ALLEGHANY CORP /DE
Form 10-Q
May 06, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(MARK ONE)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR QUARTERLY PERIOD ENDED MARCH 31, 2010

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 1-9371
ALLEGHANY CORPORATION
EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER
DELAWARE
STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION
51-0283071
I.R.S. EMPLOYER IDENTIFICATION NO.
7 TIMES SQUARE TOWER, 17TH FLOOR, NY, NY 10036
ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE
212-752-1356
REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE
NOT APPLICABLE
FORMER NAME, FORMER ADDRESS, AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES þ NO o

INDICATE BY CHECK MARK WHETHER THE REGISTRANT HAS SUBMITTED ELECTRONICALLY AND POSTED ON ITS CORPORATE WEB SITE, IF ANY, EVERY INTERACTIVE DATA FILE REQUIRED TO BE SUBMITTED AND POSTED PURSUANT TO RULE 405 OF REGULATION S-T (SECTION 232.405 OF THIS CHAPTER) DURING THE PRECEDING 12 MONTHS (OR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO SUBMIT AND POST SUCH FILES).

YES o NO o

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, OR A NON-ACCELERATED FILER. SEE DEFINITION OF ACCELERATED FILER AND LARGE ACCELERATED FILER IN RULE 12b-2 OF THE EXCHANGE ACT.
(CHECK ONE):

GE ACCELERATED FILER þ ACCELERATED FILER o NON-ACCELERATED FILER o SMALLER REPORTING COMPA

(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

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER S CLASSES OF COMMON STOCK, AS OF THE LAST PRACTICABLE DATE.

9,022,040 SHARES AS OF MAY 3, 2010

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Part I. FINANCIAL INFORMATION
Item 1. Financial Statements.
ALLEGHANY CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets

	March 31, 2010	December 31, 2009
	(in thousands, except share amounts)	
	(unaudited)	
Assets		
Investments		
Available-for-sale securities at fair value:		
Equity securities (cost: 2010 $746,316; 2009 $530,945)	**$ 839,964**	$ 624,546
Debt securities (amortized cost: 2010 $3,006,885; 2009 $3,235,595)	**3,070,666**	3,289,013
Short-term investments	**204,706**	262,903
	4,115,336	4,176,462
Other invested assets	**242,609**	238,227
Total investments	**4,357,945**	4,414,689
Cash	**55,775**	32,526
Premium balances receivable	**152,295**	145,992
Reinsurance recoverables	**968,296**	976,172
Ceded unearned premium reserves	**152,202**	160,713
Deferred acquisition costs	**67,968**	71,098
Property and equipment at cost, net of accumulated depreciation and amortization	**19,738**	20,097
Goodwill and other intangibles, net of amortization	**144,829**	145,667
Net deferred tax assets	**114,304**	124,266
Other assets	**152,944**	101,550
	$ 6,186,296	$ 6,192,770
Liabilities and Stockholders Equity		
Losses and loss adjustment expenses	**$ 2,479,326**	$ 2,520,979
Unearned premiums	**540,809**	573,906
Reinsurance payable	**51,563**	51,795
Current taxes payable	**12,245**	3,827
Other liabilities	**328,061**	324,742
Total liabilities	**3,412,004**	3,475,249
Common stock (shares authorized: 2010 and 2009 22,000,000; issued and outstanding 2010 9,300,448; 2009 9,300,734)	**9,118**	9,118

Contributed capital	**916,822**	921,225
Accumulated other comprehensive income	**107,407**	94,045
Treasury stock, at cost (2010 276,625 shares; 2009 258,013 shares)	**(71,858)**	(66,325)
Retained earnings	**1,812,803**	1,759,458
Total stockholders equity	**2,774,292**	2,717,521
	$ 6,186,296	$ 6,192,770

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES
Consolidated Statements of Earnings and Comprehensive Income
(unaudited)

	Three Months Ended March 31,	
	2010	2009
	(in thousands, except per share amounts)	
Revenues		
Net premiums earned	**$ 194,700**	$ 218,044
Net investment income	**31,429**	27,069
Net realized capital gains	**26,467**	60,482
Other than temporary impairment losses	**(1,077)**	(66,126)
Other income	**133**	449
Total revenues	**251,652**	239,918
Costs and expenses		
Loss and loss adjustment expenses	**96,627**	112,837
Commissions, brokerage and other underwriting expenses	**66,356**	67,450
Other operating expenses	**8,851**	9,213
Corporate administration	**5,234**	(92)
Interest expense	**219**	163
Total costs and expenses	**177,287**	189,571
Earnings before income taxes	**74,365**	50,347
Income taxes	**16,196**	5,773
Net earnings	**$ 58,169**	$ 44,574
Other comprehensive income		
Change in unrealized gains (losses), net of deferred taxes	**$ 29,818**	$ (40,717)
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes	**(16,504)**	3,669
Other	**49**	(56)
Comprehensive income	**$ 71,532**	$ 7,470
Net earnings	**$ 58,169**	$ 44,574
Preferred dividends		3,908
Net earnings available to common stockholders	**$ 58,169**	$ 40,666
Basic earnings per share*	**$ 6.44**	$ 4.73
Diluted earnings per share*	**$ 6.38**	$ 4.45

*

Amounts reflect subsequent common stock dividends.

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(unaudited)

	Three Months Ended March 31,	
	2010	2009
	(in thousands)	
Cash flows from operating activities		
Net earnings	**$ 58,169**	$ 44,574
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	**10,587**	7,742
Net realized capital (gains) losses	**(26,467)**	(60,482)
Other than temporary impairment losses	**1,077**	66,126
(Increase) decrease in other assets	**(2,705)**	(11,743)
(Increase) decrease in reinsurance receivable, net of reinsurance payable	**7,644**	31,266
(Increase) decrease in premium balances receivable	**(6,303)**	(19,331)
(Increase) decrease in ceded unearned premium reserves	**8,511**	2,978
(Increase) decrease in deferred acquisition costs	**3,130**	2,695
Increase (decrease) in other liabilities and current taxes	**(21,744)**	(40,236)
Increase (decrease) in unearned premiums	**(33,097)**	(17,705)
Increase (decrease) in losses and loss adjustment expenses	**(41,653)**	(10,468)
Net adjustments	**(101,020)**	(49,158)
Net cash (used in) provided by operating activities	**(42,851)**	(4,584)
Cash flows from investing activities		
Purchase of investments	**(480,229)**	(603,015)
Sales of investments	**440,116**	289,853
Maturities of investments	**59,564**	63,525
Purchases of property and equipment	**(1,389)**	(1,388)
Net change in short-term investments	**58,208**	385,181
Other, net	**(2,828)**	1,182
Net cash (used in) provided by investing activities	**73,442**	135,338
Cash flows from financing activities		
Treasury stock acquisitions	**(7,517)**	(9,101)
Convertible preferred stock acquisition		(83,794)
Convertible preferred stock dividends paid		(4,304)
Other, net	**175**	(810)
Net cash (used in) provided by financing activities	**(7,342)**	(98,009)
Net cash increase (decrease) in cash	**23,249**	32,745
Cash at beginning of period	**32,526**	18,125

Cash at end of period	**$**	**55,775**	$	50,870
Supplemental disclosures of cash flow information				
Cash paid during the period for:				
Interest	**$**		$	
Income taxes paid (refunds received)	**$**	**2,453**	$	58

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

1. Principles of Financial Statement Presentation

This report should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2009 (the 2009 10-K) of Alleghany Corporation (Alleghany).

Alleghany, a Delaware corporation, is engaged in the property and casualty and surety insurance business through its wholly-owned subsidiary Alleghany Insurance Holdings LLC (AIHL). AIHL s insurance business is conducted through its wholly-owned subsidiaries RSUI Group, Inc. (RSUI), Capitol Transamerica Corporation and Platte River Insurance Company (collectively CATA), and Pacific Compensation Corporation, formerly known as Employers Direct Corporation. Effective April 12, 2010, as part of a strategic repositioning effort, Employers Direct Corporation changed its name to Pacific Compensation Corporation (PCC), and the name of its insurance subsidiary from Employers Direct Insurance Company to Pacific Compensation Insurance Company. AIHL Re LLC (AIHL Re), a captive reinsurance subsidiary of AIHL, has in the past provided reinsurance to Alleghany operating units and affiliates. In addition, Alleghany owns approximately 33 percent of the outstanding shares of common stock of Homesite Group Incorporated (Homesite), a national, full-service, mono-line provider of homeowners insurance, and approximately 38 percent of ORX Exploration, Inc. (ORX), a regional oil and gas exploration and production company. These investments are reflected in Alleghany s financial statements in other invested assets. Alleghany also owns and manages properties in the Sacramento, California region through its subsidiary Alleghany Properties Holdings LLC (Alleghany Properties) and makes strategic investments in operating companies and conducts other activities at the parent level.

The financial statements contained in this Quarterly Report on Form 10-Q are unaudited, but reflect all adjustments which, in the opinion of management, are necessary to a fair statement of results of the interim periods covered thereby. All adjustments are of a normal and recurring nature except as described herein.

The accompanying consolidated financial statements include the results of Alleghany and its wholly-owned subsidiaries, and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All significant inter-company balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those reported results to the extent that those estimates and assumptions prove to be inaccurate.

Certain prior year amounts have been reclassified to conform to the 2010 presentation.

2. Recently Adopted Accounting Pronouncements

In June 2009, Financial Accounting Standards Board (FASB) issued guidance that establishes the FASB Accounting Standards Codification (the ASC) as the single source of authoritative accounting principles in the preparation of financial statements in conformity with GAAP. The ASC is effective for interim and annual periods ending after September 15, 2009. Alleghany adopted the ASC in the 2009 third quarter, and the implementation did not have any impact on its results of operations and financial condition.

In September 2009, FASB issued guidance that allows investors to use net asset value as a practical expedient to estimate the fair value of investments in investment companies (and like entities) that do not have readily determinable fair values. This guidance does not apply to investments accounted for using the equity method. This guidance is effective for interim and annual periods ending after December 15, 2009, with early application permitted. Alleghany adopted this guidance in the fourth quarter of 2009, and the implementation did not have any impact on its results of operations and financial condition. Alleghany s partnership investments that are accounted for as available-for-sale are subject to this guidance. Net asset value quotes from the third-party general partner of the entity in which such investments are held, which will often be based on unobservable market inputs, constitute the primary input in Alleghany s determination of the fair value of such investments. The fair value of Alleghany s available-for-sale partnership investments was $33.5 million at March 31, 2010 and $35.2 million at December 31, 2009.

In June 2009, FASB issued guidance that changes the way entities account for securitizations and special-purpose entities. This guidance eliminates the concept of a qualifying special-purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosure about transfers of financial assets, including securitization transactions and an entity s continuing exposure to the risks related to transferred financial assets. This guidance also changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting rights (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. This guidance is generally effective for periods beginning in 2010. Alleghany adopted this guidance in the 2010 first quarter, and the implementation did not have an impact on its results of operations and financial condition. Alleghany did not have any off-balance sheet arrangements outstanding at March 31, 2010 or December 31, 2009, including those that may involve the types of entities contemplated in this guidance.

In January 2010, FASB issued guidance that provides for additional financial statement disclosure regarding fair value measurements, including how fair values are measured. This guidance is effective for interim and annual periods ending after December 15, 2009. Alleghany adopted this guidance in the 2010 first quarter, and the implementation did not have any impact on its results of operations and financial condition.

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3. Earnings Per Share of Common Stock

The following is a reconciliation of the income and share data used in the basic and diluted earnings per share computations for the three months ended March 31, 2010 and 2009 (in millions, except share amounts):

	2010	2009
Net earnings	$ 58.2	$ 44.6
Preferred dividends		3.9
Income available to common stockholders for basic earnings per share	58.2	40.7
Preferred dividends		3.9
Effect of other dilutive securities	(0.5)	(1.5)
Income available to common stockholders for diluted earnings per share	$ 57.7	$ 43.1
Weighted average shares outstanding applicable to basic earnings per share	9,032,600	8,602,713
Preferred stock		1,083,407
Effect of other dilutive securities	10,223	2,359
Adjusted weighted average shares outstanding applicable to diluted earnings per share	9,042,823	9,688,479

Contingently issuable shares of 39,606 and 36,255 were potentially available during the 2010 and 2009 first quarters, respectively, but were not included in the computations of diluted earnings per share because the impact was anti-dilutive to the earnings per share calculation.

Earnings per share by quarter may not equal the amount for the full year due to rounding.

4. Commitments and Contingencies

(a) Leases

Alleghany leases certain facilities, furniture and equipment under long-term lease agreements.

(b) Litigation

Alleghany s subsidiaries are parties to pending litigation and claims in connection with the ordinary course of their businesses. Each such subsidiary makes provisions for estimated losses to be incurred in such litigation and claims, including legal costs. In the opinion of management, such provisions are adequate.

(c) Asbestos and Environmental Impairment Exposure

AIHL s reserves for unpaid losses and loss adjustment expenses includes $18.0 million of gross reserves and $17.9 million of net reserves at March 31, 2010, and $18.9 million of gross reserves and $18.8 million of net reserves at December 31, 2009, for various liability coverages related to asbestos and environmental impairment claims that arose from reinsurance assumed by a subsidiary of CATA between 1969 and 1976. This subsidiary exited such business in 1976. Although Alleghany is unable at this time to determine whether additional reserves, which could have a material impact upon its results of operations, may be necessary in the future, Alleghany believes that CATA s asbestos and environmental reserves were adequate at March 31, 2010. Additional information concerning CATA s asbestos and environmental exposure can be found in Note 13 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2009 10-K.

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(d) Indemnification Obligations

On July 14, 2005, Alleghany completed the sale of its world-wide industrial minerals business, World Minerals, Inc. (World Minerals), to Imerys USA, Inc. (the Purchaser), a wholly-owned subsidiary of Imerys, S.A., pursuant to a Stock Purchase Agreement, dated as of May 19, 2005, by and among the Purchaser, Imerys, S.A. and Alleghany (the Stock Purchase Agreement). Pursuant to the Stock Purchase Agreement, Alleghany undertook certain indemnification obligations, including a general indemnification for breaches of representations and warranties set forth in the Stock Purchase Agreement (the Contract Indemnification) and a special indemnification (the Products Liability Indemnification) related to products liability claims arising from events that occurred during pre-closing periods, including the period of Alleghany ownership (the Alleghany Period).

The Products Liability Indemnification is divided into two parts, the first relating to products liability claims arising in respect of events occurring during the period prior to Alleghany s acquisition of the World Minerals business from Johns Manville Corporation, Inc., formerly known as Manville Sales Corporation, (Manville) in July 1991 (the Manville Period), and the second relating to products liability claims arising in respect of events occurring during the period of Alleghany ownership (the Alleghany Period).

Under the terms of the Stock Purchase Agreement, Alleghany will provide indemnification at a rate of 100 percent for the first $100.0 million of losses arising from products liability claims relating to the Manville Period and at a rate of 50 percent for the next $100.0 million of such losses, so that Alleghany s maximum indemnification obligation in respect of products liability claims relating to the Manville Period is $150.0 million. This indemnification obligation in respect of Manville Period products liability claims will expire on July 31, 2016. The Stock Purchase Agreement states that it is the intention of the parties that, with regard to losses incurred in respect of products liability claims relating to the Manville Period, recovery should first be sought from Manville, and that Alleghany s indemnification obligation in respect of products liability claims relating to the Manville Period is intended to indemnify the Purchaser for such losses which are not recovered from Manville within a reasonable period of time after recovery is sought from Manville. In connection with World Minerals acquisition of the assets of the industrial minerals business of Manville in 1991, Manville agreed to indemnify World Minerals for certain product liability claims, in respect of products of the industrial minerals business manufactured during the Manville Period, asserted against World Minerals through July 31, 2006. In June 2006, Manville agreed to extend its indemnification for such claims asserted against World Minerals through July 31, 2009. Notwithstanding the recent expiration of the Manville indemnity, World Minerals did not, as part of its 1991 acquisition of the assets of Manville s industrial minerals business assets, assume liability for product liability claims to the extent that such claims relate, in whole or in part, to the Manville Period, and Manville should continue to be responsible for such claims.

With respect to the Contract Indemnification, substantially all of the representations and warranties to which the Contract Indemnification applies survived until July 14, 2007, with the exception of certain representations and warranties such as those related to environmental, real estate and tax matters, which survive for longer periods and generally, except for tax and certain other matters, apply only to aggregate losses in excess of $2.5 million, up to a maximum of approximately $123.0 million. The Stock Purchase Agreement provides that Alleghany has no responsibility for products liability claims arising in respect of events occurring after the closing, and that any products liability claims involving both pre-closing and post-closing periods will be apportioned on an equitable basis.

Additional information concerning the Contract Indemnification and Products Liability Indemnification can be found in Note 13 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2009 10-K.

Based on Alleghany s historical experience and other analyses, in July 2005, Alleghany established a $0.6 million reserve in connection with the Products Liability Indemnification for the Alleghany Period. Such reserve was approximately $0.3 million at both March 31, 2010 and December 31, 2009.

(e) Equity Holdings Concentration

At March 31, 2010 and December 31, 2009, Alleghany had a concentration of market risk in its available-for-sale equity securities portfolio with respect to certain energy sector businesses of $625.1 million and $399.2 million, respectively. Of the $625.1 million, $269.9 million represents Alleghany s ownership of common stock of Exxon Mobil Corporation.

5. Segments of Business

Information related to Alleghany s reportable segment is shown in the table below. Property and casualty and surety insurance operations are conducted by AIHL through its insurance operating units RSUI, CATA and PCC. In addition, AIHL Re is a wholly-owned subsidiary of AIHL that has in the past provided reinsurance to Alleghany s insurance operating units and affiliates.

Alleghany s reportable segment is reported in a manner consistent with the way management evaluates the businesses. As such, insurance underwriting activities are evaluated separately from investment activities. Net realized capital gains and other-than-temporary impairment losses are not considered relevant in evaluating investment performance on an annual basis. Segment accounting policies are described in Note 1 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2009 10-K.

The primary components of corporate activities are Alleghany Properties, Alleghany s investments in Homesite and ORX and strategic investments and other activities at the parent level.

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	Three Months Ended March 31,	
	2010	2009
	(in millions)	
Revenues:		
AIHL insurance group:		
Net premiums earned		
RSUI	$ 150.3	$ 160.7
CATA	40.6	41.9
PCC	3.8	15.4
AIHL Re		
	194.7	218.0
Net investment income	33.4	27.0
Net realized capital gains	22.7	7.5
Other than temporary impairment losses (1)	(1.1)	(66.1)
Other income	0.1	0.5
Total insurance group	249.8	186.9
Corporate activities:		
Net investment income (2)	(1.9)	
Net realized capital gains (3)	3.8	53.0
Other than temporary impairment losses		
Other income		
Total	$ 251.7	$ 239.9
Earnings before income taxes:		
AIHL insurance group:		
Underwriting profit (loss) (4)		
RSUI	$ 36.8	$ 42.2
CATA	0.3	2.2
PCC	(5.4)	(6.6)
AIHL Re		
	31.7	37.8
Net investment income	33.4	27.0
Net realized capital gains	22.7	7.5
Other than temporary impairment losses (1)	(1.1)	(66.1)
Other income, less other expenses	(8.4)	(8.4)
Total insurance group	78.3	(2.2)

Corporate activities:		
Net investment income (2)	(1.9)	
Net realized capital gains (3)	3.8	53.0
Other than temporary impairment losses		
Other income		
Corporate administration and other expenses	5.7	0.2
Interest expense	0.1	0.2
Total	$ 74.4	$ 50.4

(1) Reflects impairment charges for unrealized losses related to AIHL s investment portfolio that were deemed to be other-than temporary. See Note 7.

(2) Includes $1.8 million and $1.1 million of Alleghany s equity in losses of Homesite, net of purchase accounting adjustments, for the three months ended March 31, 2010 and 2009, respectively. Also includes $2.4 million and $0.7 million of Alleghany s equity in losses of ORX, net of purchase accounting adjustments, for three months ended March 31, 2010 and 2009,

respectively.

(3) With respect to the three months ended March 31, 2009, primarily reflects net realized capital gains from the sale of shares of Burlington Northern Santa Fe Corporation common stock.

(4) Represents net premiums earned less loss and loss adjustment expenses and commission, brokerage and other underwriting expenses, all as determined in accordance with GAAP, and does not include net investment income, net realized capital gains,

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other-than-temporary impairment losses, other income or other expenses. Commission, brokerage and other underwriting expenses represent commission and brokerage expenses and that portion of salaries, administration and other operating expenses attributable primarily to underwriting activities, whereas the remainder constitutes other expenses.

6. Reinsurance

As discussed in the 2009 10-K, RSUI reinsures its property lines of business through a program consisting of surplus share treaties, facultative placements, per risk, and catastrophe excess of loss treaties. RSUI s catastrophe reinsurance program (which covers catastrophe risks including, among others, windstorms and earthquakes) and per risk reinsurance program run on an annual basis from May 1 to the following April 30 and thus expired on April 30, 2010. RSUI placed all of its catastrophe reinsurance program for the 2010-2011 period, and the new program is substantially similar to the expired program. The new reinsurance program provides coverage in two layers for $400.0 million of losses in excess of a $100.0 million net retention after application of the surplus share treaties, facultative reinsurance and per risk covers. The first layer provides coverage for $100.0 million of losses, before a 33.00 percent co-participation by RSUI, in excess of the $100.0 million net retention, and the second layer provides coverage for $300.0 million of losses, before a 5 percent co-participation by RSUI, in excess of $200.0 million. In addition, RSUI s property per risk reinsurance program for the 2010-2011 period provides RSUI with coverage for $90.0 million of losses, before a 10.0 percent co-participation by RSUI (compared with no RSUI co-participation under the expired program), in excess of a $10.0 million net retention per risk after application of the surplus share treaties and facultative reinsurance. As discussed in Note 5(d) to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2009 10-K, RSUI reinsures its other lines of business through quota share treaties, except for professional liability and binding authority lines where RSUI retains all of such business.

7. Investments

(a) Fair Value

The estimated carrying values and fair values of Alleghany s financial instruments as of March 31, 2010 and December 31, 2009 are as follows (in millions):

	March 31, 2010		December 31, 2009	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Assets				
Investments (excluding equity method investments and loans)*	$4,148.9	$4,148.9	$4,211.6	$4,211.6

* This table includes available-for-sale investments (securities as well as partnership investments carried at fair value that are included in other invested assets). This table excludes investments accounted for using the equity method (Homesite, ORX and other partnership investments) as well as certain loans receivable that are carried at cost, all of which are included in other invested assets. The fair value of short-term investments approximates amortized cost. The fair value of all other categories of investments is discussed below.

GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are not adjusted for transaction costs. In addition, GAAP has a three-tiered hierarchy for inputs used in management s determination of fair value of financial instruments that emphasizes the use of observable inputs over the use of unobservable inputs by requiring that the observable inputs be used when available. Observable inputs are market participant assumptions based on market data obtained from sources independent of the reporting entity. Unobservable inputs are the reporting entity s own assumptions about market participant assumptions based on

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the best information available under the circumstances. In assessing the appropriateness of using observable inputs in making its fair value determinations, Alleghany considers whether the market for a particular security is active or not based on all the relevant facts and circumstances. For example, Alleghany may consider a market to be inactive if there are relatively few recent transactions or if there is a significant decrease in market volume. Furthermore, Alleghany considers whether observable transactions are orderly or not. Alleghany does not consider a transaction to be orderly if there is evidence of a forced liquidation or other distressed condition, and as such, little or no weight is given to that transaction as an indicator of fair value.

The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1 Valuations are based on unadjusted quoted prices in active markets for identical, unrestricted assets. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these assets does not involve any meaningful degree of judgment. An active market is defined as a market where transactions for the financial instrument occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Alleghany s Level 1 assets generally include publicly traded common stocks and debt securities issued directly by the U.S. Government, where Alleghany s valuations are based on quoted market prices.

Level 2 Valuations are based on quoted market prices where such markets are not deemed to be sufficiently active. In such circumstances, additional valuation metrics will be used which involve direct or indirect observable market inputs. Alleghany s Level 2 assets generally include preferred stocks and debt securities other than debt issued directly by the U.S. Government. Substantially all of the determinations of value in this category are based on a single quote from third-party dealers and pricing services. As Alleghany generally does not make any adjustments thereto, such quote typically constitutes the sole input in Alleghany s determination of the fair value of these types of securities. In developing a quote, such third parties will use the terms of the security and market-based inputs. Terms of the security include coupon, maturity date, and any special provisions that may, for example, enable the investor, at its election, to redeem the security prior to its scheduled maturity date. Market-based inputs include the level of interest rates applicable to comparable securities in the market place and current credit rating(s) of the security. Such quotes are generally non-binding.

Level 3 Valuations are based on inputs that are unobservable and significant to the overall fair value measurement. Valuation under Level 3 generally involves a significant degree of judgment on the part of Alleghany. Alleghany s Level 3 assets are primarily limited to partnership investments. Net asset value quotes from the third-party general partner of the entity in which such investments are held, which will often be based on unobservable market inputs, constitute the primary input in Alleghany s determination of the fair value of such assets.

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Alleghany validates the reasonableness of its fair value determinations for Level 2 securities by testing the methodology of the relevant third-party dealer or pricing service that provides the quotes upon which the fair value determinations are made. Alleghany tests the methodology by comparing such quotes with prices from executed market trades when such trades occur. Alleghany discusses with the relevant third-party dealer or pricing service any identified material discrepancy between the quote derived from its methodology and the executed market trade in order to resolve the discrepancy. Alleghany uses the quote from the third-party dealer or pricing service unless Alleghany determines that the methodology used to produce such quote is not in compliance with GAAP. In addition to such procedures, Alleghany also compares the aggregate amount of the fair value for such Level 2 securities with the aggregate fair value provided by a third-party financial institution. Furthermore, Alleghany reviews the reasonableness of its classification of securities within the three-tiered hierarchy to ensure that the classification is consistent with GAAP. The estimated carrying values of Alleghany s financial instruments as of March 31, 2010 and December 31, 2009 allocated among the three levels set forth above were as follows (in millions):

	Level 1	Level 2	Level 3 (1)	Total
As of March 31, 2010				