VALIDUS HOLDINGS LTD
Form 10-Q
November 05, 2010

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

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2010
Commission file number 001-33606

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

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 þ **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 November 3, 2010, there were 107,882,874 outstanding Common Shares, $0.175 par value per share, of the registrant.

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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

Validus Holdings, Ltd.

Consolidated Balance Sheets

As at September 30, 2010 (unaudited) and December 31, 2009

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

	September 30, 2010 (unaudited)	December 31, 2009
Assets		
Fixed maturities, at fair value (amortized cost: 2010 - $5,105,832; 2009 - $4,870,395)	$ 5,200,285	$ 4,869,378
Short-term investments, at fair value (amortized cost: 2010 - $228,354; 2009 - $482,632)	228,356	481,766
Other investments, at fair value (amortized cost: 2010 - $18,392; 2009 - $35,941)	19,888	37,615
Cash and cash equivalents	518,770	387,585
Total investments and cash	5,967,299	5,776,344
Premiums receivable	745,968	551,616
Deferred acquisition costs	151,701	112,329
Prepaid reinsurance premiums	88,651	73,164
Securities lending collateral	33,135	90,350
Loss reserves recoverable	268,821	181,765
Paid losses recoverable	19,560	14,782
Income taxes recoverable	1,027	2,043
Intangible assets	119,935	123,055
Goodwill	20,393	20,393
Accrued investment income	41,464	38,077
Other assets	45,288	35,222
Total assets	$ 7,503,242	$ 7,019,140
Liabilities		
Reserve for losses and loss expenses	$ 2,020,845	$ 1,622,134
Unearned premiums	955,236	724,104
Reinsurance balances payable	60,561	65,414
Securities lending payable	33,905	90,106
Deferred income taxes	23,827	24,508
Net payable for investments purchased	14,415	44,145
Accounts payable and accrued expenses	96,521	127,809
Senior notes payable	246,847	
Debentures payable	289,800	289,800
Total liabilities	3,741,957	2,988,020

Commitments and contingent liabilities				
Shareholders equity				
Common shares, 571,428,571 authorized, par value $0.175 (Issued: 2010 - 132,308,157; 2009 - 131,616,349; Outstanding: 2010 - 109,237,890; 2009 - 128,459,478)		23,154		23,033
Treasury shares (2010 - 23,070,267; 2009 - 3,156,871)		(4,037)		(553)
Additional paid-in-capital		2,193,140		2,675,680
Accumulated other comprehensive (loss)		(4,945)		(4,851)
Retained earnings		1,553,973		1,337,811
Total shareholders equity		3,761,285		4,031,120
Total liabilities and shareholders equity	$	7,503,242	$	7,019,140

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

Validus Holdings, Ltd.
Consolidated Statements of Operations and Comprehensive Income
For the Three and Nine Months Ended September 30, 2010 and 2009 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Three Months Ended		Nine Months Ended	
	September 30, 2010 (unaudited)	**September 30, 2009 (unaudited)**	**September 30, 2010 (unaudited)**	**September 30, 2009 (unaudited)**
Revenues				
Gross premiums written	$ 344,040	$ 331,028	$ 1,731,835	$ 1,365,951
Reinsurance premiums ceded	(35,641)	(67,687)	(194,106)	(202,489)
Net premiums written	308,399	263,341	1,537,729	1,163,462
Change in unearned premiums	124,275	111,376	(209,417)	(141,786)
Net premiums earned	432,674	374,717	1,328,312	1,021,676
Gain on bargain purchase, net of expenses		302,950		287,099
Net investment income	34,033	29,532	103,141	83,267
Net realized gains (losses) on investments	23,058	5,429	46,897	(20,642)
Net unrealized gains on investments	31,588	50,437	88,641	109,839
Other income	1,082	1,101	4,667	2,875
Foreign exchanges gains (losses)	10,790	(5,244)	(2,073)	(1,012)
Total revenues	533,225	758,922	1,569,585	1,483,102
Expenses				
Losses and loss expenses	158,936	134,152	832,361	390,736
Policy acquisition costs	67,074	64,236	217,376	190,125
General and administrative expenses	48,831	46,036	154,779	125,315
Share compensation expenses	7,618	5,862	21,040	18,848
Finance expenses	13,715	11,257	42,084	29,732
Total expenses	296,174	261,543	1,267,640	754,756
Net income before taxes	237,051	497,379	301,945	728,346
Tax benefit (expense)	1,422	1,799	(2,068)	3,301
Net income	$ 238,473	$ 499,178	$ 299,877	$ 731,647
Comprehensive income				
	1,781	(915)	(94)	2,882

Foreign currency translation adjustments				
Comprehensive income	$ 240,254	$ 498,263	$ 299,783	$ 734,529
Earnings per share				
Weighted average number of common shares and common share equivalents outstanding				
Basic	110,601,888	92,492,373	119,414,906	81,458,329
Diluted	114,842,742	95,834,809	123,735,683	84,626,505
Basic earnings per share	$ 2.14	$ 5.38	$ 2.47	$ 8.92
Diluted earnings per share	$ 2.08	$ 5.21	$ 2.42	$ 8.65
Cash dividends declared per share	$ 0.22	$ 0.20	$ 0.66	$ 0.60

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

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Validus Holdings, Ltd.
Consolidated Statements of Shareholders Equity
For the Nine Months Ended September 30, 2010 and 2009 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	September 30, 2010 (unaudited)	September 30, 2009 (unaudited)
Common shares		
Balance Beginning of period	$ 23,033	$ 13,235
Common shares issued, net	121	9,709
Balance End of period	$ 23,154	$ 22,944
Treasury shares		
Balance Beginning of period	$ (553)	$
Repurchase of common shares	(3,484)	
Balance End of period	$ (4,037)	$
Additional paid-in capital		
Balance Beginning of period	$ 2,675,680	$ 1,412,635
Common shares (redeemed) issued, net	(605)	1,311,207
Repurchase of common shares	(502,975)	
Share compensation expenses	21,040	24,279
Balance End of period	$ 2,193,140	$ 2,748,121
Accumulated other comprehensive (loss)		
Balance Beginning of period	$ (4,851)	$ (7,858)
Foreign currency translation adjustments	(94)	2,882
Balance End of period	$ (4,945)	$ (4,976)
Retained earnings		
Balance Beginning of period	$ 1,337,811	$ 520,722
Dividends	(83,715)	(52,266)
Net income	299,877	731,647
Balance End of period	$ 1,553,973	$ 1,200,103
Total shareholders equity	$ 3,761,285	$ 3,966,192

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

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Validus Holdings, Ltd.
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30, 2010 and 2009 (unaudited)
(Expressed in thousands of U.S. dollars, except share and per share information)

	September 30, 2010 (unaudited)	September 30, 2009 (unaudited)
Cash flows provided by (used in) operating activities		
Net income	$ 299,877	$ 731,647
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Share compensation expenses	21,040	24,279
Gain on bargain purchase		(352,349)
Amortization of discount on senior notes	54	
Net realized (gains) losses on investments	(46,897)	20,642
Net unrealized (gains) on investments	(88,641)	(109,838)
Amortization of intangible assets	3,120	24,792
Foreign exchange (gains) on cash and cash equivalents included in net income	(3,432)	(10,487)
Amortization of premium on fixed maturities	22,936	8,969
Change in:		
Premiums receivable	(194,939)	(134,007)
Deferred acquisition costs	(39,372)	(8,914)
Prepaid reinsurance premiums	(15,487)	(75,617)
Loss reserves recoverable	(87,199)	42,634
Paid losses recoverable	(4,779)	(8,621)
Income taxes recoverable	1,019	(1,486)
Accrued investment income	(3,396)	66
Other assets	(9,287)	(557)
Reserve for losses and loss expenses	400,405	(8,900)
Unearned premiums	231,132	210,099
Reinsurance balances payable	(4,526)	3,903
Deferred income taxes	(608)	4,731
Accounts payable and accrued expenses	(32,356)	(12,602)
Net cash provided by operating activities	448,664	348,384
Cash flows provided by (used in) investing activities		
Proceeds on sales of investments	3,972,225	2,247,581
Proceeds on maturities of investments	272,169	466,065
Purchases of fixed maturities	(4,495,131)	(2,792,562)
Sales of short-term investments, net	253,340	91,354
Sales (purchases) of other investments	18,070	(2,047)
Decrease in securities lending collateral	56,201	4,649
Purchase of subsidiary, net of cash acquired		(376,878)

Net cash provided by (used in) investing activities		76,874		(361,838)
Cash flows provided by (used in) financing activities				
Net proceeds on issuance of senior notes		246,793		
Redemption of common shares, net		(484)		(1,774)
Purchases of common shares under share repurchase program		(506,459)		
Dividends paid		(81,859)		(50,938)
(Decrease) in securities lending payable		(56,201)		(4,649)
Net cash (used in) financing activities		(398,210)		(57,361)
Effect of foreign currency rate changes on cash and cash equivalents		3,857		14,755
Net increase (decrease) in cash		131,185		(56,060)
Cash and cash equivalents beginning of period		387,585		449,848
Cash and cash equivalents end of period	$	518,770	$	393,788
Taxes paid during the period	$	2,358	$	1,395
Interest paid during the period	$	30,188	$	20,016

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

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

1. Basis of preparation and consolidation

These unaudited consolidated financial statements include Validus Holdings, Ltd. and its wholly and majority owned subsidiaries (together, the Company) and have been prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 in Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In addition, the year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. This Quarterly Report should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2009, 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 term ASC used in these notes refers to Accounting Standard Codifications issued by the United States Financial Accounting Standards Board (FASB).

The consolidated financial statements include the results of operations and cash flows of IPC Holdings Ltd. (IPC), since the date of acquisition on September 4, 2009 and not any prior periods (including for comparative purposes), except with respect to Supplemental Pro Forma Information included in Note 3.

2. Recent accounting pronouncements

In June 2009, the FASB issued authoritative guidance on accounting for *Transfers and Servicing* (ASC 860). This update addresses practices that have developed 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. This update is effective for financial asset transfers in the interim and annual periods beginning January 1, 2010. The adoption of this guidance has not had a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued authoritative guidance which amends the *Consolidation* guidance that applies to Variable Interest Entities (VIEs) (ASC 810). This update amends the guidance for the identification of VIEs and their primary beneficiaries and the financial statement disclosures required. This update is effective for interim and annual periods beginning January 1, 2010. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

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

In January 2010, the FASB issued authoritative guidance on *Fair Value Measurements and Disclosures* (ASC 820). This update requires additional disclosures regarding (1) significant transfers in and out of Levels 1 and 2 and the reasons that such transfers were made; (2) inputs and valuation techniques used to measure fair value for financial assets and liabilities that fall in either Level 2 or Level 3; (3) the activity within Level 3 fair value measurements, including information on a gross basis for purchases, sales, issuances, and settlements; and (4) disaggregation of financial assets and liabilities measured at fair value into classes of financial assets and liabilities. This guidance is effective for interim and annual reporting periods beginning January 1, 2010, except for Level 3 reconciliation disclosures which are effective for interim and annual periods beginning January 1, 2011. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

In February 2010, the FASB issued authoritative guidance which amends the *Subsequent Events* guidance (ASC 855). The guidance requires SEC filers to evaluate subsequent events through the date the financial statements are issued, and also exempts SEC filers from disclosing the date through which subsequent events have been evaluated. This update was effective immediately for financial statements that are (1) issued or available to be issued or (2) revised. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

In March 2010, the FASB issued authoritative guidance which clarifies the *Embedded Derivatives* guidance (ASC 815). All entities that enter into contracts containing an embedded credit derivative feature related to the transfer of credit risk that is not only in the form of subordination of one financial instrument to another will be affected by the amendments. The amendments in this update are effective for interim periods beginning after June 15, 2010. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

In April 2010, the FASB issued authoritative guidance which clarifies the *Stock Compensation* guidance (ASC 718). This guidance clarifies the accounting for certain employee share-based payment awards. Awards with an exercise price denominated in the currency of a market in which a substantial portion of the entity s equity securities trades would not be considered to contain a condition that is not a market, performance or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. This accounting guidance is effective for accounting periods beginning on or after December 15, 2010, with earlier application permitted. The Company has evaluated the impact of this guidance, and has concluded that it will not have a material impact on the Company s consolidated financial statements.

In October 2010, the FASB issued Accounting Standards Update No. 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* (ASU 2010-26). The objective of ASU 2010-26 is to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. ASU 2010-26 is effective for interim and annual periods beginning after December 15, 2011 and may be applied prospectively or retrospectively. The Company is currently assessing the potential impact, if any, of the adoption of ASU 2010-26 on the Company s consolidated financial statements.

3. Business combination

On September 4, 2009, pursuant to an amalgamation agreement, the Company acquired all of the outstanding common shares of IPC (the IPC Acquisition) in exchange for 0.9727 Company common shares and $7.50 cash per IPC common share. IPC s operations were focused on short-tail lines of reinsurance. The primary lines in which IPC conducted business were property catastrophe reinsurance and, to a limited extent, property-per-risk excess, aviation (including satellite) and other short-tail reinsurance on a worldwide basis. The IPC Acquisition was undertaken to gain a strategic advantage in the reinsurance market where capacity had been depleted and to increase the Company s capital base.

The aggregate purchase price paid by the Company was $1,746,224 for adjusted tangible net assets acquired of $2,076,902. During 2009, the global financial crisis and related market illiquidity led to several publicly traded companies trading at substantial discounts. This was the primary factor responsible for a purchase price less than the book value of IPC s net assets, and the recognition of a bargain purchase gain on acquisition.

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

The estimates of fair values for tangible assets acquired and liabilities assumed were determined by management based on various market and income analyses and asset appraisals. Significant judgment was required to arrive at these estimates of fair value and changes to assumptions used could have led to materially different results.

An adjustment of $50,000 was made to IPC s net assets acquired in respect of the termination fee (the Max Termination Fee) paid under the Agreement and Plan of Amalgamation among Max Capital Group Ltd. (Max), IPC and IPC Limited. The Max Termination Fee was advanced to IPC by Validus on July 9, 2009, but was repayable in certain circumstances.

In addition, at closing, the Company recorded a $21,671 intangible asset for the acquired IPC customer relationships. This intangible asset was related to the acquired broker distribution network and was fair valued using a variation of the income approach. Under this approach, the Company estimated the present value of expected future cash flows to an assumed hypothetical market participant resulting from the existing IPC customer relationships, considering attrition, and discounting at a weighted average cost of capital.

The composition of purchase price and fair value of net assets acquired is summarized as follows:

Total allocable purchase price		
IPC shares outstanding at September 4, 2009	56,110,096	
Exchange ratio	0.9727	
Validus common shares issued	54,578,268	
Validus closing share price on September 4, 2009	$ 24.10	
Total value of Validus shares to be issued		$ 1,315,337
Total cash consideration paid at $7.50 per IPC share		420,826
Share compensation awards issued to IPC employees pursuant to the Amalgamation Agreement and earned prior to the Amalgamation		10,061
Total allocable purchase price		1,746,224
Tangible Assets Acquired		
Cash and investments	$ 2,463,374	
Receivables (a)	202,278	
Tangible Assets Acquired		2,665,652
Liabilities Acquired		
Net loss reserves and paid losses recoverable	$ 304,957	
Unearned premiums, net of expenses	180,370	
Other liabilities	53,423	
Liabilities acquired		538,750
Net tangible assets acquired, at fair value		2,126,902
Max Termination Fee		(50,000)
Net tangible assets acquired, at fair value, adjusted		2,076,902
Bargain purchase gain before establishment of intangible assets		330,678

Intangible asset customer relationships	21,671
Bargain purchase gain on acquisition of IPC	$ 352,349

(a) The fair value of receivables approximates the gross contractual amounts receivable.

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

The Company also incurred transaction and termination expenses related to the IPC Acquisition. Transaction expenses included legal, corporate advisory, and audit related services. Termination expenses included severance costs and accelerated share compensation costs in connection with certain IPC employment contracts that have been terminated. Finally, the customer relationships intangible asset has been fully amortized as it is not expected to significantly contribute to the Company s future cash flows beyond December 31, 2009. The gain on bargain purchase, net of expenses has been presented as a separate line item in the Company s Consolidated Statements of Operations and Comprehensive Income, and is composed of the following:

	September 30, 2009	
	Three months ended	Nine months ended
Bargain purchase gain on acquisition of IPC	$ 352,349	$ 352,349
Transaction expenses	(13,597)	(29,448)
Termination expenses	(14,131)	(14,131)
Amortization of intangible asset customer relationships	(21,671)	(21,671)
Gain on bargain purchase, net of expenses	$ 302,950	$ 287,099

The following selected unaudited information has been provided to present a summary of the results of IPC since the acquisition date, that have been included within the Validus Re segment in the consolidated financial statements.

	From Acquisition Date to September 30, 2009
Net premiums written	$ (658)
Total revenue	57,434
Total expenses	13,550
Net income	$ 43,884

Supplemental Pro Forma Information

Operating results of IPC have been included in the consolidated financial statements from the September 4, 2009 acquisition date. The following selected unaudited pro forma financial information has been provided to present a summary of the combined results of the Company and IPC, assuming the transaction had been effected on January 1, 2009. The unaudited pro forma data is for informational purposes only and does not necessarily represent results that would have occurred if the transaction had taken place on the basis assumed above.

	September 30, 2009	
	Three months ended	Nine months ended
Net premiums written	$ 288,605	$ 1,544,270
Total revenue	609,620	1,620,181
Total expenses	274,365	841,921
Net income	335,255	778,260

Basic earnings per share	$	3.61	$	9.49
Diluted earnings per share	$	3.50	$	9.20

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

4. Investments

The Company s investments in fixed maturities are classified as trading and carried at fair value, with related net unrealized gains or losses included in earnings. The Company has adopted all authoritative guidance in effect as of the balance sheet date regarding certain market conditions that allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable.

(a) Classification within the fair value hierarchy

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

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

Level 1 primarily consists of financial instruments whose value is based on quoted market prices or alternative indices including overnight repos and commercial paper. Level 2 includes financial instruments that are valued through independent external sources using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. The Company performs internal procedures on the valuations received from independent external sources. Financial instruments in this category include U.S. and U.K. Treasuries, sovereign debt, corporate debt, catastrophe bonds 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. A hedge fund is the only financial instrument in this category as at September 30, 2010.

The Company s external investment advisors had noted illiquidity and dislocation in the non-Agency RMBS market for the period September 30, 2008 through to June 30, 2010. During this period, the Company identified certain non-Agency RMBS securities in its portfolio trading in inactive markets (identified RMBS securities). In order to gauge market activity for the identified RMBS securities, the Company, with assistance from external investment advisors, reviewed the pricing sources for each security in the portfolio. The Company utilized various pricing vendors to obtain market pricing information for investment securities.

Consistent with U.S. GAAP, market approach fair value measurements for securities trading in inactive markets are not determinative. In weighing the fair value measurements resulting from market approach and income approach valuation techniques, the Company previously placed less reliance on the market approach fair value measurements. The income approach valuation technique determines the fair value of each security on the basis of contractual cash flows, discounted using a risk-adjusted discount rate. As the income approach valuation technique incorporates both observable and significant unobservable inputs, the securities were included as Level 3 assets with respect to the fair value hierarchy. The foundation for the income approach was the amount and timing of future cash flows.

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

During the three months ended September 30, 2010, the Company, with assistance from external investment advisors, determined that market activity had increased for the identified RMBS securities. Therefore, a market approach valuation technique was adopted for the identified RMBS securities. As the market approach incorporates observable inputs, the identified RMBS securities are classified as Level 2 with respect to the fair value hierarchy at September 30, 2010. Subsequent to the balance sheet date, the Company liquidated substantially all of the identified RMBS securities which had previously been classified as Level 3 securities. This did not have a material impact on the Company s shareholders equity.

Other investments consist of an investment in a fund of hedge funds and a deferred compensation trust held in mutual funds. During the fourth quarter of 2009, a majority of the fund of hedge funds was redeemed. The remaining portion is a side pocket valued at $12,332 at September 30, 2010. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is unknown. The fund investment manager provides monthly reported net asset values (NAV) with a one-month delay in its valuation. As a result, the fund investment manager s August 31, 2010 NAV was used as a partial basis for fair value measurement in the Company s September 30, 2010 balance sheet. The fund investment manager s NAV relies on an estimate of the performance of the fund based on the month end positions from the underlying third-party funds. The Company utilizes the fund investment manager s primary market approach estimated NAV that incorporates relevant valuation sources on a timely basis. As this valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset. To determine the reasonableness of the estimated NAV, the Company assesses the variance between the estimated NAV and the one-month delayed fund investment manager s NAV. Immaterial variances are recorded in the following reporting period.

At September 30, 2010, the Company s investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. Government and Government Agency	$	$ 1,923,730	$	$ 1,923,730
Non-U.S. Government and Government Agency		641,265		641,265
States, municipalities, political subdivision		17,529		17,529
Agency residential mortgage-backed securities		453,036		453,036
Non-Agency residential mortgage-backed securities		117,886		117,886
U.S. corporate		1,353,191		1,353,191
Non-U.S. corporate		481,517		481,517
Catastrophe bonds		63,818		63,818
Asset-backed securities		124,371		124,371
Commercial mortgage-backed securities		23,942		23,942
Total fixed maturities		5,200,285		5,200,285
Short-term investments	215,573	12,783		228,356
Hedge fund			12,332	12,332
Mutual funds		7,556		7,556
Total	$ 215,573	$ 5,220,624	$ 12,332	$ 5,448,529

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At December 31, 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	$	$ 1,918,811	$	$ 1,918,811
Non-U.S. Government and Government Agency		673,680		673,680
States, municipalities, political subdivision		19,359		19,359
Agency residential mortgage-backed securities		551,610		551,610
Non-Agency residential mortgage-backed securities		52,233	85,336	137,569
U.S. corporate		1,027,225		1,027,225
Non-U.S. corporate		409,398		409,398
Catastrophe bonds		52,351		52,351
Asset-backed securities		36,712		36,712
Commercial mortgage-backed securities		42,663		42,663
Total fixed maturities		4,784,042	85,336	4,869,378
Short-term investments	479,552	2,214		481,766
Hedge fund			25,670	25,670
Mutual funds		11,945		11,945
Total	$ 479,552	$ 4,798,201	$ 111,006	$ 5,388,759

At September 30, 2010, Level 3 investments totaled $12,332, representing 0.2% of total investments measured at fair value on a recurring basis. At December 31, 2009, Level 3 investments totaled $111,006 representing 2.1% 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 September 30, 2010 and December 31, 2009:

	Nine Months Ended September 30, 2010		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments - Beginning of period	$ 85,336	$ 25,670	$ 111,006
Payments and purchases			
Sales and maturities		(13,851)	(13,851)
Realized gains		662	662
Unrealized (losses)	(6,307)	(149)	(6,456)
Amortization	(11,841)		(11,841)
Transfers (out)	(67,188)		(67,188)
Level 3 investments End of period	$	$ 12,332	$ 12,332

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	Year Ended December 31, 2009		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments Beginning of period	$ 111,318	$	$ 111,318
Payments and purchases		115,351	115,351
Sales and maturities	(822)	(92,004)	(92,826)
Realized (losses) gains	(1,284)	1,609	325
Unrealized (losses) gains	(7,329)	714	(6,615)
Amortization	(16,547)		(16,547)
Transfers in (out)			
Level 3 investments End of period	$ 85,336	$ 25,670	$ 111,006

(b) Net investment income

Net investment income was derived from the following sources:

	Three Months Ended		Nine Months Ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Fixed maturities and short-term investments	$ 34,531	$ 29,427	$ 106,632	$ 82,341
Cash and cash equivalents	960	742	1,857	2,623
Securities lending income	49	171	168	683
Total gross investment income	35,540	30,340	108,657	85,647
Investment expenses	(1,507)	(808)	(5,516)	(2,380)
Net investment income	$ 34,033	$ 29,532	$ 103,141	$ 83,267

(c) Fixed maturity and short-term investments

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

	Three Months Ended		Nine Months Ended	
	September 30, 2010	**September 30, 2009**	**September 30, 2010**	**September 30, 2009**
Fixed maturities, short-term and other investments and cash equivalents				
Gross realized gains	$ 23,459	$ 9,795	$ 51,344	$ 23,175
Gross realized (losses)	(401)	(4,366)	(4,447)	(43,817)
Net realized gains (losses) on investments	23,058	5,429	46,897	(20,642)
Net unrealized gains (losses) on securities lending	7	1,441	(1,013)	5,747
Change in net unrealized gains on investments	31,581	48,996	89,654	104,092
Total net realized gains (losses) and change in net unrealized gains on investments	$ 54,646	$ 55,866	$ 135,538	$ 89,197

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The amortized cost, gross unrealized gains and (losses) and estimated fair value of investments at September 30, 2010 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and Government Agency	$ 1,881,417	$ 42,373	$ (60)	$ 1,923,730
Non-U.S. Government and Government Agency	630,008	18,751	(7,494)	641,265
States, municipalities, political subdivision	17,251	281	(3)	17,529
Agency residential mortgage-backed securities	437,135	16,029	(128)	453,036
Non-Agency residential mortgage-backed securities	159,851	161	(42,126)	117,886
U.S. corporate	1,301,859	51,546	(214)	1,353,191
Non-U.S. corporate	469,275	14,897	(2,655)	481,517
Catastrophe bonds	61,956	2,120	(258)	63,818
Asset-backed securities	123,666	865	(160)	124,371
Commercial mortgage-backed securities	23,414	534	(6)	23,942
Total fixed maturities	5,105,832	147,557	(53,104)	5,200,285
Total short-term investments	228,354	2		228,356
Total other investments	18,392	1,496		19,888
Total	$ 5,352,578	$ 149,055	$ (53,104)	$ 5,448,529

The amortized cost, gross unrealized gains and (losses) and estimated fair value of investments at December 31, 2009 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and Government Agency	$ 1,912,081	$ 12,308	$ (5,578)	$ 1,918,811
Non-U.S. Government and Government Agency	678,555	7,552	(12,427)	673,680
States, municipalities, political subdivision	19,310	105	(56)	19,359
Agency residential mortgage-backed securities	537,876	14,643	(909)	551,610
	176,853	481	(39,765)	137,569

Non-Agency residential mortgage-backed securities				
U.S. corporate	1,004,464	23,895	(1,134)	1,027,225
Non-U.S. corporate	411,499	4,781	(6,882)	409,398
Catastrophe bonds	51,236	1,244	(129)	52,351
Asset-backed securities	36,828	411	(527)	36,712
Commercial mortgage-backed securities	41,693	971	(1)	42,663
Total fixed maturities	4,870,395	66,391	(67,408)	4,869,378
Total short-term investments	482,632	33	(899)	481,766
Total other investments	35,941	1,674		37,615
Total	$ 5,388,968	$ 68,098	$ (68,307)	$ 5,388,759

The following table sets forth certain information regarding the investment ratings of the Company s fixed maturities portfolio as at September 30, 2010 and December 31, 2009. 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.

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	September 30, 2010		December 31, 2009	
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total
AAA	$ 3,256,140	62.6%	$ 3,287,879	67.5%
AA	488,871	9.4%	487,364	10.0%
A	1,169,035	22.5%	925,532	19.0%
BBB	130,841	2.5%	14,416	0.3%
Investment grade	5,044,887	97.0%	4,715,191	96.8%
BB	49,684	1.0%	45,191	0.9%
B	35,666	0.7%	59,116	1.2%
CCC	58,343	1.1%	45,194	1.0%
CC	7,428	0.1%		0.0%
D/NR	4,277	0.1%	4,686	0.1%
Non-Investment grade	155,398	3.0%	154,187	3.2%
Total Fixed Maturities	$ 5,200,285	100.0%	$ 4,869,378	100.0%

The amortized cost and estimated fair value amounts for fixed maturity securities held at September 30, 2010 and December 31, 2009 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.

	September 30, 2010		December 31, 2009	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 465,643	$ 467,582	$ 269,889	$ 270,688
Due after one year through five years	3,716,150	3,827,180	3,498,792	3,521,167
Due after five years through ten years	177,234	183,472	306,065	306,502
Due after ten years	2,739	2,816	2,399	2,467
	4,361,766	4,481,050	4,077,145	4,100,824
Asset-backed and mortgage-backed securities	744,066	719,235	793,250	768,554
Total	$ 5,105,832	$ 5,200,285	$ 4,870,395	$ 4,869,378

The Company has a five year, $500,000 secured letter of credit facility provided by a syndicate of commercial banks. At September 30, 2010, approximately $234,837 (December 31, 2009: $225,823) of letters of credit were issued and outstanding under this facility for which $325,268 of investments were pledged as collateral (December 31, 2009: $314,857). In 2007, the Company entered into a $100,000 standby letter of credit facility which provides Funds at Lloyd s (the Talbot FAL Facility). On November 19, 2009, the Company entered into a Second Amendment to the Talbot FAL Facility to reduce the commitment from $100,000 to $25,000. At September 30, 2010, $25,000 (December 31, 2009: $25,000) of letters of credit were issued and outstanding under the Talbot FAL Facility for which $45,919 of investments were pledged as collateral (December 31, 2009: $128,798). In addition, $1,681,727 of investments were held in trust at September 30, 2010 (December 31, 2009: $1,517,249). Of those, $1,536,794 were held in trust for the benefit of Talbot s cedants and policyholders, and to facilitate the accreditation of Talbot as an alien insurer/reinsurer by certain regulators (December 31, 2009: $1,408,084).

The Company assumed two letters of credit facilities as part of the IPC Acquisition. A $250,000 Credit Facility between IPC, IPCRe Limited, the Lenders party thereto and Wachovia Bank, National Association (the IPC Syndicated Facility) and a $350,000 Letters of Credit Master Agreement between Citibank N.A. and IPCRe Limited (the IPC Bi-Lateral Facility).

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At March 31, 2010, the IPC Syndicated Facility was closed. At September 30, 2010, the IPC Bi-Lateral Facility had $75,864 (December 31, 2009: $96,047) letters of credit issued and outstanding for which $99,906 (December 31, 2009: $219,004) of investments were held in an associated collateral account.

(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 September 30, 2010, the Company had $33,181 (December 31, 2009: $88,146) in securities on loan. During the three months ended September 30, 2010, the Company recorded a $7 unrealized gain on this collateral in its Statements of Operations (September 30, 2009: unrealized gain $1,441). During the nine months ended September 30, 2010, the Company recorded a $1,013 unrealized loss on this collateral in its Statements of Operations (September 30, 2009: unrealized gain $5,747).

Securities lending collateral reinvested includes corporate floating rate securities and overnight repo with an average reset period of 14.4 days (December 31, 2009: 26.1 days). As at September 30, 2010, 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	$	$ 216	$	$ 216
Agency				
Asset-backed securities		5,010		5,010
Short-term investments	8,298	19,611		27,909
Total	$ 8,298	$ 24,837	$	$ 33,135

As at December 31, 2009, the securities lending collateral reinvested by the Company in connection with its securities program was allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
Corporate	$	$ 14,123	$	$ 14,123
Agency		9,363		9,363
Asset-backed securities		6,153		6,153
Short-term investments	730	59,981		60,711
Total	$ 730	$ 89,620	$	$ 90,350

The following table sets forth certain information regarding the investment ratings of the Company s securities lending collateral reinvested as at September 30, 2010 and December 31, 2009. 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.

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	September 30, 2010		December 31, 2009	
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total
AAA	$ 10,622	32.1%	$ 33,501	37.1%
AA+	11,016	33.2%	12,011	13.3%
AA		0.0%	4,998	5.5%
AA-	2,983	9.0%	19,910	22.0%
A+		0.0%	9,999	11.1%
A		0.0%	9,006	10.0%
NR	216	0.7%	195	0.2%
	24,837	75.0%	89,620	99.2%
NR- Short-term investments (1)	8,298	25.0%	730	0.8%
Total	$ 33,135	100.0%	$ 90,350	100.0%

(1) This amount relates to short-term investments and is therefore not a rated security.

The amortized cost and estimated fair value amounts for securities lending collateral reinvested by the Company at September 30, 2010 and December 31, 2009 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.

	September 30, 2010		December 31, 2009	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 27,905	$ 27,909	$ 68,895	$ 70,074
Due after one year through five years	6,000	5,226	21,211	20,276
Total	$ 33,905	$ 33,135	$ 90,106	$ 90,350

5. Reserve for losses and loss expenses

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

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The following table represents an analysis of paid and unpaid losses and loss expenses incurred and a reconciliation of the beginning and ending unpaid loss expenses as at September 30, 2010 and December 31, 2009:

	Nine Months Ended September 30, 2010	Year ended December 31, 2009
Reserve for losses and loss expenses, beginning of period	$ 1,622,134	$ 1,305,303
Losses and loss expenses recoverable	(181,765)	(208,796)
Net reserves for losses and loss expenses, beginning of period	1,440,369	1,096,507
Net reserves acquired in purchase of IPC		304,957
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:		
Current year	958,406	625,810
Prior years	(126,045)	(102,053)
Total incurred losses and loss expenses	832,361	523,757
Total net paid losses	(519,930)	(507,435)
Foreign exchange	(776)	22,583
Net reserve for losses and loss expenses, end of period	1,752,024	1,440,369
Losses and loss expenses recoverable	268,821	181,765
Reserve for losses and loss expenses, end of period	$ 2,020,845	$ 1,622,134

6. 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. At September 30, 2010, 99.0% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A- or better and included $132,312 of IBNR recoverable (December 31, 2009: $99,587). Reinsurance recoverables by reinsurer are as follows:

	September 30, 2010		December 31, 2009	
	Reinsurance Recoverable		Reinsurance Recoverable	

		% of Total		**% of Total**
Top 10 reinsurers	$ 211,844	73.5%	170,810	86.9%
Other reinsurers balances > $1 million	67,797	23.5%	19,818	10.1%
Other reinsurers balances < $1 million	8,740	3.0%	5,919	3.0%
Total	$ 288,381	100.0%	196,547	100.0%

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Top 10 Reinsurers	Rating	September 30, 2010 Reinsurance Recoverable	% of Total
Lloyd s Syndicates	A+	$ 51,660	24.3%
Fully collateralized reinsurers	NR	38,249	18.1%
Hannover Re	AA-	23,658	11.2%
Montpelier Re	A-	20,000	9.4%
Munich Re	AA-	18,852	8.9%
Everest Re	A+	13,109	6.2%
Transatlantic Re	A+	12,348	5.8%
Tokio Millennium Re	AA	11,980	5.7%
Odyssey Re	A-	11,773	5.6%
Brit Insurance	A+	10,215	4.8%
Total		$ 211,844	100.0%

Top 10 Reinsurers	Rating	December 31, 2009 Reinsurance recoverable	% of Total
Fully collateralized reinsurers	NR	$ 50,840	29.8%
Lloyd s Syndicates	A+	33,103	19.4%
Munich Re	AA-	19,921	11.7%
Hannover Re	AA-	13,427	7.8%
Aspen	A	11,417	6.7%
Allianz	AA	9,645	5.6%
Swiss Re	A+	8,995	5.3%
Transatlantic Re	A+	8,804	5.1%
Brit Insurance Limited	A	8,159	4.8%
Platinum Underwriters	A	6,499	3.8%
Total		$ 170,810	100.0%

At September 30, 2010 and December 31, 2009, the provision for uncollectible reinsurance relating to losses recoverable was $5,113 and $3,477, respectively. To estimate the provision for uncollectible reinsurance recoverable, the reinsurance recoverable is first allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment is applied. As part of this process, ceded IBNR is allocated by reinsurer. Of the $288,381 reinsurance recoverable at September 30, 2010, $38,249 was fully collateralized (December 31, 2009: $50,840).

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.

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7. 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 per share. 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 Company may from time to time repurchase its securities, including common shares, Junior Subordinated Deferrable Debentures and Senior Notes. In November 2009, the Board of Directors of the Company authorized an initial $400,000 share repurchase program. On February 17, 2010, the Board of Directors of the Company authorized the Company to return up to $750,000 to shareholders. This amount is in addition to, and in excess of, the $135,494 of common shares purchased by the Company through February 17, 2010 under its previously authorized $400,000 share repurchase program. On May 6, 2010, the Board of Directors authorized a self tender offer pursuant to which the Company has repurchased $300,000 in common shares.

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

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

	Common Shares
Common shares issued, December 31, 2009	131,616,349
Restricted share awards vested, net of shares withheld	369,576
Restricted share units vested, net of shares withheld	57,192
Employee seller shares vested	203,544
Options exercised	58,500
Warrants exercised	2,996
Common shares issued, September 30, 2010	132,308,157
Shares repurchased, September 30, 2010	(23,070,267)
Common shares outstanding, September 30, 2010	109,237,890

	Common Shares
Common shares issued and outstanding, December 31, 2008	75,624,697
IPC acquisition issuance	54,556,762
Restricted share awards vested, net of shares withheld	423,746
Restricted share units vested, net of shares withheld	360,383
Employee seller shares vested	248,085
Options exercised	164,834
Warrants exercised	237,842
Common shares issued, December 31, 2009	131,616,349

Shares repurchased, December 31, 2009	(3,156,871)
Common shares outstanding, December 31, 2009	128,459,478

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b) Warrants

During the three and nine months ended September 30, 2010, 10,018 warrants were exercised which resulted in the net share issuance of 2,996 common shares. During the three months ended September 30, 2009, nil warrants were exercised. During the nine months ended September 30, 2009, 728,010 warrants were exercised which resulted in the net share issuance of 237,842 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 September 30, 2010 were 4,694 (December 31, 2009: 4,577).

d) Dividends

On August 4, 2010, the Company announced a quarterly cash dividend of $0.22 (2009: $0.20) per common share and $0.22 per common share equivalent for which each outstanding warrant is then exercisable. This dividend was paid on September 30, 2010 to holders of record on September 15, 2010.

8. Stock plans

a) Long Term Incentive Plan and Short Term Incentive Plan

The Company s Long Term Incentive Plan (LTIP) provides for grants to employees of options, stock appreciation rights (SARs), restricted shares, restricted share units, performance shares, performance units, dividend equivalents or other share-based awards. In addition, the Company may issue restricted share awards or restricted share units in connection with awards issued under its annual Short Term Incentive Plan (STIP). The total number of shares reserved for issuance under the LTIP and STIP are 13,126,896 shares of which 7,218,577 shares are remaining. The LTIP and STIP are administered by the Compensation Committee of the Board of Directors. No SARs or performance shares have been granted to date. Grant prices are established at the fair market value of the Company s common shares at the date of grant.

i. Options

Options may be exercised for voting common shares upon vesting. Options have a life of 10 years and vest either ratably or at the end of the required service period from the date of grant. All options granted in 2009 were as a result of the IPC Acquisition. 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%	0.0%	7	30.0%
2008	3.5%	3.2%	7	30.0%
2009	3.9%	3.7%	2	34.6%

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Expected volatility is based on stock price volatility of comparable publicly-traded companies. The Company used the simplified method consistent with U.S. GAAP authoritative guidance on stock compensation expenses to estimate expected lives for options granted during the period as historical exercise data was not available and the options met the requirement as set out in the guidance.

Share compensation expenses of $1,059 were recorded for the three months ended September 30, 2010 (2009: $1,063). Share compensation expenses of $3,133 were recorded for the nine months ended September 30, 2010 (2009: $3,037). 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 nine months ended September 30, 2010 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2009	3,278,015	$ 6.83	$ 19.88
Options granted			
Options exercised	(58,500)	5.97	21.91
Options forfeited	(4,317)	10.30	20.39
Options outstanding, September 30, 2010	3,215,198	$ 6.84	$ 19.84
Options exercisable at September 30, 2010	2,545,289	$ 6.05	$ 20.10

Activity with respect to options for the nine months ended September 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	650,557	3.42	27.27
Options exercised	(12,033)	6.32	21.11
Options forfeited	(7,646)	10.30	20.39
Options outstanding, September 30, 2009	3,430,816	$ 6.80	$ 19.93
Options exercisable at September 30, 2009	1,520,416	$ 7.56	$ 17.89

At September 30, 2010, there were $1,534 (December 31, 2009: $4,713) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.0 years (December 31, 2009: 1.3 years).

ii. Restricted share awards

Restricted shares granted under the LTIP and STIP 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 $5,134 were recorded for the three months ended September 30, 2010 (2009: $3,621). Share compensation expenses of $14,195 were recorded for the nine months ended September 30, 2010 (2009: $12,008). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period.

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Activity with respect to unvested restricted shares for the nine months ended September 30, 2010 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2009	2,525,958	$ 23.43
Restricted share awards granted	1,108,169	25.75
Restricted share awards vested	(453,851)	23.43
Restricted share awards forfeited	(34,901)	23.29
Restricted share awards outstanding, September 30, 2010	3,145,375	$ 24.25

Activity with respect to unvested restricted share awards for the nine months ended September 30, 2009 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2008	2,307,402	$ 22.73
Restricted share awards granted	736,030	24.62
Restricted share awards vested	(459,910)	22.32
Restricted share awards forfeited	(4,517)	21.19
Restricted share awards outstanding, September 30, 2009	2,579,005	$ 23.34

At September 30, 2010, there were $50,075 (December 31, 2009: $38,395) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.8 years (December 31, 2009: 2.8 years).

iii. Restricted share units

Restricted share units under the LTIP and STIP vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $68 were recorded for the three months ended September 30, 2010 (2009: $5,324). Share compensation expenses of $302 were recorded for the nine months ended September 30, 2010 (2009: $5,360). 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 nine months ended September 30, 2010 was as follows:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2009	78,591	$ 24.84

Restricted share units granted	26,782		25.65
Restricted share units vested	(59,019)		24.76
Restricted share units forfeited	(1,094)		21.49
Restricted share units outstanding, September 30, 2010	45,260	$	25.50

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Activity with respect to unvested restricted share units for the nine months ended September 30, 2009 was as follows:

	Restricted Share Units		Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2008	11,853	$	25.28
Restricted share units granted	228,136		24.76
Restricted share units vested	(51,753)		24.76
Restricted share units forfeited			
Restricted share units outstanding, September 30, 2009	188,236	$	24.79

At September 30, 2010, there were $901 (December 31, 2009: $578) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.9 years (December 31, 2009: 2.5 years). Additional restricted share units are issued in lieu of accrued dividends for each unvested restricted share unit. As at September 30, 2010, unvested restricted share units issued in lieu of dividends were 1,476 (December 31, 2009: 858).

b) Employee seller shares

Pursuant to the Share Sale Agreement for the purchase of Talbot Holdings, Ltd. (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 the potential for forfeiture will be completely extinguished.

Share compensation expenses of $1,357 were recorded for the three months ended September 30, 2010 (2009: $1,285). Share compensation expenses of $3,410 were recorded for the nine months ended September 30, 2010 (2009: $3,874). 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 nine months ended September 30, 2010 was as follows:

	Employee Seller Shares		Weighted Average Grant Date Fair Value
Employee seller shares outstanding, December 31, 2009	410,667	$	22.01
Employee seller shares granted			
Employee seller shares vested	(203,544)		22.01

Employee seller shares forfeited	(3,551)		22.01
Employee seller shares outstanding, September 30, 2010	203,572	$	22.01

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Activity with respect to unvested employee seller shares for the nine months ended September 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	(248,085)	22.01
Employee seller shares forfeited	(3,799)	22.01
Employee seller shares outstanding, September 30, 2009	411,491	$ 22.01

At September 30, 2010, there were $2,726 (December 31, 2009: $6,135) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 0.8 years (December 31, 2009: 1.5 years).

c) Total share compensation expenses

Total share compensation expenses for the three and nine months ended September 30, 2009 included $5,431 of IPC-related termination expenses which were included in the gain on bargain purchase, net of expenses in the Statements of Operations. The breakdown of share compensation expenses by award type was as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Options	$ 1,059	$ 1,063	$ 3,133	$ 3,037
Restricted share awards	5,134	3,621	14,195	12,008
Restricted share units	68	5,324	302	5,360
Employee seller shares	1,357	1,285	3,410	3,874
Total	$ 7,618	$ 11,293	$ 21,040	$ 24,279

9. Debt and financing arrangements

a) Financing structure and finance expenses

The financing structure at September 30, 2010 was:

	Commitment	Outstanding (1)	Drawn
9.069% Junior Subordinated Deferrable Debentures	$ 150,000	$ 150,000	$ 150,000