MARKEL CORP
Form 10-Q
November 04, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2009**

or

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ______ to ______**

Commission File Number: 001-15811

MARKEL CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	**54-1959284**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

4521 Highwoods Parkway, Glen Allen, Virginia 23060-6148

(Address of principal executive offices)

(Zip Code)

(804) 747-0136

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Number of shares of the registrant s common stock outstanding at October 30, 2009: 9,816,300

Table of Contents

Markel Corporation

Form 10-Q

Index

		Page Number
PART I. FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Consolidated Balance Sheets September 30, 2009 and December 31, 2008	3
	Consolidated Statements of Operations and Comprehensive Income (Loss) Quarters and Nine Months Ended September 30, 2009 and 2008	4
	Consolidated Statements of Changes in Shareholders Equity Nine Months Ended September 30, 2009 and 2008	5
	Consolidated Statements of Cash Flows Nine Months Ended September 30, 2009 and 2008	6
	Notes to Consolidated Financial Statements	7
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	26
	Critical Accounting Estimates	26
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	35
Item 4.	Controls and Procedures	36
Safe Harbor and Cautionary Statement		37
PART II. OTHER INFORMATION		
Item 6.	Exhibits	38
Signatures		39
Exhibit Index		40

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

	September 30, 2009	December 31, 2008
	(dollars in thousands)	
ASSETS		
Investments, available-for-sale, at estimated fair value:		
Fixed maturities (amortized cost of $4,715,607 in 2009 and $4,722,371 in 2008)	$ 4,910,739	$ 4,592,552
Equity securities (cost of $820,964 in 2009 and $855,188 in 2008)	1,279,890	1,073,769
Short-term investments (estimated fair value approximates cost)	666,310	508,834
Investments in affiliates	76,037	93,723
Total Investments	6,932,976	6,268,878
Cash and cash equivalents	1,038,411	639,578
Receivables	288,851	271,067
Reinsurance recoverable on unpaid losses	918,257	1,026,858
Reinsurance recoverable on paid losses	75,259	71,890
Deferred policy acquisition costs	169,478	183,755
Prepaid reinsurance premiums	77,350	86,534
Goodwill and intangible assets	340,495	344,031
Other assets	360,576	585,099
Total Assets	$ 10,201,653	$ 9,477,690
LIABILITIES AND SHAREHOLDERS EQUITY		
Unpaid losses and loss adjustment expenses	$ 5,496,489	$ 5,492,339
Unearned premiums	792,348	827,888
Payables to insurance companies	56,251	42,399
Long-term debt (estimated fair value of $980,000 in 2009 and $620,000 in 2008)	951,248	688,509
Other liabilities	212,502	245,881
Total Liabilities	7,508,838	7,297,016
Shareholders equity:		
Common stock	872,153	869,744
Retained earnings	1,421,483	1,297,901
Accumulated other comprehensive income	399,179	13,029
Total Shareholders Equity	2,692,815	2,180,674
Commitments and contingencies		
Total Liabilities and Shareholders Equity	$ 10,201,653	$ 9,477,690

See accompanying notes to consolidated financial statements.

Table of Contents

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations and Comprehensive Income (Loss)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
	(dollars in thousands, except per share data)			
OPERATING REVENUES				
Earned premiums	$ 448,398	$ 516,063	$ 1,360,858	$ 1,520,187
Net investment income	66,663	68,232	200,765	220,765
Net realized investment losses:				
Other-than-temporary impairment losses	(26,651)	(94,607)	(93,888)	(187,145)
Less other-than-temporary impairment losses recognized in other comprehensive income (loss)	4,219		7,976	
Other-than-temporary impairment losses recognized in net income (loss)	(22,432)	(94,607)	(85,912)	(187,145)
Net realized investment losses, excluding other-than-temporary impairment losses	(7,338)	(74,072)	(14,477)	(13,102)
Net realized investment losses	(29,770)	(168,679)	(100,389)	(200,247)
Total Operating Revenues	485,291	415,616	1,461,234	1,540,705
OPERATING EXPENSES				
Losses and loss adjustment expenses	237,331	456,172	776,881	1,029,005
Underwriting, acquisition and insurance expenses	193,087	186,206	541,318	552,069
Amortization of intangible assets	1,179	1,141	3,536	3,239
Total Operating Expenses	431,597	643,519	1,321,735	1,584,313
Operating Income (Loss)	53,694	(227,903)	139,499	(43,608)
Interest expense	12,000	11,024	34,984	35,789
Income (Loss) Before Income Taxes	41,694	(238,927)	104,515	(79,397)
Income tax benefit	(17,432)	(96,640)	(3,767)	(53,340)
Net Income (Loss)	$ 59,126	$ (142,287)	$ 108,282	$ (26,057)
OTHER COMPREHENSIVE INCOME (LOSS)				
Change in net unrealized gains on investments, net of taxes:				
Net holding gains (losses) arising during the period	$ 273,709	$ (122,832)	$ 340,060	$ (374,303)
Unrealized other-than-temporary impairment losses on fixed maturities arising during the period, net of taxes	(3,835)		(6,917)	
Less reclassification adjustments for net losses included in net income (loss)	7,665	109,749	56,615	130,583
Change in net unrealized gains (losses)	277,539	(13,083)	389,758	(243,720)
Change in currency translation adjustments, net of taxes	6,066	(3,647)	13,885	(3,380)
Change in net actuarial pension loss, net of taxes	(2,872)	195	(2,193)	748
Total Other Comprehensive Income (Loss)	280,733	(16,535)	401,450	(246,352)
Comprehensive Income (Loss)	$ 339,859	$ (158,822)	$ 509,732	$ (272,409)
NET INCOME (LOSS) PER SHARE				
Basic	$ 6.02	$ (14.46)	$ 11.03	$ (2.63)
Diluted	$ 6.02	$ (14.46)	$ 11.02	$ (2.63)

See accompanying notes to consolidated financial statements.

Table of Contents

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders Equity

	Nine Months Ended September 30,	
	2009	2008
	(dollars in thousands)	
COMMON STOCK		
Balance at beginning of period	$ 869,744	$ 866,362
Restricted stock units expensed	1,906	2,971
Other	503	1,195
Balance at end of period	$ 872,153	$ 870,528
RETAINED EARNINGS		
Balance at beginning of period	$ 1,297,901	$ 1,417,269
Net income (loss)	108,282	(26,057)
Cumulative effect of adoption of FASB ASC 320-10, net of taxes	15,300	
Repurchases of common stock		(60,238)
Balance at end of period	$ 1,421,483	$ 1,330,974
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Net unrealized holding gains on investments, net of taxes:		
Balance at beginning of period	$ 58,652	$ 388,521
Change in net unrealized holding gains on investments, net of taxes	391,422	(243,720)
Balance at end of period	450,074	144,801
Unrealized other-than-temporary impairment losses on fixed maturities, net of taxes:		
Balance beginning of period		
Cumulative effect of adoption of FASB ASC 320-10, net of taxes	(15,300)	
Change in unrealized other-than-temporary impairment losses on fixed maturities, net of taxes	(1,664)	
Balance at end of period	(16,964)	
Cumulative translation adjustments, net of taxes:		
Balance at beginning of period	(15,416)	(7,523)
Change in currency translation adjustments, net of taxes	13,885	(3,380)
Balance at end of period	(1,531)	(10,903)
Net actuarial pension loss, net of taxes:		
Balance at beginning of period	(30,207)	(23,467)
Change in net actuarial pension loss, net of taxes	(2,193)	748
Balance at end of period	(32,400)	(22,719)
Balance at end of period	$ 399,179	$ 111,179
SHAREHOLDERS EQUITY AT END OF PERIOD	$ 2,692,815	$ 2,312,681

See accompanying notes to consolidated financial statements.

Table of Contents

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Nine Months Ended September 30,	
	2009	**2008**
	(dollars in thousands)	
OPERATING ACTIVITIES		
Net income (loss)	$ 108,282	$ (26,057)
Adjustments to reconcile net income (loss) to net cash provided by operating activities	108,293	372,896
Net Cash Provided By Operating Activities	216,575	346,839
INVESTING ACTIVITIES		
Proceeds from sales of fixed maturities and equity securities	116,728	570,166
Proceeds from maturities, calls and prepayments of fixed maturities	253,268	316,474
Cost of fixed maturities and equity securities purchased	(313,559)	(594,487)
Net change in short-term investments	(149,024)	(275,572)
Cost of investments in affiliates	(5,946)	(11,634)
Other	18,727	(72,425)
Net Cash Used By Investing Activities	(79,806)	(67,478)
FINANCING ACTIVITIES		
Additions to long-term debt	497,172	
Repayment of long-term debt	(250,000)	(93,050)
Repurchases of common stock		(60,238)
Net Cash Provided (Used) By Financing Activities	247,172	(153,288)
Effect of foreign currency rate changes on cash and cash equivalents	14,892	(15,275)
Increase in cash and cash equivalents	398,833	110,798
Cash and cash equivalents at beginning of period	639,578	477,661
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,038,411	$ 588,459

See accompanying notes to consolidated financial statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Principles of Consolidation

Markel Corporation (the Company) markets and underwrites specialty insurance products and programs to a variety of niche markets.

The consolidated balance sheet as of September 30, 2009, the related consolidated statements of operations and comprehensive income (loss), changes in shareholders equity and cash flows for the quarters and nine months ended September 30, 2009 and 2008 are unaudited. In the opinion of management, all adjustments necessary for fair presentation of such consolidated financial statements have been included. Such adjustments consist only of normal, recurring items. Interim results are not necessarily indicative of results of operations for the entire year. The consolidated balance sheet as of December 31, 2008 was derived from the Company s audited annual consolidated financial statements.

The preparation of financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results may differ from the estimates and assumptions used in preparing the consolidated financial statements.

The consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company s annual consolidated financial statements and notes. Readers are urged to review the Company s 2008 Annual Report on Form 10-K for a more complete description of the Company s business and accounting policies.

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

2. Net Income (Loss) per Share

Net income (loss) per share was determined by dividing net income (loss) by the applicable weighted average shares outstanding.

	Quarter Ended September 30,		**Nine Months Ended September 30,**	
(in thousands, except per share amounts)	**2009**	**2008**	**2009**	**2008**
Net income (loss) as reported	$ 59,126	$ (142,287)	$ 108,282	$ (26,057)
Basic common shares outstanding	9,816	9,842	9,815	9,897
Dilutive potential common shares	13		10	
Diluted shares outstanding	9,829	9,842	9,825	9,897
Basic net income (loss) per share	$ 6.02	$ (14.46)	$ 11.03	$ (2.63)
Diluted net income (loss) per share	$ 6.02	$ (14.46)	$ 11.02	$ (2.63)

Table of Contents

3. Reinsurance

The following tables summarize the effect of reinsurance on premiums written and earned.

(dollars in thousands)	Quarter Ended September 30, 2009		2008	
	Written	**Earned**	**Written**	**Earned**
Direct	$ 433,210	$ 445,887	$ 511,424	$ 534,958
Assumed	51,567	56,240	52,472	54,846
Ceded	(53,822)	(53,729)	(65,793)	(73,741)
Net premiums	$ 430,955	$ 448,398	$ 498,103	$ 516,063

(dollars in thousands)	Nine Months Ended September 30, 2009		2008	
	Written	**Earned**	**Written**	**Earned**
Direct	$ 1,286,943	$ 1,361,057	$ 1,562,272	$ 1,584,990
Assumed	190,345	162,273	185,289	149,014
Ceded	(152,085)	(162,472)	(205,273)	(213,817)
Net premiums	$ 1,325,203	$ 1,360,858	$ 1,542,288	$ 1,520,187

Incurred losses and loss adjustment expenses were net of reinsurance recoverables (ceded incurred losses and loss adjustment expenses) of $21.3 million and $126.5 million, respectively, for the quarters ended September 30, 2009 and 2008 and $38.1 million and $245.8 million, respectively, for the nine months ended September 30, 2009 and 2008. Both periods of 2008 included $87.7 million of estimated reinsurance recoverables related to Hurricanes Gustav and Ike.

4. Investments

a) The following table summarizes the Company s available-for-sale investments.

(dollars in thousands)	September 30, 2009 Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Unrealized Other-Than-Temporary Impairment Losses	Estimated Fair Value
Fixed maturities:					
U.S. Treasury securities and obligations of U.S. government agencies	$ 365,214	$ 20,711	$ (3)	$	$ 385,922
Obligations of states, municipalities and political subdivisions	1,996,182	97,329	(5,016)		2,088,495
Foreign governments	313,922	16,875	(288)		330,509
Residential mortgage-backed securities	424,721	28,029	(1,354)	(14,697)	436,699
Asset-backed securities	27,558	343	(1,042)		26,859
Public utilities	142,092	8,138			150,230
Convertible bonds	29,531				29,531
All other corporate bonds	1,416,387	66,785	(10,281)	(10,397)	1,462,494
Total fixed maturities	4,715,607	238,210	(17,984)	(25,094)	4,910,739
Equity securities:					
Insurance companies, banks and trusts	342,325	243,408	(668)		585,065
Industrial, consumer and all other	478,639	217,718	(1,532)		694,825
Total equity securities	820,964	461,126	(2,200)		1,279,890
Short-term investments	666,283	38	(11)		666,310
Investments, available-for-sale	$ 6,202,854	$ 699,374	$ (20,195)	$ (25,094)	$ 6,856,939

8

b) The following table summarizes gross unrealized investment losses by the length of time that securities have continuously been in an unrealized loss position.

	September 30, 2009					
	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses
Fixed maturities:						
U.S. Treasury securities and obligations of U.S. government agencies	$ 610	$ (3)	$	$	$ 610	$ (3)
Obligations of states, municipalities and political subdivisions	21,082	(345)	167,402	(4,671)	188,484	(5,016)
Foreign governments	9,978	(288)			9,978	(288)
Residential mortgage-backed securities	11,132	(14,854)	17,487	(1,197)	28,619	(16,051)
Asset-backed securities			10,553	(1,042)	10,553	(1,042)
Public utilities						
All other corporate bonds	52,308	(11,895)	205,247	(8,783)	257,555	(20,678)
Total fixed maturities	95,110	(27,385)	400,689	(15,693)	495,799	(43,078)
Equity securities:						
Insurance companies, banks and trusts	26,156	(668)			26,156	(668)
Industrial, consumer and all other	42,510	(214)	30,058	(1,318)	72,568	(1,532)
Total equity securities	68,666	(882)	30,058	(1,318)	98,724	(2,200)
Short-term investments	49,337	(11)			49,337	(11)
Total	$ 213,113	$ (28,278)	$ 430,747	$ (17,011)	$ 643,860	$ (45,289)

At September 30, 2009, the Company held 132 securities with a total estimated fair value of $643.9 million and gross unrealized losses of $45.3 million. Of these 132 securities, 101 securities had been in a continuous unrealized loss position for greater than one year and had a total estimated fair value of $430.7 million and gross unrealized losses of $17.0 million. Of these securities, 99 securities were fixed maturities where the Company expects to receive all interest and principal payments when contractually due and two were equity securities. The Company does not intend to sell or believe it will be required to sell these fixed maturities before recovery of their amortized cost. Each of the equity securities had a fair value in excess of 95% of their cost basis at September 30, 2009.

The Company completes a detailed analysis each quarter to assess whether the decline in the fair value of any investment below its cost basis is deemed other-than-temporary. All securities with unrealized losses are reviewed. The Company considers many factors in completing its quarterly review of securities with unrealized losses for other-than-temporary impairment, including the length of time and the extent to which fair value has been below cost and the financial condition and near-term prospects of the issuer. For equity securities, the ability and intent to hold the security for a period of time sufficient to allow for any anticipated recovery is considered. For fixed maturities, the Company considers whether it intends to sell the security or if it is more likely than not that it will be required to sell the security before recovery, the implied yield-to-maturity, the credit quality of the issuer and the ability to recover all amounts outstanding when contractually due.

Table of Contents

For equity securities, a decline in fair value that is considered to be other-than-temporary is recognized in net income based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security. For fixed maturities where the Company intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost, a decline in fair value that is considered to be other-than-temporary is recognized in net income based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security. If the decline in fair value of a fixed maturity below its amortized cost is considered to be other-than-temporary based upon other considerations, the Company compares the estimated present value of the cash flows expected to be collected to the amortized cost of the security. The extent to which the estimated present value of the cash flows expected to be collected is less than the amortized cost of the security represents the credit-related portion of the other-than-temporary impairment, which is recognized in net income, resulting in a new cost basis for the security. Any remaining decline in fair value represents the non-credit portion of the other-than-temporary impairment, which is recognized in other comprehensive income (loss). The discount rate used to calculate the estimated present value of the cash flows expected to be collected is the effective interest rate implicit for the security at the date of purchase.

When assessing whether it intends to sell a fixed maturity or if it is likely to be required to sell a fixed maturity before recovery of its amortized cost, the Company evaluates facts and circumstances including, but not limited to, decisions to reposition the investment portfolio, potential sales of investments to meet cash flow needs and potential sales of investments to capitalize on favorable pricing. Additional information on the methodology and significant inputs, by security type, that the Company used in 2009 to determine the amount of credit loss recognized on fixed maturities with declines in fair value below amortized cost that were considered to be other-than-temporary is provided below.

Residential mortgage-backed securities. For U.S. mortgage-backed securities, credit impairment is assessed by estimating future cash flows from the underlying mortgage loans and interest payments. The cash flow estimate incorporates actual cash flows on the mortgage-backed securities through the current period and then projects the remaining cash flows using a number of assumptions, including prepayment rates, default rates, recovery rates on foreclosed properties and loss severity assumptions. Management develops specific assumptions using market data and internal estimates, as well as estimates from rating agencies and other third party sources. Default rates are estimated by considering current underlying mortgage loan performance. Estimates of future cash flows are discounted to present value. If the present value of expected cash flows is less than the amortized cost, the Company recognizes the estimated credit loss in net income (loss).

Table of Contents

Corporate bonds. For corporate bonds, credit impairment is assessed by evaluating the underlying issuer. As part of this assessment, the Company analyzes various factors, including the following:

- fundamentals of the issuer, including current and projected earnings, current liquidity position and ability to raise capital;
- fundamentals of the industry in which the issuer operates;
- expectations of defaults and recovery rates;
- changes in ratings by the rating agencies;
- other relevant market considerations; and
- receipt of interest payments

Default probabilities and recovery rates from rating agencies are key factors used in calculating the credit loss. Additional research of the industry and issuer is completed to determine if there is any current information that may affect the fixed maturity or its issuer in a negative manner and require an adjustment to the cash flow assumptions.

Table of Contents

c) The amortized cost and estimated fair value of fixed maturities at September 30, 2009 are shown below by contractual maturity and investment type.

(dollars in thousands)	Amortized Cost	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. government agencies:		
Due in one year or less	$ 32,621	$ 33,230
Due after one year through five years	163,922	174,586
Due after five years through ten years	168,007	177,342
Due after ten years	664	764
Total	365,214	385,922
Obligations of states, municipalities and political subdivisions:		
Due in one year or less		
Due after one year through five years	49,286	50,460
Due after five years through ten years	549,731	579,370
Due after ten years	1,397,165	1,458,665
Total	1,996,182	2,088,495
Foreign governments:		
Due in one year or less	3,971	4,011
Due after one year through five years	147,232	154,377
Due after five years through ten years	162,719	172,121
Due after ten years		
Total	313,922	330,509
Residential mortgage-backed securities:		
Due in one year or less	3,749	3,664
Due after one year through five years	13,233	13,972
Due after five years through ten years	49,354	50,658
Due after ten years	358,385	368,405
Total	424,721	436,699
Asset-backed securities:		
Due in one year or less	1,863	1,887
Due after one year through five years	12,539	11,507
Due after five years through ten years	1,000	1,087
Due after ten years	12,156	12,378
Total	27,558	26,859
Public utilities:		
Due in one year or less	12,463	12,785
Due after one year through five years	100,963	107,288
Due after five years through ten years	28,666	30,157
Due after ten years		
Total	142,092	150,230
Convertible bonds and all other corporate bonds:		
Due in one year or less	128,071	131,200
Due after one year through five years	659,339	685,481
Due after five years through ten years	623,535	640,577
Due after ten years	34,973	34,767
Total	1,445,918	1,492,025
Total fixed maturities:		
Due in one year or less	182,738	186,777
Due after one year through five years	1,146,514	1,197,671
Due after five years through ten years	1,583,012	1,651,312
Due after ten years	1,803,343	1,874,979
Total fixed maturities	$ 4,715,607	$ 4,910,739

Table of Contents

d) The following table summarizes the activity for credit losses recognized in net income on fixed maturities where other-than-temporary impairment was identified and a portion of the other-than-temporary impairment was included in other comprehensive income.

(dollars in thousands)	**Quarter Ended September 30, 2009**	**Nine Months Ended September 30, 2009**
Cumulative credit loss, beginning balance	$ 6,214	$
Adoption of FASB ASC 320-10		237
Additions:		
Other-than-temporary impairment losses not previously recognized	1,599	6,012
Increases related to other-than-temporary impairment losses previously recognized	85	1,649
Total additions	1,684	7,661
Reductions:		
Sales of fixed maturities on which credit losses were recognized	177	177
Cumulative credit loss, ending balance	$ 7,721	$ 7,721

e) The following tables present net realized investment losses and the change in net unrealized gains.

(dollars in thousands)	**Quarter Ended September 30, 2009**	**2008**
Realized gains:		
Sales of fixed maturities	$ 1,398	$ 723
Sales of equity securities	602	8,690
Other		166
Total realized gains	2,000	9,579
Realized losses:		
Sales of fixed maturities	(9,170)	(83,637)
Sales of equity securities	(43)	(14)
Other-than-temporary impairments	(22,432)	(94,607)
Other	(125)	
Total realized losses	(31,770)	(178,258)
Net realized investment losses	$ (29,770)	$ (168,679)
Change in net unrealized gains:		
Fixed maturities	$ 200,462	$ (98,711)
Equity securities	217,057	79,400
Short-term investments	46	7
Net increase (decrease)	$ 417,565	$ (19,304)

Table of Contents

(dollars in thousands)	Nine Months Ended September 30, 2009	2008
Realized gains:		
Sales of fixed maturities	$ 3,741	$ 9,425
Sales of equity securities	1,232	65,948
Other	4,562	1,267
Total realized gains	9,535	76,640
Realized losses:		
Sales of fixed maturities	(23,955)	(85,495)
Sales of equity securities	(57)	(3,657)
Other-than-temporary impairments	(85,912)	(187,145)
Other		(590)
Total realized losses	(109,924)	(276,887)
Net realized investment losses	$ (100,389)	$ (200,247)
Change in net unrealized gains:		
Fixed maturities	$ 324,951	$ (207,443)
Equity securities	240,345	(166,468)
Short-term investments	5	7
Net increase (decrease)	$ 565,301	$ (373,904)

f) The following tables present other-than-temporary impairment losses recognized in net income (loss) and included in net realized investment losses by investment type.

(dollars in thousands)	Quarter Ended September 30, 2009	2008
Fixed maturities:		
Corporate bonds	$ (1,599)	$ (30,881)
Residential mortgage-backed securities	(85)	
Other		
Total fixed maturities	(1,684)	(30,881)
Equity securities:		
Insurance companies, banks and trusts	(280)	(11)
Industrial, consumer and all other		(54,715)
Total equity securities	(280)	(54,726)
Preferred stock		(9,000)
Investments in affiliates	(20,468)	
Total	$ (22,432)	$ (94,607)

(dollars in thousands)	Nine Months Ended September 30, 2009	2008
Fixed maturities:		
Corporate bonds	$ (7,310)	$ (32,407)
Residential mortgage-backed securities	(2,121)	
Other	(1,487)	
Total fixed maturities	(10,918)	(32,407)
Equity securities:		
Insurance companies, banks and trusts	(15,978)	(69,275)
Industrial, consumer and all other	(38,548)	(76,463)
Total equity securities	(54,526)	(145,738)
Preferred stock		(9,000)
Investments in affiliates	(20,468)	
Total	$ (85,912)	$ (187,145)

Total write downs for other-than-temporary declines in the estimated fair value of investments for the third quarter of 2009 were $26.7 million, of which $22.4 million was recognized in net income and $4.2 million was recognized in other comprehensive income. The write downs for other-than-temporary declines in the estimated fair value of investments for the third quarter of 2009 related to one equity security, four fixed maturities and one investment in affiliate. Total write downs for other-than-temporary declines in the estimated fair value of investments for the nine months ended September 30, 2009 were $93.9 million, of which $85.9 million was recognized in net income and $8.0 million was recognized in other comprehensive income. The write downs for other-than-temporary declines in the estimated fair value of investments for the nine months ended September 30, 2009 related to 29 equity securities, 14 fixed maturities and one investment in affiliate. Write downs for the nine months ended September 30, 2009 included write downs to the Company s equity holdings in General Electric Company and United Parcel Service, Inc. of $21.0 million and $9.5 million, respectively. Given the extent to which the fair value of these equity securities was below cost and management s belief that these securities were unlikely to recover in the near term, the decline in fair value for these securities was deemed other-than-temporary and was recognized in net income. The write down related to an investment in affiliate, which is accounted for under the equity method of accounting, was due to an anticipated merger that is expected to reduce the value of the Company s investment. Net realized investment losses included $94.6 million and $187.1 million of write downs for other-than-temporary declines in the estimated fair value of investments for the quarter and nine months ended September 30, 2008, respectively.

5. Long-term Debt

On September 22, 2009, the Company issued $350 million of 7.125% unsecured senior notes due September 30, 2019. Net proceeds to the Company were $347.2 million, which will be used for general corporate purposes, including acquisitions.

On September 14, 2009, the Company repaid $150 million of borrowings that were outstanding under its revolving credit facility.

Table of Contents

6. Segment Reporting Disclosures

The Company operates in three segments of the specialty insurance marketplace: the Excess and Surplus Lines, the Specialty Admitted and the London markets.

All investing activities are included in the Investing segment. For purposes of segment reporting, the Other segment includes lines of business that have been discontinued in conjunction with an acquisition.

The Company considers many factors, including the nature of its insurance products, production sources, distribution strategies and regulatory environment in determining how to aggregate operating segments.

Segment profit or loss for each of the Company s operating segments is measured by underwriting profit or loss. The property and casualty insurance industry commonly defines underwriting profit or loss as earned premiums net of losses and loss adjustment expenses and underwriting, acquisition and insurance expenses. Underwriting profit or loss does not replace operating income (loss) or net income (loss) computed in accordance with U.S. GAAP as a measure of profitability. Underwriting profit or loss provides a basis for management to evaluate the Company s underwriting performance. Segment profit for the Investing segment is measured by net investment income and net realized investment gains or losses.

The Company does not allocate assets to the Excess and Surplus Lines, Specialty Admitted and London Insurance Market operating segments for management reporting purposes. Total invested assets and the related net investment income are allocated to the Investing segment since these assets are available for payment of losses and expenses for all operating segments. The Company does not allocate capital expenditures for long-lived assets to any of its operating segments for management reporting purposes.

a) The following tables summarize the Company s segment disclosures.

	Quarter Ended September 30, 2009					
(dollars in thousands)	**Excess and Surplus Lines**	**Specialty Admitted**	**London Insurance Market**	**Investing**	**Other**	**Consolidated**
Gross premium volume	$ 246,790	$ 86,146	$ 151,768	$	$ 73	$ 484,777
Net written premiums	219,237	79,135	132,543		40	430,955
Earned premiums	$ 226,650	$ 73,456	$ 148,252	$	$ 40	$ 448,398
Losses and loss adjustment expenses:						
Current year	149,946	46,448	102,426			298,820
Prior years	(37,494)	(4,375)	(29,273)		9,653	(61,489)
Underwriting, acquisition and insurance expenses	100,203	30,867	62,171		(154)	193,087
Underwriting profit (loss)	13,995	516	12,928		(9,459)	17,980
Net investment income				66,663		66,663
Net realized investment losses				(29,770)		(29,770)
Segment profit (loss)	$ 13,995	$ 516	$ 12,928	$ 36,893	$ (9,459)	$ 54,873
Amortization of intangible assets						1,179
Interest expense						12,000
Income before income taxes						$ 41,694
U.S. GAAP combined ratio[1]	94%	99%	91%		NM[2]	96%

	Quarter Ended September 30, 2008					
(dollars in thousands)	**Excess and Surplus Lines**	**Specialty Admitted**	**London Insurance Market**	**Investing**	**Other**	**Consolidated**
Gross premium volume	$ 298,180	$ 99,050	$ 166,484	$	$ 182	$ 563,896
Net written premiums	264,974	91,447	141,541		141	498,103
Earned premiums	$ 275,893	$ 78,707	$ 161,320	$	$ 143	$ 516,063
Losses and loss adjustment expenses:						
Current year	230,157	72,079	173,667			475,903
Prior years	(24,545)	(5,253)	(13,603)		23,670	(19,731)
Underwriting, acquisition and insurance expenses	96,576	29,806	59,078		746	186,206
Underwriting loss	(26,295)	(17,925)	(57,822)		(24,273)	(126,315)
Net investment income				68,232		68,232
Net realized investment losses				(168,679)		(168,679)
Segment loss	$ (26,295)	$ (17,925)	$ (57,822)	$ (100,447)	$ (24,273)	$ (226,762)
Amortization of intangible assets						1,141
Interest expense						11,024
Loss before income taxes						$ (238,927)
U.S. GAAP combined ratio[1]	110%	123%	136%		NM[2]	124%

(1) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(2) NM Ratio is not meaningful.

	Nine Months Ended September 30, 2009					
(dollars in thousands)	Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Investing	Other	Consolidated
Gross premium volume	$ 740,485	$ 226,697	$ 509,967	$	$ 139	$ 1,477,288
Net written premiums	666,237	209,007	450,099		(140)	1,325,203
Earned premiums	$ 717,453	$ 226,945	$ 416,600	$	$ (140)	$ 1,360,858
Losses and loss adjustment expenses:						
Current year	491,669	145,930	295,202			932,801
Prior years	(88,514)	(4,802)	(67,169)		4,565	(155,920)
Underwriting, acquisition and insurance expenses	297,163	84,242	159,320		593	541,318
Underwriting profit (loss)	17,135	1,575	29,247		(5,298)	42,659
Net investment income				200,765		200,765
Net realized investment losses				(100,389)		(100,389)
Segment profit (loss)	$ 17,135	$ 1,575	$ 29,247	$ 100,376	$ (5,298)	$ 143,035
Amortization of intangible assets						3,536
Interest expense						34,984
Income before income taxes						$ 104,515
U.S. GAAP combined ratio[1]	98%	99%	93%		NM[2]	97%

	Nine Months Ended September 30, 2008					
(dollars in thousands)	Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Investing	Other	Consolidated
Gross premium volume	$ 909,031	$ 266,238	$ 571,819	$	$ 473	$ 1,747,561
Net written premiums	799,906	242,082	500,147		153	1,542,288
Earned premiums	$ 826,856	$ 234,154	$ 459,022	$	$ 155	$ 1,520,187
Losses and loss adjustment expenses:						
Current year	579,281	169,586	379,003			1,127,870
Prior years	(72,300)	(9,766)	(42,655)		25,856	(98,865)
Underwriting, acquisition and insurance expenses	290,943	90,164	173,077		(2,115)	552,069
Underwriting profit (loss)	28,932	(15,830)	(50,403)		(23,586)	(60,887)
Net investment income				220,765		220,765
Net realized investment losses				(200,247)		(200,247)
Segment profit (loss)	$ 28,932	$ (15,830)	$ (50,403)	$ 20,518	$ (23,586)	$ (40,369)
Amortization of intangible assets						3,239
Interest expense						35,789
Loss before income taxes						$ (79,397)
U.S. GAAP combined ratio[1]	97%	107%	111%		NM[2]	104%

(1) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(2) NM Ratio is not meaningful.

b) The following table reconciles segment assets to the Company s consolidated balance sheets.

(dollars in thousands)	**September 30, 2009**	**December 31, 2008**
Segment Assets:		
Investing	$ 7,971,387	$ 6,908,456
Other	2,230,266	2,569,234
Total Assets	$ 10,201,653	$ 9,477,690

7. Derivatives

In 2007, the Company entered into a credit default swap agreement, under which third party credit risk was transferred from a counterparty to the Company in exchange for $30.0 million. The Company entered into the credit default swap agreement for investment purposes. The initial notional amount of the credit default swap was $50.0 million, which represented the Company s aggregate exposure to losses if specified credit events involving third party reference entities occur. These third party reference entities are specified under the terms of the agreement and represent a portfolio of names upon which the Company has assumed credit risk from the counterparty. The Company s exposure to loss from any one reference entity is limited to $20.0 million. The credit default swap has a scheduled termination date of December 2014.

The credit default swap is accounted for as a derivative instrument and is recorded at fair value with any changes in fair value recorded in net investment income. At September 30, 2009, the credit default swap had a fair value of $27.0 million. The fair value of the credit default swap is determined by the Company using an external valuation model that is dependent upon several inputs, including changes in interest rates, credit spreads, expected default rates, changes in credit quality, future expected recovery rates and other market factors. The fair value of the credit default swap is included in other liabilities on the consolidated balance sheet. For the quarter and nine months ended September 30, 2009, net investment income included a favorable change in the fair value of the credit default swap of $0.6 million and $3.0 million, respectively. For the quarter and nine months ended September 30, 2008, net investment income included an adverse change in the fair value of the credit default swap of $7.7 million and $11.7 million, respectively.

Since entering into the credit default swap agreement, the Company has paid $16.9 million to settle its obligations related to credit events. These payments reduced the Company s liability related to its credit default swap; as a result, the notional amount for which the Company has exposure decreased to $33.1 million.

The Company had no other material derivative instruments at September 30, 2009.

8. Employee Benefit Plans

a) Expenses relating to all of the Company s defined contribution plans were $3.3 million and $9.4 million, respectively, for the quarter and nine months ended September 30, 2009 and $3.3 million and $10.0 million, respectively, for the same periods in 2008.

Table of Contents

b) The following table presents the components of net periodic benefit cost for the Terra Nova Pension Plan, a defined benefit plan.

(dollars in thousands)	Quarter Ended September 30, 2009	Quarter Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Service cost	$ 428	$ 511	$ 1,222	$ 1,552
Interest cost	1,527	1,541	4,355	4,678
Expected return on plan assets	(1,743)	(1,899)	(4,973)	(5,763)
Amortization of net actuarial pension loss	517	422	1,474	1,278
Net periodic benefit cost	$ 729	$ 575	$ 2,078	$ 1,745

The Company contributed $6.4 million to the Terra Nova Pension Plan during the nine months ended September 30, 2009. The Company expects plan contributions to approximate $6.7 million in 2009.

9. Income Taxes

The Company recognized an income tax benefit of $3.8 million for the nine months ended September 30, 2009 compared to an income tax benefit of $53.3 million for the same period of 2008. The tax benefit for the nine months ended September 30, 2009 included a benefit of approximately $25 million related to a change in United Kingdom tax law that became effective in the third quarter of 2009. This change in tax law allowed the Company to translate the value of its United Kingdom net operating losses at more favorable, historical currency exchange rates. Before considering the change in United Kingdom tax law, the Company s estimated annual effective tax rate for the nine months ended September 30, 2009 was 20%, which differs from the statutory rate of 35% primarily as a result of tax-exempt investment income. The provision for income tax benefit for the nine months ended September 30, 2008 reflected an effective rate of 67% and was calculated based on actual loss before income taxes and estimated permanent differences through that date. The rate of tax benefit was higher than that obtained by applying the statutory rate of 35% to our loss before income taxes in 2008 due to the additional tax benefits associated with favorable permanent differences, principally tax-exempt investment income.

10. Contingencies

On February 10, 2009, Guaranty Bank, an insured under a program written by the Company covering financial institutions against defaults on second mortgages and home equity loans, filed a lawsuit against the Company s subsidiary, Evanston Insurance Company (Evanston), and the managing general agent for the program, Universal Assurors Agency, Inc., in the United States District Court for the Eastern District of Wisconsin. The lawsuit alleges violations of the Wisconsin insurance code relating to Guaranty Bank s policy, which has been in force since 2004, and seeks, among other things, the return of all premiums paid under the policy and a declaration requiring continued coverage of losses notwithstanding the claim for return of premiums paid.

Premiums paid from inception of Guaranty Bank s policy through September 30, 2009 have been approximately $49 million and covered losses have been approximately $38 million. At September 30, 2009, the policy insured a portfolio of loans totaling approximately $568 million, and the limit of the Company s liability for additional losses with respect to the covered loans is estimated to be approximately $118 million.

On March 23, 2009, Guaranty Bank filed a motion for a preliminary injunction with the court, asking that it be relieved from paying premiums while the litigation is pending, with the Company still being required to pay losses. On July 14, 2009, the court issued an order denying the motion for a preliminary injunction.

In October 2009, the Company was separately notified that the Office of the Commissioner of Insurance of Wisconsin had undertaken an investigation and was alleging that the insurance policies written by Evanston in Wisconsin, including Guaranty Bank s policy, were mortgage guaranty insurance and could not be written on a surplus lines basis in that state. In settlement of the allegations and without admitting any violation, Evanston has agreed to pay a fine of $100,000 and to refrain from writing similar policies in the future. The Guaranty Bank policy accounts for over 95% of the premiums written under this program in Wisconsin.

While the Company does not believe Guaranty Bank is entitled to the relief it has sought, the final outcome of the lawsuit cannot be predicted at this time.

Other contingencies arise in the normal conduct of the Company s operations and are not expected to have a material impact on the Company s financial condition or results of operations. However, adverse outcomes are possible and could negatively impact the Company s financial condition and results of operations.

11. Recent Accounting Pronouncements

Effective April 1, 2009, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320-10-65, *Investments Debt and Equity Securities*. This guidance amends the requirements for recognizing other-than-temporary impairment on debt securities and modifies the presentation of other-than-temporary impairment losses in the financial statements. The guidance requires other-than-temporary impairment of a debt security to be separated into two components when there are credit-related losses associated with the impaired debt security for which management asserts that it does not have the intent to sell the security and it is more likely than not that it will not be required to sell the security before recovery of the security s amortized cost. The amount of the other-than-temporary impairment related to a credit loss is recognized in net income (loss), and the amount of the other-than-temporary impairment related to other factors is recognized in other comprehensive income (loss), net of applicable taxes. The guidance also expands disclosure requirements related to other-than-temporary impairment, but does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities.

Upon adoption of FASB ASC 320-10-65, the Company recorded an increase of $15.3 million, net of taxes, to the opening balance of retained earnings with a corresponding decrease to accumulated other comprehensive income to reclassify the non-credit portion of previously recognized other-than-temporary impairment losses on debt securities held as of April 1, 2009 for which the Company did not intend to sell the securities and did not believe that it would be required to sell the securities before recovery of their amortized cost.

Effective in the second quarter of 2009, the Company adopted FASB ASC 820-10-65*, Fair Value Measurements and Disclosures*, which provides additional guidance on how to estimate fair value when the volume and level of market activity for an asset or liability have significantly decreased. Under the provisions of this guidance, if an entity determines that there has been a significant decrease in the volume and level of activity for an asset or liability (or similar assets or liabilities), then transactions or quoted prices may not accurately reflect fair value. In such instances, further analysis of the transactions or quoted prices is required, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value. FASB

Table of Contents

ASC 820-10-65 also provides guidance on identifying circumstances that may indicate a transaction is not orderly. Under the provisions of this guidance, if evidence indicates that a transaction is not orderly, an entity should place little, if any, weight on that transaction price when estimating fair value. The adoption of FASB ASC 820-10-65 did not have a material impact on the Company s financial position, results of operations or cash flows.

Effective in the second quarter of 2009, the Company adopted FASB ASC 825-10-65, *Financial Instruments*. This guidance requires disclosures about the fair value of financial instruments to be included in interim financial statements, adding to the existing requirement to provide those disclosures in annual financial statements. This guidance also requires entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments and to highlight any changes in these methods and assumptions from prior periods. Since FASB ASC 825-10-65 addresses financial statement disclosures only, the adoption of this guidance did not have an impact on the Company s financial position, results of operations or cash flows.

Effective in the second quarter of 2009, the Company adopted FASB ASC 855-10, *Subsequent Events,* which provides guidance on the period after the balance sheet date during which management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements. The adoption of this guidance did not have an impact on the Company s financial position, results of operations or cash flows.

In June 2009, the FASB issued Statement of Financial Accounting Standards (Statement) No. 167, *Amendments to FASB Interpretation No. 46(R)*. This guidance removes the scope exception for qualifying special-purpose entities, includes new criteria for determining the primary beneficiary of a variable interest entity and increases the frequency of required assessments to determine whether an entity is the primary beneficiary of a variable interest entity. Statement No. 167 becomes effective for the Company beginning January 1, 2010. The Company is currently evaluating Statement No. 167 to determine the potential impact that adopting this standard will have on its consolidated financial statements.

12. Fair Value Measurements

Effective January 1, 2008, the Company adopted FASB ASC 820-10, *Fair Value Measurements and Disclosures.* This guidance establishes a framework for measuring fair value, clarifies the definition of fair value within that framework and expands disclosure requirements regarding the use of fair value measurements. The adoption of FASB ASC 820-10 did not have a material impact on the Company s financial position, results of operations or cash flows.

In February 2008, the FASB issued FASB ASC 820-10-55, *Fair Value Measurements and Disclosure Implementation Guidance and Illustrations*. This guidance deferred the effective date of FASB ASC 820 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis, until January 1, 2009. The adoption of FASB ASC 820-10-55 did not have an impact on the Company s financial position, results of operations or cash flows.

FASB ASC 820-10 establishes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the assets or liabilities fall within different levels of the hierarchy, the classification is based on the lowest level input that is significant to the fair value measurement of the asset or liability. Classification of

Table of Contents

assets and liabilities within the hierarchy considers the markets in which the assets and liabilities are traded and the reliability and transparency of the assumptions used to determine fair value. The hierarchy requires the use of observable market data when available. The levels of the hierarchy are defined as follows:

Level 1 Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities traded in active markets.

Level 2 Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and market-corroborated inputs.

Level 3 Inputs to the valuation methodology are unobservable for the asset or liability and are significant to the fair value measurement.

In accordance with FASB ASC 820, the Company determines fair value based on 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. In determining fair value, the Company uses various methods, including the market, income and cost approaches. The Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The following section describes the valuation methodologies used by the Company to measure assets and liabilities at fair value, including an indication of the level within the fair value hierarchy in which each asset or liability is generally classified.

Investments available-for-sale. Investments available-for-sale are recorded at fair value on a recurring basis and include fixed maturities, equity securities and short-term investments. Short-term investments include certificates of deposit, commercial paper, discount notes and treasury bills with original maturities of one year or less. Fair value for investments available for sale is determined by the Company after considering various sources of information, including information provided by a third party pricing service. The pricing service provides prices for substantially all of the Company s fixed maturities and equity securities. In determining fair value, the Company generally does not adjust the prices obtained from the pricing service. The Company obtains an understanding of the pricing service s valuation methodologies and related inputs, which include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers, duration, credit ratings, estimated cash flows and prepayment speeds. The Company validates prices provided by the pricing service by reviewing prices from other pricing sources and analyzing pricing data in certain instances.

Fair value for investments available for sale is measured based upon quoted prices in active markets, if available. Due to variations in trading volumes and the lack of quoted market prices for fixed maturities, the fair value of fixed maturities is normally derived through recent reported trades for identical or similar securities, making adjustments through the reporting date based upon available market observable data described above. If there are no recent reported trades, the fair value of fixed maturities may be derived through the use of matrix pricing or model processes, where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate.

The Company has evaluated the various types of securities in its investment portfolio to determine an appropriate fair value hierarchy level based upon trading activity and the observability of market inputs. Level 1 investments include those traded on an active exchange, such as the New York Stock Exchange. Level 2 investments include U.S. Treasury securities and obligations of U.S. government agencies, municipal bonds, foreign government bonds and corporate debt securities.

Table of Contents

Derivatives. Derivatives are recorded at fair value on a recurring basis and include a credit default swap. The fair value of the credit default swap is measured by the Company using a third party pricing model. See note 7 for a discussion of the valuation model for the credit default swap, including the key inputs and assumptions to the model. Due to the significance of unobservable inputs required in measuring the fair value of the credit default swap, the credit default swap has been classified as Level 3 within the fair value hierarchy.

The following table presents the balances of assets and liabilities measured at fair value on a recurring basis as of September 30, 2009, by level within the fair value hierarchy.

(dollars in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Investments available-for-sale:				
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. government agencies	$	$ 385,922	$	$ 385,922
Obligations of states, municipalities and political subdivisions		2,088,495		2,088,495
Foreign governments		330,509		330,509
Residential mortgage-backed securities		436,699		436,699
Asset-backed securities		26,859		26,859
Public utilities		150,230		150,230
Convertible bonds		29,531		29,531
All other corporate bonds		1,462,494		1,462,494
Total fixed maturities		4,910,739		4,910,739
Equity securities:				
Insurance companies, banks and trusts	585,065			585,065
Industrial, consumer and all other	694,825			694,825
Total equity securities	1,279,890			1,279,890
Short-term investments	618,609	47,701		666,310
Total investments available-for-sale	1,898,499	4,958,440		6,856,939
Liabilities:				
Derivative contracts	$	$	$ 26,981	$ 26,981

Table of Contents

The following tables summarize changes in Level 3 liabilities measured at fair value on a recurring basis.

(dollars in thousands)	**Derivatives**
Beginning balance as of June 30, 2009	$ 27,630
Total net gains included in:	
Net income	(649)
Other comprehensive income	
Net transfers into (out of) Level 3	
Ending balance as of September 30, 2009	$ 26,981
Net unrealized gains included in net income for the period relating to liabilities held at September 30, 2009	$ 649 [1]

(dollars in thousands)	**Derivatives**
Beginning balance as of January 1, 2009	$ 29,964
Total net gains included in:	
Net income	(2,983)
Other comprehensive income	
Net transfers into (out of) Level 3	
Ending balance as of September 30, 2009	$ 26,981
Net unrealized gains included in net income for the period relating to liabilities held at September 30, 2009	$ 2,983[1]

[1] Included in net investment income in the consolidated statements of operations and comprehensive income (loss).

The Company did not have any assets or liabilities measured at fair value on a non-recurring basis during the nine months ended September 30, 2009.

The estimated fair value of the Company s long-term debt is based on quoted market prices.

13. Subsequent Events

On October 1, 2009, the Company acquired a Canadian managing general agent that provides insurance underwriting and administrative services to insurers. In connection with this acquisition, the Company paid approximately $70 million.

The Company evaluated subsequent events through the date the accompanying financial statements were issued, which was November 4, 2009.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The accompanying consolidated financial statements and related notes have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of Markel Corporation and all subsidiaries.

Critical Accounting Estimates

Critical accounting estimates are those estimates that both are important to the portrayal of our financial condition and results of operations and require us to exercise significant judgment. The preparation of financial statements in accordance with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of material contingent assets and liabilities, including litigation contingencies. These estimates, by necessity, are based on assumptions about numerous factors.

We review our critical accounting estimates and assumptions quarterly. These reviews include evaluating the adequacy of reserves for unpaid losses and loss adjustment expenses, the reinsurance allowance for doubtful accounts and income tax liabilities, as well as analyzing the recoverability of deferred tax assets, assessing goodwill for impairment and evaluating the investment portfolio for other-than-temporary declines in estimated fair value. Actual results may differ materially from the estimates and assumptions used in preparing the consolidated financial statements.

Readers are urged to review our 2008 Annual Report on Form 10-K for a more complete description of our critical accounting estimates.

Our Business

We market and underwrite specialty insurance products and programs to a variety of niche markets and believe that our specialty product focus and niche market strategy enable us to develop expertise and specialized market knowledge. We seek to differentiate ourselves from competitors by our expertise, service, continuity and other value-based considerations. We compete in three segments of the specialty insurance marketplace: the Excess and Surplus Lines, the Specialty Admitted and the London markets. Our financial goals are to earn consistent underwriting profits and superior investment returns to build shareholder value.

Our Excess and Surplus Lines segment writes property and casualty insurance outside of the standard market for hard-to-place risks including catastrophe-exposed property, professional liability, products liability, general liability, commercial umbrella and other coverages tailored for unique exposures. In 2008, our Excess and Surplus Lines segment was comprised of four underwriting units, each with product-focused specialists servicing brokers, agents and insureds across the United States from their respective underwriting unit locations. In late March 2009, we transitioned the four underwriting units included in our Excess and Surplus Lines segment to a customer-focused regional office model as part of our previously announced One Markel initiative. Under this new model, each of our five regional offices will be responsible for serving the needs of the wholesale producers located in its region. The underwriters at our regional offices have access to and expertise in all of our product offerings and are located closer to our producers.

Table of Contents

Our Specialty Admitted segment writes risks that, although unique and hard-to-place in the standard market, must remain with an admitted insurance company for marketing and regulatory reasons. Our underwriting units in this segment write specialty program insurance for well-defined niche markets and personal and commercial property and liability coverages. During 2009, our Specialty Admitted segment consists of two underwriting units. Our Specialty Admitted segment included a third underwriting unit, Markel Global Marine and Energy, until late 2008 when we decided to close that unit and place its programs into run-off.

Our London Insurance Market segment writes specialty property, casualty, professional liability and marine insurance and reinsurance on a worldwide basis. We participate in the London Market through Markel International, which includes Markel Capital Limited and Markel International Insurance Company Limited, wholly-owned subsidiaries. Markel Capital Limited is the corporate capital provider for Markel Syndicate 3000 at Lloyd s, which is managed by Markel Syndicate Management Limited, a wholly-owned subsidiary.

For purposes of segment reporting, the Other segment includes lines of business that have been discontinued in conjunction with an acquisition.

Key Performance Indicators

We measure financial success by our ability to compound growth in book value per share at a high rate of return over a long period of time. We recognize that it is difficult to grow book value consistently each year, so we measure ourselves over a five-year period. We believe that growth in book value per share is the most comprehensive measure of our success because it includes all underwriting and investing results. We measure underwriting results by our underwriting profit or loss and combined ratio. These measures are discussed in greater detail under Results of Operations.

Results of Operations

The following table compares the components of net income (loss).

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	**2009**	**2008**	**2009**	**2008**
Underwriting profit (loss)	$ 17,980	$ (126,315)		