regulators (December 31, 2009: \$1,408.1 million). Total cash and cash equivalents and investments in Talbot were \$1,442.5 million at June 30, 2010 (December 31, 2009: \$1,420.4 million).

As of June 30, 2010, the Company had approximately \$3.1 million of asset-backed securities with sub-prime collateral (December 31, 2009: \$3.6 million) and \$72.8 million of Alt-A RMBS (December 31, 2009: \$82.3 million).

As described more fully under the Critical Accounting Policies and Estimates in Item 7, *Management's Discussion and Analysis of Results of Operations and Financial Condition* in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, the Company identified certain non-Agency RMBS securities trading in inactive markets. During the three months ended June 30, 2010, the change in fair value for the identified RMBS securities resulted in a \$2.6 million decrease in net unrealized loss on investments. This increase in net unrealized losses on investments resulted in a \$2.6 million increase in shareholders' equity as at June 30, 2010.

### **Cash Flows**

During the six months ended June 30, 2010 and 2009, the Company generated net cash from operating activities of \$263.6 million and \$209.8 million, respectively. Cash flows from operations generally represent premiums collected, investment earnings realized and investment gains realized less losses and loss expenses paid and underwriting and other expenses paid. Cash flows from operations may differ substantially from net income.

As of June 30, 2010 and December 31, 2009, the Company had cash and cash equivalents of \$492.5 million and \$387.6 million, respectively.

The Company has written certain business that has loss experience generally characterized as having low frequency and high severity. This results in volatility in both results and operational cash flows. The potential for large claims or a series of claims under one or more reinsurance contracts means that substantial and unpredictable payments may be required within relatively short periods of time. As a result, cash flows from operating activities may fluctuate, perhaps significantly, between individual quarters and years. Management believes the Company's unused credit facility amounts and highly liquid investment portfolio are sufficient to support any potential operating cash flow deficiencies. Please refer to the table detailing the Company's borrowings and credit facilities as at June 30, 2010, presented above.

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

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

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

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

unpredictability and severity of catastrophic events;

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

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

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

the Company's limited operating history;

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

adequacy of the Company's loss reserves;

continued availability of capital and financing;

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

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

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

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

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

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

the integration of businesses we may acquire or new business ventures, including overseas offices, we may start;

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

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

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

availability and cost of reinsurance and retrocession coverage;

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

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

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

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

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

the other factors set forth herein under Part I Item 1A Risk Factors and under Part II Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operations* and the other sections of the Company's Annual Report on Form 10-K for the year ended December 31, 2009, as well as the risk and other factors set forth in the Company's other filings with the SEC, as well as management's response to any of the aforementioned factors.

In addition, other general factors could affect our results, including: (a) developments in the world's financial and capital markets and our access to such markets; (b) changes in regulations or tax laws applicable to us, including, without limitation, any such changes resulting from the recent investigations relating to the insurance industry and any attendant litigation; and (c) the effects of business disruption or economic contraction due to terrorism or other hostilities.

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

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

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

- interest rate risk;
- foreign currency risk;
- credit risk;



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liquidity risk; and  
effects of inflation.

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

As at June 30, 2010, the impact on the Company's fixed maturity and short-term investments from an immediate 100 basis point increase in market interest rates (based on U.S. treasury yield) would have resulted in an estimated decrease in market value of 2.3%, or approximately \$122.0 million. As at June 30, 2010, the impact on the Company's fixed maturity portfolio from an immediate 100 basis point decrease in market interest rates would have resulted in an estimated increase in market value of 1.9% or approximately \$102.9 million.

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

As at June 30, 2010, the Company held \$744.0 million (December 31, 2009: \$768.6 million), or 15.0% (December 31, 2009: 15.8%), of the Company's fixed maturity portfolio in asset-backed and mortgage-backed securities. These assets are exposed to prepayment risk, which occurs when holders of underlying loans increase the frequency with which they prepay the outstanding principal before the maturity date and refinance at a lower interest rate cost. The adverse impact of prepayment is more evident in a declining interest rate environment. As a result, the Company will be exposed to reinvestment risk, as cash flows received by the Company will be accelerated and will be reinvested at the prevailing interest rates.

*Foreign Currency Risk:* Certain of the Company's reinsurance contracts provide that ultimate losses may be payable in foreign currencies depending on the country of original loss. Foreign currency exchange rate risk exists to the extent that there is an increase in the exchange rate of the foreign currency in which losses are ultimately owed. Therefore, we attempt to manage our foreign currency risk by seeking to match our liabilities under insurance and reinsurance policies that are payable in foreign currencies with cash and investments that are denominated in such currencies. As of June 30, 2010, \$526.3 million, or 6.9% of our total assets and \$494.3 million, or 12.3% of our total liabilities was held in foreign currencies. As of March 31, 2010, \$95.9 million, or 2.4% of our total liabilities held in foreign currencies was non-monetary items which do not require revaluation at each reporting date. As of June 30, 2009, \$432.0 million, or 8.7% of our total assets and \$410.8 million, or 14.5% of our total liabilities was held in foreign currencies. As of March 31, 2009, \$94.1 million, or 3.3% of our total liabilities held in foreign currencies were non-monetary items which do not require revaluation at each reporting date. The Company does not transact in foreign exchange markets to hedge its foreign currency exposure. To the extent foreign currency exposure is not hedged, the Company may experience exchange losses, which in turn would adversely affect the results of operations and financial condition.

*Credit Risk:* We are exposed to credit risk primarily from the possibility that counterparties may default on their obligations to us. We attempt to limit our credit exposure by purchasing high quality fixed income investments to maintain an average portfolio credit quality of AA- or higher with mortgage and commercial mortgage-backed issues having an aggregate weighted average credit quality of AAA. In addition, we have limited our exposure to any single issuer to 3.0% or less of total investments, excluding treasury and agency securities. The minimum credit rating of any security purchased is BBB-/Baa3 and where investments are downgraded below BBB-/Baa3, we permit our investment managers to hold up to 2.0% in aggregate market value, or up to 10.0% with written authorization of the

Company. At June 30, 2010, 3.1% of the portfolio was below BBB-/Baa3 and we did not have

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an aggregate exposure to any single issuer of more than 1.5% of total investments, other than with respect to government securities.

The amount of the maximum exposure to credit risk is indicated by the carrying value of the Company's financial assets. The Company's primary credit risks reside in investment in U.S. corporate bonds and recoverables from reinsurers at the Talbot segment. The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- or better rated by S & P or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. At June 30, 2010, 99.2% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A-, (December 31, 2009 99.3% rated A-) or from reinsurers posting full collateral. Validus Re does not have any reinsurance recoverable balances that are not fully collateralized.

*Liquidity risk:* Certain of the Company's investments may become illiquid. The current disruption in the credit markets may materially affect the liquidity of the Company's investments, including residential mortgage-backed securities which represent 10.9% (December 31, 2009: 11.9%) of total cash and investments. If the Company requires significant amounts of cash on short notice in excess of normal cash requirements (which could include claims on a major catastrophic event) in a period of market illiquidity, the investments may be difficult to sell in a timely manner and may have to be disposed of for less than what may otherwise have been possible under other conditions. At June 30, 2010, the Company had \$2,409.4 million of unrestricted, liquid assets, defined as unpledged cash and cash equivalents, short term investments, government and government agency securities. Details of the Company's debt and financing arrangements at June 30, 2010 are provided below.

| <b>(Dollars in thousands)</b>                            | <b>Maturity<br/>Date /<br/>Term</b> | <b>In Use/<br/>Outstanding</b> |
|--|-------------------------------------|--------------------------------|
| 9.069% Junior Subordinated Deferrable Debentures         | June 15, 2036                       | \$ 150,000                     |
| 8.480% Junior Subordinated Deferrable Debentures         | June 15, 2037                       | 139,800                        |
|  | January 26,<br>2040                 | 250,000                        |
| 8.875% Senior Notes due 2040                             |                                     |                                |
| \$340,000 syndicated unsecured letter of credit facility | March 12, 2012                      |                                |
| \$60,000 bilateral unsecured letter of credit facility   | March 12, 2012                      |                                |
| \$500,000 secured letter of credit facility              | March 12, 2012                      | 239,056                        |
| Talbot FAL facility                                      | April 13, 2011                      | 25,000                         |
|  | December 31,<br>2010                | 77,603                         |
| \$350,000 IPC Bi-Lateral Facility                        |                                     |                                |
| <b>Total</b>   |                                     | <b>\$ 881,459</b>              |

On September 4, 2009, as part of the acquisition of IPC, the Company assumed IPC's investment portfolio containing \$1,820.9 million of corporate bonds, \$112.9 million of agency residential mortgage-backed securities, \$234.7 million of equity mutual funds, \$114.8 million fund of hedge funds and \$11.0 million of equity mutual funds contained within a deferred compensation trust. On September 9, 2009, the Company realized a gain of \$4.5 million on the disposition of \$234.7 million of equity mutual funds. A redemption request for the fund of hedge funds was submitted for value as at October 31, 2009. The redemption amounted to \$89.4 million. As of June 30, 2010 the Company had received \$80.5 million and accordingly, a receivable exists for the remaining \$8.9 million with full and final payment received during July 2010. As of June 30, 2010, the Company held a fund of hedge fund side pocket of \$19.1 million. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is indeterminable. During the current quarter, \$2.7 million was received from the side pocket.

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

by inflation.

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**ITEM 4. CONTROLS AND PROCEDURES**

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

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of disclosure controls and procedures pursuant to Rules 13a-15 and 15d-15 promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report.

Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective to provide reasonable assurance that all material information relating to the Company required to be filed in this report has been made known to them in a timely fashion.

**Changes in Internal Control Over Financial Reporting**

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

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

Please refer to the discussion of Risk Factors in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

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

**Final Results of Modified Dutch Auction Tender Offer**

On June 14, 2010, the Company announced the final results of the Modified Dutch Auction Tender Offer which expired at 5:00 p.m., New York City time, on June 8, 2010. The Company has accepted for purchase 12,000,000 of its common shares at a price of \$25.00 per common share for a total cost of \$300.0 million, excluding fees and expenses relating to the tender offer. The common shares purchased pursuant to the tender offer represent approximately 9.5 percent of the common shares outstanding as of June 7, 2010. The Company funded the purchase of the shares in the tender offer using cash on hand.

Based on the final count by the depositary (and excluding any conditional tenders that were not accepted due to the specified condition not being satisfied), 13,896,804 common shares were properly tendered and not withdrawn at or below a price of \$25.00 per share.

As noted in the Company's Offer to Purchase, the Company may in the future consider various forms of share repurchases, including open market purchases, tender offers and/or accelerated share repurchases or otherwise. Under applicable securities laws, the Company may not repurchase any of its common shares until after June 22, 2010. Following completion of the tender offer, Validus has approximately \$364 million remaining under its current share repurchase program. The timing, form and amount of any future share repurchases under the program will depend on a variety of factors, including the Company's results of operations, financial position and capital requirements, general business conditions, legal, tax, regulatory, rating agency and contractual constraints or restrictions and other factors its board of directors deems relevant. The share repurchase program may be modified, extended or terminated by the Company's board of directors at any time.

In November 2009, the Board of Directors of the Company approved a share repurchase program, authorizing the Company to repurchase up to \$400.0 million of its common shares.

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The Company also announced that on February 17, 2010, the Board of Directors authorized the Company to return up to \$750.0 million to shareholders. To this end, the Board of Directors has expanded the Company's share repurchase program authorizing the Company to repurchase up to \$750.0 million of common shares. Company expects the repurchases 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 Company has repurchased approximately 8.3 million common shares for an aggregate purchase price of \$221.1 million from the inception of the share repurchase program to May 7, 2010.

The Company has accepted for purchase 12,000,000 of its common shares at a price of \$25.00 per common share for a total cost of \$300 million, excluding fees and expenses relating to the tender offer. The common shares purchased pursuant to the tender offer represent approximately 9.5 percent of the common shares outstanding as of June 7, 2010. Validus has been informed by BNY Mellon Shareowner Services, the depository for the tender offer, that the final proration factor for the tender offer is approximately 86.3 percent. Validus funded the purchase of the shares in the tender offer using cash on hand.

Share repurchases includes repurchases by the Company of shares, from time to time, from employees in order to facilitate the payment of withholding taxes on restricted shares granted and the exercise of stock appreciation rights. We purchased these shares at their fair market value, as determined by reference to the closing price of our common shares on the day the restricted shares vested or the stock appreciation rights were exercised.

**Share Repurchase Activity**

|  | <b>As at March<br/>31,<br/>2010</b> | <b>April</b> | <b>May</b> | <b>June</b> | <b>As at June 30,<br/>2010</b> |
|--|-------------------------------------|--------------|------------|-------------|--------------------------------|
| <b>Effect of share repurchases:</b>              | <b>(cumulative)</b>                 |              |            |             |                                |
| Aggregate purchase price (1)                     | \$ 212,521                          | \$ 8,590     | \$         | \$ 307,343  | \$ 315,933                     |
| Shares repurchased                               | 7,983,471                           | 314,923      |            | 12,300,200  | 12,615,123                     |
| Average price (1)                                | \$ 26.62                            | \$ 27.28     | \$         | \$ 24.99    | \$ 25.04                       |
| Estimated net accretive<br>(dilutive) impact on: |                                     |              |            |             |                                |
| Diluted BV per common share (2)                  | \$ 0.10                             |              |            |             | 0.66                           |
| Diluted EPS Quarter (3)                          | \$                                  |              |            |             | 0.07                           |

**Share Repurchase Activity**

|  | <b>As at June 30,<br/>2010</b> | <b>July</b> | <b>August</b> | <b>As at August<br/>4,<br/>2010</b> | <b>Cumulative to<br/>Date<br/>Effect</b> |
|--|--------------------------------|-------------|---------------|-------------------------------------|--|
| <b>Effect of share repurchases:</b>              |                                |             |               |                                     |  |
| Aggregate purchase price (1)                     | \$ 315,933                     | \$ 3,995    | \$            | \$ 3,995                            | \$ 532,449                               |
| Shares repurchased                               | 12,615,123                     | 163,100     |               | 163,100                             | 20,761,694                               |
| Average price (1)                                | \$ 25.04                       | \$ 24.48    | \$            | \$ 24.48                            | \$ 25.65                                 |
| Estimated net accretive<br>(dilutive) impact on: |                                |             |               |                                     |  |
| Diluted BV per common share (2)                  | 0.66                           |             |               |                                     | 0.66                                     |
| Diluted EPS Quarter (3)                          | 0.07                           |             |               |                                     |  |

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- (1) Share transactions are on a trade date basis through August 4, 2010 and are inclusive of commissions. Average share price is rounded to two decimal places.
- (2) As the average price per share repurchased during the periods 2009 and 2010 was lower than the book value per common share, the repurchase of shares increased the ending book value per share.
- (3) The estimated impact on diluted earnings per share was calculated by comparing reported results versus i) net income per share plus an estimate of lost net investment income on the cumulative share repurchases divided by ii) weighted average diluted shares

outstanding  
excluding the  
weighted  
average impact  
of cumulative  
share  
repurchases.  
The impact of  
cumulative  
share  
repurchases was  
accretive to  
diluted earnings  
per share.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. (Removed and Reserved)**

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

| <b>Exhibit</b> | <b>Description</b> |
|----------------|--------------------|
|----------------|--------------------|

|               |   |
|---------------|---|
| Exhibit 31.1* | Certification of Chief Executive Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.                     |
| Exhibit 31.2* | Certification of Chief Financial Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.                     |
| Exhibit 32*   | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002. |

\* Filed herewith



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**SIGNATURES**

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

**VALIDUS HOLDINGS, LTD.**  
(Registrant)

Date: August 6, 2010

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

Date: August 6, 2010

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