

VALIDUS HOLDINGS LTD  
Form 10-Q  
August 08, 2013

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

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Form 10-Q

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

For the quarterly period ended June 30, 2013

Commission file number 001-33606

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

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

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

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

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

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

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

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

As of August 6, 2013 there were 99,823,852 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 June 30, 2013 and December 31, 2012 (unaudited)

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

	June 30, 2013 (unaudited)	December 31, 2012
<b>Assets</b>		
Fixed maturities, at fair value (amortized cost: 2013—\$5,322,882; 2012—\$5,008,514)	\$5,318,993	\$5,085,334
Short-term investments, at fair value (amortized cost: 2013—\$611,708; 2012—\$1,112,929)	609,778	1,114,250
Other investments, at fair value (cost: 2013—\$604,092; 2012—\$583,068)	514,385	564,448
Cash and cash equivalents	1,317,061	1,219,379
Total investments and cash	7,760,217	7,983,411
Investments in affiliates	110,472	172,329
Premiums receivable	1,374,486	802,159
Deferred acquisition costs	206,623	146,588
Prepaid reinsurance premiums	224,886	99,593
Securities lending collateral	1,900	225
Loss reserves recoverable	418,693	439,967
Paid losses recoverable	22,356	46,435
Income taxes recoverable	1,725	—
Intangible assets	108,489	110,569
Goodwill	20,393	20,393
Accrued investment income	19,334	21,321
Other assets	318,805	177,274
Total assets	\$10,588,379	\$10,020,264
<b>Liabilities</b>		
Reserve for losses and loss expenses	\$3,283,450	\$3,517,573
Unearned premiums	1,439,597	894,362
Reinsurance balances payable	344,418	138,550
Securities lending payable	2,366	691
Deferred income taxes	22,600	20,259
Net payable for investments purchased	29,031	38,346
Accounts payable and accrued expenses	131,903	167,577
Variable funding notes	431,093	—
Senior notes payable	247,144	247,090
Debentures payable	540,476	540,709
Total liabilities	\$6,472,078	\$5,565,157
Commitments and contingent liabilities		
Shareholders' equity		
	\$26,989	\$26,722

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Common shares, 571,428,571 authorized, par value \$0.175 (Issued: 2013—154,225,781; 2012—152,698,191; Outstanding: 2013—99,737,461; 2012—107,921,259)			
Treasury shares (2013—54,488,320; 2012—44,776,932)	(9,535	) (7,836	)
Additional paid-in-capital	1,813,461	2,160,478	
Accumulated other comprehensive (loss)	(8,262	) (2,953	)
Retained earnings	1,795,203	1,844,416	
Total shareholders' equity available to Validus	3,617,856	4,020,827	
Noncontrolling interest	498,445	434,280	
Total shareholders' equity	\$4,116,301	\$4,455,107	
Total liabilities and shareholders' equity	\$10,588,379	\$10,020,264	

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

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Validus Holdings, Ltd.

Consolidated Statements of Comprehensive Income

For the Three and Six Months Ended June 30, 2013 and 2012 (unaudited)

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

	Three Months Ended		Six Months Ended	
	June 30, 2013 (unaudited)	June 30, 2012 (unaudited)	June 30, 2013 (unaudited)	June 30, 2012 (unaudited)
<b>Revenues</b>				
Gross premiums written	\$702,313	\$627,089	\$1,807,073	\$1,464,378
Reinsurance premiums ceded	(121,396)	(119,052)	(308,612)	(226,104)
Net premiums written	580,917	508,037	1,498,461	1,238,274
Change in unearned premiums	(33,459)	(60,410)	(419,942)	(339,448)
Net premiums earned	547,458	447,627	1,078,519	898,826
Net investment income	26,210	25,885	51,859	53,645
Net realized gains on investments	3,409	6,154	5,130	13,686
Net unrealized (losses) on investments	(141,348)	(53,574)	(148,585)	(32,903)
Income (loss) from investment affiliate	1,753	(398)	3,230	(398)
Other income	4,418	5,994	7,103	14,885
Foreign exchange (losses) gains	(8,223)	(652)	(1,301)	2,514
Total revenues	433,677	431,036	995,955	950,255
<b>Expenses</b>				
Losses and loss expenses	265,044	153,692	409,815	385,681
Policy acquisition costs	87,152	76,129	180,763	154,261
General and administrative expenses	70,967	61,635	151,246	128,010
Share compensation expenses	6,638	6,800	8,956	12,238
Finance expenses	37,830	13,706	62,276	29,985
Total expenses	467,631	311,962	813,056	710,175
(Loss) income before taxes and income from operating affiliates	(33,954)	119,074	182,899	240,080
Tax (expense) benefit	(93)	(404)	225	(543)
Income from operating affiliates	3,793	3,592	7,316	6,959
Net (loss) income	\$(30,254)	\$122,262	\$190,440	\$246,496
Net loss attributable to noncontrolling interest	60,976	45,360	63,525	45,360
Net income available to Validus	\$30,722	\$167,622	\$253,965	\$291,856
<b>Other comprehensive income (loss)</b>				
Foreign currency translation adjustments	186	(757)	(9,599)	636
Other comprehensive income (loss)	\$186	\$(757)	\$(9,599)	\$636
Comprehensive income available to Validus	\$30,908	\$166,865	\$244,366	\$292,492
<b>Earnings per share</b>				
Weighted average number of common shares and common share equivalents outstanding				

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Basic	103,133,188	98,254,186	105,259,813	98,839,663
Diluted	104,734,643	103,667,967	107,393,822	104,382,030
Basic earnings per share available to common shareholders	\$0.28	\$1.69	\$2.26	\$2.92
Diluted earnings per share available to common shareholders	\$0.28	\$1.62	\$2.21	\$2.80
Cash dividends declared per share	\$0.30	\$0.25	\$2.60	\$0.50

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 Six Months Ended June 30, 2013 and 2012 (unaudited)

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

	June 30, 2013 (unaudited)	June 30, 2012 (unaudited)
Common shares		
Balance - Beginning of period	\$26,722	\$23,538
Common shares issued, net	267	153
Balance - End of period	\$26,989	\$23,691
Treasury shares		
Balance - Beginning of period	\$(7,836	) \$(6,131
Repurchase of common shares	(1,699	) (1,212
Balance - End of period	\$(9,535	) \$(7,343
Additional paid-in capital		
Balance - Beginning of period	\$2,160,478	\$1,893,890
Common shares (redeemed), net	(488	) (1,307
Repurchase of common shares	(355,485	) (220,040
Share compensation expenses	8,956	12,238
Balance - End of period	\$1,813,461	\$1,684,781
Accumulated other comprehensive (loss)		
Balance - Beginning of period	\$(2,953	) \$(6,601
Amounts reclassified to retained earnings	4,290	—
Other comprehensive (loss) income	(9,599	) 636
Balance - End of period	\$(8,262	) \$(5,965
Retained earnings		
Balance - Beginning of period	\$1,844,416	\$1,543,729
Dividends	(298,888	) (52,915
Net income	190,440	246,496
Net loss attributable to noncontrolling interest	63,525	45,360
Amounts reclassified from accumulated other comprehensive income	(4,290	) —
Balance - End of period	\$1,795,203	\$1,782,670
Total shareholders' equity available to Validus	\$3,617,856	\$3,477,834
Noncontrolling interest	\$498,445	\$404,740
Total shareholders' equity	\$4,116,301	\$3,882,574

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 Six Months Ended June 30, 2013 and 2012 (unaudited)

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

	June 30, 2013 (unaudited)	June 30, 2012 (unaudited)
Cash flows provided by (used in) operating activities		
Net income	\$ 190,440	\$ 246,496
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	8,956	12,238
Amortization of discount on senior notes	54	54
(Income) loss from investment affiliate	(3,230	) 398
Net realized (gains) on investments	(5,130	) (13,686 )
Net unrealized losses on investments	148,585	32,903
Amortization of intangible assets	2,080	2,080
(Income) from operating affiliates	(7,316	) (6,959 )
Foreign exchange losses (gains) included in net income	30,868	(5,844 )
Amortization of premium on fixed maturities	10,163	12,253
Change in:		
Premiums receivable	(558,107	) (330,214 )
Deferred acquisition costs	(60,035	) (54,667 )
Prepaid reinsurance premiums	(125,293	) (85,006 )
Loss reserves recoverable	20,000	1,475
Paid losses recoverable	23,840	58,149
Income taxes recoverable	(852	) (2,720 )
Accrued investment income	1,903	4,534
Other assets	22,009	(11,777 )
Reserve for losses and loss expenses	(216,535	) (43,198 )
Unearned premiums	545,235	424,454
Reinsurance balances payable	186,906	65,154
Deferred income taxes	2,081	2,565
Accounts payable and accrued expenses	(42,917	) (3,518 )
Net cash provided by operating activities	173,705	305,164
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	2,686,285	1,829,294
Proceeds on maturities of investments	316,860	295,192
Purchases of fixed maturities	(3,318,638	) (1,975,225 )
Sales (purchases) of short-term investments, net	500,191	(31,629 )
(Purchases) of other investments	(23,674	) (500,632 )
(Increase) decrease in securities lending collateral	(1,675	) 4,317
Redemption from (purchase of) investment in operating affiliates	79,307	(26,500 )
Purchase of investment in investment affiliate	(6,904	) (3,368 )
Net cash provided by (used in) investing activities	231,752	(408,551 )
Cash flows provided by (used in) financing activities		

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Net proceeds on issuance of variable funding notes	262,037	—	
(Redemption) of common shares, net	(221	) (1,154	)
Purchases of common shares under share repurchase program	(357,184	) (221,252	)
Dividends paid	(297,539	) (56,260	)
Increase (decrease) in securities lending payable	1,675	(4,317	)
Third party investment in noncontrolling interest	127,690	450,100	
Net cash (used in) provided by financing activities	(263,542	) 167,117	
Effect of foreign currency rate changes on cash and cash equivalents	(44,233	) 6,736	
Net increase in cash	97,682	70,466	
Cash and cash equivalents - beginning of period	\$1,219,379	\$832,844	
Cash and cash equivalents - end of period	\$1,317,061	\$903,310	
Taxes paid during the period	\$(1,326	) \$3,764	
Interest paid during the period	\$24,955	\$20,117	
The accompanying notes are an integral part of these consolidated financial statements (unaudited).			

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### 1. Basis of preparation and consolidation

These unaudited consolidated financial statements include Validus Holdings, Ltd. and its subsidiaries (together, the "Company") and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 in Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. This Quarterly Report should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2012, as filed with the U.S. Securities and Exchange Commission (the "SEC").

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

On November 30, 2012, the Company acquired all of the outstanding common shares of Flagstone Reinsurance Holdings, S.A. ("Flagstone") in exchange for 0.1935 Company common shares and \$2.00 in cash per Flagstone common share (the "Flagstone Acquisition"). For segmental reporting purposes, the results of Flagstone's operations since the acquisition date have been included within the Validus Re segment in the consolidated financial statements. On April 25, 2013, the Company acquired Longhorn Re, Ltd., a single contract Bermuda domiciled crop reinsurer.

### 2. Recent accounting pronouncements

#### (a) Adoption of new accounting standards

##### Disclosures about Offsetting Assets and Liabilities

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, "Disclosures about Offsetting Assets and Liabilities" ("ASU 2011-11"). The objective of ASU 2011-11 is to enhance disclosures by requiring improved information about financial instruments and derivative instruments in relation to netting arrangements.

In January 2013, the FASB issued Accounting Standards Update No. 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities" ("ASU 2013-01"). The objective of ASU 2013-01 is to address implementation issues about the scope of ASU 2011-11, Disclosures about Offsetting Assets and Liabilities. The amendments clarify that the scope of ASU 2011-11 applies to derivatives, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either or subject to an enforceable master netting arrangement or similar agreement. Entities with other types of financial assets and financial liabilities subject to a master netting arrangement or similar agreement also are affected

because these amendments make them no longer subject to the disclosure requirements in ASU 2011-11. ASU 2011-11 and 2013-01 became effective for fiscal periods beginning on or after January 1, 2013, and as a result, the Company adopted ASU 2011-11 and 2013-01 effective January 1, 2013. The adoption of these new accounting standards impacts disclosures only; therefore they did not have an impact on the Company's consolidated financial statements. Please refer to Note 7: "Derivative instruments".

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued Accounting Standard Update No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" ("ASU 2013-02"). The objective of this update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. The amendments became effective for reporting periods beginning after December 15, 2012, and as a result, the Company adopted ASU 2013-02 effective January 1, 2013. Please refer to Note 14 "Accumulated other comprehensive income (loss)."

(b) Recently issued accounting standards not yet adopted

In March 2013, the FASB issued Accounting Standard Update No. 2013-05, "Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity" ("ASU 2013-05"). The objective of this update is to resolve the diversity in practice about whether Subtopic 810-10, Consolidation-Overall, or Subtopic 830-30, Foreign Currency Matters-Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary within a foreign entity. The amendments in this Update are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. Early adoption is permitted. The Company is currently evaluating the impact of this guidance; however it is not expected to have a material impact on the Company's consolidated financial statements.

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 design to determine whether it is an investment company. The amendments in this Update are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. Early adoption is prohibited. The Company is currently evaluating the impact of this guidance; however it is not expected to have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued Accounting Standard Update No. 2013-10, "Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes" ("ASU 2013-10"). The amendments in this Update permit the Fed Funds Effective Swap Rate also referred to as the overnight index swap rate ("OIS") to be used as a U.S. benchmark interest rate for hedge accounting purposes in addition to U.S. Treasury rate and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. Before the amendments in this Update, only the U.S. Treasury rate and the LIBOR swap rate were considered benchmark interest rates in the United States. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The Company is currently evaluating the impact of this guidance; however it is not expected to have a material impact on the Company's consolidated financial statements.

In 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 2013-10"). 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 in this Update are effective for fiscal years beginning after December 15, 2013. The Company is currently evaluating the impact of this guidance; however it is not expected to have a material impact on the Company's consolidated financial statements.

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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

## 3. Investments

## (a) Trading Securities

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

The amortized cost (or cost), gross unrealized gains and (losses) and estimated fair value of investments at June 30, 2013 were as follows:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and government agency	\$ 1,209,597	\$ 2,430	\$(5,807)	) \$ 1,206,220
Non-U.S. government and government agency States, municipalities, political subdivision	385,458	2,089	(6,523)	) 381,024
Agency residential mortgage-backed securities	44,230	485	(422)	) 44,293
Non-agency residential mortgage-backed securities	338,313	9,042	(1,841)	) 345,514
U.S. corporate	25,584	121	(1,069)	) 24,636
Non-U.S. corporate	1,378,522	9,232	(14,224)	) 1,373,530
Bank loans	668,678	4,760	(7,341)	) 666,097
Catastrophe bonds	750,527	5,470	(1,378)	) 754,619
Asset-backed securities	54,005	1,139	(381)	) 54,763
Total fixed maturities	467,968	1,670	(1,341)	) 468,297
Total short-term investments	5,322,882	36,438	(40,327)	) 5,318,993
Other investments	611,708	30	(1,960)	) 609,778
Fund of hedge funds	3,733	216	(921)	) 3,028
Private equity investments	12,771	984	(67)	) 13,688
Hedge funds (a)	581,389	22,718	(115,665)	) 488,442
Mutual funds	6,199	3,028	—	) 9,227
Total other investments	604,092	26,946	(116,653)	) 514,385
Total	\$ 6,538,682	\$ 63,414	\$(158,940)	) \$ 6,443,156
Noncontrolling interest (a)	\$(508,500)	) \$(18,492)	) \$ 104,099	) \$(422,893)
Total investments excluding noncontrolling interest	\$ 6,030,182	\$ 44,922	\$(54,841)	) \$ 6,020,263

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



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Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (unaudited)

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

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

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