VALIDUS HOLDINGS LTD
Form 10-Q
November 06, 2012

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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 September 30, 2012

Commission file number 001-33606

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

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 November 5, 2012 there were 93,506,829 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 September 30, 2012 (unaudited) and December 31, 2011
(Expressed in thousands of U.S. dollars, except share and per share information)

	September 30, 2012 (unaudited)	December 31, 2011
Assets		
Fixed maturities, at fair value (amortized cost: 2012—$4,803,217; 2011—$4,859,705)	$4,887,622	$4,894,145
Short-term investments, at fair value (amortized cost: 2012—$275,099; 2011—$280,299)	275,324	280,191
Other investments, at fair value (amortized cost: 2012—$511,310; 2011—$15,002)	525,441	16,787
Cash and cash equivalents	1,005,829	832,844
Total investments and cash	6,694,216	6,023,967
Investments in affiliates	99,312	53,031
Premiums receivable	781,991	646,354
Deferred acquisition costs	155,456	121,505
Prepaid reinsurance premiums	144,788	91,381
Securities lending collateral	10,383	7,736
Loss reserves recoverable	317,252	372,485
Paid losses recoverable	36,209	90,495
Income taxes recoverable	5,019	—
Intangible assets	111,611	114,731
Goodwill	20,393	20,393
Accrued investment income	19,945	25,906
Other assets	67,245	50,487
Total assets	$8,463,820	$7,618,471
Liabilities		
Reserve for losses and loss expenses	$2,562,604	$2,631,143
Unearned premiums	1,034,605	772,382
Reinsurance balances payable	87,955	119,899
Securities lending payable	10,849	8,462
Deferred income taxes	22,848	16,720
Net payable for investments purchased	26,629	1,256
Accounts payable and accrued expenses	86,128	83,402
Senior notes payable	247,063	246,982
Debentures payable	289,800	289,800
Total liabilities	$4,368,481	$4,170,046
Commitments and contingent liabilities		
Shareholders' equity		
Common shares, 571,428,571 authorized, par value $0.175 (Issued: 2012—136,632,448; 2011—134,503,065; Outstanding: 2012—93,494,391; 2011—99,471,080)	$23,911	$23,538
Treasury shares (2012—43,138,057; 2011—35,031,985)	(7,549)	(6,131)

Additional paid-in-capital	1,657,767	1,893,890
Accumulated other comprehensive (loss)	(4,565)	(6,601)
Retained earnings	1,964,289	1,543,729
Total shareholders' equity available to Validus	3,633,853	3,448,425
Noncontrolling interest	461,486	—
Total shareholders' equity	$4,095,339	$3,448,425
Total liabilities and shareholders' equity	$8,463,820	$7,618,471

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 (Loss)
For the Three and Nine Months Ended September 30, 2012 and 2011 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Three Months Ended		Nine Months Ended	
	September 30, 2012 (unaudited)	September 30, 2011 (unaudited)	September 30, 2012 (unaudited)	September 30, 2011 (unaudited)
Revenues				
Gross premiums written	$390,215	$391,129	$1,854,593	$1,846,412
Reinsurance premiums ceded	(45,743)	(30,586)	(271,847)	(272,752)
Net premiums written	344,472	360,543	1,582,746	1,573,660
Change in unearned premiums	130,632	98,081	(208,816)	(259,863)
Net premiums earned	475,104	458,624	1,373,930	1,313,797
Net investment income	25,489	27,747	79,134	84,216
Net realized gains on investments	9,063	5,246	22,749	23,177
Net unrealized gains (losses) on investments	86,345	(27,848)	53,442	(22,150)
(Loss) from investment affiliate	(160)	—	(558)	—
Other income	7,324	—	22,209	2,201
Foreign exchange gains (losses)	1,103	(19,932)	3,617	(22,390)
Total revenues	604,268	443,837	1,554,523	1,378,851
Expenses				
Losses and loss expenses	155,455	226,067	541,136	909,572
Policy acquisition costs	98,623	77,405	252,884	232,931
General and administrative expenses	70,547	35,926	198,557	145,244
Share compensation expenses	7,345	7,382	19,583	27,059
Finance expenses	9,362	10,935	39,347	41,297
Transaction expenses	3,784	13,583	3,784	13,583
Total expenses	345,116	371,298	1,055,291	1,369,686
Net income before taxes and income from operating affiliates	259,152	72,539	499,232	9,165
Tax (expense)	(1,343)	(2,538)	(1,886)	(1,050)
Income from operating affiliates	6,235	—	13,194	—
Net income	$264,044	$70,001	$510,540	$8,115
Net (income) attributable to noncontrolling interest	(56,746)	(13,516)	(11,386)	(14,110)
Net income (loss) available (attributable) to Validus	$207,298	$56,485	$499,154	$(5,995)
Other comprehensive income (loss)				
Foreign currency translation adjustments	1,400	(413)	2,036	523
Other comprehensive income (loss)	$1,400	$(413)	$2,036	$523
Comprehensive income (loss) available (attributable) to Validus	$208,698	$56,072	$501,190	$(5,472)
Earnings per share				

Weighted average number of common shares and common share equivalents outstanding				
Basic	93,368,775	98,961,795	97,016,034	98,430,686
Diluted	98,236,490	100,823,335	102,333,515	98,430,686
Basic earnings (loss) per share available (attributable) to common shareholders	$2.20	$0.55	$5.09	$(0.12)
Diluted earnings (loss) per share available (attributable) to common shareholders	$2.11	$0.54	$4.88	$(0.12)
Cash dividends declared per share	$0.25	$0.25	$0.75	$0.75

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 Nine Months Ended September 30, 2012 and 2011 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	September 30, 2012 (unaudited)	September 30, 2011 (unaudited)
Common shares		
Balance - Beginning of period	$23,538	$23,247
Common shares issued, net	373	216
Balance - End of period	$23,911	$23,463
Treasury shares		
Balance - Beginning of period	$(6,131)	$(6,096)
Repurchase of common shares	(1,418)	(35)
Balance - End of period	$(7,549)	$(6,131)
Additional paid-in capital		
Balance - Beginning of period	$1,893,890	$1,860,960
Common shares issued, net	2,551	4,838
Repurchase of common shares	(258,257)	(5,960)
Share compensation expenses	19,583	27,059
Balance - End of period	$1,657,767	$1,886,897
Accumulated other comprehensive (loss)		
Balance - Beginning of period	$(6,601)	$(5,455)
Foreign currency translation adjustments	2,036	523
Balance - End of period	$(4,565)	$(4,932)
Retained earnings		
Balance - Beginning of period	$1,543,729	$1,632,175
Dividends	(78,594)	(81,608)
Net income	510,540	8,115
Net (income) attributable to noncontrolling interest	(11,386)	(14,110)
Balance - End of period	$1,964,289	$1,544,572
Total shareholders' equity available to Validus	$3,633,853	$3,443,869
Noncontrolling interest	$461,486	$146,223
Total shareholders' equity	$4,095,339	$3,590,092

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 Nine Months Ended September 30, 2012 and 2011 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	September 30, 2012 (unaudited)	September 30, 2011 (unaudited)
Cash flows provided by (used in) operating activities		
Net income	$510,540	$8,115
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	19,583	27,059
Amortization of discount on senior notes	81	81
Loss from investment affiliate	558	—
Net realized (gains) on investments	(22,749)	(23,177)
Net unrealized (gains) losses on investments	(53,442)	22,150
Amortization of intangible assets	3,120	3,120
Income from operating affiliates	(13,194)	—
Foreign exchange (gains) losses included in net income	(17,064)	9,602
Amortization of premium on fixed maturities	19,214	23,470
Change in:		
Premiums receivable	(132,292)	(239,934)
Deferred acquisition costs	(33,951)	(30,797)
Prepaid reinsurance premiums	(53,407)	(70,214)
Loss reserves recoverable	57,574	(103,048)
Paid losses recoverable	54,559	(52,853)
Income taxes recoverable	(5,041)	(2,164)
Accrued investment income	6,015	6,620
Other assets	(16,050)	7,740
Reserve for losses and loss expenses	(80,954)	530,925
Unearned premiums	262,223	330,077
Reinsurance balances payable	(33,487)	40,206
Deferred income taxes	6,241	(518)
Accounts payable and accrued expenses	4,948	(16,557)
Net cash provided by operating activities	483,025	469,903
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	2,528,442	3,424,462
Proceeds on maturities of investments	385,642	266,594
Purchases of fixed maturities	(2,832,179)	(3,697,544)
Sales (purchases) of short-term investments, net	5,123	(273,939)
(Purchases) sales of other investments	(499,178)	4,364
(Increase) in securities lending collateral	(2,387)	(1,907)
Purchase of investment in operating affiliates	(26,500)	—
Purchase of investment in investment affiliate	(3,798)	—
Net cash (used in) investing activities	(444,835)	(277,970)
Cash flows provided by (used in) financing activities		

Issuance of common shares, net	2,924	5,054
Purchases of common shares under share repurchase program	(259,675)	(5,995)
Dividends paid	(81,391)	(81,108)
Increase in securities lending payable	2,387	1,907
Third party investment in noncontrolling interest	450,100	132,113
Net cash provided by financing activities	114,345	51,971
Effect of foreign currency rate changes on cash and cash equivalents	20,450	(8,662)
Net increase in cash	172,985	235,242
Cash and cash equivalents - beginning of period	$832,844	$620,740
Cash and cash equivalents - end of period	$1,005,829	$855,982
Taxes paid (recovered) during the period	$3,640	$(3,676)
Interest paid during the period	$37,122	$39,336

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 for the year ended December 31, 2011, as filed with the U.S. Securities and Exchange Commission (the "SEC").

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

On April 2, 2012, the Company joined with other investors in capitalizing PaCRe, Ltd. (“PaCRe”) a new Class 4 Bermuda reinsurer formed for the purpose of writing high excess property catastrophe reinsurance. Validus Reinsurance, Ltd. (“Validus Re”) has an equity interest in PaCRe and as Validus Re holds a majority of PaCRe's outstanding voting rights, the financial statements of PaCRe are included in the consolidated financial statements of the Company. The portion of PaCRe's earnings attributable to third party investors for the three and nine months ended September 30, 2012 is recorded in the consolidated Statements of Comprehensive Income (loss) as net income attributable to noncontrolling interest. Refer to Note 5 "Noncontrolling interest" for further information.

On May 29, 2012, the Company joined with other investors in capitalizing AlphaCat Re 2012, Ltd. (“AlphaCat Re 2012”) a new special purpose reinsurer formed for the purpose of writing collateralized reinsurance with a particular focus on windstorm risks for Florida domiciled insurance companies. Validus Re has an equity interest and voting interest in AlphaCat Re 2012 which is below 50%, therefore the investment in AlphaCat Re 2012 is included as an equity method investment in the consolidated financial statements of the Company. Refer to Note 4 “Investments in affiliates” for further information.

2. Recent accounting pronouncements

(a) Adoption of New Accounting Standards

Fair Value Measurement and Disclosures

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, "Amendments to Achieve Common Fair Value
Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" ("ASU 2011-04"). The objective of ASU 2011-04 is to provide common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the amendments do not result in a change in the application of the requirements in ASC Topic 820 "Fair Value Measurements". ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. Effective January 1, 2012, the Company prospectively adopted this amended guidance. The adoption of this guidance did not impact our results of operations, financial condition or liquidity. The adoption of this guidance did not have a significant impact on the current disclosures included in Note 3 "Investments".

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Presentation of Comprehensive Income
In June 2011, the FASB issued Accounting Standards Update No. 2011-05, "Presentation of Comprehensive Income" ("ASU 2011-05"). The objective of ASU 2011-05 is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. ASU 2011-05 is effective for interim and annual periods beginning after December 15, 2011. In December 2011, the FASB issued Accounting Standards Update No. 2011-12, "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05". ASU 2011-12 indefinitely defers certain reclassification adjustment provisions of ASU 2011-05. ASU 2011-12 is also effective for interim and annual periods beginning after December 15, 2011. Effective January 1, 2012, the Company retrospectively adopted this guidance. The adoption of this guidance did not impact our results of operations, financial condition or liquidity.
Technical Amendments and Corrections to SEC Sections
In July 2012, the FASB issued Accounting Standards Update No. 2012-3, “Technical Amendments and Corrections to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 114, Technical Amendments Pursuant to SEC Release No. 33-9250, and Corrections Related to FASB Accounting Standards Update 2010-22 (SEC Update)” (“ASU 2012-3”). ASU 2012-3 is effective upon issuance. The adoption of this guidance did not impact our results of operations, financial condition or liquidity.

(b) Recently Issued Accounting Standards Not Yet Adopted

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. ASU 2011-11 is effective for interim and annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of this guidance; however, since this update affects disclosures only, it is not expected to have a material impact on the Company's consolidated financial statements.

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, "Testing Indefinite-Lived Intangible Assets for Impairment" ("ASU 2012-02"). The objective of ASU 2012-02 is to simplify how entities test intangibles for impairment. The amendments permit an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment described in ASC Topic 350 "Intangibles - Goodwill and Other - General Intangibles Other than Goodwill." The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued. The Company has evaluated the impact of this guidance and has concluded that it will not have a material impact on the Company's consolidated financial statements.

In October 2012, the FASB issued Accounting Standards Update No. 2012-04, “Technical Corrections and Improvements” (“ASU - 2012-04”). The objective of ASU 2012-04 is to clarify the Codification, correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Additionally, the amendments will make the Codification easier to understand and the fair value measurement guidance easier to apply by eliminating inconsistencies and providing needed clarifications. The amendments that will not have transition guidance will be effective upon issuance. For public entities, the amendments that are subject to the transition guidance will be effective for fiscal periods beginning after December 15, 2012. The Company is currently evaluating the impact of this guidance; however it is not expected to have a material impact on the Company's consolidated financial statements.

3. Investments

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

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(a) Classification within the fair value hierarchy

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

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

Level 1 primarily consists of financial instruments whose value is based on quoted market prices or alternative indices including overnight repos and commercial paper.

Level 2 includes financial instruments that are valued through independent external sources using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. The Company performs internal procedures on the valuations received from independent external sources. Investments in U.S. and Non-U.S. government/agency securities, corporate bonds, mortgage backed securities, bank loans, municipal bonds and asset-backed securities are classified as Level 2 in the fair value hierarchy. The fair value of these securities is derived from index providers, pricing vendors and broker quotations based on inputs that are observable for the asset such as reported trades, bids, offers, benchmark yields and broker-dealer quotes. Catastrophe bonds are classified as Level 2 in the fair value hierarchy as determined by reference to direct dealer quotations. Those indications are based on current market conditions, including liquidity and transactional history, recent issue price of similar catastrophe bonds and seasonality of the underlying risks.

Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. An investment in four Paulson & Co. Inc. managed hedge funds and an investment in a fund of hedge funds are the only financial instruments in this category as at September 30, 2012. 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”).

Other investments consist of an investment in four Paulson & Co. Inc. managed hedge funds (the "hedge funds"), a fund of hedge funds and a deferred compensation trust held in mutual funds. The hedge funds were valued at $512,138 at September 30, 2012. The funds' administrator provides monthly reported NAVs with a one-month delay in its valuation. As a result, the funds' administrator's August 31, 2012 NAV was used as a partial basis for fair value measurement in the Company's September 30, 2012 balance sheet. The fund manager provides an estimate of the NAV at September 30, 2012 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. As this valuation technique incorporates both observable and significant unobservable inputs, the fund is classified as a Level 3 asset. 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. Immaterial variances are recorded in the following reporting period. These managed hedge funds are subject to quarterly liquidity.

The fund of hedge funds includes a side pocket valued at $4,521 at September 30, 2012. 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 August 31, 2012 NAV was used as a basis for fair value measurement in the Company’s September 30, 2012 balance sheet. The fund manager provides an estimate of the fund NAV at September 30, 2012 based on the estimated performance provided from the underlying third-party funds. To determine the reasonableness of the NAV, the Company compares the one-month delayed fund administrator's NAV to the fund manager’s

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estimated NAV that incorporates relevant valuation sources on a timely basis. 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.

At September 30, 2012, the Company's investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. Government and Government Agency	$—	$1,229,273	$—	$1,229,273
Non-U.S. Government and Government Agency	—	307,760	—	307,760
States, municipalities, political subdivision	—	42,538	—	42,538
Agency residential mortgage-backed securities	—	421,975	—	421,975
Non-Agency residential mortgage-backed securities	—	23,832	—	23,832
U.S. corporate	—	1,242,888	—	1,242,888
Non-U.S. corporate	—	598,253	—	598,253
Bank loans	—	602,856	—	602,856
Catastrophe bonds	—	38,466	—	38,466
Asset-backed securities	—	379,781	—	379,781
Commercial mortgage-backed securities	—	—	—	—
Total fixed maturities	—	4,887,622	—	4,887,622
Short-term investments	241,972	33,352	—	275,324
Fund of hedge funds	—	—	5,117	5,117
Hedge funds (a)	—	—	512,138	512,138
Mutual funds	—	8,186	—	8,186
Total	$241,972	$4,929,160	$517,255	$5,688,387
Noncontrolling interest (a)	—	—	(460,924)	(460,924)
Total investments excluding noncontrolling interest	$241,972	$4,929,160	$56,331	$5,227,463

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

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At December 31, 2011, 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	$—	$1,182,393	$—	$1,182,393
Non-U.S. Government and Government Agency	—	449,358	—	449,358
States, municipalities, political subdivision	—	26,291	—	26,291
Agency residential mortgage-backed securities	—	468,054	—	468,054
Non-Agency residential mortgage-backed securities	—	32,706	—	32,706
U.S. corporate	—	1,329,758	—	1,329,758
Non-U.S. corporate	—	579,675	—	579,675
Bank loans	—	467,256	—	467,256
Catastrophe bonds	—	29,952	—	29,952
Asset-backed securities	—	328,299	—	328,299
Commercial mortgage-backed securities	—	403	—	403
Total fixed maturities	—	4,894,145	—	4,894,145
Short-term investments	257,854	22,337	—	280,191
Fund of hedge funds	—	—	5,627	5,627
Private equity investment	—	—	3,253	3,253
Mutual funds	—	7,907	—	7,907
Total	$257,854	$4,924,389	$8,880	$5,191,123

At September 30, 2012, Level 3 investments excluding the noncontrolling interest totaled $56,331, representing 1.1% of total investments, excluding noncontrolling interest, measured at fair value on a recurring basis. At December 31, 2011, Level 3 investments totaled $8,880 representing 0.2% of total investments measured at fair value on a recurring basis.

The following tables present a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the three and nine month periods ending September 30, 2012 and 2011:

	Three Months Ended September 30, 2012		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$—	$454,793	$454,793
Purchases	—	—	—
Sales	—	(218)	(218)
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	13	13
Unrealized gains	—	61,746	61,746
Amortization	—	—	—
Transfers	—	921	921
Level 3 investments - End of period	$—	$517,255	$517,255
Noncontrolling interest (a)	—	(460,924)	(460,924)
Level 3 investments excluding noncontrolling interest	$—	$56,331	$56,331

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	Three Months Ended September 30, 2011		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$—	$9,776	$9,776
Purchases	—	—	—
Sales	—	(556)	(556)
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	73	73
Unrealized (losses)	—	(526)	(526)
Amortization	—	—	—
Transfers	—	—	—
Level 3 investments - End of period	$—	$8,767	$8,767

	Nine Months Ended September 30, 2012		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$—	$8,880	$8,880
Purchases	—	500,000	500,000
Sales	—	(1,115)	(1,115)
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	61	61
Unrealized gains	—	11,762	11,762
Amortization	—	—	—
Transfers	—	(2,333)	(2,333)
Level 3 investments - End of period	$—	$517,255	$517,255
Noncontrolling interest (a)	—	(460,924)	(460,924)
Level 3 investments excluding noncontrolling interest	$—	$56,331	$56,331

	Nine Months Ended September 30, 2011		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$—	$12,892	$12,892
Purchases	—	—	—
Sales	—	(4,365)	(4,365)
Issuances	—	—	—
Settlements	—	—	—
Realized gains	—	508	508
Unrealized (losses)	—	(268)	(268)
Amortization	—	—	—
Transfers	—	—	—
Level 3 investments - End of period	$—	$8,767	$8,767

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

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There have not been any transfers between Levels 1 and 2 during the three or nine months ended September 30, 2012. During the three months ended September 30, 2012, there was a transfer of an investment into Level 3 of the fair value hierarchy. This transfer was due to the conversion of a bank loan to an other investment. During the three months ended June 30, 2012, there was a transfer of the private equity investment out of Level 3 "Other investments" to "Investments in affiliates." Refer to Note 4 "Investments in affiliates."

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Fixed maturities and short-term investments	$25,703	$27,773	$79,450	$84,243
Cash and cash equivalents	1,770	1,864	5,536	5,132
Securities lending income	3	7	9	31
Total gross investment income	27,476	29,644		