

ALLEGHANY CORP /DE
Form 10-Q
August 06, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2012

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 1-9371

ALLEGHANY CORPORATION

EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER

DELAWARE

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 ☒ 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 ☒ NO ☐

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

LARGE ACCELERATED FILER ☒

ACCELERATED FILER ☐

NON-ACCELERATED FILER ☐

SMALLER REPORTING COMPANY ☐

(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 ☐ NO ☒

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

16,930,793 SHARES, PAR VALUE \$1.00 PER SHARE, AS OF AUGUST 1, 2012

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

	June 30, 2012 (unaudited) (in thousands, except share amounts)	December 31, 2011
Assets		
Investments:		
Available-for-sale securities at fair value:		
Equity securities (cost: 2012 \$1,046,323; 2011 \$775,741)	\$ 1,047,070	\$ 870,950
Debt securities (amortized cost: 2012 \$15,372,156; 2011 \$2,538,872)	15,596,786	2,679,528
Short-term investments	1,023,144	1,096,517
	17,667,000	4,646,995
Other invested assets	433,930	179,815
Total investments	18,100,930	4,826,810
Cash	404,615	84,749
Accrued investment income	163,893	28,879
Premium balances receivable	762,145	147,006
Reinsurance recoverables	1,292,878	852,845
Ceded unearned premiums	171,054	142,946
Deferred acquisition costs	225,385	70,537
Property and equipment at cost, net of accumulated depreciation and amortization	31,541	17,906
Goodwill	82,495	48,095
Intangible assets, net of amortization	275,076	90,863
Current taxes receivable	69,356	
Net deferred tax assets	500,076	80,975
Other assets	339,248	86,478
	\$ 22,418,692	\$ 6,478,089
Liabilities and Stockholders' Equity		
Loss and loss adjustment expenses	\$ 11,720,944	\$ 2,313,035
Unearned premiums	1,848,558	549,740
Senior Notes	1,819,825	299,035
Reinsurance payable	95,189	45,462
Current taxes payable		16,247
Other liabilities	654,051	328,893
Total liabilities	16,138,567	3,552,412
Common stock (shares authorized: 2012 and 2011 22,000,000; issued 2012 17,478,746; 2011 9,117,787)	17,479	9,118
Contributed capital	3,626,571	938,037
Accumulated other comprehensive income	139,031	155,532
Treasury stock, at cost (2012 547,953 shares; 2011 566,141 shares)	(161,944)	(167,319)
Retained earnings	2,658,988	1,990,309

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Total stockholders' equity	6,280,125	2,925,677
	\$ 22,418,692	\$ 6,478,089

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**ALLEGHANY CORPORATION AND SUBSIDIARIES****Consolidated Statements of Earnings and Comprehensive Income**

(unaudited)

	Three Months Ended June 30,	
	2012	2011
	(in thousands, except per share amounts)	
Revenues		
Net premiums earned	\$ 1,095,932	\$ 183,878
Net investment income	90,860	28,545
Net realized capital gains	39,452	6,490
Other than temporary impairment losses	(1,129)	
Gain on bargain purchase		
Other income	9,276	248
Total revenues	1,234,391	219,161
Costs and Expenses		
Net loss and loss adjustment expenses	680,885	122,619
Commissions, brokerage and other underwriting expenses	239,193	64,132
Other operating expenses	34,826	7,834
Corporate administration	11,094	5,002
Amortization of intangible assets	108,098	839
Interest expense	15,743	4,268
Total costs and expenses	1,089,839	204,694
Earnings before income taxes	144,552	14,467
Income taxes	35,243	(615)
Net earnings	\$ 109,309	\$ 15,082
Other comprehensive income:		
Change in unrealized gains (losses), net of deferred taxes of \$14,257 and \$(13,154) for 2012 and 2011, respectively	26,477	(24,428)
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes of \$(13,413) and \$(2,271) for 2012 and 2011, respectively	(24,910)	(4,218)
Change in unrealized currency translation adjustment, net of deferred taxes of \$(8,012) and \$0 for 2012 and 2011, respectively	(14,880)	
Retirement plans	(14)	(50)
Comprehensive income	\$ 95,982	\$ (13,614)
Basic earnings per share*	\$ 6.46	\$ 1.69
Diluted earnings per share*	6.45	1.68

* 2011 amounts reflect subsequent common stock dividends.

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**ALLEGHANY CORPORATION AND SUBSIDIARIES****Consolidated Statements of Earnings and Comprehensive Income**

(unaudited)

	Six Months Ended June 30,	
	2012	2011
	(in thousands, except per share amounts)	
Revenues		
Net premiums earned	\$ 1,530,139	\$ 364,858
Net investment income	144,054	60,124
Net realized capital gains	107,441	41,182
Other than temporary impairment losses	(2,907)	
Gain on bargain purchase	494,940	
Other income	9,591	1,133
Total revenues	2,283,258	467,297
Costs and Expenses		
Net loss and loss adjustment expenses	914,831	193,641
Commissions, brokerage and other underwriting expenses	339,053	130,660
Other operating expenses	50,478	17,241
Corporate administration	58,387	11,381
Amortization of intangible assets	140,037	1,678
Interest expense	24,820	8,720
Total costs and expenses	1,527,606	363,321
Earnings before income taxes	755,652	103,976
Income taxes	86,240	17,554
Net earnings	\$ 669,412	\$ 86,422
Other comprehensive income:		
Change in unrealized gains (losses), net of deferred taxes of \$34,402 and \$40,295 for 2012 and 2011, respectively	63,889	74,834
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes of \$(36,587) and \$(14,414) for 2012 and 2011, respectively	(67,947)	(26,768)
Change in unrealized currency translation adjustment, net of deferred taxes of \$(6,282) and \$0 for 2012 and 2011, respectively	(11,667)	
Retirement plans	(774)	(179)
Comprehensive income	\$ 652,913	\$ 134,309
Basic earnings per share*	\$ 48.03	\$ 9.69
Diluted earnings per share*	47.96	9.66

* 2011 amounts reflect subsequent common stock dividends.

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**ALLEGHANY CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows**

(unaudited)

	Six Months Ended June 30,	
	2012	2011
	(in thousands)	
Cash flows from operating activities		
Net earnings	\$ 669,412	\$ 86,422
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	218,001	13,445
Net realized capital (gains) losses	(107,441)	(41,182)
Other than temporary impairment losses	2,907	
(Increase) decrease in reinsurance recoverables, net of reinsurance payable	68,881	26,447
(Increase) decrease in premium balances receivable	61,089	(67,910)
(Increase) decrease in ceded unearned premiums	(21,370)	(18,708)
(Increase) decrease in deferred acquisition costs	(154,848)	(4,433)
Increase (decrease) in unearned premiums	138,662	64,921
Increase (decrease) in loss and loss adjustment expenses	(147,562)	(4,356)
Change in unrealized foreign exchange (losses) gains	31,632	
Gain on bargain purchase	(494,940)	
Other, net	(119,175)	(24,701)
Net adjustments	(524,164)	(56,477)
Net cash provided by (used in) operating activities	145,248	29,945
Cash flows from investing activities		
Purchases of debt securities	(1,338,155)	(300,624)
Purchases of equity securities	(609,586)	(394,186)
Sales of debt securities	724,914	204,676
Maturities and redemptions of debt securities	743,074	154,709
Sales of equity securities	596,018	337,265
Net (purchase) sale in short-term investments	222,815	2,386
Purchases of property and equipment	(1,950)	(4,582)
Purchase of subsidiary, net of cash acquired	(477,075)	
Other, net	(74,962)	(457)
Net cash (used in) provided by investing activities	(214,907)	(813)
Cash flows from financing activities		
Proceeds from issuance of Senior Notes	399,592	
Debt issue costs paid	(3,600)	
Treasury stock acquisitions		(21,277)
Tax benefit on stock based compensation	295	645
Other, net	374	243
Net cash provided by (used in) financing activities	396,661	(20,389)
Effect of exchange rate changes on cash	(7,136)	
Net increase (decrease) in cash	319,866	8,743

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Cash at beginning of period	84,749	76,741
Cash at end of period	\$ 404,615	\$ 85,484

Supplemental disclosures of cash flow information

Cash paid during the period for:

Interest paid	\$ 41,614	\$ 8,203
Income taxes paid (refunds received)	83,677	20,724

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

1. Summary of Significant Accounting Principles

(a) 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, 2011 (the "2011 10-K") and the Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 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 reinsurance and insurance business. Reinsurance business is conducted through certain subsidiaries of Alleghany's wholly-owned subsidiary Transatlantic Holdings, Inc. ("Transatlantic"), which was acquired on March 6, 2012 (the "Acquisition Date") (see Note 2). Insurance business is conducted through certain subsidiaries of Alleghany Insurance Holdings LLC ("AIHL").

Transatlantic, through its principal wholly-owned subsidiaries, Transatlantic Reinsurance Company ("TRC"), Trans Re Zurich Reinsurance Company Ltd. ("TRZ") and Fair American Insurance and Reinsurance Company ("FAIRCO"), offers reinsurance capacity to reinsurance and insurance companies for a full range of property and casualty products, through brokers and on a direct basis, in both the domestic and foreign markets. Transatlantic is headquartered in New York with six other locations in the United States and has operations worldwide, including: Bermuda, Canada, seven locations in the United Kingdom and Europe, three locations in Central and South America, three locations in Asia, Australia, and Africa. One or both of TRC and FAIRCO are licensed, accredited or authorized or can serve as a reinsurer in 50 states and the District of Columbia in the United States and in Puerto Rico and Guam. TRC is also licensed in Bermuda, Canada, Japan, the United Kingdom, the Dominican Republic, the Hong Kong Special Administrative Region of the People's Republic of China, Germany and Australia. In addition, TRZ is licensed as a reinsurer in Switzerland.

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").

Alleghany's equity investments, including those held by Transatlantic's and AIHL's 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"). On April 26, 2012, Alleghany acquired BKH Holdings, Inc. and its majority-owned subsidiary Bourn & Koch, Inc. ("Bourn & Koch"), a manufacturer and remanufacturer/retrofitter of precision machine tools and supplier of replacement parts, headquartered in Rockford, Illinois.

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 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 that, in the opinion of management, are necessary for 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 results of Transatlantic are included from the Acquisition Date to June 30, 2012 and not in any prior periods, except with respect to Supplemental Pro Forma Information included in Note 2(e), and the results of Bourn & Koch are included from April 26, 2012 to June 30, 2012 and not in any prior periods.

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. Alleghany relies on historical experience and on various other assumptions that it believes to be reasonable under the circumstances to make judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from those reported results to the extent that those

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estimates and assumptions prove to be inaccurate. Changes in estimates are reflected in the consolidated statement of earnings and comprehensive income in the period in which the change is made. The results of operations for any interim period are not necessarily indicative of results for the full year.

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(b) Investments

Investments consist of debt securities, equity securities, short-term investments and other invested assets. Alleghany considers all of its marketable equity securities, debt securities and short-term investments as available-for-sale (AFS). Debt securities consist of securities with an initial fixed maturity of more than one year. Debt securities typically take the form of bonds. Equity securities generally consist of securities that represent ownership interests in an enterprise. Equity securities typically take the form of common stock. Mutual funds are also classified as equity securities, including funds that invest mostly in debt securities. Short-term investments include commercial paper, certificates of deposit, money market instruments and any fixed maturity investment with an initial maturity of one year or less.

AFS securities are recorded at fair value. Unrealized gains and losses during the year, net of the related tax effect applicable to AFS securities, as well as partnership investments that Alleghany accounts for as AFS, are excluded from earnings and reflected in comprehensive income, and the cumulative effect is reported as a separate component of stockholders' equity until realized. If a decline in fair value is deemed to be other than temporary, the investment is written down to its carrying value and the amount of the write-down is recorded as an other than temporary impairment (OTTI) loss on the statement of earnings. In addition, any portion of such decline that relates to debt securities that is believed to arise from factors other than credit is recorded as a component of other comprehensive income, rather than against earnings.

Other invested assets include invested assets not identified above, primarily related to: (i) equity investments in operating companies where Alleghany has significant influence; (ii) partnership investments (including hedge funds and private equity funds); and (iii) loans receivable. Equity investments in operating companies where Alleghany has significant influence (an aggregate common stock position held at or above 20 percent is presumed to convey significant influence) are accounted for using the equity method. Partnership investments are accounted for as either AFS, or using the equity method where Alleghany has significant influence. Loans receivable are carried at unpaid principal balance.

Net realized gains and losses on investments are determined in accordance with the specific identification method.

Net investment income consists primarily of: (i) interest income from debt securities, short-term investments and cash, including any premium or discount amortization; (ii) dividend income from equity securities; and (iii) investment income from other invested assets, which generally includes distributions when receivable and earnings from investments accounted for under the equity method; less expenses related to investments. Interest income is accrued when earned. Premiums and discounts arising from the purchase of certain debt securities are treated as a yield adjustment over the estimated useful life of the securities, adjusted for anticipated prepayments using the retrospective interest method. Under this method, the effective yield on a security is estimated. Such estimates are based on the prepayment terms of the security, past actual cash flows, and assumptions as to future expected cash flow. The future cash flow assumptions consider various prepayment assumptions based on historical experience, as well as current market conditions. Periodically, the effective yield is re-estimated to reflect actual prepayments and updated future cash flow assumptions. Upon a re-estimation, a security's book value is restated at the most recently calculated effective yield, assuming that yield had been in effect since the security was purchased. This treatment results in an increase or decrease to net investment income (amortization of premium or discount) at the new measurement date.

See Note 4 for further information regarding investments.

(c) Fair value

Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between willing, able and knowledgeable market participants at the measurement date. Fair value measurements are not adjusted for transaction costs. In addition, a three-tiered hierarchy for inputs is 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 fair value determinations, Alleghany considers whether the market for a particular security is active or not based on all the relevant facts and circumstances. A market may be considered 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.

Although Alleghany is responsible for the determination of the value of the financial assets and the supporting methodologies and assumptions, it employs third party valuation service providers to gather, analyze and interpret market information and derive fair values based upon relevant methodologies and assumptions for individual instruments. When those providers are unable to obtain sufficient market observable information upon which to estimate the fair value for a particular security, fair value is determined either by requesting a quote, which is generally

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non-binding, from brokers who are knowledgeable about these securities or by employing widely accepted internal valuation models.

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Valuation service providers typically obtain data about market transactions and other key valuation model inputs from multiple sources and, through the use of widely accepted internal valuation models, provide a single fair value measurement for individual securities. The inputs used by the valuation service providers include, but are not limited to, market prices from recently completed transactions and transactions of comparable securities, interest rate yield curves, credit spreads, currency rates, and other market observable information, as applicable. The valuation models take into account, among other things, market observable information as of the measurement date as well as the specific attributes of the security being valued including its term, interest rate, credit rating, industry sector, and when applicable, collateral quality and other issue or issuer specific information. When market transactions or other market observable data is limited, the extent to which judgment is applied in determining fair value is greatly increased.

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 that Alleghany has the ability to access for identical, unrestricted assets, and do 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 include publicly traded common stocks and mutual funds where Alleghany's valuations are based on quoted market prices.

Level 2 Valuations are based on direct and indirect observable inputs other than quoted market prices included in Level 1. Level 2 inputs include quoted prices for similar assets in active markets and inputs other than quoted prices that are observable for the asset, such as 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 interest rates and yield curves that are observable at commonly quoted intervals and current credit rating(s) of the security. Level 2 assets generally include short-term investments and most debt securities. Alleghany's Level 2 liabilities consist of the Senior Notes.

Level 3 Valuations are based on techniques that use significant inputs that are unobservable. The valuation of Level 3 assets requires the greatest degree of judgment, as these valuations are based on techniques that use significant inputs that are unobservable. These measurements may be made under circumstances in which there is little, if any, market activity for the asset. Alleghany's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment. In making the assessment, Alleghany considers factors specific to the asset. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement is classified is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Some Level 3 valuations are based entirely on non-binding broker quotes. These securities consist primarily of mortgage and asset-backed securities where reliable pool and loan level collateral information cannot be reasonably obtained. Assets classified as Level 3 principally include certain residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), other asset-backed securities, and partnership investments.

Mortgage and asset-backed securities are initially valued at the transaction price. Subsequently, Alleghany uses widely accepted valuation practices that produce a fair value measurement by comparison to transactions in similarly structured instruments, use of discounted cash flows, or option adjusted spread analyses. Unobservable inputs, significant to the measurement and valuation of mortgage and asset-backed securities, include assumptions about prepayment speed and collateral performance, including default, delinquency and loss severity rates. Significant changes to any one of these inputs, or combination of inputs, could significantly change the fair value measurement for these securities.

The impact of prepayment speeds on fair value is dependent on a number of variables including whether the securities were purchased at a premium or discount. A decrease in interest rates generally increases the assumed rate of prepayments, and an increase in interest rates generally decreases the assumed speed of prepayments. Increased prepayments increase the yield on securities purchased at a discount, and reduce the yield on securities purchased at a premium. In a decreasing prepayment environment, yields on securities purchased at a discount are reduced but are increased for securities purchased at a premium. Changes in default assumptions on underlying collateral are generally accompanied by directionally similar changes in other collateral performance factors, but generally result in a directionally opposite change in prepayment assumptions.

Fair values for partnership and private equity investments are initially valued at the transaction price. Subsequently, fair value is based on the performance of the portfolio of investments or results of operations of the investee, as derived from their financial statements. Significant

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improvements or disruptions in the financial markets may result in directionally similar or opposite changes to the portfolio of the investee, depending on how management of the investee has correlated the portfolio of investments to the market. Also, any changes made by the investee to the investment strategy of the private equity investment could result in significant changes to fair value that have a positive or negative correlation to the performance observed in the equity markets. For those investments whose performance is based on the results of operations within a specific industry, significant events impacting that industry could materially impact fair value. Also, decisions and changes to strategy made by management of the investee could result in positive or negative outcomes, which could significantly impact the results of operations of the investee and subsequently fair value.

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Alleghany employs specific control processes to determine the reasonableness of the fair values of its financial assets and liabilities. Alleghany's processes are designed to ensure that the values received or internally estimated are accurately recorded and that the data inputs and the valuation techniques utilized are appropriate, consistently applied, and that the assumptions are reasonable and consistent with the objective of determining fair value. Alleghany assesses the reasonableness of individual security values received from valuation service providers through various analytical techniques. In addition, Alleghany validates the reasonableness of fair values by comparing information obtained from Alleghany's valuation service providers to other third party valuation sources for selected securities. Alleghany also validates prices obtained from brokers for selected securities through reviews by those who have relevant expertise and who are independent of those charged with executing investing transactions.

In addition to such procedures, Alleghany reviews the reasonableness of its classification of securities within the three-tiered hierarchy to ensure that the classification is consistent with GAAP.

See Note 3 for further information regarding fair value.

(d) Cash

Cash includes all deposit balances with a bank that are available for immediate withdrawal, whether interest-bearing or non-interest bearing.

(e) Premiums and Unearned Premiums

Premiums are recognized as revenue on a pro-rata basis over the term of an insurance policy. Assumed reinsurance premiums written and earned are based on reports received from ceding companies for pro rata treaty contracts and are generally recorded as written based on contract terms for excess-of-loss treaty contracts. Premiums are earned ratably over the terms of the related coverages.

Unearned premiums and ceded unearned premiums represent the portion of gross premiums written and ceded premiums written, respectively, relating to the unexpired terms of such coverages. Assumed reinsurance premiums written and earned, along with related costs, for which data has not been reported by the ceding companies, are estimated based on historical patterns and other relevant information. These estimates may change when actual data for such estimated items becomes available.

Premium balances receivable are reported net of an allowance for estimated uncollectible premium amounts. Such allowance is based upon an ongoing review of amounts outstanding, length of collection periods, the creditworthiness of the insured, and other relevant factors. Amounts deemed to be uncollectible are written off against the allowance.

(f) Reinsurance Ceded

Reinsurance is used to mitigate the exposure to losses, manage capacity and protect capital resources. Reinsuring loss exposures does not relieve the ceding entity from its obligations to policyholders. Reinsurance recoverables (including amounts related to claims incurred but not reported) and ceded unearned premiums are reported as assets. To minimize exposure to losses from a reinsurer's inability to pay, the financial condition of such reinsurer is evaluated initially upon placement of the reinsurance and periodically thereafter. In addition to considering the financial condition of a reinsurer, the collectibility of the reinsurance recoverables is evaluated (and where appropriate, whether an allowance for estimated uncollectible reinsurance recoverables is to be established), based upon a number of other factors. Such factors include the amounts outstanding, length of collection periods, disputes, any collateral or letters of credit held, and other relevant factors. To the extent that an allowance for uncollectible reinsurance recoverable is established, amounts deemed to be uncollectible are written off against the allowance for estimated uncollectible reinsurance recoverables. There is currently no allowance for uncollectible reinsurance recoverables. See Note 5.

Ceded premiums written are recorded in accordance with the applicable terms of the various reinsurance contracts, and ceded premiums earned are charged against revenue over the period of the various reinsurance contracts. This also generally applies to reinstatement premiums paid to a reinsurer, which arise when contractually-specified ceded loss triggers have been breached. Ceded commissions reduce commissions, brokerage and other underwriting expenses, and ceded losses incurred reduce net loss and loss adjustment expense (LAE) incurred over the applicable periods of the various reinsurance contracts with third party reinsurers. If premiums or commissions are subject to adjustment (for example, retrospectively-rated or experience-rated), the estimated ultimate premium or commission is recognized over the period of the contract.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business and consistent with the terms of the underlying reinsurance contract.

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(g) Deferred Acquisition Costs

As discussed in more detail in Note 1(q), Alleghany adopted new accounting guidance in the first quarter of 2012 related to acquisition costs.

Acquisition costs related to unearned premiums that vary with, and are directly related to, the production of such premiums are deferred. Furthermore, such deferred costs: (i) represent only incremental, direct costs associated with the successful acquisition of a new or renewal insurance or reinsurance contract; (ii) are essential to the contract transaction; (iii) would not have been incurred had the contract transaction not occurred; and (iv) are related directly to the acquisition activities involving underwriting, policy issuance and processing. Acquisition costs principally relate to commissions. To a lesser extent, acquisition costs can include premium taxes and certain qualifying underwriting expenses. For insurance policies written, acquisition costs are generally incurred directly, and include commissions, premium taxes and certain qualifying underwriting expenses. For reinsurance contracts written, acquisition costs are generally incurred through brokerage commissions and indirectly through ceding commissions, which are deferred. Deferred acquisition costs are amortized to expense as the related premiums are earned, generally over a period of one year. Deferred acquisition costs are reviewed at least annually to determine their recoverability from future income, including investment income. If any such costs are determined not to be recoverable they are charged to expense.

Anticipated net loss and LAE and estimated remaining costs of servicing the contracts are considered when evaluating recoverability of deferred acquisition costs.

(h) Property and Equipment

Property and equipment is carried at cost, net of accumulated depreciation and amortization. Depreciation of buildings and equipment is principally calculated using the straight-line method over the estimated useful life of the respective assets. Estimated useful lives for such assets range from 3 to 20 years. Amortization of leasehold improvements is principally calculated using the straight-line method over the estimated useful life of the leasehold improvement or the life of the lease, whichever is less. Rental expense on operating leases is recorded on a straight-line basis over the term of the lease, regardless of the timing of actual lease payments.

(i) Goodwill and Other Intangible Assets

Goodwill and other intangible assets, net of amortization, are recorded as a consequence of business acquisitions. Goodwill represents the excess, if any, of the amount paid to acquire subsidiaries and other businesses over the fair value of their net assets at the date of acquisition. Other intangible assets are recorded at their fair value as of the acquisition date. A significant amount of judgment is needed to determine the fair values at the date of acquisition of other intangible assets and the net assets acquired in a business acquisition. The determination of the fair value of other intangible assets and net assets often involves the use of valuation models and other estimates, which involve many assumptions and variables and are inherently subjective. Other intangible assets that are not deemed to have an indefinite useful life are amortized over their estimated useful lives. Goodwill and those intangible assets that have an indefinite useful life are not subject to amortization.

Goodwill and other intangible assets deemed to have an indefinite useful life are tested annually in the fourth quarter of every year for impairment. Goodwill and other intangible assets are also tested whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. A significant amount of judgment is required in performing goodwill and other intangible asset impairment tests. These tests include estimating the fair value of Alleghany's operating units and other intangible assets. If it is determined that an asset has been impaired, the asset is written down by the amount of the impairment, with a corresponding charge to net earnings. Subsequent reversal of any impairment charge is not permitted.

With respect to goodwill, a qualitative assessment is first made to determine whether it is necessary to perform quantitative testing. This initial assessment includes, among others, consideration of: (i) past, current and projected future earnings and equity; (ii) recent trends and market conditions; and (iii) valuation metrics involving similar companies that are publicly-traded and acquisitions of similar companies, if available. If this initial qualitative assessment indicates that the fair value of an operating unit may be less than its respective carrying amount, a second step is taken, involving a comparison between the estimated fair values of the operating units with their respective carrying amounts including goodwill. Under GAAP, fair value refers to the amount for which the entire operating unit may be bought or sold. The methods for estimating operating unit values include asset and liability fair values and other valuation techniques, such as discounted cash flows and multiples of earnings or revenues. All of these methods involve significant estimates and assumptions. If the carrying value exceeds estimated fair value, there is an indication of potential impairment, and a third step is performed to measure the amount of impairment. The third step involves calculating an implied fair value of goodwill by measuring the excess of the estimated fair value of the operating units over the aggregate estimated fair values of the individual assets less liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill, an impairment charge is recorded for the excess.

See Note 1(q) and Note 2 for further information on goodwill and other intangible assets.

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(j) Income Taxes

Alleghany files a consolidated federal income tax return with its subsidiaries. Following the Acquisition Date, Alleghany's consolidated federal income tax return will include as part of its taxable income those items of income of non-U.S. subsidiaries that are subject to U.S. income tax currently, pursuant to Subpart F income rules of the Internal Revenue Code. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Current tax liabilities or assets are recognized for the estimated taxes payable or refundable on tax returns for the current year.

A valuation allowance is provided when it is more likely than not that some portion of the deferred tax assets will not be realized. This determination is based upon a review of all available evidence, both positive and negative, including Alleghany's earnings history, the timing, character and amount of future earnings potential, the reversal of taxable temporary differences and the tax planning strategies available.

See Note 9 for further information on income taxes.

(k) Loss Reserves

The reserves for loss and LAE represent management's best estimate of the ultimate cost of all reported and unreported losses incurred through the balance sheet date.

The reserves for loss and LAE include but are not limited to: (i) reports and individual case estimates received from ceding companies, with respect to assumed reinsurance business; (ii) the accumulation of individual estimates for claims reported, with respect to direct insurance business; (iii) estimates for incurred but not reported (IBNR) claims based on past experience, modified for current trends and industry data; and (iv) estimates of expenses for investigating and settling claims based on past experience. The methods used to determine such estimates and to establish the resulting reserves are continually reviewed and updated. Any adjustments are reflected in current income. Net loss and LAE incurred consists of the estimated ultimate cost of settling claims incurred within the reporting period (net of related reinsurance recoverable), including IBNR claims, plus changes in estimates of prior period losses.

The estimation of loss reserves is inherently difficult and subjective, especially in view of changing legal and economic environments that impact the development of loss reserves. Therefore, quantitative techniques have to be supplemented by subjective considerations and managerial judgment. In addition, trends that have affected development of liabilities in the past may not necessarily occur or affect liability development to the same degree in the future.

Although the reserving process is difficult for insurance companies, the inherent uncertainties of estimating loss reserves are even greater for reinsurers, due primarily to a lag in claims reporting, the longer-term nature of much of the reinsurance business, the diversity of development patterns among different types of reinsurance treaties or facultative contracts, the necessary reliance on the ceding companies for information regarding reported claims, and differing reserving practices among ceding companies, which may change without notice. Alleghany writes a significant amount of non-proportional assumed casualty reinsurance as well as proportional assumed reinsurance of excess liability business for classes such as medical malpractice, directors and officers (D&O) liability, errors and omissions liability and general casualty. Claims from such classes can exhibit greater volatility over time than most other classes due to their low frequency, high severity nature and loss cost trends that are more difficult to predict. Net loss and LAE also include amounts for risks relating to asbestos-related illnesses and environmental impairment. See Notes 6 and 12(d).

(l) Earnings Per Share of Common Stock

Basic earnings per share of common stock is based on the average number of shares of common stock, par value \$1.00 per share, of Alleghany (Common Stock) outstanding during the period, retroactively adjusted for stock dividends. Diluted earnings per share of Common Stock are based on those shares used to calculate basic earnings per share of Common Stock plus the dilutive effect of stock-based compensation awards, retroactively adjusted for stock dividends. See Note 11 for further information on earnings per share.

(m) Stock-Based Compensation Plans

The cost resulting from all stock-based compensation transactions is recognized in the financial statements, with fair value as the measurement objective in accounting for stock-based compensation arrangements. The fair value-based measurement method applies in accounting for

stock-based compensation transactions with employees. Non-employee directors are treated as employees for accounting purposes.

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With respect to stock option grants, the fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. Expected volatilities are based on historical volatility of the Common Stock. Alleghany uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

(n) Senior Notes

Debt consists of senior notes issued by Alleghany (the Alleghany Senior Notes) and senior notes issued by Transatlantic (the Transatlantic Senior Notes, and collectively with the Alleghany Senior Notes, the Senior Notes). The Senior Notes are carried at unpaid principal balance including any unamortized premium or discount.

See Note 8 for further information regarding the Senior Notes.

(o) Currency Translation

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at period-end exchange rates. Income and expense accounts are translated at average exchange rates for the year. The resulting unrealized currency translation gain (loss) for functional currencies is recorded, net of tax, in accumulated other comprehensive income, a component of stockholders' equity.

Transaction gains and losses on assets and liabilities denominated in foreign currencies are recorded as a component of net realized capital gains (losses) during the period in which they occur.

(p) Reclassification

Certain prior year amounts have been reclassified to conform to the 2012 presentation of the financial statements.

(q) Recent Accounting Standards

Recently Adopted

In September 2011, the Financial Accounting Standards Board (the FASB) issued revised guidance on the testing of goodwill for impairment. This guidance simplifies how an entity tests goodwill for impairment by allowing an entity to first make a qualitative assessment to determine whether it is necessary to perform quantitative testing. Based on the results of such assessment, an entity will no longer be required to perform quantitative testing if it is more likely than not that the fair value of a reporting unit is greater than its carrying value. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. Alleghany adopted this guidance in the first quarter of 2012, and the implementation did not have an impact on its results of operations and financial condition.

In June 2011, the FASB issued guidance on the presentation of comprehensive income. This guidance, as amended in December 2011, 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. This guidance does not change the items that must be reported within other comprehensive income. This guidance is generally effective for interim and annual periods beginning after December 15, 2011. Alleghany adopted this guidance in the first quarter of 2012, and the implementation did not have an impact on its results of operations and financial condition.

In May 2011, the 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 adopted this guidance in the first quarter of 2012, and the implementation did not have a material impact on its results of operations and financial condition.

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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

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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. Alleghany adopted this guidance in the first quarter of 2012, and the implementation did not have a material impact on its results of operations and financial condition.

Future Application of Accounting Standards

In July 2012, the FASB issued revised guidance on the testing of certain intangible assets for impairment. This guidance simplifies how an entity tests for impairment intangible assets other than goodwill, such as licenses and trade names, that are determined to have an indefinite life. It does so by allowing an entity to first make a qualitative assessment to determine whether it is necessary to perform quantitative testing. Based on the results of such assessment, an entity will only be required to perform quantitative testing if it is more likely than not that the asset is impaired. This guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. Alleghany will adopt this guidance in the fourth quarter of 2012, and Alleghany currently does not believe that the implementation will have a material impact on its results of operations and financial condition.

In December 2011, the FASB issued guidance on disclosure requirements related to offsetting arrangements. The guidance provides for additional financial statement disclosure regarding offsetting and related arrangements to enable financial statement users to understand the effect of those arrangements on an entity's financial position. This guidance is effective for interim and annual reporting periods beginning on or after January 1, 2013. Alleghany will adopt this guidance in the first quarter of 2013, and Alleghany currently does not believe that the implementation will have a material impact on its results of operations and financial condition.

2. Merger with Transatlantic

(a) Overview

On November 20, 2011, Alleghany entered into an Agreement and Plan of Merger (the "Merger Agreement") with its wholly-owned subsidiary, Shoreline Merger Sub, LLC (subsequently converted into a corporation) ("Merger Sub"), and Transatlantic Holdings, Inc. ("Old Transatlantic"). On the Acquisition Date, Old Transatlantic was merged with (the "merger") and into Merger Sub, which was renamed Transatlantic Holdings, Inc., and became a wholly-owned subsidiary of Alleghany.

Pursuant to the terms of the Merger Agreement, on the Acquisition Date, stockholders of Old Transatlantic were entitled to receive, in exchange for each share of Old Transatlantic common stock held, either shares of Common Stock or cash consideration with a value equal to approximately \$61.14 ("Per Share Consideration"), which was the sum of (i) 0.145 multiplied by the average of the closing sales prices on the New York Stock Exchange for Common Stock during the five trading days ending the day before the Acquisition Date ("the Average Closing Price") and (ii) \$14.22, as more fully described in the Merger Agreement. In total, Alleghany paid to the stockholders of Old Transatlantic consideration of approximately \$3.5 billion, consisting of cash consideration of \$816.0 million and stock consideration of 8,360,959 shares of Common Stock. The stock consideration is generally expected to be tax free to Old Transatlantic stockholders.

Following the Acquisition Date, the Alleghany board of directors consisted of all 11 members from its pre-merger board of directors and three additional members (the "Continuing Directors") who had served on the board of directors of Old Transatlantic.

Alleghany incurred due diligence, legal, investment banking and other merger-related costs ("Transaction Costs") of \$33.8 million in the first six months of 2012, including \$18.0 million payable to Alleghany's investment bankers, in connection with the merger. Alleghany also incurred \$19.3 million of Transaction Costs in the fourth quarter of 2011 in connection with the merger. Transaction Costs are reported as a component of corporate administration expense.

The merger was accounted for using the acquisition method of accounting. Based on the relative voting interests of Alleghany stockholders (approximately 51 percent) and Old Transatlantic stockholders (approximately 49 percent) in Alleghany post-merger, the composition of Alleghany's board of directors and senior management after the merger and other factors, it was determined that Alleghany is the acquiring entity for accounting purposes. Under the acquisition method of accounting, the assets, liabilities and commitments of Transatlantic are adjusted to their fair values on the Acquisition Date. Significant judgment was required to arrive at estimates of fair values.

The excess of the fair value of the net assets acquired over the purchase price was recorded as a gain on bargain purchase of \$494.9 million and is shown as a separate component of revenues in the statement of earnings for the six months ended June 30, 2012. The gain on bargain purchase determination is consistent with the fact that prior to the merger, Old Transatlantic's shares of common stock, similar to shares of certain other

reinsurance and insurance companies, traded at a discount to book value per common share.

Table of Contents**(b) Purchase Price**

Alleghany's total purchase price for Old Transatlantic as of the Acquisition Date is calculated in accordance with GAAP as follows (in millions, except per share amounts):

Shares of Old Transatlantic common stock outstanding as of the Acquisition Date	57.6
Multiplied by per share exchange ratio of 0.145 shares of Common Stock per share of Old Transatlantic common stock	0.145
Shares of Common Stock issued	8.4
Multiplied by the Acquisition Date closing price per share of Common Stock ⁽¹⁾	\$ 322.50
Portion of purchase price based on shares of Common Stock issued	\$ 2,696.4
Shares of Old Transatlantic common stock outstanding as of the Acquisition Date	57.6
Adjustment to Old Transatlantic common stock ⁽²⁾	(0.2)
Old Transatlantic common stock, as adjusted	57.4
Multiplied by cash price per share component	\$ 14.22
Portion of purchase price based on cash consideration	816.0
Total purchase price	\$ 3,512.4

- (1) As noted previously, the Merger Agreement determined aggregate consideration paid based on the Average Closing Price. For GAAP purposes, the purchase price is determined based on the closing price of the Common Stock as of the Acquisition Date.
- (2) The \$816.0 million cash consideration was fixed as of the date of the Merger Agreement, predicated on the 57.4 million shares of common stock of Old Transatlantic outstanding at that date multiplied by \$14.22 per share. Therefore, the additional 0.2 million of Old Transatlantic shares outstanding as of the Acquisition Date do not cause the cash consideration to increase and are adjusted for in this presentation.

(c) Fair Value of Net Assets Acquired and Gain on Bargain Purchase

The total fair value of net assets acquired and the gain on bargain purchase as of the Acquisition Date are calculated as follows (in millions):

Net book value of net assets acquired prior to fair value adjustments	\$ 4,062.7
Adjustments for fair value, by applicable balance sheet caption:	
Assets:	
Deferred acquisition costs	(250.7)
Intangible assets	323.5
Net deferred tax assets	21.5
All other assets	(25.3)
Liabilities:	
Transatlantic Senior Notes	(124.4)
Fair value of net assets acquired	4,007.3
Less purchase price	(3,512.4)
Gain on bargain purchase (before all Transaction Costs)	\$ 494.9

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Pursuant to the terms of the Merger Agreement, each outstanding stock option to acquire Old Transatlantic common stock was converted into the right to receive a cash payment based on its Black-Scholes value on the Acquisition Date based on assumptions set forth in the Merger Agreement. As of the Acquisition Date, the value of the Old Transatlantic stock options was determined to be \$11.1 million, which amount was paid by Alleghany in March 2012.

Pursuant to the terms of the Merger Agreement, each outstanding Old Transatlantic restricted stock unit (including performance-based Old Transatlantic restricted stock units) held by current or former employees or non-employee directors of Old Transatlantic was converted into the right to receive a cash payment in an amount equal to the Per Share Consideration, with the same terms and conditions as were applicable under such restricted stock unit prior to its conversion, that was: (i) deemed notionally invested in the equity of Transatlantic, referred to as book value units; (ii) with respect to the Continuing Directors, deemed notionally invested in Common Stock; or (iii) maintained in a cash account while continuing to vest on the existing vesting schedule. As of the Acquisition Date, the value of the Transatlantic restricted stock units was determined to be \$49.5 million, of which \$1.1 million was paid by Alleghany in the first six months of 2012 with the remainder expected to be paid over the next three years.

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Prior to the Acquisition Date, Old Transatlantic established a liability for its stock option and restricted stock awards that was previously accounted for as equity, and this liability is reflected in the net book value of net assets acquired prior to fair value adjustments.

An explanation of the adjustments for fair value is as follows:

Deferred acquisition costs - Elimination of Transatlantic's deferred acquisition costs asset.

Intangible assets - Establish fair value of intangible assets related to Transatlantic (see below for further detail).

Net deferred tax assets - Adjustment to deferred tax assets, net, related to fair value adjustments. See Note 9.

All other assets - Elimination of Transatlantic's carried goodwill, deferred debt issuance costs, allowance for doubtful accounts and the recording of fair value adjustments to other asset categories.

Transatlantic Senior Notes - Adjustments of the Transatlantic Senior Notes to their estimated fair value based on prevailing interest rates and other factors as of the Acquisition Date. See Note 8(b).

The net intangible assets (liabilities) included in intangible assets in the table above, and as of June 30, 2012, consist of the following (in millions):

	Amount	Economic Useful Life
Value of business in-force	\$ 291.4	One Year
Loss and LAE reserves	(98.8)	15 years
State and foreign insurance licenses	19.0	Indefinite
Trade name	50.0	Indefinite
Renewal rights	44.0	14 years
Leases	(28.1)	10 years
Gain contingency on dispute previously in arbitration	36.0	As settled
Internally-developed software	10.0	2.5 years
Net intangible assets, before amortization, as of the Acquisition Date	\$ 323.5	
Amortization (from the Acquisition Date through June 30, 2012)	\$ 138.3	
Net intangible assets, after amortization, as of June 30, 2012	\$ 185.2	

An explanation of the intangible assets and related future amortization is as follows:

Value of business in-force - Intangible asset resulting from the adjustment of unearned premiums to the estimated fair value of profit within Transatlantic's unearned premiums as of the Acquisition Date, adjusted for a risk factor. This will be amortized as the contracts for business in-force as of the Acquisition Date expire.

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Loss and LAE reserves - Adjustment resulting from the difference between the estimated fair value and the historical carrying value of Transatlantic's unpaid loss and LAE, net of related reinsurance recoverable, as of the Acquisition Date. The estimated fair value consists of the present value of the net loss reserves plus a risk premium. This will be amortized over the estimated payout pattern of net reserves as of the Acquisition Date.

State and foreign licenses - Addition of the estimated fair value of identifiable intangible assets resulting from the merger arising from the ability to write reinsurance in all 50 U.S. states and the District of Columbia and various foreign jurisdictions.

Trade name - Addition of the estimated fair value of identifiable intangible assets resulting from the merger arising from trade names and trademarks used by Transatlantic in conducting its business worldwide.

Renewal rights - Addition of the estimated fair value of identifiable intangible assets resulting from the merger arising from renewal rights. This will be amortized over the net earnings pattern of renewed reinsurance contracts, estimated as of the Acquisition Date.

Leases - Adjustment resulting from the difference between the estimated fair value of Transatlantic's operating leases for its office space and its operating lease commitments, as of the Acquisition Date. This will be amortized on a straight-line basis over the future remaining terms of the operating leases as of the Acquisition Date.

Gain contingency on dispute previously in arbitration - Estimated minimum recovery, net of estimated legal costs, from a dispute previously in arbitration. See Note 12(a) for further discussion of the dispute previously in arbitration.

Internally-developed software - Addition of the estimated fair value of identifiable intangible assets resulting from the merger arising from internally-developed software. This will be amortized on a straight-line basis over its economic useful life.

Table of Contents**(d) Financial Results**

The following information summarizes the results of Transatlantic since the Acquisition Date that have been included within Alleghany's Consolidated Statements of Earnings and Comprehensive Income (in millions):

	Three Months Ended June 30, 2012	For the Period from March 6, 2012 to June 30, 2012
Revenues		
Net premiums earned	\$ 893.3	\$ 1,136.4
Net investment income	70.7	89.1
Net realized capital gains	6.6	7.1
Other than temporary impairment losses		
Gain on bargain purchase		
Other income	0.6	0.8
Total revenues	971.2	1,233.4
Costs and Expenses		
Net loss and loss adjustment expenses	560.8	708.5
Commissions, brokerage and other underwriting expenses	167.0	196.2
Other operating expenses	20.1	25.1
Corporate administration		
Amortization of intangible assets	107.2	138.3
Interest expense	11.0	15.7
Total costs and expenses	866.1	1,083.8
Earnings before income taxes	105.1	149.6
Income taxes	17.9	29.8
Net earnings	\$ 87.2	\$ 119.8

(e) Supplemental Pro forma Information

Transatlantic's results have been included in Alleghany's Consolidated Financial Statements from the Acquisition Date to June 30, 2012. The following pro forma financial information for the six months ended June 30, 2012 and 2011 is presented for informational purposes only and is not necessarily indicative of the results that would have occurred had the merger been consummated at the beginning of each period presented, nor is it necessarily indicative of future results. Significant assumptions used to determine pro forma results include amortization of intangible assets related to the merger and the assumption that Alleghany's acquisition of Transatlantic occurred on January 1 of each of the respective periods. Transaction Costs and gain on bargain purchase that are included in Alleghany's financial statements have not been included in the unaudited pro forma consolidated information. The table presents unaudited pro forma consolidated information for the six months ended June 30, 2012 and 2011 (in millions, except per share data):

	Pro Forma Six Months Ended June 30,	
	2012	2011
Total revenues ⁽¹⁾	\$ 2,573.4	\$ 2,649.2
Net earnings (losses) ⁽¹⁾⁽²⁾	231.3	(88.8)
Basic earnings per share	\$ 13.67	\$ (5.14)

- (1) Among other adjustments, reflects an increase in amortization expense on Transatlantic's AFS debt securities resulting from the adjustment of amortized cost to their Acquisition Date fair value. Such adjustment reduced the net investment income of Transatlantic.
- (2) Among other adjustments, reflects adjustments to amortization expense on the Transatlantic Senior Notes resulting from the adjustment to their Acquisition Date fair value. Such adjustment reduced the interest expense of Transatlantic. See Note 8(b). Also reflects adjustments to amortization expense associated with intangible assets arising from the merger.

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The decrease in pro forma revenues in the first six months of 2012 from the first six months of 2011 reflects a decrease in Transatlantic's revenues primarily due to lower net premiums earned and lower net investment income, partially offset by an increase in Alleghany's revenues primarily due to higher net realized capital gains and an increase in net premiums earned.

The increase in pro forma net earnings in the first six months of 2012 from the first six months of 2011 reflects significantly lower catastrophe losses incurred by Transatlantic, and, to a lesser extent, an increase in Alleghany's net realized capital gains in the first six months of 2012, partially offset by a reduction of Transatlantic's revenues primarily due to lower net premiums earned and lower investment income.

The pro forma results include Transatlantic's pre-tax catastrophe losses, net of reinsurance and reinstatement premiums, of \$53.7 million and \$611.8 million in the first six months of 2012 and 2011, respectively. The \$53.7 million of the pre-tax catastrophe losses, net of reinsurance and reinstatement premiums, incurred in the first six months of 2012 were incurred by Old Transatlantic prior to the Acquisition Date and are not included in Alleghany's GAAP net earnings for the six month period ending June 30, 2012. In addition, Transatlantic recorded pre-tax losses and LAE of \$19.0 million in the first six months of 2012 related to the capsizing of the luxury liner, Costa Concordia, off the coast of Italy.

Table of Contents**(f) Goodwill and Intangible Assets**

The amount of goodwill and intangible assets, net of accumulated amortization expense, reported on Alleghany's consolidated balance sheets as of June 30, 2012 and December 31, 2011 is as follows (in millions):

	June 30, 2012		December 31, 2011			
	Gross Carrying Value ⁽¹⁾	Accumulated Amortization	Net Carrying Value ⁽²⁾	Gross Carrying Value ⁽¹⁾	Accumulated Amortization	Net Carrying Value ⁽²⁾
Insurance segment ⁽³⁾ - Goodwill	\$ 48.1	\$	\$ 48.1	\$ 48.1	\$	\$ 48.1
Insurance segment - Intangible assets:						
Agency relationships	21.7	7.6	14.1	21.7	7.1	14.6
State insurance licenses	25.8		25.8	25.8		25.8
Trade name	35.5		35.5	35.5		35.5
Brokerage and reinsurance relationships	33.8	20.3	13.5	33.8	19.1	14.7
Renewal and distribution rights	24.3	24.0	0.3	24.3	24.0	0.3
Other	4.1	4.1		4.1	4.1	
Total insurance segment intangibles	145.2	56.0	89.2	145.2	54.3	90.9
Total insurance segment goodwill and other intangibles	\$ 193.3	\$ 56.0	\$ 137.3	\$ 193.3	\$ 54.3	\$ 139.0
Reinsurance segment ⁽³⁾ - Intangible assets:						
Value of business in-force	\$ 291.4	\$ 144.7	\$ 146.7	\$	\$	\$
Loss and LAE reserves	(98.8)	(7.4)	(91.4)			
State and foreign insurance licenses	19.0		19.0			
Trade name	50.0		50.0			
Renewal rights	44.0	0.7	43.3			
Leases	(28.1)	(0.9)	(27.2)			
Gain contingency on dispute previously in arbitration	36.0		36.0			
Internally-developed software	10.0	1.2	8.8			
Total reinsurance segment intangibles	\$ 323.5	\$ 138.3	\$ 185.2	\$	\$	\$
Corporate activities ⁽³⁾⁽⁴⁾ - Goodwill	\$ 34.4	\$	\$ 34.4	\$	\$	\$
Corporate activities ⁽⁴⁾ - Intangible assets:						
Trade name	0.4		0.4			
Other	0.3		0.3			
Total corporate activities intangibles	0.7		0.7			
Total corporate activities goodwill and other intangibles	\$ 35.1	\$	\$ 35.1	\$	\$	\$
Alleghany consolidated goodwill and other intangibles	\$ 551.9	\$ 194.3	\$ 357.6	\$ 193.3	\$ 54.3	\$ 139.0

(1) See Note 4 of Notes to Consolidated Financial Statements set forth in Item 8 of the 2011 10-K for further detail.

(2) Goodwill and intangible assets have been reduced by amounts written-down in prior periods. See Note 4(a) of Notes to Consolidated Financial Statements set forth in Item 8 of the 2011 10-K for further detail.

(3) See Note 13 for further detail regarding Alleghany's segments of business.

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- (4) Represents goodwill and other intangible assets related to the acquisition of Bourn & Koch on April 26, 2012, which was purchased for \$55.0 million, including estimated contingent consideration of \$8.0 million based on future profitability.

Table of Contents**3. Fair Value of Financial Instruments**

The carrying values and estimated fair values of Alleghany's consolidated financial instruments as of June 30, 2012 and December 31, 2011 were as follows (in millions):

	June 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Investments (excluding equity method investments) ⁽¹⁾	\$ 17,704.6	\$ 17,704.6	\$ 4,670.6	\$ 4,670.6
Liabilities				
Senior Notes ⁽²⁾	\$ 1,819.8	\$ 1,878.3	\$ 299.0	\$ 314.8

(1) This table includes AFS investments (debt and equity 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 (including Homesite, ORX and other equity method 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.

(2) See Note 8.

Alleghany's financial instruments measured at fair value and the level of the fair value hierarchy of inputs used as of June 30, 2012 and December 31, 2011 were as follows (in millions):

	Level 1	Level 2	Level 3	Total
As of June 30, 2012				
Equity securities:				
Common stock ⁽¹⁾	\$ 1,047.1	\$	\$	\$ 1,047.1
Preferred stock				
Total equity securities	1,047.1			1,047.1
Debt securities:				
U.S. Government obligations		528.6		528.6
Municipal bonds		6,602.3		6,602.3
Foreign government obligations		824.2		824.2
U.S. corporate bonds		3,034.6	6.3	3,040.9
Foreign corporate bonds		1,944.9		1,944.9
Mortgage and asset-backed securities:				
RMBS ⁽²⁾		1,927.8	50.9	1,978.7
CMBS		393.5	34.3	427.8
Other asset-backed securities		242.8	6.6	249.4
Total debt securities		15,498.7	98.1	15,596.8
Short-term investments		1,023.1		1,023.1
Other invested assets (excluding equity method investments) ⁽³⁾			37.6	37.6
Total investments (excluding equity method investments)	\$ 1,047.1	\$ 16,521.8	\$ 135.7	\$ 17,704.6
Senior Notes	\$	\$ 1,878.3	\$	\$ 1,878.3

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	Level 1	Level 2	Level 3	Total
As of December 31, 2011				
Equity securities:				
Common stock ⁽¹⁾	\$ 871.0	\$	\$	\$ 871.0
Preferred stock				
Total equity securities	871.0			871.0
Debt securities:				
U.S. Government obligations	267.8			267.8
Municipal bonds		1,113.6		1,113.6
Foreign government obligations				
U.S. corporate bonds		354.1		354.1
Foreign corporate bonds		83.5		83.5
Mortgage and asset-backed securities:				
RMBS ⁽²⁾		497.3		497.3
CMBS		144.7		144.7
Other asset-backed securities		218.5		218.5
Total debt securities	267.8	2,411.7		2,679.5
Short-term investments	54.3	1,042.2		1,096.5
Other invested assets (excluding equity method investments) ⁽³⁾			23.6	23.6
Total investments (excluding equity method investments)	\$ 1,193.1	\$ 3,453.9	\$ 23.6	\$ 4,670.6
Senior Notes	\$	\$ 314.8	\$	\$ 314.8

(1) Of the \$1,047.1 million and \$871.0 million of fair value as of June 30, 2012 and December 31, 2011, respectively, \$461.8 million and \$573.3 million, respectively, related to certain energy sector businesses.

(2) Includes government agency pass-through securities guaranteed by a government agency or government sponsored enterprise, among other types of RMBS.

(3) Includes partnership investments accounted for on an AFS basis.

In the three months ended June 30, 2012 there were no transfers in or out of Level 1, Level 2 or Level 3. In the six months ended June 30, 2012, transfers in or out of Level 1, Level 2 or Level 3 consisted of a \$267.8 million transfer of U.S. Government obligations out of Level 1 and into Level 2, reflecting a change in Alleghany's classification practice for U.S. Government obligations, effective January 1, 2012, based on a review of trading activity. In the three and six months ended June 30, 2011, there were no transfers in or out of Level 1, Level 2 or Level 3.

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The following tables present reconciliations of the changes during the six months ended June 30, 2012 in Level 3 assets measured at fair value (in millions):

Six Months Ended June 30, 2012	Foreign Government Obligations	U.S. Corporate Bonds	Debt Securities Mortgage and asset-backed		Other Asset- backed Securities	Other Invested Assets ⁽¹⁾	Total
			RMBS	CMBS			
Balance January 1, 2012	\$	\$	\$	\$	\$	\$ 23.6	\$ 23.6
Net realized/unrealized gains (losses) included in:							
Net earnings ⁽²⁾			2.1	0.7	0.1	(0.2)	2.7
Other comprehensive income			(2.6)	(1.8)		0.5	(3.9)
Purchases ⁽³⁾		6.5	55.1	37.2	6.5	16.7	122.0
Sales		(0.2)				(3.0)	(3.2)
Issuances							
Settlements			(3.7)	(1.8)			(5.5)
Transfers into Level 3							
Transfers out of Level 3							
Balance June 30, 2012	\$	\$ 6.3	\$ 50.9	\$ 34.3	\$ 6.6	\$ 37.6	\$ 135.7

(1) Includes partnership investments accounted for on an AFS basis.

(2) There were no OTTI losses recorded in net earnings related to level 3 instruments still held as of June 30, 2012.

(3) Principally consists of Level 3 assets acquired as part of the merger.

Net unrealized losses related to Level 3 investments as of June 30, 2012 and December 31, 2011 were not material.

See Note 1(c) for Alleghany's accounting policy on fair value.

Table of Contents**4. Investments****(a) Unrealized Gains and Losses**

The amortized cost or cost and the fair value of AFS securities as of June 30, 2012 and December 31, 2011 are summarized as follows (in millions):

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of June 30, 2012				
Equity securities:				
Common stock*	\$ 1,046.3	\$ 71.2	\$ (70.4)	\$ 1,047.1
Preferred stock				
Total equity securities	1,046.3	71.2	(70.4)	1,047.1
Debt securities:				
U.S. Government obligations	519.7	8.9		528.6
Municipal bonds	6,486.6	120.3	(4.6)	6,602.3
Foreign government obligations	814.0	10.2		824.2
U.S. corporate bonds	3,020.2	24.9	(4.2)	3,040.9
Foreign corporate bonds	1,927.4	21.3	(3.8)	1,944.9
Mortgage and asset-backed securities:				
RMBS	1,943.3	42.6	(7.2)	1,978.7
CMBS	416.5	13.9	(2.6)	427.8
Other asset-backed securities	244.5	4.9		249.4
Total debt securities	15,372.2	247.0	(22.4)	15,596.8
Short-term investments	1,023.1			1,023.1
Total	\$ 17,441.6	\$ 318.2	\$ (92.8)	\$ 17,667.0

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of December 31, 2011				
Equity securities:				
Common stock*	\$ 775.8	\$ 121.4	\$ (26.2)	\$ 871.0
Preferred stock				
Total equity securities	775.8	121.4	(26.2)	871.0
Debt securities:				
U.S. Government obligations	260.6	7.2		267.8
Municipal bonds	1,038.2	75.7	(0.3)	1,113.6
Foreign government obligations				
U.S. corporate bonds	341.8	14.4	(2.1)	354.1
Foreign corporate bonds	81.8	2.2	(0.5)	83.5
Mortgage and asset-backed securities:				
RMBS	467.7	31.0	(1.4)	497.3
CMBS	133.5	13.0	(1.8)	144.7
Other asset-backed securities	215.3	3.3	(0.1)	218.5
Total debt securities	2,538.9	146.8	(6.2)	2,679.5

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Short-term investments	1,096.5	1,096.5
Total	\$ 4,411.2	\$ 268.2
		\$ (32.4)
		\$ 4,647.0

* Of the \$1,047.1 million and \$871.0 million of fair value as of June 30, 2012 and December 31, 2011, respectively, \$461.8 million and \$573.3 million, respectively, related to certain energy sector businesses.

Table of Contents**(b) Contractual Maturity**

The amortized cost and estimated fair value of debt securities as of June 30, 2012 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 or Cost	Fair Value
Short-term investments due in one year or less	\$ 1,023.1	\$ 1,023.1
Mortgage and asset-backed securities*	2,604.3	2,655.9
Debt securities with maturity dates:		
One year or less	463.6	464.7
Over one through five years	4,806.2	4,835.0
Over five through ten years	3,650.1	3,735.3
Over ten years	3,848.0	3,905.9
Total debt securities	15,372.2	15,596.8
Equity securities	1,046.3	1,047.1
Total	\$ 17,441.6	\$ 17,667.0

* Mortgage and asset-backed securities by their nature do not generally have single maturity dates.

(c) Net Investment Income

Net investment income for the three and six months ended June 30, 2012 and 2011 was as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Interest income	\$ 88.9	\$ 25.5	\$ 130.0	\$ 51.0
Dividend income	4.3	10.5	6.2	20.3
Investment expenses	(5.0)	(1.4)	(7.8)	(3.2)
Equity income (losses) of Homesite	(2.2)	(6.6)	12.4	(7.1)
Equity (losses) of ORX	(1.5)	(1.2)	(3.3)	(2.2)
Other investment income	6.4	1.8	6.6	1.4
Total	\$ 90.9	\$ 28.6	\$ 144.1	\$ 60.2

As of June 30, 2012, non-income producing invested assets were insignificant.

(d) Realized Gains and Losses

The proceeds from sales of AFS securities were \$0.7 billion and \$0.4 billion for the three months ended June 30, 2012 and 2011, respectively, and \$1.3 billion and \$0.5 billion in the six months ended June 30, 2012 and 2011, respectively.

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Realized capital gains and losses in the six months ended June 30, 2012 and 2011 arose primarily from the sales of equity securities and include \$63.1 million of capital gains from the sales of shares of common stock of Exxon Mobil Corporation in January 2012. The amount of gross realized capital gains and gross realized capital losses of AFS securities (primarily equity securities) for the three and six months ended June 30, 2012 and 2011 were as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Gross realized gains	\$ 41.0	\$ 7.6	\$ 113.9	\$ 48.5
Gross realized losses	(1.6)	(1.1)	(6.4)	(7.3)
Net realized gains	\$ 39.4	\$ 6.5	\$ 107.5	\$ 41.2

Gross realized loss amounts exclude OTTI losses, as discussed below.

(e) OTTI losses

Alleghany holds its equity and debt securities as AFS, and as such, these securities are recorded at fair value. Alleghany continually monitors the difference between cost and the estimated fair value of its investments, which involves uncertainty as to

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whether declines in value are temporary in nature. The analysis of any individual security's decline in value is performed in its functional currency. If the decline of a particular investment is deemed temporary, Alleghany records the decline as an unrealized loss in stockholders equity. If the decline is deemed to be other than temporary, Alleghany writes its cost- or amortized cost-basis down to the fair value of the investment and records an OTTI loss on its statement of earnings, regardless of whether Alleghany continues to hold the security. In addition, any portion of such decline that relates to debt securities that is believed to arise from factors other than credit is recorded as a component of other comprehensive income, rather than charged against earnings.

Management's assessment of equity securities initially involves an evaluation of all securities that are in an unrealized loss position, regardless of the duration or severity of the loss, as of the applicable balance sheet date. Such initial review consists primarily of assessing whether:

- (i) there has been a negative credit or news event with respect to the issuer that could indicate the existence of an OTTI; and
- (ii) Alleghany has the ability and intent to hold an equity security for a period of time sufficient to allow for an anticipated recovery (generally considered to be less than one year from the balance sheet date).

To the extent that an equity security in an unrealized loss position is not impaired based on the initial review described above, Alleghany then further evaluates such equity security and deems it to be other-than-temporarily impaired if it has been in an unrealized loss position for twelve months or more or if its unrealized loss position is greater than 50 percent of its cost, absent compelling evidence to the contrary.

Alleghany then evaluates those equity securities where the unrealized loss is 20 percent or more of cost as of the balance sheet date or which have been in an unrealized loss position continuously for six months or more preceding the balance sheet date. This evaluation takes into account quantitative and qualitative factors in determining whether such securities are other-than-temporarily impaired including:

- (i) market valuation metrics associated with the equity security (*e.g.*, dividend yield and price-to-earnings ratio);
- (ii) current views on the equity security, as expressed by either Alleghany's internal stock analysts and/or by third party stock analysts or rating agencies; and
- (iii) discrete credit or news events associated with a specific company, such as negative news releases and rating agency downgrades with respect to the issuer of the investment.

Debt securities in an unrealized loss position are evaluated for OTTI if they meet any of the following criteria:

- (i) they are trading at a 20 percent discount to amortized cost for an extended period of time (nine consecutive months or longer);
- (ii) there has been a negative credit or news event with respect to the issuer that could indicate the existence of an OTTI;
- (iii) Alleghany intends to sell or it is more likely than not that Alleghany will sell the debt security before recovery of its amortized cost basis; and
- (iv) Alleghany may not realize a full recovery on its investment, regardless of the occurrence of one or more of the foregoing events.

If Alleghany intends to sell, or it is more likely than not that Alleghany will sell, a debt security before recovery of its amortized cost basis, the total amount of the unrealized loss position is recognized as an OTTI loss in earnings. To the extent that a debt security that is in an unrealized

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loss position is not impaired based on the preceding, Alleghany will consider a debt security to be impaired when it believes it to be probable that Alleghany will not be able to collect the entire amortized cost basis. For debt securities in an unrealized loss position as of the end of each quarter, Alleghany develops a best estimate of the present value of expected cash flows on a security by security basis. If the results of the cash flow analysis indicate Alleghany will not recover the full amount of its amortized cost basis in the investment, Alleghany records an OTTI loss in earnings equal to the difference between the present value of expected cash flows and the amortized cost basis of the security. If applicable, the difference between the total unrealized loss position on the security and the OTTI loss recognized in earnings is the non-credit related portion and is recorded as a component of other comprehensive income.

In developing the cash flow analyses for debt securities, Alleghany considers various factors for the different categories of debt securities. For municipal bonds, Alleghany takes into account the taxing power of the issuer, source of revenue, credit risk and credit enhancements and pre-refunding. For mortgage and asset-backed securities, Alleghany discounts its best estimate of future cash flows at an effective rate equal to the original effective yield of the security or, in the case of floating rate securities, at the current coupon. Alleghany's models include assumptions about prepayment speeds, default and delinquency rates, and underlying collateral (if any), as well as credit ratings, credit enhancements and other observable market data. For corporate bonds, Alleghany reviews business prospects, credit ratings and available information from asset managers and rating agencies for individual securities.

OTTI losses for the six months ended June 30, 2012 reflect \$2.9 million of unrealized losses that were deemed to be other than temporary and, as such, were required to be charged against earnings, compared with no OTTI losses in the six months ended June 30, 2011. Upon the ultimate disposition of securities for which OTTI losses have been recorded, a portion of the loss may be recoverable

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depending on market conditions at the time of disposition. Of the \$2.9 million, \$1.7 million is related to equity securities (primarily in the energy sector), and \$1.2 million is related to debt securities. Of the \$2.9 million of impairment losses, \$1.1 million was incurred in the second quarter of 2012. The determination that unrealized losses on such securities were other than temporary was primarily based on the duration of the decline in fair value of such security relative to their cost as of the balance sheet date.

After adjusting the cost basis of securities for the recognition of OTTI losses, the remaining gross unrealized investment losses for debt and equity securities as of June 30, 2012 were deemed to be temporary, based on, among other things:

- (i) the duration of time and the relative magnitude to which fair values of these investments has been below cost was not indicative of an OTTI loss (for example, no equity security was in a continuous unrealized loss position for twelve months or more as of June 30, 2012);
- (ii) the absence of compelling evidence that would cause Alleghany to call into question the financial condition or near-term prospects of the issuer of the investment; and

(iii) Alleghany's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. Alleghany may ultimately record a realized loss after having originally concluded that the decline in value was temporary. Risks and uncertainties are inherent in the methodology Alleghany uses to assess other-than-temporary declines in value. Risks and uncertainties could include, but are not limited to, incorrect assumptions about financial condition, liquidity or future prospects, inadequacy of any underlying collateral, and unfavorable changes in economic conditions or social trends, interest rates or credit ratings.

(f) Aging of Gross Unrealized Losses

As of June 30, 2012 and December 31, 2011, gross unrealized investment losses and related fair values for debt securities and equity securities, grouped by length of time in a continuous unrealized loss position, were as follows (in millions):

	Fair Value	Less Than 12 Months Gross Unrealized Losses	Fair Value	12 Months or More Gross Unrealized Losses	Fair Value	Total Gross Unrealized Losses
As of June 30, 2012						
Debt securities:						
U.S. Government obligations	\$ 15.4	\$	\$	\$	\$ 15.4	\$
Municipal bonds	1,759.5	4.4	5.5	0.2	1,765.0	4.6
Foreign government obligations	34.3				34.3	
U.S. corporate bonds	1,463.4	4.1	6.6	0.1	1,470.0	4.2
Foreign corporate bonds	452.4	3.8			452.4	3.8
Mortgage and asset-backed securities:						
RMBS	110.1	7.0	3.3	0.2	113.4	7.2
CMBS	71.1	1.1	8.5	1.5	79.6	2.6
Other asset-backed securities	29.7		0.4		30.1	
Total debt securities	3,935.9	20.4	24.3	2.0	3,960.2	22.4
Equity securities:						
Common stock	494.2	70.4			494.2	70.4
Preferred stock						