VALIDUS HOLDINGS LTD
Form 10-Q
August 07, 2009

Table of Contents

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2009
Commission file number 001-33606

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

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

19 Par-La-Ville Road, Hamilton, Bermuda HM 11
(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 þ 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 o 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 þ	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 þ

As of August 7, 2009, there were 76,462,412 outstanding Common Shares, $0.175 par value per share, of the registrant.

INDEX

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements:	
Consolidated Balance Sheets as at June 30, 2009 (unaudited) and December 31, 2008	3
Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2009 and 2008 (unaudited)	4
Consolidated Statements of Shareholders Equity for the six months ended June 30, 2009 and 2008 (unaudited)	5
Consolidated Statements of Cash Flows for the six months ended June 30, 2009 and 2008 (unaudited)	6
Notes to Consolidated Financial Statements (unaudited)	7
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	37
Item 3. Quantitative and Qualitative Disclosures About Market Risk	85
Item 4. Controls and Procedures	87
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	88
Item 1A. Risk Factors	88
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	91
Item 3. Defaults Upon Senior Securities	91
Item 4. Submission of Matters to a Vote of Security Holders	91
Item 5. Other Information	93
Item 6. Exhibits	93
Signatures	94
EX-31.1	
EX-31.2	
EX-32	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

Table of Contents

Validus Holdings, Ltd.
Consolidated Balance Sheets
As at June 30, 2009 (unaudited) and December 31, 2008

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

	June 30, 2009 (Unaudited)	December 31, 2008
Assets		
Fixed maturities, at fair value (amortized cost: 2009 - $2,836,299; 2008 - $2,553,018)	$ 2,816,536	$ 2,454,501
Short-term investments, at fair value (amortized cost: 2009 - $324,773; 2008 - $379,537)	323,940	377,036
Cash and cash equivalents	390,090	449,848
Total investments and cash	3,530,566	3,281,385
Premiums receivable	679,189	408,259
Deferred acquisition costs	145,615	108,156
Prepaid reinsurance premiums	87,798	22,459
Securities lending collateral	166,496	98,954
Loss reserves recoverable	169,666	208,796
Paid losses recoverable	36,624	1,388
Net receivable for investments sold		490
Income taxes recoverable	1,876	1,365
Intangible assets	125,136	127,217
Goodwill	20,393	20,393
Accrued investment income	19,636	20,433
Other assets	25,455	23,185
Total assets	$ 5,008,450	$ 4,322,480
Liabilities		
Reserve for losses and loss expenses	$ 1,311,935	$ 1,305,303
Unearned premiums	856,138	539,450
Reinsurance balances payable	101,004	33,042
Securities lending payable	168,923	105,688
Deferred income taxes	22,163	21,779
Net payable for investments purchased	16,346	
Accounts payable and accrued expenses	75,672	74,184
Debentures payable	304,300	304,300
Total liabilities	2,856,481	2,383,746
Commitments and contingent liabilities		
Shareholders equity		
	13,327	13,235

Common shares, 571,428,571 authorized, par value $0.175		
Issued and outstanding (2009 - 76,151,473; 2008 - 75,624,697)		
Additional paid-in capital	1,424,378	1,412,635
Accumulated other comprehensive (loss)	(4,061)	(7,858)
Retained earnings	718,325	520,722
Total shareholders equity	2,151,969	1,938,734
Total liabilities and shareholders equity	$ 5,008,450	$ 4,322,480

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

3

Validus Holdings, Ltd.
Consolidated Statements of Operations and Comprehensive Income
For the three and six months ended June 30, 2009 and 2008 (Unaudited)

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

	Three months ended June 30, 2009 (Unaudited)	**Three months ended June 30, 2008** (Unaudited)	**Six months ended June 30, 2009** (Unaudited)	**Six months ended June 30, 2008** (Unaudited)
Revenues				
Gross premiums written	$ 425,032	$ 379,919	$ 1,034,924	$ 901,513
Reinsurance premiums ceded	(62,291)	(1,399)	(134,803)	(86,299)
Net premiums written	362,741	378,520	900,121	815,214
Change in unearned premiums	(34,541)	(69,222)	(253,162)	(214,052)
Net premiums earned	328,200	309,298	646,959	601,162
Net investment income	26,963	36,435	53,735	72,478
Realized gain on repurchase of debentures		8,752		8,752
Net realized (losses) gains on investments	(2,650)	(2,425)	(26,071)	5,319
Net unrealized gains (losses) on investments	37,249	(42,982)	59,402	(57,959)
Other income	1,017	1,462	1,774	2,397
Foreign exchange gains	8,432	911	4,232	9,090
Total revenues	399,211	311,451	740,031	641,239
Expenses				
Losses and loss expenses	124,751	122,089	256,585	262,113
Policy acquisition costs	64,438	56,419	125,887	113,120
General and administrative expenses	41,200	33,912	79,279	71,019
Share compensation expenses	5,632	7,271	12,986	13,806
Finance expenses	10,752	12,762	18,475	34,279
Transaction expenses	15,851		15,851	
Total expenses	262,624	232,453	509,063	494,337
Net income before taxes	136,587	78,998	230,968	146,902
Income tax benefit (expense)	976	(3,077)	1,502	(4,506)
Net income	$ 137,563	$ 75,921	$ 232,470	$ 142,396

Comprehensive income

Foreign currency translation adjustments		3,993		10		3,797		77
Comprehensive income	$	141,556	$	75,931	$	236,267	$	142,473
Earnings per share								
Weighted average number of common shares and common share equivalents outstanding								
Basic		76,138,038		74,233,425		75,941,308		74,221,398
Diluted		78,942,065		77,257,545		79,022,355		77,793,636
Basic earnings per share	$	1.79	$	1.00	$	3.02	$	1.87
Diluted earnings per share	$	1.74	$	0.98	$	2.94	$	1.83
Cash dividends declared per share	$	0.20	$	0.20	$	0.40	$	0.40

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

Table of Contents

Validus Holdings, Ltd.
Consolidated Statements of Shareholders Equity

For the six months ended June 30, 2009 and 2008 (Unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	June 30, 2009 (Unaudited)	June 30, 2008 (Unaudited)
Common shares		
Balance Beginning of period	$ 13,235	$ 12,985
Issue of common shares	92	8
Balance End of period	$ 13,327	$ 12,993
Additional paid-in capital		
Balance Beginning of period	$ 1,412,635	$ 1,384,604
Issue of common shares, net of expenses	(1,243)	503
Share compensation expense	12,986	13,806
Balance End of period	$ 1,424,378	$ 1,398,913
Accumulated other comprehensive (loss) income		
Balance Beginning of period	$ (7,858)	$ (49)
Currency translation adjustments	3,797	77
Balance End of period	$ (4,061)	$ 28
Retaining earnings (deficit)		
Balance Beginning of period	$ 520,722	$ 537,260
Dividends	(34,867)	(34,809)
Net income	232,470	142,396
Balance End of period	$ 718,325	$ 644,847
Total shareholders equity	$ 2,151,969	$ 2,056,781

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

Table of Contents

Validus Holdings, Ltd.
Consolidated Statements of Cash Flows

For the six months ended June 30, 2009 and 2008 (Unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	June 30, 2009 (Unaudited)	June 30, 2008 (Unaudited)
Cash flows provided by (used in) operating activities		
Net income for the period	$ 232,470	$ 142,396
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expense	12,986	13,806
Realized gain on repurchase of debentures		(8,752)
Net realized losses (gains) on sales of investments	26,071	(5,319)
Net unrealized (gains) losses on investments	(59,402)	57,959
Amortization of intangible assets	2,081	2,081
Foreign exchange (gains) on cash and cash equivalents included in net income	(9,593)	(6,254)
Amortization of premium on fixed maturities	4,123	1,753
Change in:		
Premiums receivable	(264,194)	(208,431)
Deferred acquisition costs	(37,460)	(40,715)
Prepaid reinsurance premiums	(63,532)	(22,867)
Loss reserves recoverable	42,977	1,480
Paid losses recoverable	(34,083)	5,122
Income taxes recoverable	(522)	482
Accrued investment income	680	(4,520)
Other assets	258	(700)
Reserve for losses and loss expenses	(18,001)	104,284
Unearned premiums	316,689	236,193
Reinsurance balances payable	66,957	29,501
Deferred income taxes	(2,504)	3,489
Accounts payable and accrued expenses	(6,190)	(53,581)
Net cash provided by operating activities	209,811	247,407
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	1,509,773	1,109,536
Proceeds on the maturities of investments	311,221	100,787
Purchases of fixed maturities	(2,122,514)	(1,460,975)
Sales of short-term investments, net	53,781	109,580
(Increase) in securities lending collateral	(63,235)	(35,644)
Net cash (used in) investing activities	(310,974)	(176,716)
Cash flows provided by (used in) financing activities		

Repurchase of debentures				(36,948)
Issue of common shares, net of expenses		(1,182)		511
Dividends paid		(33,973)		(33,642)
Increase in securities lending payable		63,235		35,644
Net cash provided by (used in) financing activities		28,080		(34,435)
Effect of foreign currency rate changes on cash and cash equivalents		13,325		6,306
Net (decrease) increase in cash		(59,758)		42,562
Cash and cash equivalents Beginning of period		449,848		444,698
Cash and cash equivalents End of period	$	390,090	$	487,260
Taxes paid during the period	$	1,199	$	410
Interest paid during the period	$	13,344	$	14,625

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

6

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

1. Basis of preparation and consolidation

These unaudited consolidated financial statements include Validus Holdings, Ltd. and its wholly owned subsidiaries (together, the Company) and have been prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. This Quarterly Report should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the U.S. Securities and Exchange Commission (the SEC).

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

2. Recent accounting pronouncements

In December 2007, the FASB issued Statements No. 141(R), Business Combinations (FAS 141(R)) and No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 (FAS 160) which are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. In April 2009, the FASB issued FASB Staff Position FAS 141(R)-1 Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies (FSP FAS 141(R)-1). FSP FAS 141(R)-1 has amended FAS 141(R) s guidance on the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets acquired and liabilities assumed in a business combination that arise from contingencies.

Significant changes arising from FAS 141 (R) and FSP FAS 141(R)-1 which impact current and future acquisitions include the determination of the purchase price and treatment of transaction expenses, restructuring charges and negative goodwill as follows;

Purchase Price Under FAS 141(R), the purchase price is determined as of the acquisition date, which is the date that the acquirer obtains control. Previously, the date the business combination was announced was used as the effective date in determining the purchase price;

Transaction Expenses Under FAS 141(R), all costs associated with purchase transactions must be expensed as incurred. Previously, all such costs could be capitalized and included as part of transaction purchase price, adding to the amount of goodwill recognized;

Restructuring Costs Under FAS 141(R), expected restructuring costs are not recorded at the closing date, but rather after the transaction. The only costs to be included as a liability at the closing date are

7

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

those for which an acquirer is obligated at the time of the closing. Previously, restructuring costs that were planned to occur after the closing of the transaction were recognized and recorded at the closing date as a liability;

Negative Goodwill/Bargain Purchases Under FAS 141(R), where total fair value of net assets acquired exceeds consideration paid (creating negative goodwill), the acquirer will record a gain as a result of the bargain purchase, to be recognized through the income statement at the close of the transaction. Previously, negative goodwill was recognized as a pro rata reduction of the assets assumed to allow the net assets acquired to equal the consideration paid; and

Noncontrolling Interests Under FAS 141(R), in a partial or step acquisition where control is obtained, 100% of goodwill and identifiable net assets are recognized at fair value and the noncontrolling (sometimes called minority interest) interest is also recorded at fair value. Previously, in a partial acquisition only the controlling interest s share of goodwill was recognized, the controlling interest s share of identifiable net assets was recognized at fair value and the noncontrolling interest s share of identifiable net assets was recognized at carrying value. Under FAS 160, a noncontrolling interest is now recognized in the equity section, presented separately from the controlling interest s equity. Previously, noncontrolling interest in general was recorded in the mezzanine section.

As a result of the adoption of FAS 141(R) and FSP FAS 141(R)-1 the Company has expensed as incurred the transaction costs related to the definitive amalgamation agreement with IPC Holdings, Ltd. (IPC), as described in Note 11. The adoption of FAS 141(R) and FSP FAS 141(R)-1 materially impacts the consolidated financial statement recognition and measurement of current and future acquisitions.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions may be participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing basic earnings per share (EPS) pursuant to the two-class method described in paragraphs 60 and 61 of FASB Statement No. 128, Earnings per Share. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of FSP EITF 03-6-1 has not had a material impact on the Company s consolidated financial statements.

In January 2009, the FASB issued FASB Staff Position EITF 99-20-1 Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets (FSP EITF 99-20-1). FSP EITF 99-20-1 amends certain recognition aspects of other-than-temporary impairments (OTTI). FSP EITF 99-20-1 is effective prospectively for interim and annual periods ending after December 15, 2008. Retrospective application of FSP EITF 99-20-1 to a prior interim or annual period is prohibited. As the Company s investment portfolio is classified as trading, the adoption of the FSP EITF 99-20-1 has not had a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FASB Staff Positions FAS 157-4 Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4) and FAS 115-2 and FAS 124-2 Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2). FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with FAS 157, Fair Value Measurements, specifically; (1) estimating the fair value of an asset or liability (financial and nonfinancial) when the volume and level of activity for the asset or liability have significantly decreased; and (2) identifying transactions that are not orderly. The primary change to the OTTI model for debt securities, as a result of FSP FAS 115-2 and FAS 124-2, is the change in focus from an entity s intent and ability to

hold a security until recovery. Instead, an OTTI is triggered if; (1) an entity has the intent to sell the security; (2) it is more likely than not that it will be required to sell the security before recovery; or (3) it does not expect to recover the entire amortized cost basis of the security. Both FSPs are effective for interim and annual

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
periods ending after June 15, 2009. The adoption of FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2 have not had a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position FAS 107-1 and APB 28-1 Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 expands the fair value disclosures required for all financial instruments within the scope of Statement 107 to interim periods for publicly traded entities. The FSP also requires entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim basis and to highlight any changes of the methods and significant assumptions from prior periods. FSP FAS 107-1 and APB 28-1 is effective for interim and annual periods ending after June 15, 2009. As FSP FAS 107-1 and APB 28-1 only expands certain disclosures requirements it has not had a material impact on the Company s consolidated financial statements.

In May 2009, the FASB issued Statements No. 165, Subsequent Events (FAS 165), which provides guidance on management s assessment of subsequent events. FAS 165 clarifies that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued or are available to be issued. FAS 165 is effective prospectively for interim and annual periods ending after June 15, 2009. The adoption of FAS 165 has not had a material impact on management s existing processes for assessing subsequent events, and consequently the Company s consolidated financial statements.

In June 2009, the FASB issued Statements No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 (FAS 166) which amends the derecognition guidance in FAS 140. FAS 166 addresses practices that have developed since the issuance of FAS 140 that are not consistent with the original intent and key requirements and concerns that derecognized financial assets and related obligations should continue to be reported in the transferors financial statements. FAS 166 is effective for financial asset transfers in the interim and annual periods beginning after November 15, 2009. Early adoption is prohibited. The adoption of FAS 166 is not expected to have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued Statements No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167) which amends the consolidation guidance that applies to Variable Interest Entities (VIEs). FAS 167 amends the guidance for the identification of VIEs and their primary beneficiaries and the financial statement disclosures required. FAS 167 is effective for interim and annual periods beginning after November 15, 2009. Early adoption is prohibited. The adoption of FAS 167 is not expected to have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued Statements No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 (FAS 168) which prescribes the use of the FASB Accounting Standards Codification (the Codification) as the authoritative source of U.S. GAAP. Once the Codification is in effect, all of its content will carry the same level of authority, effectively superseding FAS 162 to include only two levels of U.S. GAAP: authoritative and nonauthoritative. FAS 168 is effective for interim and annual periods ending after September 15, 2009. The adoption of FAS 168 will not have a material impact on the Company s consolidated financial statements.

3. Investments

During the first quarter of 2007, the Company adopted FAS 157 and FAS 159. Prior to January 1, 2007, the Company s investments in fixed maturities were classified as available-for-sale and carried at fair value, with related net unrealized gains or losses excluded from earnings and included in shareholders equity as a component of accumulated other comprehensive income. The Company believes that accounting for its investment portfolio as trading more closely reflects its investment guidelines. Beginning on January 1, 2007, the Company s investments in fixed maturities were classified as trading and carried at fair value, with related net unrealized gains or losses included in earnings.

9

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

During the third quarter of 2008, the Company adopted FSP FAS 157-3. Consistent with this statement, certain market conditions allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable. Effective for interim and annual periods ending after June 15, 2009, FSP FAS 157-3 has been superseded by FSP 157-4.

(a) ***Classification within the fair value hierarchy under FAS 157***

Under FAS 157, a company must determine the appropriate level in the fair value hierarchy for each fair value measurement. The fair value hierarchy in FAS 157 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 but for which the Company typically obtained independent external valuation information including U.S. and U.K. Treasuries, 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. Sustainably all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. The Company performs internal procedures on the valuations received from independent external sources. Financial instruments in this category include U.S. Treasuries, sovereign debt, corporate debt and U.S. agency and non-agency mortgage and asset-backed securities. Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. Financial instruments in this category include certain residential mortgage-backed securities.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

At June 30, 2009, 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	$	$ 994,086	$	$ 994,086
Non-U.S. Government and Government Agency		139,766		139,766
States, municipalities, political subdivision		8,543		8,543
Agency residential mortgage-backed securities		542,352		542,352
Non-Agency residential mortgage-backed Securities		80,804	100,952	181,756
U.S. corporate		619,633		619,633
Non-U.S. corporate		169,017		169,017
Catastrophe bonds		18,776		18,776
Asset-backed securities		76,238		76,238
Commercial mortgage-backed securities		66,369		66,369
Total fixed maturities		2,715,584	100,952	2,816,536
Total short-term investments	318,872	5,068		323,940
Total	$ 318,872	$ 2,720,652	$ 100,952	$ 3,140,476

At December 31, 2008, 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	$	$ 768,344	$	$ 768,344
Non-U.S. Government and Government Agency		96,073		96,073
States, municipalities, political subdivision		15,516		15,516
Agency residential mortgage-backed securities		433,736		433,736
Non-Agency residential mortgage-backed securities		119,813	111,318	231,131
U.S. corporate		443,847		443,847
Non-U.S. corporate		125,700		125,700
Catastrophe bonds		10,872		10,872
Asset-backed securities		137,023		137,023
Commercial mortgage-backed securities		192,259		192,259
Total fixed maturities		2,343,183	111,318	2,454,501
Total short-term investments	365,357	11,679		377,036
Total	$ 365,357	$ 2,354,862	$ 111,318	$ 2,831,537

At June 30, 2009, Level 3 investments totaled $100,952, representing 3.2% of total investments measured at fair value on a recurring basis. At December 31, 2008, Level 3 investments totaled $111,318, representing 3.9% of total investments measured at fair value on a recurring basis.

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs as at June 30, 2009 and December 31, 2008:

11

Table of Contents

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

	Six months ended June 30, 2009	Year ended December 31, 2008
Level 3 investments Beginning of period	$ 111,318	$
Payments and purchases		
Sales and maturities	(822)	(59)
Realized losses	(1,284)	
Unrealized losses	(1,495)	(14,603)
Amortization	(6,765)	(4,048)
Transfers in		130,028
Level 3 investments End of period	$ 100,952	$ 111,318

(b) ***Net investment income***

Net investment income was derived from the following sources:

	Three months ended		Six months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Fixed maturities and short-term investments	$ 26,396	$ 34,519	$ 52,914	$ 66,210
Cash and cash equivalents	1,120	2,378	1,881	7,216
Securities lending income	173	455	512	890
Total gross investment income	27,689	37,352	55,307	74,316
Investment expenses	(726)	(917)	(1,572)	(1,838)
Net investment income	$ 26,963	$ 36,435	$ 53,735	$ 72,478

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

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

	Three months ended		Six months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Fixed maturities, short-term investments and cash equivalents				
Gross realized gains	$ 3,928	$ 2,957	$ 13,381	$ 11,313
Gross realized losses	(6,578)	(5,382)	(39,452)	(5,994)

Net realized (losses) gains on investments	(2,650)	(2,425)	(26,071)	5,319
Change in unrealized gains (losses) of securities lending	3,214	317	4,306	(895)
Change in unrealized gains (losses) of investments	34,035	(43,299)	55,096	(57,064)
Total net realized (losses) gains and change in unrealized gains (losses) of investments	$ 34,599	$ (45,407)	$ 33,331	$ (52,640)

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at June 30, 2009 were as follows:

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Government and Government Agency	$ 978,409	$ 16,256	$ (579)	$ 994,086
Non-U.S. Government and Government Agency	143,249	5,609	(9,092)	139,766
States, municipalities, political subdivision	8,500	43		8,543
Agency residential mortgage-backed securities	529,386	13,535	(569)	542,352
Non-Agency residential mortgage-backed securities	231,737		(49,981)	181,756
U.S. corporate	610,405	12,722	(3,494)	619,633
Non-U.S. corporate	173,440	2,416	(6,839)	169,017
Catastrophe bonds	19,009	84	(317)	18,776
Asset-backed securities	76,254	981	(997)	76,238
Commercial mortgage-backed securities	65,910	494	(35)	66,369
Total fixed maturities	2,836,299	52,140	(71,903)	2,816,536
Total short-term investments	324,773	57	(890)	323,940
Total	$ 3,161,072	$ 52,197	$ (72,793)	$ 3,140,476

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at December 31, 2008 were as follows:

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Government and Government Agency	$ 732,155	$ 36,189	$	$ 768,344
Non-U.S. Government and Government Agency	115,389	4,403	(23,719)	96,073
States, municipalities, political subdivision	14,954	562		15,516
Agency residential mortgage-backed securities	425,533	8,358	(155)	433,736
Non-Agency residential mortgage-backed securities	299,346	6	(68,221)	231,131
U.S. corporate	454,810	2,126	(13,089)	443,847

Non-U.S. corporate	140,807	1,696	(16,803)	125,700
Catastrophe bonds	11,012	2	(142)	10,872
Asset-backed securities	141,209		(4,186)	137,023
Commercial mortgage-backed securities	217,803		(25,544)	192,259
Total fixed maturities	2,553,018	53,342	(151,859)	2,454,501
Total short-term investments	379,537	55	(2,556)	377,036
Total	$ 2,932,555	$ 53,397	$ (154,415)	$ 2,831,537

The following table sets forth certain information regarding the investment ratings of the Company s fixed maturities portfolio as at June 30, 2009 and December 31, 2008. Investment ratings are the lower of Moody s or Standard & Poor s rating for each investment security, presented in Standard & Poor s equivalent rating. For

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
investments where Moody s and Standard & Poor s ratings are not available, Fitch ratings are used and presented in Standard & Poor s equivalent rating.

	June 30, 2009		December 31, 2008	
	Estimated fair value	% of total	Estimated fair value	% of total
AAA	$ 1,971,837	70.0%	$ 1,941,349	79.1%
AA	130,921	4.7%	146,923	6.0%
A	578,209	20.5%	338,966	13.8%
BBB	20,252	0.7%	12,427	0.5%
Investment grade	2,701,219	95.9%	2,439,665	99.4%
BB	30,668	1.1%	7,416	0.3%
B	61,383	2.2%	7,420	0.3%
CCC	23,266	0.8%		
Non-Investment grade	115,317	4.1%	14,836	0.6%
Total	$ 2,816,536	100.0%	$ 2,454,501	100.0%

The amortized cost and estimated fair value amounts for fixed maturity securities held at June 30, 2009 and December 31, 2008 are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

	June 30, 2009		December 31, 2008	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due in one year or less	$ 275,126	$ 276,070	$ 277,137	$ 279,727
Due after one year through five years	1,633,788	1,649,817	1,143,494	1,134,275
Due after five years through ten years	21,715	21,437	17,451	17,493
Due after ten years	2,383	2,497	31,045	28,858
	1,933,012	1,949,821	1,469,127	1,460,353
Asset-backed and mortgage-backed Securities	903,287	866,715	1,083,891	994,148
Total	$ 2,836,299	$ 2,816,536	$ 2,553,018	$ 2,454,501

The Company has a five year, $500,000 secured letter of credit facility provided by a syndicate of commercial banks. At June 30, 2009, approximately $276,955 (December 31, 2008: $199,186) of letters of credit were issued and outstanding under this facility for which $358,157 of investments were pledged as collateral (December 31, 2008: $258,573). In 2007, the Company entered into a $100,000 standby letter of credit facility which provides Funds at Lloyd s. At June 30, 2009, $100,000 (December 31, 2008: $100,000) of letters of credit were issued and outstanding

under this facility for which $127,731 of investments were pledged as collateral (December 31, 2008: $144,149). In addition, $26,773,829 of investments are held in trust at June 30, 2009 (December 31, 2008: $1,100,235). Of those, $1,093,233 are held in trust for the benefit of Talbot s cedants and policyholders, and to facilitate the accreditation as an alien insurer/reinsurer by certain regulators (December 31, 2008: $1,032,267).

14

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

(d) ***Securities lending***

The Company participates in a securities lending program whereby certain securities from its portfolio are loaned to third parties for short periods of time through a lending agent. The Company retains all economic interest in the securities it lends and receives a fee from the borrower for the temporary use of the securities. Collateral in the form of cash, government securities and letters of credit is required at a rate of 102% of the market value of the loaned securities and is held by a third party. As at June 30, 2009, the Company had $165,565 (December 31, 2008: $103,266) in securities on loan. During the six months ended June 30, 2009, the Company recorded a $4,306 unrealized gain on this collateral on its Statements of Operations (June 30, 2008: unrealized loss $895).

Securities lending collateral reinvested is primarily comprised of corporate floating rate securities with an average reset period of 15.5 days (December 31, 2008: 26.7 days). As at June 30, 2009, the securities lending collateral reinvested by the Company in connection with its securities lending program was allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
Corporate	$	$ 24,328	$	$ 24,328
Asset-backed securities		13,466		13,466
Short-term investments	75,194	53,508		128,702
Total	$ 75,194	$ 91,302	$	$ 166,496

As at December 31, 2008, the securities lending collateral reinvested by the Company in connection with its securities lending program was allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
Corporate	$	$ 57,574	$	$ 57,574
Asset-backed securities		18,228		18,228
Short-term investments	7,390	15,762		23,152
Total	$ 7,390	$ 91,564	$	$ 98,954

The following table sets forth certain information regarding the investment ratings of the Company s securities lending collateral reinvested as at June 30, 2009 and December 31, 2008. Investment ratings are the lower of Moody s or Standard & Poor s rating for each investment security, presented in Standard & Poor s equivalent rating. For investments where Moody s and Standard & Poor s ratings are not available, Fitch ratings are used and presented in Standard & Poor s equivalent rating.

	June 30, 2009		December 31, 2008	
	Estimated fair value	% of total	Estimated fair value	% of total
AAA	$ 66,942	40.2%	$ 45,137	45.7%

AA	17,392	10.4%	37,608	37.9%
A	6,820	4.1%	8,729	8.8%
NR	148	0.1%	90	0.1%
	91,302	54.8%	91,564	92.5%
NR- Cash (1)	75,194	45.2%	7,390	7.5%
Total	$ 166,496	100.0%	$ 98,954	100.0%

(1) This amount relates to cash and is therefore not a rated security.

15

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 and estimated fair value amounts for securities lending collateral reinvested held at June 30, 2009 and December 31, 2008 are shown by contractual maturity below. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

	June 30, 2009		December 31, 2008	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due in one year or less	$ 129,180	$ 128,702	$ 24,390	$ 23,152
Due after one year through five years	39,743	37,794	81,298	75,802
Total	$ 168,923	$ 166,496	$ 105,688	$ 98,954

4. Reinsurance

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

a) Credit risk

The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- or better rated by Standard & Poor s or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. 99.6% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) at June 30, 2009 were from reinsurers rated A- or better and included $57,224 of IBNR recoverable (December 31, 2008: $71,580). Reinsurance recoverables by reinsurer are as follows:

	June 30, 2009		December 31, 2008	
	Reinsurance recoverable	% of Total	Reinsurance recoverable	% of Total
Top 10 reinsurers	$ 188,303	91.3%	$ 198,403	94.4%
Other reinsurers balances > $1 million	12,177	5.9%	8,987	4.3%
Other reinsurers balances < $1 million	5,810	2.8%	2,794	1.3%
Total	$ 206,290	100.0%	$ 210,184	100.0%

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

		June 30, 2009	
		Reinsurance	
Top 10 Reinsurers	**Rating**	**recoverable**	**% of Total**
Fully collateralized reinsurers	NR	$ 74,131	39.4%
Hannover Re	AA-	33,860	18.0%
Lloyd s syndicates	A+	28,427	15.1%
Allianz	AA	12,891	6.9%
Munich Re	AA-	12,135	6.4%
Swiss Re	A+	10,968	5.8%
Aspen	A	6,311	3.4%
Transatlantic Re	A+	3,435	1.8%
Platinum Underwriters	A	3,415	1.8%
Axa	AA	2,730	1.4%
Total		$ 188,303	100.0%

		December 31, 2008	
		Reinsurance	
Top 10 Reinsurers	**Rating**	**recoverable**	**% of Total**
Fully collateralized reinsurers	NR	$ 83,511	41.9%
Hannover Re	AA-	32,855	16.6%
Lloyd s syndicates	A+	25,533	12.9%
Allianz	AA	14,988	7.6%
Swiss Re	AA-	13,207	6.7%
Munich Re	AA-	12,813	6.5%
Aspen	A	6,040	3.0%
Platinum Underwriters	A	3,270	1.6%
Transatlantic Re	A+	3,096	1.6%
Axa	AA	3,090	1.6%
Total		$ 198,403	100.0%

At June 30, 2009 and December 31, 2008, the provision for uncollectible reinsurance relating to losses recoverable was $3,085, and $3,228, respectively. To estimate the provision for uncollectible reinsurance recoverable, the reinsurance recoverable must first be allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment must be applied. As part of this process, ceded IBNR is allocated by reinsurer. Of the $206,290 reinsurance recoverable at June 30, 2009, $74,131 was fully collateralized (December 31, 2008: $83,511).

The Company uses a default analysis to estimate uncollectible reinsurance. The primary components of the default analysis are reinsurance recoverable balances by reinsurer and default factors used to determine the portion of a reinsurer s balance deemed to be uncollectible. Default factors require considerable judgment and are determined using the current rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions.

b) Collateralized quota share retrocession treaties

On December 22, 2007, Validus Re entered into a collateralized retrocessional reinsurance agreement with an unaffiliated third party whereby the Company cedes certain business underwritten in the marine offshore energy lines. For the three months ended June 30, 2009 and 2008 Validus Re ceded $209 and $2,828 of premiums written through this agreement respectively. The earned portions of premiums ceded for the three months ended June 30, 2009 and 2008 were $209 and $3,721 respectively. For the six months ended June 30, 2009 and 2008 Validus Re

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
ceded $1,099 and $14,560 of premiums written through this agreement respectively. The earned portions of premiums ceded for the six months ended June 30, 2009 and 2008 were $1,280 and $6,485 respectively.

5. Share capital

a) Authorized and issued

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

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

	Common shares
Common shares outstanding, December 31, 2008	75,624,697
Restricted share awards vested	246,585
Employee seller shares vested	42,349
Options exercised	
Warrants exercised	237,842
Common shares outstanding, June 30, 2009	76,151,473

	Common shares
Common shares outstanding, December 31, 2007	74,199,836
Restricted share awards vested	777,953
Employee seller shares vested	515,103
Options exercised	112,825
Warrants exercised	18,980
Common shares outstanding, December 31, 2008	75,624,697

b) Warrants

During the three and six months ended June 30, 2009, 728,010 warrants were exercised which resulted in the net share issuance of 237,842 common shares. During the three months ended June 30, 2008, 13,068 warrants were exercised which resulted in the net share issuance of 13,067 common shares. During the six months ended June 30, 2008, 31,580 warrants were exercised which resulted in the net share issuance of 18,980 common shares.

c) Deferred share units

Under the terms of the Company s Director Stock Compensation Plan, non-management directors may elect to receive their director fees in deferred share units rather than cash. The number of share units distributed in case of election under the plan is equal to the amount of the annual retainer fee otherwise payable to the director on such payment date divided by 100% of the fair market value of a share on such payment date. Additional deferred share units are issued in lieu of dividends that accrue on these deferred share units. The total outstanding deferred share units at June 30, 2009 were 4,508 (December 31, 2008: 4,430).

d) Dividends

On May 4, 2009, the Company announced a quarterly cash dividend of $0.20 (2008: $0.20) per common share and $0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on June 30, 2009

to holders of record on June 15, 2009.

6. Stock plans

a) Long-term incentive plan

The Company s Long Term Incentive Plan (LTIP) provides for grants to employees of any option, stock appreciation right (SAR), restricted share, restricted share unit, performance share, performance unit, dividend equivalent or other share-based award. The total number of shares reserved for issuance under the LTIP is 13,126,896 shares. The LTIP is administered by the Compensation Committee of the Board of

18

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
Directors. No SARs, performance shares, performance units or dividend equivalents have been granted to date. Grant prices are established at the estimated fair market value of the Company s common shares at the date of grant.

b) LTIP options

Options granted under the LTIP may be exercised for voting common shares upon vesting. Options have a life of 10 years and vest ratably over five years from the date of grant. No options were granted since the year ended December 31, 2008. Grant prices are established at the estimated fair value of the Company s common shares at the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used for all grants to date:

Year	Weighted average risk free interest rate	Weighted average dividend yield	Expected life (years)	Expected volatility
2007 and prior years	4.5%	0.00%	7	30%
2008	3.5%	3.20%	7	30%

Expected volatility is based on stock price volatility of comparable publicly-traded companies. The Company uses the simplified method outlined in the SEC Staff Accounting Bulletin 110 to estimate expected lives for options granted during the period as historical exercise data is not available and the options met the requirement as set out in the bulletin.

Share compensation expenses of $918 were recorded for the three months ended June 30, 2009 (2008: $1,068). Share compensation expenses of $1,975 were recorded for the six months ended June 30, 2009 (2008: $2,091). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to the options for the six months ended June 30, 2009 was as follows:

	Options	Weighted average grant date fair value	Weighted average grant date exercise price
Options outstanding, December 31, 2008	2,799,938	$ 7.57	$ 18.23
Options granted			
Options exercised			
Options forfeited	(6,536)	10.30	20.39
Options outstanding, June 30, 2009	2,793,402	$ 7.56	$ 18.22
Options exercisable at June 30, 2009	1,531,092	$ 7.52	$ 17.92

Activity with respect to options for the year ended December 31, 2008 was as follows:

	Options	Weighted average grant	Weighted average grant date exercise price

		date fair value	
Options outstanding, December 31, 2007	2,761,176	$ 7.61	$ 17.82
Options granted	164,166	6.73	24.73
Options exercised	(112,825)	7.38	17.57
Options forfeited	(12,579)	8.56	18.69
Options outstanding, December 31, 2008	2,799,938	$ 7.57	$ 18.23
Options exercisable at December 31, 2008	1,396,353	$ 7.46	$ 17.63

At June 30, 2009, there were $6,857 (December 31, 2008: $9,139) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.8 years (December 31, 2008: 2.2 years).

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

c) LTIP restricted shares

Restricted shares granted under the LTIP vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $4,074 were recorded for the three months ended June 30, 2009 (2008: $3,625). Share compensation expenses of $8,386 were recorded for the six months ended June 30, 2009 (2008: $6,567). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested restricted shares for the six months ended June 30, 2009 was as follows:

	Restricted shares	Weighted average grant date fair value
Restricted shares outstanding, December 31, 2008	2,307,402	$ 22.73
Restricted shares granted	280,073	24.70
Restricted shares vested	(291,328)	22.00
Restricted shares forfeited	(3,989)	21.29
Restricted shares outstanding, June 30, 2009	2,292,158	$ 23.06

Activity with respect to unvested restricted shares for the period ended December 31, 2008 was as follows:

	Restricted shares	Weighted average grant date fair value
Restricted shares outstanding, December 31, 2007	2,158,220	$ 20.44
Restricted shares granted	1,007,083	24.09
Restricted shares vested	(822,370)	18.55
Restricted shares forfeited	(35,531)	21.87
Restricted shares outstanding, December 31, 2008	2,307,402	$ 22.73

At June 30, 2009, there were $35,650 (December 31, 2008: $35,915) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.8 years (December 31, 2008: 3.2 years).

d) Employee seller shares

Pursuant to the Share Sale Agreement for the purchase of Talbot, the Company issued 1,209,741 restricted shares to Talbot employees (the employee seller shares). Upon consummation of the acquisition, the employee seller shares were validly issued, fully-paid and non-assessable and entitled to vote and participate in distributions and dividends in accordance with the Company s Bye-laws. However, the employee seller shares are subject to a restricted period during which they are subject to forfeiture (as implemented by repurchase by the Company for a nominal amount). Forfeiture of employee seller shares will generally occur in the event that any such Talbot employee s employment

terminates, with certain exceptions, prior to the end of the restricted period. The restricted period will end for 25% of the employee seller shares on each anniversary of the closing date of July 2, 2007 for all Talbot employees other than Talbot s Chairman, such that after four years forfeiture will be completely extinguished. Share compensation expenses of $619 were recorded for the three months ended June 30, 2009 (2008: $2,567). Share compensation expenses of $2,588 were recorded for the six

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
months ended June 30, 2009 (2008: $5,134). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested employee seller shares for the six months ended June 30, 2009 was as follows:

	Employee seller shares		Weighted average grant date fair value
Employee seller shares outstanding, December 31, 2008	663,375	$	22.01
Employee seller shares granted			
Employee seller shares vested	(42,349)		22.01
Employee seller shares forfeited	(3,799)		22.01
Employee seller shares outstanding, June 30, 2009	617,227	$	22.01

Activity with respect to unvested employee seller shares for the year ended December 31, 2008 was as follows:

	Employee seller shares		Weighted average grant date fair value
Employee seller shares outstanding, December 31, 2007	1,209,741	$	22.01
Employee seller shares granted			
Employee seller shares vested	(515,103)		22.01
Employee seller shares forfeited	(31,263)		22.01
Employee seller shares outstanding, December 31, 2008	663,375	$	22.01

At June 30, 2009, there were $9,904 (December 31, 2008: $12,157) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.0 years (December 31, 2008: 2.5 years).

e) Restricted share units

Restricted share units under the LTIP vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $21 were recorded for the three months ended June 30, 2009 (2008: $11). Share compensation expenses of $37 were recorded for the six months ended June 30, 2009 (2008: $14) related to restricted share units. The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested restricted share units for the six months ended June 30, 2009 was as follows:

	Restricted	Weighted average grant

	share units		date fair value
Restricted share units outstanding, December 31, 2008	11,853	$	25.28
Restricted share units granted	4,044		25.03
Restricted share units vested	(1,569)		24.84
Restricted share units forfeited			
Restricted share units outstanding, June 30, 2009	14,328	$	25.25

Table of Contents

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
Activity with respect to unvested restricted share units for the year ended December 31, 2008 was as follows:

	Restricted share Units	Weighted average grant date fair value
Restricted share units outstanding, December 31, 2007		$
Restricted share units granted	11,853	25.28
Restricted share units vested		
Restricted share units forfeited		
Restricted share units outstanding, December 31, 2008	11,853	$ 25.28

At June 30, 2009, there were $282 (December 31, 2008: $227) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 3.2 years (December 31, 2008: 4.3 years). Additional restricted share units are issued in lieu of accrued dividends from unvested restricted share units. As at June 30, 2009 restricted share units issued in lieu of dividends were 592 (December 31, 2008: 368).

f) Share compensation expenses

The breakdown of share compensation expenses was as follows:

	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
LTIP options	$ 918	$ 1,068	$ 1,975	$ 2,091
LTIP restricted shares	4,074	3,625	8,386	6,567
LTIP restricted share units	21	11	37	14
Employee seller shares	619	2,567	2,588	5,134
Total	$ 5,632	$ 7,271	$ 12,986	$ 13,806

7. Debt and financing arrangements

a) Financing structure and finance expenses

The financing structure at June 30, 2009 was:

	Commitment	Outstanding(1)	Drawn
9.069% Junior Subordinated Deferrable Debentures	$ 150,000	$ 150,000	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	200,000	154,300	154,300
$200,000 unsecured letter of credit facility	200,000		
$500,000 secured letter of credit facility	500,000	276,955	
Talbot FAL facility (2)	100,000	100,000	
Talbot third party FAL facility (2)	121,515	121,515	
Total	$ 1,271,515	$ 802,770	$ 304,300

22

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

The financing structure at December 31, 2008 was:

	Commitment	Outstanding(1)	Drawn
9.069% Junior Subordinated Deferrable Debentures	$ 150,000	$ 150,000	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	200,000	154,300	154,300
$200,000 unsecured letter of credit facility	200,000		
$500,000 secured letter of credit facility	500,000	199,186	
Talbot FAL facility (2)	100,000	100,000	
Talbot third party FAL facility (2)	144,015	144,015	
Total	$ 1,294,015	$ 747,501	$ 304,300

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

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

Finance expenses for the three months ended June 30, 2009, was $10,752 (2008: $12,762). Finance expenses for the six months ended June 30, 2009, was $18,475 (2008: $34,279). Finance expenses consist of interest on our junior subordinated deferrable debentures, the amortization of debt offering costs, fees relating to our credit facilities and the costs of FAL as follows:

	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
9.069% Junior Subordinated Deferrable Debentures	$ 3,589	$ 3,589	$ 7,177	$ 7,177
8.480% Junior Subordinated Deferrable Debentures	3,348	3,650	6,696	8,008
Credit facilities	476	123	840	474
Talbot letter of credit facilities	42	62	105	125
Talbot other interest		(19)		112
Talbot third party FAL facility	3,297	5,357	3,657	18,383
Total	$ 10,752	$ 12,762	$ 18,475	$ 34,279

b) Junior subordinated deferrable debentures

On June 15, 2006, the Company participated in a private placement of $150,000 of junior subordinated deferrable interest debentures due 2036 (the 9.069% Junior Subordinated Deferrable Debentures). The 9.069% Junior Subordinated Deferrable Debentures mature on June 15, 2036, are redeemable at the Company s option at par

beginning June 15, 2011, and require quarterly interest payments by the Company to the holders of the 9.069% Junior Subordinated Deferrable Debentures. Interest will be payable at 9.069% per annum through June 15, 2011, and thereafter at a floating rate of three-month LIBOR plus 355 basis points, reset

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
quarterly. The proceeds of $150,000 from the sale of the 9.069% Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, are being used by the Company to fund Validus Re segment operations and for general working capital purposes. Debt issuance costs of $3,750 were deferred as an asset and are amortized to income over the five year optional redemption period.

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

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

Future expected payments of interest and principal on the Junior Subordinated Deferrable Debentures assuming that the Company exercises its call option at the earliest opportunity are as follows:

2009	$ 13,344
2010	26,688
2011	169,887
2012	160,842
2013 and thereafter	
Total minimum future payments	$ 370,761

c) Credit facilities

On March 12, 2007, the Company entered into a $200,000 three-year unsecured facility, as subsequently amended on October 25, 2007, which provides for letter of credit availability for Validus Re and our other subsidiaries and revolving credit availability for the Company (the full $200,000 of which is available for letters of credit and/or revolving loans), and a $500,000 five-year secured letter of credit facility, as subsequently amended, which provides for letter of credit availability for Validus Re and our other subsidiaries. The credit facilities were provided by a syndicate of commercial banks arranged by J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc.

The credit facilities contain covenants that include, among other things, (i) the requirement that the Company initially maintain a minimum level of consolidated net worth of at least $872,000, and commencing with the end of the fiscal quarter ending March 31, 2007 to be increased quarterly by an amount equal to 50% of our consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, (ii) the requirement that the Company maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00, and (iii) the requirement that Validus Re and any other material insurance subsidiaries maintain a financial strength rating by A.M. Best of not less than B++ (Fair). For purposes of covenant compliance (i) net worth is calculated with investments carried at amortized cost and (ii) consolidated total debt does not include the Company s junior subordinated deferrable debentures. The credit facilities

also contain restrictions on our ability to pay

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
dividends and other payments in respect of equity interests at any time that we are otherwise in default with respect to certain provisions under the credit facilities, make investments, incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others.

As of June 30, 2009 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the credit facilities.

As of June 30, 2009, we had $276,955 in outstanding letters of credit under our five-year secured letter of credit facility (December 31, 2008: $199,186) and no amounts were outstanding under our three-year unsecured facility (December 31, 2008: $nil).

On October 25, 2007, the Company entered into the First Amendment to each of its Three-Year Unsecured Letter of Credit Facility Agreement, dated as of March 12, 2007 and its Five-Year Secured Letter of Credit Facility Agreement, dated as of March 12, 2007 (together, the Credit Facilities), among the Company, Validus Reinsurance, Ltd., the Lenders party thereto, and JPMorgan Chase Bank, National Association, as administrative agent, to provide for, among other things, additional capacity to incur up to $100,000 under a new Funds at Lloyd s Letter of Credit Facility (FAL LoC Facility) to support underwriting capacity provided to Talbot 2002 Underwriting Ltd through Syndicate 1183 at Lloyd s of London for the 2008 and 2009 underwriting years of account. The amendment also modifies certain provisions in the Credit Facilities in order to permit dividend payments on existing and future preferred and hybrid securities notwithstanding certain events of default.

On November 28, 2007, Talbot entered into a $100,000 standby Letter of Credit facility (the Talbot FAL Facility) to provide Funds at Lloyd s; this facility is guaranteed by the Company and is secured against the assets of Validus Re. The Talbot FAL Facility was provided by a syndicate of commercial banks arranged by Lloyds TSB Bank plc and ING Bank N.V., London Branch. The Talbot FAL Facility contains affirmative covenants that include, among other things, (i) the requirement that we initially maintain a minimum level of consolidated net worth of at least $1,164,265, and commencing with the end of the fiscal quarter ending December 31, 2007 to be increased quarterly by an amount equal to 50% of our consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, and (ii) the requirement that we maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00.

The Talbot FAL Facility also contains restrictions on our ability to make investments, incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others. Other than in respect of existing and future preferred and hybrid securities, the payment of dividends and other payments in respect of equity interests are not permitted at any time that we are in default with respect to certain provisions under the credit facilities. As of June 30, 2009 the Company had $100,000 in outstanding letters of credit under this facility and was in compliance with all covenants and restrictions.

d) Funds at Lloyd s

Talbot s underwriting at Lloyd s is supported by Funds at Lloyd s (FAL) comprising: cash, investments and undrawn letters of credit provided by various banks on behalf of various companies and persons under reinsurance and other agreements. The FAL are provided in exchange for payment calculated principally by reference to the syndicate s results, as appropriate, when they are declared. The amounts of cash, investments and letters of credit at June 30, 2009 supporting the 2009 underwriting year amount to $346,750 all of which is provided by the Company. A third party FAL facility comprising $121,515 which supports the 2007 and prior underwriting years has now been withdrawn from Lloyd s and placed in escrow, however, the funds remain available to pay losses on that year.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

8. Commitments and contingencies

a) Concentrations of credit risk

The Company s investments are managed following prudent standards of diversification. The Company attempts to limit its credit exposure by purchasing high quality fixed income investments to maintain an average portfolio credit quality of AA- or higher with mortgage and commercial mortgage-backed issues having an aggregate weighted average credit quality of triple-A. In addition, the Company limits its exposure to any single issuer to 3% or less, excluding treasury and agency securities. The minimum credit rating of any security purchased is A-/A3 and where investments are downgraded, the Company permits a holding of up to 2% in aggregate market value, or 10% with written pre-authorization. At June 30, 2009, 4.3% of the portfolio had a split rating below A-/A3 and the Company did not have an aggregate exposure to any single issuer of more than 1.6% of our investment portfolio, other than with respect to government and agency securities.

b) Funds at Lloyd s

Talbot operates in Lloyd s through a corporate member, Talbot 2002 Underwriting Capital Ltd (T02), which is the sole participant in Syndicate 1183. Lloyd s sets T02 s required capital annually based on syndicate 1183 s business plan, rating environment, reserving environment together with input arising from Lloyd s discussions with, inter alia, regulatory and rating agencies. Such capital, called Funds at Lloyd s (FAL), comprises: cash, investments and undrawn letters of credit provided by various banks. The amounts of cash, investments and letters of credit at June 30, 2009 amounted to $346,750 (December 31, 2008: $351,394).

The FAL are provided for each year of account as follows:

	2009 Underwriting year	2008 Underwriting year
Talbot FAL facility	$ 100,000	$ 100,000
Group funds	246,750	216,483
Total	$ 346,750	$ 316,483

The amounts which the Company provides as FAL is not available for distribution to the Company for the payment of dividends. Talbot s corporate member may also be required to maintain funds under the control of Lloyd s in excess of its capital requirement and such funds also may not be available for distribution to the Company for the payment of dividends.

The amounts provided under the Talbot FAL facility would become a liability of the group in the event of the syndicate declaring a loss at a level which would call on this arrangement.

c) Lloyd s central fund

Whenever a member of Lloyd s is unable to pay its debts to policyholders, such debts may be payable by the Lloyd s central fund. If Lloyd s determines that the central fund needs to be increased, it has the power to assess premium levies on current Lloyd s members up to 3% of a member s underwriting capacity in any one year. The Company does not believe that any assessment is likely in the foreseeable future and has not provided any allowance for such an assessment. However, based on the Company s 2009 estimated premium income at Lloyd s of £400,000, the June 30, 2009 exchange rate of £1 equals $1.65 and assuming the maximum 3% assessment the Company would be assessed approximately $19,800.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

9. Related party transactions

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

a) The Company entered into an agreement on December 8, 2005 with BlackRock Financial Management, Inc. (BlackRock) under which BlackRock was appointed as an investment manager of part of Company s investment portfolio. Merril Lynch is a shareholder of Blackrock. Merrill Lynch entities, which are now wholly-owned subsidiaries of Bank of America Corp, own 6,134,530 non-voting shares in the Company, hold warrants to purchase 1,067,187 shares and have an employee on the Company s Board of Directors who does not receive compensation from the Company. Merrill Lynch s warrants are convertible to non-voting shares. Under the terms of the investment manager agreement with Blackrock, the Company incurred expenses of $527 during the three months ended June 30, 2009 (2008: $613) and $978 during the six months ended June 30, 2009 (2008: $1,223), of which $896 was included in accounts payable and accrued expenses at June 30, 2009 (December 31, 2008: $584).

b) The Company entered into an agreement on December 8, 2005 with Goldman Sachs Asset Management and its affiliates (GSAM) under which GSAM was appointed as an investment manager of part of the Company s investment portfolio. Goldman Sachs entities, own 14,057,137 non-voting shares in the Company, hold warrants to purchase 1,604,410 non-voting shares, and have an employee on the Company s Board of Directors who does not receive compensation from the Company. The Company incurred expenses of $368 during the three months ended June 30, 2009 (2008: $364) and $726 during the six months ended June 30, 2009 (2008: $747), of which $310 was included in accounts payable and accrued expenses at June 30, 2009 (December 31, 2008: $641).

c) Vestar Capital entities, which own 8,571,427 shares in the Company, hold warrants to purchase 972,810 shares, are shareholders of PARIS RE Holdings Limited (Paris Re), and have an employee on the Company s Board of Directors who does not receive compensation from the Company. Pursuant to reinsurance agreements with Paris Re, the Company recognized gross premiums written of $28 during the three months ended June 30, 2009 (2008: $nil) and $6,634 during the six months ended June 30, 2009 (2008: $6,079), of which $6,986 was included in premiums receivable at June 30, 2009 (December 31, 2008: $4,412). The earned premium adjustments of $1,710 (2008: $776) and $3,416 (2008: $1,553) was recorded for the three and six months ended June 30, 2009, respectively.

d) Aquiline Capital Partners, LLC and its related companies (Aquiline), which own 6,886,342 shares in the Company, hold warrants to purchase 3,193,865 shares, and have three employees on the Board of Directors who do not receive compensation from the Company, are shareholders of Group Ark Insurance Holdings Ltd. (Group Ark). Pursuant to reinsurance agreements with Group Ark, the Company recognized $nil (2008: $nil) of gross premiums written and $nil (2008: $nil) of reinsurance premiums ceded during the three months ended June 30, 2009 and recognized $nil (2008: $688) of gross premiums written and $800 (2008: $1.098) of reinsurance premiums ceded during the six months ended June 30, 2009, of which $500 was included in reinsurance balances payable at June 30, 2009 (December 31, 2008: $60).

e) Certain members of the Company s management and staff have provided guarantees to 1384 Capital Ltd, a company formed to indirectly facilitate the provision of Funds at Lloyd s (FAL). The Company paid $115 of finance expenses to such management and staff in respect of such provision of FAL for the three months ended June 30, 2009 (2008: $182) and $143 for the six months ended June 30, 2009 (2008: $579), all of which was included in accounts payable and accrued expenses at June 30, 2009 (December 31, 2008: $803). An amount of $nil was included in general and administrative expenses in respect of the reimbursement of expenses relating to such FAL provision for the three months ended June 30, 2009 (2008: $nil). An amount of $16 was included in general and administrative expenses in respect of the reimbursement of expenses relating to such FAL provision

for the six months ended June 30, 2009 (2008: $2).

Table of Contents

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

10. Earnings per share

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2009 and 2008:

	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Basic earnings (loss) per share				
Net income	$ 137,563	$ 75,921	$ 232,470	$ 142,396
Less: Dividends and distributions declared on outstanding warrants	(1,590)	(1,739)	(3,326)	(3,478)
Net income available to common shareholders	$ 135,973	$ 74,182	$ 229,144	$ 138,918
Weighted average shares basic common shares outstanding	76,138,038	74,233,425	75,941,308	74,221,398
Basic earnings per share	$ 1.79	$ 1.00	3.02	$ 1.87
Diluted earnings (loss) per share				
Net income	$ 137,563	$ 75,921	$ 232,470	$ 142,396
Less: Dividends and distributions declared on outstanding warrants				
Net income available to common shareholders	$ 137,563	$ 75,921	$ 232,470	$ 142,396
Weighted average shares basic common shares outstanding	76,138,038	74,233,425	75,941,308	74,221,398
Share equivalents:				
Warrants	1,806,372	1,631,819	2,056,733	2,074,835
Stock options	300,405	32,894	333,955	171,366
Unvested restricted shares	697,250	1,359,407	690,359	1,326,037
Weighted average shares diluted common shares outstanding	78,942,065	77,257,545	79,022,355	77,793,636

Diluted earnings per share	$ 1.74	$ 0.98	$ 2.94	$ 1.83

Share equivalents that would result in the issuance of common shares of 198,500 and 192,534 were outstanding for the three months ended June 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive. Share equivalents that would result in the issuance of common shares of 179,713 and 63,021 were outstanding for the six months ended June 30, 2009 and 2008, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

11. Subsequent Event

On July 9, 2009, the Company, Validus Ltd. (a wholly owned subsidiary of the Company) and IPC Holdings, Ltd. (IPC) entered into an Agreement and Plan of Amalgamation (the Amalgamation Agreement), pursuant to which, subject to the terms and conditions therein, Validus Ltd. will amalgamate with IPC (the Amalgamation). After the effective time of the Amalgamation, the IPC s shareholders will have the right to receive 0.9727 Validus voting common shares, par value $0.175 per share, $7.50 in cash, less any applicable withholding tax and without interest, and cash in lieu of fractional shares in exchange for each common share of IPC they hold, unless they exercise appraisal rights.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

The closing of the Amalgamation is subject to customary closing conditions, including the Company and IPC shareholder approvals. Aquiline Capital Partners LLC, Vestar Capital Partners, and New Mountain Capital, LLC, which collectively owned approximately 38% of Validus outstanding voting common shares as of July 27, 2009, have agreed to vote in favor of the issuance of Validus shares in connection with the transaction. Upon closing of the transaction, the Company s current shareholders will own approximately 62% of the combined company on a fully diluted basis, with IPC shareholders owning approximately 38%.

The boards of directors of both the Company and IPC have adopted the Amalgamation Agreement, and have deemed it fair, advisable and in the best interests of their respective companies and shareholders to enter into the Amalgamation Agreement and to consummate the transactions contemplated thereby.

The Amalgamation Agreement contains specified termination rights for the parties. The Amalgamation Agreement also provides that, if the Amalgamation Agreement is terminated under certain circumstances, the Company will be required to pay IPC a termination fee of $16,000 or IPC will be required to pay the Company a termination fee of $16,000.

On the same day as the execution and delivery of the Amalgamation Agreement, (1) IPC paid to Max Capital Ltd. (Max) $50,000 in respect of the termination fee under its amalgamation agreement with Max, and (2) Validus paid to IPC $50,000 in respect of and in reliance upon such payment by IPC to Max. In certain circumstances more fully described in the Amalgamation Agreement, IPC will be required to repay such amount to Validus in the event the Amalgamation Agreement is terminated.

A copy of the Amalgamation Agreement is referenced as Exhibit 10.1 hereto and is incorporated herein by reference. The description herein of the Amalgamation Agreement and the transactions contemplated thereby is not complete and is qualified in its entirety by reference to Amalgamation Agreement.

The Amalgamation Agreement has been included to provide investors and security holders with information regarding its terms. It is not intended to provide any other factual information about the Company, Validus Ltd., IPC or any of their respective subsidiaries or affiliates. The representations, warranties and covenants contained in the Amalgamation Agreement were made only for purposes of that agreement and as of specific dates; were solely for the benefit of the parties to the Amalgamation Agreement; may be subject to limitations agreed upon by the contracting parties, including being qualified by confidential disclosures made for the purposes of allocating contractual risk between the parties to the Amalgamation Agreement instead of establishing these matters as facts (such disclosures include information that has been included in IPC s and the Company s public disclosures, as well as additional non-public information); and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to investors. Investors are not third party beneficiaries under the Amalgamation Agreement (except for the right to receive the transaction consideration from and after the consummation of the Amalgamation) and should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or condition of IPC, the Company or Validus Ltd. or any of their respective subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations, warranties and covenants may change after the date of the Amalgamation Agreement, which subsequent information may or may not be fully reflected in the Company s public disclosures.

In connection with the signing of the Amalgamation Agreement, the Company has withdrawn and terminated its exchange offer for all of the outstanding common shares of IPC and has instructed BNY Mellon Shareowner Services to promptly return all IPC common shares previously tendered to the Company. Additionally, the Company has terminated its solicitation efforts in connection with its other previously announced alternative steps to complete a transaction with IPC, including a scheme of arrangement and calling of a special meeting of IPC shareholders.

On August 6, 2009, the Company filed with the SEC and announced that it will begin mailing, a joint proxy statement/prospectus in connection with the Amalgamation. The Company s special general meeting of shareholders

will be held on September 4, 2009. The Company expects the Amalgamation to close promptly following the receipt of the Company s and IPC s shareholder approvals, subject to the satisfaction or waiver of all closing conditions.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

On July 24, 2009, the Company announced that it has entered into the Second Amendment to each of its $500,000 five-year secured letter of credit facility and $200,000 three-year unsecured facility, and the First Amendment to its $100,000 Talbot FAL facility to amend a specific investment restriction clause to permit the completion of the IPC amalgamation agreement. The amendment also modifies and updates certain pricing and covenant terms.

The Company has evaluated subsequent events from the balance sheet date through to August 7, 2009.

12. Segment information

The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. and Talbot Holdings Ltd. from which two operating segments have been determined under FAS 131, Disclosures about Segments of and Enterprise and Related Information. The Company s operating segments are strategic business units that offer different products and services. They are managed and have capital allocated separately because each business requires different strategies.

Validus Re

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

Talbot

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

Corporate and other reconciling items

The Company has a Corporate function, which includes the activities of the parent company, and which carries out functions for the group. Corporate also denotes the activities of certain key executives such as the Chief Executive Officer and Chief Financial Officer. The only revenue earned by Corporate is a minor amount of interest income that is incidental to the activities of the enterprise. For internal reporting purposes, Corporate is reflected separately as a business unit, however Corporate is not considered an operating segment under these circumstances and FAS 131. Other reconciling items include, but are not limited to, the elimination of intersegment revenues and expenses and unusual items that are not allocated to segments.

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

(Expressed in thousands of U.S. dollars, except share and per share information)
The following tables summarize the underwriting results of our operating segments and corporate segment:

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

Expense ratio	27.4%	36.6%		33.9%
Combined ratio(1)	52.5%	87.4%		71.9%
Total assets	$ 3,013,433	$ 1,988,037	$ 6,980	$ 5,008,450

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

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

Three months ended June 30, 2008	Validus Re	Talbot	Corporate and other reconciling items	Total
Gross premiums written	$ 187,820	$ 197,235	$ (5,136)	$ 379,919
Reinsurance premiums ceded	(1,208)	(5,327)	5,136	(1,399)
Net premiums written	186,612	191,908		378,520
Change in unearned premiums	(22,500)	(46,722)		(69,222)
Net premiums earned	164,112	145,186		309,298
Losses and loss expenses	48,677	73,412		122,089
Policy acquisition costs	25,309	31,134	(24)	56,419
General and administrative expenses	9,955	19,787	4,170	33,912
Share compensation expenses	1,597	1,126	4,548	7,271
Underwriting income (loss)	$ 78,574	$ 19,727	$ (8,694)	$ 89,607
Net investment income	25,725	11,726	(1,016)	36,435
Realized gain on repurchase of debentures			8,752	8,752
Net realized (losses) gains on investments	(3,260)	835		(2,425)
Net unrealized (losses) on investments	(24,059)	(18,923)		(42,982)
Foreign exchange (losses) gains	(403)	1,314		911
Other income (expenses)	24	1,462	(24)	1,462
Finance expenses	(88)	(5,400)	(7,274)	(12,762)
Net income (loss) before taxes	76,513	10,741	(8,256)	78,998
Income tax (expenses)	(20)	(3,057)		(3,077)
Net income (loss)	$ 76,493	$ 7,684	$ (8,256)	$ 75,921
Loss and loss expense ratio (1)	29.7%	50.6%		39.5%
Policy acquisition cost ratio(1)	15.4%	21.4%		18.2%
General and administrative expense ratio(1)	7.0%	14.4%		13.3%
Expense ratio	22.4%	35.8%		31.5%

Combined ratio(1)	52.1%	86.4%		71.0%
Total assets	$ 2,784,016	$ 1,781,576	$ 4,150	$ 4,569,742

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

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

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

Combined ratio(1)	54.9%	89.3%		73.5%
Total assets	$ 3,013,433	$ 1,988,037	$ 6,980	$ 5,008,450

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

33

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

Six months ended June 30, 2008	Validus Re	Talbot	Corporate and Other reconciling items	Total
Gross premiums written	$ 518,869	$ 399,028	$ (16,384)	$ 901,513
Reinsurance premiums ceded	(24,951)	(77,732)	16,384	(86,299)
Net premiums written	493,918	321,296		815,214
Change in unearned premiums	(186,151)	(27,901)		(214,052)
Net premiums earned	307,767	293,395		601,162
Losses and loss expenses	107,591	154,522		262,113
Policy acquisition costs	45,712	67,432	(24)	113,120
General and administrative expenses	19,334	40,710	10,975	71,019
Share compensation expenses	2,823	2,102	8,881	13,806
Underwriting income (loss)	$ 132,307	$ 28,629	$ (19,832)	$ 141,104
Net investment income	50,752	22,708	(982)	72,478
Net realized (losses) gains on investments	(1,183)	6,502		5,319
Net unrealized (losses) on investments	(42,671)	(15,288)		(57,959)
Realized gain on repurchase of debentures			8,752	8,752
Foreign exchange gains	7,272	1,818		9,090
Other income (expenses)	24	2,397	(24)	2,397
Finance expenses	(442)	(18,620)	(15,217)	(34,279)
Net income (loss) before taxes	146,059	28,146	(27,303)	146,902
Income tax (expenses)	(48)	(4,458)		(4,506)
Net income (loss)	$ 146,011	$ 23,688	$ (27,303)	$ 142,396
Loss and loss expense ratio (1)	35.0%	52.7%		43.6%
Policy acquisition cost ratio(1)	14.9%	23.0%		18.8%
General and administrative expense ratio(1)	7.1%	14.6%		14.1%
Expense ratio	22.0%	37.6%		32.9%

Combined ratio(1)	57.0%	90.3%		76.5%
Total assets	$ 2,784,016	$ 1,781,576	$ 4,150	$ 4,569,742

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

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

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

	Three months ended June 30, 2009 Gross premiums written				
	Validus Re	**Talbot**	**Eliminations**	**Total**	**%**
United States	$ 127,975	$ 24,480	$ (259)	$ 152,196	35.8%
Worldwide excluding United States (1)	12,445	67,581	(1,593)	78,433	18.4%
Europe	6,126	17,595	(551)	23,170	5.5%
Latin America and Caribbean	7,900	15,646	(6,631)	16,915	4.0%
Japan	15,500	3,256		18,756	4.4%
Canada	112	2,219	(112)	2,219	0.5%
Sub-total, non United States	42,083	106,297	(8,887)	139,493	32.8%
Worldwide including United States (1)	19,557	16,461	(393)	35,625	8.4%
Marine and Aerospace (2)	9,945	87,875	(102)	97,718	23.0%
Total	$ 199,560	$ 235,113	$ (9,641)	$ 425,032	100.0%

	Three months ended June 30, 2008 Gross premiums written				
	Validus Re	**Talbot**	**Eliminations**	**Total**	**%**
United States	$ 132,341	$ 18,347	$ (5,136)	$ 145,552	38.3%
Worldwide excluding United States (1)	662	58,939		59,601	15.7%
Europe	5,391	15,343		20,734	5.5%
Latin America and Caribbean	1,264	9,727		10,991	2.9%
Japan	9,093	2,335		11,428	3.0%
Canada		3,095		3,095	0.8%
Sub-total, non United States	16,410	89,439		105,849	27.9%
Worldwide including United States (1)	29,632	21,226		50,858	13.4%
Marine and Aerospace (2)	9,437	68,223		77,660	20.4%

Total	$ 187,820	$ 197,235	$ (5,136)	$ 379,919	100.0%

	Six months ended June 30, 2009 Gross premiums written				
	Validus Re	**Talbot**	**Eliminations**	**Total**	**%**
United States	$ 284,859	$ 46,893	$ (5,087)	$ 326,665	31.6%
Worldwide excluding United States (1)	40,214	127,191	(9,282)	158,123	15.3%
Europe	47,358	37,908	(3,213)	82,053	7.9%
Latin America and Caribbean	20,119	32,596	(14,893)	37,822	3.6%
Japan	16,707	3,707		20,414	2.0%
Canada	652	6,378	(652)	6,378	0.6%
Sub-total, non United States	125,050	207,780	(28,040)	304,790	29.4%
Worldwide including United States (1)	54,251	31,062	(2,287)	83,026	8.0%
Marine and Aerospace (2)	145,526	177,298	(2,381)	320,443	31.0%
Total	$ 609,686	$ 463,033	$ (37,795)	$ 1,034,924	100.0%

Validus Holdings, Ltd.
Notes to Consolidated Financial Statements (Unaudited)

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

	Six months ended June 30, 2008 Gross premiums written				
	Validus Re	Talbot	Eliminations	Total	%
United States	$ 260,193	$ 37,078	$ (16,384)	$ 280,887	31.1%
Worldwide excluding United States (1)	26,541	117,236		143,777	15.9%
Europe	39,734	31,010		70,744	7.8%
Latin America and Caribbean	5,635	15,527		21,162	2.3%
Japan	9,448	2,898		12,346	1.4%
Canada		5,715		5,715	0.6%
Sub-total, non United States	81,358	172,386		253,744	28.0%
Worldwide including United States (1)	64,912	37,272		102,184	11.3%
Marine and Aerospace (2)	112,406	152,292		264,698	29.6%
Total	$ 518,869	$ 399,028	$ (16,384)	$ 901,513	100.0%

(1) Represents risks in two or more geographic zones.

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

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

The following is a discussion and analysis of the Company s consolidated results of operations for the three and six months ended June 30, 2009 and 2008 and the Company s consolidated financial condition and liquidity and capital resources at June 30, 2009 and December 31, 2008. This discussion and analysis should be read in conjunction with the audited consolidated financial statements and related notes for the fiscal year ended December 31, 2008, the discussions of critical accounting policies and the qualitative and quantitative disclosure about market risk contained in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

The Company was formed on October 19, 2005 and completed the acquisition of Talbot Holdings Ltd. (Talbot) on July 2, 2007. For a variety of reasons, the Company s historical financial results may not accurately indicate future performance. See Cautionary Note Regarding Forward-Looking Statements. The Risk Factors set forth in Item 1A of the Annual Report on Form 10-K for the fiscal year ended December 31, 2008 present a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained herein.

Executive Overview

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

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

On July 9, 2009, the Company, Validus Ltd. (a wholly owned subsidiary of the Company) and IPC Holdings, Ltd. (IPC) entered into an Agreement and Plan of Amalgamation (the Amalgamation Agreement), pursuant to which, subject to the terms and conditions therein, Validus Ltd. will amalgamate with IPC (the Amalgamation). After the effective time of the Amalgamation, the IPC s shareholders will have the right to receive 0.9727 the Company s voting common shares, par value $0.175 per share, $7.50 in cash, less any applicable withholding tax and without interest, and cash in lieu of fractional shares in exchange for each common share of IPC they hold, unless they exercise appraisal rights.

The closing of the Amalgamation is subject to customary closing conditions, including the Company and IPC shareholder approvals. Aquiline Capital Partners LLC, Vestar Capital Partners, and New Mountain Capital, LLC, which collectively owned approximately 38% of the Company s outstanding voting common shares as of July 27, 2009, have agreed to vote in favor of the issuance of the Company s shares in connection with the transaction. Upon closing of the transaction, the Company s current shareholders will own approximately 62% of the combined company on a fully diluted basis, with IPC shareholders owning approximately 38%.

The boards of directors of both the Company and IPC have adopted the Amalgamation Agreement, and have deemed it fair, advisable and in the best interests of their respective companies and shareholders to enter into the Amalgamation Agreement and to consummate the transactions contemplated thereby.

The Amalgamation Agreement contains specified termination rights for the parties. The Amalgamation Agreement also provides that, if the Amalgamation Agreement is terminated under certain circumstances, the Company will be required to pay IPC a termination fee of $16 million or IPC will be required to pay the Company a termination fee of $16 million.

On the same day as the execution and delivery of the Amalgamation Agreement, (1) IPC paid to Max Capital Ltd. (Max) $50 million in respect of the termination fee under its amalgamation agreement with Max, and (2) the Company paid to IPC $50 million in respect of and in reliance upon such payment by IPC to Max. In certain circumstances more fully described in the Amalgamation Agreement, IPC will be required to repay such amount to the Company in the event the Amalgamation Agreement is terminated.

A copy of the Amalgamation Agreement is referenced as Exhibit 10.1 hereto and is incorporated herein by reference. The description herein of the Amalgamation Agreement and the transactions contemplated thereby is not complete and is qualified in its entirety by reference to Amalgamation Agreement.

The Amalgamation Agreement has been included to provide investors and security holders with information regarding its terms. It is not intended to provide any other factual information about the Company, Validus Ltd., IPC or any of their respective subsidiaries or affiliates. The representations, warranties and covenants contained in the Amalgamation Agreement were made only for purposes of that agreement and as of specific dates; were solely for the benefit of the parties to the Amalgamation Agreement; may be subject to limitations agreed upon by the contracting parties, including being qualified by confidential disclosures made for the purposes of allocating contractual risk between the parties to the Amalgamation Agreement instead of establishing these matters as facts (such disclosures include information that has been included in IPC s and the Company s public disclosures, as well as additional non-public information); and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to investors. Investors are not third party beneficiaries under the Amalgamation Agreement (except for the right to receive the transaction consideration from and after the consummation of the Amalgamation) and should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or condition of IPC, the Company or Validus Ltd. or any of their respective subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations, warranties and covenants may change after the date of the Amalgamation Agreement, which subsequent information may or may not be fully reflected in the Company s public disclosures.

In connection with the signing of the Amalgamation Agreement, the Company has withdrawn and terminated its previously announced exchange offer for all of the outstanding common shares of IPC and has instructed BNY Mellon Shareowner Services to promptly return all IPC common shares previously tendered to the Company. Additionally, the Company has terminated its solicitation efforts in connection with its other previously announced alternative steps to complete a transaction with IPC, including a scheme of arrangement and calling of a special meeting of IPC shareholders.

On August 6, 2009, the Company filed with the SEC and announced that it will begin mailing, a joint proxy statement/prospectus in connection with the Amalgamation. The Company s special general meeting of shareholders will be held on September 4, 2009. The Company expects the Amalgamation to close promptly following the receipt of the Company s and IPC s shareholder approvals, subject to the satisfaction or waiver of all closing conditions.

Business Outlook and Trends

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

In the wake of these events, the January 2009 renewal season saw decreased competition and increased premium rates due to relatively scarce capital and increased demand. During 2009, the Company observed reinsurance

demand stabilization and modest increases in credit market liquidity. The July 2009 renewal season continued to show notable rate increases as compared to the July 2008 renewal season. Validus Re gross premiums written at January 1, 2009 grew by 26.0% from the prior year and for the six month period ended June 30, 2009 Validus Re gross premiums written grew by 17.5% from the comparable period in the prior year. This increase was largely due to rate increases coupled with modest exposure growth.

Financial Measures

The Company believes the following financial indicators are important in evaluating performance and measuring the overall growth in value generated for shareholders:

Annualized return on average equity represents the level of net income available to shareholders generated from the average shareholders equity during the period. The Company s objective is to generate superior returns on capital that appropriately reward shareholders for the risks assumed and to grow premiums written only when returns meet or exceed internal requirements. Details of annualized return on average equity are provided below.

	Three months ended		Six months ended		Year ended December
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008	31, 2008
Annualized return on average equity	26.4%	15.0%	22.8%	14.3%	2.7%

The increases in annualized return on average equity were driven primarily by increased net income for the three and six month periods ended June 30, 2009. Net income for the three months ended June 30, 2009 increased by $61.6 million or 81.2% compared to the three months ended June 30, 2008. Net income for the six months ended June 30, 2009 increased by $90.1 million or 63.3% compared to the six months ended June 30, 2008.

Annualized return on average equity is calculated by dividing the net income for the period by the average shareholders equity during the period. Average shareholders equity is the average of the beginning, ending and intervening quarter end shareholders equity balances.

Diluted book value per common share is considered by management to be an appropriate measure of our returns to common shareholders, as we believe growth in our book value on a diluted basis ultimately translates into growth of our stock price. Diluted book value per common share increased by $2.30, or 9.7%, from $23.78 at December 31, 2008 to $26.08 at June 30, 2009. The increase was substantially due to earnings generated in the six months ended June 30, 2009, partially offset by dividend payments totaling $0.40 per share and per share equivalent in the period. Diluted book value per common share is a Non-GAAP financial measure. The most comparable U.S. GAAP financial measure is book value per common share. Diluted book value per common share is calculated based on total shareholders equity plus the assumed proceeds from the exercise of outstanding options and warrants, divided by the sum of common shares, unvested restricted shares, options and warrants outstanding (assuming their exercise). A reconciliation of diluted book value per common share to book value per common share is presented below in the section entitled Non-GAAP Financial Measures.

Cash dividends per common share are an integral part of the value created for shareholders. The Company declared quarterly cash dividends of $0.20 per common share in each of the first two quarters of 2009. On July 28, 2009, the Company announced a quarterly cash dividend of $0.20 per each common share and $0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on September 30, 2009 to holders of record on August 20, 2009.

Underwriting income measures the performance of the Company s core underwriting function, excluding revenues and expenses such as net investment income (loss), other income, finance expenses, net realized and unrealized gains (losses) on investments, and foreign exchange gains (losses). The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company s core insurance and reinsurance operations. Underwriting income for the three months ended June 30, 2009 and 2008 was $92.2 million and $89.6 million, respectively. Underwriting income for the six months ended

Table of Contents

June 30, 2009 and 2008 was $172.2 million and $141.1 million, respectively. Underwriting income is a Non-GAAP financial measure as described in detail and reconciled in the section below entitled Underwriting Income.

Critical Accounting Policies and Estimates

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

- Reserve for losses and loss expenses;
- Premiums;
- Reinsurance premiums ceded and reinsurance recoverable; and
- Investment valuation.

Critical accounting policies and estimates are discussed further in Item 7, *Management s Discussion and Analysis of Results of Operations and Financial Condition* in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

Segment Reporting

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

Results of Operations

Validus Re commenced operations on December 16, 2005. The Company s fiscal year ends on December 31. Financial statements are prepared in accordance with U.S. GAAP and relevant SEC guidance.

Table of Contents

The following table presents results of operations for the three and six ended June 30, 2009 and 2008:

(Dollars in thousands)	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Gross premiums written	$ 425,032	$ 379,919	$ 1,034,924	$ 901,513
Reinsurance premiums ceded	(62,291)	(1,399)	(134,803)	(86,299)
Net premiums written	362,741	378,520	900,121	815,214
Change in unearned premiums	(34,541)	(69,222)	(253,162)	(214,052)
Net premiums earned	328,200	309,298	646,959	601,162
Losses and loss expenses	124,751	122,089	256,585	262,113
Policy acquisition costs	64,438	56,419	125,887	113,120
General and administrative expenses	41,200	33,912	79,279	71,019
Share compensation expense	5,632	7,271	12,986	13,806
Total underwriting expenses	236,021	219,691	474,737	460,058
Underwriting income (1)	92,179	89,607	172,222	141,104
Net investment income	26,963	36,435	53,735	72,478
Other income	1,017	1,462	1,774	2,397
Finance (expenses)	(10,752)	(12,762)	(18,475)	(34,279)
Operating income before taxes	109,407	114,742	209,256	181,700
Income tax benefit (expense)	976	(3,077)	1,502	(4,506)
Operating income after tax	110,383	111,665	210,758	177,194
Net realized gains (losses) on investments	(2,650)	(2,425)	(26,071)	5,319
Net unrealized gains (losses) on investments	37,249	(42,982)	59,402	(57,959)
Realized gain on repurchase of debentures		8,752		8,752
Foreign exchange gains (losses)	8,432	911	4,232	9,090
Transaction (expenses)	(15,851)		(15,851)	
Net income after taxes	$ 137,563	$ 75,921	$ 232,470	$ 142,396
Comprehensive income				
Foreign currency translation adjustments	3,993	10	3,797	77
Comprehensive income	$ 141,556	$ 75,931	$ 236,267	$ 142,473
Selected ratios				
Net premiums written/ Gross premiums written	85.3%	99.6%	87.0%	90.4%

Losses and loss expenses ratio	38.0%	39.5%	39.7%	43.6%
Policy acquisition cost ratio	19.6%	18.2%	19.5%	18.8%
General and administrative expense ratio	14.3%	13.3%	14.3%	14.1%
Expense ratio	33.9%	31.5%	33.8%	32.9%
Combined ratio	71.9%	71.0%	73.5%	76.5%

(1) Non-GAAP Financial Measures. In presenting the Company s results, management has included and discussed underwriting income (loss) and operating income that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation underwriting income

(loss) measure to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled Underwriting Income.

41

(Dollars in thousands)	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
VALIDUS RE				
Gross premiums written	$ 199,560	$ 187,820	$ 609,686	$ 518,869
Reinsurance premiums ceded	(43,070)	(1,208)	(56,359)	(24,951)
Net premiums written	156,490	186,612	553,327	493,918
Change in unearned premiums	7,207	(22,500)	(215,183)	(186,151)
Net premiums earned	163,697	164,112	338,144	307,767
Losses and loss expenses	41,121	48,677	96,583	107,591
Policy acquisition costs	29,120	25,309	57,697	45,712
General and administrative expenses	14,149	9,955	27,941	19,334
Share compensation expense	1,548	1,597	3,220	2,823
Total underwriting expenses	85,938	85,538	185,441	175,460
Underwriting income (1)	77,759	78,574	152,703	132,307
TALBOT				
Gross premiums written	$ 235,113	$ 197,235	$ 463,033	$ 399,028
Reinsurance premiums ceded	(28,862)	(5,327)	(116,239)	(77,732)
Net premiums written	206,251	191,908	346,794	321,296
Change in unearned premiums	(41,748)	(46,722)	(37,979)	(27,901)
Net premiums earned	164,503	145,186	308,815	293,395
Losses and loss expenses	83,630	73,412	160,002	154,522
Policy acquisition costs	36,114	31,134	69,271	67,432
General and administrative expenses	21,927	19,787	42,141	40,710
Share compensation expense	2,098	1,126	4,433	2,102
Total underwriting expenses	143,769	125,459	275,847	264,766
Underwriting income (1)	20,734	19,727	32,968	28,629
CORPORATE & ELIMINATIONS				
Gross premiums written	$ (9,641)	$ (5,136)	$ (37,795)	$ (16,384)
Reinsurance premiums ceded	9,641	5,136	37,795	16,384
Net premiums written				
Policy acquisition costs	(796)	(24)	(1,081)	(24)

General and administrative expenses	5,124	4,170	9,197	10,975
Share compensation	1,986	4,548	5,333	8,881
Total underwriting expenses	6,314	8,694	13,449	19,832
Underwriting income (loss) (1)	(6,314)	(8,694)	(13,449)	(19,832)
Total underwriting income (1)	$ 92,179	$ 89,607	$ 172,222	$ 141,104

(1) Non-GAAP Financial Measures. In presenting the Company s results, management has included and discussed underwriting income (loss) that is not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation of this measure to net income, the most

comparable U.S. GAAP financial measure, is presented in the section below entitled Underwriting Income.

Table of Contents

Three months ended June 30, 2009 compared to three months ended June 30, 2008

Net income for the three months ended June 30, 2009 was $137.6 million compared to net income of $75.9 million for the three months ended June 30, 2008, an increase of $61.6 million or 81.2%. The primary factors driving the increase in net income were:

Increase in net unrealized gains on investments of $80.2 million; and

Increased foreign exchange gains of $7.5 million due to an increase in the value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency which resulted in foreign exchange gains of $8.4 million for the three months ended June 30, 2009, as compared gains of $0.9 million for the three months ended June 30, 2008.

The items above were partially offset by the following factors:

Transaction expenses of $15.9 million in relation to the proposed acquisition of and amalgamation agreement with IPC; and

Decrease in net investment income of $9.5 million due to increased balances of cash and cash equivalents and lower returns on cash and fixed income investments; and

Gain on repurchase of debentures of $8.8 million realized during the three months ended June 30, 2008. No such gain was realized during the three months ended June 30, 2009.

The change in net income for the three months ended June 30, 2009 of $61.6 million is described in the following table:

	Three months ended June 30, 2009 Increase (decrease) over the three months ended June 30, 2008			
(Dollars in thousands)	Validus Re	Talbot	Corporate and other reconciling items	Total
Underwriting income	$ (815)	$ 1,007	$ 2,380	$ 2,572
Net investment income	(4,942)	(4,033)	(497)	(9,472)
Other income	878	(551)	(772)	(445)
Finance expenses	(389)	2,061	338	2,010
	(5,268)	(1,516)	1,449	(5,335)
Taxes	(8)	4,061		4,053
	(5,276)	2,545	1,449	(1,282)
Realized gain on repurchase of debentures			(8,752)	(8,752)
Net realized (losses) gains on investments	1,120	(1,345)		(225)
Net unrealized gains (losses) on investments	59,852	20,379		80,231
Foreign exchange (losses) gains	2,230	5,235	56	7,521

Transaction expenses			(15,851)	(15,851)
Net income	$ 57,926	$ 26,814	$ (23,098)	$ 61,642

Gross Premiums Written

Gross premiums written for the three months ended June 30, 2009 were $425.0 million compared to $379.9 million for the three months ended June 30, 2008, an increase of $45.1 million or 11.9%. The increase in gross premiums written was driven primarily by the property and marine lines which increased by $38.7 million and $5.4 million, respectively. Details of gross premiums written by line of business are provided below.

	Gross premiums written				
	Three months ended		**Three months ended**		
(Dollars in thousands)	**June 30, 2009**		**June 30, 2008**		**% Change**
Property	$ 255,442	60.1%	$ 216,764	57.1%	17.8%
Marine	84,431	19.9%	79,041	20.8%	6.8%
Specialty	85,159	20.0%	84,114	22.1%	1.2%
Total	$ 425,032	100.0%	$ 379,919	100.0%	11.9%

Validus Re. Validus Re gross premiums written for the three months ended June 30, 2009 were $199.6 million compared to $187.8 million for the three months ended June 30, 2008, an increase of $11.7 million or 6.3%. Details of Validus Re gross premiums written by line of business are provided below.

	Gross premiums written				
	Three months ended		Three months ended		
(Dollars in thousands)	June 30, 2009		June 30, 2008		% Change
Property	$ 183,898	92.1%	$ 171,308	91.2%	7.3%
Marine	3,957	2.0%	8,750	4.7%	(54.8)%
Specialty	11,705	5.9%	7,762	4.1%	50.8%
Total	$ 199,560	100.0%	$ 187,820	100.0%	6.3%

The increase in Validus Re gross premiums written was driven by increases in the property and specialty lines of $12.6 million and $3.9 million, respectively. The increase in the property line was due primarily to the delayed 2009 renewal of a $7.0 million proportional contract during the three months ended June 30 where the 2008 renewal occurred during the three months ended March 31. In addition, $5.1 million of additional gross premiums were written by AlphaCat Re, a Class 3 Bermuda insurance company that began writing premiums in 2009. These increases were offset by a $4.8 million decrease in the marine line due primarily to reduced gross premiums written on Gulf of Mexico exposures and fewer reinstatement premiums as compared to the three months ended June 30, 2008. Gross premiums written under the quota share and surplus treaty contracts with Talbot increased by $4.5 million as compared to the three months ended June 30, 2008. The quota share and surplus treaty contracts with Talbot are eliminated upon consolidation.

Talbot. Talbot gross premiums written for the three months ended June 30, 2009 were $235.1 million compared to $197.2 million for the three months ended June 30, 2008, an increase of $37.8 million or 19.2%. The $235.1 million of gross premiums written translated at second quarter 2008 rates of exchange would have been $249.5 million during the three months ended June 30, 2009, an increase of $52.3 million or 26.5%. Details of Talbot gross premiums written by line of business are provided below.

	Gross premiums written				
	Three months ended		Three months ended		
(Dollars in thousands)	June 30, 2009		June 30, 2008		% Change
Property	$ 78,769	33.5%	$ 47,423	24.0%	66.1%
Marine	82,657	35.2%	73,126	37.1%	13.0%
Specialty	73,687	31.3%	76,686	38.9%	(3.9)%
Total	$ 235,113	100.0%	$ 197,235	100.0%	19.2%

The increase in the property lines was due primarily to $31.2 million of gross premiums written on the Onshore Energy lines. The increase in the marine lines was due primarily to a $6.8 million increase on the Energy lines as a result of more favorable rates.

Reinsurance Premiums Ceded

Reinsurance premiums ceded for the three months ended June 30, 2009 were $62.3 million compared to $1.4 million for the three months ended June 30, 2008, an increase of $60.9 million. The increase was due primarily to a $55.2 million increase on the property lines retrocession as described below.

	Reinsurance premiums ceded		
	Three months ended	Three months ended	
(Dollars in thousands)	June 30, 2009	June 30, 2008	% Change

Property	$ 57,238	91.9%	$ 2,040	145.8%	NM
Marine	2,633	4.2%	793	56.7%	232.0%
Specialty	2,420	3.9%	(1,434)	(102.5)%	(268.8)%
Total	$ 62,291	100.0%	$ 1,399	100.0%	NM

Table of Contents

Validus Re. Validus Re reinsurance premiums ceded for the three months ended June 30, 2009 were $43.1 million compared to $1.2 million for the three months ended June 30, 2008, an increase of $41.9 million.

	Reinsurance premiums ceded				
	Three months ended June 30, 2009		Three months ended June 30, 2008		
(Dollars in thousands)					% Change
Property	$ 42,705	99.1%	$ (1,470)	(121.7)%	NM
Marine	209	0.5%	2,678	221.7%	(92.2)%
Specialty	156	0.4%		0.0%	NM
Total	$ 43,070	100.0%	$ 1,208	100.0%	NM

Reinsurance premiums ceded on the property lines increased by $44.2 million, due primarily to the advanced renewal of retrocessional coverage via ultimate net loss agreements that incepted in 2008 during the three months ended September 30, 2008. These ultimate net loss agreements resulted in the recognition of $37.0 million of reinsurance premiums ceded in the three months ended June 30, 2009. The purchased retrocessional coverage includes ultimate net loss coverage that attaches at $200.0 million of onshore property losses.

Talbot. Talbot reinsurance premiums ceded for the three months ended June 30, 2009 were $28.9 million compared to $5.3 million for the three months ended June 30, 2008, an increase of $23.5 million. The increase was due primarily to increased reinsurance premiums ceded on the property lines of business.

	Reinsurance premiums ceded				
	Three months ended June 30, 2009		Three months ended June 30, 2008		
(Dollars in thousands)					% Change
Property	$ 21,758	75.3%	$ 5,477	102.8%	297.3%
Marine	4,607	16.0%	950	17.8%	384.9%
Specialty	2,497	8.7%	(1,100)	(20.6)%	(327.0)%
Total	$ 28,862	100.0%	$ 5,327	100.0%	441.8%

Reinsurance premiums ceded on the property lines increased by $16.3 million, due primarily to $16.5 million of reinsurance premiums ceded on the Onshore Energy lines, as discussed above. Reinsurance premiums ceded under third party quota share and surplus treaty contracts on the property and specialty lines increased by $14.1 million and $3.3 million, respectively, as compared to the three months ended June 30, 2008. Reinsurance premiums ceded under the quota share and surplus treaty contracts with Validus Re for the three months ended June 30, 2009 were $9.6 million compared to $5.1 million for the three months ended June 30, 2008, an increase of $4.5 million. The quota share and surplus treaty contracts with Validus Re are eliminated upon consolidation.

Net Premiums Written

Net premiums written for the three months ended June 30, 2009 were $362.7 million compared to $378.5 million for the three months ended June 30, 2008, a decrease of $15.8 million or 4.2%. The ratios of net premiums written to gross premiums written for the three months ended June 30, 2009 and 2008 were 85.3% and 99.6%, respectively. Details of net premiums written by line of business are provided below.

	Net premiums written				
	Three months ended June 30, 2009		Three months ended June 30, 2008		
(Dollars in thousands)					% Change
Property	$ 198,204	54.7%	$ 214,724	56.7%	(7.7)%
Marine	81,798	22.5%	78,248	20.7%	4.5%
Specialty	82,739	22.8%	85,548	22.6%	(3.3)%

Total	$ 362,741	100.0%	$ 378,520	100.0%	(4.2)%

Validus Re. Validus Re net premiums written for the three months ended June 30, 2009 were $156.5 million compared to $186.6 million for the three months ended June 30, 2008, a decrease of $30.1 million or 16.1%. Details of net premiums written by line of business are provided below.

Table of Contents

	Net premiums written				
	Three months ended		Three months ended		
(Dollars in thousands)	June 30, 2009		June 30, 2008		% Change
Property	$ 141,193	90.2%	$ 172,778	92.6%	(18.3)%
Marine	3,748	2.4%	6,072	3.3%	(38.3)%
Specialty	11,549	7.4%	7,762	4.1%	48.8%
Total	$ 156,490	100.0%	$ 186,612	100.0%	(16.1)%

The decrease in Validus Re net premiums written was driven by a decrease in the property lines of $31.6 million. This decrease was a result primarily of the $37.0 million of reinsurance premiums ceded on the advanced renewal of retrocessional coverage via ultimate net loss agreements, offset by the gross premiums written on the renewal of a $7.0 million proportional contract, as discussed above. The ratios of net premiums written to gross premiums written were 78.4% and 99.4% for the three month periods ended June 30, 2009 and 2008, respectively.

Talbot. Talbot net premiums written for the three months ended June 30, 2009 were $206.3 million compared to $191.9 million for the three months ended June 30, 2008, an increase of $14.3 million or 7.5%. Details of net premiums written by line of business are provided below:

	Net premiums written				
	Three months ended		Three months ended		
(Dollars in thousands)	June 30, 2009		June 30, 2008		% Change
Property	$ 57,011	27.6%	$ 41,946	21.9%	35.9%
Marine	78,050	37.9%	72,176	37.6%	8.1%
Specialty	71,190	34.5%	77,786	40.5%	(8.5)%
Total	$ 206,251	100.0%	$ 191,908	100.0%	7.5%

The increase in net premiums written was driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded. The ratios of net premiums written to gross premiums written for the three month periods ended June 30, 2009 and 2008 were 87.7% and 97.3%, respectively. This decrease was due primarily to the 47.1% ratio of net premiums written to gross premiums written on the onshore energy lines for the three month period ended June 30, 2009.

Change in Unearned Premiums

Change in unearned premiums for the three months ended June 30, 2009 was $34.5 million compared to $69.2 million for the three months ended June 30, 2008, a decrease of $34.7 million or 50.1%.

(Dollars in thousands)	Three months ended June 30, 2009	Three months ended June 30, 2008	% Change
Change in gross unearned premium	$ (57,819)	$ (43,830)	(31.9)%
Change in prepaid reinsurance premium	23,278	(25,392)	191.7%
Net change in unearned premium	$ (34,541)	$ (69,222)	50.1%

Validus Re. Validus Re s change in unearned premiums for the three months ended June 30, 2009 was $(7.2) million compared to $22.5 million for the three months ended June 30, 2008, a decrease of

$29.7 million or 132.0%.

(Dollars in thousands)		Three months ended June 30, 2009		Three months ended June 30, 2008	% Change
Change in gross unearned premium	$	(16,316)	$	(12,169)	(34.1)%
Change in prepaid reinsurance premium		23,523		(10,331)	327.7%
Net change in unearned premium	$	7,207	$	(22,500)	132.0%

The difference in gross unearned premiums reflects the benefit of earning premiums on the increased gross premiums written during the six months ended June 30, 2009 as compared to the six months ended June 30, 2008. In respect of prepaid reinsurance premiums, the change was a result primarily of the advanced renewal of retrocessional coverage via ultimate net loss agreements, the majority of which is prepaid at June 30, 2009, as discussed above.

Talbot. The Talbot change in unearned premiums for the three months ended June 30, 2009 was $41.7 million compared to $46.7 million for the three months ended June 30, 2008, a decrease of $5.0 million, or 10.7%.

(Dollars in thousands)	Three months ended June 30, 2009	Three months ended June 30, 2008	% Change
Change in gross unearned premium	$ (41,503)	$ (31,661)	(31.1)%
Change in prepaid reinsurance premium	(245)	(15,061)	98.4%
Net change in unearned premium	$ (41,748)	$ (46,722)	10.7%

The difference in gross unearned premiums arose principally from the increased gross premiums written in the Property lines, specifically Onshore Energy exposures and premiums written by Validus Reaseguros, Inc., which acts as an approved Lloyd s coverholder for Syndicate 1183 on the property treaty lines, during the three months ended June 30, 2009, as compared to the three months ended June 30, 2008. The lower change in prepaid reinsurance premiums in the three months ended June 30, 2009 is reflective of the increased amounts of Onshore Energy exposures and premiums written by Validus Reaseguros, Inc., which have increased levels of ceded reinsurance. This results in less seasonality in the ceded reinsurance and hence a small change in prepaid reinsurance for the three months ended June 30, 2009.

Net Premiums Earned

Net premiums earned for the three months ended June 30, 2009 were $328.2 million compared to $309.3 million for the three months ended June 30, 2008, an increase of $18.9 million or 6.1%. The increase in net premiums earned was driven by increased premiums earned at Talbot of $19.3 million.

	Net premiums earned				
	Three months ended		Three months ended		
(Dollars in thousands)	June 30, 2009		June 30, 2008		% Change
Property	$ 143,843	43.8%	$ 149,431	48.3%	(3.7)%
Marine	100,953	30.8%	86,794	28.1%	16.3%
Specialty	83,404	25.4%	73,073	23.6%	14.1%
Total	$ 328,200	100.0%	$ 309,298	100.0%	6.1%

Validus Re. Validus Re net premiums earned for the three months ended June 30, 2009 were $163.7 million compared to $164.1 million for the three months ended June 30, 2008, a decrease of $0.4 million, or 0.3%.

	Net premiums earned				
	Three months ended		Three months ended		
(Dollars in thousands)	June 30, 2009		June 30, 2008		% Change
Property	$ 110,185	67.3%	$ 120,916	73.7%	(8.9)%
Marine	33,584	20.5%	26,403	16.1%	27.2%
Specialty	19,928	12.2%	16,793	10.2%	18.7%
Total	$ 163,697	100.0%	$ 164,112	100.0%	(0.3)%

The decrease in Validus Re net premiums earned was driven by decreases in the property lines of $10.7 million. $6.2 million of this decrease was a result of the advanced renewal of retrocessional coverage via ultimate net loss agreements, as discussed above. This decrease was offset by an increase in the marine lines of $7.2 million, due

partially to premium adjustments on proportional contracts.

Talbot. Talbot net premiums earned for the three months ended June 30, 2009 were $164.5 million compared to $145.2 million for the three months ended June 30, 2008, an increase of $19.3 million or 13.3%.

	Net premiums earned				
	Three months ended		Three months ended		
(Dollars in thousands)	**June 30, 2009**		**June 30, 2008**		**% Change**
Property	$ 33,658	20.4%	$ 28,515	19.6%	18.0%
Marine	67,369	41.0%	60,391	41.6%	11.6%
Specialty	63,476	38.6%	56,280	38.8%	12.8%
Total	$ 164,503	100.0%	$ 145,186	100.0%	13.3%

Table of Contents

The increase in net premiums earned is due primarily to the increased levels of net premiums written across all major business lines over the twelve months ended June 30, 2009, as compared with the twelve months ended June 30, 2008.

Losses and Loss Expenses

Losses and loss expenses for the three months ended June 30, 2009 were $124.8 million compared to $122.1 million for the three months ended June 30, 2008, an increase of $2.7 million or 2.2%. The loss ratios, defined as losses and loss expenses divided by net premiums earned, for the three months ended June 30, 2009 and 2008 were 38.0% and 39.5%, respectively. Details of loss ratios by line of business are provided below.

	Three months ended June 30, 2009	Three months ended June 30, 2008	Percentage point change
Property	16.8%	33.0%	(16.2)
Marine	48.6%	54.1%	(5.5)
Specialty	61.8%	35.3%	26.5
All lines	38.0%	39.5%	(1.5)

The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the three months ended June 30, 2009:

	Three months ended June 30, 2009			
(Dollars in thousands)	Validus Re	Talbot	Eliminations	Total
Gross reserves at period beginning	$ 527,475	$ 810,143	$ (18,886)	$ 1,318,732
Losses recoverable at period beginning	(78,687)	(144,396)	18,886	(204,197)
Net reserves at period beginning	448,788	665,747	-	1,114,535
Incurred losses - current year	44,080	93,896	-	137,976
Incurred losses - change in prior accident years	(2,959)	(10,266)	-	(13,225)
Incurred losses	41,121	83,630	-	124,751
Paid losses	(65,440)	(59,946)	-	(125,386)
Foreign exchange	3,073	25,296	-	28,369
Net reserves at period end	427,542	714,727	-	1,142,269
Losses recoverable at period end	61,798	130,810	(22,942)	169,666
Gross reserves at period end	$ 489,340	$ 845,537	$ (22,942)	$ 1,311,935

The amount recorded represents management s best estimate of expected losses and loss expenses on premiums earned. Favorable loss development on prior years totaled $13.2 million. The $10.3 million favorable loss reserve development in the Talbot segment is due primarily to $7.9 million and $4.5 million of favorable development on the property and marine lines, respectively. Favorable loss reserve development benefitted the Company s loss ratio by 4.0 percentage points for the three months ended June 30, 2009. During the three months ended June 30, 2009, the Company incurred $11.0 million of losses, or 3.4 percentage points of the loss ratio, attributable to a commercial flight loss. During the three months ended June 30, 2008, the Company incurred $10.2 million of losses attributable to certain U.S. storm and flood loss events, which represented 3.3 percentage points of the loss ratio.

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

At June 30, 2009 and 2008, gross and net reserves for losses and loss expenses were estimated using the methodology as outlined in the critical accounting policies and estimates as discussed in Item 7, *Management s Discussion and Analysis of Results of Operations and Financial Condition* in the Company s Annual Report on

48

Form 10-K for the year ended December 31, 2008. The Company did not make any significant changes in the assumptions or methodology used in its reserving process during the three months ended June 30, 2009.

	At June 30, 2009		
(Dollars in thousands)	Gross case reserves	Gross IBNR	Total gross reserve for losses and loss expenses
Property	$ 244,065	$ 183,234	$ 427,299
Marine	365,388	221,276	586,664
Specialty	108,461	189,511	297,972
Total	$ 717,914	$ 594,021	$ 1,311,935

	At June 30, 2009		
(Dollars in thousands)	Net case reserves	Net IBNR	Total net reserve for losses and loss expenses
Property	$ 241,625	$ 171,702	$ 413,327
Marine	264,169	203,171	467,340
Specialty	98,292	163,310	261,602
Total	$ 604,086	$ 538,183	$ 1,142,269

Validus Re. Validus Re losses and loss expenses for the three months ended June 30, 2009 were $41.1 million compared to $48.7 million for the three months ended June 30, 2008, a decrease of $7.6 million or 15.5%. Validus Re net paid losses for the three months ended June 30, 2009 were $65.4 million compared to $28.5 million for the three months ended June 30, 2008, an increase of $36.9 million or 129.5%, primarily as a result of losses paid on Hurricane Ike. The loss ratio, defined as losses and loss expenses divided by net premiums earned, was 25.1% and 29.7% for the three months ended June 30, 2009 and 2008, respectively. During the three months ended June 30, 2009, Validus Re did not experience any notable loss events. During the three months ended June 30, 2008, Validus Re incurred $10.2 million of losses attributable to certain U.S. storm and flood loss events, which represented 6.2 percentage points of the loss ratio. Details of loss ratios by line of business and period of incurrence are provided below.

	Three months ended June 30		
	2009	2008	Percentage point change
Property - current year	21.2%	29.0%	(7.8)
Property - change in prior accident years	(2.7)%	(3.0)%	0.3
Property - loss ratio	18.5%	26.0%	(7.5)
Marine - current year	39.7%	31.0%	8.7
Marine - change in prior accident years	0.0%	15.3%	(15.3)
Marine - loss ratio	39.7%	46.3%	(6.6)
Specialty - current year	37.1%	35.4%	1.7

Specialty - change in prior accident years	0.0%	(5.1)%	5.1
Specialty - loss ratio	37.1%	30.3%	6.8
All lines - current year	26.9%	30.0%	(3.1)
All lines - change in prior accident years	(1.8)%	(0.3)%	(1.5)
All lines - loss ratio	25.1%	29.7%	(4.6)

For the three months ended June 30, 2009, the property lines include $23.4 million related to current year losses and $3.0 million of favorable development relating to prior accident years. During the three months ended June 30,

2008, Validus Re s property lines incurred $10.2 million of losses attributable to certain U.S. storm and flood loss events, which represented 8.4 percentage points of the property lines loss ratio. Validus Re property line loss ratios, excluding prior year development and loss events identified above, for the three months ended June 30, 2009 and 2008 were 21.2% and 20.6%, respectively.

For the three months ended June 30, 2009, the marine lines include $13.3 million related to current year losses. Validus Re marine line loss ratios, excluding prior year development, for the three months ended June 30, 2009 and 2008 were 39.7% and 30.1%, respectively.

For the three months ended June 30, 2009, the specialty lines include $7.4 million related to current year losses. Validus Re specialty lines loss ratios, excluding prior year development and the loss event identified above, for the three months ended June 30, 2009 and 2008 were 37.1% and 35.4%, respectively.

Talbot. Talbot losses and loss expenses for the three months ended June 30, 2009 were $83.6 million compared to $73.4 million for the three months ended June 30, 2008, an increase of $10.2 million, or 13.9%. The loss ratio was 50.9% and 50.6% for the three months ended June 30, 2009 and 2008, respectively. During the three months ended June 30, 2009, Talbot incurred $8.3 million, or 5.0 percentage points of the loss ratio, attributable to a commercial flight loss. During the three months ended June 30, 2009, $93.9 million of losses and loss expenses related to current year losses and $10.3 million related to favorable development of prior accident years. Details of loss ratios by line of business and calendar period are provided below.

	Three months ended June 30		**Percentage point change**
	2009	**2008**	
Property current year	34.5%	61.8%	(27.3)
Property change in prior accident years	(23.5)%	1.2%	(24.7)
Property loss ratio	11.0%	63.0%	(52.0)
Marine current year	59.8%	63.4%	(3.6)
Marine change in prior accident years	(6.7)%	(5.9)%	(0.8)
Marine loss ratio	53.1%	57.5%	(4.4)
Specialty current year	66.1%	49.9%	16.2
Specialty change in prior accident years	3.5%	(13.1)%	16.6
Specialty loss ratio	69.6%	36.8%	32.8
All lines current year	57.1%	57.9%	(0.8)
All lines change in prior accident years	(6.2)%	(7.3)%	1.1
All lines - loss ratio	50.9%	50.6%	0.3

For the three months ended June 30, 2009, the property lines include $11.6 million related to current year losses and $7.9 million of favorable development relating to prior accident years. This favorable development is primarily attributable to lower than expected claims development together with $2.3 million of favorable development relating to Hurricane Katrina. Talbot property line loss ratio, excluding prior year development for the three months ended June 30, 2009 and 2008 were 34.5% and 61.8%, respectively. This decrease was due to significant number of non-catastrophe events in the three months ended June 30, 2008 compared to the same period in 2009.

For the three months ended June 30, 2009, the marine lines include $40.3 million related to current year losses and $4.5 million of favorable development relating to prior accident years. This favorable development is primarily

attributable to the Energy line. Talbot marine line loss ratios, excluding prior year development, for the three months ended June 30, 2009 and 2008 were 59.8% and 63.4%, respectively.

For the three months ended June 30, 2009, the specialty lines include $42.0 million relating to current year losses and $2.2 million due to adverse development on prior accident years. For the three months ended June 30, 2009, Talbot s specialty lines incurred $8.3 million, or 13.1 percentage points of the specialty lines loss ratio, attributable to a commercial flight loss. Talbot specialty lines loss ratios, excluding prior year development and the

Table of Contents

loss events identified above, for the three months ended June 30, 2009 and 2008 were 53.1% and 49.9%, respectively.

Policy Acquisition Costs

Policy acquisition costs for the three months ended June 30, 2009 were $64.4 million compared to $56.4 million for the three months ended June 30, 2008, an increase of $8.0 million or 14.2%. Policy acquisition costs as a percent of net premiums earned for the three months ended June 30, 2009 and 2008 were 19.6% and 18.2%, respectively.

	Policy acquisition costs				
	Three months ended June 30, 2009		Three months ended June 30, 2008		
(Dollars in thousands)					% Change
Property	$ 22,796	35.4%	$ 24,623	43.6%	(7.4)%
Marine	23,590	36.6%	16,464	29.2%	43.3%
Specialty	18,052	28.0%	15,332	27.2%	17.7%
Total	$ 64,438	100.0%	$ 56,419	100.0%	14.2%

Validus Re. Validus Re policy acquisition costs for the three months ended June 30, 2009 were $29.1 million compared to $25.3 million for the three months ended June 30, 2008, an increase of $3.8 million or 15.1%.

	Policy acquisition costs				
	Three months ended June 30, 2009		Three months ended June 30, 2008		
(Dollars in thousands)					% Change
Property	$ 18,052	62.0%	$ 19,430	76.7%	(7.1)%
Marine	8,290	28.5%	3,356	13.3%	147.0%
Specialty	2,778	9.5%	2,523	10.0%	10.1%
Total	$ 29,120	100.0%	$ 25,309	100.0%	15.1%

Policy acquisition costs include brokerage, commission and excise tax and are generally driven by contract terms and are normally a set percentage of premiums and are also net of ceding commission income on retrocessions. Policy acquisition costs as a percent of net premiums earned for the three months ended June 30, 2009 and 2008 were 17.8% and 15.4%, respectively. The policy acquisition ratio increased largely due to a 12.0 percentage point increase on the marine policy acquisition ratio. The increase in the marine policy acquisition ratio was due to an increased portion of gross premiums written being earned on proportional contracts, which generally experience higher acquisition costs.

Talbot. Talbot policy acquisition costs for the three months ended June 30, 2009 were $36.1 million compared to $31.1 million for the three months ended June 30, 2008, an increase of $5.0 million or 16.0%.

	Policy acquisition costs				
	Three months ended June 30, 2009		Three months ended June 30, 2008		
(Dollars in thousands)					% Change
Property	$ 5,540	15.3%	$ 5,217	16.8%	6.2%
Marine	15,300	42.4%	13,108	42.1%	16.7%
Specialty	15,274	42.3%	12,809	41.1%	19.2%
Total	$ 36,114	100.0%	$ 31,134	100.0%	16.0%

Policy acquisition costs as a percent of net premiums earned were 22.0% and 21.4%, respectively, for the three month periods ended June 30, 2009 and 2008.

General and Administrative Expenses

General and administrative expenses for the three months ended June 30, 2009 were $41.2 million compared to $33.9 million for the three months ended June 30, 2008, an increase of $7.3 million or 21.5%. The increase was a result of increased expenses in both the Validus Re and Talbot segments.

Table of Contents

(Dollars in thousands)	General and administrative expenses						
	Three months ended June 30, 2009			Three months ended June 30, 2008			% Change
Validus Re	$	14,149	34.4%	$	9,955	29.4%	42.1%
Talbot		21,927	53.2%		19,787	58.3%	10.8%
Corporate & Eliminations		5,124	12.4%		4,170	12.3%	22.9%
Total	$	41,200	100.0%	$	33,912	100.0%	21.5%

General and administrative expense ratios for the three month periods ended June 30, 2009 and 2008 were 14.3% and 13.3%, respectively. General and administrative expense ratio is the sum of general and administrative expenses and share compensation expense divided by net premiums earned.

(Dollars in thousands)	Three months ended June 30, 2009		Three months ended June 30, 2008	
	Expenses	Expenses as % of Net Earned Premiums	Expenses	Expenses as % of Net Earned Premiums
General and Administrative	$ 41,200	12.6%	$ 33,912	10.9%
Share Compensation	5,632	1.7%	7,271	2.4%
Total	$ 46,832	14.3%	$ 41,183	13.3%

General and administrative expenses of $41.2 million in the three months ended June 30, 2009 represents 12.6 percentage points of the expense ratio. Share compensation expense is discussed in the following section.

Validus Re. Validus Re general and administrative expenses for the three months ended June 30, 2009 were $14.1 million compared to $10.0 million for the three months ended June 30, 2008, an increase of $4.2 million or 42.1%. General and administrative expenses have increased primarily as a result of the increase in staff to 105 at June 30, 2009 from 80 at June 30, 2008. General and administrative expenses are generally comprised of salaries and benefits, professional fees, rent and office expenses. Validus Re s general and administrative expenses as a percent of net premiums earned for the three month periods ended June 30, 2009 and 2008 were 8.7% and 6.1%, respectively.

Talbot. Talbot general and administrative expenses for the three months ended June 30, 2009 were $21.9 million compared to $19.8 million for the three months ended June 30, 2008, an increase of $2.1 million or 10.8%. General and administrative expenses have increased primarily as a result of the increase in staff to 212 at June 30, 2009 from 167 at June 30, 2008 and expenses related to the new Onshore Energy and Aviation underwriting teams. Talbot s general and administrative expenses as a percent of net premiums earned for the three month periods ended June 30, 2009 and 2008 were 13.3% and 13.6%, respectively.

Corporate & Eliminations. Corporate general and administrative expenses for the three months ended June 30, 2009 were $5.1 million compared to $4.2 million for the three months ended June 30, 2008, an increase of $1.0 million or 22.9%. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other cost relating to the Company as a whole.

Share Compensation Expense

Share compensation expense for the three months ended June 30, 2009 was $5.6 million compared to $7.3 million for the three months ended June 30, 2008, a decrease of $1.6 million or 22.5%. This expense is non-cash and has no net effect on total shareholders equity, as it is balanced by an increase in additional paid-in capital.

Share compensation expense

(Dollars in thousands)		Three months ended June 30, 2009			Three months ended June 30, 2008		% Change
Validus Re	$	1,548	27.4%	$	1,597	22.0%	(3.1)%
Talbot		2,098	37.3%		1,126	15.5%	86.3%
Corporate & Eliminations		1,986	35.3%		4,548	62.5%	(56.3)%
Total	$	5,632	100.0%	$	7,271	100.0%	(22.5)%

Share compensation expense of $5.6 million in the three months ended June 30, 2009 represents 1.7 percentage points of the general and administrative expense ratio.

Validus Re. Validus Re share compensation expense for the three months ended June 30, 2009 was $1.5 million compared to $1.6 million for the three months ended June 30, 2008. Share compensation expense as a percent of net premiums earned for the three month periods ended June 30, 2009 and 2008 were 0.9% and 1.0%, respectively.

Talbot. Talbot share compensation expense for the three months ended June 30, 2009 was $2.1 million and $1.1 million for the three months ended June 30, 2008. The increase was due to the impact of grants made during 2008. Share compensation expense as a percent of net premiums earned for the three month periods ended June 30, 2009 and June 30, 2008 was 1.3% and 0.8%, respectively.

Corporate & Eliminations. Corporate share compensation expense for the three months ended June 30, 2009 was $2.0 million compared to $4.5 million for the three months ended June 30, 2008, a decrease of $2.6 million or 56.3%. This decrease was due primarily to several share award issuances with vesting periods greater than one year that vested during the year ended December 31, 2008 and therefore had no further amortization expense during the three months ended June 30, 2009.

Selected Ratios

The underwriting results of an insurance or reinsurance company are often measured by reference to its combined ratio, which is the sum of the loss ratio and the expense ratio. The net loss ratio is calculated by dividing losses and loss expenses incurred (including estimates for incurred but not reported losses) by net premiums earned. The expense ratio is calculated by dividing acquisition costs combined with general and administrative expenses by net premiums earned. The following table presents the losses and loss expenses ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the three months ended June 30, 2009 and 2008.

	Three months ended June 30, 2009	**Three months ended June 30, 2008**	**Percentage point change**
Losses and loss expenses ratio	38.0%	39.5%	(1.5)
Policy acquisition cost ratio	19.6%	18.2%	1.4
General and administrative expense ratio(1)	14.3%	13.3%	1.0
Expense ratio	33.9%	31.5%	2.4
Combined ratio	71.9%	71.0%	0.9

(1) Includes general and administrative expense and share compensation expense

Validus Re	**Three months ended June 30, 2009**	**Three months ended June 30, 2008**	**Percentage point change**
Losses and loss expenses ratio	25.1%	29.7%	(4.6)
Policy acquisition cost ratio	17.8%	15.4%	2.4

General and administrative expense ratio	9.6%	7.0%	2.6
Expense ratio	27.4%	22.4%	5.0
Combined ratio	52.5%	52.1%	0.4

Talbot	**Three months ended June 30, 2009**	**Three months ended June 30, 2008**	**Percentage point change**
Losses and loss expenses ratio	50.8%	50.6%	0.2
Policy acquisition cost ratio	22.0%	21.4%	0.6
General and administrative expense ratio	14.6%	14.4%	0.2
Expense ratio	36.6%	35.8%	0.6
Combined ratio	87.4%	86.4%	1.0

Table of Contents

Underwriting Income

Underwriting income for the three months ended June 30, 2009 was $92.2 million compared to income of $89.6 million for the three months ended June 30, 2008, a change of $2.6 million or 2.9%.

(Dollars in thousands)	Three months ended June 30, 2009	% of Sub total	Three months ended June 30, 2008	% of Sub total	% Change
Validus Re	$ 77,759	78.9%	$ 78,574	79.9%	(1.0)%
Talbot	20,734	21.1%	19,727	20.1%	5.1%
Sub total	98,493	100.0%	98,301	100.0%	0.2%
Corporate & Eliminations	(6,314)		(8,694)		(27.4)%
Total	$ 92,179		$ 89,607		2.9%

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

(Dollars in thousands)	Three months ended June 30, 2009	Three months ended June 30, 2008
Underwriting income	$ 92,179	$ 89,607
Net investment income	26,963	36,435
Other income	1,017	1,462
Finance expenses	(10,752)	(12,762)
Transaction expenses	(15,851)	
Realized gain on repurchase of debentures		8,752
Net realized gains (losses) on investments	(2,650)	(2,425)
Net unrealized gains (losses) on investments	37,249	(42,982)
Foreign exchange gains (losses)	8,432	911
Net income before taxes	$ 136,587	$ 78,998

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

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

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

Net Investment Income

Net investment income for the three months ended June 30, 2009 was $27.0 million compared to $36.4 million for the three months ended June 30, 2008, a decrease of $9.4 million or 26.0%. Net investment income decreased as a result of reduced market yields and higher quarterly average cash balances. Net investment income is comprised of accretion of premium or discount on fixed maturities, interest on coupon-paying bonds, short-term investments and cash and cash equivalents, partially offset by investment management fees. The components of net investment income for the three months ended June 30, 2009 and 2008 are as presented below.

(Dollars in thousands)	Three months ended June 30, 2009	Three months ended June 30, 2008	% Change
Fixed maturities and short-term investments	$ 26,395	$ 34,519	(23.5)%
Securities lending income	173	455	(62.0)%
Cash and cash equivalents	1,120	2,378	(52.9)%
Total investment income	27,688	37,352	(25.9)%
Investment expenses	(726)	(917)	20.8%