

VALIDUS HOLDINGS LTD

Form 10-Q

August 02, 2017

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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, 2017

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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

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

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 July 31, 2017 there were 79,465,860 outstanding Common Shares, \$0.175 par value per share, of the registrant.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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Validus Holdings, Ltd.

Consolidated Balance Sheets

As at June 30, 2017 (unaudited) and December 31, 2016

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

	June 30, 2017 (unaudited)	December 31, 2016
Assets		
Fixed maturity investments trading, at fair value (amortized cost: 2017—\$5,424,562; 2016—\$5,584,599)	\$5,418,643	\$5,543,030
Short-term investments trading, at fair value (amortized cost: 2017—\$2,871,126; 2016—\$2,796,358)	2,871,353	2,796,170
Other investments, at fair value (cost: 2017—\$416,996; 2016—\$380,130)	448,618	405,712
Investments in investment affiliates, equity method (cost: 2017—\$72,532; 2016—\$84,840)	103,377	100,431
Cash and cash equivalents	800,405	419,976
Restricted cash	195,039	70,956
Total investments and cash	9,837,435	9,336,275
Premiums receivable	1,940,637	725,390
Deferred acquisition costs	302,857	209,227
Prepaid reinsurance premiums	335,837	77,996
Securities lending collateral	2,514	9,779
Loss reserves recoverable	600,207	430,421
Paid losses recoverable	35,675	35,247
Income taxes recoverable	4,763	4,870
Deferred tax asset	52,655	43,529
Receivable for investments sold	20,519	3,901
Intangible assets	175,518	115,592
Goodwill	227,701	196,758
Accrued investment income	26,968	26,488
Other assets	387,860	134,282
Total assets	\$13,951,146	\$11,349,755
Liabilities		
Reserve for losses and loss expenses	\$3,305,191	\$2,995,195
Unearned premiums	1,970,896	1,076,049
Reinsurance balances payable	461,261	54,781
Securities lending payable	2,980	10,245
Deferred tax liability	4,012	3,331
Payable for investments purchased	92,077	29,447
Accounts payable and accrued expenses	385,958	587,648
Notes payable to AlphaCat investors	1,066,159	278,202
Senior notes payable	245,463	245,362
Debentures payable	538,400	537,226
Total liabilities	8,072,397	5,817,486
Commitments and contingent liabilities		
Redeemable noncontrolling interests	1,251,660	1,528,001
Shareholders' equity		
Preferred shares (Issued and Outstanding: 2017—16,000; 2016—6,000)	400,000	150,000
Common shares (Issued: 2017—161,934,355; 2016—161,279,976; Outstanding: 2017—79,518,581; 2016—79,132,252)	28,339	28,224

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Treasury shares (2017—82,415,774; 2016—82,147,724)	(14,423	) (14,376	)
Additional paid-in capital	807,321	821,023	
Accumulated other comprehensive loss	(19,924	) (23,216	)
Retained earnings	3,010,118	2,876,636	
Total shareholders' equity available to Validus	4,211,431	3,838,291	
Noncontrolling interests	415,658	165,977	
Total shareholders' equity	4,627,089	4,004,268	
Total liabilities, noncontrolling interests and shareholders' equity	\$13,951,146	\$11,349,755	

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

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Validus Holdings, Ltd.

Consolidated Statements of Income and Comprehensive Income

For the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(unaudited)		(unaudited)	
<b>Revenues</b>				
Gross premiums written	\$792,902	\$764,042	\$1,983,759	\$1,936,833
Reinsurance premiums ceded	(56,222 )	(36,229 )	(256,328 )	(204,064 )
Net premiums written	736,680	727,813	1,727,431	1,732,769
Change in unearned premiums	(105,653 )	(154,090 )	(521,028 )	(587,778 )
Net premiums earned	631,027	573,723	1,206,403	1,144,991
Net investment income	44,241	39,257	84,455	68,718
Net realized gains on investments	2,274	2,724	1,110	2,140
Change in net unrealized gains on investments	16,321	31,428	29,669	78,872
Income (loss) from investment affiliates	9,466	(589 )	14,654	(4,702 )
Other insurance related income and other income	1,339	824	2,669	2,237
Foreign exchange (losses) gains	(7,329 )	6,286	(5,760 )	12,531
Total revenues	697,339	653,653	1,333,200	1,304,787
<b>Expenses</b>				
Losses and loss expenses	296,149	307,130	565,734	531,577
Policy acquisition costs	117,268	107,966	228,896	215,159
General and administrative expenses	96,349	89,688	184,273	175,896
Share compensation expenses	11,146	10,727	20,637	21,964
Finance expenses	14,209	14,166	28,152	29,369
Transaction expenses	4,427	—	4,427	—
Total expenses	539,548	529,677	1,032,119	973,965
Income before taxes, loss from operating affiliate and (income) attributable to AlphaCat investors	157,791	123,976	301,081	330,822
Tax benefit (expense)	987	(1,706 )	4,536	412
Loss from operating affiliate	—	—	—	(23 )
(Income) attributable to AlphaCat investors	(11,830 )	(6,114 )	(19,333 )	(10,714 )
Net income	\$146,948	\$116,156	\$286,284	\$320,497
Net (income) attributable to noncontrolling interests	(43,650 )	(21,193 )	(86,222 )	(58,724 )
Net income available to Validus	103,298	94,963	200,062	261,773
Dividends on preferred shares	(2,203 )	—	(4,406 )	—
Net income available to Validus common shareholders	\$101,095	\$94,963	\$195,656	\$261,773
<b>Comprehensive income</b>				
Net income	\$146,948	\$116,156	\$286,284	\$320,497
Other comprehensive income (loss)				
Change in foreign currency translation adjustments	1,489	(3,287 )	2,086	(5,315 )
Change in minimum pension liability, net of tax	1,184	479	1,252	396
Change in fair value of cash flow hedge	(144 )	64	(46 )	(694 )
Other comprehensive income (loss), net of tax	2,529	(2,744 )	3,292	(5,613 )
Comprehensive (income) attributable to noncontrolling interests	(43,650 )	(21,193 )	(86,222 )	(58,724 )
Comprehensive income available to Validus	\$105,827	\$92,219	\$203,354	\$256,160

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Earnings per common share

Basic earnings per share available to Validus common shareholders	\$ 1.28	\$ 1.16	\$ 2.47	\$ 3.18
Earnings per diluted share available to Validus common shareholders	\$ 1.25	\$ 1.14	\$ 2.42	\$ 3.12
Cash dividends declared per common share	\$ 0.38	\$ 0.35	\$ 0.76	\$ 0.70

Weighted average number of common shares and common share equivalents outstanding:

Basic	79,270,561	81,950,833	79,202,116	82,386,047
Diluted	80,872,451	83,373,003	80,861,998	83,785,659

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



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Validus Holdings, Ltd.

Consolidated Statements of Shareholders' Equity

For the Six Months Ended June 30, 2017 and 2016 (unaudited)

(Expressed in thousands of U.S. dollars)

	Six Months Ended June 30,	
	2017	2016
	(unaudited)	
Preferred shares		
Balance, beginning of period	\$ 150,000	\$—
Preferred shares issued	250,000	150,000
Balance, end of period	\$400,000	\$ 150,000
Common shares		
Balance, beginning of period	\$28,224	\$28,100
Common shares issued, net	115	119
Balance, end of period	\$28,339	\$28,219
Treasury shares		
Balance, beginning of period	\$(14,376 )	\$(13,592 )
Repurchase of common shares	(47 )	(492 )
Balance, end of period	\$(14,423 )	\$(14,084 )
Additional paid-in capital		
Balance, beginning of period	\$821,023	\$1,002,980
Offering expenses on preferred shares	(8,314 )	(5,148 )
Common shares redeemed, net	(12,076 )	(7,504 )
Repurchase of common shares	(13,949 )	(128,591 )
Share compensation expenses	20,637	21,964
Balance, end of period	\$807,321	\$883,701
Accumulated other comprehensive loss		
Balance, beginning of period	\$(23,216 )	\$(12,569 )
Other comprehensive income (loss)	3,292	(5,613 )
Balance, end of period	\$(19,924 )	\$(18,182 )
Retained earnings		
Balance, beginning of period	\$2,876,636	\$2,634,056
Net income	286,284	320,497
Net (income) attributable to noncontrolling interests	(86,222 )	(58,724 )
Dividends on preferred shares	(4,406 )	—
Dividends on common shares	(62,174 )	(59,227 )
Balance, end of period	\$3,010,118	\$2,836,602
Total shareholders' equity available to Validus	\$4,211,431	\$3,866,256
Noncontrolling interests	\$415,658	\$212,154
Total shareholders' equity	\$4,627,089	\$4,078,410

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



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Validus Holdings, Ltd.

Consolidated Statements of Cash Flows

For the Six Months Ended June 30, 2017 and 2016 (unaudited)

(Expressed in thousands of U.S. dollars)

	Six Months Ended June 30,	
	2017	2016
	(unaudited)	
Cash flows provided by (used in) operating activities		
Net income	\$286,284	\$320,497
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	20,637	21,964
Loss on deconsolidation of AlphaCat ILS fund	402	—
Amortization of discount on senior notes	54	54
(Income) loss from investment affiliates	(14,654 )	4,702
Net realized and change in net unrealized gains on investments	(30,779 )	(81,012 )
Amortization of intangible assets	3,995	2,832
Loss from operating affiliate	—	23
Foreign exchange gains included in net income	(9,686 )	(6,289 )
Amortization of premium on fixed maturity investments	7,012	8,710
Change in:		
Premiums receivable	(648,195 )	(719,070 )
Deferred acquisition costs	(97,746 )	(102,211 )
Prepaid reinsurance premiums	(30,684 )	(67,575 )
Loss reserves recoverable	(113,508 )	(95,429 )
Paid losses recoverable	17,500	(4,571 )
Reserve for losses and loss expenses	199,985	147,305
Unearned premiums	488,198	655,353
Reinsurance balances payable	111,488	18,610
Other operational balance sheet items, net	(137,618 )	(34,450 )
Net cash provided by operating activities	52,685	69,443
Cash flows provided by (used in) investing activities		
Proceeds on sales of fixed maturity investments	1,632,371	1,376,077
Proceeds on maturities of fixed maturity investments	247,394	184,413
Purchases of fixed maturity investments	(1,682,609 )	(1,537,606 )
Purchases of short-term investments, net	(88,623 )	(428,040 )
Purchases of other investments, net	(33,870 )	(19,796 )
Decrease (increase) in securities lending collateral	7,265	(5,361 )
Redemption from operating affiliates	—	369
Distributions from (investments in) investment affiliates, net	11,708	(16,307 )
Increase in restricted cash	(124,083 )	(22,752 )
Purchase of subsidiary, net of cash acquired	(183,923 )	—
Net cash used in investing activities	(214,370 )	(469,003 )
Cash flows provided by (used in) financing activities		
Net proceeds on issuance of notes payable to AlphaCat investors	269,645	294,748
Net proceeds on issuance of preferred shares	241,686	144,852
Redemption of common shares, net	(11,961 )	(7,385 )

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Purchases of common shares under share repurchase program	(13,996 )	(129,083 )
Dividends paid on preferred shares	(4,406 )	—
Dividends paid on common shares	(63,286 )	(59,961 )
(Decrease) increase in securities lending payable	(7,265 )	5,361
Third party investment in redeemable noncontrolling interests	210,200	381,250
Third party redemption of redeemable noncontrolling interests	(79,334 )	(10,800 )
Third party investment in noncontrolling interests	258,300	171,674
Third party distributions of noncontrolling interests	(96,125 )	(127,103 )
Third party subscriptions deployed in AlphaCat Funds and Sidecars	(171,952 )	(411,336 )
Net cash provided by financing activities	531,506	252,217
Effect of foreign currency rate changes on cash and cash equivalents	10,608	(6,968 )
Net increase (decrease) in cash and cash equivalents	380,429	(154,311 )
Cash and cash equivalents - beginning of period	419,976	723,109
Cash and cash equivalents - end of period	\$800,405	\$568,798

Supplemental disclosure of cash flow information:

Taxes paid during the period	\$568	\$3,837
Interest paid during the period	\$27,186	\$27,552

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

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Validus Holdings, Ltd.

Notes to the 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 (the “Consolidated Financial Statements”) 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 Validus Holdings, Ltd.’s (the “Company”) Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the U.S. Securities and Exchange Commission (the “SEC”).

The Company consolidates in these Consolidated Financial Statements the results of operations and financial position of all voting interest entities (“VOE”) in which the Company has a controlling financial interest and all variable interest entities (“VIE”) in which the Company is considered to be the primary beneficiary. The consolidation assessment, including the determination as to whether an entity qualifies as a VIE or VOE, depends on the facts and circumstances surrounding each entity.

In the opinion of management, these unaudited Consolidated Financial Statements reflect all adjustments (including normal recurring adjustments) considered necessary for a fair statement of the Company’s financial position and results of operations as at the end of and for the periods presented. 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 United States Financial Accounting Standards Board (the “FASB”).

2. Recent accounting pronouncements

Recently issued accounting standards not yet adopted

In May 2017, the FASB issued ASU 2017-09, “Compensation - Stock Compensation (Topic 718).” This ASU is directed at reducing diversity in practice when applying the accounting guidance to a change in the terms or conditions of a share-based payment award. The ASU is effective for fiscal periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company has evaluated the impact of this guidance and it will not have a material impact on the Company’s Consolidated Financial Statements. The Company plans to adopt this guidance on January 1, 2018.



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Validus Holdings, Ltd.

Notes to the Consolidated Financial Statements (unaudited)

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

3. Business combination

On May 1, 2017, Western World Insurance Group, Inc. (“Western World”), a wholly owned subsidiary of the Company acquired all of the outstanding capital stock of Crop Risk Services (“CRS”) for an aggregate purchase price of \$185,576 in cash. CRS is a primary crop insurance managing general agent (“MGA”) based in Decatur, Illinois with 1,170 agents across 36 states. CRS does not have insurance licenses of its own, but acts solely as an MGA in that it can produce business for any properly licensed entity on a commission basis. Concurrent with closing of the transaction, Stratford Insurance Company (“Stratford”), a wholly-owned subsidiary of Western World, was granted the required license to write crop insurance in the United States and executed several agreements to transfer the related agriculture book of business to Stratford.

The CRS acquisition was undertaken to complement the Company’s existing agricultural business and expand the Company’s presence in U.S. primary specialty lines.

For segmental reporting purposes, the results of CRS’ operations, including the related agricultural book of business have been included within the Western World segment in the Consolidated Financial Statements from the date of acquisition.

On closing, the Company recorded intangible assets totaling \$63,921 for Distribution Channels, Brand Name and Technology. Distribution Channels and Brand Name were estimated to have finite useful economic lives of ten years on acquisition and are being amortized on a straight line basis over such period. Technology was estimated to have a finite useful economic life of two years on acquisition and is being amortized on a straight line basis over such a period.

The purchase price was allocated to the acquired assets and liabilities of CRS based on estimated fair values on May 1, 2017, the date the transaction closed, as detailed below. The Company recognized goodwill of \$30,943 primarily attributable to CRS’s assembled workforce and synergies expected to result upon the integration of CRS and its related book of business into the Company’s operations. The estimates of fair values for tangible assets acquired and liabilities assumed were determined by management based on various market and income analyses. The Company estimated the fair values of intangible assets acquired based on variations of the income and cost approaches. Significant judgment was required to arrive at these estimates of fair value and changes to assumptions used could have led to materially different results.

The purchase of CRS was a taxable transaction and as such, goodwill and intangibles recorded at closing will be deductible for income tax purposes. The Company has recognized and recorded a deferred tax asset of \$6,443 which results from the excess of tax-deductible goodwill over book goodwill as recognized in the purchase price allocation.

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Validus Holdings, Ltd.

Notes to the Consolidated Financial Statements (unaudited)

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

The fair value of net assets acquired, including GAAP adjustments, are summarized as follows:

Total purchase price	\$185,576
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Assets acquired

Cash and cash equivalents	\$1,653
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Premiums receivable	564,453
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Prepaid reinsurance premiums	227,157
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Other assets	157,146
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Assets acquired	950,409
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Liabilities acquired

Reinsurance balances payable	\$294,201
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Unearned premiums	406,649
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Net loss reserves	42,575
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Other liabilities	122,715
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Liabilities acquired	866,140
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Excess purchase price	\$101,307
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Goodwill and other intangible assets acquired

Intangible asset - Distribution channels	\$52,898
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Intangible asset - Brand name	9,568
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Intangible asset - Technology	1,455
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Total intangible assets	63,921
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Goodwill	30,943
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Deferred tax arising on Goodwill	6,443
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Total goodwill and intangible assets	\$101,307
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The Company also incurred transaction expenses related to the CRS acquisition of \$4,427. Transaction expenses included legal, financial advisory and audit related services.



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Validus Holdings, Ltd.

Notes to the Consolidated Financial Statements (unaudited)

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

The following tables reconcile the carrying amount of goodwill and intangible assets from December 31, 2016 to June 30, 2017:

	Goodwill Six Months Ended June 30, 2017		
	Talbot	Western World	Total
Balance at December 31, 2016	20,393	176,365	196,758
Additions	—	30,943	30,943
Balance at June 30, 2017	20,393	207,308	227,701

	Intangible assets Six Months Ended June 30, 2017		
	Talbot	Western World	Total
Balance at December 31, 2016	93,924	21,668	115,592
Additions	—	63,921	63,921
Amortization	(2,081 )	(1,914 )	(3,995 )
Balance at June 30, 2017	91,843	83,675	175,518

	Intangible assets Six Months Ended June 30, 2017		
	With a Finite Life	With an Indefinite Life	Total
Balance at December 31, 2016	11,424	104,168	115,592
Additions	63,921	—	63,921
Amortization	(3,995 )	—	(3,995 )
Balance at June 30, 2017	71,350	104,168	175,518

Operating results of CRS have been included in the Consolidated Financial Statements from the May 1, 2017 acquisition date.

The following selected unaudited information has been provided to present a summary of the results of CRS that have been included in the Consolidated Financial Statements for the three and six months ended June 30, 2017.

	From Acquisition Date to June 30, 2017
Net premiums written	6,988
Net premiums earned	50,044
Total underwriting deductions	44,780
Underwriting income, before general and administrative expenses	5,264



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Validus Holdings, Ltd.

Notes to the Consolidated Financial Statements (unaudited)

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

## 4. Investments

Managed investments represent assets governed by the Company's investment policy statement ("IPS") whereas, non-managed investments represent assets held in support of consolidated AlphaCat VIEs which are not governed by the Company's IPS. Refer to Note 6, "Variable interest entities," for further details.

The Company classifies its fixed maturity and short-term investments as trading and accounts for its other investments in accordance with ASC Topic 825 "Financial Instruments." As such, all investments are carried at fair value with interest and dividend income and realized and unrealized gains and losses included in net income for the period.

The amortized cost (or cost) and fair value of the Company's investments as at June 30, 2017 and December 31, 2016 were as follows:

	June 30, 2017		December 31, 2016	
	Amortized Cost or Cost	Fair Value	Amortized Cost or Cost	Fair Value
Managed investments				
U.S. government and government agency	\$649,214	\$646,436	\$809,392	\$804,126
Non-U.S. government and government agency	293,002	292,504	245,651	240,791
U.S. states, municipalities and political subdivisions	227,047	227,949	271,742	271,830
Agency residential mortgage-backed securities	786,784	783,006	684,490	679,595
Non-agency residential mortgage-backed securities	26,745	26,683	15,858	15,477
U.S. corporate	1,378,884	1,386,484	1,540,036	1,534,508
Non-U.S. corporate	380,317	379,480	418,520	410,227
Bank loans	560,446	552,901	579,121	570,399
Asset-backed securities	500,679	502,056	528,563	526,814
Commercial mortgage-backed securities	317,732	316,190	333,740	330,932
Total fixed maturities	5,120,850	5,113,689	5,427,113	5,384,699
Short-term investments	255,289	255,516	228,574	228,386
Other investments				
Fund of hedge funds	—	—	1,457	955
Hedge funds	11,292	18,303	11,292	17,381
Private equity investments	79,871	100,391	66,383	82,627
Fixed income investment funds	266,041	268,110	247,967	249,275
Overseas deposits	57,874	57,874	50,106	50,106
Mutual funds	1,918	3,940	2,925	5,368
Total other investments	416,996	448,618	380,130	405,712
Investments in investment affiliates <sup>(a)</sup>	72,532	103,377	84,840	100,431
Total managed investments	\$5,865,667	\$5,921,200	\$6,120,657	\$6,119,228
Non-managed investments				
Catastrophe bonds	\$303,712	\$304,954	\$157,486	\$158,331
Short-term investments	2,615,837	2,615,837	2,567,784	2,567,784
Total non-managed investments	2,919,549	2,920,791	2,725,270	2,726,115
Total investments	\$8,785,216	\$8,841,991	\$8,845,927	\$8,845,343

(a) The Company's investments in investment affiliates have been treated as equity method investments with the corresponding gains and losses recorded in

income as “Income (loss) from investment affiliates.”

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Validus Holdings, Ltd.

Notes to the Consolidated Financial Statements (unaudited)

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

## (a) Fixed maturity investments

The following table sets forth certain information regarding the investment ratings of the Company's fixed maturity investments as at June 30, 2017 and December 31, 2016.

	June 30, 2017		December 31, 2016	
	Fair Value	% of Total	Fair Value	% of Total
<b>Managed fixed maturities</b>				
AAA	\$2,318,254	42.8 %	\$2,405,597	43.4 %
AA	463,060	8.5 %	538,289	9.7 %
A	1,009,366	18.6 %	1,081,949	19.5 %
BBB	703,563	13.0 %	740,861	13.4 %
Total investment grade managed fixed maturities	4,494,243	82.9 %	4,766,696	86.0 %
<b>Non-managed fixed maturities</b>				
BB	229,023	4.2 %	213,568	3.9 %
B	176,743	3.3 %	177,737	3.2 %
CCC	11,114	0.2 %	13,371	0.2 %
NR	202,566	3.8 %	213,327	3.8 %
Total non-investment grade fixed maturities	619,446	11.5 %	618,003	11.1 %
Total managed fixed maturities	\$5,113,689	94.4 %	\$5,384,699	97.1 %
<b>Non-managed fixed maturities</b>				
BB	28,177	0.4 %	29,731	0.6 %
B	2,781	0.1 %	4,524	0.1 %
NR	273,996	5.1 %	124,076	2.2 %
Total non-managed fixed maturities	304,954	5.6 %	158,331	2.9 %
Total fixed maturities	\$5,418,643	100.0 %	\$5,543,030	100.0 %

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Validus Holdings, Ltd.

Notes to the Consolidated Financial Statements (unaudited)

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The amortized cost and fair value amounts for the Company's fixed maturity investments held at June 30, 2017 and December 31, 2016 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.

	June 30, 2017		December 31, 2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Managed fixed maturities				
Due in one year or less	\$497,473	\$492,256	\$350,733	\$346,161
Due after one year through five years	2,464,093	2,461,870	2,954,856	2,933,146
Due after five years through ten years	456,793	459,311	430,365	426,647
Due after ten years	70,551	72,317	128,508	125,927
	3,488,910	3,485,754	3,864,462	3,831,881
Asset-backed and mortgage-backed securities	1,631,940	1,627,935	1,562,651	1,552,818
Total managed fixed maturities	\$5,120,850	\$5,113,689	\$5,427,113	\$5,384,699
Non-managed catastrophe bonds				
Due in one year or less	\$33,662	\$32,441	\$43,664	\$45,418
Due after one year through five years	263,300	265,735	112,572	111,656
Due after five years through ten years	6,750	6,778	1,250	1,257
Due after ten years	—	—	—	—
Total non-managed fixed maturities	303,712	304,954	157,486	158,331
Total fixed maturities	\$5,424,562	\$5,418,643	\$5,584,599	\$5,543,030

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Validus Holdings, Ltd.

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

## (b) Other investments

The following tables set forth certain information regarding the Company's other investment portfolio as at June 30, 2017 and December 31, 2016:

	June 30, 2017			Redemption frequency (a)	Redemption notice period (a)
	Fair Value	Investments with redemption restrictions	Investments without redemption restrictions		
Hedge funds	18,303	18,303	—		
Private equity investments	100,391	100,391	—		
Fixed income investment funds	268,110	237,986	30,124	Daily	Daily to 2 days
Overseas deposits	57,874	57,874	—		
Mutual funds	3,940	—	3,940	Daily	Daily
Total other investments	\$448,618	\$ 414,554	\$ 34,064		

	December 31, 2016			Redemption frequency (a)	Redemption notice period (a)
	Fair Value	Investments with redemption restrictions	Investments without redemption restrictions		
Fund of hedge funds	\$955	\$ 955	\$ —		
Hedge funds	17,381	17,381	—		
Private equity investments	82,627	82,627	—		
Fixed income investment funds	249,275	218,333	30,942	Daily	2 days
Overseas deposits	50,106	50,106	—		
Mutual funds	5,368	—	5,368	Daily	Daily
Total other investments	\$405,712	\$ 369,402	\$ 36,310		

(a) The redemption frequency and notice periods only apply to investments without redemption restrictions.

Other investments include alternative investments in various funds and pooled investment schemes. These alternative investments employ various investment strategies primarily involving, but not limited to, investments in collateralized obligations, fixed income securities, private equities, distressed debt and equity securities.

Certain securities included in other investments are subject to redemption restrictions and are unable to be redeemed from the funds. Distributions from these funds will be received as the underlying investments of the funds are liquidated. Currently, it is not known to the Company when these underlying assets will be sold by their investment managers; however, it is estimated that the majority of the underlying assets of the investments would liquidate over five to ten years from inception of the funds. In addition, one of the investment funds with a fair value of \$192,437 (December 31, 2016: \$184,749), has a lock-up period of approximately two years as at June 30, 2017 and may also impose a redemption gate. A lock-up period refers to the initial amount of time an investor is contractually required to remain invested before having the ability to redeem. Typically, the imposition of a gate delays a portion of the requested redemption, with the remaining portion settled in cash shortly after the redemption date. The underlying investments held in the overseas deposit funds are liquid and will generally trade freely in an open market. However, the Company's ability to withdraw from the overseas deposit funds is restricted by an annual and quarterly funding and release process for Lloyd's market participants.

The Company's maximum exposure to any of these alternative investments is limited to the amount invested and any remaining capital commitments. Refer to Note 15, "Commitments and contingencies," for further details. As at June 30, 2017, the Company does not have any plans to sell any of the other investments listed above.



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Validus Holdings, Ltd.

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## (c) Investments in investment affiliates

Included in the Company's managed investment portfolio as at June 30, 2017 were investments in Aquiline Financial Services Fund II L.P. ("Aquiline II"), Aquiline Financial Services Fund III L.P. ("Aquiline III") and Aquiline Technology Growth Fund L.P. ("Aquiline Tech").

## Aquiline II and III

For further information regarding Aquiline II and III please refer to Note 7(c), "Investments in investment affiliates," included within the Company's Annual Report on Form 10-K for the year ended December 31, 2016. As at June 30, 2017, the Company's total unfunded investment commitment to Aquiline II and III was \$3,229 and \$62,031, respectively (December 31, 2016: \$2,040 and \$62,031).

## Aquiline Tech

On March 20, 2017, the Company entered into a Subscription Agreement (the "Subscription Agreement") with Aquiline Technology Growth GP Ltd, (the "General Partner") pursuant to which the Company committed and agreed to purchase limited partnership or other comparable limited liability equity interests in Aquiline Tech, a Cayman Islands exempted limited partnership, with a capital commitment in an amount equal to \$20,000. The limited partnership interests are governed by the terms of an amended and restated exempted limited partnership agreement. As at June 30, 2017, the unfunded investment commitment to Aquiline Tech was \$18,786.

The following table presents a reconciliation of the Company's beginning and ending investments in investment affiliates for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Investments in investment affiliates, beginning of period	\$94,697	\$84,135	\$100,431	\$87,673
Net capital (distributions) contributions	(786 )	15,732	(11,708 )	16,307
Income (loss) from investment affiliates	9,466	(589 )	14,654	(4,702 )
Investments in investment affiliates, end of period	\$103,377	\$99,278	\$103,377	\$99,278

The following table presents the Company's investments in investment affiliates as at June 30, 2017 and December 31, 2016:

	June 30, 2017			
	Investment at cost	Voting ownership %	Equity ownership %	Carrying value
Aquiline II	\$33,349	—%	8.1 %	\$52,010
Aquiline III	37,969	—%	9.0 %	50,153
Aquiline Tech	1,214	—%	16.4 %	1,214
Total investments in investment affiliates	\$72,532			\$103,377

## December 31, 2016

	Investment at cost	Voting ownership %	Equity ownership %	Carrying value
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Aquiline II	\$46,871	<del>%</del>	8.1	%	\$61,999
Aquiline III	37,969	<del>%</del>	9.0	%	38,432
Total investments in investment affiliates	\$84,840				\$100,431

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Validus Holdings, Ltd.

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

## (d) Net investment income

Net investment income was derived from the following sources:

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2017	2016	2017	2016
<b>Managed investments</b>				
Fixed maturities and short-term investments	\$31,312	\$30,621	\$62,983	\$58,638
Other investments	7,571	8,026	14,441	8,898
Cash and cash equivalents and restricted cash	616	380	1,226	1,245
Securities lending income	7	12	20	17
Total gross investment income	39,506	39,039	78,670	68,798
Investment expenses	(1,443 )	(2,190 )	(4,415 )	(4,026 )
Total managed net investment income	\$38,063	\$36,849	\$74,255	\$64,772
<b>Non managed investments</b>				
Fixed maturities and short-term investments	\$4,500	\$1,977	\$7,560	\$3,272
Restricted cash, cash and cash equivalents	1,678	431	2,640	674
Total non-managed net investment income	6,178	2,408	10,200	3,946
Total net investment income	\$44,241	\$39,257	\$84,455	\$68,718

Net investment income from other investments includes distributed and undistributed net income from hedge funds, overseas deposits and certain fixed income investment funds.

## (e) Net realized and change in net unrealized gains on investments

The following table sets forth an analysis of net realized gains and the change in net unrealized gains on investments:

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2017	2016	2017	2016
<b>Managed fixed maturities, short-term and other investments</b>				
Gross realized gains	\$5,175	\$3,306	\$7,865	\$6,523
Gross realized (losses)	(2,906 )	(786 )	(8,488 )	(5,089 )
Net realized gains (losses) on investments	2,269	2,520	(623 )	1,434
Change in net unrealized gains on investments	15,942	30,052	30,291	77,130
Total net realized and change in net unrealized gains on managed investments	\$18,211	\$32,572	\$29,668	\$78,564
<b>Non-managed fixed maturities, short-term and other investments</b>				
Gross realized gains	\$5	\$204	\$1,733	\$715
Gross realized (losses)	—	—	—	(9 )
Net realized gains on investments	5	204	1,733	706
Change in net unrealized gains (losses) on investments	379	1,376	(622 )	1,742
Total net realized and change in net unrealized gains on non-managed investments	384	1,580	1,111	2,448
Total net realized and change in net unrealized gains on total investments	\$18,595	\$34,152	\$30,779	\$81,012

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Validus Holdings, Ltd.

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(f) Pledged cash and investments

As at June 30, 2017, the Company had \$5,221,174 (December 31, 2016: \$5,173,966) of cash and cash equivalents, restricted cash, short-term investments and fixed maturity investments that were pledged during the normal course of business. Of those, \$5,156,173 were held in trust (December 31, 2016: \$5,068,092). 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 Validus Reinsurance, Ltd., Validus Reinsurance (Switzerland) Ltd. ("Validus Re Swiss") and Talbot as an alien Insurer/Reinsurer by certain regulators.

In addition, the Company has pledged cash and investments as collateral under the Company's credit facilities in the total amount of \$404,516 (December 31, 2016: \$442,184). For further details on the credit facilities, please refer to Note 13, "Debt and financing arrangements."

5. 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 the Company's 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 the Company to change the selection of our valuation technique (for example, from market to cash flow approach) or 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.

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At June 30, 2017, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

Level 1	Level 2	Level 3	NAV		Total
			Fair value based on practical expedient <sup>(a)</sup>		