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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Validus Holdings, Ltd. First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded.

I would like to introduce your host for today's conference, Vice President, Investor Relations, Miranda Hunter. Ma'am, please go ahead.

Miranda Hunter - *Validus Holdings, Ltd. - VP, Head of Investor Relations*

Thanks, Michelle. Good morning, and welcome to the Validus Holdings Conference Call for the Quarter Ended March 31, 2017. After the market close yesterday, we issued an earnings press release and financial supplement, which are available on our website located at validusholdings.com. Today's call is being simultaneously webcast and will be available for replay until May 11. Details are provided on our website.

Leading today's call are Ed Noonan, Validus' Chairman and CEO; and Jeff Sangster, Validus' Chief Financial Officer.

Before we begin, I'd like to remind you certain comments made during this call may be deemed forward-looking statements as defined within U.S. federal securities laws. These statements address matters that involve risks and uncertainties, many of which are beyond the company's control. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements, and therefore, you should not place undue reliance on any such statements. More details about these risks and uncertainties can be found in the company's most recent annual report on Form 10-K and quarterly report on Form 10-Q, both as filed with the U.S. Securities and Exchange Commission.

Management will also refer to certain non-GAAP financial measures when describing the company's performance. These items are reconciled and explained in our earnings release and financial supplements.

And with that, I turn the call over to Ed Noonan.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Well, thank you, Miranda. Good morning, and thanks for taking the time to join us today. This was another good quarter for Validus Group. We had $94.6 million in net income and an annualized return on average equity of 10.2% in the quarter. Our combined ratio of 83.2% reflected our continued commitment to underwriting profits, and most importantly, we grew our book value per diluted share, including dividends, by 2.9% during the quarter.

The big news for Validus in the quarter is our acquisition of Crop Risk Services. Integration is progressing well, and we'll formally close on this transaction shortly.

This morning, Jeff Sangster will review our financial results in more detail, and then I'll provide more color on our operations. After which, we'll be happy to take any questions you may have. Jeff?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Thanks, Ed. And, thank you all for joining the call today. Picking up on Ed's comments regarding the closing of CRS, I'd like to draw your attention to the historical CRS information that we included in the supplement this quarter. We included both gross and net results. However, given we don't plan to purchase external quota share coverage from 2018 onward, we view the gross results as the most useful information.

Turning to the quarter's financial results. The first quarter produced a good financial result for Validus in a very challenging trading environment. We saw quarter with an elevated level of frequency for midsized losses and weather-related events. Despite that frequency, our combined ratio for the quarter was 83.2%.

Net income available to Validus common shareholders was $95 million and $1.17 per diluted common share. Net operating income available to Validus common shareholders was $77 million or $0.95 per diluted common share. Annualized return on average equity for the quarter was 10.2%, and annualized net operating return on average equity was 8.3%.

Our book value per diluted common share was $45.88 at March 31, an increase of 2.9% from December 31st inclusive of dividends due in part to the ongoing excellent performance on short-duration investment portfolio.

Speaking in more detail to the quarter's results. Total gross premiums written were $1.2 billion for the quarter, an increase of $18 million or 1.5% from Q1 2016. The increase in premiums was driven by the Western world segment, offset by a decrease in premiums in the Validus Re and Talbot segments.

Validus Re's gross premiums written were down $71 million compared to the same period last year, which was mainly due to a decrease in the ag premiums of $76 million. $62 million of the decrease in ag premiums was related to recent M&A activity in the sector, including our announced acquisition of CRS in the quarter. The decrease of Validus Re was more than offset by an increase in ag premiums of $84 million recorded in the Western World segment as a result of new business written by CRS under a quota share arrangement with Validus Re Switzerland. The results of that quota share have been presented within the Western World segment in anticipation of these premiums being written by Western World upon closing of the transaction in the second quarter. In keeping with our practice on the existing quota share ag business, the CRS business has been booked at a 100% combined ratio this quarter.

Validus Re also wrote $9 million on the NFIP's reinsurance program in the quarter, though ceded $6 million of the premium to retrocession partners. Beyond the NFIP program, Validus Re increased premiums ceded as we continue to prudently protect our book with a robust retro program in a challenging market.

Excluding ag, gross premiums written in the Western World segment increased by $24 million over the prior year's quarter. The increase was driven primarily by $13 million increase in the property lines and $11 million increase in the liability lines as we continue to build out our offerings in short-tail property lines and see benefits from the Validus Specialty Underwriters platform.

Talbot segment gross premiums written decreased by $19 million over the prior year's quarter to $247 million from $266 million. After normalizing for upward adjustments in the prior year, Talbot's premium decreased modestly, driven by a reduction in participation in non-renewals of business across a number of classes due to the current rate environment.

Shifting to the discussion of losses. Our quarterly combined ratio was 83.2%, including a loss ratio of 46.9%. We did not incur any notable loss events and had one non-notable loss event during the quarter of $20 million incurred from an energy risk. While there was only one non-notable loss, we saw a higher level of midsize losses at Talbot, including $13 million of losses on the January gasoline price riots in Mexico.

At Western World, we incurred $8 million of net losses in the property lines from 13 U.S. weather-related events, with the most significant being storms in Mississippi, California and Pennsylvania. Net favorable development from prior years was $61 million equal to 10.6 loss ratio points. Our favorable development is primarily from non-event reserves in the amount of $51 million. The overall accident year loss ratio, excluding the non-notable loss event and changes in prior accident years for the quarter, was 54.1% compared to 48.7% in Q1 2016.

Beyond underwriting results, I'll comment on the AlphaCat contribution earnings, the quarterly investment results and our capital position. AlphaCat had total assets under management of $2.9 billion at April 1st, $2.7 billion of which is managed for third parties. In the quarter, AlphaCat earned management fees of $5 million, offset by expenses incurred by AlphaCat Managers of $4 million. Including investment income from the AlphaCat sidecars and ILS funds of $5 million, AlphaCat contributed $6 million of income in the quarter, net of noncontrolling interest.

Our consolidated investment portfolio, including cash and cash equivalents and restricted cash, was $9.4 billion as at March 31, 2017. Of this, our managed portfolio was $6.6 billion, and the non-managed portfolio was $2.8 billion. Excluding the non-managed investment component, managed net investment income of $36 million contributed to quarterly annualized effective yield of 2.27%, an increase of 48 basis points from Q1 2016 annualized effective yield of 1.79% and an increase of 2 basis points from the Q4 2016 annualized effective yield of 2.25%. The increase from prior year's quarter was primarily driven by returns on company's portfolio of structured securities of which $4 million was generated from a single fixed income fund during the quarter compared to a loss of $2 million in the same funds in the prior year quarter. Net of our non-managed portfolio, we recorded $3 million in realized investment losses and $14 million in unrealized investment gains in the quarter.

Total shareholders' equity available to Validus at March 31 was $3.9 billion, and total capitalization available to Validus at March 31 was $4.7 billion. Our 1 in 100 U.S. wind storm PML is 15.3% of total capital, excluding noncontrolling interest, which is marginally lower than a year ago.

Our historically conservative view on share repurchases in the first half of the year is further supported this year given our current stock price valuation and over $100 million of capital deployed in the CRS transaction. As a result, we did not repurchase any shares during the first quarter. And as of the market close on April 26th, we had not repurchased any shares in the second quarter either, leaving $320 million remaining on our existing share repurchase authorization.

As our actual results developed during the year, we plan to continue to be an active manager of capital as evidenced by the increase in our quarterly dividend announced in February of $0.03 per share or 8.6%.

With that, I'll turn the call back to Ed.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Well, thank you, Jeff. Let me start with Talbot Underwriters. Talbot's gross written premiums were down $19 million in the quarter. Market conditions in London continue to be the most competitive in the world. However, while too much capacity and broker facilities are fueling market deteriorations, we are beginning to see the first faint glimmers of sanity beginning to emerge. Rates were off 4.9% across our entire portfolio in the quarter. The worst performers were marine hull and yachts and the continuing excessive competition across the energy market. Aside from these classes, we saw a more modest rate decrease across the portfolio and a number of loss-affected classes were flat to up 2%. The market has a lot of ground to retrace, and this may only be a temporary slowing, but it's the first positive sign in London for quite a while.

We had 2 meaningful losses in the quarter that affected Talbot's loss ratio. The first was rioting across Mexico related to increases in gas prices. This event is covered under the Riots, Strike and Civil Commotion coverage provided -- pardon me, the Riots, Strike and Civil Commotion coverage purchased as part of some terrorism policies. The second event was a reported energy loss in the Middle East.

Talbot had an elevated G&A ratio in the quarter, which adversely affected the expense ratio. The first quarter typically runs higher than the rest of the year, but this is also a function of the declining premium base as we exit underpriced business. Our dollar expenses in Talbot are flat, but we're not surprised to see the expense ratio increase at this point in the cycle. Talbot ran a 97.9% combined ratio in the quarter. In looking at Talbot's results, I would remind you that the reserving methodologies that lead to consistent favorable development begin with a conservative view of the current accident year. If past is prologue, Talbot's combined ratio is likely to be a few points better than our first estimate.

Before leaving London, I would note that some recent quotes attributed to me in the media were accurate but need context. In commenting on London facilities, I addressed the economic impact of the ultimate insured. I didn't make any comments regarding the quality of broker practices which vary widely. We know from our conversations with the two biggest brokers in the market, they have very strong internal controls and take compliance very seriously around facilities. And while we may not like the model, fairness requires us not to paint all brokers with the same brush. For more comments on this topic, please refer to every transcript for the last three years or you'll find me perched on a soapbox in Central Park Saturday afternoons from 2 to 5.

Moving to Western World, there continue to be 2 stories at work. Western World's core binding authority business is growing strongly, and ran a 99% combined ratio in the quarter. As we continue to grow this business, we are driving down the G&A ratio and improving margins. Western World grew by 37% over the prior year quarter, with most of the growth coming in the contract binding authority class, which we love to see. This trend is likely to continue as we see ongoing opportunities in this market.

The second part of the Western World story is the short-tail products that we have introduced, which incurred localized weather-related losses in the first quarter. In total, we ran about 7.5 loss ratio points above our expectations as a result, we are spending a good deal of time with our research team revisiting the question on whether the industry charges for localized weather events and convective storms. In the meantime, Western World has been taking rate increases in all of its key states without too much pushback from producers. Western World also bears a meaningful amount to the cost as we carefully build Validus Specialty Underwriters, our internal MGA. Despite this, Western World's G&A ratio is down 5 points in the quarter at 15.4% compared to 20.6% at this time last year. This improvement does not reflect any contribution from Crop Risk Services.

The Western World acquisition of Crop Risk Services is well on track and will formally close very shortly. The integration is going very nicely, and there's a strong team at CRS Decatur that has made the process very easy, along with great collaboration from the team at Archer Daniels Midland. We've already been able to realize some of our expected synergies to more efficient capital optimization around reinsurance purchasing, and our research team and agricultural experts added insight into this year's fund designation model, which will only get better in the future. We're excited about this business and the very high quality team that's joining us.

The only comments I would offer on the crop business at this stage is that the drought monitor shows the U.S., and particularly the key corn-producing states, to be in excellent shape. In fact, corn planting is a bit behind schedule due to wet fields. Additionally, there's a meaningful shift in planned planting with soybean acreage up 7% and corn likely to be down 4%. Any comments beyond this quickly reveals My Cousin Vinny background, as a guy from Brooklyn talking about farming. So I'll stop there.

The acquisition of CRS likely leads to some reductions in our reinsurance account, but we held our position surprisingly well. This is a function of the value that we bring to our clients beyond reinsurance capacity, particularly in analytics and new product development. There's a firewall between Validus Re's business and CRS, and so far, our customers have been very supportive.

I'd like to spend a few minutes on Validus Specialty Underwriters. My sense is that this might be a difficult part of our business to understand from the outside, and we want to make sure we're providing the best possible transparency. VSU underwrites on behalf of both Western World and Talbot based on whatever the customer's preference is. Its business is generally E&S in nature, but with a heavier emphasis on underwriting individual risks as contrasted against Western World's contract binding authority business. The only exceptions would be a handful of specialty programs such as our flood business that VSU took over from Western World.

The broad goal is to position ourselves for the next leg of the U.S. cycle by having underwriters on the ground to capitalize when rates begin to rise. We're very disciplined in our staffing as we continue to want to see better evidence of a firming of the market on the horizon before building up the expense base. The combination of property losses in the quarter and early-stage expenses led to a net underwriting loss to Western World of $5.3 million from VSU in the quarter. At the same time, VSU contributed $3 million of underwriting profit to Talbot in the quarter.

VSU will be a growth story for quite some time to come as we're finding space to push some of Talbot's higher-margin products in the U.S., and we're building off a relatively small base. We don't want to compete with the large U.S. players in most classes, and thus our business has much smaller average premiums per policy. There's a little bit less competition in this end of the market.

Turning to AlphaCat, our third-party asset manager. We had another good quarter. AlphaCat added $160 million to third-party assets under management in the quarter, we now have $2.9 billion in total assets under management, over 90% from third parties. We saw our BetaCat fund gain traction in the quarter. This is essentially an index fund of cat bonds with a fee structure reflecting the passive strategy. It's also very a good entry point for new investors in the class and to AlphaCat in particular, and so we're happy to continue to make progress here. AlphaCat contributed $6.1 million in income in the quarter.

Finally, turning to Validus Re, it was an excellent quarter. Validus Re had a 67.2% combined ratio in the quarter and generated $71.8 million in underwriting income. Premiums were off as a result in the decline in our crop reinsurance account that I mentioned earlier, but we continue to build increasing diversity of product into the business. The April 1 renewals were in line with January 1, and we expanded our Japanese account as we consider the Japanese customers to be excellent long-term partners and rates in the Japanese market have been more stable than much of the world.

Validus Re's acquisition cost ratio was up in the quarter, driven by profit commissions on our marine account, which continues to perform very well. The quarter was very quiet from a claim perspective, with nothing of note to discuss. Our attritional loss ratio was at normal levels, and our favorable prior period development continued at a relatively similar rate as recent quarters.

Back to Validus Group. Despite $61 million in favorable development, our reserve position relative to our internal actuary's estimate did not change. Regarding taxes and the discussions in Washington, at this point, it's not clear where policy will end on corporate rates, border adjustment or if, in fact, any tax changes will take place at all. We follow the discussion closely but remain comfortable with our current position as roughly 60% of the business we write in Bermuda is non-U.S.

Looking at the Validus Group. Broadly, we have a couple of businesses performing well and a couple that are facing stiffer headwinds. However, the overall model is functioning very nicely. And if you had told me who could generate these types of results at this point in the cycle, I would have been skeptical. We keep working hard at Western World, and we see progress emerging in the numbers and in the key metrics. So we know the business will get to its targets. The addition of CRS makes our position in the U.S. specialty market significantly larger. We write close to $1 billion in London, roughly $1 billion in Bermuda, and with the addition of CRS on a full year basis, roughly $1 billion in the U.S. While maintaining our leadership position in the most profitable parts of the global reinsurance market, our specialty insurance business is now larger than our reinsurance, which is consistent with the long-term strategy we've described to you. And while I'm not yet bullish, I am getting rather upbeat as the softest part of the insurance cycle is in its final act in many classes. There are more potholes being reported in this industry results and more corrective actions being taken by competitors. We haven't been perfect, but we've been cautious and quick in identifying hotspots to avoid big problems.

I feel like we're really very well positioned for the next leg of the cycle without having weakened our reserve position or dug any holes we'll have to fill. Validus is a very good business. We made strong progress in executing on our strategic plans.

And with that, we'll be happy to take any questions you may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

So we're having a little bit of trouble getting operator to come back on the line. I think she may be out buying Validus stock, not clear. So I don't want to make that -- that's one of those comments that you can't place undue reliance on, but that's the most logical explanation. If anybody is still inclined to e-mail, you can e-mail questions to Miranda while we're waiting for the operator to reappear. In the meantime, we've already put out an amber alert.

Operator

(Operator Instructions)

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Operator, we're having a really difficult time hearing you. This is usually the part where the CEO loses it and starts screaming and (inaudible). I'll resist the urge.

Operator

(Operator Instructions).

(technical difficulty)

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Operator, we're on the line. Can you hear us?

Operator

Mr. Noonan?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Yes. Can you hear us?

Operator

I can now, sir. Our first question comes from the line of Matt Carletti with JMP Securities.

Matthew J. Carletti - *JMP Securities LLC, Research Division - MD and Senior Analyst*

You guys hear me okay?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Matt, we hear you really, really well. Thank you.

Matthew J. Carletti - *JMP Securities LLC, Research Division - MD and Senior Analyst*

Wonderful. I'm happy to hear that. Just a few questions.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Matt, before you go any further, could I just note? We've had a lot trouble with Russian hackers, and I think what's happening here is -- that's the story in a nutshell.

Matthew J. Carletti - *JMP Securities LLC, Research Division - MD and Senior Analyst*

That's a very logical explanation. Let's see. Couple numbers questions. First off, thank you for the additional CRS disclosure in the supplement. Can you help us on a quarterly basis just, it's a big impact or benefit to Western World this quarter. How should we think about kind of the remaining 3 quarters? Because a lot of what we see in the supplement is just the annual numbers. So how should we think about kind of the seasonality as the rest of the year comes through with CRS?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Yes. Thanks, Matt. A number of moving pieces that -- in terms of modeling, we should probably get to you in a separate call. In terms of the premium written, it'll primarily be a second quarter event and then earned over the remainder of the year for the summer growing season and we also have the fall growing season, which represents about 15% of the book, which will be written in the fourth quarter and then earned over the first quarter. So probably leave it at that for today. And then, as I said, get into a little more detail separately.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Matt, in Western World numbers in the first quarter, Western World took a quota share of the in-force business as part of their sale transaction, but that was booked at a 100% combined. And it looks exactly like all of our crop quota share reinsurance where we don't recognize any anticipated profit until it's well past end of the growing season.

Matthew J. Carletti - *JMP Securities LLC, Research Division - MD and Senior Analyst*

Okay, that makes sense. So the underlying seasonality is what we'd expect out of crop and the in-force quota shares would kind of bump Q1 up, which would normally be a lot lighter. Is that right?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Yes, that's right. Just we have the rights in entirety of the 17-year, however, not closing on the deal till May 1. We took the deal -- obviously, the first four months of the year will be through that quota share. And then subsequent to that, it'll look more like what you'd expect from other direct crop writers.

Matthew J. Carletti - *JMP Securities LLC, Research Division - MD and Senior Analyst*

Okay. And then just other question. Still a month away from kind of midyear renewals. But from what we've heard, there's been a lot of people going early to market. Just I'd be curious, Ed, your views on how June, July is shaping up.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

It seems to be in line with January 1 and April 1. We're not -- I think there's a recognition gratefully among reinsurers that things are about as low as they can go. And so if there's any movement downward, it'll be very low single digits. And so people have come to market early for Florida, in particular. But we're still early enough in the process that I probably can't cite any hard numbers on it, but that's our general sense.

Operator

And our next question comes from the line of Amit Kumar with Macquarie.

Amit Kumar - *Macquarie Research - VP and Senior Analyst*

Maybe just two or three quick questions. The first question is, I was wondering have you -- has there been any thought in terms of, I guess, preannouncing non-notable losses when they are a meaningful number?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Amit, good question. Obviously, it's something that we think about whenever we have losses. This quarter felt like the energy loss was -- had been in as the trade press and wasn't a surprise either in magnitude or that we would take an energy loss. The other loss is more of a frequency where we had a series of small events across the U.S. and then some nonweather events outside the U.S. So we didn't feel like there was a single event to preannounce on, and none of that really reach our threshold to preannounce.

Amit Kumar - *Macquarie Research - VP and Senior Analyst*

I guess moving on to the quarter, the first question goes back to the discussion on capital. And again, we know about the acquisition and its closing time. How should we think about capital management down the road? I mean, does it pick up or does it match the net income? Just maybe help us understand how the remainder of the year shapes up.

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Sure. So a couple of things. One, we'll be cautious ahead of wind season as we've been in the past. And if you look at our share repurchases, they were loaded to the back half of the year over the last several years. So that trend is likely to continue. As I mentioned in my comments, we've also got the added high-class benefits and high-class problem of where our stock's trading. And so we need to watch that and consider whether share repurchases or potentially a lean towards dividends makes sense. So not definitive by any means, but I would say that special dividend, if valuations continue where they are, is in the -- would be on the books for consideration later in the year as well.

Amit Kumar - *Macquarie Research - VP and Senior Analyst*

Got it. And then the only other question and I'll requeue. This is for Ed. Just going back to the discussion on, I guess, broker facilities and the expense ratio, and we saw your comments in the press which talks about, I guess, $0.41 or $0.42 on the $1. Is this really going to end somewhere in terms of the discussion regarding the disintermediation? Or is this entire discussion more, I guess, aspirational at this point?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

I mean, it's going to take time. But everything that's too good to last ultimately doesn't last. And the idea that our industry can spend $0.41 out of premium dollar on distribution and administration, and that includes carriers, it's unsustainable. I mean in this day and age, it's almost ridiculous. So when I think about the kind of bubbling InsurTech movement, there'll be advances made in underwriting because predictive analytics will improve, machine learning will improve. Our ability to access data to prepopulate our models and applications will improve. But where the big dollars are is in distribution. And it's not a big leap to say that there's the opportunity to disintermediate or perhaps reintermediate distribution in the U.S., particularly for small business. If you look at what simply business accomplished in the U.K., that was a massive reintermediation at much lower costs, and they had great success at it. The U.S. is a little bit trickier because of the 50-state regulatory environment and things like that, but not insurmountable. And so my expectation is that what we will see is carriers will get better and more efficient, but distribution is where the big dollars are. And if you're a start-up investor in InsurTech, that's where you're going to want to lean to make the biggest gain. So it's not sustainable to be quite candid, and it's not sustainable for the distribution network. It's not sustainable for carriers to run cost at these levels.

Operator

And our next question comes from the line of Josh Shanker with Deutsche Bank.

Joshua David Shanker - *Deutsche Bank AG, Research Division - Research Analyst*

Yes. Jeff, I just want to understand what you're (inaudible) up in COGS and about your stock price. I mean, heaven forbid, you're not telling us you think the stock might be too expensive for your to buy back? What do you mean exactly?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Yes, I think what we've always said is if we traded through 1.15 or 1.20 of book, we would have a fresh look at the value. Understanding the strength of our balance sheet and the strength of our franchise, we still see our stock as a buy obviously. And we have a grid in the market every day. It's been more defensive over the course of the first four months of the year. But we will be -- we'll be in the market buying. It's just -- you can run the models as easy as I can at 1.25 of book. The math doesn't look quite as attractive as it did at book value.

Joshua David Shanker - *Deutsche Bank AG, Research Division - Research Analyst*

Again, so that's sort of rule of thumb current market conditions, obviously 1.2x book would be quite attractive if the company could generate a 15%, 20% ROE?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Yes, I think that's right, Josh. You shouldn't interpret our comments as tilting one way or the other. Just the observation as we've made in the past that there are times when, given the stock price, special dividend might be more attractive. Whether we're there or not today is really isn't a conversation, it's just to kind of make the point to make sure it's out there.

Joshua David Shanker - *Deutsche Bank AG, Research Division - Research Analyst*

And the other question was -- maybe two. What are the implications of the U.S. exiting NAFTA for the crop insurance market?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Yes. I'll tell you what, if you untangle that one, give me a call. The subsidies that go back and forth, both internal and within countries and all this border adjustment talk and that, certainly as a massive exporter of crop, including to places like Mexico, NAFTA has had benefit for us. Now we're also a massive importer of some types of crop, but the United States is the bread basket of the world and continues to be. So any change in tax policy has to factor that in. And we also have to be mindful of the fact that places like Brazil are now -- actually Brazil is a bigger soybean producer than United States this year. And so we're not immune to global market forces, and I think tax policy has to contemplate that. I work from the logical man basis that says, "Okay, nobody would do anything crazy enough to harm our agricultural business, which is one of our primary exports." And the farm lobby in Washington is extraordinarily influential. So I start with the supposition that nobody would be crazy enough to screw with that.

Joshua David Shanker - *Deutsche Bank AG, Research Division - Research Analyst*

And then just one more question. What do you think normal volatility should be on Western World's results from noncatastrophe and catastrophe weather? Initially, when you made the acquisition, I thought of this contract binding business as largely noncat related, but this quarter maybe changes the view a little bit.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Yes, that's a good question, Josh. I had said a while back that we thought that we could get Western World under 100 by the fourth quarter. We actually got Western World under 100 by the first quarter this year. So we're a quarter late. But that's the historic Western World. And the team in New Jersey has done an outstanding job at that in the business. We love the glide path. What we also thought in acquiring the business was that they really didn't write any short-tail product. And so we write a big short-tail account in Bermuda. We write a big short-tail insurance account in London, and doing it on the ground in the states is a sensible thing to do. But the results for the short-tail components of it, which I look at as what Validus has brought to Western World have really been a drag on Western World. It's not just this quarter. And so in terms of the volatility, I think you're seeing it this quarter. Western World does buy reinsurance, and they buy reinsurance on an aggregate basis. So that caps out the maximum volatility as it were. But at the same time, I'm not sure that we should be quite so comfortable that we've got pricing for localized weather and convective storms, right? And so we need to spend some more time on that. And then simultaneously, the crude way of addressing is, we just a take rate increase, and that's going through nicely. So I think you're probably seeing -- this isn't the worst case volatility in the quarter, but you're probably seeing what would be bad volatility in the quarter. But unfortunately, this one I have to put on Validus (technical difficulty) starting with me, we had the great idea that Western World would be a better company with more short-tail product. And I think at most points in the cycle when you look at their peer companies, that's true, not at this point in the cycle or at least this point in light of local weather.

Joshua David Shanker - *Deutsche Bank AG, Research Division - Research Analyst*

And if I sneak one more in, can you talk about the impact to PMLs on RMS's latest changes?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Yes. So that's an interesting one. RMS, when we started the company, RMS had just dialed up their frequency function pretty radically on the basis that not only were we in the warm signal of the Atlantic oscillation, but also that we should expect frequency that looked like 2004 and 2005. So they really overweighted the most recent years. We didn't agree with that, and so we actually didn't overweight the most recent years. And so from 2005 until now, our frequency function has been somewhat lower than RMS's. Now they've made a bunch of adjustments over the years that come down towards our frequency function. With this next adjustment in the model, they actually dropped down below us, again because they're overweighting the most recent years, which have been extraordinarily quiet from numbers of landfall and hurricanes. So we expect that the impact on PMLs it's somewhere in the 10% to 15% range, and that's true across everything exposed to Atlantic Basin wind, so everything from Maine to Texas. We still don't agree with the methodology of overweighting the most recent years. It's not that it's invalid. We just have a different scientific view of it. And so we'll continue to use our own frequency function. That might put us slightly out of line with the market, but there's more play in market forces than just the output of the RMS model.

Operator

And our next question comes from the line of Meyer Shields with KBW.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

So you talked a little bit about feeling more optimistic, and I get the idea that rate decreases are broadly decelerating. But at the same time, we have the recent [Marsh] (inaudible) announcement bringing third-party capital to retail property in the U.S. And I'm wondering what are you doing for the short-tail specialty lines in terms of accessing third-party capital beyond sort of what we would now call traditional alternative capital?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Really good question, Meyer. We think that was -- from what we know of it, what we understand, we think that was a very sensible deal. One of our thoughts in acquiring Western World was writing short-tail business. And again, that hasn't exactly worked the way we hoped. But over time, I think we'll get it right, writing short-tail business and accessing lower cost of capital through AlphaCat using pension funds. So I think Marsh is perhaps a step ahead of us on that. I think it's a very sensible model. I think you also have to look at where -- it still comes down to where third-party capital wants to play and where traditional capacity wants to play. And so I think in this case, the carrier involved. Alliance, is taking the tail risk. And there's only so much tail risk you can take before you really have an imbalance. It may be outside of your rating agency PMLs, but it's still a lot of tail risk. That's one of the issues that the market hasn't broken the code on yet. Although in this case, using Alliance, they have. But we expect to see the ILS market be a perfect vehicle for it. And we'll package it the same way. Investors who are looking for 5.75% return will play at different levels than investors who are looking for 7% return. And our capital or other industry capital would still tend to play in that kind of up to the 1 in 50 or 1 in 60 year return level. And so I think in the end, it becomes a more efficient vehicle for matching up capital with the original risk. And we think that's a very good model for the future and one that we spend a lot of time with.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Second question, is the in-house MGA that you talked about building within Western World going to write for any non-Validus company?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Not currently, and I wouldn't anticipate it. For us, it was a recognition that we have underwriting talents in London that we'd like to export to the U.S. and expertise. And we had distribution access in the U.S. that we'd like to avail London of. And at the same time, there's business that is -- would normally fit someone who looks like Western World, but Western World is really focused on contract binding authority business. So brokers, individual risk business (technical difficulty) in the U.S. fits better in our internal MGA. So we wouldn't anticipate underwriting for third parties. But there are some classes of risks or flood business, for example, as that continues to grow, you may well bring in third-party capital more likely to do it through reinsurance or ILS than using other carriers.

Operator

And our next question comes from the line of Brian Meredith with UBS.

Brian Robert Meredith - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head, Global Insurance Strategist, and Senior Property Casualty Insurance Analyst*

Just one quick numbers question for you. With all the moving parts going on in Talbot right now, what's the right attritional loss ratio that you're thinking about right there for the quarter?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Sure, Brian. Good question. For that, I look to the supplements and the normalized loss ratio page on 29. So there, you see what we call normalized ratio, 64.9%. That's running high compared to comparative quarters. Obviously, the biggest driver there is the Mexican riot loss of about $13 million (inaudible) . So had that been $2 million worse, that would have dropped down into the non-notable loss events, and that 64.9% would have dropped to a 58.2%. So what we've guided in the past is mid- to high-50s underlying loss ratio at Talbot. I think that continues to be the right place. And as I said, we just have one-off this quarter that happens to be sitting in that normalized number.

Brian Robert Meredith - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head, Global Insurance Strategist, and Senior Property Casualty Insurance Analyst*

Got you. And Ed, with your comments that there may be some rational thinking possibly in the London market now, should we expect that your margins at Talbot have kind of bottomed out?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Brian, I don't know the answer to that yet. We're not -- I don't want to overstate it. We're not seeing suddenly every Lloyd's underwriter praying at the church before he goes to work. And certainly, there's still disproportionate influence by distribution in the market. It's a factor. But what we are seeing is enough syndicates falling out of bed, some that won't be able to get back in bed and resume trading in the market. And others, we're -- it's clear. When we look at people's earnings numbers, the reserve releases are declining. We know that from third parties that we talk to that across the Lloyd's market the reserve redundancy is being eaten up very quickly, whereas we keep ours static. And so we just know that that's moving us closer. And now we're seeing in the market, and part of this I give some kudos to Lloyd's itself, which is a good disciplinarian, what we're seeing in the market is behavior is starting to revert back to underwriting, again starting to. And we could be that when we talk next quarter, or I'd say, gee, that was a head fake. Hopefully, not the case. But I think there's a general recognition in the market that we've probably gone about as low as we ought to be going in some classes and facilities are not, but prices have to start to stabilize. And then hopefully, as results continue to worsen for some people, prices will start to move up. So I don't know when Talbot hits bottom on margin. Hopefully, we're looking at 2017 as the low point in the cycle. But I don't want to commit to that at this point.

Brian Robert Meredith - *UBS Investment Bank, Research Division - MD, Financials Research Sector Head, Global Insurance Strategist, and Senior Property Casualty Insurance Analyst*

Great. And then just last question. Mortgage reinsurance, you briefly mentioned that in your annual report as a potential growth area. You've talked about it. Can you give me kind of what kind of thoughts on the market in general there? It seems like everybody wants into that market right now, it's incredibly profitable for a lot of the reinsurance players.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Yes. You know what, one of the things that troubles us is it looks like a freebie to reinsurers, and there are no free risks in the world. What we are seeing in the first quarter is the GSE's issue, what we refer to as stacker deals. And what we're seeing is in the auctions this quarter, the price that reinsurers were willing to take that risk at was lower than you could get that risk in the securities market. Hence, we didn't participate in those auctions or we didn't actually buy in those auctions. It's not a million miles away in terms of pricing, but it's below what you could get it for in the market. And everything we do in this area is fully integrated with our investment function. So when we take on $1 of mortgage risk, we reduce the mortgage risk in our insurance -- in our investment portfolio. So I think we are seeing market saturation. What I get some encouragement from is that every insurer in the class has to have a fixed amount of aggregate that they can take on. And so with each auction, people are consuming their aggregate. And that does tend to mean that supply will start to shrink, and hopefully, with that, pricing will firm up a little bit. But yes, I think there is -- I don't want to call it frothiness because it's not that bad, but we do see people taking on risk at prices that don't make any sense relative to what you could take that same risk for in the investment market.

Operator

And our next question comes from the line of Ian Gutterman with Balyasny.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

So my question on the Mexican riots is, I was wondering how you plan for your PML possibly going up if they build the wall? And how much does the PML go up every time the wall gets 10 feet higher?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

So our research team has done extensive work on correlation between height of impediment and ensuing insurance losses specifically related to strike, riot and civil commotion and terrorism policies. And what we find is that the correlation is meaningless. It is an interesting situation because what happened in Mexico was the price of gas spiked in all across the country. In 7 different states in Mexico, there was significant rioting and looting. And then it affected a few of our insurers. But what happens in that event, typically, you would say -- you get to a certain point and we recover from our terrorism reinsurance contracts. But in this particular event, because they happened all across the country in 7 different states, they actually don't meet the definition of one event, which requires contiguous geolocation. So if our PML goes up, actually, we will get into our reinsurance program in the next event like that. But it did actually cause us to step back and say, hey, you know we need to maybe look at this a little bit differently going forward.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Got it. Got it. And then for Jeff, on the investment income, I just want to make sure because this has come up with few quarters in row with this one structured fund and so on Page 31 where you give the investment income by components. Do I see that $4 million, is that in the other investments? Where exactly do I see that? Or is it in the fixed maturities?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Yes, that's sitting in the other investments.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Okay. So that's part of the 7 -- or is it in that nonmanaged investments at the bottom?

THOMSON REUTERS

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

No, it's sitting in other investments. So that comes in -- so it comes into the $36 million of net investment income and the 2.27% yield. I would say, it's going to jump around a bit as we talked about. Q1 last year, it was a loss of about $2.5 million. But a couple of quarters in a row now, a return on that fund has been exactly $4 million. So that probably feels like a run rate, but there is going to be a couple of million dollars in either direction of noise around that.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Got it. That's what I was trying to figure out. Okay. And then on the specialty reinsurance bucket, obviously, the crop leaving impacted that. First, I guess maybe the first thing to understand is, the decline in the reinsurance, that was more than just CRS, that was other stuff as well, other contracts as well?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

It's a good question, Ian, because candidly, we're not even certain that the decline of our reinsurance was CRS related. There's been a number of acquisitions in the crop space that have taken reinsurance out of the market. It seems everybody who buys a crop company like us stops buying a quota share. So the market is much more competitive. And some of the acquisitions have also entailed ongoing reinsurance relationships between the parties. And so it's not entirely clear to us that we lost business because of CRS. We start with the assumption that we probably would. But it may just be normal market forces as a result of all the M&A in the space.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Got it, okay.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

I'd make the observation though that the scarcity value of crop insurers at this point causes us to just feel even that much better about the CRS acquisition.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Absolutely. Understood. And then just the mix impact of that, it looks like the accident year in specialty re went up. Is that because the crop premiums went down as part of that subsegment?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Yes, so you're just talking about loss ratio?

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

(inaudible) loss ratio, yes.

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Yes, exactly. So as you know, we book that business at 100% combined for Q1 through Q3 at least. So removal of that business in this quarter would have a (inaudible).

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Actually, (inaudible) should have a positive impact, right?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Positive impact, yes.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Okay, okay. Was there something else then in the specialty re where there was loss because it seem like the accident year was higher than normal?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Nothing particular.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

We booked the mortgage business at a higher loss ratio. So as that's growing, that has an impact.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Got it, okay. And then just one more thing on crop, and then I have a Western question. Ed, one of the -- I think appealing things over the years has been talked about for sort of the natural hedge, if you will, of the crop business, right, that if it's a bad crop prices go up, so you're protected. And if it's a good crop, prices go down, but you're protected by the good volume. One of the things that seems to be changing is that the market, especially for corn, is becoming more global. I mean, Brazil seems to becoming a bigger impact on global prices. Does that natural hedge potentially go away where a boom crop in Brazil can cause lower prices irrespective of what may go on in the U.S. crop? Does that change the appeal of the business some?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Certainly, it adds a broader dynamic to it, and it's not just Brazil. The farming revolution is taking hold in Eastern Europe as well, you have places like Ukraine and Hungary, Romania that you have to be mindful of. And so global supply certainly becomes much more of a factor. But I'd also note that you start each year at kind of a reset. And just as global supply, Brazil may have a great crop in any given year and drive down the price. Brazil may have a terrible crop in any year and drive up the price. And so I think it probably creates a bit more volatility in the overall pricing of crops, but it's -- that's not fatal to the product that's -- because we do essentially set the insurance price of a product early in the year, and that factors in. For example, today, we had a pretty strong sense of the yields coming out of Brazil and Argentina in there, particularly for soybean, incredible. Brazil is having an incredible corn year as well. But that actually is already baked into the price at this point in the year for corn.

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

Got it, okay. And then just lastly on Western I was going to ask you. One of the things that seems to be emerging over the last couple quarters is just a general uptick in loss inflation in certain classes. And I get that you obviously shrunk commercial auto and things like that but there is some concern that it's becoming a little bit (inaudible) umbrella or some places over time. Given that you've sort of grown up as a reinsurer and are new to the insurance business, how do you go about assessing an environment where it seems like the loss trend is changing and making sure you're not the last to know because you don't have the insurance expertise of say, Chubb, who's done it forever?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Ian, that hurts a little bit. I spent my first three or four years in the business in a family insurance agency in Brooklyn. I ran a big insurance company in the States all through the 90's and into the early 2000's (inaudible).

Ian Gutterman - *Balyasny Asset Management L.P. - Portfolio Manager*

I was speaking more of the greater Validus rather than Ed.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

No actually, it's a good question because that is a risk. Reinsurers don't understand primary insurance but really are convinced they do. One of the things we've done is got really good, solid people in the primary insurance business for that reason. But directly to your point, we do see some trends emerging. We've noticed a lot more claims being reported already in litigation. And again, these are million dollar policies and we're more in the slip-and-fall category. But have a lot of them coming to us in litigation. Those are frequency issues and driving up the average claim value of small claims. The only way around that is, it's not a selection issue, it's really a price issue. And one of the great things about Western World is we have the ability to change the price of the product every single day and at any moment. And change the price of the product in any state, or any class, put it through our system and that's the product, that's the price that is now getting quoted. And we do that. We do take rate increase. Sometimes we just take it to push the market and see where the price point is. That is how we -- the primary way of dealing with it. The classes we write today -- being out of commercial auto for a few years and things like that -- we like the classes. It's just a question of making sure we're staying ahead of claim inflation and pricing force.

Operator

Thank you. And our next question comes from the line of Jay Cohen with Bank of America. Your line is open, please go ahead.

Jay Cohen - *Bank of America - Analyst*

Thank you. A couple questions, the first on Western World. If we do back out this weather impact, the loss ratio that we saw in the quarter -- I guess you'd be around 70% accident year ex weather. Is that a fairly good number to go off of given the higher crop percentage in the book?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

Yes, I think absent crop if you look at the - separately -- the property obviously was driven, the property loss ratio was driven by the cats this quarter. So you've got to back that out. The underlying there would run lower than that. But on the liability side the loss ratio did run a little higher this quarter. Page 28 of the Supp, where we break down the loss and loss ratio for Western World, you see under liability that we had $2.6 million of adverse development on liability coming from five different classes. Nothing specific. The only one of note is the 2014 (inaudible) class. But all in all, a little bit of adverse development. We didn't want to let anything get ahead of us there, and make sure that we are continuing to reserve that prudently. So you can see on that page that it added 4.6 loss ratio points to the liability business. The underlying ratio, absent that development, of 68.7 feels like about the right place for that business.

Jay Cohen - *Bank of America - Analyst*

Got it, that's helpful. And then on the Val Re segment should we expect a similar impact on written premiums over the next three quarters from lower crop-related premiums?

Jeffrey D. Sangster - *Validus Holdings, Ltd. - CFO and EVP*

No, all of their written is in the first quarter. So it wouldn't be on written. You'd just have the knock-on effect on earned. That quota share business -- we've earned that evenly over the four quarters so simply take the movement in the written and spread that evenly over the 2017 full year.

Jay Cohen - *Bank of America - Analyst*

Perfect. And then last question, maybe bigger picture. If you look at this quarter, and obviously you had some frequency of smaller and mid-sized events but really a lack of notable events. If you take it as a whole, the ROE this quarter, do you consider that to be a pretty representative return for where your business is today?

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

It's in the range, Jay. There will certainly be quarters that are quiet, where you don't have riots in Mexico or refineries exploding, and that will lead to much higher ROEs. But then there will be quarters like this. I don't think this is, by any means, worst case quarter, but it's in the range. And as I say, at this point in the cycle, where you have most of our businesses in pretty deep into a soft market, I'm not going to complain too loudly.

Operator

And I'm showing no further questions at this time. And I would like to turn the conference back over to Ed Noonan for any closing remarks.

Edward Joseph Noonan - *Validus Holdings, Ltd. - Chairman, CEO, Chairman of the Validus Group and CEO of the Validus Group*

Yes, thank you very much. So first, let me apologize for the technical difficulties we encountered. We've already sacked everyone involved in that. So that won't happen again until next quarter. But I appreciate everybody taking the time to join us this morning, and look forward to talking to you in another 3 months. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.
