ALLEGHANY CORP /DE
Form 10-K
February 21, 2018
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017

or

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 1-9371

**ALLEGHANY CORPORATION**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **51-0283071** |
| (State or other jurisdiction of | (I.R.S. Employer |
| incorporation or organization) | Identification Number) |
| **1411 Broadway, 34th Floor** | |
| **New York, New York** | **10018** |
| (Address of principal executive offices) | (Zip Code) |

Registrant s telephone number, including area code:

**212-752-1356**

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

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| **Common Stock, $1.00 par value** | **New York Stock Exchange** |

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

**Not applicable**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

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 No

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.

Yes No

Indicate by check mark 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act. (Check one):

| | | | | |
|---|---|---|---|---|
| e accelerated filer | Accelerated filer | Non-accelerated filer (Do not check if a smaller reporting company) | Smaller reporting company | Emerging growth comp |

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 126-2 of the Act).

Yes No

The aggregate market value of voting and non-voting common shares held by non-affiliates of the registrant as of June 30, 2017 (the last business day of the registrant s most recently completed second fiscal quarter) was approximately $8,815,683,664 based on the closing sale price of the registrant s common shares on the New York Stock Exchange on that date.

As of February 12, 2018, 15,391,416 shares of the registrant s common stock, par value $1.00 per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement relating to the Annual Meeting of Stockholders of Alleghany Corporation to be held on April 27, 2018 to be filed with the Securities and Exchange Commission pursuant to Regulation 14A are incorporated by reference into Part III of this Annual Report on Form 10-K.

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**ALLEGHANY CORPORATION**

References in this Annual Report on Form 10-K for the year ended December 31, 2017, or this Form 10-K, to the Company, Alleghany, we, us, and our refer to Alleghany Corporation and its consolidated subsidiaries unless the context otherwise requires. In addition, unless the context otherwise requires, references to

TransRe are to our wholly-owned reinsurance holding company subsidiary Transatlantic Holdings, Inc. and its subsidiaries;

AIHL are to our wholly-owned insurance holding company subsidiary Alleghany Insurance Holdings LLC;

RSUI are to our wholly-owned subsidiary RSUI Group, Inc. and its subsidiaries;

CapSpecialty are to our wholly-owned subsidiary CapSpecialty, Inc. and its subsidiaries;

PacificComp are to our former wholly-owned subsidiary Pacific Compensation Corporation and its subsidiary, which were sold on December 31, 2017;

AIHL Re are to our wholly-owned subsidiary AIHL Re LLC;

Roundwood are to our wholly-owned subsidiary Roundwood Asset Management LLC;

Alleghany Capital are to our wholly-owned subsidiary Alleghany Capital Corporation and its subsidiaries;

SORC are to our wholly-owned subsidiary Stranded Oil Resources Corporation and its subsidiaries;

Bourn & Koch are to our majority-owned subsidiary Bourn & Koch, Inc. and its subsidiary;

Kentucky Trailer are to our majority-owned subsidiary R.C. Tway Company, LLC and its subsidiaries;

IPS are to our majority-owned subsidiary IPS-Integrated Project Services, LLC and its subsidiaries;

Jazwares are to our majority-owned subsidiary Jazwares, LLC and its subsidiaries and affiliates;

W&W|AFCO Steel are to our majority-owned subsidiary WWSC Holdings, LLC and its subsidiaries; and

Alleghany Properties are to our wholly-owned subsidiary Alleghany Properties Holdings LLC and its subsidiaries.

**NOTE ON FORWARD-LOOKING STATEMENTS**

Certain statements contained in this Form 10-K may be deemed to be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of words such as may, will, expect, project, estimate, anticipate, plan, believe, potential, should or th of those words or other comparable words. Forward-looking statements do not relate solely to historical or current facts, rather they are based on management s expectations as well as certain assumptions and estimates made by, and information available to, management at the time. These statements are not guarantees of future performance. These forward-looking statements are based upon Alleghany s current expectations and are subject to a number of uncertainties and risks that could significantly affect current plans, anticipated actions and Alleghany s future financial condition and results. Factors that could cause these forward-looking statements to differ, possibly materially, from that currently contemplated include:

significant weather-related or other natural or man-made catastrophes and disasters;

the cyclical nature of the property and casualty reinsurance and insurance industries;

changes in market prices of our significant equity investments and changes in value of our debt securities portfolio;

adverse loss development for events insured by our reinsurance and insurance subsidiaries in either the current year or prior years;

the long-tail and potentially volatile nature of certain casualty lines of business written by our reinsurance and insurance subsidiaries;

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- the cost and availability of reinsurance;
- the reliance by our reinsurance and insurance operating subsidiaries on a limited number of brokers;
- legal, political, judicial and regulatory changes;
- increases in the levels of risk retention by our reinsurance and insurance subsidiaries;
- changes in the ratings assigned to our reinsurance and insurance subsidiaries;
- claims development and the process of estimating reserves;
- exposure to terrorist acts and acts of war;
- the willingness and ability of our reinsurance and insurance subsidiaries reinsurers to pay reinsurance recoverables owed to our reinsurance and insurance subsidiaries;
- the uncertain nature of damage theories and loss amounts;
- the loss of key personnel of our reinsurance or insurance operating subsidiaries;
- fluctuation in foreign currency exchange rates;
- the failure to comply with the restrictive covenants contained in the agreements governing our indebtedness;
- the ability to make payments on, or repay or refinance, our debt;
- risks inherent in international operations; and
- difficult and volatile conditions in the global market.

Additional risks and uncertainties include general economic and political conditions, including the effects of a prolonged U.S. or global economic downturn or recession; changes in costs; variations in political, economic or other factors; risks relating to conducting operations in a competitive environment; effects of acquisition and disposition activities, inflation rates, or recessionary or expansive trends; changes in interest rates; extended labor disruptions, civil unrest, or other external factors over which we have no control; changes in our plans, strategies, objectives, expectations, or intentions, which may happen at any time at our discretion; and other factors discussed in this Form 10-K and subsequent filings with the Securities and Exchange Commission, or the SEC. All forward-looking statements speak only as of the date they are made and are based on information available at that time. Alleghany does not undertake any obligation to update or revise any forward-looking statements to reflect subsequent circumstances or events. See Part I, Item 1A, Risk Factors of this Form 10-K for additional information.

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# PART I

## Item 1. Business.

### Overview

We are a Delaware corporation which owns and manages certain operating subsidiaries and investments, anchored by a core position in property and casualty reinsurance and insurance. We were incorporated in Delaware in 1984. Through our wholly-owned subsidiary TransRe, we are engaged in the property and casualty reinsurance business. TransRe has been our wholly-owned subsidiary since March 2012. Through our wholly-owned subsidiary AIHL and its subsidiaries, we are engaged in the property and casualty insurance business. AIHL s insurance operations are principally conducted by its subsidiaries RSUI, CapSpecialty and, prior to its sale on December 31, 2017, PacificComp. CapSpecialty has been a subsidiary of AIHL since January 2002, RSUI has been a subsidiary of AIHL since July 2003 and PacificComp had been a subsidiary of AIHL since July 2007. AIHL Re, a captive reinsurance company which provides reinsurance to Alleghany s current and former insurance operating subsidiaries and affiliates, has been a wholly-owned subsidiary of Alleghany since its formation in May 2006.

Although our primary sources of revenues and earnings are our reinsurance and insurance operations and investments, we also source, execute, manage and monitor certain private investments primarily through our wholly-owned subsidiary Alleghany Capital. Alleghany Capital s investments are included in other activities for segment reporting purposes and include:

*SORC.* In June 2011, we formed SORC, an exploration and production company focused on enhanced oil recovery, headquartered in Golden, Colorado.

*Bourn & Koch.* On April 26, 2012, we acquired Bourn & Koch, a manufacturer/remanufacturer of specialty machine tools and supplier of replacement parts, accessories and services for a variety of cutting technologies, headquartered in Rockford, Illinois.

*Kentucky Trailer.* On August 30, 2013, we invested in Kentucky Trailer, a manufacturer of custom trailers and truck bodies for the moving and storage industry and other markets, headquartered in Louisville, Kentucky, for a controlling equity interest.

*IPS.* On October 31, 2015, we acquired IPS, a technical engineering-focused service provider focused on the global pharmaceutical and biotechnology industries, headquartered in Blue Bell, Pennsylvania.

*Jazwares.* On July 31, 2014, we invested in Jazwares, a global toy, entertainment and musical instrument company, headquartered in Sunrise, Florida for a 30 percent interest. On April 15, 2016, we acquired an additional 50 percent of Jazwares outstanding equity, bringing our equity ownership to 80 percent and, as of that date, the results of Jazwares have been included in our consolidated results. Prior to April 15, 2016, Jazwares was accounted for under the equity method of accounting.

*W&W|AFCO Steel.* On April 28, 2017, we acquired W&W|AFCO Steel, a structural steel fabricator and erector, headquartered in Oklahoma City, Oklahoma. And,

*Wilbert.* On August 1, 2017, we acquired a 45 percent equity interest in Wilbert, a provider of products and services for the funeral and cemetery industries and precast concrete markets, headquartered in Overland Park, Kansas. Wilbert is accounted for under the equity method of accounting.

In addition, we own and manage properties in the Sacramento, California region through our wholly-owned subsidiary Alleghany Properties. We owned an approximately 15 percent equity interest in ORX Exploration, Inc., or ORX, a regional oil and gas exploration and production company, until it was sold on December 23, 2016. Our public equity investments are managed primarily through our wholly-owned subsidiary Roundwood.

As of December 31, 2017, we had total assets of $25.4 billion and total stockholders equity attributable to Alleghany stockholders of $8.5 billion.

Our principal executive offices are located in leased office space at 1411 Broadway, 34th Floor, New York, New York, 10018, and our telephone number is (212) 752-1356. Our Annual Reports 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 Securities Exchange Act of 1934, as amended, or the Exchange Act, are available, free of charge, on our website at www.alleghany.com, as soon as reasonably practicable after we electronically file this material with, or furnish it to, the SEC. Reports and other information we file with the SEC may also be viewed at the SEC s website at www.sec.gov or viewed or obtained at the SEC Public Reference Room at 100 F Street, N.E., Washington, District of Columbia 20549. Our Financial Personnel Code of Ethics, Employee Code of Business Conduct and Ethics, Director Code of Business Conduct and Ethics, Code of Business Conduct and Ethics for our Business Partners, Corporate Governance Guidelines and the charters for our Audit, Compensation and Nominating and Governance Committees are also available on our website. In addition, interested parties may obtain, free of charge, copies of any of the above reports or documents upon request to the Secretary of Alleghany.

**Segment Information**

Our segments are reported in a manner consistent with the way management evaluates the businesses. As such, we classify our business into two reportable segments reinsurance and insurance. Other activities include Alleghany Capital and corporate activities. In addition, reinsurance and insurance underwriting activities are evaluated separately from investment and other activities.

The components of other activities are Alleghany Capital and corporate activities. Alleghany Capital consists of manufacturing and service operations, oil and gas operations and corporate operations and investments at the Alleghany Capital level. Manufacturing and service operations are conducted through Bourn & Koch, Kentucky Trailer, IPS, Jazwares, W&W|AFCO Steel and Alleghany Capital s investment in Wilbert. Oil and gas operations are conducted through SORC, and also included Alleghany Capital s investment in ORX until it was sold on December 23, 2016. Wilbert is, and ORX was, accounted for under the equity method of accounting. The primary components of corporate activities are Alleghany Properties and other activities at the Alleghany parent company.

See below and Note 13 to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of this Form 10-K for an analysis of our underwriting results by segment and other activities, and Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Consolidated Results of Operations.

**Reinsurance Segment**

*General*. The reinsurance segment consists of property and casualty reinsurance operations conducted by TransRe s reinsurance operating subsidiaries.

TransRe, through its principal wholly-owned subsidiaries Transatlantic Reinsurance Company, or TRC, TransRe London Ltd., or TRL, and TransRe Zurich Ltd., or TRZ, offers reinsurance capacity to reinsurance and insurance companies for property and casualty products. These products are distributed through brokers and on a direct basis in the domestic and foreign markets. TransRe is headquartered in New York, New York, with six other locations in the U.S. and has operations worldwide, including: Africa, Australia, Bermuda, Canada, five locations in Asia, three locations in Central and South America, and five locations in the U.K. and Europe. TRC is licensed, accredited or authorized or can serve as a reinsurer in all 50 states and the District of Columbia in the U.S. and in Puerto Rico and Guam. TRC is also licensed in Bermuda, Canada, Japan, the U.K., the Dominican Republic, the Hong Kong Special Administrative Region of the People s Republic of China, Germany, Australia and Singapore. In addition, TRL is licensed as a reinsurer in the U.K. and TRZ is licensed as a reinsurer in Switzerland and Dubai.

The reinsurance segment is reported through two major product lines, property and casualty & other.

*Property*. TransRe s principal lines of business within property include fire, allied lines, auto physical damage and homeowners multiple peril (which include property catastrophe risks). In 2017, property reinsurance accounted for approximately 37 percent of TransRe s gross premiums written.

*Casualty & other*. TransRe s principal lines of business within casualty & other include liability (including directors and officers liability, errors and omissions liability and general liability), medical malpractice, ocean marine and aviation, auto liability (including non-standard risks), accident and health, surety and credit. In 2017, casualty & other reinsurance accounted for approximately 63 percent of TransRe s gross premiums written.

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Reinsurance contracts are generally classified as treaty or facultative contracts. TransRe offers reinsurance capacity on both a treaty and facultative basis. Treaty reinsurance is a contractual arrangement that provides for the automatic reinsuring of all or a portion of a specified class of risk underwritten by the ceding company. Facultative reinsurance is the reinsurance of individual risks. Rather than agreeing to reinsure all or a portion of a class of risk, the reinsurer separately rates and underwrites each risk. Facultative reinsurance is normally purchased for risks not covered by treaty reinsurance or for individual risks covered by reinsurance treaties that are in need of capacity beyond that provided by such treaties.

A ceding company s reinsurance program may involve pro rata and excess-of-loss reinsurance on both a treaty and facultative basis. TransRe provides pro rata and excess-of-loss reinsurance for most major lines of business. Under pro rata reinsurance (also referred to as proportional or quota share reinsurance), the ceding company and the reinsurer share the premiums as well as the losses and expenses in an agreed proportion, and such proportional sharing of losses may be subject to a predetermined limit. As pro rata business is a proportional sharing of premiums and losses between the ceding company and the reinsurer, generally the underwriting results of such business more closely reflect the underwriting results of the business ceded than do the results of excess-of-loss business. In pro rata reinsurance, the reinsurer generally pays the ceding company a ceding commission, which is generally based on the ceding company s cost of obtaining the business being reinsured, such as brokers and agents commissions, local taxes and administrative expenses. Under excess-of-loss reinsurance (also referred to as non-proportional reinsurance), the reinsurer indemnifies the ceding company for all or a portion of the losses in excess of a predetermined amount, usually up to a predetermined limit. Premiums paid by the ceding company to the reinsurer for excess-of-loss coverage are generally not proportional to the premiums that the ceding company receives because the reinsurer does not assume a proportionate risk. Often there is no ceding commission on excess-of-loss reinsurance and therefore the pricing mechanism used by reinsurers in those instances is a rate applicable to premiums of the individual policy or policies subject to the reinsurance agreement. Both pro rata and excess-of-loss reinsurance may provide for aggregate limits of indemnification.

In July 2016, TransRe entered into an initial five-year agreement with General Reinsurance Corporation, a wholly owned subsidiary of Berkshire Hathaway Inc., for TransRe to act as exclusive underwriting manager on behalf of General Reinsurance Corporation for U.S. and Canadian property and casualty treaty reinsurance business produced by brokers and intermediaries. Fees earned under this agreement are included in other revenue in the Consolidated Statements of Earnings and Comprehensive Income.

As of December 31, 2017, the statutory surplus of TRC was $5.0 billion, as determined in accordance with statutory accounting principles, or SAP, and the consolidated equity of TransRe was $5.2 billion, as determined in accordance with accounting principles generally accepted in the U.S., or GAAP.

*Distribution.* TransRe provides property and casualty reinsurance capacity through brokers as well as directly to insurance and reinsurance companies in domestic and foreign markets. In 2017, approximately 85 percent of TransRe s gross premiums written were written through brokers with the balance written directly with ceding company clients. In the reinsurance brokerage industry, brokers are engaged by the ceding companies to place reinsurance on their behalf. In 2017, companies controlled by Aon plc, TigerRisk Partners, LLC and Marsh & McLennan Companies, Inc. were TransRe s largest brokerage sources of business, accounting for approximately 24 percent, 19 percent and 16 percent, respectively, of gross premiums written. The reinsurance brokerage industry is dominated by certain of these brokers. Due to the substantial percentages of premiums written through these brokers, the loss of business from any one of them could have a material adverse effect on TransRe s business.

*Underwriting.* TransRe s underwriting process emphasizes a team approach among TransRe s underwriters, actuaries, claims staff and senior management, as appropriate. Treaties are reviewed for compliance with TransRe s underwriting guidelines and objectives, and most treaties are evaluated in part based upon actuarial analyses conducted by TransRe. TransRe s actuarial models used in such analyses are tailored in each case to the exposures and experience underlying the specific treaty and the loss experience for the risks covered. Property catastrophe-exposed treaties are generally evaluated using industry standard models, as well as proprietary TransRe models. These models are used as a guide for risk assessment and portfolio optimization and are continually updated. TransRe also frequently conducts underwriting and claims audits at the offices of a ceding company before and after entering into major treaties, because reinsurers, including TransRe, do not separately evaluate each of the individual risks assumed under their treaties and, consequently, are largely dependent on the original underwriting decisions made by the ceding company. Such dependence subjects TransRe, and reinsurers in general, to the possibility that the ceding companies have not adequately evaluated and priced the risks to be reinsured and, therefore, that the premiums ceded may not adequately compensate reinsurers for the risk assumed.

TransRe often seeks to lead treaty placements. The lead reinsurer on a treaty generally accepts one of the largest percentage shares of the treaty and takes the initiative in negotiating price, terms and conditions. TransRe believes that this strategy enables it to influence more effectively the terms and conditions of the treaties in which it participates. TransRe may decline any treaty business offered to it based upon its assessment of all relevant factors. Such factors include type and level of risk assumed; actuarial and underwriting judgment with respect to rate adequacy; various treaty terms; prior and anticipated loss experience (including exposure to natural and man-made catastrophes) on the treaty; prior business experience with the ceding company; overall financial position; operating results; ratings from credit rating agencies of the ceding company; and social, legal, regulatory, environmental and general economic conditions affecting the risks assumed or the ceding company.

*Ratings*. TRC, TRL and TRZ are rated A+ by Standard & Poor s Ratings Services, or S&P, and A+ (Superior) by A.M. Best Company, Inc., or A.M. Best, and TRC is rated A1 by Moody s Investors Service Inc., or Moody s, independent organizations that analyze the insurance industry and the financial positions of reinsurance and insurance companies. Additional information regarding ratings and the risks related to ratings from ratings agencies can be found on page 58 of this Form 10-K.

**Insurance Segment**

The insurance segment consists of property and casualty insurance operations conducted by AIHL through its insurance operating subsidiaries RSUI, headquartered in Atlanta, Georgia; CapSpecialty, headquartered in Middleton, Wisconsin; and, prior to December 31, 2017, PacificComp, headquartered in Westlake Village, California. AIHL Re, our Vermont-domiciled captive reinsurance company, provides reinsurance to our current and former insurance operating subsidiaries and affiliates. Unless we state otherwise, references to AIHL include the operations of RSUI, CapSpecialty, PacificComp and AIHL Re.

In 2017, property insurance accounted for approximately 33 percent, and casualty insurance accounted for approximately 67 percent, of AIHL s gross premiums written.

***RSUI***

*General.* RSUI, which includes the operations of its wholly-owned subsidiaries RSUI Indemnity Company, or RIC, Landmark American Insurance Company, or Landmark, and Covington Specialty Insurance Company, or Covington, underwrites specialty insurance coverages in the property, umbrella/excess liability, general liability, management liability and professional liability lines of business. RSUI also writes a modest amount of reinsurance business on an assumed basis, which is included in the insurance segment.

The market for specialty insurance coverages differs significantly from the market for standard insurance coverages. The specialty market provides coverage for hard-to-place risks that generally do not fit the underwriting criteria of the standard market which provides coverage for largely uniform and relatively predictable exposures and is highly regulated with respect to rates and forms.

RSUI writes specialty business on both an admitted and non-admitted basis. Insurers may market, sell and service insurance policies in the states where they are licensed. These insurers are referred to as admitted insurers. Admitted insurers are generally required to obtain regulatory approval of their policy forms and premium rates. Non-admitted insurance markets have developed to provide insurance that is otherwise unavailable from a state s admitted insurance markets. Non-admitted insurance is procured by either state-licensed surplus lines brokers who place risks with insurers not licensed in that state or by insureds direct procurement from non-admitted insurers. Non-admitted insurance is subject to considerably less regulation with respect to policy rates and forms. RSUI writes specialty business in the admitted specialty market primarily through RIC, a New Hampshire-domiciled insurer, in the 50 states and the District of Columbia where RIC is licensed and subject to state form and rate regulations. Most of the risks in the admitted specialty market are unique and hard-to-place in the standard market, but must remain with an admitted insurance company for regulatory and/or marketing reasons. As an admitted carrier, RIC is subject to more state regulation than a non-admitted carrier, particularly with regard to rate and form filing requirements, restrictions on the ability to exit lines of business, premium tax payments and membership in various state associations, such as state guaranty funds and assigned risk plans.

RSUI writes business on an approved, non-admitted basis primarily through Landmark, a New Hampshire-domiciled insurer. Landmark, as a non-admitted company, is not subject to state form and rate regulations and thus has more flexibility in its rates and coverages for specialized or hard-to-place risks. This typically results in coverages that are more restrictive and expensive than coverages written by a standard insurance company. As of December 31, 2017, Landmark was approved to write business on a non-admitted basis in 50 states.

Covington, a New Hampshire-domiciled insurer, was formed in September 2007 to, among other things, support non-admitted business written primarily by RSUI s binding authority department, which writes small, specialized coverages pursuant to underwriting authority arrangements with managing general agents.

Pursuant to quota share arrangements, effective as of January 1, 2009, Landmark and Covington cede 90 percent of all their respective premiums and losses, gross of third-party reinsurance, to RIC.

As of December 31, 2017, the statutory surplus of RIC was approximately $1.6 billion, the statutory surplus of Landmark was approximately $185 million, the statutory surplus of Covington was approximately $47 million, each as determined in accordance with SAP, and the consolidated equity of RSUI was $1.7 billion, as determined in accordance with GAAP.

*Distribution.* As of December 31, 2017, RSUI conducted its insurance business through approximately 103 independent wholesale insurance brokers located throughout the U.S. and 23 managing general agents. RSUI s wholesale brokers are appointed on an individual basis based on management s appraisal of expertise, premium production potential, loss history with other insurance companies that they represent, and the size and experience of the agency, and only specific locations of a wholesale broker s operations may be appointed to distribute RSUI s products. Producer agreements which stipulate premium collection, payment terms and commission arrangements are in place with each wholesale broker. No wholesale broker holds underwriting, claims or reinsurance authority for RSUI. RSUI s top five producing wholesale brokers accounted for approximately 69 percent of gross premiums written by RSUI in 2017. RSUI s top two producing wholesale brokers, CRC Insurance Services, Inc. and AmWINS Group, Inc., accounted for, in the aggregate, approximately 43 percent of RSUI s gross premiums written in 2017. RSUI has entered into underwriting authority arrangements with 23 managing general agents for small, specialized coverages.

*Underwriting.* RSUI s underwriting philosophy is based on handling only product lines in which its underwriters have underwriting expertise. RSUI generally focuses on higher severity, lower frequency specialty risks that can be effectively desk underwritten without the need for inspection or engineering reviews. RSUI tracks underwriting results for each of its underwriters and believes that the underwriting systems and applications it has in place facilitate efficient underwriting and high productivity levels. Underwriting authority is delegated on a top-down basis ultimately to individual underwriters based on experience and expertise. This authority is in writing and addresses maximum limits, excluded classes and coverages and premium size referral. Referral to a product line manager is required for risks exceeding an underwriter s authority.

*Ratings.* RIC is rated A+ (Superior) by A.M. Best. Landmark and Covington are rated A+ (Superior) on a reinsured basis by A.M. Best, all three companies are rated A by S&P, and RIC and Landmark are rated A2 by Moody s.

***CapSpecialty***

*General.* CapSpecialty, primarily through its wholly-owned subsidiaries Capitol Indemnity Corporation, or CIC, Capitol Specialty Insurance Corporation, or CSIC, and Platte River Insurance Company, or Platte River, operates in the 50 states and the District of Columbia. CapSpecialty also includes the operations and results of Professional Risk Management Services, Inc., which was acquired from TransRe effective January 1, 2014.

CIC conducts its property and casualty insurance business on an admitted basis throughout the U.S. CIC also writes surety products such as commercial surety bonds and contract surety bonds on a national basis. Commercial surety bonds include all surety bonds other than contract surety bonds and cover obligations typically required by law or regulation, such as licenses and permits. CIC offers contract surety bonds in the non-construction segment of the market which secure performance under supply, service and maintenance contracts.

CSIC conducts substantially all of its business on an approved, non-admitted basis nationally and writes primarily specialty lines of property and casualty insurance, including the professional lines of business.

Platte River is licensed in the 50 states and the District of Columbia and operates in conjunction with CIC, primarily providing surety products and offering pricing flexibility in those jurisdictions where both CIC and Platte River are licensed.

Effective January 1, 2014, CapSpecialty was recapitalized pursuant to a series of transactions which included the exchange by AIHL of its common stock in CapSpecialty for Series A Convertible Preferred Stock carrying a five percent preference, or the Preferred Stock, and the subsequent sale by AIHL to TransRe of 24.9 percent of the Preferred Stock for a cash purchase price based on CapSpecialty s December 31, 2013 GAAP book value. At the same time, CapSpecialty reserved shares of restricted common stock, or the Restricted Stock, which are subordinate to the Preferred Stock, for issuance to the management of CapSpecialty pursuant to a restricted stock plan. To the extent all shares of Restricted Stock are vested and issued, the Restricted Stock will represent 20 percent of the value of CapSpecialty in excess of the Preferred Stock and its cumulative preference.

In the third quarter of 2015, AIHL Re and CapSpecialty (specifically, the insurance subsidiaries of CapSpecialty) entered into an intercompany reinsurance contract, effective July 1, 2015, pursuant to which AIHL Re provides CapSpecialty with coverage primarily for adverse development on certain net loss and allocated loss adjustment expenses, or LAE, in excess of its carried reserves at June 30, 2015. AIHL Re s commitments are intended to cover the statutory collateral requirements at CapSpecialty, if and when necessary, and AIHL Re s obligations are subject to an aggregate limit of $50.0 million. See Note 5(e) to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of this Form 10-K for additional detail on the reinsurance contract.

As of December 31, 2017, the statutory surplus of CIC was approximately $265 million, which included the statutory surplus of CSIC of approximately $59 million and the statutory surplus of Platte River of approximately $48 million, each as determined in accordance with SAP. As of December 31, 2017, the consolidated equity of CapSpecialty was $367.7 million, as determined in accordance with GAAP.

*Distribution.* CapSpecialty conducts its insurance business through independent wholesale brokerage and retail agents and general insurance agents located throughout the U.S. As of December 31, 2017, CapSpecialty had 66 general agents licensed to write property and casualty and surety coverages, approximately 109 brokers specializing in professional liability coverages and approximately 272 independent agents licensed only to write surety coverages. Certain independent agents have binding authority for specific business owner policy products, including property and liability coverages, and non-contract surety products.

*Underwriting.* Elements of CapSpecialty s underwriting process include prudent risk selection, appropriate pricing and coverage customization. All accounts are reviewed on an individual basis to determine underwriting acceptability. CapSpecialty is a subscriber to the Insurance Service Organization, or the ISO, and the Surety and Fidelity Association of America, or SFAA, insurance reference resources recognized by the insurance industry. CapSpecialty s underwriting procedures, rates and contractual coverage obligations are based on procedures and data developed by the ISO for property and casualty lines and by the SFAA for surety lines. Underwriting acceptability is determined by type of business, claims experience, length of time in business and business experience, age and condition of premises occupied and financial stability. Information is obtained from, among other sources, agent applications, financial reports and on-site loss control surveys. If an account does not meet pre-determined acceptability parameters, coverage is declined. If an in-force policy becomes unprofitable due to extraordinary claims activity or inadequate premium levels, a non-renewal notice is issued in accordance with individual state statutes and rules.

*Ratings.* CIC, CSIC and Platte River are rated A (Excellent) on a reinsured basis by A.M. Best.

***PacificComp***

*General.* PacificComp, a provider of workers compensation insurance primarily in the state of the California, had been a subsidiary of AIHL since July 2007.

*Sale.* On September 12, 2017, AIHL signed a definitive agreement to sell PacificComp to CopperPoint Mutual Insurance Company, or CopperPoint, for total cash consideration of approximately $158 million. The transaction closed on December 31, 2017, at which time: (i) approximately $442 million of PacificComp assets, consisting primarily of debt securities, and approximately $316 million of PacificComp liabilities, consisting primarily of loss and LAE reserves, were transferred; and (ii) AIHL recorded an after-tax gain of approximately $16 million, which included a tax benefit. In connection with the transaction, AIHL Re will continue to provide adverse development reinsurance coverage on PacificComp s pre-acquisition claims, subject to certain terms and conditions. AIHL Re s obligations, which are guaranteed by Alleghany, are subject to: (i) an aggregate limit of $150.0 million; and (ii) a final commutation and settlement as of December 31, 2024.

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## Reserves

Each of our reinsurance and insurance subsidiaries establishes reserves on its balance sheet for unpaid loss and LAE related to its property and casualty reinsurance and insurance contracts. The reserves for loss and LAE represent management s best estimate of the ultimate cost of all reported and unreported losses incurred through the balance sheet date. The process of estimating these reserves is inherently difficult and involves a considerable degree of judgment, especially in view of changing legal and economic environments that impact loss reserve development. Therefore, quantitative techniques have to be supplemented by subjective considerations and managerial judgment. In addition, conditions and trends that have affected development of liabilities in the past may not necessarily occur or affect liability development to the same degree in the future. See Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates of this Form 10-K for additional detail on our critical accounting estimates.

Information on prior year loss reserve development and incurred and paid loss and LAE development by segment can be found in Note 6(b) and Note 6(c), respectively, to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of this Form 10-K.

The reconciliation between the aggregate net loss and LAE reserves of our reinsurance and insurance subsidiaries reported in the annual statements filed with state insurance departments prepared in accordance with SAP and those reported in our consolidated financial statements prepared in accordance with GAAP for the last three years is presented below:

**Reconciliation of Reserves for Loss and LAE from SAP Basis to GAAP Basis**

| | As of December 31, 2017 | 2016 ($ in millions) | 2015 |
|---|---|---|---|
| Statutory reserves | $ 9,633.4 | $ 9,339.8 | $ 9,137.0 |
| Net reserves of non-U.S. subsidiaries[1] | 587.8 | 511.2 | 492.9 |
| Reinsurance recoverables[2] | 1,650.1 | 1,236.2 | 1,169.3 |
| GAAP reserves | $ 11,871.3 | $ 11,087.2 | $ 10,799.2 |

(1) TransRe s non-U.S. subsidiaries do not file annual statements with state insurance departments in the U.S.
(2) Reinsurance recoverables in this table include only unpaid ceded loss and LAE reserves.

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The reconciliation of beginning and ending aggregate reserves for unpaid loss and LAE of our reinsurance and insurance subsidiaries for the last three years is presented below:

**Reconciliation of Reserves for Loss and LAE**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| | ($ in millions) | | |
| Reserves as of January 1 | $ 11,087.2 | $ 10,799.2 | $ 11,597.2 |
| Less: reinsurance recoverables[(1)] | 1,236.2 | 1,169.3 | 1,289.4 |
| Net reserves as of January 1 | 9,851.0 | 9,629.9 | 10,307.8 |
| Other adjustments | (293.7)[(2)] | 2.4 | (1.9) |
| Incurred loss and LAE, net of reinsurance, related to: | | | |
| Current year | 3,918.8 | 3,285.2 | 2,555.3 |
| Prior years | (298.6) | (368.0) | (215.5) |
| Total incurred loss and LAE, net of reinsurance | 3,620.2 | 2,917.2 | 2,339.8 |
| Paid loss and LAE, net of reinsurance, related to:[(3)] | | | |
| Current year | 853.2 | 734.3 | 417.6 |
| Prior years | 2,225.2 | 1,866.5 | 2,390.4 |
| Total paid loss and LAE, net of reinsurance | 3,078.4 | 2,600.8 | 2,808.0 |
| Foreign exchange effect | 122.1 | (97.7) | (207.8) |