Validus Reinsurance (Switzerland) Ltd

Report on the Financial Condition

2016

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1. General Remarks

This report on the financial condition of Validus Reinsurance (Switzerland) Ltd (hereafter referred to as “the Company” or “VRS”) has been prepared to comply with article 111a of the Swiss Insurance Supervision Ordinance applicable since 1 January 2016 and is not intended, nor necessarily suitable, for any other purpose. The content and structure of this report are in accordance with circular 2016/02 Public disclosure (the “Circular”) issued by the Swiss Financial Market Supervisory Authority (“FINMA”) and considering the specific situation, size and complexity of the Company. This report contains both qualitative and quantitative information.

Quantitative information is based on *i)* the Company’s 2016 audited financial statements (“statutory financial statements”) and *ii)* the Company’s 2017 reporting on the Swiss Solvency Test (“SST”) as submitted to FINMA in April 2017, which is still subject to FINMA’s regulatory review. The information contained in this report is consistent with information reported to FINMA in accordance with article 25 of the Insurance Supervision Act and article 53 for the Insurance Supervision Ordinance. Appendix I contains the report of the statutory auditor to the General Meeting on the financial statements 2016, including the statutory financial statements prepared in accordance with Swiss law. Appendix II contains further quantitative information as prescribed by FINMA, including the performance of the Company with line of business specific information, the solvency balance sheet as well as details on the Company’s risk bearing capital, target capital and resulting SST ratio.

This report has been prepared for the first time for the financial year 2016, i.e. the period from 1 January 2016 to 31 December 2016. In line with the transitional provisions as defined in margin 116 of the Circular, comparisons with prior periods were generally not included in this report, unless it was deemed appropriate in the context.

The Company’s Board of Directors approved this report on 8 June 2017.

2. Management Summary

The Company forms part of the Validus Group's reinsurance segment and is a Zurich based reinsurer with a Bermuda branch, underwriting reinsurance in the following lines of business: Property, Marine, Agriculture, Casualty and Specialty. The year 2016 was another successful year for the Company in respect of both headline growth and profitability, particularly due to new Casualty reinsurance operations but also supported by increased Marine, Property and Specialty business.

Total gross written premiums for the year 2016 amounted to CHF 502.4m. The combined ratio for the year ended 2016 improved to 97% and net income amounts to CHF 30.7m. The solvency ratio (based on the Swiss Solvency Test) is 262% with a total risk-bearing capital of CHF 800m, supporting VRS' strong capital position. The Company currently holds an AM Best and S&P rating of A.

This report provides a more detailed overview of VRS' business activities including its lines of business and corporate strategy in Section 3. Section 4 summarises the performance of the Company during the financial year 2016, where applicable in context with the preceding financial year. Sections 5 and 6 of the report elaborate on the Company's Corporate Governance and Risk Management framework as well as on its risk profile. The quantitative information contained in the report and its appendix is complemented by Section 7, providing details on valuation methods used and differences between solvency and statutory views. Section 8 describes VRS' capital management strategy and capital position, including the statutory equity of the Company as at 31 December 2016 and significant valuation differences between solvency and statutory views. The solvency information provided in Section 9 is based on information provided in the Company's 2017 SST report as submitted to FINMA.

3. Business Activities

3.1. Shareholding, strategy, objectives and key business segments

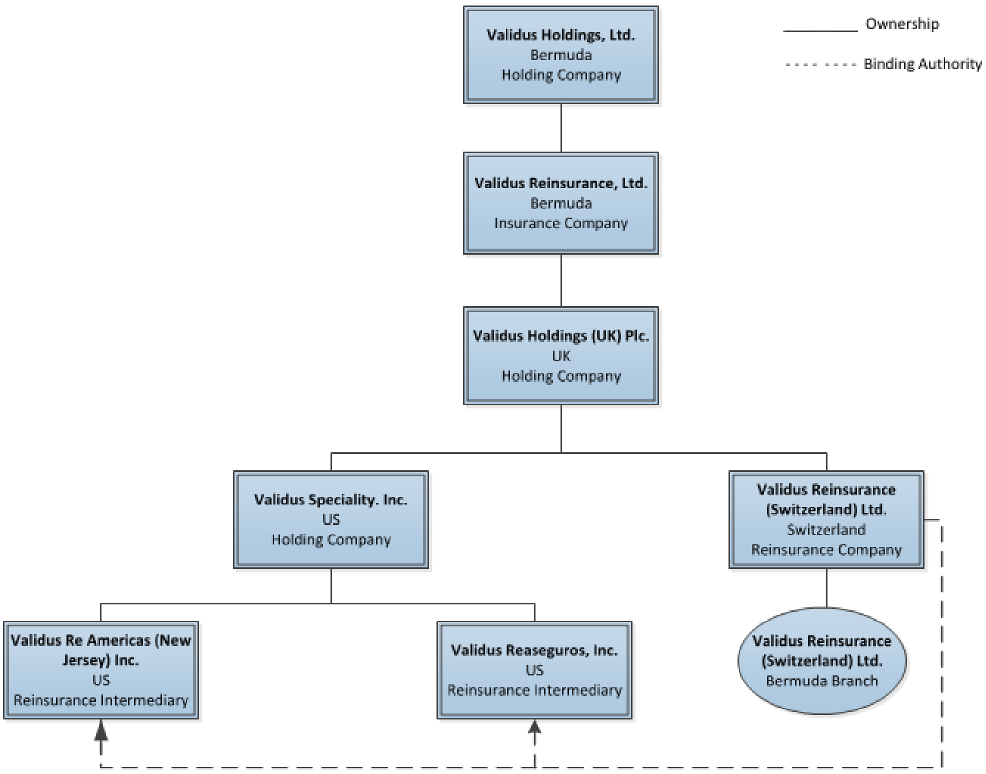
VRS is a direct wholly owned subsidiary of Validus Holdings (UK) Plc, which is ultimately a wholly owned subsidiary of Validus Holdings, Ltd. (together with its subsidiaries referred to as “Validus Group” or “group”). Validus Holdings, Ltd. is a Bermuda corporation listed on the New York Stock Exchange (“NYSE”) and subject to the NYSE and U.S. Securities and Exchange Commission's rules and regulations. VRS is based in Zurich, Switzerland. It is licensed by FINMA in Switzerland. The Company is also a licensed permit company through its Bermuda branch, registered as a Class 4 insurer under the Bermuda Insurance Act. VRS forms part of the reinsurance segment of the Validus Group (hereafter referred to as “Validus Re”) and writes reinsurance business worldwide.

The group’s strategy is to be a leader in the global insurance and reinsurance markets. The principal objective is to use the capital efficiently by underwriting a portfolio of insurance and reinsurance contracts that maximises the return on equity subject to prudent risk constraints on the amount of capital that the group exposes to any single event. The group manages risks through a variety of means, including contract terms, portfolio selection, diversification by lines of business and by geographies, and by using proprietary and commercially available third-party vendor catastrophe models. The Company’s strategy is closely aligned with the group strategy and focuses on efficient capital use and the underwriting of reinsurance contracts with superior risk and return characteristics while ensuring risks, and corresponding solvency requirements, are assessed appropriately.

The Company primarily writes Property Cat, Property per risk, Marine and Other Specialty reinsurance business from its Swiss head office and its Bermuda branch. In addition, VRS conducts an important part of its business activities through affiliated U.S. Managing General Agents (“MGAs”) writing onto VRS paper. Specifically, these reinsurance intermediaries are Validus Re Americas (New Jersey), Inc. ("VRA") and Validus Reaseguros, Inc., Florida ("VRI").

VRS has engaged VRA to originate and underwrite Agriculture and Casualty business, whereas VRI is engaged to write Latin American business for the benefit of VRS.

The following shows a simplified group structure chart:



3.2. Group structure and group transactions

Validus Group operates worldwide based on four operating segments: Validus Re, Talbot, Western World, and AlphaCat.

Validus Re is the reinsurance segment focused on treaty reinsurance. VRS is core to the Validus Re segment of the Validus Group. Talbot is a specialty insurance segment, primarily operating within the Lloyd's insurance market through Syndicate 1183. Western World is a U.S. based specialty excess and surplus lines insurance segment operating within the U.S. commercial market. AlphaCat is a Bermuda-based investment adviser, managing capital for third parties and the Validus Group in insurance linked securities and other investments in the property-catastrophe reinsurance space.

Besides the operational setup involving affiliated MGAs as described above under 3.1, VRS entered into notable group transactions in the form of quota-share reinsurance contracts with Western World.

3.3. Major shareholders

As noted above, the Company is a wholly owned subsidiary of Validus Holdings (UK) Plc, which indirectly is a wholly owned subsidiary of the group’s top holding company Validus Holdings, Ltd.

3.4. Major branches and subsidiaries

VRS notably operates through a Bermuda registered branch. Additionally, VRS fully owns LP Holdings Ltd., an investment company based in Limassol, Cyprus. The subsidiary did not have any trading activities during 2016.

3.5. External auditors

The Company’s external auditors pursuant to article 28 of the Insurance Supervisory Act are PricewaterhouseCoopers AG, Birchstrasse 160, 8050 Zurich, Switzerland.

3.6. Extraordinary events

There were no significant unusual or extraordinary events for VRS during the course of the year 2016 up to the date of this report, of which the Company is aware.

4. Performance

4.1. Underwriting performance

In 2016, the Company continued to develop and diversify its lines of business, notably with new casualty reinsurance operations deployed through VRA, an affiliated New Jersey (U.S.) MGA, and with the hiring of a Marine underwriter based in Zurich.

The Company's primary lines of business are Property, Marine, Agriculture, Casualty and Other Specialty. Premiums written by line of business for the financial year 2016 and 2015, respectively, were as follows (per VRS statutory financial statements, in CHF millions):

Premiums written	**2016**			**2015**		
	Gross	**Ceded**	**Net**	**Gross**	**Ceded**	**Net**
Property	80.5	(6.7)	73.9	64.5	(1.1)	63.4
Marine	18.2	(0.3)	17.9	8.5	(0.5)	8.0
Agriculture	248.9	(3.4)	245.5	260.8	(1.1)	259.7
Casualty	98.8	-	98.7	6.9	-	6.9
Other Specialty	56.0	(2.8)	53.2	42.7	(3.6)	39.1
Total	**502.4**	**(13.2)**	**489.2**	**383.4**	**(6.4)**	**377.0**

Premiums are written by underwriters in Switzerland and Bermuda, and through VRA and VRI. Despite a continuously challenging reinsurance market environment and decreased pricing for 2016 due to the global softening market, the Company grew its premium volume for a number of reasons.

The main driver for the growth in premiums from 2015 to 2016 was the entering into U.S. Casualty business written through VRA. In addition, Property premiums growth during 2016 was driven by higher premiums from one of the quota share contracts with Western World. Marine premiums increased mainly due to the hiring of a new Marine underwriter in Zurich. Other Specialty premiums grew mainly due to an increase in Financial Lines. The overall premium growth of the Company was partially offset by lower Agriculture business volume.

The information included in the table above is generally consistent with information contained in Appendix II; Agriculture and Other Specialty lines as per above table are included under Miscellaneous in Appendix II.

4.2. Financial performance

Financial Year (in CHF millions)	2016	2015
Gross premiums written	502.4	383.4
Net premiums written	489.2	377.0
Net earned premiums	407.3	343.6
Net claims incurred	(276.1)	(268.0)
Net acquisition costs	(104.7)	(65.3)
Underwriting result	26.5	10.3
Administrative expenses	(14.1)	(13.1)
Investment return	19.8	13.2
Foreign exchange gain	-	9.9
Others, net	(1.5)	0.3
Net income for the financial year	**30.7**	**20.6**

Kev Performance indicators		
Loss ratio %	67.8	78.0
Expense ratio %	29.2	22.8
Combined ratio %	**97.0**	**100.8**

The loss ratio is the ratio of claims incurred to net earned premiums. The expense ratio is the ratio of acquisition costs plus administrative expenses to net earned premiums.

Profits per VRS statutory financial statements for the year were CHF 30.7m compared to CHF 20.6m in 2015. Gross premiums written increased by CHF 119.0m to CHF 502.4m and premiums earned after retrocession increased by CHF 63.7m to CHF 407.3m. The increase in premium volume compared to 2015 is described in detail in Section 4.1.

Claims after reinsurance recoveries were CHF 276.1m, an increase of CHF 8.1m compared to last year. Operating expenses including acquisition costs increased by CHF 40.4m to CHF 118.8m. The increase in claims is due to a generally higher business volume. Overall, the favourable loss development reflected in a lower loss ratio compared to prior year is mainly due to lower event losses and favourable attritional loss development in 2016 compared to 2015. The expense ratio increased primarily due to higher acquisition costs attributable to the increase in business volume during 2016 as well as higher profit commissions for certain contracts as a result of favourable loss experience. Overall, the combined ratio for the year was 97.0% compared to 100.8% in 2015, mainly driven by higher net earned premiums and favourable loss development, slightly offset by higher acquisition expenses.

The net investment return increased to CHF 19.8m from CHF 13.2m in 2015 primarily due to an unrealised loss of CHF 7m in 2015 (2016: deferred unrealised gain). Market conditions as well as our asset allocation remained largely unchanged compared to prior year. The vast majority of the investment income is generated from the Company's fixed maturities portfolio.

The Company did not record any gains or losses directly in equity.

5. Corporate Governance and Risk Management

5.1. Corporate governance

5.1.1. Board of Directors

The Company's Board of Directors, which is entrusted with the supervision and the ultimate management of the Company as well as with the supervision and control of management, is composed of the following members:

- Peter Gujer is an independent, non-executive Board member and the Chairman of the Board of Directors;
- Michael Carpenter is also an independent, non-executive member of the Board of Directors. He was appointed as an additional member of the Board of Directors in spring 2016;
- Jeffrey Sangster is a member and Vice-Chairman of the Board of Directors. He also serves as Chief Financial Officer of the Validus Group;
- Robert Kuzloski is a member and the Secretary of the Board of Directors. He is also General Counsel of the Validus Group;
- Patrick Boisvert is a member of the Board of Directors and Chief Accounting Officer of the Validus Group.
- Stephane Sauthier is member of the Board of Directors and Swiss Counsel of VRS.

There were no further changes to the Company's Board of Directors in 2016 other than the change noted above.

5.1.2. Executive Management

The Executive Management of the Company, which manages the operations and the overall business of the Company and controls all employees of the Company, consists of the following individuals:

- Sven Wehmeyer is the Chief Executive Officer. He was appointed at the end of 2016 in replacement of Kean Driscoll, the Validus Re CEO;
- Robert Marcotte is the Chief Financial Officer and Head of Investments. He was also appointed at the end of 2016 in replacement of Patrick Boisvert, the former Managing Director and Chief Financial Officer of VRS;
- Stéphane Sauthier is the Swiss Counsel.

There were no further changes to the Company's Executive Management in 2016 other than the changes noted above, which primarily followed the appointment of Patrick Boisvert as Chief Accounting Officer of the Validus Group in Bermuda. Both Sven Wehmeyer and Robert Marcotte have held executive positions at Validus Re for many years and bring a wealth of experience to VRS.

5.2. Risk management

The Company's Board of Directors is ultimately responsible for risk management matters and organisation of the Company's internal control system ("ICS"). Management is responsible for ensuring that appropriate risk management structures and procedures, including the ICS, are implemented with the decision-making persons having the requisite seniority, knowledge and experience. Management also formulates the Company's risk appetite for approval by the Board of Directors. Management has established the Validus Re Risk Working Group headed by the Company's Chief Risk Officer to ensure that proper standards for risk management are established in respect of all material risks faced by the Company.

The Company has adopted the Validus Re Risk Management Framework, which fits within the Company's overall Internal Control System structure. The framework outlines the risk management governance structure, key roles and responsibilities, various risk management tools, a risk classification system and procedures to identify, assess, control and monitor risks faced by the Company.

The framework is also designed to assist in setting strategic objectives in line with those of the Validus Group and promote the use of qualitative and quantitative tools to evaluate the risk/reward trade-offs associated with key strategic decisions.

The Risk Management Framework also provides a risk classification scheme, which yields a consistent and common language for purposes of capturing all material risks and comparing them with each other and across other areas within the Validus Group. Risk categories include Insurance Risk (Underwriting, Catastrophe and Reserving), Market Risk, Credit Risk and Operational Risks.

The Company performs a regular risk assessment process for the identification, assessment, control and monitoring of risks that considers the likelihood and impact of causes of risk, both before and after the existence of relevant controls. The approaches used to identify and update causes of risk include scenario building, incident and near miss reporting and market intelligence. Controls have been established to appropriately manage the likelihood and impact of risks, focused on those with the most significance and after considering the tolerance level established for each risk. New controls may also be designed as a result of the incident reporting process.

The Company also has in place policies, including underwriting, investment, and credit policies, to manage the assumption of risk. These policies provide for the Company's risk limits, tolerance levels and other guidelines, as well as the processes for ensuring compliance with the desired risk profile of the Company. The Company has at its disposal a variety of risk mitigation tools, including the purchase of reinsurance and retrocessional coverage, which it uses to ensure that its risk profile stays within prescribed limits and tolerance levels.

In order to manage the assumption of insurance risk, the Company has established risk limits through both qualitative and quantitative considerations, including market share, history of and expertise in a class of business or jurisdiction, transparency and symmetry of available information, reliability of pricing models and availability and cost of reinsurance. These limits are reviewed at least annually and aligned to the overall risk appetite approved by the Company's Board of Directors. In addition, an exposure management policy is in place to ensure appropriate and consistent risk assessment and aggregation of exposures that accumulate across the Company.

In addition to the Risk Management function, VRS has a separate Compliance function that is responsible for ensuring compliance with regulatory requirements and other internal policies and procedures. The Compliance function reports breaches and issues directly to Management, and reports to the Board of Directors at least on an annual basis. Compliance and Risk Management meet quarterly, or more frequently if required, to discuss any potential issues surrounding risks, control performance and incident reporting.

The Internal Audit function has been established on a Validus Group level and includes VRS. Part of the Internal Audit function's role is to report to the Board of Directors at least annually on the implementation of the annual audit plan, which forms part of the Company's overall Risk Management Framework.

VRS has in place an ICS that is governed by its Internal Control Policy. The ICS of the Company is built on three lines of defence, with the control owners being the 1st Line of Defence, Compliance and Risk Management being the 2nd Line of Defence, and Internal Audit as well as External Audit being the 3rd Line of Defence. The ICS includes control activities as described in relevant VRS Policies and Procedures, communication within the Company to all relevant functions, and monitoring and reporting on the Company's ICS to the relevant committees and Board of Directors.

There were no material changes to the risk management and compliance functions or processes during the year under report.

6. Risk Profile

The main risks faced by VRS and some of the activities directly associated with controlling such risks are outlined below. Quantitative information in respect of the Company's risk profile is provided as part of Section 9.2 on Target Capital.

6.1. Insurance Risk

Insurance risk is considered as the risk of loss arising from inadequate pricing or of adverse change in the value of insurance liabilities due to inadequate provisioning assumptions. For VRS, the most significant insurance risk is underwriting risk, which in turn is driven by our exposures to natural catastrophe perils as well as the casualty and agriculture underwriting classes. Other material risks include the risk that the Company underestimates its reserves for incurred losses, the risk of heightened claims due to emerging claims or coverage issues, the risk posed by competition leading to a loss of market share or a deterioration in business quality.

6.1.1 Underwriting Risk

To help mitigate Underwriting Risk, VRS has established a set of risk tolerances for significant risk classes. These are combined with available equity to determine absolute underwriting limits by product line and geographical area and reflect the maximum loss the Company is willing to incur per category. The scope of the geographical areas over which the limits are aggregated is based on the largest areas likely to be impacted by any one event. Aggregate limits in-force by peril and zone are updated and monitored quarterly, at a minimum, to ensure compliance with key underwriting risk limits and reported to the VRS Board of Directors.

Additionally, the underwriting process for all business is governed by the Validus Re Global Underwriting Guidelines as adopted by VRS. All transactions are entered into the underwriting system, and underwriting authorisation limits are automated within the system in accordance with the Validus Re Global Underwriting Guidelines.

Additional Underwriting Risk mitigation is currently delivered through retrocession purchases covering catastrophe risks at the Validus Re segment level, and is therefore inclusive of VRS risks.

6.1.2 Reserving Risk

Reserves are set at the actuarial best estimate, which is also the basis for the booked reserves. Given the uncertainty of Reserving Risk, our strategy is to book reserves that represent management's best estimate of the likely future claims payments. To that end, the reserve estimation process is subject to an extensive and rigorous process. This includes initial assessment by the reserving actuaries, followed by a Reserve Committee review with annual, independent actuarial reviews from both our independent Responsible Actuary, as well as an external consulting firm.

6.2. Market Risk

Market risk is the risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of financial instruments. The predominant effect of this is on potential for losses in the Company's investment portfolio.

Management and oversight procedures relating to the investments of the Company are outlined in the Company's Investment Policy. It sets out appetites relating to Market Risk and provides investment guidelines relating to asset class, type of security, concentrations for issuers and industries, and credit quality, the latter of which are designed to manage investment related Credit Risk. It also outlines tools to control liquidity risk by assessing the duration of the asset portfolio in relation to liability cash flows. With respect to the latter liquidity risk, the Company produces a Liquidity Report for the Board of Directors on an annual basis. The report notably discusses liquidity risk management, liquidity positions under normal and stressed circumstances, off balance sheet risks and results of the liquidity assessment.

6.3. Credit Risk

Credit risk is the risk of loss or of adverse change in the financial situation, resulting from the deterioration of the credit quality or default of an issuer of a financial instrument, a borrower, or a counterparty in a reinsurance. VRS' most significant credit risks are from reinsurance/retrocession counterparties.

Control activities relating to counterparty Credit Risk are overseen by the Validus Re Security Committee. This committee approves retrocessional arrangements where either the limit is fully collateralised and the collateral is invested in cash, cash equivalents or U.S. backed securities, or with counterparties that have a minimum of USD 1 billion in total capital and a minimum rating of A from AM Best or A+ from S&P. Counterparties not meeting the minimum standard for normal approval can be approved with limitations at the discretion of the Committee.

6.4. Operational Risk

The processes for identifying, assessing, controlling and monitoring Operational Risks, as outlined in detail in the Company's Risk Management Framework, are summarised below. The main Operational Risks are losses arising from inadequate or failed internal processes, personnel or systems, or from external events; or the risk of loss arising from the adverse effect of management decisions on both business strategies and their execution, as well as from unexpected changes in environmental trends that damage the operating economics of the business.

The identification process starts with an inventory of strategic and internal business processes. The risk management team works with managers of the respective functional or executive areas to document each business process, including its estimated reputational or financial impact, and creates a workflow diagram outlining major steps and interrelations involved in the process where possible. The Risk Working Group selects processes for the risk identification stage based on the estimated financial and/or reputational impact. Risks and related causes are then identified through scenario building, internal incident and near-miss reports and external incident/market intelligence reports.

The assessment process for these risks consists of scoring each identified cause of risk for its likelihood of occurrence and financial/reputational impact given occurrence. The risk management team works with risk owners to calibrate scoring to maintain consistency across functional areas and business processes. All scoring schemes, tolerance levels and scores assigned to risks are approved by the Risk Working Group.

A control framework is established to manage the impact of each cause of risk on the Company. Each cause is prioritised based on its impact and likelihood scoring relative to its tolerance or established limit.

Risks and controls are documented in the VRS Risk and Control Register. This register includes information about the control owners, mechanisms, objectives and frequency of performance along with scoring for financial impact and likelihood. Risk controls are monitored by risk owners to ensure they are working as intended and the Risk and Control Register is reviewed annually by the Risk Management function for relevance and adequacy. Changes to the Risk and Control Register are presented to the Company's Board of Directors.

Incident and near miss reports, which are prepared by risk owners, are presented to the Risk Working Group, which then escalates significant incidents to the Validus Group Risk Management Committee, the VRS executive management and Board of Directors, and the Risk Committee of the Validus Group Board.

6.5. Other material risks

There are no other material risks that the Company is aware of, which are not already included above.

6.6. Material off-balance sheet positions

The Company has CHF 220.7m of investments pledged as collateral under the Company's credit facilities as at 31 December 2016. In addition, CHF 95.5m of fixed maturities were pledged during the normal course of business as at 31 December 2016, all of which were held in trusts.

7. Valuation for solvency purposes

This Section provides details on methods used for the valuation of the Company's assets and liabilities for solvency purposes as part of the SST calculation. It also provides details on methods used for valuation in the statutory financial statements, and where relevant provides explanations of the differences between solvency and statutory views. In general, market-consistent values are used for SST purposes and further details are provided in Appendix II.

7.1. Valuation of assets

7.1.1. Value of investments by investment class

The following table summarises the investments by investment class held by the Company as at 31 December 2016 and 2015, respectively, including market-consistent values relevant for solvency purposes and amortised cost values. The below value of investment in subsidiary represents cost less necessary impairments in line with both solvency and statutory valuation requirements.

As at 31 December (in CHF millions)	Market value 2016	Market value 2015	Amortized cost 2016	Amortized cost 2015	Market value Variance	Variance %
Fixed Income Securities						
Agency RMBS	97.5	69.1	98.5	69.0	28.5	29%
Non-Agency RMBS	5.1	11.1	5.2	11.1	(6.0)	-116%
CMBS	152.6	122.6	153.2	123.8	29.9	20%
Asset-Backed Securities	325.2	317.7	326.1	320.3	7.5	2%
Non-US Corporate	54.2	51.7	54.3	52.4	2.6	5%
Non-US Government & Government Agency	17.8	9.4	18.0	10.4	8.4	47%
States, Municipalities	46.9	50.7	46.9	50.8	(3.8)	-8%
US Corporate	187.3	179.4	187.2	182.2	7.9	4%
US Government & Government Agency	79.4	66.8	79.9	67.4	12.6	16%
	966.1	**878.6**	**969.2**	**887.2**	**87.5**	**10.0%**
Other Investments						
Investment Funds	31.6	35.0	16.0	21.4	(3.4)	-11%
Investment in subsidiary	13.9	13.9	13.9	13.9	0.0	0%
Total Investments	**1,011.6**	**927.5**	**999.1**	**922.5**	**84.1**	**8%**

7.1.2. Basis and methods used for the valuation of investments

The amortised cost and market-consistent values of both fixed maturities and other investments are determined based on information provided by the Company's independent fund administrator. Amortised cost values are determined based on the scientific amortisation or constant yield method, whereas market-consistent values are generally based on observable market prices, or in the absence thereof, on model valuations. The Company does not adjust the market or amortised cost values as provided by the independent fund administrator.

7.1.3. Explanation of significant differences between the solvency and statutory valuation of investments

For SST purposes, the Company uses market-consistent values for investments except for investments in subsidiaries as noted above. In the statutory financial statements, the Company uses the lower of amortised cost and market-consistent values per individual security to record its fixed income securities and other investment balances. As at 31 December 2016, this leads to a lower statutory valuation of CHF 10.2m compared to the valuation used for solvency purposes. Since the valuation for Swiss statutory purposes is performed on an individual security level, the total of amortised cost values as per the table above is slightly different to the amount recorded in the statutory financial statements.

In addition to the investments in fixed maturities and other investments, the Company holds asset positions in cash and cash equivalents, receivables, and other assets. These assets are recorded at their nominal value and there is no difference between their solvency and statutory valuation (except for a gross up of intercompany receivables and payables for statutory purposes, which was recorded net in the market-consistent balance sheet used for SST purposes).

Refer to Appendix II for the market-consistent balance sheet used for SST purposes.

7.1.4. Other assets

Other assets as per Appendix II contain cash and cash equivalents, reinsurance receivables and other receivables as well as deferred acquisition costs, all which are held at nominal values and there is no difference between the market-consistent and statutory values.

7.2. Valuation of technical provisions

7.2.1. Gross and net value of technical provisions

The following table provides an overview of the Company's gross and net best estimate of reserves for losses and loss expenses on both an undiscounted and discounted basis as at 31 December 2016 (in CHF millions):

2016	Undiscounted	Discounted
Gross reserves for losses and loss expenses	332	322
Ceded reserves for losses and loss expenses	(19)	(19)
Net loss reserves for losses and loss expenses	**313**	**303**
Risk Margin	-	26
Total	**313**	**329**

As at 31 December 2016, the reserves for losses and loss expenses ("loss reserves") based on the Company's best estimate, net of retrocession, are CHF 313m on an undiscounted and CHF 303m on a discounted basis as per the table above. Discounting is performed in line with FINMA requirements and prescribed yield curves.

For solvency purposes and as disclosed in the SST balance sheet as per Appendix II, the gross best estimate loss reserves amount to CHF 322m on a discounted basis and the gross unearned premium reserves amount to CHF 156m, providing for a total gross best estimate liability of CHF 478m.

For statutory purposes, the value of the loss reserves is the higher of the undiscounted best estimate liabilities and the market value reserves, being the discounted best estimate liabilities plus the risk margin (refer to Section 7.2.3). The details of gross and ceded technical provisions by classification as at 31 December 2016 and 2015, respectively, were as follows as per the Company's statutory financial statements (in CHF millions):

2016	Gross	Ceded	Net Reserve
Reserves for unearned premiums	155.6	(0.3)	155.3
Reserves for losses and loss expenses	348.0	(19.0)	329.0
Total	**503.6**	**(19.3)**	**484.3**

2015	Gross	Ceded	Net Reserve
Reserves for unearned premiums	72.5	(0.7)	71.8
Reserves for losses and loss expenses	357.7	(21.7)	336.0
Total	**430.2**	**(22.4)**	**407.8**

7.2.1.1. Basis, methods and key assumptions used in the valuation of best estimate liabilities

The loss reserves include reserves for unpaid reported losses ("case reserves") and for losses incurred but not reported ("IBNR") as well as unallocated loss adjustment expenses. Case reserves are established by Management based on reports from brokers, ceding companies and insureds and represents the estimated ultimate cost of events or conditions that have been reported to, or specifically identified by, the Company. IBNR reserves are established by Management based on actuarially determined estimates of ultimate losses and loss expenses using the reported loss development, reported Bornhuetter-Ferguson or Initial Expected Loss methods. Inherent in the estimate of ultimate losses and loss expenses are expected trends in claim severity and frequency and other factors, which may vary significantly as claims are settled. Accordingly, ultimate losses and loss expenses may differ materially from the amounts recorded in the statutory financial statements of the Company. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, will be recorded in earnings in the period in which they become known. Prior period development arises from changes to these estimates recognised in the current year that relate to reserves for losses and loss expenses established in previous calendar years.

Reserves for unearned premiums represent the portion of the premiums written applicable to the unexpired terms of the underlying contracts and policies in force.

7.2.2. Risk margin

7.2.2.1. Value of the risk margin and other effects on target capital

As at 31 December 2016, the risk margin also referred to as the market value margin (MVM) is CHF 26m. For the computation of the Company's target capital including the risk margin and other effects on target capital as per the 2017 SST calculation, refer to Section 9.2 and Appendix II of this report.

7.2.2.2. Basis, methods and key assumptions used

The risk margin for VRS is determined as part of the 2017 SST process using the FINMA Standard Model. This assumes a 6% cost of capital and that the capital requirement at each point in the run-off is a constant proportion of the outstanding run-off reserve, where the constant proportion is determined as the ratio of Reserve Risk to the total net reserves as at 31 December 2016.

7.2.3. Explanation of significant differences between the solvency and statutory valuation

For Swiss statutory purposes and in accordance with regulatory requirements, the loss reserves are the higher of the best estimate loss reserves and the market value loss reserves. Market value loss reserves are determined by discounting the best estimate loss reserves and adding the risk margin as detailed above under section 7.2.2.

As at 31 December 2016, the net loss reserves in the Company's statutory financial statements amount to CHF 329m and represent the discounted best estimate liabilities of CHF 303m plus the risk margin of CHF 26m, i.e. the market value loss reserves. Loss reserves for SST purposes equalled the Company's discounted best estimate of CHF 303m, hence a difference of CHF 26m.

There is no difference between the statutory and solvency values of reserves for unearned premiums of CHF 156m.

Refer to Appendix II for the SST market consistent balance sheet.

7.3. Valuation of other liabilities

7.3.1. Value of provisions for other liabilities

For solvency purposes, other liabilities according to the SST balance sheet included as Appendix II amount to CHF 29m as at 31 December 2016. The other liabilities are recorded at nominal value, i.e. the net payable as at 31 December 2016. The position comprises accrued expenses and accounts payable.

7.3.2. Basis, methods and key assumptions used in the valuation

As noted above, the other liabilities are recorded at nominal value, with no difference between solvency and statutory valuation.

8. Capital Management

8.1. Goals, strategy and time horizon for capital planning

The primary capital management objectives of the Company are as follows:

1. Ensure sufficient capital to meet and/or exceed all relevant solvency requirements;
2. Maintain some amount of excess capital over and above item 1;
3. Return true excess capital above items 1 and 2 to the Company's shareholders.

The Company regularly assesses its overall capital and solvency position, including the SST ratio and A.M. Best Capital Adequacy Ratio. When assessing the level of shareholder's equity in relation to these measures, the Company will also consider recent business development and strategic planning, current and future market conditions, uncertainty around loss reserves development and other relevant factors.

8.2. Structure, level and quality of equity

The statutory shareholder's equity of the Company as at 31 December 2016 and 2015, respectively, is structured as follows:

Shareholder's equity (in CHF millions)	2016	2015
Statutory share capital	73.0	73.0
Statutory capital reserves		
Legal reserves from capital contributions	36.5	36.5
Other reserves from capital contributions	598.7	598.7
Organisation fund from capital contributions	7.6	7.6
Accumulated loss	(28.5)	(59.2)
Total	**687.3**	**656.6**

8.3. Description of material changes during the period

In 2016, there were no changes in the shareholder's equity of the Company other than the reduction in accumulated loss due to the positive financial result of the year.

8.4. Explanation of discrepancies between solvency and statutory equity

The Risk-bearing Capital as at 31 December 2016, which represents the difference between market-consistent assets and liabilities used for solvency purposes (refer to Appendix II and Section 9 of this report), amounts to CHF 831m pre deductions of CHF 31m for potential dividend. The difference of CHF 143.8m to statutory equity of CHF 687.2m can be explained as follows:

in CHF millions	31 December 2016
Risk-bearing capital	800
Potential dividend	31
Risk-bearing capital (pre deductions)	**831**
Provision for currency translation gain related to the translation of VRS USD functional currency to CHF reporting currency for statutory purposes	(105)
Provision for unrealised gain on investments (vs. income recognition through earnings) required for statutory purposes	(5)
Adjustment for investments as per section 7.1.3 above	(10)
Adjustments for loss reserves as per section 7.2.3 above	(26)
Other adjustments for statutory purposes	2
Statutory shareholder's equity	**687**

9. Solvency

9.1. Solvency model

In the absence of a Standard Model for reinsurers, the Company used its internal model, which has not yet been approved by FINMA, to assess the following risks as part of the 2017 SST process:

- Insurance Risks, including both Underwriting and Reserving Risks;
- Market Risk, including volatility on the discounting of insurance liabilities and volatility of the market value of assets.

Dependencies are applied between classes within both Underwriting Risk and Reserving Risk, and between Underwriting Risk and Reserving Risk. Dependencies are also applied between asset types within the Economic Scenario Generator, which feeds into Market Risk.

Other elements of the SST calculation are modelled using the Standard Formula and templates as set out by FINMA. These include Credit Risk (which is modelled using the Basel III approach), the Risk Margin, Standard Scenarios and adjustments for expected financial performance. These items are combined with the internally modelled risks above using the approach set out in the FINMA templates. As such, no diversification is given between Credit Risk and the combined Insurance and Market Risk.

9.2. Target Capital

For solvency purposes, the Target Capital is the capital required as a minimum based on the SST calculation taking into account the expected shortfall at the 99% confidence level of the overall distribution, expected insurance result, expected financial performance and Risk Margin.

Target Capital for the 2017 SST is determined to be CHF 321m. This is CHF 49m above the 2016 Target Capital.

The increase is driven primarily by Insurance Risk, which is in turn driven by increased Underwriting Risk. Underwriting risk accounts for CHF 261m and Reserve Risk for CHF 79m, with diversification effects of CHF 54m. Scenarios are also effected by the assumption of additional risk; in particular, the Agricultural exposures contribute to the increase in this component.

Lastly, the movements in both Expected Insurance Result and the Risk Margin are primarily due to growth in Casualty. The increase in the expected Insurance Result of CHF 24m to CHF 39m in 2017 is in large part due to the discount credit attained via Casualty in relation to the long tail nature of this class. This is also, however, the predominant contributor to the increase in Risk Margin, which reflects the longer duration, and hence larger risk charge, that is required to support the Casualty reserves.

Components of the calculation are given below:

Target Capital Composition (in CHF millions)	2016	2017	Change
Internal Model based Results (Expected Shortfall)			
Insurance Risk	(231)	(286)	(55)
Market Risk	(56)	(55)	1
Insurance & Market Risk	**(236)**	**(290)**	**(54)**
Standard Model based Results			
Credit Risk	(48)	(49)	(1)
Scenarios	(5)	(7)	(2)
Aggregation with Insurance & Market Risk	**(288)**	**(346)**	**(57)**
Allowance for Expected Results			
Expected Insurance Result	15	39	24
Expected Financial Performance over 1 year risk free	11	10	(1)
Capital for Insurance & Market & Credit Risks	**261**	**296**	**35**
Risk Margin	**11**	**26**	**15**
Target Capital	**272**	**321**	**49**

9.3. Risk-bearing Capital

For solvency purpose, the Risk-bearing Capital is the Company's total market-consistent value of assets less best-estimate liabilities and market-consistent value of other liabilities. All of the Company's risk-bearing capital is considered core capital, with no supplementary capital in place.

In line with Appendix II, the total Risk-bearing Capital for VRS as at 31 December 2016 is **CHF 800m**. The breakdown of this figure is given below:

Risk-bearing Capital (in CHF millions)	31 Dec 2016
Assets	
Investments	1,011
Cash and cash equivalents	74
Premiums Receivable	124
Other assets	110
Total assets	**1,320**
Liabilities	
Gross discounted reserves	322
Gross unearned premium reserves	156
Less: ceded discounted reserves	(18)
Reinsurance balances payable and accrued expenses	29
Total liabilities	**488**
Risk-bearing Capital (pre deductions)	**831**
Potential dividend	**(31)**
Risk-bearing Capital	**800**

Further details are provided in Section 7 of this report regarding valuation of all assets and liabilities.

A potential dividend of CHF 31m included in the calculation of Risk-bearing Capital was used in the SST calculation to provide for a conservative solvency view at the time of the solvency calculation. Subsequently, the Company's General Meeting of Shareholders decided not to pay any ordinary dividend based on the 2016 statutory financial statements.

Based on the information above, the Company's SST ratio for 2017 amounts to 262% in accordance with the FINMA updated calculation formula deducting the risk margin of CHF 26m from both the Company's Risk-bearing Capital and Target Capital (i.e. CHF 774m Risk-bearing Capital divided by CHF 295m Target Capital). This is well above the Company's minimum capital expectations and demonstrates the Company's strong solvency position.

The solvency information contained in this Section is consistent with the information provided to FINMA as part of the Company's 2017 SST reporting which is subject to regulatory review by FINMA.

10. Appendix

In accordance with the Circular, the report of the statutory auditor to the General Meeting on the financial statements 2016 including the statutory financial statements (Appendix I), as well as the quantitative template for VRS (Appendix II), respectively, are attached to this report.

10.1. Appendix I

10.2. Appendix II

Validus Reinsurance (Switzerland) Ltd
Talstrasse 83
8001 Zurich
Switzerland

T +41 43 344 7310
F +41 43 344 7311