VALIDUS HOLDINGS LTD
Form 10-Q
May 02, 2014

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

Form 10-Q

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

For the quarterly period ended March 31, 2014

Commission file number 001-33606

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

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

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x
As of April 30, 2014 there were 90,786,820 outstanding Common Shares, $0.175 par value per share, of the registrant.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Validus Holdings, Ltd.
Consolidated Balance Sheets
As at March 31, 2014 (unaudited) and December 31, 2013
(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2014 (unaudited)	December 31, 2013
Assets		
Fixed maturities, at fair value (amortized cost: 2014—$5,263,024; 2013—$5,522,853)	$5,287,600	$5,542,258
Short-term investments, at fair value (amortized cost: 2014—$831,679; 2013—$751,784)	831,800	751,778
Other investments, at fair value (cost: 2014—$632,924; 2013—$637,728)	662,974	618,316
Cash and cash equivalents	1,017,350	1,056,346
Total investments and cash	7,799,724	7,968,698
Investments in affiliates	221,607	141,243
Premiums receivable	1,091,391	697,233
Deferred acquisition costs	202,367	134,269
Prepaid reinsurance premiums	218,363	103,251
Securities lending collateral	4,877	3,392
Loss reserves recoverable	348,407	370,154
Paid losses recoverable	37,032	80,080
Intangible assets	105,367	106,407
Goodwill	20,393	20,393
Accrued investment income	16,518	18,876
Other assets	190,043	202,436
Total assets	$10,256,089	$9,846,432
Liabilities		
Reserve for losses and loss expenses	$2,925,059	$3,030,399
Unearned premiums	1,273,734	824,496
Reinsurance balances payable	212,807	154,874
Securities lending payable	5,343	3,858
Deferred income taxes	22,609	19,086
Net payable for investments purchased	84,303	19,383
Accounts payable and accrued expenses	183,794	278,187
Notes payable to operating affiliates	561,373	439,272
Senior notes payable	247,225	247,198
Debentures payable	541,454	541,416
Total liabilities	$6,057,701	$5,558,169
Commitments and contingent liabilities		
Redeemable noncontrolling interest	8,390	86,512
Shareholders’ equity		
	$27,055	$27,036

Common shares, 571,428,571 authorized, par value $0.175 (Issued: 2014—154,597,094; 2013—154,488,497; Outstanding: 2014—90,786,237; 2013—96,044,312)		
Treasury shares (2014—63,810,857; 2013—58,444,185)	(11,167)	(10,228)
Additional paid-in-capital	1,490,652	1,677,894
Accumulated other comprehensive (loss)	(155)	(617)
Retained earnings	2,142,679	2,010,009
Total shareholders' equity available to Validus	3,649,064	3,704,094
Noncontrolling interest	540,934	497,657
Total shareholders' equity	$4,189,998	$4,201,751
Total liabilities, noncontrolling interests and shareholders' equity	$10,256,089	$9,846,432

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

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Validus Holdings, Ltd.
Consolidated Statements of Comprehensive Income
For the Three Months Ended March 31, 2014 and 2013 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Three Months Ended	
	March 31, 2014 (unaudited)	March 31, 2013 (unaudited)
Revenues		
Gross premiums written	$1,011,991	$1,104,760
Reinsurance premiums ceded	(194,908)	(187,216)
Net premiums written	817,083	917,544
Change in unearned premiums	(334,126)	(386,483)
Net premiums earned	482,957	531,061
Net investment income	23,362	25,649
Net realized gains on investments	3,740	1,721
Change in net unrealized gains (losses) on investments	55,693	(7,237)
Income from investment affiliate	5,348	1,477
Other income	13,830	2,685
Foreign exchange (losses) gains	(6,478)	6,922
Total revenues	578,452	562,278
Expenses		
Losses and loss expenses	162,671	144,771
Policy acquisition costs	85,649	93,611
General and administrative expenses	74,445	80,279
Share compensation expenses	7,147	2,318
Finance expenses	15,900	14,369
Total expenses	345,812	335,348
Income before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	232,640	226,930
Tax benefit	40	318
Income from operating affiliates	4,927	3,523
(Income) attributable to operating affiliate investors	(31,710)	(10,077)
Net income	$205,897	$220,694
Net (income) loss attributable to noncontrolling interest	(43,509)	2,549
Net income available to Validus	$162,388	$223,243
Other comprehensive income (loss)		
Foreign currency translation adjustments	462	(9,785)
Other comprehensive income (loss)	$462	$(9,785)
Comprehensive income available to Validus	$162,850	$213,458

Earnings per share		
Weighted average number of common shares and common share equivalents outstanding		
Basic	93,451,999	107,386,438
Diluted	97,799,519	110,052,999
Basic earnings per share available to common shareholders	$1.72	$1.94
Earnings per diluted share available to common shareholders	$1.66	$1.90
Cash dividends declared per share	$0.30	$2.30

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

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Validus Holdings, Ltd.
Consolidated Statements of Shareholders' Equity
For the Three Months Ended March 31, 2014 and 2013 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2014 (unaudited)	March 31, 2013 (unaudited)
Common shares		
Balance - Beginning of period	$27,036	$26,722
Common shares issued, net	19	47
Balance - End of period	$27,055	$26,769
Treasury shares		
Balance - Beginning of period	$(10,228)	$(7,836)
Repurchase of common shares	(939)	(333)
Balance - End of period	$(11,167)	$(8,169)
Additional paid-in capital		
Balance - Beginning of period	$1,677,894	$2,160,478
Common shares issued, net	2,011	3,074
Repurchase of common shares	(196,400)	(69,358)
Share compensation expenses	7,147	2,318
Balance - End of period	$1,490,652	$2,096,512
Accumulated other comprehensive (loss)		
Balance - Beginning of period	$(617)	$(2,953)
Other comprehensive income (loss)	462	(9,785)
Balance - End of period	$(155)	$(12,738)
Retained earnings		
Balance - Beginning of period	$2,010,009	$1,844,416
Dividends	(29,718)	(266,143)
Net income	205,897	220,694
Net (income) loss attributable to noncontrolling interest	(43,509)	2,549
Balance - End of period	$2,142,679	$1,801,516
Total shareholders' equity available to Validus	$3,649,064	$3,903,890
Noncontrolling interest	$540,934	$431,144
Total shareholders' equity	$4,189,998	$4,335,034

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

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Validus Holdings, Ltd.
Consolidated Statements of Cash Flows
For the Three Months Ended March 31, 2014 and 2013 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	March 31, 2014 (unaudited)	March 31, 2013 (unaudited)
Cash flows provided by (used in) operating activities		
Net income	$205,897	$220,694
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	7,147	2,318
Gain on deconsolidation of subsidiary	(1,372)	—
Amortization of discount on senior notes	27	27
Income from investment affiliate	(5,348)	(1,477)
Net realized gains on investments	(3,740)	(1,721)
Change in net unrealized (gains) losses on investments	(55,693)	7,237
Amortization of intangible assets	1,040	1,040
Income from operating affiliates	(4,927)	(3,523)
Foreign exchange (gains) losses included in net income	(4,347)	18,906
Amortization of premium on fixed maturities	4,117	5,059
Change in:		
Premiums receivable	(393,543)	(400,153)
Deferred acquisition costs	(68,098)	(72,916)
Prepaid reinsurance premiums	(115,112)	(100,984)
Loss reserves recoverable	21,832	6,447
Paid losses recoverable	43,054	30,438
Income taxes recoverable	—	(2,132)
Accrued investment income	2,366	1,532
Other assets	13,558	8,020
Reserve for losses and loss expenses	(105,842)	(138,633)
Unearned premiums	449,238	487,467
Reinsurance balances payable	57,765	51,300
Deferred income taxes	3,551	1,250
Accounts payable and accrued expenses	(95,997)	(40,113)
Net cash (used in) provided by operating activities	(44,427)	80,083
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	1,086,527	1,410,509
Proceeds on maturities of investments	124,716	125,841
Purchases of fixed maturities	(884,461)	(2,140,447)
(Purchases) sales of short-term investments, net	(107,411)	744,518
Sales of other investments	3,539	31,121
Increase in securities lending collateral	(1,485)	(1,689)
Redemption of investment in operating affiliates	43,366	50,222
Purchase of investment in investment affiliate	—	(1,341)

Net cash provided by investing activities	264,791	218,734
Cash flows provided by (used in) financing activities		
Net (repayment of) proceeds on issuance of notes payable to operating affiliates	(30,600)	175,637
Issuance of common shares, net	2,030	3,121
Purchases of common shares under share repurchase program	(197,339)	(69,691)
Dividends paid	(29,330)	(262,232)
Increase in securities lending payable	1,485	1,689
(Redemption of) investment in third party redeemable noncontrolling interest	(10,496)	36,290
Net cash (used in) financing activities	(264,250)	(115,186)
Effect of foreign currency rate changes on cash and cash equivalents	4,890	(33,786)
Net (decrease) increase in cash	(38,996)	149,845
Cash and cash equivalents - beginning of period	$1,056,346	$1,219,379
Cash and cash equivalents - end of period	$1,017,350	$1,369,224
Taxes paid during the period	$175	$693
Interest paid during the period	$19,174	$17,819

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

In the opinion of management, these unaudited consolidated financial statements reflect all adjustments (including normal recurring adjustments) considered necessary for a fair presentation of the Company's financial position and results of operations as at the end of and for the periods presented. To facilitate comparison of information, certain amounts in prior periods have been reclassified to conform to current period presentation. The consolidated statement of cash flows for the three months ended March 31, 2013 includes a reclassification of $19,400 from cash flows used in financing activities to cash flows provided by operating activities to revise the presentation of subscriptions received in advance from third party investors. For the three months ended March 31, 2013, $10,077 within finance expenses has been reclassified into income attributable to operating affiliate investors to conform to current period presentation. All significant intercompany accounts and transactions have been eliminated. The results of operations for any interim period are not necessarily indicative of the results for a full year.

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

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

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

2. Recent accounting pronouncements

Adoption of New Accounting Standards

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

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

subsidiary within a foreign entity. The amendments became effective for the Company on January 1, 2014. Adoption of this guidance did not have a material impact on the Company’s Consolidated Financial Statements.
Financial Services - Investment Companies - Amendments to the Scope, Measurement, and Disclosure Requirements
In June 2013, the FASB issued Accounting Standard Update No. 2013-08, “Financial Services - Investment Companies - Amendments to the Scope, Measurement, and Disclosure Requirements” (ASU 2013-08). The amendments in this Update change the assessment of whether an entity is an investment company by developing a new two-tiered approach for that assessment, which

requires an entity to possess certain fundamental characteristics while allowing judgment in assessing other typical characteristics. The new approach requires an entity to assess all of the characteristics of an investment company and consider its purpose and determine whether it is an investment company. The amendments became effective for the Company on January 1, 2014. The Company performed an assessment and has concluded that the AlphaCat ILS funds meet the characteristics outlined in this Update and therefore will continue to be treated as investment companies.

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

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

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

3. Investments

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

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

The amortized cost (or cost), gross unrealized gains and (losses) and estimated fair value of investments at March 31, 2014 were as follows:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	$ 1,122,846	$ 2,241	$ (4,232)	$ 1,120,855
Non-U.S. government and government agency	438,415	5,138	(1,224)	442,329
U.S. states, municipalities and political subdivisions	43,960	626	(122)	44,464
Agency residential mortgage-backed securities	293,013	8,201	(1,653)	299,561
Non-agency residential mortgage-backed securities	16,721	254	(645)	16,330
U.S. corporate	1,331,550	9,315	(3,455)	1,337,410
Non-U.S. corporate	699,404	6,460	(1,973)	703,891
Bank loans	640,672	4,678	(1,649)	643,701
Catastrophe bonds	30,500	1,747	—	32,247
Asset-backed securities	623,631	1,408	(540)	624,499
Commercial mortgage-backed securities	22,312	7	(6)	22,313
Total fixed maturities	5,263,024	40,075	(15,499)	5,287,600
Total short-term investments	831,679	121	—	831,800
Other investments				
Fund of hedge funds	2,977	138	(921)	2,194
Hedge funds (a)	581,369	110,058	(84,965)	606,462
Private equity investments	12,068	2,562	(668)	13,962
Investment funds	30,311	188	—	30,499
Mutual funds	6,199	3,658	—	9,857
Total other investments	632,924	116,604	(86,554)	662,974
Total investments including noncontrolling interests	$ 6,727,627	$ 156,800	$ (102,053)	$ 6,782,374
Noncontrolling interest (a)	$ (512,121)	$ (95,750)	$ 76,468	$ (531,403)
Redeemable noncontrolling interest (b)	$ (1,976)	$ —	$ —	$ (1,976)
Total investments excluding noncontrolling interests	$ 6,213,530	$ 61,050	$ (25,585)	$ 6,248,995

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

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

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

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

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

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

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

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

The following table sets forth certain information regarding the investment ratings of the Company's fixed maturities portfolio as at March 31, 2014 and December 31, 2013. Investment ratings are the lower of Moody's or Standard & Poor's rating for each investment security, presented in Standard & Poor's equivalent rating. For investments where Moody's and Standard & Poor's ratings are not available, Fitch ratings are used and presented in Standard & Poor's equivalent rating.

	March 31, 2014		December 31, 2013	
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total
AAA	$906,648	17.1 %	$788,490	14.2 %
AA	2,124,629	40.2 %	2,378,491	42.9 %
A	1,178,357	22.3 %	1,174,562	21.2 %
BBB	397,563	7.5 %	420,559	7.6 %
Total investment-grade fixed maturities	4,607,197	87.1 %	4,762,102	85.9 %
BB	336,265	6.4 %	350,678	6.3 %
B	321,128	6.1 %	390,430	7.0 %
CCC	4,247	0.1 %	4,659	0.1 %
CC	2,602	— %	2,731	0.1 %
D/NR	16,161	0.3 %	31,658	0.6 %
Total non-investment grade fixed maturities	680,403	12.9 %	780,156	14.1 %
Total fixed maturities	$5,287,600	100.0 %	$5,542,258	100.0 %

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

	March 31, 2014		December 31, 2013	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$625,774	$629,800	$688,855	$692,768
Due after one year through five years	3,311,970	3,325,578	3,603,459	3,613,847
Due after five years through ten years	366,524	366,409	396,389	395,633
Due after ten years	3,079	3,110	3,079	3,095
	4,307,347	4,324,897	4,691,782	4,705,343
Asset-backed and mortgage-backed securities	955,677	962,703	831,071	836,915
Total fixed maturities	$5,263,024	$5,287,600	$5,522,853	$5,542,258

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended	
	March 31, 2014	March 31, 2013
Fixed maturities and short-term investments	$23,297	$27,531
Cash and cash equivalents	1,957	533
Securities lending income	2	—
Total gross investment income	25,256	28,064
Investment expenses	(1,894)	(2,415)
Total net investment income	$23,362	$25,649

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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)

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

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

	Three Months Ended	
	March 31, 2014	March 31, 2013
Fixed maturities, short-term and other investments and cash equivalents		
Gross realized gains	$5,296	$10,720
Gross realized (losses)	(1,556)	(8,999)
Net realized gains on investments	3,740	1,721
Change in net unrealized gains (losses) on investments (a)	55,693	(7,237)
Total net realized gains and change in net unrealized gains (losses) on investments including noncontrolling interest	59,433	(5,516)
Noncontrolling interest (a)	(42,002)	4,651
Total net realized gains and change in net unrealized gains (losses) on investments excluding noncontrolling interest	$17,431	$(865)

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

(d) Pledged investments

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

	March 31, 2014		
Description	Commitment	Issued and Outstanding	Investments and cash pledged as collateral
$400,000 syndicated unsecured letter of credit facility	$400,000	$—	$—
$525,000 syndicated secured letter of credit facility	525,000	309,422	499,905
$200,000 secured bi-lateral letter of credit facility	200,000	18,676	35,225
Talbot FAL facility	25,000	25,000	30,897
PaCRe senior secured letter of credit facility	10,000	294	—
AlphaCat Re secured letter of credit facility	30,000	24,800	30,022
IPC bi-lateral facility	40,000	19,817	96,960
$375,000 Flagstone bi-lateral facility	375,000	292,532	453,943
	$1,605,000	$690,541	$1,146,952

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

	$1,599,800	$751,250	$1,246,406

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In addition, $2,889,470 of cash and cash equivalents and investments were pledged during the normal course of business as at March 31, 2014 (December 31, 2013: $2,947,475). Of those, $2,884,472 were held in trust (December 31, 2013: $2,942,508). Pledged assets are generally for the benefit of the Company's cedants and policyholders, to support AlphaCat's fully collateralized reinsurance transactions and to facilitate the accreditation of Talbot as an alien insurer/reinsurer by certain regulators. See Note 14 (b) for detail on Talbot's FAL facility.

4. Fair value measurements

(a) Classification within the fair value hierarchy

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

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

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

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

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

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

Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This may lead us to change the selection of our valuation technique (for example, from market to cash flow approach) or may cause us to use multiple valuation techniques to estimate the fair value of a financial instrument. These circumstances could cause an instrument to be reclassified between levels within the fair value hierarchy.

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

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At March 31, 2014, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. government and government agency	$—	$1,120,855	$—	$1,120,855
Non-U.S. government and government agency	—	442,329	—	442,329
U.S. states, municipalities and political subdivisions	—	44,464	—	44,464
Agency residential mortgage-backed securities	—	299,561	—	299,561
Non-agency residential mortgage-backed securities	—	16,330	—	16,330
U.S. corporate	—	1,337,410	—	1,337,410
Non-U.S. corporate	—	703,891	—	703,891
Bank loans	—	643,701	—	643,701
Catastrophe bonds	—	25,544	6,703	32,247
Asset-backed securities	—	624,499	—	624,499
Commercial mortgage-backed securities	—	22,313	—	22,313
Total fixed maturities	—	5,280,897	6,703	5,287,600
Total short-term investments	817,937	13,863	—	831,800
Other investments				
Fund of hedge funds	—	—	2,194	2,194
Hedge funds (a)	—	—	606,462	606,462
Private equity investments	—	—	13,962	13,962
Investment fund	—	30,499	—	30,499
Mutual funds	—	9,857	—	9,857
Total other investments	—	40,356	622,618	662,974
Total investments including noncontrolling interests	$817,937	$5,335,116	$629,321	$6,782,374
Noncontrolling interest (a)	$—	$—	$(531,403)	$(531,403)
Redeemable noncontrolling interest (b)	$(1,976)	$—	$—	$(1,976)
Total investments excluding noncontrolling interests	$815,961	$5,335,116	$97,918	$6,248,995

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

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

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

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

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

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

At March 31, 2014, Level 3 investments excluding the noncontrolling interest totaled $97,918 (December 31, 2013: $87,469), representing 1.6% (December 31, 2013: 1.4%) of total investments, excluding noncontrolling interest, measured at fair value on a recurring basis.

(b) Level 1 assets measured at fair value

Short term investments

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

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(c) Level 2 assets measured at fair value

Fixed maturity investments

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

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

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

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

U.S. government and government agency

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

Non-U.S. government and government agency

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

U.S. states, municipalities and political subdivisions

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

Agency residential mortgage-backed securities

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

Non-agency residential mortgage-backed securities

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

U.S. corporate

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

Non-U.S. corporate

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

Bank loans

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

Catastrophe bonds

Catastrophe bonds are based on broker or underwriter bid indications.

Asset-backed securities

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

Commercial mortgage-backed securities

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

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Short term investments

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

Investment fund

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

Mutual funds

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

(d) Level 3 assets measured at fair value

Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. The Company's hedge funds, a fund of hedge funds, private equity investments and certain catastrophe bonds are the only financial instruments in this category as at March 31, 2014. For each respective hedge fund investment, the Company obtains and reviews the valuation methodology used by the fund administrators and investment managers to ensure that the hedge fund investments are following fair value principles consistent with U.S. GAAP in determining the net asset value ("NAV"). Within the hedge fund industry, there is a general lack of transparency necessary to facilitate a detailed independent assessment of the values placed on the securities underlying the NAV provided by the fund manager or fund administrator. To address this, on a quarterly basis, we perform a number of monitoring procedures designed to assist us in the assessment of the quality of the information provided by managers and administrators. These procedures include, but are not limited to, regular review and discussion of each fund's performance with its manager and regular evaluation of fund performance against applicable benchmarks.

Fund of hedge funds

The fund of hedge funds includes a side pocket. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is unknown. The fund's administrator provides a monthly reported NAV with a one-month delay in its valuation. As a result, the fund administrator's February 28, 2014 NAV was used as a basis for fair value measurement in the Company's March 31, 2014 balance sheet. The fund manager has provided an estimate of the fund NAV at March 31, 2014 based on the estimated performance provided from the underlying funds. To determine the reasonableness of the estimated NAV, the Company compares the one-month delayed fund administrator's NAV to the fund manager's estimated NAV that incorporates relevant valuation sources on a timely basis. Material variances are recorded in the current reporting period while immaterial variances are recorded in the following reporting period. As this valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset.

Hedge funds

The hedge funds were valued at $606,462 at March 31, 2014 (December 31, 2013: $561,083). The hedge funds consist of an investment in four Paulson & Co. managed funds (the "Paulson hedge funds") and one investment fund assumed from the Flagstone Acquisition (the "Flagstone investment fund").

The Paulson hedge funds' administrator provides monthly reported NAVs with a one-month delay in its valuation. As a result, the funds' administrator's February 28, 2014 NAV was used as a partial basis for fair value measurement in the Company's March 31, 2014 balance sheet. The fund manager provides an estimate of the NAV at March 31, 2014 based on estimated performance. The Company adjusts fair value to the fund manager's estimated NAV that incorporates relevant valuation sources on a timely basis. To determine the reasonableness of the estimated NAV, the Company assesses the variance between the fund manager's estimated NAV and the fund administrator's NAV. Material variances are recorded in the current reporting period while immaterial variances are recorded in the following reporting period. Historically, our valuation estimates have not materially differed from the subsequent NAVs.

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The Flagstone investment fund's administrator provides quarterly NAVs with a three-month delay in valuation. As a result, the December 31, 2013 NAV was used as a basis for fair value measurement in the Company's March 31, 2014 balance sheet.

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

Private equity investments

Private equity investments consist of investments in three private equity funds assumed from the Flagstone Acquisition. The private equity funds' respective fund administrators provide quarterly or semi-annual NAVs with a three-month or six-month delay in valuation as well as audited NAVs as at December 31. As a result, the December 31, 2013 NAV was used as a basis for the fair value measurement in the Company's March 31, 2014 balance sheet. As this valuation technique incorporates both observable and significant unobservable inputs, the private equity investments are classified as Level 3 assets.

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the three months ended March 31, 2014 and 2013:

	Three Months Ended	
	March 31, 2014	March 31, 2013
Level 3 investments - Beginning of period	$576,871	$556,234
Purchases	—	459
Sales	(3,589)	(31,334)
Net realized gains	10	40
Net unrealized gains (losses)	49,326	(1,706)
Transfers into Level 3	6,703	—
Level 3 investments - End of period	$629,321	$523,693
Noncontrolling interest (a)	(531,403)	(428,087)
Level 3 investments excluding noncontrolling interest	$97,918	$95,606

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

There have not been any transfers between Levels 1 and 2 during the three months ended March 31, 2014 or 2013. During the three months ended March 31, 2014 there was a transfer of investments from Level 2 into Level 3 of the fair value hierarchy. This transfer was due to a reassessment of the extent of unobservable inputs used in establishing the fair value of certain catastrophe bonds. There were no transfers into or out of Level 3 during the three months ended March 31, 2013.

5. Investments in affiliates

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

	As at March 31, 2014	As at December 31, 2013
Investment affiliate	$39,848	$34,500
Operating affiliates	181,759	106,743
Investments in affiliates	$221,607	$141,243

(a) Investment affiliate

Aquiline Financial Services Fund II L.P.

On December 20, 2011, the Company entered into an Assignment and Assumption Agreement (the "Agreement") with Aquiline Capital Partners LLC, a Delaware limited liability company (the "Assignor") and Aquiline Capital

Partners II GP (Offshore) Ltd., a Cayman Islands company limited by shares (the "General Partner") pursuant to which the Company has assumed 100% of the Assignor's interest in Aquiline Financial Services Fund II L.P. (the "Partnership") representing a total capital commitment of $50,000 (the "Commitment"), as a limited partner in the Partnership (the "Transferred Interest"). The Transferred Interest is governed by the

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terms of an Amended and Restated Exempted Limited Partnership Agreement dated as of July 2, 2010 (the "Limited Partnership Agreement"). Pursuant to the terms of the Limited Partnership Agreement, the Commitment will expire on July 2, 2015.

The Partnership provides quarterly capital account statements with a three-month delay in its valuation. As a result, the Partnership's December 31, 2013 capital account statement was used as the basis for calculating the Company's share of Partnership income for the period.

The following table presents a reconciliation of the beginning and ending investment in the Company's investment affiliate balance for the three months ended March 31, 2014 and 2013:

	Three Months Ended	
	March 31, 2014	March 31, 2013
Investment affiliate, beginning of period	$34,500	$15,218
Capital contributions	—	1,341
Income from investment affiliate	5,348	1,477
Investment affiliate, end of period	$39,848	$18,036

The following table presents the Company's investment in the Partnership as at March 31, 2014:

	Investment in investment affiliate			
	Investment at cost	Voting ownership %	Equity Ownership	Carrying Value
Aquiline Financial Services Fund II L.P.	$32,110	— %	6.7 %	$39,848

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

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

(b) Operating affiliates

AlphaCat Re 2011 Ltd.

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

AlphaCat Re 2011 is now considered "off-risk" as the risk periods for all reinsurance contracts written have expired. As a result, partial returns of investment have been made to the investors of AlphaCat Re 2011.The Company's portion of the returns made during the three months ended March 31, 2014 and 2013 are included in the tables below.

AlphaCat Re 2012 Ltd.

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

AlphaCat Re 2012 is now considered "off-risk" as the risk periods for all reinsurance contracts written have expired. As a result, partial returns of investment have been made to the investors of AlphaCat Re 2012.The Company's portion of the returns made during the three months ended March 31, 2014 and 2013 are included in the tables below.

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AlphaCat 2013, Ltd.

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

Partial returns of investment have been made to the investors of AlphaCat 2013.The Company's portion of the returns made during the three months ended March 31, 2014 are included in the tables below.

AlphaCat 2014, Ltd.

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

AlphaCat ILS funds

The AlphaCat ILS funds invest in instruments with returns linked to property catastrophe reinsurance, retrocession and insurance linked securities ("ILS") contracts. AlphaCat ILS funds all deploy their capital through the AlphaCat Master Fund Ltd. (the “Master Fund”) and AlphaCat Re. All three funds are variable interest entities, with one being consolidated by the Company as the primary beneficiary and one being accounted for as an equity method investment since the Company holds an equity interest of 9.1%. The third fund had been consolidated by the Company as the primary beneficiary from its formation through to December 31, 2013. However, on January 1, 2014 the fund received $35,000 in additional third party subscriptions, resulting in a reduction of the Company’s equity interest below 50%. Since the Company retains significant influence, this fund has been deconsolidated and accounted for as an equity method investment from January 1, 2014. The fair value of the retained interest, based on the fair value of the underlying instruments in Master Fund and AlphaCat Re, amounted to $113,455 at January 1, 2014. The deconsolidation resulted in a gain of $1,372 and is included in the Consolidated Statements of Comprehensive Income as other income. The Company's maximum exposure to any of the funds is the amount of capital invested at any given time.

AlphaCat Master Fund Ltd. and AlphaCat Reinsurance Ltd.

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

The following tables present a reconciliation of the beginning and ending investment in operating affiliates for the three months ended March 31, 2014 and 2013:

	AlphaCat Re 2011	AlphaCat Re 2012	AlphaCat 2013	AlphaCat 2014	AlphaCat ILS funds	Total
As at December 31, 2013	$9,809	$1,313	$51,744	$21,982	$21,895	$106,743
Return of investment	(5,825)	—	(37,541)	—	—	(43,366)
Fair value of retained interest on deconsolidation of AlphaCat ILS fund	—	—	—	—	113,455	113,455
Income (loss) from operating affiliates	193	(36)	1,475	1,611	1,684	4,927
As at March 31, 2014	$4,177	$1,277	$15,678	$23,593	$137,034	$181,759

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	Three Months Ended March 31, 2013				
	AlphaCat Re 2011	AlphaCat Re 2012	AlphaCat 2013	AlphaCat ILS fund	Total
As at December 31, 2012	$62,792	$29,319	$45,000	$20,000	$157,111
Return of investment	(46,436)	(3,786)	—	—	(50,222)
Income from operating affiliates	449	1,825	1,100	149	3,523
As at March 31, 2013	$16,805	$27,358	$46,100	$20,149	$110,412

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

	Investment in operating affiliates			
	Cost	Voting ownership %	Equity ownership %	Carrying value
AlphaCat Re 2011	$4,178	43.7 %	22.3 %	$4,177
AlphaCat Re 2012	654	49.0 %	37.9 %	1,277
AlphaCat 2013	16,454	40.9 %	19.7 %	15,678
AlphaCat 2014	22,000	42.3 %	19.6 %	23,593
AlphaCat ILS funds (a)	133,455	n/a	n/a	137,034
Total	$176,741			$181,759

(a) Equity ownerships in the two funds were 9.1% and 49.7% respectively as at March 31, 2014.

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

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

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

Notes are issued during the course of a year by Master Fund and AlphaCat Re to AlphaCat 2013, AlphaCat 2014 and the AlphaCat ILS funds (collectively the “feeder funds”) in order to fund the purchase of capital market products and to write collateralized reinsurance on their behalf. These notes are subsequently redeemed as the underlying transactions are settled. The Company’s investments in the feeder funds, together with investments made by third parties, are provided as consideration for these notes to Master Fund and AlphaCat Re, which are consolidated in the Company’s Consolidated Financial Statements. The effective economic interest in Master Fund and AlphaCat Re that results from these transactions is represented on the Consolidated Balance Sheet as notes payable to operating affiliates. The subsequent income or loss generated by the relevant capital market products or collateralized reinsurance is transferred to the operating affiliates as (income) loss attributable to operating affiliate investors in the Company’s Consolidated Statements of Comprehensive Income. To the extent that the (income) loss attributable to operating affiliate investors has not been returned to investors, it is included in accounts payable and accrued expenses in the

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Notes issued during the three months ended March 31, 2014 amounted to $334,444 (2013: $294,349). The underlying capital market products and collateralized reinsurance typically have at least a twelve month duration. The notes do not have any principal amount, since the final amount payable is dependent on the income or loss as discussed above. They also do not have any stated maturity date, since repayment is dependent on the settlement of the underlying transactions. During the three months ended March 31, 2014 there have been repayments of these notes amounting to $391,115 (2013: $nil).

The following tables present a reconciliation of the beginning and ending notes payable to operating affiliates for the three months ended March 31, 2014 and 2013:

	AlphaCat 2013	AlphaCat 2014	AlphaCat ILS funds	Total
As at December 31, 2013	$223,809	$—	$215,463	$439,272
Notes payable to operating affiliates recognized on deconsolidation of AlphaCat ILS fund	—	—	178,837	178,837
Issuance of notes payable to operating affiliates	—	149,707	184,737	334,444
Redemption of notes payable to operating affiliates	(175,349)	—	(215,766)	(391,115)
Foreign exchange (gain) loss	(297)	109	123	(65)
As at March 31, 2014	$48,163	$149,816	$363,394	$561,373

	AlphaCat 2013	AlphaCat ILS funds	Total
As at December 31, 2012	$—	$—	$—
Issuance of notes payable to operating affiliates	162,506	131,843	294,349
Foreign exchange gain	(1,067)	(2,694)	(3,761)
As at March 31, 2013	$161,439	$129,149	$290,588

The portion of notes payable to operating affiliates that were due to the Company, as an investor in the affiliates, and third party investors as at March 31, 2014 amounted to $141,343 and $420,030, respectively (December 31, 2013: $63,654 and $375,618).

The following table presents the (income) attributable to operating affiliate investors for the three months ended March 31, 2014 and 2013:

	March 31, 2014	March 31, 2013
AlphaCat 2013	$(10,476)	$(8,141)
AlphaCat 2014	(10,789)	—
AlphaCat ILS funds	(10,445)	(1,936)
(Income) attributable to operating affiliate investors	$(31,710)	$(10,077)

The portion of income attributable to operating affiliate investors that was due to the Company, as an investor in the affiliates, and third party investors for the three months ended March 31, 2014 amounted to $6,472 and $25,238, respectively (2013: $1,847 and $8,230).

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6. Noncontrolling interest

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

The portion of PaCRe’s earnings attributable to third party investors is recorded in the Consolidated Statements of Comprehensive Income as net (income) loss attributable to noncontrolling interest. PaCRe's shareholder rights do not include redemption features within the control of the third party shareholders. The third party equity is recorded in the Company’s Consolidated Balance Sheets as noncontrolling interest.

The portion of the earnings from the one consolidated AlphaCat ILS fund attributable to third party investors is recorded in the Consolidated Statements of Comprehensive Income as net (income) loss attributable to noncontrolling interest. The AlphaCat ILS funds have rights that enable shareholders, subject to certain limitations, to redeem their shares. The third party equity is therefore recorded in the Company’s Consolidated Balance Sheets as redeemable noncontrolling interest. When and if a redemption notice is received, the fair value of the redemption is reclassified to a liability.

The following table presents a reconciliation of the beginning and ending balances of redeemable noncontrolling interest and noncontrolling interest for the three months ended March 31, 2014:

	Three Months Ended March 31, 2014		
	Redeemable noncontrolling interest	Noncontrolling interest	Total
As at December 31, 2013	$86,512	$497,657	$584,169
Income attributable to third parties	232	43,277	43,509
Adjustment to noncontrolling interest as a result of deconsolidation	(78,354)	—	(78,354)
As at March 31, 2014	$8,390	$540,934	$549,324

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

	Three Months Ended March 31, 2013		
	Redeemable noncontrolling interest	Noncontrolling interest	Total
As at December 31, 2012	$—	$434,280	$434,280
Issuance of shares	55,690	—	55,690
Income (loss) attributable to third parties	587	(3,136)	(2,549)
As at March 31, 2013	$56,277	$431,144	$487,421

7. Derivative instruments

The Company enters into derivative instruments for risk management purposes, specifically to hedge unmatched foreign currency exposures and interest rate exposures. As at March 31, 2014, the Company held foreign currency forward contracts to mitigate the risk of fluctuations in the U.S. dollar against a number of foreign currencies. As at March 31, 2014, the Company held two interest rate swaps to fix the payment of interest on the Company's 2006 and 2007 Junior Subordinated Deferrable Debentures, as well as three interest rate swaps and one cross-currency interest rate swap to fix the payment of interest and mitigate the foreign exchange rate impact on Flagstone's 2006 and 2007 Junior Subordinated Deferrable Debentures.

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The following table summarizes information on the classification and amount of the fair value of derivatives designated as hedging instruments on the consolidated balance sheets at March 31, 2014 and December 31, 2013:

	As at March 31, 2014			As at December 31, 2013		
Derivatives designated as hedging instruments:	Net notional exposure	Asset Derivative at Fair Value (a)	Liability Derivative at Fair Value (a)	Net notional exposure	Asset Derivative at Fair Value (a)	Liability Derivative at Fair Value (a)
Foreign currency forward contracts	$151,853	$3,839	$477	$163,576	$1,167	$2,313
Interest rate swap contracts	$552,263	$—	$867	$552,263	$—	$911

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

(a) Classification within the fair value hierarchy

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

(b) Derivative instruments designated as a fair value hedge

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

The following table provides the total impact on earnings, recognized in income within foreign exchange gains (losses), relating to the derivative instruments formally designated as fair value hedges along with the impact of the related hedged items for the three months ended March 31, 2014 and 2013:

Foreign currency forward contracts	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Amount of gain (loss) recognized in income on derivative	$3,303	$1,261
Amount of gain (loss) on hedged item recognized in income attributable to risk being hedged	$(3,303)	$(1,261)
Amount of gain (loss) recognized in income on derivative (ineffective portion)	$—	$—

(c) Derivative instruments designated as a cash flow hedge

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

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The following table provides the total impact on other comprehensive income (loss) and earnings relating to the derivative instruments formally designated as cash flow hedges along with the impact of the related hedged items for the three months ended March 31, 2014 and 2013:

Interest rate swap contracts	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Amount of effective portion recognized in other comprehensive income	$3,208	$1,608
Amount of effective portion subsequently reclassified to earnings	$(3,208)	$(1,608)
Amount of ineffective portion excluded from effectiveness testing	$—	$—

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

(d) Balance sheet offsetting

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

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

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

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8. Reserve for losses and loss expenses

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

The following table represents an analysis of paid and unpaid losses and loss expenses incurred and a reconciliation of the beginning and ending unpaid losses and loss expenses for the three months ended March 31, 2014 and 2013:

	Three Months Ended	
	March 31, 2014	March 31, 2013
Reserve for losses and loss expenses, beginning of period	$3,030,399	$3,517,573
Losses and loss expenses recoverable	(370,154)	(439,967)
Net reserves for losses and loss expenses, beginning of period	2,660,245	3,077,606
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:		
Current year	202,086	210,569
Prior years	(39,415)	(65,798)
Total incurred losses and loss expenses	162,671	144,771
Less net losses and loss expenses paid in respect of losses occurring in:		
Current year	(7,967)	(4,838)
Prior years	(250,115)	(255,274)
Total net paid losses	(258,082)	(260,112)
Foreign exchange loss (gain)	11,818	(33,826)
Net reserve for losses and loss expenses, end of period	2,576,652	2,928,439
Losses and loss expenses recoverable	348,407	429,252
Reserve for losses and loss expenses, end of period	$2,925,059	$3,357,691

Incurred losses and loss expenses comprise:

	Three Months Ended	
	March 31, 2014	March 31, 2013
Gross losses and loss expenses	$181,975	$162,411
Reinsurance recoverable	(19,304)	(17,640)
Net incurred losses and loss expenses	$162,671	$144,771

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9. Reinsurance

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

Credit risk

The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- or better as rated by Standard & Poor's or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. At March 31, 2014, 98.5% (December 31, 2013: 96.7%) of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses and $183,858 of total IBNR recoverable (December 31, 2013: $196,840)) were fully collateralized or from reinsurers rated A- or better.

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

	March 31, 2014			December 31, 2013		
	Reinsurance Recoverable	% of Total		Reinsurance Recoverable	% of Total	
Top 10 reinsurers	$291,958	75.7	%	$340,253	75.6	%
Other reinsurers’ balances > $1 million	85,348	22.2	%	100,784	22.4	%
Other reinsurers’ balances < $1 million	8,133	2.1	%	9,197	2.0	%
Total	$385,439	100.0	%	$450,234	100.0	%

	March 31, 2014			
Top 10 Reinsurers	Rating	Reinsurance Recoverable	% of Total	
Lloyd's Syndicates	A+	$66,563	17.3	%
Everest Re	A+	49,838	12.9	%
Fully Collateralized	NR	39,120	10.1	%
Hannover Re	AA-	36,377	9.4	%
Third Point Reinsurance Ltd	A-	34,081	8.8	%
Swiss Re	AA-	17,108	4.5	%
Transatlantic Re	A+	13,449	3.5	%
XL Re	A+	12,608	3.3	%
Munich Re	AA-	12,333	3.2	%
Merrimack Mutual Fire Insurance	A+	10,481	2.7	%
Total		$291,958	75.7	%

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

NR: Not rated

At March 31, 2014 and December 31, 2013, the provision for uncollectible reinsurance relating to reinsurance recoverables was $5,427 and $5,794, respectively. To estimate the provision for uncollectible reinsurance, the reinsurance recoverable is first allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment is applied, especially in relation to ceded IBNR. The Company then uses default factors to determine the portion of a reinsurer’s balance deemed to be uncollectible. Default factors require considerable judgment and are determined in part using the current rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions.

10. Share capital

(a) Authorized and issued

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

The Company may from time to time repurchase its securities, including common shares, Junior Subordinated Deferrable Debentures and Senior Notes. On February 5, 2014, the Board of Directors of the Company approved an increase in the Company's common share purchase authorization to $500,000. This amount is in addition to the $1,774,436 of common shares repurchased by the Company through February 5, 2014 under its previously authorized share repurchase programs.

The Company has repurchased 62,171,982 common shares for an aggregate purchase price of $1,917,688 from the inception of its share repurchase program to March 31, 2014. The Company had $356,748 remaining under its authorized share repurchase program as of March 31, 2014.

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

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

	Common Shares
Common shares issued, December 31, 2013	154,488,497
Restricted share awards vested, net of shares withheld	18,219
Options exercised	90,019
Direct issuance of common stock	359
Common shares issued, March 31, 2014	154,597,094
Treasury shares, March 31, 2014	(63,810,857)
Common shares outstanding, March 31, 2014	90,786,237

	Common Shares
Common shares issued, December 31, 2012	152,698,191
Restricted share awards vested, net of shares withheld	130,637
Restricted share units vested, net of shares withheld	3,796
Options exercised	128,020
Direct issuance of common stock	183
Deferred share units vested, net of shares withheld	2,935
Common shares issued, March 31, 2013	152,963,762
Treasury shares, March 31, 2013	(46,681,321)
Common shares outstanding, March 31, 2013	106,282,441

(b) Warrants

During the three months ended March 31, 2014 and 2013, no warrants were exercised. Holders of the outstanding warrants are entitled to exercise the warrants in whole or in part at any time until the expiration date. The total outstanding warrants at March 31, 2014 were 5,174,114 (December 31, 2013: 5,296,056). No further warrants are anticipated to be issued.

(c) Deferred share units

Under the terms of the Company’s Director Stock Compensation Plan, non-management directors may elect to receive their director fees in deferred share units rather than cash. The number of share units distributed in case of election under the plan is equal to the amount of the annual retainer fee otherwise payable to the director on such payment date divided by 100% of the fair market value of a share on such payment date. Additional deferred share units are issued in lieu of dividends that accrue on these deferred share units. There were no outstanding deferred share units at March 31, 2014 (December 31, 2013: $nil).

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

(d) Dividends

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

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

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11. Stock plans
(a) Long Term Incentive Plan and Short Term Incentive Plan
The Company's Amended and Restated 2005 Long Term Incentive Plan ("LTIP") provides for grants to employees of options, stock appreciation rights ("SARs"), restricted shares, restricted share units, performance shares, dividend equivalents or other share-based awards. In addition, the Company may issue restricted share awards or restricted share units in connection with awards issued under its annual Short Term Incentive Plan ("STIP"). The total number of shares reserved for issuance under the LTIP and STIP are 13,126,896 shares of which 1,987,700 shares are remaining. The LTIP and STIP are administered by the Compensation Committee of the Board of Directors. No SARs have been granted to date. Grant prices are established at the fair market value of the Company's common shares at the date of grant.
i. Options
Options may be exercised for voting common shares upon vesting. Options have a life of 10 years and vest either pro rata or at the end of the required service period from the date of grant. Fair value of the option awards at the date of grant is determined using the Black-Scholes option-pricing model.
Expected volatility is based on stock price volatility of comparable publicly-traded companies. The Company used the simplified method consistent with U.S. GAAP authoritative guidance on stock compensation expenses to estimate expected lives for options granted during the period as historical exercise data was not available and the options met the requirement as set out in the guidance.
The Company has not granted any stock options since September 4, 2009.
There were no share compensation expenses in respect of options recorded for the three months ended March 31, 2014 and 2013.
A modification event was triggered as a result of the 2013 Special Dividend. In accordance with the terms of the LTIP under which the options were issued, an adjustment was required to protect the holders of such stock options from changes in the value of the stock options following the declaration of the 2013 Special Dividend. The modification of the options included a decrease in the exercise price of each stock option and an increase in the number of shares underlying each stock option. The fair value of the options before and after the modification was unchanged.
Activity with respect to options for the three months ended March 31, 2014 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2013	1,572,713	$6.66	$18.88
Options exercised	(90,019)	4.25	25.46
Options outstanding, March 31, 2014	1,482,694	$6.81	$18.48

Activity with respect to options for the three months ended March 31, 2013 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2012	1,823,947	$6.52	$20.69
Options regranted (modified)	1,833,414	6.76	19.02
Options exercised	(128,020)	3.40	28.98
Options cancelled (modified)	(1,733,139)	6.76	20.12
Options outstanding, March 31, 2013	1,796,202	$6.75	$18.95

At March 31, 2014 and 2013, there were no unrecognized share compensation expenses in respect of options.

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ii. Restricted share awards

Restricted shares granted under the LTIP and STIP vest either pro rata or at the end of the required service period and contain certain restrictions during the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $7,001 were recorded for the three months ended March 31, 2014 (2013: $4,061). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested restricted share awards for the three months ended March 31, 2014 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2013	2,684,745	$33.74
Restricted share awards granted	17,533	36.81
Restricted share awards vested	(27,353)	29.31
Restricted share awards forfeited	(23,094)	34.57
Restricted share awards outstanding, March 31, 2014	2,651,831	$33.80

Activity with respect to unvested restricted share awards for the three months ended March 31, 2013 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2012	2,170,547	$29.24
Restricted share awards granted	22,005	35.63
Restricted share awards vested	(148,304)	25.97
Restricted share awards forfeited	(93,993)	28.42
Restricted share awards outstanding, March 31, 2013	1,950,255	$29.60

At March 31, 2014, there were $62,370 (December 31, 2013: $69,219) of total unrecognized share compensation expenses in respect of restricted share awards that are expected to be recognized over a weighted-average period of 3.0 years (December 31, 2013: 3.2 years).

iii. Restricted share units

Restricted share units under the LTIP and STIP vest either ratably or at the end of the required service period and contain certain restrictions during the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $166 were recorded for the three months ended March 31, 2014 (2013: $121). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

Activity with respect to unvested restricted share units for the three months ended March 31, 2014 was as follows:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2013	66,518	$33.74
Restricted share units issued in lieu of cash dividends	495	33.74
Restricted share units outstanding, March 31, 2014	67,013	$33.74

Activity with respect to unvested restricted share units for the three months ended March 31, 2013 was as follows:

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	Restricted Share Units	Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2012	47,238	$29.61
Restricted share units vested	(5,468)	25.27
Restricted share units issued in lieu of cash dividends	3,020	29.69
Restricted share units outstanding, March 31, 2013	44,790	$30.15

At March 31, 2014, there were $1,519 (December 31, 2013: $1,678) of total unrecognized share compensation expenses in respect of restricted share units that are expected to be recognized over a weighted-average period of 3.2 years (December 31, 2013: 3.4 years).

iv. Performance share awards

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

Share compensation expenses of $(20) were recorded for the three months ended March 31, 2014 (2013: $(1,864)). The negative expense is due to a reversal of expenses on unvested performance share awards based on a review of current and projected performance criteria.

Activity with respect to unvested performance share awards for the three months ended March 31, 2014 was as follows:

	Performance Share Awards	Weighted Average Grant Date Fair Value
Performance share awards outstanding, December 31, 2013	101,820	$33.56
Performance share awards conversion adjustment	(15,344)	31.38
Performance share awards outstanding, March 31, 2014	86,476	$33.95

Activity with respect to unvested performance share awards for the three months ended March 31, 2013 was as follows:

	Performance Share Awards	Weighted Average Grant Date Fair Value
Performance share awards outstanding, December 31, 2012	220,845	$31.81
Performance share awards forfeited	(128,667)	32.41
Performance share awards outstanding, March 31, 2013	92,178	$30.99

At March 31, 2014, there were $1,207 (December 31, 2013: $1,642) of total unrecognized share compensation expenses in respect of performance share awards that are expected to be recognized over a weighted-average period of 1.9 years (December 31, 2013: 2.0 years).

(b) Total share compensation expenses

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

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	Three Months Ended	
	March 31, 2014	March 31, 2013
Restricted share awards	$7,001	$4,061
Restricted share units	166	121
Performance share awards	(20)	(1,864)
Total	$7,147	$2,318

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12. Debt and financing arrangements
(a) Financing structure
The financing structure at March 31, 2014 was:

	Commitment	Issued and outstanding (a)	Drawn
2006 Junior Subordinated Deferrable Debentures	$150,000	$150,000	$150,000
2007 Junior Subordinated Deferrable Debentures	200,000	139,800	139,800
Flagstone 2006 Junior Subordinated Deferrable Debentures	137,904	137,904	137,904
Flagstone 2007 Junior Subordinated Deferrable Debentures	113,750	113,750	113,750
Total debentures payable	601,654	541,454	541,454
2010 Senior Notes due 2040	250,000	250,000	247,225
Total debentures and senior notes payable	851,654	791,454	788,679
$400,000 syndicated unsecured letter of credit facility	400,000	—	—
$525,000 syndicated secured letter of credit facility	525,000	309,422	—
$200,000 secured bi-lateral letter of credit facility	200,000	18,676	—
Talbot FAL facility	25,000	25,000	—
PaCRe senior secured letter of credit facility	10,000	294	—
AlphaCat Re secured letter of credit facility	30,000	24,800	—
IPC bi-lateral facility	40,000	19,817	—
$375,000 Flagstone bi-lateral facility	375,000	292,532	—
Total credit and other facilities	1,605,000	690,541	—
Total debt and financing arrangements	$2,456,654	$1,481,995	$788,679

The financing structure at December 31, 2013 was:

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

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

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(b) Senior notes and junior subordinated deferrable debentures

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

Description	Issuance date	Commitment	Maturity date	Fixed/Spread			Interest payments due
2006 Junior Subordinated Deferrable Debentures	June 15, 2006	$ 150,000	June 15, 2036	9.069	%	(b)	Quarterly
Flagstone 2006 Junior Subordinated Deferrable Debentures	August 23, 2006	$ 137,904	September 15, 2036	3.540	%	(a)	Quarterly
2007 Junior Subordinated Deferrable Debentures	June 21, 2007	$ 200,000	June 15, 2037	8.480	%	(b)	Quarterly
Flagstone 2007 Junior Subordinated Deferrable Debentures	June 8, 2007	$ 88,750	July 30, 2037	3.000	%	(a)	Quarterly
Flagstone 2007 Junior Subordinated Deferrable Debentures	September 20, 2007	$ 25,000	September 15, 2037	3.100	%	(a)	Quarterly
2010 Senior Notes due 2040	January 26, 2010	$ 250,000	January 26, 2040	8.875	%	(b)	Semi-annually in arrears

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

The following table summarizes the key terms of the Company's senior notes and junior subordinated deferrable debentures as at March 31, 2014:

Description	Issuance date	Commitment	Maturity date	Fixed/Spread			Interest payments due
2006 Junior Subordinated Deferrable Debentures	June 15, 2006	$ 150,000	June 15, 2036	5.831	%	(b)	Quarterly
Flagstone 2006 Junior Subordinated Deferrable Debentures	August 23, 2006	$ 137,904	September 15, 2036	6.463	%	(b)	Quarterly
2007 Junior Subordinated Deferrable Debentures	June 21, 2007	$ 200,000	June 15, 2037	5.180	%	(b)	Quarterly
Flagstone 2007 Junior Subordinated Deferrable Debentures	June 8, 2007	$ 88,750	July 30, 2037	5.900	%	(b)	Quarterly
Flagstone 2007 Junior Subordinated Deferrable Debentures	September 20, 2007	$ 25,000	September 15, 2037	5.983	%	(b)	Quarterly
2010 Senior Notes due 2040	January 26, 2010	$ 250,000	January 26, 2040	8.875	%	(a)	Semi-annually in arrears

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

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Senior Notes

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

Debt issuance costs were deferred as an asset and are amortized over the life of the 2010 Senior Notes. There were no redemptions made during the three months ended March 31, 2014 and 2013.

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

Future payments of principal of $250,000 on the 2010 Senior Notes are all expected to be after 2018.

Junior subordinated deferrable debentures

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

Debt issuance costs for the 2006 and 2007 Junior Subordinated Deferrable Debentures were deferred as an asset and were amortized to income over the five year optional redemption periods. They are redeemable at the Company's option at par. There were no redemptions made during the three months ended March 31, 2014 and 2013.

As part of the acquisition of Flagstone, the Company assumed junior subordinated deferrable debentures due 2036 and 2037 (respectively, the "Flagstone 2006 Junior Subordinated Deferrable Debentures" and "Flagstone 2007 Junior Subordinated Deferrable Debentures"). These debentures are redeemable quarterly at par. There were no redemptions made during the three months ended March 31, 2014 and 2013.

Future payments of principal of $541,454 on the debentures discussed above are all expected to be after 2018.

(c) Credit facilities

i. $400,000 syndicated unsecured letter of credit facility and $525,000 syndicated secured letter of credit facility

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

Also on March 9, 2012, the Company entered into a $525,000 four-year secured credit facility, with the same parties, which provides for letter of credit availability for the Company (the "Four Year Secured Facility" and together with the Four Year Unsecured Facility, the "Credit Facilities"). The Four Year Secured Facility was also provided by a syndicate of commercial banks. Letters of credit under the Four Year Secured Facility will be available to support obligations in connection with the insurance business of the Company. The Company may request that existing lenders under the Four Year Secured Facility or prospective additional lenders agree to make available additional commitments from time to time so long as the aggregate commitments under the Four Year Secured Facility do not exceed $700,000. The obligations of the Company under the Four Year Secured Facility are secured by cash and securities deposited into cash collateral accounts from time to time with The Bank of New York Mellon.

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As of March 31, 2014, there were $309,422 in outstanding letters of credit under the Four Year Secured Facility (December 31, 2013: $358,567) and $nil outstanding under the Four Year Unsecured Facility.

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

On March 9, 2012, upon entering into the Credit Facilities, the Company terminated its (a) three-year bi-lateral $60,000 unsecured revolving credit facility, dated March 12, 2010, (b) $340,000 three-year unsecured credit facility, dated March 12, 2010 and (c) $500,000 five-year secured credit facility, dated March 12, 2007. No early termination penalties were incurred.

ii. $25,000 Talbot FAL facility

Talbot holds a standby Letter of Credit facility (the "Talbot FAL facility") to provide Funds at Lloyd's to support the 2010, 2011, 2012, 2013, 2014 and 2015 underwriting years of account. As of March 31, 2014 the Company had $25,000 (December 31, 2013: $25,000) in outstanding letters of credit under the Talbot FAL facility.

The Talbot FAL facility contains affirmative covenants that include requirements for consolidated net worth and debt to capital ratios in line with those in place for the Credit Facilities and discussed above. The Talbot FAL facility also contains restrictions on our ability to incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others. Other than in respect of existing and future preferred and hybrid securities, the payment of dividends and other payments in respect of equity interests are not permitted at any time that we are in default with respect to certain provisions under the Talbot FAL facility. As of March 31, 2014 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Talbot FAL facility.

iii. $40,000 IPC bi-lateral facility

The Company assumed an existing evergreen letter of credit facility through the acquisition of IPC (the "IPC bi-lateral facility"). As of March 31, 2014, there were $19,817 outstanding letters of credit issued under the IPC bi-lateral facility (December 31, 2013: $20,177). As of March 31, 2014 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the IPC bi-lateral facility.

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

The Company holds an uncommitted secured bi-lateral letter of credit facility with Citibank Europe plc (the "Secured bi-lateral letter of credit facility"). As of March 31, 2014, $18,676 (December 31, 2013: $16,726) of letters of credit were outstanding under the Secured bi-lateral letter of credit facility. The Secured bi-lateral letter of credit facility has no fixed termination date and as of March 31, 2014, the Company is in compliance with all terms and covenants thereof.

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

On May 11, 2012, PaCRe (as "Borrower") and its subsidiary, PaCRe Investments, Ltd. (as "Guarantor") entered into a secured evergreen credit and letter of credit facility with JPMorgan Chase Bank, N.A. This facility provides for revolving borrowings by the Borrower and for letters of credit issued by the Borrower to be used to support its reinsurance obligations in aggregate amount of $10,000. As of March 31, 2014, $294 (December 31, 2013: $294) of letters of credit were outstanding under this facility. As of March 31, 2014, and throughout the reporting periods presented, PaCRe was in compliance with all covenants and restrictions thereof.

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

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

vii. $375,000 Flagstone bi-lateral facility

As part of the Flagstone Acquisition, the Company assumed an evergreen Letters of Credit Master Agreement between Citibank Europe Plc and Flagstone Reassurance Suisse, S.A. (the “Flagstone Bi-Lateral Facility”). At March 31, 2014, the Flagstone Bi-Lateral Facility had $292,532 (December 31, 2013: $305,686) letters of credit issued and outstanding. As of March 31, 2014, and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Flagstone Bi-Lateral Facility.

(d) Finance expenses

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

	Three Months Ended	
	March 31, 2014	March 31, 2013
2006 Junior Subordinated Deferrable Debentures	$2,187	$2,187
2007 Junior Subordinated Deferrable Debentures	1,809	1,809
Flagstone 2006 Junior Subordinated Deferrable Debentures	2,223	1,472
Flagstone 2007 Junior Subordinated Deferrable Debentures	1,750	1,072
2010 Senior Notes due 2040	5,597	5,597
Credit facilities	1,559	954
Bank charges	113	133
AlphaCat ILS funds fees (a)	677	1,114
Talbot FAL Facility	(15)	31
Total finance expenses	$15,900	$14,369

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

13. Accumulated other comprehensive (loss)

The changes in accumulated other comprehensive income ("AOCI"), by component for the three months ended March 31, 2014 and 2013 is as follows:

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Beginning balance, December 31	$(617)	$(2,953)
Current period foreign currency translation adjustments	462	(9,785)
Ending balance, March 31	$(155)	$(12,738)

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14. Commitments and contingencies

(a) Concentrations of credit risk

The Company’s investments are managed following prudent standards of diversification. The Company attempts to limit its credit exposure by purchasing high quality fixed income investments to maintain an average portfolio, excluding bank loans, credit quality of AA- or higher, with mortgage and commercial mortgage-backed issues having an aggregate weighted average credit quality of AAA. In addition, the Company limits its exposure to any single issuer to 3% of its investment portfolio or less, excluding government and agency securities. With the exception of the Company's bank loan portfolio, which represents 9.5% of the Company's total investments as at March 31, 2014, the minimum credit rating of any security purchased is Baa3/BBB-. In the case where currently held investments are downgraded below Baa3/BBB-, the Company tolerates a holding of up to 2% of its investment portfolio in aggregate market value, or 10% with written authorization. Excluding bank loans, 1.0% of the portfolio had a split rating below Baa3/BBB- as at March 31, 2014. The Company did not have an aggregate exposure to any single issuer of more than 0.9% of its investment portfolio, other than with respect to government and agency securities as at March 31, 2014.

(b) Funds at Lloyd's

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

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

The amounts of cash, investments and letters of credit provided for each year of account as follows:

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

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

(c) Lloyd's Central Fund

Whenever a member of Lloyd's is unable to pay its debts to policyholders, such debts may be payable by the Lloyd's Central Fund. If Lloyd's determines that the Central Fund needs to be increased, it has the power to assess premium levies on current Lloyd's members up to 3% of a member's underwriting capacity in any one year. The Company does not believe that any assessment is likely in the foreseeable future and has not provided any allowance for such an assessment. However, based on the Company's 2014 estimated premium income at Lloyd's of £625,000, at the March 31, 2014 exchange rate of £1 equals $1.6658 and assuming the maximum 3% assessment, the Company would be assessed approximately $31,234.

(d) Aquiline Commitment

As discussed in Note 5 "Investments in affiliates," the Company entered into an Assignment and Assumption Agreement with Aquiline Capital Partners LLC, pursuant to which it assumed a total capital commitment of $50,000 which will expire on July 2, 2015. The Company's remaining commitment at March 31, 2014 was $17,890

(December 31, 2013: $17,890).

15. Related party transactions

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

Aquiline Capital Partners, LLC and its related companies ("Aquiline"), which own 3,446,643 shares in the Company, hold warrants to purchase 2,756,088 shares, and have two employees on the Company's Board of Directors who do not receive compensation from the Company and are shareholders of Group Ark Insurance Holdings Ltd. ("Group Ark"). Christopher E. Watson, a director of the Company, serves as a director of Group Ark. Pursuant to reinsurance agreements with a subsidiary of Group Ark, the Company recognized gross premiums written during the three months ended March 31, 2014 of $1,373 (2013: $1,795), with $181 included in premiums receivable at March 31, 2014 (December 31, 2013: $242). The Company also recognized reinsurance premiums ceded during the three months ended March 31, 2014 of $5 (2013: $4). The Company recorded $2,688 of loss reserves recoverable at March 31, 2014 (December 31, 2013: $3,698). Earned premium adjustments of $1,441 (2013: $719) were recorded during the three months ended March 31, 2014.

On November 24, 2009, the Company entered into an Investment Management Agreement with Conning, Inc. ("Conning") to manage a portion of the Company's investment portfolio. Aquiline acquired Conning on June 16, 2009. Jeffrey W. Greenberg, a director of the Company, serves as a director of Conning Holdings Corp., the parent company of Conning. Investment management fees earned by Conning for the three months ended March 31, 2014 were $56 (2013: $191) with $170 included in accounts payable and accrued expenses at March 31, 2014 (December 31, 2013: $283).

On December 20, 2011, the Company entered into an Assignment and Assumption Agreement (the "Agreement") with Aquiline Capital Partners LLC, a Delaware limited liability company (the "Assignor") and Aquiline Capital Partners II GP (Offshore) Ltd., a Cayman Islands company limited by shares (the "General Partner") pursuant to which the Company has assumed 100% of the Assignor's interest in Aquiline Financial Services Fund II L.P. (the "Partnership") representing a total capital commitment of $50,000 (the "Commitment"), as a limited partner in the Partnership (the "Transferred Interest"). Messrs. Greenberg and Watson, directors of the Company, serve as managing principal and senior principal, respectively, of Aquiline Capital Partners LLC. For the three months ended March 31, 2014, the Company incurred $nil (2013: $120) in partnership fees and made $nil (2013: $1,341) capital contributions. There were no amounts included in accounts payable and accrued expenses at March 31, 2014 (December 31, 2013: $nil).

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

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16. Earnings per share

The following table sets forth the computation of basic and earnings per diluted share for the three months ended March 31, 2014 and 2013:

	Three Months Ended	
	March 31, 2014	March 31, 2013
Basic earnings per share		
Net income	$205,897	$220,694
(Income) loss attributable to noncontrolling interest	(43,509)	2,549
Net income available to Validus	162,388	223,243
Less: Dividends and distributions declared on outstanding warrants	(1,552)	(14,464)
Income available to common shareholders	$160,836	$208,779
Weighted average number of common shares outstanding	93,451,999	107,386,438
Basic earnings per share available to common shareholders	$1.72	$1.94
Earnings per diluted share		
Net income	$205,897	$220,694
(Income) loss attributable to noncontrolling interest	(43,509)	2,549
Net income available to Validus	162,388	223,243
Less: Dividends and distributions declared on outstanding warrants	—	(14,464)
Income available to common shareholders	$162,388	$208,779
Weighted average number of common shares outstanding	93,451,999	107,386,438
Share equivalents:		
Warrants	2,716,010	—
Stock options	750,369	1,631,556
Unvested restricted shares	881,141	1,035,005
Weighted average number of diluted common shares outstanding	97,799,519	110,052,999
Earnings per diluted share available to common shareholders	$1.66	$1.90

Share equivalents that would result in the issuance of common shares of 12,498 (2013: 104,405) were outstanding for the three months ended March 31, 2014, but were not included in the computation of earnings per diluted share because the effect would be antidilutive.

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17. Segment information

The Company conducts its operations worldwide through three operating segments, which have been determined under U.S. GAAP segment reporting to be Validus Re, AlphaCat and Talbot. The Company's operating segments are strategic business units that offer different products and services. They are managed and have capital allocated separately because each segment requires different strategies.

Validus Re Segment

The Validus Re segment is focused on short-tail lines of reinsurance. The primary lines in which the segment conducts business are property, marine and specialty which includes agriculture, aerospace and aviation, financial lines of business, nuclear, terrorism, life, accident & health, workers' compensation, crisis management, contingency, motor, technical lines, composite and trade credit.

AlphaCat Segment

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

Talbot Segment

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

Corporate and eliminations

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

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

Three Months Ended March 31, 2014	Validus Re Segment	AlphaCat Segment	Talbot Segment	Corporate & Eliminations	Total
Underwriting income					
Gross premiums written	$678,986	$84,347	$290,695	$(42,037)	$1,011,991
Reinsurance premiums ceded	(142,640)	(3,700)	(90,605)	42,037	(194,908)
Net premiums written	536,346	80,647	200,090	—	817,083
Change in unearned premiums	(297,960)	(49,964)	13,798	—	(334,126)
Net premiums earned	238,386	30,683	213,888	—	482,957
Underwriting deductions					
Losses and loss expenses	68,155	(7,860)	102,376	—	162,671
Policy acquisition costs	39,245	2,980	44,928	(1,504)	85,649
General and administrative expenses	18,195	4,128	35,149	16,973	74,445
Share compensation expenses	2,208	(10)	2,582	2,367	7,147
Total underwriting deductions	127,803	(762)	185,035	17,836	329,912
Underwriting income (loss)	$110,583	$31,445	$28,853	$(17,836)	$153,045
Net investment income	18,765	880	4,686	(969)	23,362
Other income	6,770	9,497	17	(2,454)	13,830
Finance expenses	(3,839)	(683)	(26)	(11,352)	(15,900)
Operating income (loss) before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	132,279	41,139	33,530	(32,611)	174,337
Tax benefit (expense)	578	—	130	(668)	40
Income from operating affiliates	—	4,927	—	—	4,927
(Income) attributable to operating affiliate investors	—	(31,710)	—	—	(31,710)
Net operating income (loss)	$132,857	$14,356	$33,660	$(33,279)	$147,594
Net realized gains on investments	2,446	1,225	69	—	3,740
Change in net unrealized gains (losses) on investments	11,898	45,872	2,577	(4,654)	55,693
Income from investment affiliate	5,348	—	—	—	5,348
Foreign exchange (losses) gains	(6,176)	38	(150)	(190)	(6,478)
Net income (loss)	$146,373	$61,491	$36,156	$(38,123)	$205,897
Net (income) attributable to noncontrolling interest	—	(43,509)	—	—	(43,509)
Net income (loss) available (attributable) to Validus	$146,373	$17,982	$36,156	$(38,123)	$162,388

Selected ratios (a):					
Net premiums written / Gross premiums written	79.0 %	95.6 %	68.8 %		80.7 %
Losses and loss expenses	28.6 %	(25.6)%	47.9 %		33.7 %
Policy acquisition costs	16.5 %	9.7 %	21.0 %		17.7 %
General and administrative expenses (b)	8.5 %	13.4 %	17.6 %		16.9 %
Expense ratio	25.0 %	23.1 %	38.6 %		34.6 %
Combined ratio	53.6 %	(2.5)%	86.5 %		68.3 %
Total assets	$5,603,777	$1,582,014	$2,975,510	$94,788	$10,256,089

(a) Ratios are based on net premiums earned.

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

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Three Months Ended March 31, 2013	Validus Re Segment	AlphaCat Segment	Talbot Segment	Corporate & Eliminations	Total
Underwriting income					
Gross premiums written	$747,963	$96,516	$293,530	$(33,249)	$1,104,760
Reinsurance premiums ceded	(125,728)	—	(94,737)	33,249	(187,216)
Net premiums written	622,235	96,516	198,793	—	917,544
Change in unearned premiums	(319,101)	(68,899)	1,517	—	(386,483)
Net premiums earned	303,134	27,617	200,310	—	531,061
Underwriting deductions					
Losses and loss expenses	73,402	—	71,369	—	144,771
Policy acquisition costs	51,744	2,638	40,526	(1,297)	93,611
General and administrative expenses	29,441	4,037	30,912	15,889	80,279
Share compensation expenses	1,413	77	1,405	(577)	2,318
Total underwriting deductions	156,000	6,752	144,212	14,015	320,979
Underwriting income (loss)	$147,134	$20,865	$56,098	$(14,015)	$210,082
Net investment income	23,193	881	4,718	(3,143)	25,649
Other income	13,490	6,633	—	(17,438)	2,685
Finance expenses	(3,252)	(1,248)	(74)	(9,795)	(14,369)
Operating income (loss) before taxes, income from operating affiliates and (income) attributable to operating affiliate investors	180,565	27,131	60,742	(44,391)	224,047
Tax expense (benefit)	1,757	—	(1,054)	(385)	318
Income from operating affiliates	—	3,523	—	—	3,523
(Income) attributable to operating affiliate investors	—	(10,077)	—	—	(10,077)
Net operating income (loss)	$182,322	$20,577	$59,688	$(44,776)	$217,811
Net realized gains on investments	1,593	—	128	—	1,721
Change in net unrealized (losses) on investments	(2,193)	(4,788)	(256)	—	(7,237)
Income from investment affiliate	1,477	—	—	—	1,477
Foreign exchange gains (losses)	11,162	(1,187)	(3,918)	865	6,922
Net income (loss)	$194,361	$14,602	$55,642	$(43,911)	$220,694
Net loss attributable to noncontrolling interest	—	2,549	—	—	2,549
Net income (loss) available (attributable) to Validus	$194,361	$17,151	$55,642	$(43,911)	$223,243

Selected ratios (a):

Net premiums written / Gross premiums written	83.2 %	100.0 %	67.7 %		83.1 %
Losses and loss expenses	24.2 %	0.0 %	35.6 %		27.3 %
Policy acquisition costs	17.1 %	9.6 %	20.2 %		17.6 %
General and administrative expenses (b)	10.2 %	14.9 %	16.1 %		15.6 %
Expense ratio	27.3 %	24.5 %	36.3 %		33.2 %
Combined ratio	51.5 %	24.5 %	71.9 %		60.5 %
Total assets	$6,299,481	$1,189,190	$3,043,312	$32,417	$10,564,400

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

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

	Three Months Ended March 31, 2014					
	Gross Premiums Written					
	Validus Re	AlphaCat	Talbot	Eliminations	Total	%
United States	$191,868	$8,698	$26,311	$(5,665)	$221,212	21.9 %
Worldwide excluding United States (a)	61,534	7,678	37,182	(4,740)	101,654	9.9 %
Australia and New Zealand	12,816	1,019	2,880	(281)	16,434	1.6 %
Europe	37,896	1,301	18,791	(2,817)	55,171	5.5 %
Latin America and Caribbean	6,934	—	31,239	(3,052)	35,121	3.5 %
Japan	159	—	538	(53)	644	0.1 %
Canada	2,899	216	3,145	(523)	5,737	0.6 %
Rest of the world (b)	53,850	—	18,404	(1,798)	70,456	7.0 %
Sub-total, non United States	176,088	10,214	112,179	(13,264)	285,217	28.2 %
Worldwide including United States (a)	105,191	65,435	23,653	(6,646)	187,633	18.5 %
Other location non-specific (c)	205,839	—	128,552	(16,462)	317,929	31.4 %
Total	$678,986	$84,347	$290,695	$(42,037)	$1,011,991	100.0 %

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

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

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18. Subsequent events

(a) Quarterly Dividend

On April 30, 2014, the Company announced a quarterly cash dividend of $0.30 per each common share and $0.30 per common share equivalent for which each outstanding warrant is exercisable, payable on June 30, 2014 to holders of record on June 13, 2014.

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

For a variety of reasons, the Company's historical financial results may not accurately indicate future performance. See "Cautionary Note Regarding Forward-Looking Statements." The Risk Factors set forth in Part I Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013 present a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained herein.

Executive Overview

The Company conducts its operations worldwide through three operating segments which have been determined under U.S. GAAP segment reporting to be Validus Re, AlphaCat and Talbot. Validus Re is a Bermuda-based reinsurance segment focused on short tail lines of reinsurance. AlphaCat is a Bermuda-based investment adviser, managing capital from third parties and the Company in insurance linked securities and other investments in the property catastrophe reinsurance space. Talbot is a specialty insurance segment, primarily operating within the Lloyd's insurance market through Syndicate 1183.

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

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

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

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Business Outlook and Trends

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

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

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

During the January 2014 renewal season, the Validus Re and AlphaCat segments underwrote $575.2 million in gross premiums written, a decrease of 3.2% from the prior period, excluding the impact of the agriculture business in both years. This decrease was primarily driven by a challenging rate environment in our U.S. property catastrophe business, which experienced a reduction in rates of approximately 12.5%.

Financial Measures

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

	Three Months Ended March 31,		Year Ended December 31,
	2014	2013	2013
Book value per diluted common share plus accumulated dividends	$45.56	$41.57	$43.91
Book value per diluted common share	37.58	34.79	36.23
Underwriting income	153,045	210,082	604,908
Net operating income attributable to Validus	146,090	215,618	578,672

Annualized return on average equity	17.7 %	22.5 %	14.0 %

Book value per diluted common share plus accumulated dividends is considered by management to be the primary indicator of financial performance, as we believe growth in book value on a diluted basis, plus the dividends that have accumulated, ultimately translates into the return that a shareholder will receive. Book value per diluted common share plus accumulated dividends increased by $1.65, or 3.8%, from $43.91 at December 31, 2013 to $45.56 at March 31, 2014. Cash dividends per common share are an integral part of the value created for shareholders. The Company paid quarterly cash dividends of $0.30 per common share and common

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share equivalent in the three months ended March 31, 2014. On April 30, 2014, the Company announced a quarterly cash dividend of $0.30 per common share and $0.30 per common share equivalent for which each outstanding warrant is exercisable, payable on June 30, 2014 to holders of record on June 13, 2014. Book value per diluted common share plus accumulated dividends is calculated based on total shareholders' equity plus the assumed proceeds from the exercise of outstanding options and warrants, divided by the sum of common shares, unvested restricted shares and options and warrants outstanding (assuming their exercise), plus accumulated dividends. Book value per diluted common share plus accumulated dividends is a non-GAAP financial measure, as described in more detail in the section entitled "Non-GAAP Financial Measures."

Book value per diluted common share is considered by management to be a measure of our returns to common shareholders, as we believe growth in book value on a diluted basis ultimately translates into growth in stock price. Book value per diluted common share after dividends paid, increased by $1.35, or 3.7%, from $36.23 at December 31, 2013 to $37.58 at March 31, 2014. The increase was as a result of the net income available to Validus for the three months ended March 31, 2014. Book value per diluted common share is a non-GAAP financial measure, as described in more detail in the section entitled "Non-GAAP Financial Measures."

Underwriting income measures the performance of the Company's core underwriting function, excluding revenues and expenses such as net investment income (loss), other income, finance expenses, net realized and change in net unrealized gains (losses) on investments, foreign exchange gains (losses) and non-recurring items. The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company's core insurance and reinsurance operations. Underwriting income is a non-GAAP financial measure, as described in more detail in the section entitled "Non-GAAP Financial Measures."

Net operating income available to Validus is defined as net income excluding net realized and change in net unrealized gains (losses) on investments, income (loss) from investment affiliate, foreign exchange gains (losses), non-recurring items and income (loss) (attributable) to noncontrolling interest. This measure focuses on the underlying fundamentals of our operations without the influence of gains (losses) from the sale of investments, translation of non-U.S. dollar currencies and non-recurring items. Net operating income is a non-GAAP financial measure, as described in more detail in the section entitled "Non-GAAP Financial Measures."

Annualized return on average equity represents the return generated on common shareholders' capital during the period. Return on average equity is calculated by dividing the net income available to Validus for the period by the average shareholders' equity available to Validus during the period. Average shareholders' equity is the average of the beginning, ending and intervening quarter end shareholders' equity balances. The Company's objective is to generate superior returns on capital that appropriately reward shareholders for the risks assumed. The decrease in annualized return on average equity for the three months ended March 31, 2014 was driven primarily by a decrease in net income available to Validus. Net income available to Validus for the three months ended March 31, 2014 decreased by $60.9 million or 27.3% compared to the three months ended March 31, 2013.

First Quarter 2014 Summarized Consolidated Results of Operations

- Gross premiums written for the three months ended March 31, 2014 were $1,012.0 million compared to $1,104.8 million for the three months ended March 31, 2013, a decrease of $92.8 million, or 8.4%.
- Net premiums earned for the three months ended March 31, 2014 were $483.0 million compared to $531.1 million for the three months ended March 31, 2013, a decrease of $48.1 million, or 9.1%.
- Underwriting income for the three months ended March 31, 2014 was $153.0 million compared to $210.1 million for the three months ended March 31, 2013, a decrease of $57.0 million, or 27.1%.
- Combined ratio for the three months ended March 31, 2014 of 68.3% which included $39.4 million of favorable loss reserve development on prior accident years, benefiting the loss ratio by 8.2 percentage points compared to a combined ratio for the three months ended March 31, 2013 of 60.5% which included $65.8 million of favorable loss reserve development on prior accident years, benefiting the loss ratio by 12.4 percentage points.

- Loss ratio for the three months ended March 31, 2014 of 33.7% compared to 27.3% for the three months ended March 31, 2013.
- Loss ratios by line of business are as follows:

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	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013	Percentage Point Change
Property	14.3 %	5.4 %	8.9 %
Marine	40.1 %	34.7 %	5.4 %
Specialty	55.2 %	61.1 %	(5.9)%
All lines	33.7 %	27.3 %	6.4 %

- Net investment income for the three months ended March 31, 2014 was $23.4 million compared to $25.6 million for the three months ended March 31, 2013, a decrease of $2.3 million, or 8.9%.
- Net operating income available to Validus for the three months ended March 31, 2014 was $146.1 million compared to $215.6 million for the three months ended March 31, 2013, a decrease of $69.5 million, or 32.2%.
- Net income available to Validus for the three months ended March 31, 2014 was $162.4 million, or $1.66 per diluted common share compared to $223.2 million or $1.90 per diluted common share for the three months ended March 31, 2013.
- Losses and loss expenses from notable loss events for the three months ended March 31, 2014 and March 31, 2013 were $nil.
- Investment yield for the three months ended March 31, 2014 was 1.29% compared to 1.38% for the three months ended March 31, 2013.
- Annualized return on average equity and annualized net operating return on average equity for the three months ended March 31, 2014 were 17.7% and 15.9%, respectively, compared to 22.5% and 21.8% for the three months ended March 31, 2013.
- Total investments and cash as at March 31, 2014 was $7.8 billion compared to $8.0 billion at December 31, 2013.

Overview of the Results of Operations for the Three Months Ended March 31, 2014 compared to the Three Months Ended March 31, 2013.

The change in net operating income available to Validus for the three months ended March 31, 2014 compared to the three months ended March 31, 2013 is described in the following table:

(Dollars in thousands)	Increase (decrease) to net operating income available to Validus over the three months ended March 31 2014 compared to 2013
Net premiums earned	$ (48,104)
Notable losses (a)	—
Incurred current year losses, excluding notable losses	8,483
Prior period loss development	(26,383)
Other underwriting deductions (b)	8,967
Underwriting income (c)	(57,037)
(Income) attributable to operating affiliate investors	(21,633)
Other operating expenses and income, net (d)	8,453
Net operating income (c)	(70,217)
Net operating (income) loss attributable to noncontrolling interest	689
Net operating income available to Validus (c)	$ (69,528)

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(a) There were no notable loss events for the three months ended March 31, 2014 and 2013, respectively.
(b) Other underwriting deductions consist of policy acquisition costs, general & administrative expenses and share compensation expenses.
(c) Non-GAAP Financial Measures. In presenting the Company's results, management has included and discussed underwriting income and operating income that is not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. Further discussion of these measures is presented in the section entitled "Non-GAAP Financial Measures."
(d) Other operating expenses and income, net, consists of net investment income, other income, finance expenses, taxes and income (loss) from operating affiliates.

Net operating income available to Validus for the three months ended March 31, 2014 was $146.1 million compared to $215.6 million for the three months ended March 31, 2013, a decrease of $69.5 million or 32.2%. The primary factors driving the decrease in net operating income were:

- Decrease in underwriting income of $57.0 million primarily due to:

- A decrease in net premiums earned of $48.1 million, primarily due to a reduction in gross premiums written; and

- A decrease in favorable prior period loss development of $26.4 million, offset by;

- A favorable movement in policy acquisition costs of $8.0 million.

Also contributing to the decrease was an unfavorable movement in income attributable to operating affiliate investors of $21.6 million, offset by an increase in other income of $11.1 million.

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

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First Quarter 2014 Results of Operations - Validus Re Segment

The following table presents results of operations for the three months ended March 31, 2014 and 2013, respectively:

	Three Months Ended March 31,	
(Dollars in thousands)	2014	2013
Underwriting income		
Gross premiums written	$678,986	$747,963
Reinsurance premiums ceded	(142,640)	(125,728)
Net premiums written	536,346	622,235
Change in unearned premiums	(297,960)	(319,101)
Net premiums earned	238,386	303,134
Underwriting deductions		
Losses and loss expenses	68,155	73,402
Policy acquisition costs	39,245	51,744
General and administrative expenses	18,195	29,441
Share compensation expenses	2,208	1,413
Total underwriting deductions	127,803	156,000
Underwriting income (a)	110,583	147,134
Net investment income	18,765	23,193
Other income	6,770	13,490
Finance expenses	(3,839)	(3,252)
Operating income before taxes	132,279	180,565
Tax benefit	578	1,757
Net operating income (a)	$132,857	$182,322
Selected ratios:		
Net premiums written / Gross premiums written	79.0%	83.2%
Losses and loss expenses	28.6%	24.2%
Policy acquisition costs	16.5%	17.1%
General and administrative expenses (b)	8.5%	10.2%
Expense ratio	25.0%	27.3%
Combined ratio	53.6%	51.5%

a) Non-GAAP Financial Measures: In presenting the Company's results, management has included and discussed underwriting income and net operating income that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. Further discussion of these measures is presented in the section entitled “Non-GAAP Financial Measures.”

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

The change in net operating income for the three months ended March 31, 2014 compared to the three months ended March 31, 2013, respectively, is described in the following table:

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(Dollars in thousands)	Increase (decrease) to net operating income over the three months ended March 31 2014 compared to 2013
Net premiums earned	$(64,748)
Notable losses (a)	—
Incurred current year losses, excluding notable losses	24,001
Prior period loss development	(18,754)
Other underwriting deductions (b)	22,950
Underwriting income (d)	(36,551)
Other operating income and expenses, net (c)	(12,914)
Net operating income (d)	$(49,465)

(a) There were no notable loss events for the three months ended March 31, 2014 and 2013, respectively.

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

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

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

Gross Premiums Written

	Gross Premiums Written Three Months Ended March 31,		
(Dollars in thousands)	2014	2013	Change
Property	$270,602	$326,024	$(55,422)
Marine	152,962	161,432	(8,470)
Specialty	255,422	260,507	(5,085)
Total	$678,986	$747,963	$(68,977)

The decrease in gross premiums written in the property lines of $55.4 million was primarily due to a reduction in catastrophe excess of loss treaties of $45.2 million. This was as a result of current market conditions, the impact of a program that was withdrawn and a number of non-renewals due to both unfavorable pricing and the inclusion of terror exposure on some programs without an appropriate premium for the additional risk. The decrease in gross premiums written of $8.5 million in the marine lines was primarily due to non-renewals and some business historically written in marine lines being renewed in specialty lines. The decrease in gross premiums written of $5.1 million in the specialty lines was due to a $37.5 million reduction in agricultural business as a result of reduced participation in a number of quota share agreements, offset by new composite business as well as business written by the new trade credit team, totaling $17.9 million and $15.3 million, respectively.

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(Dollars in thousands)	Business Mix - Ratio of Gross Premiums Written by Line of Business to Total Gross Premiums Written			
	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013	
	Gross Premiums Written	Gross Premiums Written (%)	Gross Premiums Written	Gross Premiums Written (%)
Property	$270,602	39.9 %	$326,024	43.6 %
Marine	152,962	22.5 %	161,432	21.6 %
Specialty	255,422	37.6 %	260,507	34.8 %
Total	$678,986	100.0 %	$747,963	100.0 %

Reinsurance Premiums Ceded

(Dollars in thousands)	Reinsurance Premiums Ceded Three Months Ended March 31, 2014	2013	Change
Property	$121,870	$84,058	$37,812
Marine	13,365	2,972	10,393
Specialty	7,405	38,698	(31,293)
Total	$142,640	$125,728	$16,912

Reinsurance premiums ceded in the property lines increased by $37.8 million, due to significant restructuring of retrocessional coverage purchased, reflecting favorable market conditions and changes in timing of purchases, that resulted in $64.9 million of new aggregate excess of loss and industry loss warranty purchases. This was offset by a $28.1 million decrease in catastrophe bond coverage due to the non-renewal of a contract. The increase in reinsurance premiums in the marine lines of $10.4 million was primarily due to additional quota share coverage purchased as a result of price reductions and broader coverage and terms available in the market. The decrease in reinsurance premiums ceded in the specialty lines of $31.3 million was due primarily to the non-renewal of proportional coverage that was purchased in the first quarter of 2013 and related to the agriculture business.

Net Premiums Written

(Dollars in thousands)	Net Premiums Written Three Months Ended March 31, 2014	2013	Change
Property	$148,732	$241,966	$(93,234)
Marine	139,597	158,460	(18,863)
Specialty	248,017	221,809	26,208
Total	$536,346	$622,235	$(85,889)

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

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	Net Retention - Ratio of Net Premiums Written to Gross Premiums Written			
	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013	
(Dollars in thousands)	Net Premiums Written	% of Gross Premiums Written	Net Premiums Written	% of Gross Premiums Written
Property	$148,732	55.0 %	$241,966	74.2 %
Marine	139,597	91.3 %	158,460	98.2 %
Specialty	248,017	97.1 %	221,809	85.1 %
Total	$536,346	79.0 %	$622,235	83.2 %

The property ratio has decreased by 19.2 percentage points reflecting the restructuring of the property retrocessional coverage and specifically the increase in non-proportional coverage as well as a reduction in gross written premium. The marine ratio has decreased by 6.9 percentage due to an increase in ceded premiums as a result of the factors mentioned above. The specialty ratio has increased by12.0 percentage due to the decrease in reinsurance coverage purchased for the agriculture business.

Net Premiums Earned

	Net Premiums Earned		
	Three Months Ended March 31,		
(Dollars in thousands)	2014	2013	Change