VALIDUS HOLDINGS LTD
Form 10-K
March 06, 2008

Table of Contents

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

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2007

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:	**Name of Each Exchange on Which Registered:**
Common Shares, $0.175 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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 o	Accelerated filer o	Non-accelerated filer þ	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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 March 6, 2008, there were 74,205,749 outstanding Common Shares, $0.175 par value per share, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates information from certain portions of the registrant s definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the fiscal year end of December 31, 2007.

Validus Holdings, Ltd.

2007 Form 10-K Annual Report

TABLE OF CONTENTS

PART I

All amounts presented in this part are in U.S. dollars except as otherwise noted.

Item 1. *Business*

Overview

Validus Holdings, Ltd. (the Company) was incorporated under the laws of Bermuda on October 19, 2005. Our initial investor, which we refer to as our founding investor, is Aquiline Capital Partners LLC, a private equity firm dedicated to investing in financial services companies. Other sponsoring investors include private equity funds managed by Goldman Sachs Capital Partners, Vestar Capital Partners, New Mountain Capital and Merrill Lynch Global Private Equity. The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. (Validus Re) and Talbot Holdings Ltd. (Talbot). The Company, through its subsidiaries, provides reinsurance coverage in the Property, Marine and Specialty lines markets, effective January 1, 2006, and insurance coverage in the same markets effective July 2, 2007.

We seek to establish ourselves as a leader in the global insurance and reinsurance markets. Our principal operating objective is to use our capital efficiently by underwriting primarily short-tail insurance and reinsurance contracts with superior risk and return characteristics. Our primary underwriting objective is to construct a portfolio of short-tail insurance and reinsurance contracts which maximize our return on equity subject to prudent risk constraints on the amount of capital we expose to any single extreme event. We manage our risks through a variety of means, including contract terms, portfolio selection, diversification criteria, including geographic diversification criteria, and proprietary and commercially available third-party vendor models. We have assembled a senior management team with substantial industry expertise and longstanding industry relationships. We are well positioned to take advantage of current market conditions; we have also built our operations so that we may effectively take advantage of future market conditions as they develop.

Since our formation in 2005, we have been able to achieve substantial success in the development of our business. Selected examples of our accomplishments are as follows:

Assembling an executive management team with an average of 20 years of industry experience and senior expertise spanning multiple aspects of the global insurance and reinsurance business.

Building a risk analytics staff comprised of 24 individuals, many of whom have advanced technical degrees, including five PhDs and six Masters degrees in related fields.

Developing Validus Capital Allocation and Pricing System (VCAPS), a proprietary computer-based system for modeling, pricing, allocating capital and analyzing catastrophe-exposed risks.

Raising approximately $1.0 billion of initial equity capital in December 2005.

Entering the global reinsurance market in January 2006 and underwriting $217.4 million in gross premiums written in the January 1 renewal season.

Entering into a sidecar collateralized quota share retrocession relationship with Petrel Re Limited in May 2006.

Augmenting our equity through the placement of $150.0 million of Junior Subordinated Deferrable Debentures in June 2006.

Underwriting $362.0 million in gross premiums written for the January 1, 2007 renewal season, representing an increase of $144.6 million or 66.5% over the comparable period for 2006.

Issuing an additional $200.0 million in aggregate principal amount of junior subordinated deferrable debentures due 2037 in June 2007.

Acquiring all of the outstanding shares of Talbot Holdings Ltd. on July 2, 2007.

Completing an initial public offering (IPO) on July 30, 2007.

Table of Contents

The Company sold 15,244,888 common shares at a price of $22.00 per share in the IPO and the net proceeds to the Company from the IPO were approximately $310,730,522 after deducting the underwriters discount and fees. On August 27, 2007, the Company issued an additional 453,933 common shares at a price of $22.00 per share pursuant to the underwriters option to purchase additional common shares; the net proceeds to the Company were approximately $9,349,884 and total IPO proceeds inclusive of the underwriters option to purchase additional common shares were $320,080,406.

Our Operating Subsidiaries

The following chart shows how our Company and its operating subsidiaries are organized.

Our Segments

Validus Re: Validus Re, the Company s principal reinsurance operating subsidiary, operates as a Bermuda-based provider of short-tail reinsurance products on a global basis. Validus Re concentrates on first-party risks, which are property risks and other reinsurance lines commonly referred to as short-tail in nature due to the brief period between the occurrence and payment of a claim.

Validus Re was registered as a Class 4 insurer under The Insurance Act 1978 of Bermuda, amendments thereto and related regulations (the Insurance Act) in November 2005. It commenced operations with approximately $1.0 billion of equity capital and a balance sheet unencumbered by any historical losses relating to the 2005 hurricane season, the events of September 11, 2001, asbestos or other legacy exposures affecting our industry.

Validus Re entered the global reinsurance market in 2006 during a period of imbalance between the supply of underwriting capacity available for reinsurance on catastrophe-exposed property, marine and energy risks and demand for such reinsurance coverage. Our business strategy was responsive to these capacity needs and as of January 1, 2006 a significant portion of our current underwriting and analytical staff was in place, including six underwriters and four catastrophe modelers and risk analytic experts. As a consequence, we believe Validus Re developed an industry reputation for thorough and timely quotes for difficult technical risks. A significant volume of property catastrophe business is written in the January 1 renewal period and we believe the combination of our available capacity, staffing levels and management leadership permitted Validus Re to underwrite an attractive portfolio of catastrophe-exposed risks at January 1, 2006. Our gross premiums written for the three months ended March 31, 2006 were $248.2 million, of which $217.4 million was underwritten at January 1. In the January 1, 2007 renewal period we believe we were able to capitalize on our established relationships and to further expand our business. In total for the January 1, 2007 renewal season, we underwrote $362.0 million in gross premiums written, representing an increase of $144.6 million or 66.5% over the January 1, 2006 renewal period.

The following are the primary lines in which Validus Re conducts its business. Details of gross premiums written by line of business are provided below:

	Year Ended December 31, 2007		Year Ended December 31, 2006	
Line of Business	**Gross Premiums Written (Dollars in thousands)**	**Gross Premiums Written (%)**	**Gross Premiums Written (Dollars in thousands)**	**Gross Premiums Written (%)**
Property	$ 498,375	71.0%	$ 370,958	68.6%
Marine	136,710	19.5%	104,584	19.3%
Specialty	67,013	9.5%	65,247	12.1%
Total	$ 702,098	100.0%	$ 540,789	100.0%

Property: Validus Re underwrites property catastrophe reinsurance, property per risk reinsurance and property pro rata reinsurance.

Property catastrophe: Property catastrophe provides reinsurance for insurance companies exposures to an accumulation of property and related losses from separate policies, typically relating to natural disasters or other catastrophic events. Property catastrophe reinsurance is generally written on an excess of loss basis, which provides coverage to primary insurance companies when aggregate claims and claim expenses from a single occurrence from a covered peril exceed a certain amount specified in a particular contract. Under these contracts, the Company provides protection to an insurer for a portion of the total losses in excess of a specified loss amount, up to a maximum amount per loss specified in the contract. In the event of a loss, most contracts provide for coverage of a second occurrence following the payment of a premium to reinstate the coverage under the contract, which is referred to as a reinstatement premium. The coverage provided under excess of loss reinsurance contracts may be on a worldwide basis or limited in scope to specific regions or geographical areas. Coverage can also vary from all property perils, which is the most expansive form of coverage, to more limited coverage of specified perils such as windstorm-only coverage. Property catastrophe reinsurance contracts are typically all risk in nature, providing protection against losses from earthquakes and hurricanes, as well as other natural and man-made catastrophes such as floods, tornadoes, fires and storms. The predominant exposures covered are losses stemming from property damage and business interruption coverage resulting from a covered peril. Certain risks, such as war or nuclear contamination may be excluded, partially or wholly, from certain contracts. Gross premiums written on property catastrophe business during the year ended December 31, 2007 were $352.0 million

Property per risk: Property per risk provides reinsurance for insurance companies excess retention on individual property and related risks, such as highly-valued buildings. Risk excess of loss reinsurance protects insurance companies on their primary insurance risks on a single risk basis. A risk in this context might mean the insurance coverage on one building or a group of buildings or the insurance coverage under a single policy which the reinsured treats as a single risk. Coverage is usually triggered by a large loss sustained by an individual risk rather than by smaller losses which fall below the specified retention of the reinsurance contract. Such property risk coverages are generally written on an excess of loss basis, which provides the reinsured protection beyond a specified amount up to the limit set within the reinsurance contract. Gross premiums written on property per risk business during the year ended December 31, 2007 were $47.6 million

Property pro rata: Property pro rata contracts require that the reinsurer share the premiums as well as the losses and expenses in an agreed proportion with the cedant. Gross premiums written on property pro rata business during the year ended December 31, 2007 were $98.8 million

Marine: Validus Re underwrites reinsurance on marine risks covering damage to or losses of marine vessels and cargo, third-party liability for marine accidents and physical loss and liability from principally offshore energy properties. Validus Re underwrites marine on an excess of loss basis, and to a lesser extent, on a pro rata basis. Gross premiums written on marine business during the year ended December 31, 2007 were $136.7 million.

Specialty: Validus Re underwrites other lines of business depending on an evaluation of pricing and market conditions, which include aerospace, terrorism, life and accident & health and workers compensation catastrophe. The Company seeks to underwrite other specialty lines with very limited exposure correlation with its property, marine and energy portfolios. With the exception of the aerospace line of business, which has a meaningful portion of its gross premiums written volume on a proportional basis, the Company s other specialty lines are written on an excess of loss basis. Gross premiums written on specialty business during the year ended December 31, 2007 were $67.0 million.

Talbot: On July 2, 2007, the Company acquired all of the outstanding shares of Talbot. Talbot is the Bermuda parent of a specialty insurance group primarily operating within the Lloyd s of London (Lloyd s) insurance market through Syndicate 1183. The acquisition of Talbot provides us with significant benefits in terms of product line and geographic diversification as well as offering us broader access to underwriting expertise. Similar to Validus Re, Talbot writes primarily short-tail lines of business but, as a complement to Validus Re, focuses mostly on insurance, as opposed to reinsurance, risks and on specialty lines where Validus Re currently has limited or no presence (e.g. war, financial institutions, contingency, bloodstock and livestock, accident and health). In addition, Talbot provides us with access to the Lloyd s marketplace where Validus Re does not operate. As a London-based insurer, Talbot also writes the majority of its premiums on risks outside the United States, which risks generally do not aggregate with Validus Re s. Talbot s highly experienced team of underwriters have, in many cases, spent most of their careers writing niche, short-tail business and bring their expertise to bear on expanding our short-tail insurance and reinsurance franchise.

The following are the primary lines in which Talbot conducts its business. Details of gross premiums written by line of business are provided below:

	Year Ended December 31, 2007(1)		Year Ended December 31, 2006(1)	
Line of Business	**Gross Premiums Written (Dollars in thousands)**	**Gross Premiums Written (%)**	**Gross Premiums Written (Dollars in thousands)**	**Gross Premiums Written (%)**
Property	$ 151,245	22.0%	$ 159,374	24.6%
Marine	264,008	38.4%	244,535	37.7%
Specialty	272,472	39.6%	244,743	37.7%
Total	$ 687,725	100.0%	$ 648,652	100.0%

(1)

Talbot was acquired on July 2, 2007. Talbot s gross premium written for the full years ended December 31, 2007 and 2006 has been presented above for informational purposes only and is not included within the consolidated results.

Property: The main sub-classes within property are international and North American direct and facultative contracts, lineslips and binding authorities together with a book of business written on a treaty reinsurance basis. The business written is mostly commercial and industrial insurance though there is a modest personal lines component. The business is short-tail with reinsurance risks substantially earned within 12 months, direct and facultative risks substantially earned after 18 months and lineslips and binding authorities earned within 24 months of the expiry of the contract. Gross premiums written on property business during the year ended December 31, 2007 were $151.2 million. Gross premiums written and consolidated by the Company subsequent to the July 2, 2007 acquisition of Talbot were $49.2 million.

Marine: The main types of business within marine are hull, cargo, energy, marine and energy liabilities and yachts and marinas. Hull consists primarily of ocean going vessels and cargo covers worldwide risks. Energy covers a variety of oil and gas industry risks. The marine and energy liability account provides cover for protection and indemnity clubs and a wide range of companies operating in the marine and energy sector. Yacht and marina policies are primarily written through Underwriting Risk Services, an underwriting agency that is a subsidiary of Talbot. Each of the sub-classes within marine have a different profile of contracts written some, such as energy, derive up to 50% of their business through writing facultative contracts while others, such as cargo, only derive 15% of their business from this method. Each of the sub-classes also has a different geographical risk allocation. Most business written is short-tail which helps to establish confidence over profitability levels quickly; the marine and energy liability account, which makes up $35.6 million of the $264.0 million of gross premiums written during the year ended December 31, 2007, is the primary long-tail class in this line. The business written is mainly on a direct and facultative basis with a small element written on a reinsurance basis either as excess of loss reinsurance or proportional reinsurance. Gross premiums written on marine business during the year ended December 31, 2007 were $264.0 million. Gross premiums written and consolidated by the Company subsequent to the July 2, 2007 acquisition of Talbot were $114.0 million.

Specialty: This class consists of war (which comprises marine & aviation war, political risks and political violence), financial institutions, contingency, bloodstock and livestock, accident and health, and aviation and other treaty. With the exception of aviation and other treaty, most of the business written under the specialty accounts is written on a direct or facultative basis or under a binding authority through a coverholder. Gross premiums written on specialty business during the year ended December 31, 2007 were $272.5 million. Gross premiums written and consolidated by the Company subsequent to the July 2, 2007 acquisition of Talbot were $123.3 million.

War. The marine & aviation war account covers physical damage to aircraft and marine vessels caused by acts of war and terrorism. The political risk account deals primarily with expropriation, contract frustration/trade credit, kidnap and ransom, and malicious and accidental product temper. The political violence account mainly insures physical loss to property or goods anywhere in the world, caused by war, terrorism or civil unrest. This class is often written in conjunction with cargo, specie, property, energy, contingency and political risk. The period of the risks can extend up to 36 months and beyond, particularly with construction risks. The attritional losses on the account are traditionally low but the account can be affected by large individual losses. Talbot is a leader in the war and political violence classes. Gross premiums written for war business during the year ended December 31, 2007 were $128.9 million. Gross premiums written and consolidated by the Company subsequent to the July 2, 2007 acquisition of Talbot were $59.8 million.

Financial Institutions. Talbot s financial institutions team predominantly underwrites bankers blanket bond, professional indemnity and directors and officers coverage for various types of financial institutions and similar companies. Bankers blanket bond insurance products are specifically designed to protect against direct financial loss caused by fraud/criminal actions and mitigate the damage such activities may have on the asset base of these institutions. Professional indemnity insurance protects businesses in the event that legal action is taken against them by third parties claiming to have suffered a loss as a result of advice received. Directors and officers insurance protects directors and officers against personal liability for losses incurred by a third party due to negligent performance by the director or officer. Gross premiums written in financial institutions for the year ended December 31, 2007 was $43.8 million, comprised of:

	Year Ended December 31, 2007(1)	
	Gross Premiums Written	Gross Premiums Written (%)
	(Dollars in thousands)	
Bankers blanket bond	$ 27,180	62.1%
Professional indemnity	14,810	33.8%

Directors and Officers		1,447	3.3%
Other		366	0.8%
Total	$	43,803	100.0%

(1) Talbot was acquired on July 2, 2007. Talbot s gross premium written for the full year ended December 31, 2007 has been presented above for informational purposes only and is not included within the consolidated results.

The risks covered in financial institutions are primarily fraud related and are principally written on an excess of loss basis. Talbot s financial institutions account is concentrated on non-U.S. based clients, with 42.2% of gross premium written in 2007 generated in Europe, 11.6% from the U.S and 46.2% from other geographical regions. In addition, Talbot seeks to write regional accounts rather than global financial institutions with exposure in multiple jurisdictions and has only limited participation in exposures to publicly listed U.S. companies. The underwriters actively avoid writing U.S. directors and officers risks. The Company has identified no liability exposure to any U.S. domiciled financial institution that has announced a write down related to the current credit crisis. As of December 31, 2007, the Company had gross reserves related to the Financial Institutions business of $96.3 million, comprised of $71.6 million (74.4%) of IBNR and $24.7 million (25.6%) of case reserves.

Contingency. The main types of covers written under the contingency account are event cancellation and non-appearance business. Gross premiums written for contingency business during the year ended December 31, 2007 were $24.7 million. Gross premiums written and consolidated by the Company subsequent to the July 2, 2007 acquisition of Talbot were $12.3 million.

Bloodstock and Livestock. The bloodstock and livestock account mainly insures bloodstock, livestock, agricultural, zoological, private and commercial risks. Gross premiums written for bloodstock and livestock business during the year ended December 31, 2007 were $15.6 million. Gross premiums written and consolidated by the Company subsequent to the July 2, 2007 acquisition of Talbot were $9.7 million.

Accident and Health. The accident and health account provides insurance in respect of individuals in both their personal and business activity together with corporations where they have an insurable interest relating to death or disability of employees or those under contract. Gross premiums written for accident and health business during the year ended December 31, 2007 were $14.2 million. Gross premiums written and consolidated by the Company subsequent to the July 2, 2007 acquisition of Talbot were $8.7 million.

Aviation and Other Treaty. The aviation account insures major airlines, general aviation, aviation hull war and satellites. The coverage is mainly excess of loss treaty with medium to high attachment points. The other treaty account is mainly marine treaty and other excess of loss treaty covers. Gross premiums written for aviation and other treaty business during the year ended December 31, 2007 were $45.3 million. Gross premiums written and consolidated by the Company subsequent to the July 2, 2007 acquisition of Talbot were $11.8 million.

Underwriting and Risk Management

We underwrite and manage risk through superior risk selection and analysis. Through a detailed examination of contract terms, diversification criteria, contract experience and exposure, we believe we will consistently outperform our peers. While the experience of an individual underwriter is critical, we strive to provide our underwriters with technically sound and objective information. We believe a strong working relationship between the underwriting, catastrophe modeling and actuarial disciplines is critical to long-term success and solid decision-making.

A principal focus of the Company is to develop and apply sophisticated computer models and other analytical tools to assess the risks and aggregation of the risks that we underwrite and to optimize our portfolio of contracts. In particular, we devote a substantial amount of our efforts to the optimization of our catastrophe risk profile. As compared against relying solely on Probable Maximum Loss (PML) data, which calculates the maximum amount of loss expected from a contract measured over various return periods or measured probabilistically, our approach to risk control imposes a limit on our net maximum potential loss for any single event in any one risk zone, which reduces the risks inherent in probabilistic modeling. Further, we recognize that the reliability and credibility of the models is contingent upon the accuracy, reliability and quality of the data that is used in modeling efforts.

Underwriting

All of the Company s underwriters are subject to a set of underwriting guidelines that are established by the Chief Underwriting Officer at Validus Re and the Chief Executive Officer at Talbot and are subject to review and approval by the Underwriting Committee of our Board of Directors. They are also issued letters of authority that more specifically address the limits of their underwriting authority and their referral criteria. The Company s current underwriting guidelines and letters of authority include:

- lines of business that a particular underwriter is authorized to write;
- exposure limits by line of business;
- contractual exposures and limits requiring mandatory referrals to the Chief Underwriting Officer at Validus Re and the Chief Executive Officer at Talbot;
- level of analysis to be performed by lines of business; and
- minimum data requirements and data standards that maximize data integrity for purposes of modeling.

In general, our underwriting approach is to:

- seek high quality clients who have demonstrated superior performance over an extended period;
- evaluate our clients exposures and make adjustments where their exposure is not adequately reflected;
- apply the comprehensive knowledge and experience of our entire underwriting team to make progressive and cohesive decisions about the business they underwrite;
- employ our well-founded and carefully maintained market contacts within the group to enhance our robust distribution capabilities;
- price submissions using the best available analytical tools available on either a proprietary or vendor model basis;
- rank and select treaty reinsurance submissions using VCAPS in order to optimize our portfolio; and
- refer submissions to the Chief Underwriting Officer at Validus Re, the Chief Executive Officer at Talbot, Chief Executive Officer and the Underwriting Committee of our Board of Directors according to our underwriting guidelines.

The underwriting guidelines are subject to waiver or change by the Chief Underwriting Officer at Validus Re or the Chief Executive Officer at Talbot subject to their authority as overseen by the Underwriting Committee.

Our underwriters have the responsibility to analyze all submissions and determine if the related potential exposures meet with both the Company s risk profile and aggregate limitations. In order to ensure compliance, we run underwriting reports and conduct peer reviews. Further, our treaty reinsurance operation has the authority limits of individual underwriters built into VCAPS while Talbot maintains separate compliance procedures to ensure that the appropriate policies and guidelines are followed.

Validus Re: We have established a referral process whereby business exceeding set exposure or premium limits is referred to the Chief Underwriting Officer for review. As the reviewer of such potential business, the Chief Underwriting Officer has the ability to determine if the business meets the Company s overall desired risk profile. The Chief Underwriting Officer has defined underwriting authority for each underwriter, and risks outside of this authority must be referred to the Chief Underwriting Officer. The Underwriting Committee reviews business that is outside the authority of the Chief Underwriting Officer.

Talbot: Our risk review and control processes have been designed to ensure that all written risks comply with underwriting and risk control strategies. The various types of review are sequential in timing and emphasize the application of an appropriate level of scrutiny. A workflow system automates the referral of risks to relevant reviewers. These reviews are monitored and reports prepared on a regular basis.

Collectively, the various peer review procedures serve numerous objectives, including:

- Validating that underwriting decisions are in accordance with risk appetite, authorities, agreed business plans and standards for type, quality and profitability of risk.

- Providing an experienced and suitably qualified second review of individual risks, at times including independent third party review.

Ensuring that risks identified as higher risks undergo the highest level of technical underwriting review.

Elevating technical underwriting queries and/or need for remedial actions on a timely basis

Improving database accuracy and coding for subsequent management reporting

The principal elements of the underwriting review process are as follows:

Underwriter Review: The underwriter must evidence data entry review by confirming review and agreement on the workflow system within a specified number of working days of entry being completed by contracted third party.

Peer Review: Risks are peer reviewed by a peer review underwriter within a specified number of working days of data entry being completed. There is an agreed matrix of peer review underwriters who are authorized to peer review. Endorsements that increases exposure and are scanned into the workflow system also are subject to the current peer review procedures.

Class of business review: Risks written into a class by an underwriter other than the nominated class underwriter generally are forwarded to and reviewed by the nominated class underwriter.

Exceptions review: Risks that exceed a set of pre-determined criteria will also be referred to the Active Underwriter, the Underwriting Risk Officer or Underwriting Operations Officer for review. Such risks are discussed by the underwriters at regular underwriting meetings in the presence of at least one of the above. In certain circumstances, some risks may be referred to the Insurance Management Committee or the Talbot Underwriting Ltd (TUL) Board for final approval. These reviews also commonly include reports of risks renewed where there has been a large loss ratio in the recent past.

Insurance Management Committee: At its regular meetings, the Committee reviews a range of key performance indicators including: premium income written versus plan; movements in syndicate cash and investments; and aggregate exposures in the direct property account. The Committee also reviews claim movements over a financial threshold.

Expert Review Sub-committee (ERC): The ERC is a committee that meets regularly to review the underwriting activities of syndicate 1183 and other related activities to provide assurance that the underwriting risks assumed are within the parameters of the business plan. This is achieved with the help of four expert reviewers who report their findings to the ERC. The expert reviewers obtain and review a sample of risks underwritten in each class and report their findings to regular meetings of the ERC. Findings range from general comments on approach and processes to specific points in respect of individual risks.

The expert reviewers obtain and review a sample of risks underwritten in each class and report their findings to the quarterly meetings of the ERC. Findings range from general comments on approach and processes to specific points in respect of individual risks.

Risk Management

A pivotal factor in determining whether to found and fund the Company was the opportunity for differentiation based upon superior risk management expertise; specifically, managing catastrophe risk and optimizing our portfolio to generate attractive returns on capital while controlling our exposure to risk, and assembling a management team with the experience and expertise to do so. The Company s proprietary models are current with emerging scientific trends.

This has enabled the Company to gain a competitive advantage over those reinsurers who rely exclusively on commercial models for pricing and portfolio management. The Company has made a significant investment in expertise in the risk modeling area to capitalize on this opportunity. The Company has assembled an experienced group of professional experts who operate in an environment designed to allow them to use their expertise as a competitive advantage. While the Company uses both proprietary and commercial probabilistic models, risk is ultimately subject to absolute aggregate limitations based on risk levels determined by the Underwriting Committee of our Board of Directors.

Vendor Models: The Company has global licenses for all three major vendor models (RMS, AIR and EQECAT) to assess the adequacy of risk pricing and to monitor our overall exposure to risk in correlated geographic zones. The Company models property exposures that could potentially lead to an over-aggregation of property risks (i.e., catastrophe-exposed business) using the vendor models. The vendor models enable us to aggregate exposures by correlated event loss scenarios, which are probability-weighted. This enables the generation of exceedance probability curves for the portfolio and major geographic areas. Once exposures are modeled using one of the vendor models, the two other models are used as a reasonability check and validation of the loss scenarios developed and reported by the first. The underwriters generally compare the modeled outputs from all three models and apply their underwriting judgment to determine the most reliable modeled loss scenarios.

The three commercial models each have unique strengths and weaknesses. It is necessary to impose changes to frequency and severity ahead of changes made by the model vendors.

The Company s view of market practice revealed a number of areas where quantitative expertise can be used to improve the reliability of the vendor model outputs:

Ceding companies may often report insufficient data and many reinsurers may not be sufficiently critical in their analysis of this data. The Company generally scrutinizes data for anomalies that may indicate insufficient data quality. These circumstances are addressed by either declining the program or, if the variances are manageable, by modifying the model output and pricing to reflect insufficient data quality.

Prior to making overall adjustments for changes in climate variables, other variables are adjusted (for example, demand surge, storm surge, and secondary uncertainty).

Pricing individual contracts frequently requires further adjustments to the three vendor models. Examples include bias in damage curves for commercial structures and occupancies and frequency of specific perils.

In addition, many risks, such as second-event covers, aggregate excess of loss, or attritional loss components cannot be fully evaluated using the vendor models. In order to better evaluate and price these risks, the Company has developed proprietary analytical tools, such as VCAPS and other models and data sets.

Proprietary Models: In addition to making frequency and severity adjustments to the vendor model outputs, the Company has implemented proprietary pricing and risk management tool, VCAPS, to assist in pricing submissions and monitoring risk aggregation.

To supplement the analysis performed using vendor models VCAPS uses the gross loss output of catastrophe models to generate 100,000-year simulation set (vs. 10,000-year with certain vendor models), which is used for both pricing and risk management. This approach allows more precise measurement and pricing of exposures. The two primary benefits of this approach are:

VCAPS takes into account annual limits, event/franchise/annual aggregate deductibles, and reinstatement premiums. This allows for more accurate evaluation of treaties with a broad range of features, including both common (reinstatement premium and annual limits) and complex features (second or third event coverage, aggregate excess of loss, attritional loss components covers with varying attachment across different geographical zones or lines of businesses and covers with complicated structures).

VCAPS use of 100,000-year simulation enables robust pricing of catastrophe-exposed business. This is possible in real-time operation because the Company has designed a computing hardware platform and software environment to accommodate the significant computing needs.

In addition to VCAPS the Company uses other proprietary models and other data in evaluating exposures. The Company cannot assure that the models and assumptions used by the software will accurately predict losses. Further, the Company cannot assure that the software is free of defects in the modeling logic or in the software code. In addition, the Company has not sought copyright or other legal protection for VCAPS.

Program Limits: Overall exposure to risk is controlled by limiting the amount of reinsurance underwritten in a particular program or contract. This helps to diversify within and across risk zones. The Underwriting Committee sets these limits, which may be exceeded only with its approval.

Geographic Diversification: The Company actively manages our aggregate exposures by geographic or risk zone (zones) to maintain a balanced and diverse portfolio of underlying risks. The coverage the Company is willing to provide for any risk located in a particular zone is limited to a predetermined level, thus limiting the net aggregate loss exposure from all contracts covering risks believed to be located in any zone. Contracts that have worldwide territorial limits have exposures in several geographic zones. Generally, if a proposed reinsurance program would cause the limit to be exceeded, the program would be declined, regardless of its desirability, unless the Company buys retrocessional coverage, thereby reducing the net aggregate exposure to the maximum limit permitted or less.

	Year Ended December 31, 2007 Gross Premiums Written			
	Validus Re	Talbot(1)	Total(1)	%
United States	$ 342,502	$ 69,813	$ 412,315	29.8%
Worldwide excluding United States(2)	22,794	216,511	239,305	17.2%
Europe	44,266	64,490	108,756	7.8%
Latin America and Caribbean	7,218	30,900	38,118	2.7%
Japan	8,252	4,599	12,851	0.9%
Canada		8,351	8,351	0.6%
Sub-total, non United States	82,530	324,851	407,381	29.2%
Worldwide including United States(2)	103,997	60,204	164,201	11.8%
Marine and Aerospace(3)	173,069	232,857	405,926	29.2%
Total	$ 702,098	$ 687,725	$ 1,389,823	100.0%

(1) Talbot was acquired on July 2, 2007. Talbot s gross premium written for the full year ended December 31, 2007 has been presented above for informational purposes only and is not included within the consolidated results.

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

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

The effectiveness of geographic zone limits in managing risk exposure depends on the degree to which an actual event is confined to the zone in question and on the Company s ability to determine the actual location of the risks believed to be covered under a particular reinsurance program. Accordingly, there can be no assurance that risk exposure in any particular zone will not exceed that zone s limits. Further diversification is achieved through guidelines covering the types and amounts of business written in product classes and lines within a class.

Validus Re Ceded Reinsurance: Validus Re monitors the opportunity to purchase retrocessional coverage based on pricing and other market conditions. This coverage may be purchased on an indemnity basis as well as on an industry basis (i.e., industry loss warranties). Validus Re also considers alternative retrocessional structures, including capital markets products, if the structures offer effective income statement or balance sheet protection.

When Validus Re buys retrocessional coverage on an indemnity basis, payment is for an agreed upon portion of the losses actually suffered. In contrast, when Validus Re buys an industry loss warranty cover, which is a reinsurance contract in which the payout is dependent on both the insured loss of the policy purchaser and the measure of the industry-wide loss, payment is made only if both Validus Re and the industry suffer a loss, as reported by one of a number of independent agencies, in excess of specified threshold amounts. With an industry loss warranty, Validus Re bears the risk of suffering a loss while receiving no payment because the industry loss was less than the specified threshold amount.

Validus Re may use capital markets instruments for risk management in the future (e.g., catastrophe bonds, further sidecar facilities and other forms of risk securitization) where the pricing and terms are attractive.

Talbot Ceded Reinsurance: Talbot enters into reinsurance agreements in order to mitigate its accumulation of loss, reduce its liability on individual risks and enable it to underwrite policies with higher limits. The ceding of the insurance does not legally discharge Talbot from its primary liability for the full amount of the policies, and

Talbot is required to pay the loss and bear collection risk if the reinsurer fails to meet its obligations under the reinsurance agreement.

The following describes the Talbot group s process in the purchase and authorization of excess of loss policies only. It does not cover the purchase of quota share and facultative business because these premiums are not significant.

In September before the start of the covered period, the currently active reinsurance program (i.e. the reinsurance currently in use) is reviewed by the Chief Executive Officer of Talbot and modified to create a first draft of the reinsurance program that will incept during the following year (predominantly on the January renewals).

The review and modification is based upon the following:

- budgeted underwriting for the coming year;
- loss experience from prior years;
- loss information from the coming year s individual capital assessment calculations;
- changes to risk limits and aggregation limits either expected or enforced and any other changes to Talbot s risk tolerance;
- scenario planning;
- changes to capital requirements; and,
- Realistic Disaster Scenarios (RDSs) prescribed by Lloyd s.

The main type of reinsurance purchased is losses occurring; however, for a few lines of business, where the timing of the loss event is less easily verified or where such cover is available, risk attaching policies are purchased.

The proposed reinsurance program is discussed and amended by the Insurance Management Committee, and the TUL board; they together define at least the type, quantity and cost of cover.

Once this has occurred, the reinsurance program is bought in the months running up until the beginning of the covered period. All reinsurance contracts arranged are reviewed by the relevant underwriters to ensure that the cover provided is adequate and authorized before being ordered.

Distribution

Business is derived primarily through insurance and reinsurance intermediaries (brokers), who access business from clients and coverholders. We are able to attract business through our recognized lead capability in each class we underwrite, particularly in classes where such lead ability is rare.

Currently, our largest broker relationships, as measured by gross premiums written, are with Marsh & McLennan Companies, Inc./Guy Carpenter & Co., Willis Group Holdings Ltd., Aon Corporation and Benfield Group Ltd. The following table sets forth the Company s gross premiums written by broker:

Year Ended December 31, 2007

	Gross Premiums Written			
Name of Broker	**Validus Re**	**Talbot(1)**	**Total(1)**	**%**
Marsh Inc./Guy Carpenter & Co.	$ 272,569	$ 100,613	$ 373,182	26.9%
Willis Group Holdings Ltd.	135,406	83,414	218,820	15.7%
Aon Corporation	120,840	89,423	210,263	15.1%
Benfield Group Ltd.	96,391	32,693	129,084	9.3%
Sub-total	625,206	306,143	931,349	67.0%
All Others	76,892	381,582	458,474	33.0%
Total	$ 702,098	$ 687,725	$ 1,389,823	100.0%

(1) Talbot was acquired on July 2, 2007. Talbot s gross premium written for the full year ended December 31, 2007 has been presented above for informational purposes only and is not included within the consolidated results.

Reserve for losses and loss expenses

For insurance and reinsurance companies, the most significant judgment made by management is the estimation of the reserve for losses and loss expenses. The Company establishes its reserve for losses and loss expenses to cover the estimated incurred liability for both reported and unreported claims. The Company s acquisition of Talbot substantially increased carried reserves effective in the third quarter of 2007.

The following tables show certain information with respect to the Company s reserves:

	At December 31, 2007		
	Gross Case Reserves	Gross IBNR	Total Gross Reserve for Losses and Loss Expenses
	(Dollars in thousands)		
Property	$ 162,122	$ 137,388	$ 299,510
Marine	236,703	168,490	405,193
Specialty	64,546	156,868	221,414
Total	$ 463,371	$ 462,746	$ 926,117

	At December 31, 2007		
	Net Case Reserves	Net IBNR	Total Net Reserve for Losses and Loss Expenses
	(Dollars in thousands)		
Property	$ 148,838	$ 135,232	$ 284,070
Marine	155,161	150,180	305,341
Specialty	59,596	142,706	202,302
Total	$ 363,595	$ 428,118	$ 791,713

Validus Re: Validus Re s loss reserves are established based upon an estimate of the total cost of claims that have been incurred, including estimates of unpaid liability on known individual claims (case reserves), the costs of additional case reserves on claims reported but not considered to be adequately reserved in such reporting (ACRs) and amounts that have been incurred but not yet reported (IBNR). ACRs are calculated based on management s estimate of the required case reserve on an individual claim less the amounts reported by the client (paid and case reserves).

U.S. GAAP does not permit the establishment of loss reserves until an event occurs that gives rise to a loss.

For reported losses, Validus Re establishes case reserves within the parameters of the coverage provided in the reinsurance contracts. Where there is a reported claim for which the reported case reserve is determined to be insufficient, Validus Re may book an ACR or individual claim IBNR estimate that is adjusted as claims notifications are received. Validus Re estimates IBNR using generally accepted actuarial techniques. Validus Re also uses historical insurance industry loss emergence patterns, as well as estimates of future trends in claims severity, frequency and other factors, to aid us in establishing loss reserves.

Loss reserves represent estimates, including actuarial and statistical projections at a given point in time, of the expectations of the ultimate settlement and administration costs of claims incurred. Such estimates are not precise in that, among other things, they are based on predictions of future developments and estimates of future trends in loss severity and frequency and other variable factors such as inflation, litigation and tort reform. This uncertainty is heightened by the short time in which Validus Re has operated, thereby providing limited claims loss emergence patterns that directly pertain to Validus Re s operations. This has necessitated the use of industry loss emergence patterns in deriving IBNR, which despite management s and our actuaries care in selecting them, will differ from actual experience. Further, expected losses and loss ratios are typically developed using vendor and proprietary computer models and these expected loss ratios are a significant component in the calculation deriving IBNR. As a result of these uncertainties, it is likely that the ultimate liability will differ from such estimates, perhaps significantly.

Loss reserves are reviewed regularly and adjustments to reserves, if any, will be recorded in earnings in the period in which they are determined. Even after such adjustments, the ultimate liability may exceed or be less than the revised estimates.

Talbot: Talbot s loss reserves are established based upon an estimate of the total cost of claims that have been incurred, including case reserves and IBNR. Ultimate losses are generally calculated via direct projection, and as such ACRs are not generally used.

Talbot performs internal assessments of liabilities on a quarterly basis. Talbot s loss reserving process initially involves the assessment of actuarial estimates of gross ultimate losses, split by underwriting year and class of business, and generally also between attritional, large and catastrophe losses. These estimates are made using a variety of generally accepted actuarial projection methodologies, as well as additional qualitative consideration of future trends in frequency, severity and other factors. The gross estimates are used to estimate ceded reinsurance recoveries, which are in turn used to calculate net ultimate premiums and ultimate losses as the difference between gross and ceded. These figures are subsequently used by Talbot s management to help it assess its best estimate of the full underwriting year gross and net ultimate losses. The final selected estimate is then translated from a full underwriting year basis to an earned basis, first on an inception-to-date basis from which earned movements are calculated.

As with Validus Re, Talbot s loss reserves represent estimates, including actuarial and statistical projections at a given point in time, of the expectations of the ultimate settlement and administration costs of claims incurred. Such estimates are not precise in that, among other things, they are based on predictions of future developments and estimates of future trends in loss severity and frequency and other variable factors such as inflation, litigation and tort reform. As a result of these uncertainties, it is likely that the ultimate liability will differ from such estimates, perhaps significantly.

Talbot s loss reserves are reviewed regularly and adjustments to reserves, if any, will be recorded in earnings in the period in which they are determined. Even after such adjustments, the ultimate liability may exceed or be less than the revised estimates.

Claims Management

Claims management includes the receipt of initial loss notifications, generation of appropriate responses to claim reports, identification and handling of coverage issues, determination of whether further investigation is required and, where appropriate retention of legal representation, establishment of case reserves, approval of loss payments and notification to reinsurers.

Validus Re: As a result of our short operating history and the relatively low level of catastrophic events in 2006 and 2007, we have not experienced a high volume of claims to date. The role of our claims department is to investigate, evaluate and pay claims efficiently. Our claims director has implemented claims handling guidelines, reporting and control procedures. The primary objectives of the claims department are to ensure that each claim is addressed, evaluated and processed and appropriately documented in a timely and efficient manner and information relevant to the management of the claim is retained.

Talbot: Where Talbot is a leading syndicate on business written, the claims adjusters will deal with the broker representing the insured. This may involve appointing attorneys, loss adjusters or other experts. The central Lloyd s market claims bureau will respond on behalf of follow syndicates.

Where Talbot is not the lead underwriter on the business, the case reserves are established by the lead underwriter in conjunction with third party/bureau input who then advise movements in loss reserves to all syndicates participating on the risk. Material claims and claims movements are subject to review by Talbot.

Table of Contents

Investments

The Company manages its investment portfolio on a consolidated basis. As we provide short-tail insurance and reinsurance coverage, we could become liable to pay substantial claims on short notice. Accordingly, we follow a conservative investment strategy designed to emphasize the preservation of invested assets and provide sufficient liquidity for the prompt payment of claims. Our Board of Directors, including our Finance Committee, oversees our investment strategy, and in consultation with BlackRock Financial Management, Inc. and Goldman Sachs Asset Management, our portfolio advisors, has established investment guidelines. The investment guidelines dictate the portfolio s overall objective, benchmark portfolio, eligible securities, duration, use of derivatives, inclusion of foreign securities, diversification requirements and average portfolio rating. The Board periodically reviews these guidelines in light of our investment goals and consequently they may change at any time. We also have entered into a securities lending agreement under which we loan certain fixed income securities to third parties and receive collateral, primarily in the form of cash. The collateral received is reinvested and is reflected as a short-term investment.

Substantially all of the fixed maturity investments held at December 31, 2007 were publicly traded. The average duration of the Company s fixed maturity portfolio was 2.00 years (December 31, 2006 and 2005: 0.9 and 0.56 years). At the time of formation, management determined that it would emphasize capital preservation for the Validus Re portfolio and maintain a significant allocation of short-term investments. In the fourth quarter of 2007 we modified the benchmarks against which we measure our investment managers performance. The previous benchmarks had assigned equal weightings to (a) the Lehman 1-5 year government and high quality bond index and (b) the Lehman 3 month treasury bill index. By the end of the year, we had eliminated the Lehman 3 month treasury bill index component of the benchmark. As a result, the duration of the benchmark portfolio against which we measure our investment managers against extended from approximately 1.30 years to approximately 2.36 years. The average rating of the portfolio was AAA (December 31, 2006 and 2005: AA+ and AAA), of which $2,029.6 million or 84.2% (December 31, 2006 and 2005: $644.1 million and $192.6 million) were rated AAA, at December 31, 2007.

Financial Strength Ratings

Validus Re: Validus Re s ability to underwrite business is dependent upon the quality of claims paying and financial strength ratings as evaluated by independent rating agencies. Validus Re was assigned a rating of A− (Excellent) by A.M. Best Company in December 2005 (which was affirmed by A.M. Best on August 29, 2007). Ratings are not an evaluation directed to investors in the Company s securities or a recommendation to buy, sell or hold the Company s securities. Ratings may be revised or revoked at the sole discretion of A.M. Best or S & P. In the normal course of business, the Company evaluates its capital needs to support the volume of business written in order to maintain claims paying and financial strength ratings. Financial information is regularly provided to rating agencies to both maintain and enhance existing ratings. In the event of a downgrade below A− (Excellent), the Company believes its ability to write business would be materially adversely affected.

Syndicate 1183 at Lloyd s of London: All Lloyd s syndicates benefit from Lloyd s central resources, including the Lloyd s brand, its network of global licenses and the Central Fund. The Central Fund is available at the discretion of the Council of Lloyd s to meet any valid claim that cannot be met by the resources of any member. As all Lloyd s policies are ultimately backed by this common security, a single market rating can be applied. Lloyd s as a market is rated as follows:

AM Best	A	Excellent	Stable outlook
Fitch Ratings	A+	Strong	Stable outlook
Standard & Poor s	A+	Strong	Stable outlook

The syndicate benefits from these ratings and the Company believes that ratings impairments below A- would materially impair the syndicate s ability to write business.

Table of Contents

Competition

The insurance and reinsurance industries are highly competitive. We compete with major U.S., Bermuda, European and other international insurers and reinsurers and certain underwriting syndicates and insurers. We suffer competition in all of our classes of business but there is less competition in those of our lines where we are a specialist underwriter. The Company competes with insurance and reinsurance providers such as;

ACE Tempest Re, Allied World Assurance Company Holdings Limited, Arch Capital Group Limited, AXIS Capital Holdings Limited, Endurance Specialty Holdings Limited, Everest Re Group Limited, Flagstone Reinsurance Holdings Group Limited, IPC Holdings Limited, Lloyd s of London syndicates, Munich Re, PartnerRe Ltd., Platinum Underwriters Holdings Ltd., Renaissance Reinsurance Holdings Ltd., Swiss Re and XL Re;

Amlin plc, Aspen Insurance Holdings Limited, Catlin Group Limited, Hiscox and others in the Lloyd s market;

Direct insurers who compete with Lloyd s on a worldwide basis;

Various capital markets participants who access insurance and reinsurance business in securitized form, through special purpose entities or derivative transactions;

Government-sponsored insurers and reinsurers.

Competition varies depending on the type of business being insured or reinsured and whether the Company is in a leading or successive position. Competition in the types of business that the Company underwrites is based on many factors, including:

Premiums charged and other terms and conditions offered;

Services provided;

Financial ratings assigned by independent rating agencies;

Speed of claims payment;

Reputation;

Perceived financial strength; and

The experience of the underwriter in the line of insurance or reinsurance written.

Increased competition could result in fewer submissions, lower premium rates, lower share of alloted cover, and less favorable policy terms, which could adversely impact the Company s growth and profitability. Capital market participants have created alternative products such as catastrophe bonds that are intended to compete with reinsurance products. The Company is unable to predict the extent to which these new, proposed or potential initiatives may affect the demand for products or the risks that may be available to consider underwriting.

Regulation

United States

Talbot operates primarily within the Lloyd s insurance market through Syndicate 1183, and Lloyd s operations are subject to regulation in the United States in addition to being regulated in the United Kingdom, as discussed below. The Lloyd s of London market is licensed to engage in insurance business in Illinois, Kentucky and the U.S. Virgin Islands and operates as an eligible excess and surplus lines insurer in all states and territories except Kentucky and the U.S. Virgin Islands. Lloyd s is also an accredited reinsurer in all states and territories of the United States. Lloyd s maintains various trust funds in the state of New York to protect its United States business and is therefore subject to regulation by the New York Insurance Department, which acts as the domiciliary department for Lloyd s U.S. trust funds. There are deposit trust funds in other states to support Lloyd s reinsurance and excess and surplus lines insurance business.

Talbot is subject to a Closing Agreement between Lloyd s and the U.S. Internal Revenue Service pursuant to which Talbot is subject to U.S. federal income tax to the extent its income is attributable to U.S. agents who have authority to bind Talbot. Specifically, U.S. federal income tax is imposed on 35% of its income attributable to U.S. binding authorities (70% for Illinois or Kentucky business).

We currently conduct our business in a manner such that we expect that Validus Re will not be subject to insurance and/or reinsurance licensing requirements or regulations in the United States. Although we do not currently intend for Validus Re to engage in activities which would require it to comply with insurance and reinsurance licensing requirements in the United States, should we choose to engage in activities that would require Validus Re to become licensed in the United States, we cannot assure you that we will be able to do so or to do so in a timely manner. Furthermore, the laws and regulations applicable to direct insurers could indirectly affect us, such as collateral requirements in various U.S. states to enable such insurers to receive credit for reinsurance ceded to us.

In addition, the insurance and reinsurance regulatory framework of Bermuda and the insurance of U.S. risk by companies based in Bermuda and not licensed or authorized in the United States recently has become subject to increased scrutiny in many jurisdictions, including the United States. We are not able to predict the future impact on the Company s operations of changes in the laws and regulation to which we are or may become subject.

United Kingdom

The financial services industry in the UK is regulated by the Financial Services Authority (FSA). The FSA is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. Although accountable to treasury ministers and through them to Parliament, it is funded entirely by the firms it regulates. The FSA has wide ranging powers in relation to rule-making, investigation and enforcement to enable it to meet its four statutory objectives, which are summarized as one overall aim: to promote efficient, orderly and fair markets and to help retail consumers achieve a fair deal .

In relation to insurance business, the FSA regulates insurers, insurance intermediaries and Lloyd s itself. The FSA and Lloyd s have common objectives in ensuring that Lloyd s market is appropriately regulated and, to minimize duplication, the FSA has agreed arrangements with Lloyd s for co-operation on supervision and enforcement.

Talbot s underwriting activities are therefore regulated by the FSA as well as being subject to the Lloyd s franchise . Both FSA and Lloyd s have powers to remove their respective authorization to manage Lloyd s syndicates. Lloyd s approves annually Syndicate 1183 s business plan and any subsequent material changes, and the amount of capital required to support that plan. Lloyd s may require changes to any business plan presented to it or additional capital to be provided to support the underwriting (known as Funds as Lloyd s).

In addition, Talbot s small intermediary company, Underwriting Risk Services Ltd. is regulated by the FSA as an insurance intermediary.

In November 2007 Talbot established Talbot Risk Services Pte Ltd in Singapore to source business in the Far East under the Lloyd s Asia Scheme. The Lloyds Asia Scheme was established by the Monetary Authority of Singapore to encourage members of Lloyd s to expand insurance activities in Asia.

Bermuda

Bermuda Insurance Regulation: Bermuda s Insurance Act 1978, as amended, and related regulations (the Insurance Act), which regulates the business of Validus Re and Talbot Insurance (Bermuda) Ltd (TIBL), provides that no person shall carry on an insurance or reinsurance business in or from within Bermuda unless registered as an insurer under the Insurance Act by the BMA. Generally, in Bermuda there is no difference in the regulation of insurance and reinsurance. The BMA, in deciding whether to grant registration, has broad discretion to act in the public interest. The Insurance Act requires the BMA to determine whether the applicant is a fit and proper body to be engaged in the insurance business and, in particular, whether it has, or has available to it, adequate knowledge and expertise. The registration of an applicant as an insurer is subject to its complying with the terms of its registration and such other conditions as the BMA may impose at any time.

Table of Contents

The Insurance Act also grants to the BMA powers to supervise, investigate and intervene in the affairs of insurance companies.

An Insurance Advisory Committee appointed by the Bermuda Minister of Finance advises the BMA on matters connected with the discharge of the BMA s functions and subcommittees thereof supervise, investigate and review the law and practice of insurance in Bermuda, including reviews of accounting and administrative procedures.

The Insurance Act imposes on Bermuda insurance companies solvency and liquidity standards, as well as auditing and reporting requirements. Certain significant aspects of the Bermuda insurance regulatory framework are set forth below.

Classification of Insurers: The Insurance Act distinguishes between insurers carrying on long-term business and insurers carrying on general business. There are four classifications of insurers carrying on general business, with Class 4 insurers subject to the strictest regulation. As Validus Re has been incorporated to carry on general insurance and reinsurance business, including property catastrophe reinsurance, it has been registered as a Class 4 insurer in Bermuda and is regulated as such under the Insurance Act. Validus Re is not licensed to carry on long-term business. Long-term business broadly includes life insurance and disability insurance with terms in excess of five years. General business broadly includes all types of insurance that is not long-term business.

TIBL has been incorporated to carry on general insurance and reinsurance business, excluding excess liability and property catastrophe reinsurance. TIBL is not licensed to carry on long-term business. TIBL is registered as a Class 3 insurer in Bermuda and is regulated as such under the Insurance Act.

Cancellation of Insurer s Registration: An insurer s registration may be cancelled by the BMA on certain grounds specified in the Insurance Act. Failure of the insurer to comply with its obligations under the Insurance Act or if the BMA believes that the insurer has not been carrying on business in accordance with sound insurance principles, would be such grounds.

Principal Representative: An insurer is required to maintain a principal office in Bermuda and to appoint and maintain a principal representative in Bermuda. For the purpose of the Insurance Act, Validus Re s principal office is its executive offices in 19 Par-la-Ville Road, Hamilton HM 11, Bermuda, and its principal representative is Joseph E. (Jeff) Consolino, the Company s Chief Financial Officer. TIBL s principal office is 19 Par-la-Ville Road, Hamilton HM 11, Bermuda, and its principal representative is C. Jerome Dill, the Company s General Counsel. Without a reason acceptable to the BMA, an insurer may not terminate the appointment of its principal representative, and the principal representative may not cease to act as such, unless 30 days notice in writing to the BMA is given of the intention to do so. It is the duty of the principal representative to forthwith notify the BMA when the principal representative believes there is a likelihood of the insurer (for which the principal representative acts) becoming insolvent or that a reportable event has, to the principal representative s knowledge, occurred or is believed to have occurred. Examples of such a reportable event include failure by the insurer to comply substantially with a condition imposed upon the insurer by the BMA relating to a solvency margin or a liquidity or other ratio. Within 14 days of such notification to the BMA, the principal representative must furnish the BMA with a written report setting out all the particulars of the case that are available to the principal representative.

Independent Approved Auditor: Every registered insurer must appoint an independent auditor who will annually audit and report on the statutory financial statements and the statutory financial return of the insurer. Validus Re and TIBL are required to file their statutory financial statements and statutory financial returns annually with the BMA. The independent auditor of the insurer must be approved by the BMA and may be the same person or firm that audits the insurer s consolidated financial statements and reports for presentation to its shareholders. Validus Re s and TIBL s independent auditor is PricewaterhouseCoopers, which also audits the consolidated financial statements of the

Company.

Loss Reserve Specialist: As Class 3 and 4 insurers, TIBL and Validus Re are required to submit an opinion of approved loss reserve specialist with their statutory financial selected returns in respect of their losses and loss expenses provisions. Loss reserve specialists will normally be a qualified actuary and must be approved by the BMA. Andrew E. Kudera (FCAS, MAAA, ASA, FCIA), a qualified actuary, has been approved by the BMA as

Validus Re s loss reserve specialist. Paul Murray (MA FIA) has been approved by the BMA as TIBL s loss reserve specialist.

Annual Statutory Financial Statements: An insurer must prepare annual statutory financial statements. The Insurance Act prescribes rules for the preparation and substance of such statutory financial statements (which include, in statutory form, a balance sheet, income statement, statement of capital and surplus, and notes thereto). The insurer is required to give detailed information and analysis regarding premiums, claims, reinsurance and investments. The statutory financial statements are not prepared in accordance with U.S. GAAP. They are distinct from the financial statements prepared for presentation to the insurer s shareholders under the Companies Act 1981 of Bermuda, which may be prepared in accordance with U.S. GAAP. An insurer is required to submit the annual statutory financial statements as part of the annual statutory financial return. The statutory financial statements and the statutory financial return do not form part of the public records maintained by the BMA or the Registrar of Companies.

Annual Statutory Financial Return: Validus Re and TIBL are required to file with the BMA a statutory financial return no later than four months after its financial year end (unless specifically extended). The statutory financial return includes, among other matters, a report of the approved independent auditor on the statutory financial statements of the insurer, a general business solvency certificate, the statutory financial statements themselves and the opinion of the loss reserve specialist. The principal representative and at least two directors of the insurer must sign the solvency certificate. The directors are required to certify whether the minimum solvency margin has been met, and the independent approved auditor is required to state whether in its opinion it was reasonable for the directors to so certify. Where an insurer s accounts have been audited for any purpose other than compliance with the Insurance Act, a statement to that effect must be filed with the statutory financial return.

Minimum Solvency Margin and Restrictions on Dividends and Distributions: The Insurance Act provides that the statutory assets of an insurer must exceed its statutory liabilities by an amount greater than the prescribed minimum solvency margin.

Validus Re is registered as a Class 4 insurer in Bermuda and as such:

1. Validus Re is required to maintain a minimum statutory capital and surplus equal to the greatest of:

(A) $100,000,000,

(B) 50% of its net premiums written for general business that year (being gross premiums written less any premiums ceded for reinsurance, provided they do not exceed 25% of gross premiums written), and

(C) 15% of its net loss and loss expense provisions and other insurance reserves;

2. Validus Re is prohibited from declaring or paying any dividends during any financial year if it is in breach of its minimum solvency margin or minimum liquidity ratio or if the declaration or payment of such dividends would cause it to fail to meet such margin or ratio (if it has failed to meet its minimum solvency margin or minimum liquidity ratio on the last day of any financial year, the insurer will be prohibited, without the approval of the BMA, from declaring or paying any dividends during the next financial year);

3. Validus Re is prohibited from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous statutory balance sheet) unless it files with the BMA an affidavit stating that it will continue to meet the required margins;

4. Validus Re is prohibited, without the approval of the BMA, from reducing by 15% or more its total statutory capital, as set out in its previous year s financial statements and any application for such approval must include an affidavit stating that it will continue to meet the required margins; and

5. Validus Re is required, at any time it fails to meet its solvency margin, within 30 days (45 days where total statutory capital and surplus falls to $75 million or less) after becoming aware of that failure or having reason to believe that such failure has occurred, to file with the BMA a written report containing certain information.

Table of Contents

TIBL is registered as a Class 3 insurer in Bermuda and as such is required to maintain a minimum statutory capital and surplus equal to the greatest of:

(A) $1,000,000,

(B) 20% of its first $6,000,000 of premiums and 15% of premiums in excess of $6,000,000, and

(C) 15% of its net loss and loss expense provisions and other insurance reserves.

Minimum Liquidity Ratio: The Insurance Act provides a minimum liquidity ratio for general business. An insurer engaged in general business is required to maintain the value of its relevant assets at not less than 75% of the amount of its relevant liabilities.

> Relevant assets include cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, accounts and premiums receivable and reinsurance balances receivable. There are certain categories of assets which, unless specifically permitted by the BMA, do not automatically qualify as relevant assets, such as unquoted equity securities, investments in and advances to affiliates and real estate and collateral loans.
>
> The relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax and sundry liabilities (by interpretation, those not specifically defined).

Supervision, Investigation and Intervention: The BMA may appoint an inspector with extensive powers to investigate the affairs of an insurer if the BMA believes that such an investigation is in the best interests of its policyholders or persons who may become policyholders. In order to verify or supplement information otherwise provided to the BMA, the BMA may direct an insurer to produce documents or information relating to matters connected with its business.

If it appears to the BMA that there is a risk of an insurer becoming insolvent, or that it is in breach of the Insurance Act or any conditions imposed upon its registration, the BMA may, among other things, direct the insurer (1) not to take on any new insurance business, (2) not to vary any insurance contract if the effect would be to increase its liabilities, (3) not to make certain investments, (4) to realize certain investments, (5) to maintain or transfer to the custody of a specified bank, certain assets, (6) not to declare or pay any dividends or other distributions or to restrict the making of such payments and/or (7) to limit its premium income.

Disclosure of Information: In addition to powers under the Insurance Act to investigate the affairs of an insurer, the BMA may require certain information from an insurer (or certain other persons) to be provided to the BMA. Further, the BMA has been given powers to assist other regulatory authorities, including foreign insurance regulatory authorities, with their investigations involving insurance and reinsurance companies in Bermuda subject to certain restrictions. For example, the BMA must be satisfied that the assistance being requested is in connection with the discharge of regulatory responsibilities of the foreign regulatory authority. Further, the BMA must consider whether cooperation is in the public interest. The grounds for disclosure are limited and the Insurance Act provides sanctions for breach of the statutory duty of confidentiality.

Notification by Shareholder Controller of New or Increased Control: Any person who, directly or indirectly, becomes a holder of at least 10 percent, 20 percent, 33 percent or 50 percent of our common shares must notify the BMA in writing within 45 days of becoming such a holder or 30 days from the date they have knowledge of having such a holding, whichever is later. The BMA may, by written notice, object to such a person if it appears to the BMA that the person is not fit and proper to be such a holder. The BMA may require the holder to reduce its holding of common shares in the Company and direct, among other things, that voting rights attaching to the common shares shall not be exercisable. A person that does not comply with such a notice or direction from the BMA will be guilty of an offense.

Objection to Existing Shareholder Controller: For so long as the Company has as subsidiaries insurers such as Validus Re and TIBL registered under the Insurance Act, the BMA may at any time, by written notice, object to a person holding 10 percent or more of the Company s common shares if it appears to the BMA that the person is not or is no longer fit and proper to be such a holder. In such a case, the BMA may require the shareholder to reduce its holding of common shares in the Company and direct, among other things, that such shareholder s voting rights attaching to the common shares shall not be exercisable. A person who does not comply with such a notice or direction from the BMA will be guilty of an offense.

Bermuda Companies Act: Under the Companies Act, a Bermuda company may not declare and pay a dividend or make a distribution out of contributed surplus as defined under the Companies Act, if there are reasonable grounds for believing that such company is, and after the payment will be, unable to pay its liabilities as they become due or that the realizable value of such company s assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. The Companies Act also regulates and restricts the reduction and return of capital and paid-in share premium, including repurchase and redemption of shares, and imposes minimum issued and outstanding share capital requirements.

Certain Other Bermuda Law Considerations: Although we are incorporated in Bermuda, we are classified as a non-resident of Bermuda for exchange control purposes by the BMA. Pursuant to our non-resident status, we may engage in transactions in currencies other than Bermuda dollars and there are no exchange control restrictions on our ability to transfer funds, other than funds denominated in Bermuda dollars, inside and outside of Bermuda or to pay dividends to U.S. residents that are holders of our common shares.

Under Bermuda law, exempted companies, meaning companies that are exempted from certain provisions of Bermuda law that stipulate that at least 60% of a particular company s equity must be beneficially owned by Bermudians, are companies formed for the purpose of conducting business outside Bermuda from a principal place of business in Bermuda. As an exempted company, we may not, except pursuant to a license or consent granted by the Minister of Finance, participate in certain business or other transactions, including: (1) the acquisition or holding of land in Bermuda, except for land that is held by way of lease or tenancy agreement, is required for its business and is held for a term not exceeding 50 years, or that is used to provide accommodation or recreational facilities for our officers and employees and held with the consent of the Bermuda Minister of Finance for a term not exceeding 21 years, (2) the taking of mortgages on land in Bermuda to secure a principal amount in excess of $50,000, unless the Minister of Finance consents to such higher amount, and (3) the carrying on of business of any kind or type for which we are not duly licensed in Bermuda, except in certain limited circumstances, such as doing business with another exempted undertaking in furtherance of our business carried on outside Bermuda.

We are not currently subject to taxes computed on profits or income or computed on any capital asset, gain or appreciation. Bermuda companies pay, as applicable, annual government fees, business fees, payroll tax and other taxes and duties. See Certain Tax Considerations.

Special considerations apply to our Bermuda operations. Under Bermuda law, non-Bermudians, other than spouses of Bermudians and individuals holding permanent resident certificates or working resident certificates, are not permitted to engage in any gainful occupation in Bermuda without a work permit issued by the Bermuda government. A work permit is granted or extended only if an employer can show that, after a proper public advertisement, no Bermudian, spouse of a Bermudian or individual holding a permanent resident certificate is available who meets the minimum standards for the relevant position. The Bermuda government has announced a policy that places a six-year term limit on individuals with work permits, subject to specified exemptions for persons deemed key employees. Currently, all of our Bermuda-based professional employees who require work permits have been granted permits by the Bermuda government.

Employees

The following table details our personnel by geographic location as at December 31, 2007:

Location	Validus Re	Talbot	Corporate	Total	%
London, England		154		154	67.6%
Hamilton, Bermuda	52		5	57	25.0%
Waterloo, Canada	11			11	4.8%
Singapore City, Singapore		3		3	1.3%
Miami, United States	3			3	1.3%
Total	66	157	5	228	100.0%

We believe our relations with our employees are excellent.

Available Information

The Company files periodic reports, proxy statements and other information with the Securities and Exchange Commission (SEC). The public may read and copy any materials filed with the SEC at the SEC s Public Reference Room at 100 F Street, NE., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC s website address is http://www.sec.gov. The Company s common shares are traded on the NYSE with the symbol VR . Similar information concerning the Company can be reviewed at the office of the NYSE at 20 Broad Street, New York, New York, 10005. The Company s website address is http://www.validusre.bm. Information contained in this website is not part of this report.

The Company s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the U.S. Securities Exchange Act of 1934 (the Exchange Act) are available free of charge, including through our website, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. Copies of the charters for the audit committee, the compensation committee, the corporate governance and nominating committee, the finance committee and the underwriting committee, as well as the Company s Corporate Governance Guidelines, Code of Business Conduct and Ethics for Directors, Officers and Employees, which applies to all of the Company s Directors, officers and employees, and Code of Ethics for Senior Officers, which applies to the Company s principal executive officer, principal accounting officer and other persons holding a comparable position, are available free of charge on the Company s website at www.validusre.bm or by writing to Investor Relations, Validus Holdings, Ltd., 19 Par-La-Ville Road, Hamilton HM11 Bermuda. The Company will also post on its website any amendment to the Code and any waiver of the Code granted to any of its directors or executive officers to the extent required by applicable rules.

Item 1A. ***Risk Factors***

Risks Related to Our Company

We have a limited operating history and our historical financial results do not accurately indicate our future performance.

Validus Re was formed in October 2005 and was fully operational by December 2005. Talbot was formed in 2002. We, therefore, have a limited operating and financial history. Validus Re began underwriting with risks attaching no earlier than January 1, 2006. It has been reported that among the last 20 years, 2006 has produced the third-lowest level of insured losses, after 1997 and 1988. As of December 31, 2007, Validus Re has not experienced any catastrophe events such as those experienced by the industry in 2004 and 2005. Talbot experienced losses in 2004 and 2005 but was formed following the events of September 11, 2001 thus had no exposure to losses prior to 2002. As a result, we cannot provide assurances as to how our business model or risk controls would respond to such events. There is limited historical financial and operating information available to help evaluate our past performance or make a decision about an investment in our common shares. As a recently formed company, we face substantial business and financial risks and may suffer significant losses. As a result of these risks, it is possible that we may not be successful in the continued implementation of our business strategy or completing the development of the infrastructure necessary to run our business.

In addition, particularly as a recently formed company, our business strategy may change and may be affected by acquisitions, joint venture or other business, investment and/or growth opportunities that may, in the future, become available to us or that we may pursue. In the future, we may pursue investments in or acquisitions of companies complementary to our business. There can be no assurance that any such investments or acquisitions will occur, or if such investments or acquisitions do occur, that they will be on terms favorable to us.

Table of Contents

Claims on policies written under our short-tail insurance lines that arise from unpredictable and severe catastrophic events could adversely affect our financial condition or results of operations.

Substantially all of our gross premiums written to date are in short-tail lines, which means we could become liable for a significant amount of losses in a brief period. Short-tail policies expose us to claims arising out of unpredictable natural and other catastrophic events, such as hurricanes, windstorms, tsunamis, severe winter weather, earthquakes, floods, fires, explosions, acts of terrorism and other natural and man-made disasters. Many observers believe that the Atlantic basin is in the active phase of a multi-decade cycle in which conditions in the ocean and atmosphere, including warmer-than-average sea-surface temperatures and low wind shear, enhance hurricane activity. This increase in the number and intensity of tropical storms and hurricanes can span multiple decades (approximately 20 to 30 years). These conditions may translate to a greater potential for hurricanes to make landfall in the U.S. at higher intensities over the next five years. The frequency and severity of catastrophes are inherently unpredictable.

The extent of losses from catastrophes is a function of both the number and severity of the insured events and the total amount of insured exposure in the areas affected. Increases in the value and concentrations of insured property, the effects of inflation and changes in cyclical weather patterns may increase the severity of claims from catastrophic events in the future. Claims from catastrophic events could reduce our earnings and cause substantial volatility in our results of operations for any fiscal quarter or year, which could adversely affect our financial condition, possibly to the extent of eliminating our shareholders equity. Our ability to write new reinsurance policies could also be affected as a result of corresponding reductions in our capital.

Underwriting is inherently a matter of judgment, involving important assumptions about matters that are unpredictable and beyond our control, and for which historical experience and probability analysis may not provide sufficient guidance. One or more catastrophic or other events could result in claims that substantially exceed our expectations and which would become due in a short period of time, which could materially adversely effect our financial condition, liquidity or results of operations.

Emerging claim and coverage issues could adversely affect our business.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have issued reinsurance contracts that are affected by the changes. For example, a reinsurance contract might limit the amount that can be recovered as a result of flooding. However, if the flood damage was caused by an event that also caused extensive wind damage, the quantification of the two types of damage is often a matter of judgment. Similarly, one geographic zone could be affected by more than one catastrophic event. In this case, the amount recoverable from a reinsurer may in part be determined by the judgmental allocation of damage between the storms. Given the magnitude of the amounts at stake involved with a catastrophic event, these types of issues occasionally necessitate judicial resolution. In addition, our actual losses may vary materially from our current estimate of the loss based on a number of factors, including receipt of additional information from insureds or brokers, the attribution of losses to coverages that had not previously been considered as exposed and inflation in repair costs due to additional demand for labor and materials. As a result, the full extent of liability under an insurance or reinsurance contract may not be known for many years after such contract is issued and a loss occurs. Our exposure to this uncertainty is greater in our longer tail lines (marine and energy liabilities and financial institutions).

We depend on ratings from third party rating agencies. Our financial strength rating could be revised downward, which could affect our standing among brokers and customers, cause our premiums and earnings to decrease and limit our ability to pay dividends on the common shares.

Third-party rating agencies assess and rate the financial strength of reinsurers based upon criteria established by the rating agencies, which criteria are subject to change. The financial strength ratings assigned by rating agencies to insurance and reinsurance companies represent independent opinions of financial strength and ability to meet policyholder obligations and are not directed toward the protection of investors. Ratings have become an increasingly important factor in establishing the competitive position of insurance and reinsurance companies. Insurers and intermediaries use these ratings as one measure by which to assess the financial strength and quality of insurers and reinsurers. These ratings are often a key factor in the decision by an insured or intermediary of whether to place business with a particular insurance or reinsurance provider. These ratings are not an evaluation directed toward the protection of investors or a recommendation to buy, sell or hold our common shares.

Validus Re was assigned a rating of A– (Excellent) by A.M. Best Company in December 2005, which was affirmed by A.M. Best on August 29, 2007. This rating action followed the Company s closing of the acquisition of Talbot Holdings (Talbot), as well as the Company s completion of its capital raising initiatives, which were necessary to support the risk-adjusted capital position of the Company. Talbot s subsidiary, Talbot Underwriting Ltd., which manages Syndicate 1183 at Lloyd s, uses the Lloyd s rating. On March 7, 2007, A.M. Best Company assigned an issuer credit rating of bbb- to Validus Holdings, Ltd. Lloyd s is rated A (Excellent) by A.M. Best and A+ (Strong) by Standard & Poor s (S&P).

If our financial strength rating is reduced from current levels, our competitive position in the reinsurance industry would suffer, and it would be more difficult for us to market our products. A downgrade could result in a significant reduction in the number of reinsurance contracts we write and in a substantial loss of business as our customers, and brokers that place such business, move to other competitors with higher financial strength ratings. The substantial majority of reinsurance contracts issued through reinsurance brokers contains provisions permitting the ceding company to cancel such contracts in the event of a downgrade of the reinsurer by A.M. Best below A– (Excellent). Consequently, substantially all of our business could be affected by a downgrade of our A.M. Best rating.

It is increasingly common for our reinsurance contracts to contain terms that would allow the ceding companies to cancel the contract for the remaining portion of our period of obligation if our financial strength rating is downgraded below A– (Excellent) by A.M. Best. We cannot predict in advance the extent to which this cancellation right would be exercised, if at all, or what effect any such cancellations would have on our financial condition or future operations, but such effect could be material.

The indenture governing our Junior Subordinated Deferrable Debentures would restrict us from declaring or paying dividends on our common shares if we are downgraded by A.M. Best to a financial strength rating of B (Fair) or below or if A.M. Best withdraws its financial strength rating on any of our material insurance subsidiaries.

A downgrade of the Company s A.M. Best financial strength rating below B++ (Fair) would also constitute an event of default under our credit facilities. Either of these events could, among other things, reduce the Company s financial flexibility.

If Validus Re s risk management and loss limitation methods fail to adequately manage exposure to losses from catastrophic events, our financial condition and results of operations could be adversely affected.

Validus Re manages exposure to catastrophic losses by analyzing the probability and severity of the occurrence of catastrophic events and the impact of such events on our overall reinsurance and investment portfolio. Validus Re uses various tools to analyze and manage the reinsurance exposures assumed from ceding companies and risks from a catastrophic event that could have an adverse effect on their investment portfolio. VCAPS, a proprietary risk modeling software, enables Validus Re to assess the adequacy of risk pricing and to monitor the overall exposure to risk in correlated geographic zones. VCAPS is new and relatively untested and Validus Re cannot assure the models and assumptions used by the software will accurately predict losses. Further, Validus Re cannot assure that it is free of defects in the modeling logic or in the software code. In addition, Validus Re has not sought copyright or other legal protection for VCAPS.

In addition, much of the information that Validus Re enters into the risk modeling software is based on third-party data that they cannot assure to be reliable, as well as estimates and assumptions that are dependent on many variables, such as assumptions about building material and labor demand surge, storm surge, the expenses of settling claims, which are known as loss adjustment expenses, insurance-to-value and storm intensity. Accordingly, if the estimates and assumptions that are entered into the proprietary risk model are incorrect, or if the proprietary risk model proves to be an inaccurate forecasting tool, the losses Validus Re might incur from an actual catastrophe could be materially higher than their expectation of losses generated from modeled catastrophe scenarios, and their financial condition and results of operations could be adversely affected.

Validus Re also seeks to limit loss exposure through loss limitation provisions in their policies, such as limitations on the amount of losses that can be claimed under a policy, limitations or exclusions from coverage and provisions relating to choice of forum, which are intended to assure that their policies are legally interpreted as intended. Validus Re cannot assure that these contractual provisions will be enforceable in the manner expected or that disputes relating to coverage will be resolved in their favor. If the loss limitation provisions in the policies are not enforceable or disputes arise concerning the application of such provisions, the losses they might incur from a catastrophic event could be materially higher than expectation, and their financial condition and results of operations could be adversely affected.

The insurance and reinsurance business is historically cyclical, and we expect to experience periods with excess underwriting capacity and unfavorable premium rates and policy terms and conditions, which could materially adversely affect our financial condition and results of operations.

The insurance and reinsurance industry has historically been cyclical. Insurers and reinsurers have experienced significant fluctuations in operating results due to competition, frequency of occurrence or severity of catastrophic events, levels of underwriting capacity, underwriting results of primary insurers, general economic conditions and other factors. The supply of insurance and reinsurance is related to prevailing prices, the level of insured losses and the level of industry surplus which, in turn, may fluctuate, including in response to changes in rates of return on investments being earned in the reinsurance industry.

The insurance and reinsurance pricing cycle has historically been a market phenomenon, driven by supply and demand rather than by the actual cost of coverage. The upward phase of a cycle is often triggered when a major event forces insurers and reinsurers to make large claim payments, thereby drawing down capital. This, combined with increased demand for insurance against the risk associated with the event, pushes prices upwards. Over time, insurers and reinsurers capital is replenished with the higher revenues. At the same time, new entrants flock to the industry seeking a part of the profitable business. This combination prompts a slide in prices the downward cycle until a major insured event restarts the upward phase. As a result, the insurance and reinsurance business has been characterized by periods of intense competition on price and policy terms due to excessive underwriting capacity, which is the percentage of surplus or the dollar amount of exposure that a reinsurer is willing to place at risk, as well as periods when shortages of capacity result in favorable premium rates and policy terms and conditions.

Premium levels may be adversely affected by a number of factors which fluctuate and may contribute to price declines generally in the reinsurance industry. For example, as premium levels for many products have increased subsequent to the significant natural catastrophes of 2004 and 2005, the supply of reinsurance has increased and is likely to increase further, either as a result of capital provided by new entrants or by the commitment of additional capital by existing reinsurers. In addition, some of the prior upward cycles were initiated following each of Hurricane Andrew in 1992 and the events of September 11, 2001. Continued increases in the supply of insurance and reinsurance may have consequences for the reinsurance industry generally and for us including fewer contracts written, lower premium rates, increased expenses for customer acquisition and retention, and less favorable policy terms and conditions. For instance, the Company has noted an increase in the amount of available underwriting capacity in most lines in which it is involved throughout 2007 and continuing through the January renewal period of 2008. As a consequence, the Company has experienced greater competition on most insurance and reinsurance lines. This has adversely affected the rates we receive for our reinsurance and our overall gross premiums written to date. Furthermore, the State of Florida has instituted a law that, in part, increases the amount of reinsurance available to primary insurers from the Florida Hurricane Catastrophe Fund.

The cyclical trends in the industry and the industry s profitability can also be affected significantly by volatile and unpredictable developments, such as natural disasters (such as catastrophic hurricanes, windstorms, tornados, earthquakes and floods), courts granting large awards for certain damages, fluctuations in interest rates, changes in the investment environment that affect market prices of investments and inflationary pressures that may tend to affect the size of losses experienced by insureds and primary insurance companies. We expect to experience the effects of cyclicality, which could materially adversely affect our financial condition and results of operations.

If we underestimate our reserve for losses and loss expenses, our financial condition and results of operations could be adversely affected.

Our success depends on our ability to accurately assess the risks associated with the businesses and properties that we reinsure. If unpredictable catastrophic events occur, or if we fail to adequately manage our exposure to losses or fail to adequately estimate our reserve requirements, our actual losses and loss expenses may deviate, perhaps substantially, from our reserve estimates.

We estimate the risks associated with our outstanding obligations, including the risk embedded within our unearned premiums. To do this, we establish reserves for losses and loss expenses (or loss reserves), which are liabilities that we record to reflect the estimated costs of claim payment and the related expenses that we will ultimately be required to pay in respect of premiums written and include case reserves and incurred but not reported (IBNR) reserves. However, under U.S. GAAP, we are not permitted to establish reserves for losses with respect to our property catastrophe reinsurance until an event which gives rise to a claim occurs. As a result, only reserves applicable to losses incurred up to the reporting date may be set aside on our financial statements, with no allowance for the provision of loss reserves to account for possible other future losses with respect to our catastrophe-exposed reinsurance. Case reserves are reserves established with respect to specific individual reported claims. IBNR reserves are reserves for estimated losses that we have incurred but that have not yet been reported to us. Property catastrophe reinsurance covers insurance companies exposures to an accumulation of property and related losses from separate policies, typically relating to natural disasters or other catastrophic events.

Our reserve estimates do not represent an exact calculation of liability. Rather, they are estimates of what we expect the ultimate settlement and administration of claims will cost. These estimates are based upon actuarial and statistical projections and on our assessment of currently available data, predictions of future developments and estimates of future trends and other variable factors such as inflation. Establishing an appropriate level of our loss reserve estimates is an inherently uncertain process. It is likely that the ultimate liability will be greater or less than these estimates and that, at times, this variance will be material. Our reserve estimates are regularly refined as experience develops and claims are reported and settled. Establishing an appropriate level for our reserve estimates is an inherently uncertain process. In addition, as we operate solely through intermediaries, reserving for our business can involve added uncertainty arising from our dependence on information from ceding companies which, in addition to the risk of receiving inaccurate information involves an inherent time lag between reporting information from the primary insurer to us. Additionally, ceding companies employ differing reserving practices which adds further uncertainty to the establishment of our reserves. Moreover, these uncertainties are greater for reinsurers like us than for reinsurers with a longer operating history, because we do not yet have an established loss history. The lack of historical information for the Company has necessitated the use of industry loss emergence patterns in deriving IBNR. Loss emergence patterns are development patterns used to project current reported or paid loss amounts to their ultimate settlement value or amount. Further, expected losses and loss ratios are typically developed using vendor and proprietary computer models and these expected loss ratios are a material component in the calculation deriving IBNR. Actual loss ratios will deviate from expected loss ratios and ultimate loss ratios will be greater or less than expected loss ratios. Because of these uncertainties, it is possible that our estimates for reserves at any given time could prove inadequate.

To the extent we determine that actual losses and loss adjustment expenses from events which have occurred exceed our expectations and the loss reserves reflected in our financial statements, we will be required to reflect these changes in the current period. This could cause a sudden and material increase in our liabilities and a reduction in our profitability, including operating losses and reduction of capital, which could materially restrict our ability to write new business and adversely affect our financial condition and results of operations and potentially our A.M. Best rating.

We rely on key personnel and the loss of their services may adversely affect us. The Bermuda location of our head office may be an impediment to attracting and retaining experienced personnel.

Various aspects of our business depend on the services and skills of key personnel of the Company. We believe there are only a limited number of available qualified executives in the business lines in which we compete. We rely substantially upon the services of Edward J. Noonan, Chairman of our Board of Directors and Chief Executive Officer; George P. Reeth, President and the Deputy Chairman of our Board of Directors; C.N. Rupert Atkin, Chief Executive Officer of the Talbot Group; Michael J. Belfatti, Executive Vice President and Chief Actuary; Gilles A. M. Bonvarlet, Chief Operating Officer of the Talbot Group; Michael E.A. Carpenter, Chairman of the Talbot Group; Joseph E. (Jeff) Consolino, Chief Financial Officer; C. Jerome Dill, General Counsel; Stuart W. Mercer, Chief Risk Officer; and Conan M. Ward, Chief Underwriting Officer, among other key employees. Although we are not aware of any planned departures, the loss of any of their services or the services of other members of our management team or any difficulty in attracting and retaining other talented personnel could impede the further implementation of our business strategy, reduce our revenues and decrease our operational effectiveness. Although we have an employment agreement with each of the above named executives, there is a possibility that these employment agreements may not be enforceable in the event any of these employees leave. The employment agreements for each of the above-named executives provide that the terms of the agreement will continue for a defined period after either party giving notice of termination, and will terminate immediately upon the Company giving notice of termination for cause. We do not currently maintain key man life insurance policies with respect to them or any of our other employees.

The operating location of our head office and Validus Re subsidiary may be an impediment to attracting and retaining experienced personnel. Under Bermuda law, non-Bermudians (other than spouses of Bermudians) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Our success may depend in part on the continued services of key employees in Bermuda. A work permit may be granted or renewed upon demonstrating that, after proper public advertisement, no Bermudian (or spouse of a Bermudian or a holder of a permanent resident s certificate or holder of a working resident s certificate) is available who meets the minimum standards reasonably required by the employer. The Bermuda government s policy places a six-year term limit on individuals with work permits, subject to certain exemptions for key employees. A work permit is issued with an expiry date (up to five years) and no assurances can be given that any work permit will be issued or, if issued, renewed upon the expiration of the relevant term. If work permits are not obtained, or are not renewed, for our principal employees, we would lose their services, which could materially affect our business. Work permits are currently required for 26 of our Bermuda employees, all of whom have obtained three- or five-year work permits except Mr. Belfatti whose five year work permit has been applied for but not yet approved due his recent start date with the Company.

Certain of our directors and officers may have conflicts of interest with us.

Entities affiliated with some of our directors have sponsored or invested in, and may in the future sponsor or invest in, other entities engaged in or intending to engage in insurance and reinsurance underwriting, some of which compete with us. They have also entered into, or may in the future enter into, agreements with companies that compete with us.

We have a policy in place applicable to each of our directors and officers which provides for the resolution of potential conflicts of interest. However, we may not be in a position to influence any party s decision to engage in activities that would give rise to a conflict of interest, and they may take actions that are not in our shareholders best interests.

We may require additional capital or credit in the future, which may not be available or only available on unfavorable terms.

We monitor our capital adequacy on a regular basis. The capital requirements of our business depend on many factors, including our premiums written, loss reserves, investment portfolio composition and risk exposures, as well as satisfying regulatory and rating agency capital requirements. Our ability to underwrite is largely dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. To the extent that our existing capital is insufficient to fund our future operating requirements and/or cover claim losses, we may need to raise additional funds through financings or limit our growth. Any equity or debt financing, if available at all, may be on terms that are unfavorable to us. In the case of equity financings, dilution to our shareholders could result, and, in any case, such securities may have rights, preferences and privileges that are senior to those of our outstanding securities. If we are not able to obtain adequate capital, our business, results of operations and financial condition could be adversely affected.

In addition, as an alien reinsurer (not licensed in the United States), we are required to post collateral security with respect to any reinsurance liabilities that we assume from ceding insurers domiciled in the United States in order for U.S. ceding companies to obtain full statutory and regulatory credit for our reinsurance. Other jurisdictions and non-U.S. ceding insurers may have similar collateral requirements. Under applicable statutory provisions, these security arrangements may be in the form of letters of credit, reinsurance trusts maintained by trustees or funds-withheld arrangements where assets are held by the ceding company. We intend to satisfy such statutory requirements by providing to primary insurers letters of credit issued under our credit facilities. To the extent that we are required to post additional security in the future, we may require additional letter of credit capacity and we cannot assure that we will be able to obtain such additional capacity or arrange for other types of security on commercially acceptable terms or on terms as favorable as under our current letter of credit facilities. Our inability to provide collateral satisfying the statutory and regulatory guidelines applicable to primary insurers would have a material effect on our ability to provide reinsurance to third parties and negatively affect our financial position and results of operations.

Security arrangements may subject our assets to security interests and/or require that a portion of our assets be pledged to, or otherwise held by, third parties. Although the investment income derived from our assets while held in trust typically accrues to our benefit, the investment of these assets is governed by the investment regulations of the state of domicile of the ceding insurer.

Competition for business in our industry is intense, and if we are unable to compete effectively, we may not be able to retain market share and our business may be materially adversely affected.

The insurance and reinsurance industries are highly competitive. We face intense competition, based upon (among other things) global capacity, product breadth, reputation and experience with respect to particular lines of business, relationships with reinsurance intermediaries, quality of service, capital and perceived financial strength (including independent rating agencies ratings), innovation and price. We compete with major global insurance and reinsurance companies and underwriting syndicates, many of which have extensive experience in reinsurance and may have greater financial, marketing and employee resources available to them than us. Other financial institutions, such as banks and hedge funds, now offer products and services similar to our products and services through alternative capital markets products that are structured to provide protections similar to those provided by reinsurers. These products, such as catastrophe-linked bonds, compete with our products. In the future, underwriting capacity will continue to enter the market from these identified competitors and perhaps other sources. After the events of September 11, 2001, and then again following the three major hurricanes of 2005 (Katrina, Rita and Wilma), new capital flowed into Bermuda, and much of these new proceeds went to a variety of Bermuda-based start-up companies. The full extent and effect of this additional capital on the reinsurance market will not be known for some time and market conditions could become less favorable. Increased competition could result in fewer submissions and lower rates, which could have an adverse effect on our growth and profitability. If we are unable to compete effectively against these competitors, we may not be able to retain market share.

In addition, insureds have been retaining a greater proportion of their risk portfolios than previously, and industrial and commercial companies have been increasingly relying upon their own subsidiary insurance companies, known as captive insurance companies, self-insurance pools, risk retention groups, mutual insurance companies and other mechanisms for funding their risks, rather than risk transferring insurance. This has put downward pressure on insurance premiums.

Loss of business from one or more major brokers could adversely affect us.

We market our insurance and reinsurance on a worldwide basis primarily through brokers, and we depend on a small number of brokers for a large portion of our revenues. For the year ended December 31, 2007 (1), our business was primarily sourced from the following brokers: Marsh Inc./Guy Carpenter & Co. 26.9%, Willis Group Holdings Ltd. 15.7%, Aon Corporation 15.1% and Benfield Group Ltd. 9.3%. These four brokers provided a total of 67.0% of our gross premiums written for the year ended December 31, 2007. Talbot was acquired on July 2, 2007. Talbot s gross premium written for the full year ended December 31, 2007 has been included in the above analysis for informational purposes only and is not included within the consolidated results. Loss of all or a substantial portion of the business provided by one or more of these brokers could adversely affect our business.

We assume a degree of credit risk associated with substantially all of our brokers.

In accordance with industry practice, we frequently pay amounts owed on claims under our policies to brokers and the brokers, in turn, pay these amounts over to the ceding insurers and reinsurers that have reinsured a portion of their liabilities with us. In some jurisdictions, if a broker fails to make such a payment, we might remain liable to the ceding insurer or reinsurer for the deficiency notwithstanding the broker s obligation to make such payment. Conversely, in certain jurisdictions, when the ceding insurer or reinsurer pays premiums for these policies to reinsurance brokers for payment to us, these premiums are considered to have been paid and the ceding insurer or reinsurer will no longer be liable to us for these premiums, whether or not we have actually received them. Consequently, we assume a degree of credit risk associated with substantially all of our brokers.

Our success depends on our ability to establish and maintain effective operating procedures and internal controls. Failure to detect control issues and any instances of fraud could adversely affect us.

Our success is dependent upon our ability to establish and maintain operating procedures and internal controls (including the timely and successful implementation of information technology systems and programs) to effectively support our business and our regulatory and reporting requirements. We may not be successful in such efforts. Even if and when implemented, as a result of the inherent limitations in all control systems, no evaluation of controls can provide full assurance that all control issues and instances of fraud, if any, within the Company will be detected.

We may be unable to purchase reinsurance or retrocessional reinsurance in the future, and if we successfully purchase retrocessional reinsurance, we may be unable to collect, which could adversely affect our business, financial condition and results of operations.

We purchase reinsurance and retrocessional reinsurance in order that we may offer insureds and cedants greater capacity, and to mitigate the effect of large and multiple losses upon our financial condition. Reinsurance is a transaction whereby an insurer or reinsurer cedes to a reinsurer all or part of the reinsurance it has assumed. A reinsurer s or retrocessional reinsurers insolvency or inability or refusal to make timely payments under the terms of its reinsurance agreement with us could have an adverse effect on us because we remain liable to our client. From time to time, market conditions have limited, and in some cases have prevented, insurers and reinsurers from obtaining the types and amounts of reinsurance or retrocessional reinsurance that they consider adequate for their business needs. Accordingly, we may not be able to obtain our desired amounts of reinsurance or retrocessional reinsurance or negotiate terms that we deem appropriate or acceptable or obtain reinsurance or retrocessional reinsurance from entities with satisfactory creditworthiness.

Our investment portfolio may suffer reduced returns or losses which could adversely affect our results of operations and financial condition. Any increase in interest rates or volatility in the fixed income markets could result in significant unrealized losses in the fair value of our investment portfolio which, commencing in 2007,

would reduce our net income.

Our operating results depend in part on the performance of our investment portfolio, which currently consists of fixed maturity securities, as well as the ability of our investment managers to effectively implement our investment strategy. Our Board of Directors, including our Finance Committee, oversees our investment strategy, and in consultation with BlackRock Financial Management, Inc. and Goldman Sachs Asset Management, our portfolio advisors, has established investment guidelines. The investment guidelines dictate the portfolio s overall objective, benchmark portfolio, eligible securities, duration, limitations on the use of derivatives and inclusion of foreign securities, diversification requirements and average portfolio rating. The Board periodically reviews these guidelines in light of our investment goals and consequently they may change at any time.

The investment income derived from our invested assets was $112.3 million or 27.9% of our net income for the year ended December 31, 2007. While we follow a conservative investment strategy designed to emphasize the preservation of invested assets and to provide sufficient liquidity for the prompt payment of claims, we will nevertheless be subject to market-wide risks including illiquidity and pricing uncertainty and fluctuations, as well as to risks inherent in particular securities. Our investment performance may vary substantially over time, and we cannot assure that we will achieve our investment objectives. Unlike more established reinsurance companies with longer operating histories, Validus Re has a limited performance record to which investors can refer. See Business Investments.

Investment results will also be affected by general economic conditions, market volatility, interest rate fluctuations, liquidity and credit risks beyond our control. In addition, our need for liquidity may result in investment returns below our expectations. Also, with respect to certain of our investments, we are subject to prepayment or reinvestment risk. In particular, our fixed income portfolio is subject to reinvestment risk, and as at December 31, 2007, 44.5% of the fixed income portfolio is comprised of mortgage backed and asset backed securities which are subject to prepayment risk. Although we attempt to manage the risks of investing in a changing interest rate environment, a significant increase in interest rates could result in significant losses, realized or unrealized, in the fair value of our investment portfolio and, consequently, could have an adverse affect on our results of operations.

As of January 1, 2007, the Company s investments were accounted for as trading and, as such, all unrealized gains and losses are included in Net Income on the Statement of Operations. Including unrealized gains and losses in Net Income may have the effect of increasing the volatility of our earnings.

The movement in foreign currency exchange rates could adversely affect our operating results because we enter into insurance and reinsurance contracts where the premiums receivable and losses payable are denominated in currencies other than the U.S. dollar and we maintain a portion of our investments and liabilities in currencies other than the U.S. dollar.

The U.S. dollar is our reporting currency. We enter into insurance and reinsurance contracts where the premiums receivable and losses payable are denominated in currencies other than the U.S. dollar. In addition, we maintain a portion of our investments and liabilities in currencies other than the U.S. dollar. Premiums received in non-U.S. currencies are generally converted into U.S. dollars at the time of receipt. When we incur a liability in a non-U.S. currency, we carry such liability on our books in the original currency. These liabilities are converted from the non-U.S. currency to U.S. dollars at the time of payment. We will therefore realize foreign currency exchange gains or losses as we ultimately receive premiums and settle claims required to be paid in foreign currencies. At December 31, 2007, 8.7% of our investments and 30.9% of our reserves for losses and loss expenses were in foreign currencies.

To the extent that we do not seek to hedge our foreign currency risk, the impact of a movement in foreign currency exchange rates could adversely affect our operating results.

The preparation of our financial statements will require us to make many estimates and judgments, which are even more difficult than those made in a mature company, and which, if inaccurate, could cause volatility in our results.

The Company s consolidated financial statements have been prepared in accordance with U.S. GAAP. Management believes the item that requires the most subjective and complex estimates is the reserve for losses and loss expenses. Due to Validus Re s short operating history, loss experience is limited and reliable evidence of changes in trends of numbers of claims incurred, average settlement amounts, numbers of claims outstanding and average losses per claim will necessarily take many years to develop. Following a major catastrophic event, the possibility of future litigation or legislative change that may affect interpretation of policy terms further increases

Table of Contents

the degree of uncertainty in the reserving process. The uncertainties inherent in the reserving process, together with the potential for unforeseen developments, including changes in laws and the prevailing interpretation of policy terms, may result in losses and loss expenses materially different than the reserves initially established. Changes to prior year reserves will affect current underwriting results by increasing net income if the prior year reserves prove to be redundant or by decreasing net income if the prior year reserves prove to be insufficient. The Company expects volatility in results in periods in which significant loss events occur because U.S. GAAP does not permit insurers or reinsurers to reserve for loss events until they have occurred and are expected to give rise to a claim. As a result, the Company is not allowed to record contingency reserves to account for expected future losses. The Company anticipates that claims arising from future events will require the establishment of substantial reserves from time to time.

An inability to implement, for the fiscal year ending December 31, 2008, the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 in a timely and satisfactory manner could cause the price of our common shares to fall.

We are presently evaluating our existing internal controls with respect to the standards adopted by the Public Company Accounting Oversight Board. We cannot be certain at this time that we will be able to successfully and satisfactorily complete the procedures, certification and attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002 by the time that we are required to file our Annual Report on Form 10-K for the year ending December 31, 2008, which is the first time that our management and our external auditors will be required to deliver reports on our internal controls and procedures in accordance with the Sarbanes-Oxley Act of 2002. Uncertainty as to our ability to comply with such requirements or any material weaknesses uncovered as a result of such procedures could have a material adverse effect on the trading price of our common shares. In addition, we may incur increased costs associated with such procedures or a diversion of internal resources necessary to prepare for or comply with such requirements.

Risks Related to Acquisitions and New Ventures

There can be no assurance that we will fully realize the expected benefits of the Talbot acquisition in the anticipated time.

In order to realize the benefits of the Talbot acquisition, our and Talbot s management will be required to devote considerable effort to projects such as upgrading and integrating financial, actuarial, underwriting and other systems and preparing financial reports on a timely basis, whether for a public company or otherwise, and no assurances can be given as to the impact these efforts may have upon our operations. In addition, no assurances can be given as to how much business Talbot will be permitted by Lloyd s to write in 2009 and subsequent years nor as to the viability or cost of the capital structure we may use as a substitute for the external capital and reinsurance used by Talbot in 2007 and prior underwriting years. The Company has recorded intangible assets related to the acquisition of Talbot based on assumptions of anticipated benefits. These intangible assets may become impaired if anticipated benefits are not achieved, resulting in a corresponding impact on our income.

Any future acquisitions or new ventures may expose us to operational risks.

We may in the future make strategic acquisitions, either of other companies or selected blocks of business, or grow our business organically. Any future acquisitions or new ventures may expose us to operational challenges and risks, including:

integrating financial and operational reporting systems;

establishing satisfactory budgetary and other financial controls;

funding increased capital needs and overhead expenses;

obtaining management personnel required for expanded operations;

funding cash flow shortages that may occur if anticipated sales and revenues are not realized or are delayed, whether by general economic or market conditions or unforeseen internal difficulties;

the value of assets related to acquisitions or new ventures may be lower than expected or may diminish due to credit defaults or changes in interest rates and liabilities assumed may be greater than expected;

the assets and liabilities related to acquisitions or new ventures may be subject to foreign currency exchange rate fluctuation; and

financial exposures in the event that the sellers of the entities we acquire are unable or unwilling to meet their indemnification, reinsurance and other obligations to us.

Our failure to manage successfully these operational challenges and risks may impact our results of operations.

Risks Relating to Lloyd s and Other U.K. Regulatory Matters

The regulation of Lloyd s members by Lloyd s and of Lloyd s by the U.K. Financial Services Authority (FSA) and under European Directives and other local laws may result in intervention that could have a significant negative impact on Talbot.

Talbot operates in a regulated industry. Its underwriting activities are regulated by the FSA and franchised by Lloyd s. The FSA has substantial powers of intervention in relation to the Lloyd s managing agents (such as Talbot Underwriting Ltd.) which it regulates, including the power to remove their authorization to manage Lloyd s syndicates. In addition, the Lloyd s Franchise Board requires annual approval of Syndicate 1183 s business plan, including a maximum underwriting capacity, and may require changes to any business plan presented to it or additional capital to be provided to support underwriting (known as Funds at Lloyd s or FAL). An adverse determination in any of these cases could lead to a change in business strategy which may have an adverse effect on Talbot s financial condition and operating results.

European Directives affect the regulation governing the carrying on of insurance business in the United Kingdom. A new Directive covering the prudential supervision of insurance companies is being developed to replace the existing insurance Directives. The proposed Solvency II insurance Directive is presently under consultation and is unlikely to come into force before 2009. Likewise, a new reinsurance Directive was adopted on 17 October 2005, which is likely to be fully implemented in the U.K. by the end of 2010. There can be no assurance that future legislation will not have an adverse effect on Talbot.

Additionally, Lloyd s worldwide insurance and reinsurance business is subject to local regulation. Changes in such regulation may have an adverse effect on Lloyd s generally and on Talbot.

Should Lloyd s Council decide additional levies are required to support the New Central Fund, this could adversely affect Talbot.

The New Central Fund, which is funded by annual contributions and loans from Lloyd s members, acts as a policyholders protection fund to make payments where any Lloyd s member has failed to pay, or is unable to pay, valid claims. The Lloyd s Council may resolve to make payments from the New Central Fund for the advancement and protection of policyholders, which could lead to additional or special contributions being payable by Lloyd s members, including Talbot. This, in turn, could adversely affect Talbot.

Lloyd s 1992 and prior liabilities.

Notwithstanding the firebreak introduced when Lloyd s implemented the Reconstruction and Renewal Plan in 1996, Lloyd s members, including Talbot subsidiaries, remain indirectly exposed in a number of ways to 1992 and prior business reinsured by Equitas, including through the application of overseas deposits and the New Central Fund.

Lloyd s currently has a number of contingent liabilities in respect of risks under certain policies allocated to 1992 or prior Years of Account. If the statutory transfer of business from Equitas to National Indemnity Company (NICO) is not implemented, and the limit of the NICO retrocession cover proves to be insufficient and as a consequence Equitas is unable to pay the 1992 and prior liabilities in full, Lloyd s will be liable to meet any shortfall arising in respect of those policies. The New Central Fund, which can, subject to Lloyd s regulations, issue calls on current underwriting members of Lloyd s (which will include Talbot subsidiaries), may be applied for these purposes. Lloyd s also has contingent liabilities under indemnities in respect of claims against certain persons and from residual litigation with Lloyd s members who have not accepted the settlement offer.

The failure of Lloyd s to satisfy the FSA s annual solvency test could result in limitations on Talbot s ability to underwrite or its ability to commence legal proceedings against Lloyd s.

The FSA requires Lloyd s to satisfy an annual solvency test. The solvency requirement in essence measures whether Lloyd s has sufficient assets in the aggregate to meet all outstanding liabilities of its members, both current and in run-off. If Lloyd s fails to satisfy the test in any year, the FSA may require Lloyd s to cease trading and/or its members to cease or reduce underwriting. In the event of Lloyd s failing to meet any solvency requirement, either the Society of Lloyd s or the FSA may apply to the court for a Lloyd s Market Reorganisation Order (LMRO). On the making of an order a reorganisation controller is appointed, and for its duration, a moratorium is imposed preventing any proceedings or legal process from being commenced or continued against any party that is the subject of such an order, which, if made, would apply to the market as a whole, including members, former members, managing agents, members agents, Lloyd s brokers, approved run-off companies and managing general agents unless individual parties are specifically excluded.

A downgrade in Lloyd s ratings would have an adverse effect on Syndicate 1183 s standing among brokers and customers and cause its premiums and earnings to decrease.

The ability of Lloyd s syndicates to trade in certain classes of business at current levels is dependent on the maintenance of a satisfactory credit rating issued by an accredited rating agency. The financial security of the Lloyd s market is regularly assessed by three independent rating agencies, A.M. Best, Standard & Poor s and Fitch Ratings. Syndicate 1183 benefits from Lloyd s current ratings and would be adversely affected if the current ratings were downgraded from their present levels.

An increase in the charges paid by Talbot to participate in the Lloyd s market could adversely affect Talbot s financial and operating results.

Lloyd s imposes a number of charges on businesses operating in the Lloyd s market, including, for example, annual subscriptions and central fund contributions for members and policy signing charges. The bases and amounts of charges may be varied by Lloyd s and could adversely affect Talbot.

An increase in the level or type of deposits required by U.S. Situs Trust Deeds to be maintained by Lloyd s could result in Syndicate 1183 being required to make a cash call which could adversely affect Talbot s financial performance.

The U.S. Situs Trust Deeds require syndicates transacting certain types of business in the United States to maintain minimum deposits as protection for U.S. policyholders. These deposits represent the syndicates estimates of unpaid claims liabilities (less premiums receivable) relating to this business, adjusted for provisions for potential bad debt on premiums earned but not received and for any anticipated profit on unearned premiums. No credit is generally allowed for potential reinsurance recoveries. The New York Insurance Department and the U.S. National Association of Insurance Commissioners currently require funding of 30% of gross liabilities in relation to insurance business classified as Surplus Lines. The Credit for Reinsurance trust fund is usually required to be funded at 100% of gross liabilities. The funds contained within the deposits are not ordinarily available to meet trading expenses.
U.S. regulators may increase the level of funding required or change the requirements as to the nature of funding. Accordingly, in the event of a major claim arising in the United States, for example from a major catastrophe, syndicates participating in such U.S. business may be required to make cash calls on their members to meet claims payments and deposit funding obligations. This could adversely affect Talbot.

Risks Related to Taxation

We may be subject to U.S. tax.

We are organized under the laws of Bermuda and presently intend to structure our activities to minimize the risk that we would be considered engaged in a U.S. trade or business. No definitive standards, however, are provided by the Internal Revenue Code of 1986, as amended (the Code), U.S. Treasury regulations or court decisions regarding activities that constitute the conduct of a U.S. trade or business. Because that determination is essentially factual, we cannot assure that the Internal Revenue Service (the IRS) will not contend that we are engaged in a U.S. trade or business. If we were found to be so engaged, we would be subject to U.S. corporate income and branch profits tax on our earnings that are effectively connected to such U.S. trade or business.

If Validus Re is entitled to the benefits of the income tax treaty between the U.S. and Bermuda (the Bermuda Treaty), it would not be subject to U.S. income tax on any income protected by the Bermuda Treaty unless that income is attributable to a permanent establishment in the U.S. The treaty clearly applies to premium income, but may be construed as not protecting other income such as investment income. If Validus Re were found to be engaged in a trade or business in the U.S. and were entitled to the benefits of the treaty in general, but the treaty were found not to protect investment income, a portion of Validus Re s investment income could be subject to U.S. tax.

U.S. persons who hold common shares may be subject to U.S. income taxation at ordinary income rates on our undistributed earnings and profits.

Controlled Foreign Corporation Status: The Company should not be a controlled foreign corporation (CFC) because its organizational documents provide that if the common shares owned, directly, indirectly or by attribution, by any person would otherwise represent more than 9.09% of the aggregate voting power of all the Company s common shares, the voting rights attached to those common shares will be reduced so that such person may not exercise and is not attributed more than 9.09% of the total voting power of the common shares. We cannot assure, however, that the provisions of the Organizational Documents will operate as intended and that the Company will not be considered a CFC. If the Company were considered a CFC, any shareholder that is a U.S. person that owns directly, indirectly or by attribution, 10% or more of the voting power of the Company may be subject to current U.S. income taxation at ordinary income tax rates on all or a portion of the Company s undistributed earnings and profits attributable to Validus Re s insurance and reinsurance income, including underwriting and investment income. Any gain realized on sale of common shares by such 10% shareholder may also be taxed as a dividend to the extent of the Company s earnings and profits attributed to such shares during the period that the shareholder held the shares and while the Company was a CFC (with certain adjustments).

Related Person Insurance Income: If the related person insurance income (RPII) of any of the Company s non-U.S. insurance subsidiaries were to equal or exceed 20% of that subsidiary s gross insurance income in any taxable year, and U.S. persons were treated as owning 25% or more of the subsidiary s stock, by vote or value, a U.S. person who directly or indirectly owns any common shares on the last day of such taxable year on which the 25% threshold is met would be required to include in income for U.S. federal income tax purposes that person s ratable share of that subsidiary s RPII for the taxable year. The amount includible in income is determined as if the RPII were distributed proportionately to U.S. holders on that date, regardless of whether that income is distributed. The amount of RPII includible in income is limited by such shareholder s share of the subsidiary s current-year earnings and profits, and possibly reduced by the shareholder s share of prior year deficits in earnings and profits. The amount of RPII earned by a subsidiary will depend on several factors, including the identity of persons directly or indirectly insured or reinsured by that subsidiary. Although we do not believe that the 20% threshold will be met for our non-U.S. insurance subsidiaries, some of the factors that might affect that determination in any period may be beyond our control. Consequently, we cannot assure that we will not exceed the RPII threshold in any taxable year.

If a U.S. person disposes of shares in a non-U.S. insurance corporation that had RPII (even if the 20% threshold was not met) and the 25% threshold is met at any time during the five-year period ending on the date of disposition, and the U.S. person owned any shares at such time, any gain from the disposition will generally be treated as a dividend to the extent of the holder s share of the corporation s undistributed earnings and profits that were accumulated during the period that the holder owned the shares (possibly whether or not those earnings and profits are attributable to RPII). In addition, the shareholder will be required to comply with specified reporting requirements, regardless of the amount of shares owned. We believe that those rules should not apply to a disposition of common shares because the Company is not itself directly engaged in the insurance business. We cannot assure, however, that the IRS will not successfully assert that those rules apply to a disposition of common shares.

U.S. persons who hold common shares will be subject to adverse tax consequences if the Company is considered a passive foreign investment company for U.S. federal income tax purposes.

If the Company is considered a passive foreign investment company (PFIC) for U.S. federal income tax purposes, a U.S. holder who owns common shares will be subject to adverse tax consequences, including a greater tax liability than might otherwise apply and an interest charge on certain taxes that are deferred as a result of the Company s non-U.S. status. We currently do not expect that the Company will be a PFIC for U.S. federal income tax purposes in the current taxable year or the foreseeable future because, through Validus Re, Talbot 2002 Underwriting Capital Ltd. and Talbot Underwriting Ltd., it intends to be predominantly engaged in the active conduct of a global insurance business. We cannot assure you, however, that the Company will not be deemed to be a PFIC by the IRS. No regulations currently exist regarding the application of the PFIC provisions to an insurance company. New regulations or pronouncements interpreting or clarifying such provisions may be forthcoming. We cannot predict what effect, if any, such guidance would have on an investor that is subject to U.S. federal income taxation.

Changes in U.S. tax laws may be retroactive and could subject a U.S. holder of common shares to other adverse tax consequences.

The tax treatment of non-U.S. companies and their U.S. and non-U.S. insurance and reinsurance subsidiaries has been the subject of Congressional discussion and legislative proposals in the U.S. We cannot assure that future legislative action will not increase the amount of U.S. tax payable by us. For example, Congress has recently conducted hearings related to the tax treatment of offshore insurance and is reported to be considering legislation that would adversely affect reinsurance between affiliates and offshore insurance and reinsurance more generally. One such proposal would increase the excise tax rate on reinsurance premiums paid to affiliated foreign reinsurers from 1% to 4%; another proposal would limit deductions for premiums ceded to affiliated non-U.S. companies above certain levels. Other proposals relating to cross-border transactions, intangible products, or non-U.S. jurisdictions generally have been introduced in a number of Congressional committees. Enactment of some versions of such legislation as well as other changes in U.S. tax laws, regulations and interpretations thereof to address these issues could adversely affect our financial condition and results of operations could be materially adversely affected.

In addition, the U.S. federal income tax laws and interpretations, including those regarding whether a company is engaged in a U.S. trade or business or is a PFIC, or whether U.S. holders would be required to include subpart F income or RPII in their gross income, are subject to change, possibly on a retroactive basis. No regulations regarding the application of the PFIC rules to insurance companies are currently in effect, and the regulations regarding RPII are still in proposed form. New regulations or pronouncements interpreting or clarifying such rules may be forthcoming. We cannot be certain if, when, or in what form, such regulations or pronouncements may be provided, and whether such guidance will have a retroactive effect.

Proposed U.S. Tax Legislation Could Adversely Affect U.S. Shareholders.

Under current U.S. law, non-corporate U.S. holders of the Company s common shares generally are taxed on dividends at a capital gains tax rate rather than ordinary income tax rates. Currently, there is proposed legislation before both Houses of Congress that would exclude shareholders of certain foreign corporations from this advantageous income tax treatment. If this legislation became law, non-corporate U.S. shareholders would no longer qualify for the capital gains tax rate on the Company s dividends.

We may become subject to taxes in Bermuda after March 28, 2016, which may have a material adverse effect on our results of operations.

Under current Bermuda law, we are not subject to tax on income or capital gains. We have received from the Minister of Finance under The Exempted Undertaking Tax Protection Act 1966, as amended, an assurance that, in the event that Bermuda enacts legislation imposing tax computed on profits, income, any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance, then the imposition of any such tax shall not be applicable to us or to any of our operations or shares, debentures or other obligations, until March 28, 2016. We could be subject to taxes in Bermuda after that date. This assurance is subject to the proviso that it is not to be construed to prevent the application of any tax or duty to such persons as are ordinarily resident in Bermuda or to prevent the application of any tax payable in accordance with the provisions of the Land Tax Act 1967 or otherwise payable in relation to any property leased to us. We and Validus Re each pay annual Bermuda government fees; Validus Re pays annual insurance license fees. In addition, all entities employing individuals in Bermuda are required to pay a payroll tax and there are other sundry taxes payable, directly or indirectly, to the Bermuda government.

The Organisation for Economic Cooperation and Development and other multinational organizations are considering measures that might increase our taxes and reduce our net income.

The Organisation for Economic Cooperation and Development, which is commonly referred to as the OECD, has published reports and launched a global dialogue among member and non-member countries on measures to limit harmful tax competition. These measures are largely directed at counteracting the effects of tax havens and preferential tax regimes in countries around the world. In the OECD s report dated 18 April 2002 and updated as of June 2004, Bermuda was not listed as an uncooperative tax haven jurisdiction because it had previously committed to eliminate harmful tax practices and to embrace international tax standards for transparency, exchange of information and the elimination of any aspects of the regimes for financial and other services that attract business with no substantial domestic activity. We are not able to predict what changes will arise from the commitment or whether such changes will subject us to additional taxes.

Our non-U.S. companies may be subject to U.K. tax.

We intend to operate in such a manner so that none of our companies other than Talbot Underwriting Ltd., which manages Syndicate 1183 at Lloyd s, Talbot 2002 Underwriting Capital Ltd. and Underwriting Risk Services Ltd. (Talbot U.K. Group) should be resident in the U.K. for tax purposes or have a permanent establishment in the U.K. Accordingly, we expect that none of our companies other than the Talbot U.K. Group should be subject to U.K. taxation. However, since applicable law and regulations do not conclusively define the activities that constitute conducting business in the U.K. through a permanent establishment, the U.K. Inland Revenue might contend successfully that one or more of our other companies, is conducting business in the U.K. through a permanent establishment in the U.K.

Risks Related to Laws and Regulations Applicable to Us

If we become subject to insurance statutes and regulations in addition to the statutes and regulations that currently apply to us, there could be a significant and negative impact on our business.

We currently conduct our business in a manner such that we expect the Company will not be subject to insurance and/or reinsurance licensing requirements or regulations in any jurisdiction other than Bermuda and, with respect to Talbot, the U.K. and jurisdictions to which Lloyds is subject. See Business Regulation United States and Bermuda . Although we do not currently intend to engage in activities which would require us to comply with insurance and reinsurance licensing requirements of other jurisdictions, should we choose to engage in activities that would require us to become licensed in such jurisdictions, we cannot assure that we will be able to do so or to do so in a timely manner. Furthermore, the laws and regulations applicable to direct insurers could indirectly affect us, such as collateral requirements in various U.S. states to enable such insurers to receive credit for reinsurance ceded to us.

The insurance and reinsurance regulatory framework of Bermuda and the insurance of U.S. risk by companies based in Bermuda that are not licensed or authorized in the U.S. have recently become subject to increased scrutiny in many jurisdictions, including the United States. In the past, there have been Congressional and other initiatives in the United States regarding increased supervision and regulation of the insurance industry, including proposals to supervise and regulate offshore reinsurers. Government regulators are generally concerned with the protection of policyholders rather than other constituencies, such as our shareholders. We are not able to predict the future impact on our operations of changes in the laws and regulations to which we are or may become subject.

Risks Related to Ownership of Our Common Shares

Because we are a holding company and substantially all of our operations are conducted by our main operating subsidiaries, Validus Re and Talbot, our ability to meet any ongoing cash requirements and to pay dividends will depend on our ability to obtain cash dividends or other cash payments or obtain loans from Validus Re and Talbot.

We conduct substantially all of our operations through subsidiaries. Our ability to meet our ongoing cash requirements, including any debt service payments or other expenses, and pay dividends on our common shares in the future, will depend on our ability to obtain cash dividends or other cash payments or obtain loans from these subsidiaries and will also depend on the financial condition of these subsidiaries. The inability of these subsidiaries to pay dividends in an amount sufficient to enable us to meet our cash requirements could have a material adverse effect on us and the value of our common shares. Each of these subsidiaries is a separate and distinct legal entity that has no obligation to pay any dividends or to lend or advance us funds and may be restricted from doing so by contract, including other financing arrangements, charter provisions or applicable legal and regulatory requirements or rating agency constraints. The payment of dividends by these subsidiaries to us is limited under Bermuda law and regulations. The Insurance Act provides that neither of these subsidiaries may declare or pay in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its statutory balance sheet in relation to the previous financial year) unless it files an affidavit with the BMA at least seven days prior to the payment signed by at least two directors and such subsidiary s principal representative, stating that in their opinion such subsidiaries will continue to satisfy the required margins following declaration of those dividends, though there is no additional requirement for BMA approval. In addition, before reducing its total statutory capital by 15% or more (as set out in its previous years statutory financial statements) each of these subsidiaries must make application to the BMA for permission to do so, such application to consist of an affidavit signed by at least two directors and such subsidiary s principal representative stating that in their opinion the proposed reduction in capital will not cause such subsidiaries to fail to meet its relevant margins, and such other information as the BMA may require. At December 31, 2007, Bermuda statutory restrictions permit Validus Re and Talbot to pay dividends of up to $1.4 billion and $209.0 million, respectively, to the Company.

We intend to pay quarterly cash dividends on our common shares and paid a dividend of $0.20 to shareholders of record at March 3, 2008. The timing and amount of any cash dividends, however, will be at the discretion of our Board of Directors and will depend upon our results of operations and cash flows, our financial position and capital requirements, general business conditions, legal, tax, regulatory, rating agency and contractual constraints or restrictions and any other factors that our Board of Directors deems relevant. In addition, the indenture governing our Junior Subordinated Deferrable Debentures would restrict us from declaring or paying dividends on our common shares if we are downgraded by A.M. Best to a financial strength rating of B (Fair) or below or if A.M. Best withdraws its financial strength rating on any of our material insurance subsidiaries.

Future sales of our common shares and grants of restricted shares may affect the market price of our common shares and the future exercise of options and warrants may result in immediate and substantial dilution of the common shares.

As of March 6, 2008 (but without giving effect to unvested restricted shares), we had 74,205,749 common shares outstanding and 8,693,216 shares issuable upon exercise of outstanding warrants. Approximately 42,385,701 of these shares were subject to the volume limitations and other conditions of Rule 144 under the Securities Act of 1933, as amended, which we refer to as the Securities Act. Furthermore, certain of our sponsoring shareholders and their transferees have the right to require us to register these common shares under the United States Securities Act for sale to the public, either in an independent offering pursuant to a demand registration or in conjunction with a public offering, subject to a lock-up agreement of no more than 90 days. Following any registration of this type, the common shares to which the registration relates will be freely transferable. In addition, we have filed one or more registration statements on Form S-8 under the Securities Act to register common shares issued or reserved for issuance under the Long Term Incentive Plan. The number of Common Shares that have been reserved for issuance under the Plan is equal to 13,126,896. We cannot predict what effect, if any, future sales of our common shares, or the availability of common shares for future sale, will have on the market price of our common shares. Sales of substantial amounts of our common shares in the public market, or the perception that sales of this type could occur, could depress the market price of our common shares and may make it more difficult for our shareholders to sell their common shares at a time and price that they deem appropriate.

Our Bye-laws authorize our Board of Directors to issue one or more series of common shares and preferred shares without stockholder approval. Specifically, we have an authorized share capital of approximately 571,428,571 shares ($0.175 par value per share), which can consist of common shares and/or preference shares, as determined by our Board of Directors. The Board of Directors has the right to issue the remaining shares without obtaining any approval from our stockholders and to fix the rights, preferences, privileges and restrictions thereof, including dividend rights, conversion rights, voting rights, terms of redemption, liquidation preferences and the number of shares constituting any series or designation of such series. Any issuance of our preferred stock could adversely affect the voting power of the holders of our common shares and could have the effect of delaying, deferring, or preventing the payment of any dividends (including any liquidating dividends) and any change in control of us. If a significant number of either common or preferred shares are issued, it may cause the market price of our common shares to decline.

We cannot predict what effect, if any, future sales of our common shares, or the availability of common shares for future sale, will have on the market price of our common shares. Sales of substantial amounts of our common shares in the public market, or the perception that such sales could occur, may adversely affect the market price of our common shares and may make it more difficult for shareholders to sell their common shares at a time and price which they deem appropriate.

Our classified board structure may prevent a change in our control.

Our board of directors is divided into three classes of directors. Each year one class of directors is elected by the shareholders for a three year term. The staggered terms of our directors may reduce the possibility of a tender offer or an attempt at a change in control, even though a tender offer or change in control might be in the best interest of our shareholders.

There are provisions in our Bye-laws that reduce the voting rights of voting common shares that are held by a person or group to the extent that such person or group holds more than 9.09% of the aggregate voting power of all common shares entitled to vote on a matter.

In general, and except as provided below, shareholders have one vote for each voting common share held by them and are entitled to vote at all meetings of shareholders. However, if, and for so long as, the common shares of a shareholder, including any votes conferred by controlled shares (as defined below), would otherwise represent more than 9.09% of the aggregate voting power of all common shares entitled to vote on a matter, including an election of directors, the votes conferred by such shares will be reduced by whatever amount is necessary such that, after giving effect to any such reduction (and any other reductions in voting power required by our Bye-laws), the votes conferred by such shares represent 9.09% of the aggregate voting power of all common shares entitled to vote on such matter. Controlled shares include, among other things, all shares that a person is deemed to own directly, indirectly or constructively (within the meaning of Section 958 of the Code, or Section 13(d)(3) of the Securities and Exchange Act of 1934, as amended (the Exchange Act)). At December 31, 2007, there were 74,205,749 voting common shares, of which 6,745,303 voting common shares would confer votes that represent 9.09% of the aggregate voting power of all common shares entitled to vote generally at an election of directors. An investor who does not hold, and is not deemed under the provisions of our Bye-laws to own, any of our common shares may therefore purchase up to such amount without being subject to voting cutback provisions in our Bye-laws.

In addition, we have the authority under our Bye-laws to request information from any shareholder for the purpose of determining ownership of controlled shares by such shareholder.

There are regulatory limitations on the ownership and transfer of our common shares which could result in the delay or denial of any transfers shareholders might seek to make.

The BMA must approve all issuances and transfers of securities of a Bermuda exempted company like us. We have received permission from the BMA to issue our common shares, and for the free transferability of our common shares as long as the common shares are listed on the New York Stock Exchange or other appointed exchange, to and among persons who are residents and non-residents of Bermuda for exchange control purposes. Any other transfers remain subject to approval by the BMA and such approval may be denied or delayed.

A shareholder of our company may have greater difficulties in protecting its interests than as a shareholder of a U.S. corporation.

The Companies Act 1981 (the Companies Act), which applies to our company, differs in material respects from laws generally applicable to U.S. corporations and their shareholders. Taken together with the provisions of our Bye-laws, some of these differences may result in a shareholder having greater difficulties in protecting its interests as a shareholder of our company than it would have as a shareholder of a U.S. corporation. This affects, among other things, the circumstances under which transactions involving an interested director are voidable, whether an interested director can be held accountable for any benefit realized in a transaction with our company, what approvals are required for business combinations by our company with a large shareholder or a wholly owned subsidiary, what rights a shareholder may have as a shareholder to enforce specified provisions of the Companies Act or our Bye-laws, and the circumstances under which we may indemnify our directors and officers.

We are a Bermuda company and it may be difficult for our shareholders to enforce judgments against us or against our directors and executive officers.

We were incorporated under the laws of Bermuda and our business is based in Bermuda. In addition, certain of our directors and officers reside outside the United States, and a portion of our assets and the assets of such persons may be located in jurisdictions outside the United States. As such, it may be difficult or impossible to effect service of process within the United States upon us or those persons, or to recover against us or them on judgments of U.S. courts, including judgments predicated upon the civil liability provisions of the U.S. federal securities laws. Further, no claim may be brought in Bermuda against us or our directors and officers in the first instance for violation of U.S. federal securities laws because these laws have no extraterritorial application under Bermuda law and do not have force of law in Bermuda; however, a Bermuda court may impose civil liability, including the possibility of monetary damages, on us or our directors and officers if the facts alleged in a complaint constitute or give rise to a cause of action under Bermuda law. Currently, of our executive officers, George Reeth, Joseph E. (Jeff) Consolino, C. Jerome Dill and Conan Ward reside in Bermuda, Edward Noonan and Stuart Mercer maintain residences in both Bermuda and the United States, Michael Belfatti resides in the United States and Rupert Atkin, Gilles Bonvarlet and Michael Carpenter reside in the United Kingdom. Of our directors, Edward Noonan maintains residences in both Bermuda and the United States, George Reeth resides in Bermuda, Jean-Marie Nessi resides in France and the remainder reside in the United States.

We have been advised by Bermuda counsel, that there is doubt as to whether the courts of Bermuda would enforce judgments of U.S. courts obtained in actions against us or our directors and officers, as well as the experts named herein, predicated upon the civil liability provisions of the U.S. federal securities laws, or original actions brought in Bermuda against us or such persons predicated solely upon U.S. federal securities laws. Further, we have been advised by Bermuda counsel that there is no treaty in effect between the United States and Bermuda providing for the enforcement of judgments of U.S. courts in civil and commercial matters, and there are grounds upon which Bermuda courts may decline to enforce the judgments of U.S. courts. Some remedies available under the laws of U.S. jurisdictions, including some remedies available under the U.S. federal securities laws, may not be allowed in Bermuda courts as contrary to public policy in Bermuda. Because judgments of U.S. courts are not automatically enforceable in Bermuda, it may be difficult for our shareholders to recover against us based upon such judgments.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

The Company and Validus Re currently occupy office space in Hamilton, Bermuda under a lease expiring on August 31, 2011. Validus Research Inc. currently occupies office space in Waterloo, Canada under a lease expiring on February 28, 2018. Validus Reaseguros, Inc. currently occupies office space in Miami, United States under a lease expiring on March 29, 2011. Talbot currently occupies office space in London, England under a lease expiring on December 24, 2013 and in Singapore under a lease expiring on December 14, 2008. We believe that our current office space is suitable for the foreseeable future.

Item 3. *Legal Proceedings*

We anticipate that, similar to the rest of the insurance and reinsurance industry, we will be subject to litigation and arbitration in the ordinary course of business.

Item 4. *Submission of Matters to a Vote of Security Holders*

No matters were submitted to a vote of ordinary shareholders during the fourth quarter of the fiscal year covered by this report.

Executive Officers of the Company

The following table provides information regarding our executive officers and key employees as of March 6, 2008:

Name	Age	Position
Edward J. Noonan	49	Chairman of the Board of Directors and Chief Executive Officer
George P. Reeth	51	President and Deputy Chairman
C.N. Rupert Atkin	49	Chief Executive Officer of the Talbot Group
Michael J. Belfatti	37	Executive Vice President and Chief Actuary
Gilles A. M. Bonvarlet	44	Chief Operating Officer of the Talbot Group
Michael E.A. Carpenter	58	Chairman of the Talbot Group
Joseph E. (Jeff) Consolino	41	Executive Vice President and Chief Financial Officer
C. Jerome Dill	47	Executive Vice President and General Counsel
Stuart W. Mercer	48	Executive Vice President and Chief Risk Officer
Conan M. Ward	40	Executive Vice President and Chief Underwriting Officer

Edward J. Noonan has been chairman of our board and the chief executive officer of the Company since its formation. Mr. Noonan has 27 years of experience in the insurance and reinsurance industry, serving most recently as the acting chief executive officer of United America Indemnity Ltd. (Nasdaq: INDM) from February 2005 through October 2005 and as a member of the board of directors from December 2003 to May 2007. Mr. Noonan served as president and chief executive officer of American Re-Insurance Company from 1997 to 2002, having joined American Re in 1983. Mr. Noonan also served as chairman of Inter-Ocean Reinsurance Holdings of Hamilton, Bermuda from 1997 to 2002. Mr. Noonan is also a director of Central Mutual Insurance Company and All American Insurance Company, both of which are property and casualty companies based in Ohio.

George P. Reeth has been president and deputy chairman of the Company since its formation and has senior operating and distribution responsibilities. Mr. Reeth, who has 30 years experience in the insurance and reinsurance industry, was a senior executive with Willis Group Limited from 1992 to 2005 and was chairman & chief executive officer of North American Reinsurance Operations for Willis Re Inc. from 2000 to 2005. Prior to Willis, Mr. Reeth was executive vice president at Wilcox, Inc.

C. N. Rupert Atkin began his career at the Alexander Howden Group in 1980 before moving to Catlin Underwriting Agencies in 1984. After six years at Catlin he left to join Talbot, then Venton Underwriting Ltd, heading up the marine classes of business within Syndicate 376. In 1995 Syndicate 1183 was constituted with Mr. Atkin as the Active Underwriter. In 2000 Syndicate 1183 was merged back into Syndicate 376. The syndicate was reconstituted once again following the management led buyout of the Talbot group in November 2001. Following the sale of Talbot to Validus in the summer of 2007 Mr. Atkin was appointed as Chief Executive Officer of Talbot. Mr. Atkin is also a director of 1384 Capital Ltd, a company incorporated in England & Wales and supporting the underwriting of the Talbot Group s syndicate for the 2005, 2006 and 2007 years of account. Mr. Atkin was appointed to the Council of Lloyd s in 2007.

Michael J. Belfatti joined the Company in January 2008 as executive vice president and chief actuary. Mr. Belfatti has 14 years of experience in the insurance and reinsurance industry, serving most recently as senior consultant and Philadelphia location manager of the Tillinghast Insurance Consulting business of Towers Perrin from 2005 through 2007. Mr. Belfatti also held the position of director within the financial function of CIGNA Group Insurance in 2005. Prior to that, Mr. Belfatti was senior vice president and chief actuary of ACE Financial Solutions from 2000 to 2004.

Gilles A. M. Bonvarlet has been Talbot s chief operating officer since 2004 when he joined the group. From 1994 through 2004 Mr. Bonvarlet was with the Brockbank Group, which became a part of XL Capital where he was, among other things, CFO of XL London Market Group and Managing Director of XL London Market Ltd. Mr. Bonvarlet began his career in 1988 at CIC Union Européene International Bank before moving to Coopers and Lybrand where he remained for five years. Between 1995 and 2000, Mr. Bonvarlet was a committee member of the Lloyd s Underwriting Agents Association and a member of various other committees such as the Lloyd s Business Development Unit Board. Mr. Bonvarlet served on the Lloyd s Market Board from 2001 to 2002.

Michael E. A. Carpenter joined Talbot in June 2001 as the chief executive officer. Following the sale of Talbot to Validus in the summer of 2007 Mr. Carpenter was appointed as Chairman. Mr. Carpenter is also a director of 1384 Capital Ltd, a company incorporated in England & Wales and supporting the underwriting of the Talbot Group s syndicate for the 2005, 2006 and 2007 years of account.

Joseph E. (Jeff) Consolino has been executive vice president and chief financial officer of the Company since March 2006. Mr. Consolino has over 15 years of experience in the financial services industry, specifically in providing investment banking services to the insurance industry, and most recently served as a managing director in Merrill Lynch s Financial Institutions Group specializing in insurance company advisory and financing transactions. He serves as a Director of National Interstate Corporation, a property and casualty company based in Ohio and of AmWINS Group, Inc., a wholesale insurance broker based in North Carolina.

C. Jerome Dill has been executive vice president and general counsel of the Company since April 1, 2007. Prior to joining the Company, Mr. Dill was a partner with the law firm of Appleby Hunter Bailhache, which he joined in 1986. Mr. Dill serves on the Board of Directors of Bermuda Commercial Bank.

Stuart W. Mercer has been executive vice president and chief risk officer of the Company since its formation. Mr. Mercer has over 18 years of experience in the financial industry focusing on structured derivatives, energy finance and reinsurance. Previously, Mr. Mercer was a senior advisor to DTE Energy Trading.

Conan M. Ward has been executive vice president and chief underwriting officer of the Company since January 2006. Mr. Ward has over 15 years of insurance industry experience. Mr. Ward was executive vice president of the Global Reinsurance division of Axis Capital Holdings, Ltd. from November 2001 until November 2005, where he oversaw the division s worldwide property catastrophe, property per risk, property pro rata portfolios. He is one of the founders of Axis Specialty, Ltd and was a member of the operating board and senior management committee of Axis Capital. From July 2000 to November 2001, Mr. Ward was a senior vice president at Guy Carpenter & Co.

PART II

All amounts presented in this part are in U.S. dollars except as otherwise noted.

Item 5.

Market for Registrants Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

The Company s common shares, $0.175 par value per share, are listed on the New York Stock Exchange under the symbol VR .

Table of Contents

The following tables sets forth the high and low sales prices per share, as reported on the New York Stock Exchange Composite Tape, of the Company s common shares per fiscal quarter commencing from the Company s IPO on July 25, 2007.

	High	Low
2007:		
3rd Quarter	$ 25.28	$ 21.11
4th Quarter	$ 26.59	$ 24.73

There were approximately 70 record holders of our common shares as of December 31, 2007. This figure does not represent the actual number of beneficial owners of our common shares because such shares are frequently held in street name by securities dealers and others for the benefit of individual owners who may vote the shares.

Performance Graph

Set forth below is a line graph comparing the percentage change in the cumulative total shareholder return, assuming the reinvestment of dividends, over the period from the Company s IPO, July 25, 2007, through December 31, 2007 as compared to the cumulative total return of the Standard & Poor s 500 Stock Index and the cumulative total return of an index of the Company s peer group. The peer group index is comprised of the following companies: ACE Limited, Arch Capital Group Limited, Aspen Insurance Holdings Limited, Allied World Assurance Company Holdings, Ltd., Axis Capital Holdings Limited, Endurance Specialty Holdings Limited, Everest Re Group Limited, Flagstone Reinsurance Holdings Group Limited, Greenlight Capital Re Ltd., IPC Holdings Ltd., Max Capital Group Ltd., Odyssey Re Holdings Corp., PartnerRe Ltd., Platinum Underwriters Holdings Ltd., RenaissanceRe Holdings Ltd., Transatlantic Holdings Inc., and XL Capital Ltd.

Dividend Policy

On February 20, 2008 the Company announced a quarterly cash dividend of $0.20 per share payable on March 17, 2008 to holders of record on March 3, 2008. The timing and amount of any future cash dividends, however, will be at the discretion of our Board of Directors and will depend upon our results of operations and cash flows, our financial position and capital requirements, general business conditions, legal, tax, regulatory, rating agency and contractual constraints or restrictions and any other factors that our Board of Directors deems relevant.

We are a holding company and have no direct operations. Our ability to pay dividends depends, in part, on the ability of Validus Re and Talbot to pay dividends to us. Each of the subsidiaries is subject to significant regulatory restrictions limiting its ability to declare and pay dividends. The Insurance Act provides that these subsidiaries may not declare or pay in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its statutory balance sheet in relation to the previous financial year) unless it files an affidavit with the BMA at least seven days prior to the payment signed by at least two directors and such subsidiary s principal representative, stating that in their opinion such subsidiaries will continue to satisfy the required margins following declaration of those dividends, though there is no additional requirement for BMA approval. In addition, before reducing its total statutory capital by 15% or more (as set out in its previous years statutory financial statements) each of these subsidiaries must make application to the BMA for permission to do so, such application to consist of an affidavit signed by at least two directors and such subsidiary s principal representative stating that in their opinion the proposed reduction in capital will not cause such subsidiary to fail to meet its relevant margins, and such other information as the BMA may require. At December 31, 2007, Bermuda statutory restrictions permit Validus Re and Talbot to pay dividends of up to $1.4 billion and $209.0 million, respectively, to the Company. In addition, the indenture governing our Junior Subordinated Deferrable Debentures would restrict us from declaring or paying dividends on our common shares if we are downgraded by A.M. Best to a financial strength rating of B (Fair) or below or if A.M. Best withdraws its financial strength rating on any of our material insurance subsidiaries. On May 16, 2007, A.M. Best placed our financial strength ratings under review with negative implications. See Business Regulation Bermuda, Risk Factors Risks Related to Ownership of Our Common Shares Because we are a holding company and substantially all of our operations are conducted by our main operating subsidiaries, Validus Re and Talbot, our ability to meet any ongoing cash requirements and to pay dividends will depend on our ability to obtain cash dividends or other cash payments or obtain loans from Validus Re and Talbot, Risk Factors Risks Related to Our Company We depend on ratings by A.M. Best Company. Our financial strength rating could be revised downward, which could affect our standing among brokers and customers, cause our premiums and earnings to decrease and limit our ability to pay dividends on our common shares.

Purchases of Equity Securities by the Issuer and Affiliate Purchases

None.

Table of Contents

Item 6. *Selected Financial Information*

The summary consolidated statement of operations data for the years ended December 31, 2007 and December 31, 2006 and the period ended December 31, 2005 and the summary consolidated balance sheet data as of December 31, 2007 and December 31, 2006 are derived from our audited consolidated financial statements. On July 2, 2007 the Company acquired Talbot Holdings Ltd. (Talbot) and is consolidating Talbot effective as of that date. As a result, Talbot is only included in the Company s consolidated results from July 2, 2007 through December 31, 2007. Talbot is not included in consolidated results for the year ended December 31, 2006 and the first six months of 2007.

You should read the following summary consolidated financial information together with the other information contained in this annual report on form 10K, including Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes included elsewhere in this annual report on form 10K.

The following table is derived from audited results for the years ended December 31, 2007 and December 31, 2006 and the period from October 19, 2005, the date of our incorporation, to December 31, 2005:

	Year Ended December 31, 2007	Year Ended December 31, 2006	Period Ended December 31, 2005
	(Dollars in thousands, except share and per share amounts)		
Revenues			
Gross premiums written	$ 988,637	$ 540,789	
Reinsurance premiums ceded	(70,210)	(63,696)	
Net premiums written	918,427	477,093	
Change in unearned premiums	(60,348)	(170,579)	
Net premiums earned	858,079	306,514	
Net investment income	112,324	58,021	2,032
Net realized gains (losses) on investments	1,608	(1,102)	39
Net unrealized gains on investments(1)	12,364		
Other income	3,301	2,157	
Foreign exchange gains (losses)	6,696		
Total revenues	994,372	365,590	2,071
Expenses			
Losses and loss expenses	283,993	91,323	
Policy acquisition costs	134,277	36,072	
General and administrative expenses(2)	100,765	38,354	2,367
Share compensation expenses	16,189	7,878	290
Finance expenses	51,754	8,789	
Fair value of warrants issued	2,893	77	49,122
Total expenses	589,871	182,493	51,779
Net income before taxes	404,501	183,097	(49,708)

Taxes		1,505				
Net income (loss)		402,996		183,097		(49,708)
Comprehensive income (loss)						
Unrealized gains arising during the period(1)				(332)		144
Foreign currency translation adjustments		(49)				
Adjustment for reclassification of losses realized in income				1,102		(39)
Comprehensive income (loss)	$	402,947	$	183,867	$	(49,603)

	Year Ended December 31, 2007	Year Ended December 31, 2006	Period Ended December 31, 2005
	(Dollars in thousands, except share and per share amounts)		
Earnings per share(3)			
Weighted average number of common shares and common share equivalents outstanding			
Basic	65,068,093	58,477,130	58,423,174
Diluted	67,786,673	58,874,567	58,423,174
Basic earnings per share	$ 6.19	$ 3.13	$ (0.85)
Diluted earnings per share	$ 5.95	$ 3.11	$ (0.85)
Selected financial ratios			
Losses and loss expenses ratio(4)	33.1%	29.8%	
Policy acquisition cost ratio(5)	15.6%	11.8%	
General and administrative expense ratio(6)	13.3%	15.1%	
Expense ratio(7)	28.9%	26.9%	
Combined ratio(8)	62.0%	56.7%	
Return on average equity(9)	26.9%	17.0%	NM

The following table sets forth summarized balance sheet data as of December 31, 2007, 2006 and 2005:

	As of December 31, 2007	As of December 31, 2006	As of December 31, 2005
	(Dollars in thousands, except share and per share amounts)		
Summary Balance Sheet Data:			
Investments at fair value	$ 2,662,021	$ 1,376,387	$ 610,800
Cash and cash equivalents	444,698	63,643	398,488
Total assets	4,144,224	1,646,423	1,014,453
Unearned premiums	557,344	178,824	
Reserve for losses and loss expenses	926,117	77,363	
Junior Subordinated Deferrable Debentures	350,000	150,000	
Total shareholders equity	1,934,800	1,192,523	999,806
Book value per common share(10)	26.08	20.39	17.11
Diluted book value per common share(11)	24.00	19.73	16.93

NM Not meaningful

(1) The Company has early adopted FAS 157 and FAS 159 as of January 1, 2007 and elected the fair value option on all securities previously accounted for as available-for-sale. Unrealized gains and losses on

available-for-sale investments at December 31, 2006 of $875,000, previously included in accumulated other comprehensive income, were treated as a cumulative-effect adjustment as of January 1, 2007. The cumulative-effect adjustment transferred the balance of unrealized gains and losses from accumulated other comprehensive income to retained earnings and has no impact on the results of operations for the annual or interim periods beginning January 1, 2007. The Company s investments were accounted for as trading for the annual or interim periods beginning January 1, 2007 and as such all unrealized gains and losses are included in net income.

(2) General and administrative expenses for the years ended December 31, 2007 and 2006 and the period ended December 31, 2005 include $4,000,000, $1,000,000 and $0, respectively, related to our Advisory Agreement with Aquiline. Our Advisory Agreement with Aquiline terminated upon completion of our IPO, in connection with which recorded general and administrative expense of $3,000,000 in the third quarter of the year ended December 31, 2007.

(3) FAS 123R require that any unrecognized stock-based compensation expense that will be recorded in future periods be included as proceeds for purposes of treasury stock repurchases, which is applied against the unvested restricted shares balance. On March 1, 2007 we effected a 1.75 for one reverse stock split of our outstanding common shares. The stock split does not affect our financial statements other than to the extent it decreases the number of outstanding shares and correspondingly increases per share information for all periods presented. The share consolidation has been reflected retroactively in these financial statements.

(4) The loss and loss expense ratio is calculated by dividing losses and loss expenses by net premiums earned.

(5) The policy acquisition cost ratio is calculated by dividing policy acquisition costs by net premiums earned.

(6) The general and administrative expense ratio for the year ended December 31, 2007 is calculated by dividing the total of general and administrative expenses plus share compensation expenses less the $3,000,000 Aquiline termination fee by net premiums earned. The general and administrative expense ratio for the year ended December 31, 2006 is calculated by dividing the sum of general and administrative expenses and share compensation expenses by net premiums earned.

(7) The expense ratio is calculated by combining the policy acquisition cost ratio and the general and administrative expense ratio.

(8) The combined ratio is calculated by combining the loss ratio, the policy acquisition cost ratio and the general and administrative expense ratio.

(9) Return on average equity is calculated by dividing the net income for the period by the average shareholders equity during the period. Quarterly average shareholders equity is the annualized average of the beginning and ending shareholders equity balances. Annual average shareholders equity is the average of the beginning, ending and intervening quarter end shareholders equity balances.

(10) Book value per common share is defined as total shareholders equity divided by the number of common shares outstanding as at the end of the period, giving no effect to dilutive securities.

(11) 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).

Item 7. ***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 months and year ended December 31, 2007 and 2006 and the Company s consolidated financial condition and liquidity and capital resources at December 31, 2007 and December 31, 2006. The Company completed the acquisition of Talbot Holdings Ltd. (Talbot) on July 2, 2007. As a result, Talbot is only included in the Company s consolidated results from July 2, 2007 through December 31, 2007. Talbot is not included in consolidated results for the year ended December 31, 2006 and the first six months of 2007. This discussion and analysis pertains to the results of the Company inclusive of Talbot from the date of acquisition. Talbot 2006 results are included in discussion of segment results for comparison purposes only and are not consolidated in the Company results for 2006 periods. This discussion and analysis should be read in conjunction with the Company s audited consolidated financial statements and related notes for the fiscal years ended December 31, 2007 and 2006.

The Company was formed on October 19, 2005 and has limited historical financial and operating information. Insurance and reinsurance companies face substantial risk in their initial stages of development. See Cautionary Note Regarding Forward-Looking Statements . In addition, for a variety of reasons, including the Company s recent formation, the acquisition of Talbot and relatively few significant catastrophe events in 2006 and 2007, the Company s historical financial results may not accurately indicate future performance.

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, and

Underwriting Risk Services Ltd, which is an underwriting agency writing primarily yachts, marinas and fine art 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.

Written premiums are a function of the number and type of contracts written, as well as prevailing market prices. Renewal dates for reinsurance business tend to be concentrated at the beginning of quarters, and the timing of premiums written varies by line of business. Most property catastrophe business is written in the January 1, April 1, June 1 and July 1 inception and renewal periods, while most insurance and specialty lines are written throughout the year. Written premiums are generally highest in the first quarter and lowest during the fourth quarter of the year. Gross premiums written for pro rata programs are initially recorded as estimates and are adjusted as actual results are reported by the cedant during the period. Pro rata reinsurance is a type of reinsurance whereby the reinsurer indemnifies the policyholder against a predetermined portion of losses. Earned premiums do not necessarily follow the written premium pattern as premiums written are primarily earned ratably over the contract term, which is ordinarily twelve months, although many pro rata contracts are written on a risks attaching basis, which means that the contracts cover claims that arise on underlying insurance policies that incept during the term of the reinsurance contract, and are generally earned over a 24 month period, which is the risk period of the underlying (twelve month) policies. Premiums are generally due in monthly or quarterly installments.

The following are the primary lines in which the Company conducts business:

Property: Validus Re underwrites property catastrophe reinsurance, property per risk reinsurance and property pro rata reinsurance. Property catastrophe includes reinsurance for insurance companies exposures to an accumulation of property and related losses from separate policies, typically relating to natural disasters or other catastrophic events. Property per risk provides reinsurance for insurance companies excess retention on individual property and related risks, such as highly-valued buildings. In property pro rata contracts the reinsurer shares the premiums as well as the losses and expenses in an agreed proportion with the cedant. Talbot primarily writes direct and facultative property insurance, lineslips and binding authorities and a limited amount of property treaty. The business written is principally commercial and industrial insurance. The business is short-tail with risks generally earned within two years.

Marine: The Company underwrites insurance and reinsurance on marine risks covering damage to or losses of marine vessels or cargo, yachts and marinas, third-party liability for marine accidents and physical loss and liability from principally offshore energy properties. Talbot primarily underwrites marine insurance on a direct and facultative basis. Validus Re underwrites marine reinsurance on an excess of loss basis, and to a lesser extent, on a pro rata basis.

Specialty: The Company underwrites other specialty lines with very limited exposure correlation with its property, marine and energy portfolios. Validus Re underwrites other lines of business depending on an evaluation of pricing and market conditions, which include aerospace, terrorism, life and accident & health and workers compensation catastrophe. With the exception of the aerospace line of business, which has a meaningful portion of its gross premiums written volume on a proportional basis, Validus Re s other specialty lines are primarily written on an excess of loss basis. Talbot underwrites war, political risks, political violence, financial institutions, contingency, bloodstock and livestock, accident and health, and aviation and other treaty. With the exception of aviation and other treaty, most of the Talbot specialty business is written on a direct or facultative basis or through a binding authority or coverholder.

Income from the Company s investment portfolio is primarily comprised of interest income on fixed maturity investments net of investment expenses and net realized/unrealized gains/losses on investments. A significant portion of the Company s contracts provide short-tail coverage for damages resulting mainly from natural and man-made catastrophes, which means that the Company could become liable for a significant amount of losses on short notice. Accordingly, the Company has structured its investment portfolio to preserve capital and maintain a high level of liquidity, which means that the large majority of the Company s investment portfolio consists of short-term fixed maturity investments. The Company s fixed income investments are classified as trading. Under U.S. GAAP, these securities are carried at fair value, and unrealized gains and losses are included in net income in the Company s consolidated statements of operations and comprehensive income.

The Company s expenses consist primarily of losses and loss expenses, acquisition costs, general and administrative expenses, and finance expenses related to debentures and our credit facilities. Organizational expenses and expenses associated with the issuance of warrants were also incurred in the first quarter of 2006 as well as in the period ended December 31, 2005. New warrants were issued in the third quarter of 2007 due to an anti-dilution provision of the warrants arising from the issuance of securities related to the Talbot acquisition. Expenses related to the issuance of warrants are included in the line item Fair value of warrants issued in the Company s consolidated statements of operations and comprehensive income.

Losses and loss expenses are a function of the amount and type of insurance and reinsurance contracts written and of the loss experience of the underlying risks. Reserves for losses and loss expense include a component for outstanding case reserves for claims which have been reported and a component for losses incurred but not reported. The uncertainties inherent in the reserving process, together with the potential for unforeseen developments, may result in losses and loss expenses materially different than the reserve initially established. Changes to prior year loss reserves will affect current underwriting results by increasing net income if a portion of the prior year reserves prove to be redundant or decreasing net income if the prior year reserves prove to be insufficient. Adjustments resulting from new information will be reflected in income in the period in which they become known. The Company s ability to estimate losses and loss expenses accurately, and the resulting impact on contract pricing, is a critical factor in determining profitability.

Since most of the lines of business underwritten have large aggregate exposures to natural and man-made catastrophes, the Company expects that claims experience will often be the result of relatively few events of significant severity. The occurrence of claims from catastrophic events is likely to result in substantial volatility in, and could potentially have a material adverse effect on, the Company s financial condition, results of operations, and ability to write new business. The acquisition of Talbot mitigates these risks by providing us with significant benefits in terms of product line and geographic diversification.

Acquisition costs consist principally of brokerage expenses and commissions which are driven by contract terms on reinsurance contracts written, and are normally a specific percentage of premiums. Under certain contracts, cedants may also receive profit commissions which will vary depending on the loss experience on the contract. Acquisition costs are presented net of commissions or fees received on any ceded premium, including premium ceded to Petrel Re.

General and administrative expenses are generally comprised of fixed expenses which do not vary with the amount of premiums written or losses incurred. Applicable expenses include salaries and benefits, professional fees, office, risk management, and stock compensation expenses. Stock compensation expenses include costs related to the Company s long-term incentive plan, under which restricted stock and stock options are granted to certain employees.

Business Outlook and Trends

The global property and casualty insurance and reinsurance industry has historically been highly cyclical. During the latter half of the 1990s, the industry experienced excess capacity for writers of insurance and reinsurance, which resulted in highly competitive market conditions. After this extended period of intense competition and eroding premium rates, the reinsurance markets began experiencing improvements in rates, terms and conditions for reinsurers in the first quarter of 2000. Continuing improvements through 2001 extended to the primary insurance industry and were accelerated by the events of September 11, 2001. While 2002 and 2003 proved to be relatively uneventful catastrophe years, the reinsurance markets were again significantly affected by natural catastrophe losses in 2004 and 2005. Taken together, 2004 and 2005 set a record for most Atlantic-basin tropical storms, hurricanes, major hurricanes (defined as category 3 or higher on the Saffir-Simpson Hurricane

Intensity Scale) and major hurricanes making U.S. landfall. The 2005 Atlantic-basin hurricane season was the costliest on record, with Hurricanes Rita and Wilma each generating in excess of $10 billion in insured losses and Katrina responsible for an estimated $45 billion in insured losses, which places it as the most costly natural catastrophe on record.

Property and other reinsurance premiums have historically risen in the aftermath of significant catastrophic losses. As loss reserves are established, industry surplus is depleted and the industry s capacity to write new business diminishes. At the same time, management believes that there is a heightened awareness of exposure to natural catastrophes on the part of cedants, rating agencies and catastrophe modeling firms, resulting in an increase in the demand for reinsurance protection. The large industry losses in 2004 and 2005 led to an increase in the perception of catastrophe risk by market participants creating a supply/demand imbalance for reinsurance capacity. The Company was formed in October 2005 to take advantage of these opportunities; we have also built our operations so that we may effectively take advantage of future market conditions as they develop. Talbot, which the Company acquired on July 2, 2007, has also seen an increase in insurance and reinsurance rates in the aftermath of 2005.

In the aggregate, the Company observed substantial increases in premium rates in 2006 compared to 2005 levels. Such rate increases were most significant in the United States catastrophe-exposed lines of business. For risks outside of the U.S., or for risks which were not substantially exposed to catastrophes, rate increases were more modest, or in some cases, decreased. During the year ended December 31, 2007 and the 2008 January renewal period, the Company 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 may increase the supply of insurance and reinsurance which could affect pricing. An increase in the supply of insurance and reinsurance could accelerate rate decreases.

Management believes the supply and demand pressures which exerted upward pressure on prices in peak U.S. property zones in 2006 will continue to decline in the near term, assuming normal catastrophe activity.

Following significant losses from Hurricane Ivan in 2004 and Hurricanes Katrina and Rita in 2005, the marine and offshore energy insurance and reinsurance accounts experienced material price increases and more restrictive conditions. Losses resulting from Katrina affected nearly all lines of business written within the marine class and reinsurance and retrocessional capacity has been reduced sharply. Management believes that many reinsurers withdrew from marine and energy business and remaining reinsurers increased pricing and tightened conditions across all sectors. In addition to rate increases, coverage terms have become more restrictive including increased use of mutually exclusive pillars and other parametric devices.

We underwrite global specialty property insurance and reinsurance and have large aggregate exposures to natural and man-made disasters. The relatively low claim experience for Validus Re has been the result of few events of high magnitude. The occurrence of claims from catastrophic events is likely to result in substantial volatility in, and could have a material adverse effect on, the Company s financial condition and results and ability to write new business. This volatility will affect results for the period in which the loss occurs because U.S. accounting principles do not permit reinsurers to reserve for such catastrophic events until they occur. Catastrophic events of significant magnitude historically have been relatively infrequent, although management believes the property catastrophe reinsurance market has experienced a higher level of worldwide catastrophic losses in terms of both frequency and severity in the period from 1992 to the present. We also expect that increases in the values and concentrations of insured property will increase the severity of such occurrences in the future. The Company seeks to reflect these trends when pricing contracts.

Critical Accounting Policies and Estimates

The Company s consolidated financial statements have been prepared in accordance with U.S. GAAP. The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect reported and disclosed amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities as at the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Management believes the following accounting policies are critical to the Company s operations as the application of these policies requires management to make significant judgments. Management believes the items that require the most subjective and complex estimates are (1) reserve for losses and loss expenses and (2) premiums and (3) reinsurance premiums ceded and reinsurance recoverables.

Reserve for Losses and Loss Expenses. For insurance and reinsurance companies, a significant judgment made by management is the estimation of the reserve for losses and loss expenses. The Company establishes its reserve for losses and loss expenses to cover the estimated remaining liability incurred for both reported claims (case reserves) and unreported amounts (incurred but not reported or IBNR reserves). For insurance and reinsurance business, the IBNR reserves include provision for circumstances that have occurred but not yet been reported to the Company as well as for future variation in case reserves (where the claim has been reported but the ultimate value is not yet known). Within the reinsurance business, the portion of total IBNR related to future variation on known claims is calculated at the individual claim level in some instances (an additional case reserve or individual claim IBNR). Within the insurance business, the provision for future variation in current case reserves is generally calculated on an implicit basis via the direct projection of total IBNR, and ACRs are not used.

Loss reserve estimates for insurance and reinsurance business are not precise in that they deal with the inherent uncertainty in the outcome of insurance and reinsurance claims made on the Company, many of which have not yet been reported to the Company. Estimating loss reserves requires management to make assumptions, both explicit and implicit, regarding future paid and reported loss development patterns, frequency and severity trends, claims settlement practices, potential changes in the legal environment and other factors. These estimates and judgments are based on numerous factors, and may be revised over time as additional experience or other data becomes available, as new or improved methodologies are developed or as current laws change.

As predominantly a broker market insurer and reinsurer, the Company must rely on loss information reported to us by brokers from clients, where such information is often incomplete or changing. The quality and type of information received varies by client and by the nature of the business, insurance or reinsurance.

For insurance business, for risks that the Company leads, the Company receives from brokers details of potential claims, on the basis of which the Company s loss adjusters make estimates of the likely ultimate outcome of the claims. For insurance business where another company is the lead, the Company additionally receives and reviews case estimates from the lead insurer. In determining these reserves, the Company takes into account a number of factors including the facts and circumstances of the individual claim, the nature of the coverage, and historical information about its experience on similar types of claims. The sum of the individual claim estimates for lead and follow business constitutes the case reserves.

For reinsurance business, the Company typically receives from brokers details of paid losses and estimated case reserves recorded by the ceding company. In addition to this, the ceding company s estimated provision for IBNR losses is sometimes also available, although this in itself introduces additional uncertainty owing to the differing and typically unknown reserving practices of ceding companies.

There will also be a time lag between a loss occurring and it being reported, first by the original claimant to its insurer, via the insurance broker, and for reinsurance business, subsequently from the insurer to the reinsurer via the reinsurance broker.

The Company writes a mix of predominantly short-tail business, both insurance and reinsurance. The combination of low claim frequency and high claim severity that is characteristic of much of this short-tail business makes the available data more volatile and less reliable for predicting ultimate losses. For example, in property lines, there can be additional uncertainty in loss estimation related to large catastrophe events, whether natural or man-made. With winds events, such as hurricanes, the damage assessment process may take more than a year. The cost of claims is subject to volatility due to supply shortages for construction materials and labor. In the case of earthquakes, the damage assessment process may take longer as buildings are discovered to have structural weaknesses not initially detected.

The Company additionally writes a relatively small amount of longer tail insurance business, predominantly financial institutions and marine and energy liabilities. For such business, the time from the occurrence of a claim to its being reported, and in particular, the subsequent time before settlement of the claim, can be years, in which time additional facts regarding individual claims and trends often will become known and current laws and case law may change.

Taken together, these issues add considerable uncertainty to the process of estimating ultimate losses, hence loss reserves, and this uncertainty is increased for reinsurance business compared with insurance business due to the additional parties in the chain of reporting from the original claimant to the reinsurer.

As a result of the uncertainties described above, the Company must estimate IBNR reserves, which consist of a provision for future development on known loss events, as well as a provision for claims which have occurred but which have not yet been reported to us by clients. Because of the degree of reliance that is necessarily placed on brokers and (re)insured companies for claims reporting, the associated time lag, the low frequency/high severity nature of much of the business underwritten, and, for reinsurance business, the varying reserving practices among ceding companies as described above, reserve estimates are highly dependent on management s judgment and are subject to uncertainty.

The Company strives to take account of these uncertainties in the judgments and assumptions made when establishing loss reserves, but it is not possible to eliminate the uncertainties. As a result, there is a risk that the Company s actual losses may be higher or lower than the reserves booked.

For the Company s insurance business written by Talbot, where a longer reserving history exists, the Company examines the development of its own historical paid and incurred losses to identify trends, which it then incorporates into the reserving process where it deems appropriate.

For the Company s reinsurance business, especially that written by Validus Re where the Company relies more heavily on information provided by clients in order to assist it in estimating reserves, the Company performs certain processes in order to help assess the completeness and accuracy of such information as follows:

1. In addition to information received from clients on reported claims, the Company also uses information on the patterns of client loss reporting and loss settlements from previous events in order to estimate the Company s ultimate liability related to these events.

2. The Company uses reinsurance industry information in order to perform consistency checks on the data provided by ceding companies and to identify trends in loss reporting and settlement activity. The Company incorporates such information in establishing reinsurance reserves.

3. For both insurance and reinsurance business, the Company supplements the loss information received from clients with loss estimates developed by market share techniques and third party catastrophe models when such information is available.

Although there is normally a lag in receiving reinsurance data from cedants, the Company currently has no backlog related to the processing of assumed reinsurance information. The Company actively manages its relationships with brokers and clients and considers existing disputes with counterparties to be in the normal course of business.

As described above, the reserve for losses and loss expenses includes both a component for outstanding case reserves for claims which have been reported and a component for IBNR reserves. IBNR reserves are the difference between ultimate losses and reported losses, where reported losses are the sum of paid losses and outstanding case reserves. Ultimate losses are estimated by management using various actuarial methods, including exposure-based and loss-based methods, as well as other qualitative assessments regarding claim trends.

The Company uses a reserving methodology that establishes a point estimate for ultimate losses. The point estimate represents management s best estimate of ultimate losses and loss expenses. The Company does not select a range as part of its loss reserving process. The extent of reliance on management judgment in the reserving process differs depending on the circumstances surrounding the estimations, including the volume and credibility of data, the perceived relevance of historical data to future conditions, the stability or lack of stability in the Company s operational processes for handlings losses (including claims practices and systems) and other factors. The Company reviews its reserving assumptions and methodologies on a quarterly basis. Two of the most critical assumptions in establishing reserves are loss emergence patterns and expected (or prior) loss ratios. Loss emergence patterns are critical to the reserving process as they can be one key indicator of the ultimate liability. A pattern of reported loss emergence different from expectations may indicate a change in the loss climate and may thus influence the estimate of future payments that should be reflected in reserves. Expected loss ratios are a primary component in the Company s calculation of estimated ultimate losses for business at an early stage in its development.

Loss emergence patterns for the business written by Talbot are generally derived from the Company s own historic loss development triangulations, supplemented in some instances by Lloyd s market data. For the business written by Validus Re, where the Company s own historic loss development triangulations are currently more limited, greater use is made of market data including reinsurance industry data available from organizations such as statistical bureaus and consulting firms, where appropriate. Expected loss ratios are estimated in a variety of ways, largely dependent upon the data available. Wherever it deems appropriate, management incorporates the Company s own loss experience in establishing initial expected loss ratios and reserves. This is particularly true for the business written by Talbot where a longer reserving history exists and expected losses and loss ratios consider, among other things, rate increases and changes in terms and conditions that have been observed in the market. For reinsurance business, expected losses and loss ratios are typically developed using vendor and proprietary computer models. The information used in these models is collected by underwriters and actuaries during the initial pricing of the business.

Other methodologies are also used by the Company in the reserving process for specific types of claims or events, such as catastrophic or other specific major events. These include estimation based on vendor catastrophe models and analyses of specific industry events, such as large claims or lawsuits.

Management anticipates that the loss estimates will be subject to annual corroborative review by independent actuaries using generally accepted actuarial principles.

The Company s three lines of business, property, marine and specialty are exposed to event-related risks that are generally reported and paid within three years of the event except for financial institutions and marine liability. The Company estimates that 86.1% of its current reserves will be paid within three years. The Company writes longer tail business in its financial institutions and energy and marine liabilities lines. Factors contributing to uncertainty in reserving for these lines include longer duration of loss development patterns, difficulty applying older loss experience to newer years, and the possibility of future litigation. The Company considers these factors when reserving for longer tail lines.

As described above, for all lines of business, the Company s reserve for losses and loss adjustment expenses and loss reserves recoverable consist of three categories: (1) case reserves, (2) in certain circumstances, ACR, and (3) IBNR reserves. For both Talbot and Validus Re, IBNR is established separately for large or catastrophe losses and smaller attritional losses. The reserves and recoverables for attritional and large or catastrophe losses are established on an annual and interim basis as follows:

1. *Case reserves* Case reserves generally are analyzed and established by the Company s claims department on all lines, making use of third party input where appropriate (including, for the reinsurance business, reports of losses from the ceding companies). For insurance business where Talbot is not the Lead underwriter on the business, the case reserves are established by the lead underwriter and validated by central Lloyd s market claims bureau, with a sample reviewed by Talbot.

2. *ACR reserves* ACRs are established for Validus Re business by our claims department in cases where we believe the case reserves reported by the cedant require adjustment. ACRs supplement case reserves based on information obtained through ceding company audits or other sources. ACRs are not used at Talbot as claim volumes are generally greater and thus the potential for future variation in case reserve estimates on known claims often can be analyzed at an aggregate level using historical data.

3. IBNR reserves:

a. *Large or catastrophe events* IBNR reserves are established for all lines based on the Company s estimates for known loss events for which not all claims have been reported to the Company. In establishing such IBNR, the Company accumulates loss information from modeling agencies, where possible, and publicly available sources. The loss information is applied to the Company s book of in-force contracts using internal and third party vendor models to establish an estimate of the Company s ultimate exposure to the loss event. Paid losses, case reserves and additional case reserves are deducted from the ultimate to ascertain the IBNR estimate for individual large claims or catastrophe events.

b. *Attritional losses* IBNR reserves are established using some combination of the actuarial methods described above, including the Chain Ladder method, the Generalized Cape Cod method and the Bornhuetter-Ferguson method. In situations where limited historic development data is available and/or the year being analyzed is more recent (less mature), the expected loss method and the Bornhuetter-Ferguson method are more commonly used. Under all methods used at both Validus Re and Talbot, an ultimate loss amount is established. Paid losses, case reserves and additional case reserves are then deducted from the ultimate to ascertain the attritional IBNR reserves.

For all sources of IBNR, net reserves are estimated by first estimating gross IBNR reserves, then estimating reinsurance recoverables on IBNR. To date, reinsurance recoverables are most material for the business written by Talbot.

The Company s reserving methodology was not changed in the quarter ended December 31, 2007 from the methodology used in the year ended December 31, 2006 for either Validus Re or Talbot. Management s best estimate of the gross reserve for losses and loss expenses and loss reserves recoverable at December 31, 2007 were $926.1 million and $134.4 million, respectively. The following table sets forth a breakdown between gross case reserves and gross IBNR by business segment at December 31, 2007.

	At December 31, 2007		
	Gross Case Reserves	Gross IBNR	Total Gross Reserve for Losses and Loss Expenses
	(Dollars in thousands)		
Validus Re	$ 71,994	$ 124,819	$ 196,813
Talbot	391,377	337,927	729,304
Total	$ 463,371	$ 462,746	$ 926,117

Management s best estimate of the gross reserve for losses and loss expenses at December 31, 2006 was $77.4 million. The following table sets forth a breakdown between gross case reserves and gross IBNR by segment at December 31, 2006.

	At December 31, 2006		
	Gross Case Reserves	Gross IBNR	Total Gross Reserve for Losses and Loss Expenses
	(Dollars in thousands)		
Validus Re	$ 38,114	$ 39,249	$ 77,363

Talbot			
Total	$ 38,114	$ 39,249	$ 77,363

To the extent insurance and reinsurance industry data is relied upon to aid in establishing reserve estimates, there is a risk that the data may not match the Company s risk profile or that the industry s reserving practices overall differ from those of the Company and its clients. In addition, reserving can prove especially difficult should a significant loss event take place near the end of an accounting period, particularly if it involves a catastrophic event. These factors further contribute to the degree of uncertainty in the reserving process.

The uncertainties inherent in the reserving process, together with the potential for unforeseen developments, including changes in laws and the prevailing interpretation of policy terms, may result in losses and loss expenses materially different from the reserves initially established. Changes to prior year reserves will affect current period underwriting income by increasing income if the prior year ultimate losses are reduced or decreasing income if the prior year ultimate losses are increased. The Company expects volatility in results in periods when significant loss events occur because U.S. GAAP does not permit insurers or reinsurers to reserve for loss events until they have both occurred and are expected to give rise to a claim. As a result, the Company is not allowed to record contingency reserves to account for expected future losses. The Company anticipates that claims arising from future events will require the establishment of substantial reserves in future periods.

Given the risks and uncertainties associated with the process for estimating reserves for losses and loss expenses, management has performed an evaluation of the potential variability in loss reserves and the impact this variability may have on reported results, financial condition and liquidity. Management s best estimate of the net reserve for losses and loss expenses at December 31, 2007 is $791.7 million. The following tables show the effect on net reserves for losses and loss expenses as of December 31, 2007 of a change in two of the most critical assumptions in establishing reserves: (1) loss emergence patterns, accelerated or decelerated by three and six months; and (2) expected loss ratios varied by plus or minus five and ten percent. Management believes that a reasonably likely scenario is represented by such a standard, as used by some professional actuaries as part of their review of an insurer s or reinsurer s reserves. Utilizing this standard as a guide, management has selected these variances to determine reasonably likely scenarios of variability in the loss emergence and loss ratio assumptions. These scenarios consider normal levels of catastrophe events. Loss reserves may vary beyond these scenarios in periods of heightened claim activity. The reserves resulting from the changes in the assumptions are not additive and should be considered separately. The following tables vary the assumptions employed therein independently.

Net reserve for losses and loss expenses at December 31, 2007 Sensitivity to loss emergence patterns

Change in Assumption	Reserve for Losses and Loss Expenses (Dollars in thousands)
Six month deceleration	$ 684,214
Three month deceleration	732,199
No change (selected)	791,713
Three month acceleration	859,055
Six month acceleration	929,881

Net reserves for loss and loss expenses at December 31, 2007 Sensitivity to expected loss ratios

Change in Assumption	Reserve for Losses and Loss Expenses (Dollars in thousands)
10% favorable	$ 760,205
5% favorable	775,960
No change (selected)	791,713
5% unfavorable	807,466
10% unfavorable	823,217

The most significant variance in the above scenarios, six month acceleration in loss emergence patterns, would have the effect of increasing losses and loss expenses by $138.2 million. In the Company s judgment, such a variance would not have a material impact on the liquidity or financial position of the Company.

Management believes that the reserve for losses and loss expenses is sufficient to cover expected claims incurred before the evaluation date on the basis of the methodologies and judgments used to support its estimates. However, there can be no assurance that actual payments will not vary significantly from total reserves. The reserve for losses and loss expenses and the methodology of estimating such reserve are regularly reviewed and updated as new information becomes known. Any resulting adjustments are reflected in income in the period in which they become known.

Premiums. For insurance business, written premium estimates are informed by the business plan estimates of premiums by class, the aggregate of underwriters estimates on a policy-by-policy basis, and projections of ultimate premiums using generally accepted actuarial methods. In particular, direct insurance premiums are recognized in accordance with the type of contract written. The majority of our insurance premium is accepted on a direct open market or facultative basis. We receive a premium which is identified in the policy and recorded as unearned premium on the inception date of the contract. This premium will adjust only if the underlying insured values adjust. We actively monitor underlying insured values and record adjustment premiums in the period in which amounts are reasonably determinable.

For business written on a facility basis, although a premium estimate is not contractually stated for the amount of business to be written under any particular facility, an initial estimate of the expected premium written is received from the coverholder via the broker. Our estimate of premium is derived by reference to one or more of the following: the historical premium volume experienced by the facility; historical premium volume of similar facilities; the estimates provided by the broker; and industry information on the underlying business. We actively monitor the development of actual reported premium against the estimates made; where actual reported premiums deviate from the estimate, we carry out an analysis to determine the cause and may, if necessary, adjust the estimated premiums. In the year ended December 31, 2007, premiums written on a facility basis accounted for $169.8 million or 24.7% of total gross premiums written at Talbot.

For reinsurance business where the assumed reinsurance premium is written on an excess of loss or on a pro rata basis, reinsurance contracts are generally written prior to the time the underlying direct policies are written by cedants and accordingly cedants must estimate such premiums when purchasing reinsurance coverage. For excess of loss contracts, the deposit premium is defined in the contract. The deposit premium is based on the client s estimated premiums, and this estimate is the amount recorded as written premium in the period the risk incepts. In the majority of cases, these contracts are adjustable at the end of the contract period to reflect the changes in underlying risks during the contract period. Subsequent adjustments, based on reports by the clients of actual premium, are recorded in the period in which the cedant reports are received, which would normally be reported within six months to one year subsequent to the expiration of the contract. For pro rata reinsurance contracts, an estimate of written premium is recorded in the period in which the risk incepts. The written premiums estimate is based on the pro rata cession percentage, on information provided by ceding companies and on management s judgment. Management critically evaluates the information provided by ceding companies based on experience with the cedant, broker and the underlying book of business. Subsequent adjustments are recorded when the actual premiums are reported by the ceding company. Reporting by the ceding company may be on a three or six month lag and may be significantly different from the original estimate.

The Company evaluates the appropriateness of these premium estimates based on the latest information available, which may include actual reported premium to date, the latest premium estimates as provided by cedants and brokers, historical experience, management s professional judgment, information obtained during the underwriting renewal process, as well as an assessment of relevant economic conditions.

For contracts written on a losses occurring basis or claims made basis, premium income is generally earned proportionately over the expected risk period, usually 12 months. For all other contracts, comprising contracts written on a risks attaching basis, premiums are generally earned over a 24 month period due to the fact that some of the underlying exposures may attach towards the end of the contract, and such underlying exposures generally have a 12 month coverage period. The portion of the premium related to the unexpired portion of the policy at the end of any reporting period is presented on the consolidated balance sheet as unearned premiums.

	Year Ended December 31, 2007		**Year Ended December 31, 2006(1)**	
	Gross Premiums	**Gross Premiums**	**Gross Premiums**	**Gross Premiums**

	Written	Written (%)	Written	Written (%)	% Change
	(Dollars in thousands)		(Dollars in thousands)		
Proportional	$ 193,598	13.9%	$ 161,512	13.6%	19.9%
Non-proportional	1,196,225	86.1%	1,027,929	86.4%	16.4%
Total	$ 1,389,823	100.0%	$ 1,189,441	100.0%	16.8%

(1) Talbot results for the year ended December 31, 2006 are presented for comparative purposes. The results of operations for Talbot are consolidated only from the July 2007 date of acquisition.

As a company with a short operating history, we have limited past history that reflects how our premium estimates will develop. Furthermore, past experience may not be indicative of how future premium estimates develop. Gross premiums written on a proportional basis are recorded using estimated premiums and thus are the portion of the Company s business that may be subject to adjustment. The Company re-evaluates estimates on a quarterly basis taking into consideration information obtained since the estimate was established, including information received from the cedant (and validated in a manner similar to how the Company evaluates cedant loss information). Based on information received, management has not made material adjustments to premium estimates to date. The Company believes that reasonably likely changes in assumptions made in the estimation process would not have a significant impact on gross premiums written as recorded.

Where contract terms on excess of loss contracts require the mandatory reinstatement of coverage after a client s loss, the mandatory reinstatement premiums are recorded as written and earned premiums when the loss event occurs.

Management includes an assessment of the creditworthiness of cedants in the review process above, primarily based on market knowledge, reports from rating agencies, the timeliness of cedants payments and the status of current balances owing. Based on this assessment, management believes that as at December 31, 2007 no provision for doubtful accounts is necessary for receivables from cedants.

Reinsurance Premiums Ceded and Reinsurance Recoverables. As discussed in Business Risk Management , the Company primarily uses ceded reinsurance for risk mitigation purposes in its Talbot segment. Talbot purchases reinsurance on an excess of loss and a proportional basis together with a relatively small amount of facultative reinsurance.

For excess of loss business, the amount of premium payable is usually contractually documented at inception and management judgment is only necessary in respect of any loss-related elements of the premium, for example reinstatement or adjustment premiums, and loss-related commissions. The full premium is recorded at inception and if the contract is purchased on a losses occurring during basis, the premium is earned on a straight line basis over the life of the contract. If the policy is purchased on a risks attaching during basis, the premium is earned in line with the inwards gross premiums to which the risk attaching relates. After the contract has expired, a No Claims Bonus may be received for certain policies, and this is recorded as a reinsurance premium adjustment in the period in which it can be reasonably determined.

Very little proportional reinsurance is purchased. This is recorded and earned in line with the underlying inwards premium.

Reinsurance receivable and reinsurance recoverable balances include amounts owed to us in respect of paid and unpaid ceded losses and loss expenses, respectively. The balances are presented net of a reserve for non-recoverability. As at December 31 2007, reinsurance recoverable balances were $134.4 million and reinsurance receivable balances were $7.8 million. In establishing our reinsurance recoverable balances, significant judgment is exercised by management in determining the amount of unpaid losses and loss expenses to be ceded as well as our ability to cede losses and loss expenses under our reinsurance contracts.

Our ceded unpaid losses and loss expense consists of two elements, those for reported losses and those for losses incurred but not reported (IBNR). Ceded amounts for IBNR are developed as part of our loss reserving process. Consequently, the estimation of ceded unpaid losses and loss expenses is subject to similar risks and uncertainties in the estimation of gross IBNR (see Reserve for Losses and Loss expenses). As at December 31 2007, ceded IBNR recoverable balances were $35.3 million.

Although our reinsurance receivable and reinsurance recoverable balances are derived from our determination of contractual provisions, the recoverability of such amounts may ultimately differ due to the potential for a reinsurer to become financially impaired or insolvent or for a contractual dispute over contract language or coverage. Consequently, we review our reinsurance recoverable balances on a regular basis to determine if there is a need to establish a provision for non-recoverability. In performing this review, we use judgment in assessing the credit worthiness of our reinsurers and the contractual provisions of our reinsurance agreements. As at December 31 2007, we had a provision for non-recoverability of $3.1 million. In the event that the credit worthiness of our reinsurers were to deteriorate, actual uncollectible amounts could be significantly greater than our provision for non-recoverability.

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.

At December 31, 2007, the use of different assumptions within the model could have a material effect on the provision for uncollectible reinsurance reflected in the Company s consolidated financial statements. To the extent the creditworthiness of the Company s reinsurers was to deteriorate due to an adverse event affecting the reinsurance industry, such as a large number of major catastrophes, actual uncollectible amounts could be significantly greater than the Company s provision.

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 Holdings, Ltd. and Validus Re were formed on October 19, 2005, and Validus Re commenced operations on December 16, 2005. Neither company had any prior operating history. The Company began writing reinsurance contracts on January 1, 2006. As there were no premiums written during period ended December 31, 2005, this period has been excluded from the following discussions. On July 2, 2007 the Company acquired Talbot Holdings Ltd. (Talbot) and is consolidating Talbot as of that date. The Company s fiscal year ends on December 31. Financial statements are prepared in accordance with U.S. GAAP.

The following table presents results of operations for the three months and the year ended December 31, 2007 and 2006:

	Three Months Ended December 31, 2007	Three Months Ended December 31, 2006	Year Ended December 31, 2007	Year Ended December 31, 2006
	(Dollars in thousands)		(Dollars in thousands)	
Gross premiums written	$ 190,996	$ 65,505	$ 988,637	$ 540,789
Reinsurance premiums ceded	(4,566)	355	(70,210)	(63,696)
Net premiums written	186,430	65,860	918,427	477,093
Change in unearned premiums	131,601	39,293	(60,348)	(170,579)
Net premiums earned	318,031	105,153	858,079	306,514
Losses and loss expenses	107,567	24,265	283,993	91,323
Policy acquisition costs	53,277	11,498	134,277	36,072
General and administrative expenses	33,676	13,002	97,765	38,354
Share compensation expense	6,135	2,223	16,189	7,878
Total underwriting expenses	200,655	50,988	532,224	173,627
Underwriting income(2)	117,376	54,165	325,855	132,887
Net investment income	37,525	17,652	112,324	58,021
Other income	1,971		3,301	
Finance expenses	(25,423)	(3,653)	(51,754)	(8,789)
Operating income before taxes	131,449	68,164	389,726	182,119
Taxes	(22)		1,505	
Operating income after tax	131,471	68,164	388,221	182,119
Fair value of warrants issued			(2,893)	(77)
Aquiline termination fee			(3,000)	
Net realized gains (losses) on investments	784	(208)	1,608	(1,102)
Net unrealized losses on investments(3)	9,229		12,364	
Foreign exchange (losses) gains	(2,515)	1,096	6,696	2,157
Net income after taxes	$ 138,969	$ 69,052	$ 402,996	$ 183,097
Comprehensive income (loss)				
Unrealized losses arising during period(3)		(522)		(332)
Foreign currency translation adjustments	(591)		(49)	
Adjustment for reclassification of losses realized in income		208		1,102
Comprehensive income (loss)	$ 138,378	$ 68,738	$ 402,947	$ 183,867

Selected ratios				
Net premiums written/Gross premiums written	97.6%	100.5%	92.9%	88.2%
Losses and loss expenses ratio	33.8%	23.1%	33.1%	29.8%
Policy acquisition cost ratio	16.8%	10.9%	15.6%	11.8%
General and administrative expense ratio	12.5%	14.5%	13.3%	15.1%
Expense ratio	29.3%	25.4%	28.9%	26.9%
Combined ratio	63.1%	48.5%	62.0%	56.7%

	Three Months Ended December 31, 2007	Three Months Ended December 31, 2006 (1)	Year Ended December 31, 2007	Year Ended December 31, 2006 (1)
	(Dollars in thousands)		(Dollars in thousands)	
VALIDUS RE				
Gross premiums written	$ 47,499	$ 65,505	$ 702,098	$ 540,789
Reinsurance premiums ceded	(3,813)	355	(68,842)	(63,696)
Net premiums written	43,686	65,860	633,256	477,093
Change in unearned premiums	118,828	39,293	(74,227)	(170,579)
Net premiums earned	162,514	105,153	559,029	306,514
Losses and loss expenses	48,244	24,265	175,538	91,323
Policy acquisition costs	22,107	11,498	70,323	36,072
General and administrative expenses	7,858	11,474	31,412	24,565
Share compensation expense	1,189	1,544	4,013	3,105
Total underwriting expenses	79,398	48,781	281,286	155,065
Underwriting income(2)	83,116	56,372	277,743	151,449
TALBOT				
Gross premiums written	$ 143,497	$	$ 286,539	$
Reinsurance premiums ceded	(753)		(1,368)	
Net premiums written	142,744		285,171	
Change in unearned premiums	12,773		13,879	
Net premiums earned	155,517		299,050	
Losses and loss expenses	59,323		108,455	
Policy acquisition costs	31,170		63,954	
General and administrative expenses	23,628		48,886	
Share compensation expense	978		1,709	
Total underwriting expenses	115,099		223,004	
Underwriting income(2)	40,418		76,046	
CORPORATE				
General and administrative expenses	2,190	1,528	17,467	13,789
Share compensation	3,968	679	10,467	4,773
Total underwriting expenses	6,158	2,207	27,934	18,562
Underwriting income (loss)(2)	(6,158)	(2,207)	(27,934)	(18,562)
Total underwriting income(2)	$ 117,376	$ 54,165	$ 325,855	$ 132,887

(1) Talbot 2006 results are included in discussion of segment results for comparison purposes only and are not consolidated in the Company s results for 2006 periods.

(2) Non-GAAP Financial Measures. In presenting the Company s results, management has included and discussed certain schedules containing 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.

(3) The Company has early adopted FAS 157 and FAS 159 as of January 1, 2007 and elected the fair value option on all securities previously accounted for as available-for-sale. Validus Re s unrealized gains on available-for-sale investments at December 31, 2006 of $875,000 previously included in the accumulated other comprehensive income, were treated as a cumulative-effect adjustment as of January 1, 2007. The cumulative-effect adjustment transferred the balance of unrealized gains from accumulated other comprehensive income to retained earnings and had no impact on the results of operations for the annual or interim periods beginning January 1, 2007. The Company s investments are accounted for as trading for the annual or interim periods beginning January 1, 2007 and as such, all unrealized gains and losses are included in net income. Upon acquisition by the Company, Talbot adopted FAS 157 and FAS 159. On January 1, 2007 Talbot had unrealized gains on available-for-sale investments of $769,000.

Three months ended December 31, 2007 compared to three months ended December 31, 2006

Net income for the three months ended December 31, 2007 was $139.0 million compared to $69.1 million for the three months ended December 31 2006, an increase of $69.9 million or 101.3%. The primary factors driving the increase were:

The consolidation of Talbot for the first time in 2007 increased underwriting income in the quarter by $40.4 million;

An increase in Validus Re underwriting income of $26.7 million or 47.4% as a result of net premiums earned which were increased by $57.4 million or 54.6% compared to the same period in 2006, offset by losses including those from the California wildland fires;

An increase in net investment income of $19.9 million or 112.6% as a result of growth in the Validus Re investment portfolio and the addition of the Talbot portfolio; and

Increased realized and unrealized gains on investments of $10.2 million. The majority of this increase is due to the early adoption on FAS 157 and FAS 159 resulting in unrealized gains on investments being recorded in net income rather than comprehensive income. The increases above were partially offset by the following factors:

An increase in foreign exchange losses of $3.6 million, and;

Increased finance expenses of $21.8 million, primarily resulting from $4.3 million finance expense on the 8.480% Junior Subordinated Deferrable Debentures and $17.2 million of Talbot Funds at Lloyd s (FAL) finance expense.

Gross Premiums Written

Gross premiums written for the three months ended December 31, 2007 were $191.0 million compared to $65.5 million for the three months ended December 31, 2006, an increase of $125.5 million or 191.6%. The increase in gross premiums written was primarily driven by the addition of Talbot which added $143.5 million of gross premiums written. The increase from Talbot was partially offset by a $25.6 million decrease in the Validus Re property lines, discussed further below.

Details of gross premiums written by line of business are provided below.

	Three Months Ended December 31, 2007		Three Months Ended December 31, 2006(1)		
	Gross Premiums Written (Dollars in thousands)	Gross Premiums Written (%)	Gross Premiums Written (Dollars in thousands)	Gross Premiums Written (%)	% Change
Property	$ 36,908	19.3%	$ 41,915	64.0%	(11.9)%

Marine	77,073	40.4%	6,604	10.1%	1067.1%
Specialty	77,015	40.3%	16,986	25.9%	353.4%
Total	$ 190,996	100.0%	$ 65,505	100.0%	191.6%

(1) The results of operations for Talbot are consolidated only from the July 2007 date of acquisition. Consequently, 2006 data does not include Talbot financial results.

Validus Re. Validus Re gross premiums written for the three months ended December 31, 2007 were $47.5 million compared to $65.5 million for the three months ended December 31, 2006, a decrease of $18.0 million or 27.5%. Details of Validus Re gross premiums written by line of business are provided below.

	Three Months Ended December 31, 2007		Three Months Ended December 31, 2006		
	Gross Premiums Written (Dollars in thousands)	Gross Premiums Written (%)	Gross Premiums Written (Dollars in thousands)	Gross Premiums Written (%)	% Change
Property	$ 16,282	34.3%	$ 41,915	64.0%	(61.2)%
Marine	18,067	38.0%	6,604	10.1%	173.6%
Specialty	13,150	27.7%	16,986	25.9%	(22.6)%
Total	$ 47,499	100.0%	$ 65,505	100.0%	(27.5)%

The decrease in Validus Re gross premiums written was primarily driven by a $25.6 million decrease in the property lines due to a 16 month contract written in the three month period ended December 31, 2006. Due to the term of this $30.0 million contract, it will come up for renewal in the first quarter of 2008. The decrease in property lines was partially offset by the marine lines which accounted for an increase of $11.5 million in gross premiums written due primarily to a surplus contract with gross premiums written of $16.5 million.

Talbot. In the three months ended December 31, 2007, Talbot gross premiums written were $143.5 million compared to $171.8 million for the three months ended December 31, 2006, a decrease of $28.3 million or 16.5%. Gross premiums written were primarily driven by the marine and specialty lines which contributed $122.9 million. Details of gross premiums written by line of business are provided below.

	Three Months Ended December 31, 2007		Three Months Ended December 31, 2006(1)		
	Gross Premiums Written (Dollars in thousands)	Gross Premiums Written (%)	Gross Premiums Written (Dollars in thousands)	Gross Premiums Written (%)	% Change
Property	$ 20,626	14.4%	$ 27,102	15.8%	(23.9)%
Marine	59,006	41.1%	66,703	38.8%	(11.5)%
Specialty	63,865	44.5%	78,019	45.4%	(18.1)%

Total	$ 143,497	100.0%	$ 171,824	100.0%	(16.5)%

(1) Talbot results for the three months ended December 31, 2006 are presented for comparative purposes. The results of operations for Talbot are consolidated only from the July 2007 date of acquisition.

The decrease in the Talbot gross premiums written was primarily driven by:

A decrease of $6.5 million in property gross premiums written;

A decrease of $13.1 million in energy gross premiums written offset by an increase in hull gross premiums written of $6.2 million; and

Increased gross premiums written of $6.1 million and $3.8 million, respectively, for the new accident and health and bloodstock and livestock classes offset by reduced war and financial institutions gross premiums written of $11.5 million and $4.5 million, respectively.

Table of Contents

Reinsurance Premiums Ceded

Reinsurance premiums ceded for the three months ended December 31, 2007 were $4.6 million compared to ($0.4) million for the three months ended December 31, 2006, an increase of $5.0 million. Reinsurance premiums ceded increased primarily as a result of an increase in property premiums ceded to Petrel Re Limited (Petrel Re).

	Three Months Ended December 31, 2007		Three Months Ended December 31, 2006(1)		
	Reinsurance Premiums Ceded (Dollars in thousands)	Reinsurance Premiums Ceded (%)	Reinsurance Premiums Ceded (Dollars in thousands)	Reinsurance Premiums Ceded (%)	% Change
Property	$ 4,308	94.3%	$ (382)	NM	1227.7%
Marine	640	14.0%	(573)	NM	211.7%
Specialty	(382)	(8.3)%	600	NM	(163.7)%
Total	$ 4,566	100.0%	$ (355)	NM	1386.2%

(1) The results of operations for Talbot are consolidated only from the July 2007 date of acquisition. Consequently, 2006 data does not include Talbot financial results.

NM Not meaningful

Validus Re. Validus Re reinsurance premiums ceded for the three months ended December 31, 2007 were $3.8 million compared to $(0.4) million for the three months ended December 31, 2006, an increase of $4.2 million. Validus Re reinsurance premiums ceded increased primarily as a result of premiums ceded of $3.8 million related to a quota share property contract. During the three month periods ended December 31, 2007 and 2006, no premiums were ceded to Petrel Re.

Three Months Ended December 31, 2007		Three Months Ended December 31, 2006
Reinsurance	Reinsurance	Reinsurance