ALLEGHANY CORP /DE
Form 10-Q
May 05, 2011

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

(MARK ONE)

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

FOR QUARTERLY PERIOD ENDED MARCH 31, 2011

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

FROM __________ TO __________

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

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

YES þ NO o

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

YES þ NO o

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

LARGE ACCELERATED	ACCELERATED FILER o	NON-ACCELERATED FILER o	SMALLER REPORTING

FILER þ	(DO NOT CHECK IF A SMALLER REPORTING COMPANY)	COMPANY o

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12b-2 OF THE EXCHANGE ACT).

YES o	NO þ

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

8,928,825 SHARES AS OF APRIL 29, 2011

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Part I. FINANCIAL INFORMATION
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ALLEGHANY CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets

	March 31, 2011	December 31, 2010
	(in thousands, except share amounts)	
	(unaudited)	
Assets		
Investments		
Available-for-sale securities at fair value:		
Equity securities (cost: 2011 $1,284,686; 2010 $1,310,009)	**$ 1,598,682**	$ 1,500,686
Debt securities (amortized cost: 2011 $2,783,146; 2010 $2,778,117)	**2,831,302**	2,832,411
Short-term investments	**246,072**	264,811
	4,676,056	4,597,908
Other invested assets	**204,634**	207,294
Total investments	**4,880,690**	4,805,202
Cash	**64,881**	76,741
Premium balances receivable	**144,251**	128,075
Reinsurance recoverables	**867,777**	873,295
Ceded unearned premium reserves	**137,684**	144,065
Deferred acquisition costs	**65,814**	67,692
Property and equipment at cost, net of accumulated depreciation and amortization	**20,189**	19,504
Goodwill and other intangibles, net of amortization	**141,474**	142,312
Net deferred tax assets	**17,714**	77,147
Other assets	**189,525**	97,666
	$ 6,529,999	$ 6,431,699
Liabilities and Stockholders Equity		
Loss and loss adjustment expenses	**$ 2,290,226**	$ 2,328,742
Unearned premiums	**503,105**	523,927
Senior Notes	**298,952**	298,923
Reinsurance payable	**44,353**	41,500
Current taxes payable	**2,557**	3,220
Other liabilities	**338,824**	326,519
Total liabilities	**3,478,017**	3,522,831
Common stock	**9,118**	9,118
(shares authorized: 2011 and 2010 22,000,000; issued and outstanding 2011		

9,300,143; 2010 9,300,448)		
Contributed capital	**928,251**	928,816
Accumulated other comprehensive income	**241,866**	170,262
Treasury stock, at cost (2011 364,793 shares; 2010 351,532 shares)	**(103,926)**	(99,686)
Retained earnings	**1,976,673**	1,900,358
Total stockholders equity	**3,051,982**	2,908,868
	$ 6,529,999	$ 6,431,699

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Earnings and Comprehensive Income

(unaudited)

	Three Months Ended March 31,	
	2011	2010
	(in thousands, except per share amounts)	
Revenues		
Net premiums earned	**$ 180,980**	$ 194,700
Net investment income	**31,579**	31,429
Net realized capital gains	**34,692**	26,467
Other than temporary impairment losses		(1,077)
Other income	**885**	133
Total revenues	**248,136**	251,652
Costs and expenses		
Loss and loss adjustment expenses	**71,022**	96,627
Commissions, brokerage and other underwriting expenses	**66,528**	66,356
Other operating expenses	**10,246**	8,851
Corporate administration	**6,379**	5,234
Interest expense	**4,452**	219
Total costs and expenses	**158,627**	177,287
Earnings before income taxes	**89,509**	74,365
Income taxes	**18,169**	16,196
Net earnings	**$ 71,340**	$ 58,169
Other comprehensive income		
Change in unrealized gains (losses), net of deferred taxes	**$ 99,262**	$ 29,818
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes	**(22,550)**	(16,504)
Other	**(129)**	49
Comprehensive income	**$ 147,923**	$ 71,532
Basic earnings per share*	**$ 7.99**	$ 6.31
Diluted earnings per share*	**$ 7.97**	$ 6.25

* Amounts reflect subsequent common stock dividends.

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2011	2010
	(in thousands)	
Cash flows from operating activities		
Net earnings	**$ 71,340**	$ 58,169
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	**6,775**	10,587
Net realized capital (gains) losses	**(34,692)**	(26,467)
Other than temporary impairment losses		1,077
(Increase) decrease in other assets	**(73,953)**	(2,705)
(Increase) decrease in reinsurance receivable, net of reinsurance payable	**8,371**	7,644
(Increase) decrease in premium balances receivable	**(16,176)**	(6,303)
(Increase) decrease in ceded unearned premium reserves	**6,381**	8,511
(Increase) decrease in deferred acquisition costs	**1,878**	3,130
Increase (decrease) in other liabilities and current taxes	**(14,126)**	(21,744)
Increase (decrease) in unearned premiums	**(20,822)**	(33,097)
Increase (decrease) in loss and loss adjustment expenses	**(38,516)**	(41,653)
Net adjustments	**(174,880)**	(101,020)
Net cash (used in) provided by operating activities	**(103,540)**	(42,851)
Cash flows from investing activities		
Purchase of investments	**(399,118)**	(480,229)
Sales of investments	**421,330**	440,116
Maturities of investments	**58,647**	59,564
Purchases of property and equipment	**(2,584)**	(1,389)
Net change in short-term investments	**18,753**	58,208
Other, net	**652**	(2,828)
Net cash (used in) provided by investing activities	**97,680**	73,442
Cash flows from financing activities		
Treasury stock acquisitions	**(6,402)**	(7,517)
Other, net	**402**	175
Net cash (used in) provided by financing activities	**(6,000)**	(7,342)
Net cash increase (decrease) in cash	**(11,860)**	23,249
Cash at beginning of period	**76,741**	32,526
Cash at end of period	**$ 64,881**	$ 55,775

Supplemental disclosures of cash flow information				
Cash paid during the period for:				
Interest	**$**	**8,203**	$	
Income taxes paid (refunds received)	**$**	**260**	$	2,453

See accompanying Notes to Unaudited Consolidated Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

1. Principles of Financial Statement Presentation

This report should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2010 (the 2010 10-K) of Alleghany Corporation (Alleghany).

Alleghany, a Delaware corporation, which together with its subsidiaries is referred to as Alleghany unless the context otherwise requires, is engaged in the property and casualty and surety insurance business through its wholly-owned subsidiary Alleghany Insurance Holdings LLC (AIHL). AIHL s insurance business is conducted through its wholly-owned subsidiaries RSUI Group, Inc. (RSUI), Capitol Transamerica Corporation and Platte River Insurance Company (collectively CATA), and Pacific Compensation Corporation (PCC). AIHL Re LLC (AIHL Re), a captive reinsurance subsidiary of AIHL, has in the past provided reinsurance to Alleghany operating units and affiliates. Alleghany s equity investments, including those held by AIHL s insurance operating units, are managed primarily by Alleghany Capital Partners LLC, an indirect, wholly-owned subsidiary of Alleghany. Alleghany also owns and manages properties in the Sacramento, California region through its subsidiary Alleghany Properties Holdings LLC (Alleghany Properties). In addition, Alleghany owns approximately 33 percent of the outstanding shares of common stock of Homesite Group Incorporated (Homesite), a national, full-service, mono-line provider of homeowners insurance, and approximately 38 percent of ORX Exploration, Inc. (ORX), a regional oil and gas exploration and production company. Alleghany also makes strategic investments in operating companies and conducts other activities at the parent level.

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

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

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

Certain prior year amounts have been reclassified to conform to the 2011 presentation.

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2. Recent Accounting Standards

Recently Adopted

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

Future Application of Accounting Standards

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

3. Earnings Per Share of Common Stock

The following is a reconciliation of the income and share data used in the basic and diluted earnings per share computations for the three months ended March 31, 2011 and 2010 (in millions, except share amounts):

	2011	2010
Net earnings	$ 71.3	$ 58.2
Effect of dilutive securities	(0.1)	(0.5)
Income available to common stockholders for diluted earnings per share	$ 71.2	$ 57.7
Weighted average shares outstanding applicable to basic earnings per share	8,928,807	9,213,252
Effect of dilutive securities	7,161	10,427
Adjusted weighted average shares outstanding applicable to diluted earnings per share	8,935,968	9,223,679

Contingently issuable shares of 45,579 and 40,398 were potentially available during the 2011 and 2010 first quarters, respectively, but were not included in the computations of diluted earnings per share because the impact was anti-dilutive to the earnings per share calculation.

Earnings per share by quarter may not equal the amount for the full year due to the timing of treasury stock purchases and rounding.

4. Commitments and Contingencies

(a) Leases

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

(b) Litigation

Alleghany s subsidiaries are parties to pending litigation and claims in connection with the ordinary course of their businesses. Each such subsidiary makes provisions for estimated losses to be incurred in such litigation and claims, including legal costs. In the opinion of management, such provisions were adequate as of March 31, 2011.

(c) Asbestos and Environmental Impairment Exposure

AIHL s reserves for unpaid loss and loss adjustment expenses include $14.0 million of gross reserves and $13.9 million of net reserves as of March 31, 2011, and $14.1 million of gross reserves and $14.0 million of net reserves as of December 31, 2010, for asbestos and environmental impairment claims that arose from reinsurance assumed by a subsidiary of CATA between 1969 and 1976. This subsidiary exited such business in 1976. Additional information concerning CATA s asbestos and environmental exposure can be found in Note 13 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2010 10-K.

(d) Indemnification Obligations

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

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

Under the terms of the Stock Purchase Agreement, Alleghany will provide indemnification at a rate of 100 percent for the first $100.0 million of losses arising from products liability claims relating to the Manville Period and at a rate of 50 percent for the next $100.0 million of such losses, so that Alleghany s maximum indemnification obligation in respect of products liability claims relating to the Manville Period is $150.0 million. This indemnification obligation in respect of Manville Period products liability claims will expire on July 31, 2016. The Stock Purchase Agreement states that it is the intention of the parties that, with regard to losses incurred in respect of products liability claims relating to the Manville Period, recovery should first be sought from Manville, and that Alleghany s indemnification obligation in respect of products liability claims relating to the Manville Period is intended to indemnify the Purchaser for such losses which are not recovered from Manville within a reasonable period of time after recovery is sought from Manville. In connection with World Minerals acquisition of the assets of the industrial minerals business of Manville in 1991, Manville agreed to indemnify World Minerals for certain products liability claims, in respect of products of the industrial minerals business manufactured during the Manville Period, asserted against World Minerals through July 31, 2006. In June 2006, Manville agreed to extend its indemnification for such claims asserted against World Minerals through July 31, 2009. Notwithstanding the expiration of the Manville indemnity on July 31, 2009, World Minerals did not, as part of its 1991 acquisition of the assets of Manville s industrial minerals business assets, assume liability for product liability claims to the extent that such claims relate, in whole or in part, to the Manville Period, and Manville should continue to be responsible for such claims. The Stock Purchase Agreement provides that Alleghany has no responsibility for products liability claims arising in respect of events occurring after the closing, and that any products liability claims involving both pre-closing and post-closing periods will be apportioned on an equitable basis.

With respect to the Contract Indemnification, substantially all of the representations and warranties to which the Contract Indemnification applies survived until July 14, 2007, with the exception of certain representations and warranties such as those related to environmental, real estate and tax matters, which survive for longer periods and generally, except for tax and certain other matters, apply only to aggregate losses in excess of $2.5 million, up to a maximum of approximately $123.0 million.

Additional information concerning the Products Liability Indemnification and Contract Indemnification can be found in Note 13 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2010 10-K.

Based on Alleghany s historical experience and other analyses, in July 2005, Alleghany established a $0.6 million reserve in connection with the Products Liability Indemnification for the Alleghany Period. Such reserve was approximately $0.2 million at both March 31, 2011 and December 31, 2010.

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(e) Equity Holdings Concentration

As of March 31, 2011 and December 31, 2010, Alleghany had a concentration of market risk in its available-for-sale equity securities portfolio with respect to certain energy sector businesses of $1,084.0 million and $1,004.8 million, respectively. Of the $1,084.0 million, $673.0 million represents Alleghany s ownership of common stock of Exxon Mobil Corporation.

5. Segments of Business

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

Alleghany s reportable segment is reported in a manner consistent with the way management evaluates the businesses. As such, insurance underwriting activities are evaluated separately from investment activities. Net realized capital gains and other-than-temporary impairment losses are not considered relevant in evaluating investment performance on an annual basis. Segment accounting policies are described in Note 1 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2010 10-K.

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

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
	(in millions)	
Revenues:		
AIHL insurance group:		
Net premiums earned		
RSUI	$ 141.6	$ 150.3
CATA	39.3	40.6
PCC	0.1	3.8
	181.0	194.7
Net investment income	30.2	33.4
Net realized capital gains	34.7	22.7
Other than temporary impairment losses (1)		(1.1)
Other income	0.1	0.1
Total insurance group	246.0	249.8
Corporate activities:		
Net investment income (2)	1.4	(1.9)
Net realized capital gains		3.8
Other than temporary impairment losses		
Other income	0.7	
Total	$ 248.1	$ 251.7
Earnings before income taxes:		
AIHL insurance group:		
Underwriting profit (loss) (3)		
RSUI	$ 49.0	$ 36.8
CATA	0.7	0.3
PCC	(6.3)	(5.4)
	43.4	31.7
Net investment income	30.2	33.4
Net realized capital gains	34.7	22.7
Other than temporary impairment losses (1)		(1.1)
Other income, less other expenses	(9.7)	(8.4)
Total insurance group	98.6	78.3
Corporate activities:		
Net investment income (2)	1.4	(1.9)

Net realized capital gains		3.8
Other than temporary impairment losses		
Other income	0.7	
Corporate administration and other expenses	6.8	5.7
Interest expense	4.4	0.1
Total	$ 89.5	$ 74.4

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

(2) Includes $0.5 million and $1.8 million of Alleghany s equity in losses of Homesite for the three months ended March 31, 2011 and 2010, respectively, and $1.0 million and $2.4 million of Alleghany s equity in losses of ORX for the three months ended March 31, 2011 and 2010, respectively.

(3) Represents net premiums earned less loss and loss adjustment expenses and commission, brokerage and other underwriting expenses, all as determined in accordance with GAAP, and does not include net investment income, net realized capital gains, other-than-temporary impairment losses, other income or other expenses. Commission, brokerage and other underwriting expenses represent commission and brokerage expenses and that portion of salaries, administration and other operating expenses attributable primarily to underwriting activities, whereas the remainder constitutes other expenses.

6. Reinsurance

As discussed in the 2010 10-K, RSUI reinsures its property lines of business through a program consisting of surplus share treaties, facultative placements, per risk and catastrophe excess of loss treaties. RSUI s catastrophe reinsurance program (which covers catastrophe risks including, among others, windstorms and earthquakes) and per risk reinsurance program run on an annual basis from May 1 to the following April 30 and thus expired on April 30, 2011. RSUI placed all of its catastrophe reinsurance program for the 2011-2012 period, and the new program is similar to the expired program. The new reinsurance program provides coverage in two layers for $400.0 million of losses in excess of a $100.0 million net retention after application of the surplus share treaties, facultative reinsurance and per risk covers. The first layer provides coverage for $100.0 million of losses, before a 47.0 percent co-participation by RSUI (compared with a 33.0 percent co-participation under the expired program), in excess of the $100.0 million net retention, and the second layer provides coverage for $300.0 million of losses, before a 5 percent co-participation by RSUI, in excess of $200.0 million. In addition, RSUI s property per risk reinsurance program for the 2011-2012 period provides RSUI with coverage for $90.0 million of losses, before a 10.0 percent co-participation by RSUI, in excess of a $10.0 million net retention per risk after application of the surplus share treaties and facultative reinsurance. As discussed in Note 5(a) to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2010 10-K, RSUI reinsures its other lines of business through quota share treaties, except for professional liability and binding authority lines where RSUI retains all of such business.

7. Investments

(a) Fair Value

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

	March 31, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Investments (excluding equity method investments)*	$4,702.2	$4,702.2	$4,622.7	$4,622.7
Liabilities				
Senior Notes**	$ 299.0	$ 302.4	$ 298.9	$ 291.8

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

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

GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are not adjusted for transaction costs. In addition, GAAP has a three-tiered hierarchy for inputs used in management s determination of fair value of financial instruments that emphasizes the use of observable inputs over the use of unobservable inputs by requiring that the observable inputs be used when available. Observable inputs are market participant assumptions based on market data obtained from sources independent of the reporting entity. Unobservable inputs are the reporting entity s own assumptions about market participant assumptions based on the best information available under the circumstances. In assessing the appropriateness of using observable inputs in making its fair value determinations, Alleghany considers whether the market for a particular security is active or not based on all the relevant facts and circumstances. For example, Alleghany may consider a market to be inactive if there are relatively few recent transactions or if there is a significant decrease in market volume. Furthermore, Alleghany considers whether observable transactions are orderly or not. Alleghany does not consider a transaction to be orderly if there is evidence of a forced liquidation or other distressed condition, and as such, little or no weight is given to that transaction as an indicator of fair value.

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

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

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

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

Alleghany validates the reasonableness of its fair value determinations for Level 2 securities by testing the methodology of the relevant third-party dealer or pricing service that provides the quotes upon which the fair value determinations are made. Alleghany tests the methodology by comparing such quotes with prices from executed market trades when such trades occur. Alleghany discusses with the relevant third-party dealer or pricing service any identified material discrepancy between the quote derived from its methodology and the executed market trade in order to resolve the discrepancy. Alleghany uses the quote from the third-party dealer or pricing service unless Alleghany determines that the methodology used to produce such quote is not in compliance with GAAP. In addition to such procedures, Alleghany also compares the aggregate amount of the fair value for such Level 2 securities with the aggregate fair value provided by a third-party financial institution. Furthermore, Alleghany reviews the reasonableness of its classification of securities within the three-tiered hierarchy to ensure that the classification is consistent with GAAP.

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

	Level 1	Level 2	Level 3	Total
As of March 31, 2011				
Equity securities:				
Common stock(1)	$ 1,598.7	$	$	$ 1,598.7
Preferred stock				
Debt securities:				
U.S. Government obligations	275.9	30.5		306.4
Mortgage and asset-backed securities(2)		952.0		952.0
States, municipalities and political subdivision bonds		1,033.0		1,033.0
Foreign bonds		117.7		117.7
Corporate bonds and other		422.2		422.2
	275.9	2,555.4		2,831.3
Short-term investments	146.8	99.3		