ALLEGHANY CORP /DE
Form 10-Q
August 04, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR QUARTERLY PERIOD ENDED JUNE 30, 2011

¨ **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 x 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 (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 x NO ¨

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):

LARGE ACCELERATED FILER	x	ACCELERATED FILER	¨
NON-ACCELERATED FILER	¨ (DO NOT CHECK IF A SMALLER REPORTING COMPANY)	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 ¨ NO x

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

8,862,012 SHARES AS OF AUGUST 2, 2011

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

	June 30, 2011 (unaudited)	December 31, 2010
	(in thousands, except share amounts)	
Assets		
Investments		
Available-for-sale securities at fair value:		
Equity securities (cost: 2011 $1,406,542; 2010 $1,310,009)	**$ 1,642,108**	$ 1,500,686
Debt securities (amortized cost: 2011 $2,706,761; 2010 $2,778,117)	**2,795,231**	2,832,411
Short-term investments	**262,445**	264,811
	4,699,784	4,597,908
Other invested assets	**198,878**	207,294
Total investments	**4,898,662**	4,805,202
Cash	**85,484**	76,741
Premium balances receivable	**195,985**	128,075
Reinsurance recoverables	**872,589**	873,295
Ceded unearned premium reserves	**162,773**	144,065
Deferred acquisition costs	**72,125**	67,692
Property and equipment at cost, net of accumulated depreciation and amortization	**20,269**	19,504
Goodwill and other intangibles, net of amortization	**140,635**	142,312
Current taxes receivable	**12,529**	
Net deferred tax assets	**37,196**	77,147
Other assets	**117,620**	97,666
	$ 6,615,867	$ 6,431,699
Liabilities and Stockholders Equity		
Loss and loss adjustment expenses	**$ 2,324,386**	$ 2,328,742
Unearned premiums	**588,848**	523,927
Senior Notes	**298,979**	298,923
Reinsurance payable	**67,241**	41,500
Current taxes payable		3,220
Other liabilities	**306,964**	326,519
Total liabilities	**3,586,418**	3,522,831
Common stock		
(shares authorized: 2011 and 2010 22,000,000; issued and outstanding 2011 9,117,787; 2010 9,300,448)	**9,117**	9,118
Contributed capital	**937,057**	928,816
Accumulated other comprehensive income	**218,149**	170,262
Treasury stock, at cost (2011 232,914 shares; 2010 351,532 shares)	**(68,271)**	(99,686)
Retained earnings	**1,933,397**	1,900,358

Total stockholders equity	**3,029,449**	2,908,868
	$ 6,615,867	$ 6,431,699

See accompanying Notes to Unaudited Consolidated Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Earnings and Comprehensive Income

(unaudited)

	Three Months Ended June 30,	
	2011	2010
	(in thousands, except per share amounts)	
Revenues		
Net premiums earned	**$ 183,878**	$ 188,809
Net investment income	**28,545**	32,694
Net realized capital gains	**6,490**	33,308
Other than temporary impairment losses		(5,703)
Other income	**248**	1,501
Total revenues	**219,161**	250,609
Costs and expenses		
Loss and loss adjustment expenses	**122,619**	83,027
Commissions, brokerage and other underwriting expenses	**64,132**	64,773
Other operating expenses	**8,673**	8,082
Corporate administration	**5,002**	6,324
Interest expense	**4,268**	216
Total costs and expenses	**204,694**	162,422
Earnings before income taxes	**14,467**	88,187
Income taxes	**(615)**	21,916
Net earnings	**$ 15,082**	$ 66,271
Other comprehensive income		
Change in unrealized gains (losses), net of deferred taxes	**$ (24,428)**	$ (57,401)
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes	**(4,218)**	(17,943)
Other	**(50)**	50
Comprehensive income	**$ (13,614)**	$ (9,023)
Basic earnings per share*	**$ 1.69**	$ 7.26
Diluted earnings per share*	**$ 1.68**	$ 7.24

* Amounts reflect subsequent common stock dividends.

See accompanying Notes to Unaudited Consolidated Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Earnings and Comprehensive Income

(unaudited)

	Six Months Ended June 30,	
	2011	2010
	(in thousands, except per share amounts)	
Revenues		
Net premiums earned	**$ 364,858**	$ 383,509
Net investment income	**60,124**	64,123
Net realized capital gains	**41,182**	59,775
Other than temporary impairment losses		(6,780)
Other income	**1,133**	1,634
Total revenues	**467,297**	502,261
Costs and expenses		
Loss and loss adjustment expenses	**193,641**	179,654
Commissions, brokerage and other underwriting expenses	**130,660**	131,129
Other operating expenses	**18,919**	16,933
Corporate administration	**11,381**	11,558
Interest expense	**8,720**	435
Total costs and expenses	**363,321**	339,709
Earnings before income taxes	**103,976**	162,552
Income taxes	**17,554**	38,112
Net earnings	**$ 86,422**	$ 124,440
Other comprehensive income		
Change in unrealized gains (losses), net of deferred taxes	**$ 74,834**	$ (27,583)
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes	**(26,768)**	(34,447)
Other	**(179)**	99
Comprehensive income	**$ 134,309**	$ 62,509
Basic earnings per share*	**$ 9.69**	$ 13.58
Diluted earnings per share*	**$ 9.66**	$ 13.50

* Amounts reflect subsequent common stock dividends.

See accompanying Notes to Unaudited Consolidated Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(unaudited)

	Six Months Ended June 30, **2011**	2010
	(in thousands)	
Cash flows from operating activities		
Net earnings	**$ 86,422**	$ 124,440
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	**13,445**	18,045
Net realized capital (gains) losses	**(41,182)**	(59,775)
Other than temporary impairment losses		6,780
(Increase) decrease in other assets	**9,227**	6,496
(Increase) decrease in reinsurance receivable, net of reinsurance payable	**26,447**	46,870
(Increase) decrease in premium balances receivable	**(67,910)**	(37,109)
(Increase) decrease in ceded unearned premium reserves	**(18,708)**	(7,319)
(Increase) decrease in deferred acquisition costs	**(4,433)**	(1,382)
Increase (decrease) in other liabilities and current taxes	**(33,928)**	(28,996)
Increase (decrease) in unearned premiums	**64,921**	22,703
Increase (decrease) in loss and loss adjustment expenses	**(4,356)**	(102,047)
Net adjustments	**(56,477)**	(135,734)
Net cash (used in) provided by operating activities	**29,945**	(11,294)
Cash flows from investing activities		
Purchase of investments	**(694,810)**	(1,050,830)
Sales of investments	**541,941**	1,078,492
Maturities of investments	**154,709**	184,185
Purchases of property and equipment	**(4,582)**	(3,550)
Net change in short-term investments	**2,386**	(90,934)
Acquisition of equity method investments		(5,000)
Other, net	**(457)**	9,759
Net cash (used in) provided by investing activities	**(813)**	122,122
Cash flows from financing activities		
Treasury stock acquisitions	**(21,277)**	(59,817)
Tax benefit on stock based compensation	**645**	513
Other, net	**243**	132
Net cash (used in) provided by financing activities	**(20,389)**	(59,172)
Net cash increase (decrease) in cash	**8,743**	51,656
Cash at beginning of period	**76,741**	32,526
Cash at end of period	**$ 85,484**	$ 84,182
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	**$ 8,203**	$
Income taxes paid (refunds received)	**$ 20,724**	$ 46,204

See accompanying Notes to Unaudited Consolidated Financial Statements.

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, 2010 (the 2010 10-K) and the Quarterly Report on Form 10-Q for the quarter ended March 31, 2011 of Alleghany Corporation (Alleghany).

Alleghany, a Delaware corporation, which together with its subsidiaries is referred to as Alleghany unless the context otherwise requires, 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 (PCC). AIHL Re LLC (AIHL Re), a captive reinsurance subsidiary of AIHL, has in the past provided reinsurance to Alleghany operating units and affiliates. Alleghany s equity investments, including those held by AIHL s insurance operating units, are managed primarily by Alleghany Capital Partners LLC, an indirect, wholly-owned subsidiary of Alleghany. Alleghany also owns and manages properties in the Sacramento, California region through its subsidiary Alleghany Properties Holdings LLC (Alleghany Properties). 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. Alleghany also 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 unaudited consolidated financial statements include the results of Alleghany and its wholly-owned and majority-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 2011 presentation.

2. Recent Accounting Standards

Recently Adopted

In July 2010, the Financial Accounting Standards Board (FASB) issued guidance that provides for additional financial statement disclosure regarding financing receivables, including the credit quality and allowance for credit losses associated with such assets. This guidance is generally effective for interim and annual periods beginning after December 15, 2010, with certain disclosures effective for interim and annual periods ending on or after December 31, 2010. Alleghany fully adopted this guidance in the 2011 first quarter, and the implementation did not have any impact on its results of operations and financial condition.

Future Application of Accounting Standards

In June 2011, the FASB issued guidance on the presentation of comprehensive income. This guidance increases the prominence of other comprehensive income in the financial statements and eliminates the current option to report other comprehensive income and its components in the statement of changes in equity, and does not change the items that must be reported in other comprehensive income. This guidance is generally effective for interim and annual periods beginning after December 15, 2011. Alleghany will adopt this guidance in the 2012 first quarter, and Alleghany does not currently believe that the implementation will have an impact on its results of operations and financial condition.

In May 2011, FASB issued guidance that addresses requirements for measuring fair value. Among other things, the guidance clarifies that the highest and best use valuation premise applies only to non-financial assets, and that premiums or discounts should be applied to valuations of an individual asset or liability only when market participants would do so. The guidance also permits measurement of fair value of financial instruments (that are carried at fair value) based on an entity s net exposure to a particular market or credit risk on a net basis if there is evidence that the entity manages its financial instruments in this way. The guidance provides for additional financial statement disclosure regarding fair value measurements, including disclosure involving transfers between categories within the fair value hierarchy, and quantitative and qualitative information about fair value measurements that involve a significant degree of judgment. This guidance is effective for interim and annual periods ending after December 15, 2011. Alleghany will adopt this guidance in the first quarter of 2012, and Alleghany does not believe the implementation will have a material impact on its results of operations and financial condition.

In October 2010, the FASB issued guidance that provides additional clarification for costs associated with acquiring or renewing insurance contracts. This guidance states that only incremental, direct costs associated with the successful acquisition of a new or renewal insurance contract may be capitalized as deferred acquisition costs. Furthermore, such costs: (i) must be essential to the contract transaction; (ii) would not have been incurred had the contract transaction not occurred; and (iii) must be related directly to the acquisition activities involving underwriting, policy issuance and processing, medical and inspection, and sales force contract selling. Advertising costs should be included in deferred acquisition costs only if the capitalization criteria in separate direct-response advertising guidance within GAAP are met. All other acquisition-related costs and other expenses should be charged to expense as incurred. This guidance is effective for interim and annual periods beginning after December 15, 2011, with early adoption permitted (but only at the beginning of an entity s annual reporting period). Alleghany will adopt this guidance in the 2012 first quarter, and Alleghany does not currently believe that the implementation will have a material impact on its results of operations and financial condition.

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 and six months ended June 30, 2011 and 2010 (in millions, except share amounts):

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Net earnings	$ 15.1	$ 66.3	$ 86.4	$ 124.4
Effect of dilutive securities	(0.1)	(0.1)	(0.2)	(0.5)
Income available to common stockholders for diluted earnings per share	$ 15.0	$ 66.2	$ 86.2	$ 123.9
Weighted average shares outstanding applicable to basic earnings per share	8,916,620	9,124,187	8,921,950	9,164,443
Effect of dilutive securities	5,352	9,788	5,168	9,489
Adjusted weighted average shares outstanding applicable to diluted earnings per share	8,921,972	9,133,975	8,927,118	9,173,932

Contingently issuable shares of 42,429 and 40,756 were potentially available during the first six months of 2011 and 2010, 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 the timing of treasury stock purchases and 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 were adequate as of June 30, 2011.

(c) Asbestos and Environmental Impairment Exposure

AIHL s reserves for unpaid loss and loss adjustment expenses include \$13.9 million of gross reserves and \$13.8 million of net reserves as of June 30, 2011, and \$14.1 million of gross reserves and \$14.0 million of net reserves as of December 31, 2010, for 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. 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 2010 10-K.

(d) Indemnification Obligations

On July 14, 2005 (the Closing Date), 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). Under the terms of the Stock Purchase Agreement, with respect to products liability claims arising in respect of events occurring during the period prior to Alleghany s acquisition of World Minerals, Alleghany will provide indemnification at a rate of 100 percent for the first $100.0 million of losses arising from such claims, 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 such period of time is $150.0 million. This indemnification obligation will expire on July 31, 2016. With respect to the Alleghany Period, based on its 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 $0.2 million at both June 30, 2011 and December 31, 2010. The Stock Purchase Agreement provides that Alleghany has no responsibility for products liability claims arising in respect of events occurring after the Closing Date, 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 Products Liability Indemnification and Contract Indemnification can be found in Note 13 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2010 10-K.

(e) Equity Holdings Concentration

As of June 30, 2011 and December 31, 2010, Alleghany had a concentration of market risk in its available-for-sale equity securities portfolio with respect to certain energy sector businesses of $1,024.9 million and $1,004.8 million, respectively. Of the $1,024.9 million, $651.0 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 2010 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.

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Revenues:				
AIHL insurance group:				
Net premiums earned				
RSUI	$ 144.4	$ 146.3	$ 286.0	$ 296.6
CATA	37.9	41.5	77.1	82.1
PCC	1.6	1.0	1.7	4.9
	183.9	188.8	364.8	383.6
Net investment income	31.0	33.0	61.2	66.3
Net realized capital gains	6.5	32.7	41.2	55.5
Other than temporary impairment losses (1)		(5.7)		(6.8)
Other income	0.1	0.2	0.3	0.3
Total insurance group	221.5	249.0	467.5	498.9
Corporate activities:				
Net investment income (2)	(2.4)	(0.3)	(1.0)	(2.2)
Net realized capital gains		0.6		4.3
Other than temporary impairment losses				
Other income	0.1	1.3	0.8	1.3
Total	$ 219.2	$ 250.6	$ 467.3	$ 502.3
Earnings before income taxes:				
AIHL insurance group:				
Underwriting profit (loss) (3)				
RSUI	$ 19.5	$ 43.8	$ 68.5	$ 80.6
CATA	(1.7)	2.7	(1.0)	3.0
PCC	(20.6)	(5.5)	(26.9)	(10.9)
	(2.8)	41.0	40.6	72.7
Net investment income	31.0	33.0	61.2	66.3
Net realized capital gains	6.5	32.7	41.2	55.5
Other than temporary impairment losses (1)		(5.7)		(6.8)
Other income, less other expenses	(7.2)	(7.5)	(16.9)	(15.9)
Total insurance group	27.5	93.5	126.1	171.8
Corporate activities:				
Net investment income (2)	(2.4)	(0.3)	(1.0)	(2.2)
Net realized capital gains		0.6		4.3
Other than temporary impairment losses				
Other income	0.1	1.3	0.8	1.3
Corporate administration and other expenses	6.4	6.8	13.2	12.5
Interest expense	4.3	0.1	8.7	0.1
Total	$ 14.5	$ 88.2	$ 104.0	$ 162.6

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

(2) Includes $7.1 million and $1.6 million of Alleghany s equity share of losses in Homesite for the six months ended June 30, 2011 and 2010, respectively, and $2.2 million and $2.8 million of Alleghany s equity share of losses in ORX for the six months ended June 30, 2011 and

2010, respectively.

(3) Represents net premiums earned less loss and loss adjustment expenses and commissions, brokerage and other underwriting expenses, all as determined in accordance with GAAP, and does not include net investment income, net realized capital gains, other-than-temporary impairment losses, other income or other expenses. Commissions, 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 2010 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, 2011. RSUI renewed all of its catastrophe reinsurance program for the 2011-2012 period, and the new reinsurance program is 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 47.0 percent co-participation by RSUI (compared with a 33.0 percent co-participation under the expired program), in excess of the $100.0 million net retention, and the second layer provides coverage for $300.0 million of losses, before a 5.0 percent co-participation by RSUI, in excess of $200.0 million. In addition, RSUI s property per risk reinsurance program for the 2011-2012 period provides RSUI with coverage for $90.0 million of losses, before a 10.0 percent co-participation by RSUI, 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(a) to the Notes to Consolidated Financial Statements set forth in Item 8 of the 2010 10-K, RSUI reinsures its other lines of business through quota share treaties, except for professional liability, binding authority and (effective April 15, 2011) the general liability lines where RSUI retains all of such business. RSUI s quota share reinsurance treaty for umbrella/excess lines of business renewed on June 1, 2011 on the same terms as the expiring treaty, providing coverage for policies with limits up to $30.0 million, with RSUI ceding 35.0 percent of the premium and loss for policies with limits up to $15.0 million and ceding 67.5 percent of the premium and loss for policies with limits in excess of $15.0 million up to $30.0 million. RSUI s directors and officers liability line quota share reinsurance treaty renewed on July 1, 2011 on the same terms as the expiring treaty, providing coverage for policies with limits up to $20.0 million, with RSUI ceding 35.0 percent of the premium and loss for policies with limits up to $10.0 million and ceding 60.0 percent of the premium and loss for policies with limits in excess of $10.0 million up to $20.0 million.

7. Investments

(a) Fair Value

The estimated carrying values and fair values of Alleghany s consolidated financial instruments as of June 30, 2011 and December 31, 2010 were as follows (in millions):

	June 30, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Investments (excluding equity method investments)*	$ 4,726.9	$ 4,726.9	$ 4,622.7	$ 4,622.7
Liabilities				
Senior Notes**	$ 299.0	$ 308.9	$ 298.9	$ 291.8

* 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 investments) and 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.

** See Note 7 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2010 10-K.

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 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. Alleghany s Level 2 liabilities include the Senior Notes. 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 its 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 investment is 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.

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 fair values of Alleghany s financial instruments as of June 30, 2011 and December 31, 2010 allocated among the three levels set forth above were as follows (in millions):

	Level 1	Level 2	Level 3	Total
As of June 30, 2011				
Equity securities:				
Common stock(1)	$ 1,642.1	$	$	$ 1,642.1
Preferred stock				
Debt securities:				
U.S. Government obligations	271.9	30.5		302.4
Mortgage and asset-backed securities(2)		1,006.3		1,006.3
States, municipalities and political subdivision bonds		1,000.6		1,000.6
Foreign bonds		90.3		90.3
Corporate bonds and other		395.6		395.6
	271.9	2,523.3		2,795.2
Short-term investments	87.4	175.0		262.4
Other invested assets(3)			27.2	27.2
Investments (excluding equity method investments)	$ 2,001.4	$ 2,698.3	$ 27.2	$ 4,726.9
Senior Notes	$	$ 308.9	$	$ 308.9
As of December 31, 2010				
Equity securities:				
Common stock(1)	$ 1,500.7	$	$	$ 1,500.7
Preferred stock				
Debt securities:				
U.S. Government obligations	307.3	30.5		337.8
Mortgage and asset-backed securities(2)		866.5		866.5
States, municipalities and political subdivision bonds		1,068.5		1,068.5
Foreign bonds		114.2		114.2
Corporate bonds and other		445.4		445.4
	307.3	2,525.1		2,832.4
Short-term investments	86.4	178.4		264.8
Other invested assets(3)			24.8	24.8
Investments (excluding equity method investments)	$ 1,894.4	$ 2,703.5	$ 24.8	$ 4,622.7
Senior Notes	$	$ 291.8	$	$ 291.8

(1) Of the $1,642.1 million of fair value as of June 30, 2011, $1,024.9 million related to certain energy sector businesses. Of the $1,500.7 million of fair value as of December 31, 2010, $1,004.8 million related to certain energy sector businesses.

(2) Of the $1,006.3 million of fair value as of June 30, 2011, $549.9 million related to residential mortgage-backed securities (RMBS), $190.5 million related to commercial mortgage-backed securities (CMBS) and $265.9 million related to other asset-backed securities. Of the $866.5 million of fair value as of December 31, 2010, $499.9 million related to RMBS, $173.4 million related to CMBS and $193.2 million related to other asset-backed securities.

(3) Level 3 securities consist of partnership investments. The carrying value of partnership investments of $27.2 million increased by $2.4 million from the December 31, 2010 carrying value of $24.8 million, due primarily to an increase in estimated fair value during the period.

(b) Available-For-Sale Securities

Available-for-sale securities as of June 30, 2011 and December 31, 2010 are summarized as follows (in millions):

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of June 30, 2011				
Equity securities:				
Common stock(1)	$ 1,406.5	$ 252.1	$ (16.5)	$ 1,642.1
Preferred stock				
Debt securities:				
U.S. Government obligations	298.4	4.4	(0.4)	302.4
Mortgage and asset-backed securities(2)	971.4	38.8	(3.9)	1,006.3
States, municipalities and political subdivision bonds	965.9	37.8	(3.1)	1,000.6
Foreign bonds	88.5	2.5	(0.7)	90.3
Corporate bonds and other	382.6	14.1	(1.1)	395.6
	2,706.8	97.6	(9.2)	2,795.2
Short-term investments	262.4			262.4
	$ 4,375.7	$ 349.7	$ (25.7)	$ 4,699.7
Industry Segment				
AIHL insurance group	$ 3,818.5	$ 249.0	$ (25.7)	$ 4,041.8
Corporate activities	557.2	100.7		657.9
	$ 4,375.7	$ 349.7	$ (25.7)	$ 4,699.7

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of December 31, 2010				
Equity securities:				
Common stock(1)	$ 1,310.0	$ 196.3	$ (5.6)	$ 1,500.7
Preferred stock				
Debt securities:				
U.S. Government obligations	334.4	4.6	(1.2)	337.8
Mortgage and asset-backed securities(2)	841.0	31.8	(6.3)	866.5
States, municipalities and political subdivision bonds	1,058.1	25.4	(15.0)	1,068.5
Foreign bonds	112.7	2.4	(0.9)	114.2
Corporate bonds and other	431.9	14.9	(1.4)	445.4
	2,778.1	79.1	(24.8)	2,832.4
Short-term investments	264.8			264.8
	$ 4,352.9	$ 275.4	$ (30.4)	$ 4,597.9
Industry Segment				
AIHL insurance group	$ 3,760.3	$ 232.7	$ (30.4)	$ 3,962.6
Corporate activities	592.6	42.7		635.3

	$ 4,352.9	$ 275.4	$ (30.4)	$ 4,597.9

(1) Of the $1,642.1 million of fair value as of June 30, 2011, $1,024.9 million related to certain energy sector businesses. Of the $1,500.7 million of fair value as of December 31, 2010, $1,004.8 million related to certain energy sector businesses.

(2) Of the $1,006.3 million of fair value as of June 30, 2011, $549.9 million related to RMBS, $190.5 million related to CMBS and $265.9 million related to other asset-backed securities. Of the $866.5 million of fair value as of December 31, 2010, $499.9 million related to RMBS, $173.4 million related to CMBS and $193.2 million related to other asset-backed securities.

The amortized cost and estimated fair value of debt securities as of June 30, 2011 by contractual maturity are shown below (in millions). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	**Fair Value**
Short-term investments due in one year or less	$ 262.4	$ 262.4
Mortgage and asset-backed securities	971.4	1,006.3
Debt securities		
One year or less	241.1	244.2
Over one through five years	540.7	561.6
Over five through ten years	569.7	594.0
Over ten years	383.9	389.1
Equity securities	1,406.5	1,642.1
	$ 4,375.7	$ 4,699.7

The proceeds from sales of available-for-sale securities were $0.5 b