

ALLEGHANY CORP /DE  
Form 10-K  
February 24, 2012  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-K**

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2011

or

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-9371

**ALLEGHANY CORPORATION**

(Exact name of registrant as specified in its charter)

<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>51-0283071</b> (I.R.S. Employer Identification Number)
7 Times Square Tower,  New York, New York (Address of principal executive offices)	10036 (Zip Code)
Registrant's telephone number, including area code:  212-752-1356	

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange

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Common Stock, \$1.00 par value

on Which Registered

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

Not applicable

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company.

Yes  No

As of June 30, 2011, the aggregate market value (based upon the closing price of these shares on the New York Stock Exchange) of the shares of Common Stock of Alleghany Corporation held by non-affiliates was \$2,834,323,730.

As of February 21, 2012, 8,551,911 shares of Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement relating to the Annual Meeting of Stockholders of Alleghany Corporation to be held on April 27, 2012 are incorporated into Part III of this Form 10-K Report.

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**ALLEGHANY CORPORATION**

**Form 10-K Report**

**for the year ended December 31, 2011**

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**PART I**

References in this Annual Report on Form 10-K for the year ended December 31, 2011, or the Form 10-K Report, to the Company, Alleghany, we, us and our refer to Alleghany Corporation and its consolidated subsidiaries, unless the context otherwise requires. In addition, unless the context otherwise requires, references to

AIHL are to our insurance holding company subsidiary Alleghany Insurance Holdings LLC,

RSUI are to our subsidiary RSUI Group, Inc. and its subsidiaries,

CATA are to our subsidiary Capitol Transamerica Corporation and its subsidiaries, and also includes the operations and results of Platte River Insurance Company, or Platte River, unless the context otherwise requires,

PCC refers to our subsidiary Pacific Compensation Corporation (formerly known as Employers Direct Corporation),

AIHL Re are to our subsidiary AIHL Re LLC, and

Alleghany Properties are to our subsidiary Alleghany Properties Holdings LLC and its subsidiaries.

**Items 1 and 2. Business and Properties.**

**Business Overview**

We are a Delaware corporation engaged, through AIHL and its subsidiaries RSUI, CATA and PCC, in the property and casualty and surety insurance business. CATA has been a subsidiary of AIHL since January 2002, and RSUI has been a subsidiary of AIHL since July 2003. In June 2006, AIHL Re was established as a captive reinsurance subsidiary of AIHL, and AIHL Re has, in the past, provided reinsurance to our insurance operating units and affiliates. In March 2007, Alleghany Capital Partners LLC, or Alleghany Capital Partners, was established to manage our equity investments, including those held by our insurance operating units. AIHL acquired PCC on July 18, 2007 for a purchase price of \$198.1 million, including \$5.6 million of incurred acquisition costs. We also own and manage land in Sacramento, California through our subsidiary Alleghany Properties.

We own an approximately 38 percent ownership stake in ORX Exploration, Inc., or ORX, a regional oil and gas exploration and production company, and an approximately 33 percent stake in Homesite Group Incorporated, or Homesite, a national, full-service, mono-line provider of homeowners insurance. We acquired our stake in ORX on July 18, 2008 through a purchase of participating preferred stock for cash consideration of \$50.0 million.

On November 20, 2011, we entered into an Agreement and Plan of Merger, or the merger agreement, with a wholly-owned subsidiary that we created, Shoreline Merger Sub, LLC, (which was subsequently converted into a corporation), or Merger Sub, and Transatlantic Holdings, Inc., or Transatlantic. The merger agreement provides for the merger of Transatlantic with and into Merger Sub, which we refer to as the merger, with Merger Sub continuing as the surviving company and our wholly-owned subsidiary. Subject to the terms and conditions of the merger agreement, the stockholders of Transatlantic will receive aggregate consideration valued at \$59.79 per share (based on the closing price of our common stock, par value \$1.00 per share, on November 18, 2011), or approximately \$3.4 billion. Each outstanding share of Transatlantic common stock, par value \$1.00 per share, will be exchanged for per-share consideration consisting of 0.145 share of our common stock and \$14.22 in cash (or \$816.0 million in total cash consideration). The actual value of the merger consideration to be paid at the closing of the merger will depend on the average closing price of Alleghany common stock in the five business days prior to closing, as more fully described in the merger agreement.

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Transatlantic is a leading international reinsurance organization headquartered in New York, with operations on six continents. Its subsidiaries, Transatlantic Reinsurance Company, Trans Re Zurich Reinsurance Company

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Ltd. and Putnam Reinsurance Company, offer reinsurance capacity on both a treaty and facultative basis structuring programs for a full range of property and casualty products, with an emphasis on specialty risks.

On February 6, 2012, Alleghany stockholders approved the issuance of our common stock in connection with the merger and Transatlantic approved the merger and certain related matters. The merger is subject to certain customary conditions, including listing of the shares of common stock to be issued in the merger on the New York Stock Exchange and receipt of required regulatory approvals. We expect that the merger will close in the first quarter of 2012.

We owned approximately 55 percent of Darwin Professional Underwriters, Inc., or Darwin, a specialty property and casualty insurer until October 20, 2008, when it was merged with a subsidiary of Allied World Assurance Company Holdings, Ltd, or AWAC. As a result of our disposition of Darwin, that business has been reclassified as discontinued operations in this Form 10-K Report.

As of December 31, 2011, we had 763 employees, with 752 at our subsidiaries and 11 at the parent level. Our principal executive offices are located in leased office space of approximately 14,200 square feet at 7 Times Square Tower, New York, New York 10036, and our telephone number is (212) 752-1356.

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, are available, free of charge, on our website at [www.alleghany.com](http://www.alleghany.com), as soon as reasonably practicable after we electronically file this material with, or furnish it to, the U.S. Securities and Exchange Commission, or the SEC. Our Financial Personnel Code of Ethics, Code of Business Conduct and Ethics, Corporate Governance Guidelines and the charters for our Audit, Compensation and Nominating and Governance Committees are also available on our website. In addition, interested parties may obtain, free of charge, copies of any of the above reports or documents upon request to the Secretary of Alleghany.

We refer you to Items 7 and 8 of this Form 10-K Report for further information about our business in 2011. Our consolidated financial statements are set forth in Item 8 of this Form 10-K Report and include our accounts and the accounts of our subsidiaries for all periods presented.

## **Property and Casualty and Surety Insurance Businesses**

### *General Description of Business*

AIHL is our holding company for our property and casualty and surety insurance operations. Property and casualty operations are conducted through RSUI, headquartered in Atlanta, Georgia; CATA, headquartered in Middleton, Wisconsin; and PCC, headquartered in Agoura Hills, California. Surety operations are conducted through CATA. AIHL Re, our Vermont-domiciled captive reinsurance company, has, in the past, provided reinsurance to our insurance operating units and affiliates. Unless we state otherwise, references to AIHL include the operations of RSUI, CATA, PCC and AIHL Re. We also own an approximately 33 percent stake in Homesite, a national, full-service, mono-line provider of homeowners insurance.

In general, property insurance protects an insured against financial loss arising out of loss of property or its use caused by an insured peril. Casualty insurance protects the insured against financial loss arising out of the insured's obligation to others for loss or damage to property or persons, including, with respect to workers' compensation insurance, persons who are employees of the insured. In 2011, property insurance accounted for approximately 48.4 percent, and casualty insurance accounted for approximately 47.2 percent, of AIHL's gross premiums written. Surety bonds, both commercial and contract, are three-party agreements in which the issuer of the bond (the surety) joins with a second party (the principal) in guaranteeing to a third party (the obligee) the fulfillment of some obligation on the part of the principal to the obligee. In 2011, surety bonds accounted for approximately 4.4 percent of AIHL's gross premiums written.

### *RSUI*

*General.* RSUI, which includes the operations of its operating subsidiaries RSUI Indemnity Company, or RIC, Landmark American Insurance Company, or Landmark, and Covington Specialty Insurance Company,

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or Covington, underwrites specialty insurance coverages in the property, umbrella/excess, general liability, directors and officers, or D&O liability and professional liability lines of business. The market for specialty insurance coverages differs significantly from the market for standard insurance coverages. The specialty market provides coverage for hard-to-place risks that generally do not fit the underwriting criteria of the standard market which provides coverage for largely uniform and relatively predictable exposures and which is highly regulated with respect to rates and forms.

RSUI writes specialty business in the admitted specialty market primarily through RIC in the 50 states and the District of Columbia where RIC is licensed and subject to state form and rate regulations. Most of the risks in the admitted specialty market are unique and hard-to-place in the standard market, but must remain with an admitted insurance company for regulatory and/or marketing reasons. As an admitted carrier, RIC is subject to more state regulation than a non-admitted carrier, particularly with regard to rate and form filing requirements, restrictions on the ability to exit lines of business, premium tax payments and membership in various state associations, such as state guaranty funds and assigned risk plans.

RSUI writes business on an approved, non-admitted basis primarily through Landmark, which, as a non-admitted company, is not subject to state form and rate regulations and thus has more flexibility in its rates and coverages for specialized or hard-to-place risks. This typically results in coverages that are more restrictive and expensive than coverages written by a standard insurance company. As of December 31, 2011, Landmark was approved to write business on a non-admitted basis in 49 states and is a domestic surplus lines company in Oklahoma.

Covington, a New Hampshire-domiciled insurer, was formed in September 2007 to, among other things, support non-admitted business written primarily by RSUI's binding authority department, which writes small, specialized coverages pursuant to underwriting authority arrangements with managing general agents.

Pursuant to quota share arrangements effective as of January 1, 2009, Landmark and Covington cede 90 percent of all their respective premiums and losses, gross of third party reinsurance, to RIC. As of December 31, 2011, the statutory surplus of RIC was approximately \$1.26 billion, the statutory surplus of Landmark was \$195.0 million, and the statutory surplus of Covington was \$46.0 million. RIC is rated A (Excellent) by A.M. Best Company, Inc., or A.M. Best, an independent organization that analyzes the insurance industry. Landmark is rated A (Excellent) on a reinsured basis by A.M. Best, and Covington is rated A (Excellent) on a reinsured basis by A.M. Best. RSUI leases approximately 133,000 square feet of office space in Atlanta, Georgia for its headquarters and approximately 34,000 square feet of office space in Sherman Oaks, California.

*Distribution.* As of December 31, 2011, RSUI conducted its insurance business through approximately 155 independent wholesale insurance brokers located throughout the United States and 30 managing general agents. RSUI's wholesale brokers are appointed on an individual basis based on management's appraisal of expertise and experience, and only specific locations of a wholesale broker's operations may be appointed to distribute RSUI's products. Producer agreements which stipulate premium collection, payment terms and commission arrangements are in place with each wholesale broker. No wholesale broker holds underwriting, claims or reinsurance authority. RSUI has entered into underwriting authority arrangements with 30 managing general agents for small, specialized coverages. RSUI's top five producing wholesale brokers accounted for approximately 56 percent of gross premiums written by RSUI in 2011. RSUI's top two producing wholesale brokers, Swett & Crawford Group and AmWINS Group, Inc. accounted for, in the aggregate, approximately 32 percent of AIHL's gross premiums written in 2011.

*Underwriting.* RSUI's underwriting philosophy is based on handling only product lines in which its underwriters have underwriting expertise. RSUI generally focuses on higher severity, lower frequency specialty risks that can be effectively desk underwritten without the need for inspection or engineering reviews. RSUI tracks underwriting results for each of its underwriters and believes that the underwriting systems and applications it has in place facilitate efficient underwriting and high productivity levels. Underwriting authority is delegated on a top-down basis ultimately to individual underwriters based on experience and expertise. This authority is in writing and addresses maximum limits, excluded classes and coverages and premium size referral. Referral to a product line manager is required for risks exceeding an underwriter's authority.

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*CATA*

*General.* CATA, primarily through its wholly-owned subsidiaries Capitol Indemnity Corporation, or Capitol Indemnity, and Capitol Specialty Insurance Corporation, or CSIC, operates in the 50 states and the District of Columbia. Capitol Indemnity conducts its property and casualty insurance business on an admitted basis, with a geographic concentration in the Midwestern and Plains states. Capitol Indemnity also writes surety products such as commercial surety bonds and contract surety bonds on a national basis. Commercial surety bonds include all surety bonds other than contract surety bonds and cover obligations typically required by law or regulation, such as licenses and permits. Capitol Indemnity offers contract surety bonds in the non-construction segment of the market which secure performance under supply, service and maintenance contracts, and developer subdivision bonds. CSIC conducts substantially all of its business on an approved, non-admitted basis on a national basis and writes primarily specialty lines of property and casualty insurance. Platte River is licensed in 50 states and the District of Columbia and operates in conjunction with Capitol Indemnity primarily by providing surety products and offering pricing flexibility in those jurisdictions where both Capitol Indemnity and Platte River are licensed. The property and casualty business of CATA accounted for approximately 66.4 percent of its gross premiums written in 2011 (including approximately 5.6 percent of professional liability), and the surety business accounted for the remainder.

As of December 31, 2011, the statutory surplus of Capitol Indemnity was \$184.2 million, including the statutory surplus of CSIC of \$37.7 million. As of December 31, 2011, the statutory surplus of Platte River was \$38.1 million. Capitol Indemnity, CSIC and Platte River are rated A (Excellent) on a reinsured basis by A.M. Best. CATA leases approximately 55,000 square feet of office space in Middleton, Wisconsin for its and Platte River's headquarters.

*Distribution.* CATA conducts its insurance business through independent and general insurance agents located throughout the United States, with a concentration in the Midwestern and Plains states. As of December 31, 2011, CATA had approximately 291 independent agents and 61 general agents licensed to write property and casualty and surety coverages, approximately 90 agents specializing in professional liability and approximately 282 independent agents licensed only to write surety coverages. The general agents write very little surety business and have full quoting and binding authority within the parameters of their agency contracts with respect to the property and casualty business that they write. Certain independent agents have binding authority for specific business owner policy products, including property and liability coverages and non-contract surety products. No agent of CATA had writings in excess of 13.1 percent of CATA's gross premiums written in 2011.

*Underwriting.* Elements of CATA's underwriting process include prudent risk selection, appropriate pricing and coverage customization. All accounts are reviewed on an individual basis to determine underwriting acceptability. CATA is a subscriber to the Insurance Service Organization, or ISO, and the Surety and Fidelity Association of America, or SFAA, insurance reference resources recognized by the insurance industry. Underwriting procedures, rates and contractual coverage obligations are based on procedures and data developed by the ISO for property and casualty lines and by the SFAA for surety lines. Underwriting acceptability is determined by type of business, claims experience, length of time in business and business experience, age and condition of premises occupied and financial stability. Information is obtained from, among other sources, agent applications, financial reports and on-site loss control surveys. If an account does not meet pre-determined acceptability parameters, coverage is declined. If an in-force policy becomes unprofitable due to extraordinary claims activity or inadequate premium levels, a non-renewal notice is issued in accordance with individual state statutes and rules.

*PCC*

*General.* Effective April 12, 2010, as part of a strategic repositioning effort, PCC changed its name from Employers Direct Corporation and changed the name of its wholly-owned insurance subsidiary from Employers Direct Insurance Company to Pacific Compensation Insurance Company, or PCIC, and took steps to emerge as a writer, through PCIC, of workers' compensation insurance distributed through independent insurance brokers. PCIC is currently licensed in California and seven additional states. Workers' compensation insurance provides



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coverage for the statutorily prescribed benefits that employers are obligated to provide for their employees who are injured in the course of employment. PCC leases approximately 66,000 square feet of office space in Agoura Hills, California.

In June 2009, PCC determined that it was unable to write business at rates it deemed adequate due to the state of the California workers compensation market. As a result, PCC ceased soliciting new or renewal business on a direct basis commencing August 1, 2009 and took corresponding expense reduction steps, including staff reductions, in light of such determination. As a result of PCC's determination to cease writing business on a direct basis and certain other factors, on June 30, 2009, A.M. Best downgraded its rating of PCIC from A- (Excellent), with a negative outlook, to B++ (Good), with a stable outlook. During the 2009 third quarter, PCC sold the renewal rights of its directly placed workers' compensation insurance policies and certain other assets and rights to an independent insurance brokerage. During 2011, PCC began writing a modest amount of new business, all of which was through brokers.

As of December 31, 2011, the statutory surplus of PCIC was \$108.9 million.

*AIHL Re LLC*

AIHL Re was formed in June 2006 as a captive reinsurance subsidiary of AIHL to provide catastrophe reinsurance coverage for RSUI. AIHL Re and RSUI entered into a reinsurance agreement, effective July 1, 2006, whereby AIHL Re, in exchange for market-based premiums, reinsured that portion of RSUI's catastrophe reinsurance program not covered by third-party reinsurers. This reinsurance coverage expired on April 30, 2007, and AIHL Re has not participated in RSUI's catastrophe reinsurance programs since that date. AIHL Re and Homesite entered into a reinsurance agreement, effective April 1, 2007, whereby AIHL Re, in exchange for annual premium of \$2.0 million, provided \$20.0 million of excess-of-loss reinsurance coverage to Homesite under its catastrophe reinsurance program which is concentrated in the Northeast region of the United States. This reinsurance coverage expired on March 31, 2008, and AIHL Re has not participated in Homesite's catastrophe reinsurance programs since that date.

*Changes in Historical Net Loss and Loss Adjustment Expense Reserves*

The following table shows changes in historical net loss and loss adjustment expense, or LAE, reserves for AIHL for each year since 2002, the year that AIHL acquired CATA. The first line of the upper portion of the table shows the net reserves as of December 31 of each of the indicated years, representing the estimated amounts of net outstanding loss and LAE for claims arising during that year and in all prior years that are unpaid, including losses that have been incurred but not yet reported, or IBNR, to AIHL's insurance operating units. The upper (paid) portion of the table shows the cumulative net amounts paid as of December 31 of successive years with respect to the net reserve liability for each year. The lower portion of the table shows the re-estimated amount of the previously recorded net reserves for each year based on experience as of the end of each succeeding year. The estimate changes as more information becomes known about claims for individual years. In evaluating the information in the table, it should be noted that a reserve amount reported in any period includes the effect of any subsequent change in such reserve amount. For example, if a loss was first reserved in 2002 at \$100,000 and was determined in 2003 to be \$150,000, the \$50,000 deficiency would be included in the Cumulative (Deficiency) Redundancy row shown below for each of the years 2002 through 2011.

Conditions and trends that have affected the development of the net reserve liability in the past may not necessarily occur in the future. Accordingly, it is not appropriate to extrapolate future redundancies or deficiencies based on this table.

**Table of Contents****Changes in Historical Net Reserves for Loss and LAE**

	Years Ended December 31									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Net liability as of the end of year	\$ 113.3	\$ 276.0	\$ 639.0	\$ 952.9	\$ 1,127.5	\$ 1,412.9	\$ 1,570.3	\$ 1,573.3	\$ 1,481.3	\$ 1,481.2
Cumulative amount of net liability paid as of:										
One year later	47.4	72.6	239.4	172.7	243.3	296.1	355.6	388.7	345.7	
Two years later	80.6	116.8	310.8	356.1	421.7	515.0	659.5	642.2		
Three years later	100.1	149.6	365.2	493.2	529.6	708.5	848.9			
Four years later	110.1	173.7	413.6	572.2	648.6	820.6				
Five years later	115.8	191.7	446.9	664.7	697.9					
Six years later	121.7	208.0	465.4	703.0						
Seven years later	124.0	220.0	475.0							
Eight years later	125.5	224.1								
Nine years later	126.6									
Net liability re-estimated as of:										
One year later	134.0	268.7	631.8	943.2	1,115.4	1,370.0	1,552.4	1,539.6	1,455.5	
Two years later	147.7	264.6	620.1	941.2	1,047.9	1,341.9	1,526.5	1,506.7		
Three years later	149.0	268.1	593.3	899.7	1,012.5	1,306.7	1,486.0			
Four years later	150.7	263.8	584.1	873.0	976.7	1,263.2				
Five years later	153.5	262.0	566.7	858.8	933.0					
Six years later	151.7	256.1	554.0	832.7						
Seven years later	148.4	252.8	537.6							
Eight years later	143.6	250.1								
Nine years later	142.3									
Cumulative (Deficiency) Redundancy	\$ (29.0)	\$ 25.9	\$ 101.4	\$ 120.2	\$ 194.5	\$ 149.7	\$ 84.3	\$ 66.6	\$ 25.8	\$
Gross Liability-End of Year	\$ 258.0	\$ 438.0	\$ 1,246.4	\$ 2,571.9	\$ 2,228.9	\$ 2,379.7	\$ 2,578.6	\$ 2,521.0	\$ 2,328.7	\$ 2,313.0
Less: Reinsurance Recoverable	144.8	162.0	607.4	1,619.0	1,101.4	966.8	1,008.3	947.7	847.4	831.8
Net Liability-End of Year	\$ 113.2	\$ 276.0	\$ 639.0	\$ 952.9	\$ 1,127.5	\$ 1,412.9	\$ 1,570.3	\$ 1,573.3	\$ 1,481.3	\$ 1,481.2
Gross Re-estimated Liability-Latest	\$ 275.2	\$ 420.7	\$ 1,091.6	\$ 2,263.5	\$ 1,797.7	\$ 2,016.0	\$ 2,291.9	\$ 2,311.6	\$ 2,245.1	\$ 2,313.0
Re-estimated Recoverable-Latest	132.9	170.7	554.0	1,430.8	864.7	752.8	805.9	804.9	789.6	831.8
Net Re-estimated Liability-Latest	\$ 142.3	\$ 250.0	\$ 537.6	\$ 832.7	\$ 933.0	\$ 1,263.2	\$ 1,486.0	\$ 1,506.7	\$ 1,455.5	\$ 1,481.2
Gross Cumulative (Deficiency) Redundancy	\$ (17.2)	\$ 17.3	\$ 154.8	\$ 308.4	\$ 431.2	\$ 363.7	\$ 286.7	\$ 209.4	\$ 83.6	\$

The net cumulative redundancies since 2003 primarily reflect casualty net reserve releases by RSUI, partially offset by catastrophe-related net reserve increases by RSUI in 2006 and 2007, as well as reserve increases at PCC in each year from 2008 through 2011. Prior year reserve adjustments are discussed on pages 45 through 47 and pages 60 and 61 of this Form 10-K Report.

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The reconciliation between the aggregate net loss and LAE reserves of AIHL reported in the annual statements filed with state insurance departments prepared in accordance with statutory accounting practices, or SAP, and those reported in AIHL's consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America, or GAAP, for the last three years is shown below (in millions):

**Reconciliation of Reserves for Loss and LAE from SAP Basis to GAAP Basis**

	2011	2010	2009
Statutory reserves	\$ 1,481.8	\$ 1,482.3	\$ 1,574.9
Reinsurance recoverables*	831.8	847.4	947.7
Purchase accounting adjustment	(0.6)	(1.0)	(1.6)
GAAP reserves	\$ 2,313.0	\$ 2,328.7	\$ 2,521.0

\* Reinsurance recoverables in this table include only ceded loss reserves. Amounts reflected under the caption Reinsurance recoverables on our consolidated balance sheets set forth in Item 8 of this Form 10-K Report also include paid loss recoverables.

The reconciliation of beginning and ending aggregate reserves for unpaid loss and LAE of AIHL for the last three years is shown below (in millions):

**Reconciliation of Reserves for Loss and LAE**

	2011	2010	2009
Reserves as of January 1	\$ 2,328.7	\$ 2,521.0	\$ 2,578.6
Less: reinsurance recoverables*	847.4	947.7	1,008.3
Net reserves	1,481.3	1,573.3	1,570.3
Incurred loss, net of reinsurance, related to:			
Current year	455.8	411.6	460.0
Prior years	(25.8)	(33.7)	(17.9)
Total incurred loss, net of reinsurance	430.0	377.9	442.1
Paid loss, net of reinsurance, related to:			
Current year	84.4	81.2	83.5
Prior years	345.7	388.7	355.6
Total paid loss, net of reinsurance	430.1	469.9	439.1
Reserves, net of reinsurance recoverables, as of December 31	1,481.2	1,481.3	1,573.3
Reinsurance recoverables as of December 31*	831.8	847.4	947.7
Reserves, gross of reinsurance recoverables, as of December 31	\$ 2,313.0	\$ 2,328.7	\$ 2,521.0

\* Reinsurance recoverables in this table include only ceded loss reserves. Amounts reflected under the caption Reinsurance recoverables on our consolidated balance sheets set forth in Item 8 of this Form 10-K Report also include paid loss recoverables.

*Asbestos and Environmental Impairment Reserves*

AIHL's reserves for loss and LAE include amounts for asbestos and environmental impairment claims that arose from reinsurance of certain general liability and commercial multiple peril coverages assumed by Capitol Indemnity between 1969 and 1976. Capitol Indemnity exited this business in 1976. As of December 31, 2011, reserves of CATA totaled \$11.0 million for asbestos liabilities and \$2.7 million for environmental liabilities, resulting in aggregate asbestos and environmental reserves of \$13.7 million. As of December 31, 2010, reserves

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of CATA totaled \$11.3 million for asbestos liabilities and \$2.8 million for environmental liabilities, resulting in aggregate asbestos and environmental reserves of \$14.1 million.

As of December 31, 2011, the reserves for asbestos liabilities were approximately 23 times the average paid claims for the prior three year period, compared with 13 times as of December 31, 2010. The reserves for environmental impairment liabilities were approximately five times the average paid claims for the prior three year period, compared with three times as of December 31, 2010. The significant changes in these metrics from December 31, 2010 to December 31, 2011 primarily reflect fluctuations in the amount and timing of commutations in recent years, which affect paid losses and loss exposure, as well as the impact of a reserve release in 2010. Additional information regarding the policies that CATA uses to set reserves for these asbestos and environmental impairment claims is set forth on page 47 of this Form 10-K Report.

The reconciliation of the beginning and ending aggregate reserves for unpaid loss and LAE related to asbestos and environmental impairment claims of AIHL for the years 2009 through 2011 is shown below (in millions):

**Reconciliation of Asbestos-Related Claims Reserves for Loss and LAE**

	2011	2010	2009
Reserves as of January 1	\$ 11.3	\$ 15.1	\$ 14.9
Loss and LAE incurred		(3.0)	0.5
Paid losses*	(0.3)	(0.8)	(0.3)
Reserves as of December 31	\$ 11.0	\$ 11.3	\$ 15.1
<b>Type of reserves</b>			
Case	\$ 1.6	\$ 1.7	\$ 1.9
IBNR	9.4	9.6	13.2
Total	\$ 11.0	\$ 11.3	\$ 15.1

\* Paid losses include commutations and legal settlements as well as regular paid losses.

**Reconciliation of Environmental Impairment Claims Reserves for Loss and LAE**

	2011	2010	2009
Reserves as of January 1	\$ 2.8	\$ 3.8	\$ 5.5
Loss and LAE incurred		(0.5)	(0.4)
Paid losses*	(0.1)	(0.5)	(1.3)
Reserves as of December 31	\$ 2.7	\$ 2.8	\$ 3.8
<b>Type of reserves</b>			
Case	\$ 0.4	\$ 0.4	\$ 0.5
IBNR	2.3	2.4	3.3
Total	\$ 2.7	\$ 2.8	\$ 3.8

\* Paid losses include commutations and legal settlements as well as regular paid losses.  
*Catastrophe Risk Management*

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AIHL's insurance operating units, particularly RSUI, expose AIHL to losses on claims arising out of natural or human-made catastrophes, including hurricanes, other windstorms, earthquakes and floods, as well as terrorist activities. The incidence and severity of catastrophes in any short period of time are inherently unpredictable. The extent of gross losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes, other windstorms, earthquakes and floods may produce significant damage when

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those areas are heavily populated. The geographic distribution of AIHL's insurance operating units subjects them to catastrophe exposure in the United States from hurricanes in the Gulf coast regions, Florida, the Mid-Atlantic, and the Northeast, from other windstorms in the Midwest and Southern regions, and earthquakes in California, the Pacific Northwest region and along the New Madrid fault line in the Midwest region.

AIHL's insurance operating units use underwriting controls and systems, including third-party catastrophe modeling software, to help evaluate potential losses. The operating units use modeled loss scenarios to set risk retention levels and help structure their reinsurance programs in an effort to ensure that the aggregate amount of catastrophe exposures conform to established risk tolerances and fit within the existing exposure portfolio. RSUI also relies on reinsurance to limit its exposure to catastrophes, which is discussed in more detail under *Reinsurance* below. Additional information regarding the risks faced by AIHL's insurance operating units, particularly RSUI, with respect to managing their catastrophe exposure risk can be found on pages 32 and 33 and pages 37 and 38 of this Form 10-K Report.

With respect to terrorism, to the extent that reinsurers have excluded coverage for terrorist acts or have priced this coverage at rates that make purchasing such coverage uneconomic, our insurance operating units will not have reinsurance protection and are exposed to potential losses as a result of any terrorist acts. To the extent an act of terrorism is certified by the U.S. Secretary of the Treasury, we may be covered under the Terrorism Act as described below under *Reinsurance*. Information regarding our insurance operating units' coverage for terrorism and the impact of the Terrorism Act on our insurance operating units can be found on pages 24 and 25 of this Form 10-K Report.

### *Reinsurance*

AIHL's insurance operating units reinsure a significant portion of the risks they underwrite in order to mitigate their exposure to losses, manage capacity and protect capital resources. If the assuming reinsurers are unable or unwilling to meet the obligations assumed under the applicable reinsurance agreements, AIHL's insurance operating units would remain liable to their policyholders for such reinsurance portion not paid by their reinsurers.

In general, the insurance operating units obtain reinsurance on a treaty and facultative basis. Treaty reinsurance is based on a contract between a primary insurer or cedent and a reinsurer and covers certain classes of risk specified in the treaty. Under most treaties, the cedent is obligated to offer, and the reinsurer is obligated to accept, a specified portion of a class of risk underwritten by the cedent. Alternatively, facultative reinsurance is the reinsurance of individual risks, whereby a reinsurer separately rates and underwrites each risk and is free to accept or reject each risk offered by the cedent. Facultative reinsurance is normally purchased for risks not otherwise covered or covered only in part by reinsurance treaties, and for unusual or large risks. Treaty and facultative reinsurance can be written on a quota share, surplus share or excess of loss basis. Under a quota share reinsurance treaty, the cedent and reinsurer share the premiums as well as the losses and expenses of any single risk, or an entire group of risks. Under a surplus share reinsurance treaty, the cedent may transfer, and the reinsurer is required to accept, the part of every risk that exceeds a predetermined amount (commonly referred to as the cedent's retention), with the reinsurer sharing premiums and losses in the same proportion as it shares in the total policy limits of the risk written by the cedent. Under an excess of loss reinsurance treaty, a reinsurer, in exchange for a premium, agrees to reimburse the cedent for all or part of any losses in excess of the cedent's retention, generally up to a predetermined limit, at which point the risk of loss is assumed by another reinsurer or reverts to the cedent.

In 2011, RSUI ceded 36.4 percent of its gross premiums written to reinsurers. Although the net amount of loss exposure retained by RSUI varies by line of business, in general, as of December 31, 2011, RSUI retained a maximum net exposure for any single property risk of \$19 million and any single casualty risk of \$10.0 million, with the exception of losses arising from acts of foreign terrorism.

RSUI reinsures its property lines of business through a program consisting of surplus share treaties, facultative placements, per risk and catastrophe excess of loss treaties. Under its surplus share treaties, which generally provide coverage on a risk attaching basis (the treaties cover policies which become effective during the treaty coverage period) from January 1 to December 31, RSUI is indemnified on a *pro rata* basis against

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covered property losses. The amount indemnified is based on the proportionate share of risk ceded after consideration of a stipulated dollar amount of line for RSUI to retain in relation to the entire limit written. Under RSUI's 2011-2012 per risk reinsurance program, which generally provides coverage on an annual basis for losses occurring from May 1 to the following April 30, RSUI is reinsured for \$90.0 million in excess of a \$10.0 million net retention per risk after application of the surplus share treaties and facultative reinsurance and subject to a 10 percent co-participation by RSUI.

RSUI's catastrophe reinsurance program (which covers catastrophe risks including, among others, windstorms and earthquakes) and per risk reinsurance program run on an annual basis from May 1 to the following April 30 and thus expired on April 30, 2011. RSUI renewed all of its catastrophe reinsurance program for the 2011-2012 period, and the new reinsurance program is similar to the expired program. The new reinsurance program provides coverage in two layers for \$400.0 million of losses in excess of a \$100.0 million net retention after application of the surplus share treaties, facultative reinsurance and per risk covers. The first layer provides coverage for \$100.0 million of losses, before a 47.0 percent co-participation by RSUI (compared with a 33.0 percent co-participation under the expired program), in excess of the \$100.0 million net retention, and the second layer provides coverage for \$300.0 million of losses, before a 5.0 percent co-participation by RSUI (the same percent co-participation as under the expired program), in excess of \$200.0 million.

When structuring its catastrophe reinsurance program, RSUI considers a number of factors, including its gross limit exposure by geographic region, the attachment point of policy coverages within its book of business, its anticipated market share percentage of aggregate industry losses and the cost of reinsurance. RSUI also considers the modeled loss estimates under different scenarios produced by third-party catastrophic modeling software. For a 250 year return period, such models in 2011 produced a net loss after tax and a resulting decline in our consolidated stockholders' equity as of December 31, 2011 ranging between 5 percent and 18 percent. Such modeled loss estimates do not necessarily represent RSUI's minimum or maximum catastrophe exposures, and it is highly likely that RSUI's actual incurred losses would vary significantly from any such estimates, as has been the case for RSUI historically. As such, there can be no assurances that RSUI will not incur a net loss in excess of such range of modeled loss estimates from one or more major catastrophic events. Additional information regarding the risks faced by our insurance operating units, particularly RSUI, with respect to managing their catastrophe exposure risk can be found on pages 32 and 33 of this Form 10-K Report.

RSUI reinsures its other lines of business through quota share treaties, except for professional liability, binding authority and (effective April 15, 2011) the general liability lines where RSUI retains all of such business. RSUI's quota share reinsurance treaty for umbrella/excess lines of business renewed on June 1, 2011 on the same terms as the expiring treaty, providing coverage for policies with limits up to \$30.0 million, with RSUI ceding 35.0 percent of the premium and loss for policies with limits up to \$15.0 million and ceding 67.5 percent of the premium and loss for policies with limits in excess of \$15.0 million up to \$30.0 million. RSUI's D&O liability line quota share reinsurance treaty renewed on July 1, 2011 on the same terms as the expiring treaty, providing coverage for policies with limits up to \$20.0 million, with RSUI ceding 35.0 percent of the premium and loss for policies with limits up to \$10.0 million and ceding 60.0 percent of the premium and loss for policies with limits in excess of \$10.0 million up to \$20.0 million.

With respect to potential losses at RSUI arising from acts of terrorism, the Terrorism Risk Insurance Act of 2002, as extended and amended by the Terrorism Risk Insurance Extension Act of 2005 and the Terrorism Risk Insurance Program Reauthorization Act of 2007, which we collectively refer to as the Terrorism Act, established a program to provide federal assistance to the insurance industry in order to meet the needs of commercial insurance policyholders for coverages against losses due to certain acts of terrorism. The Terrorism Act is administered by the U.S. Secretary of the Treasury and is effective through December 31, 2014, at which time it will automatically expire unless reauthorized by Congress. The Terrorism Act applies to foreign or domestic acts of terrorism occurring within the United States (including territorial sea and the Outer Continental Shelf), at U.S. missions abroad, or on U.S. flag vessels or aircraft. In return for requiring insurers writing certain lines of property and casualty insurance to offer coverage to commercial insurance policyholders against certain acts of terrorism, the law requires the U.S. federal government to reimburse such insurers for 85 percent of insured losses during a program year resulting from such acts of terrorism above a statutorily-defined deductible. AIHL's deductible under the Terrorism Act in 2012 will be 20 percent of its direct premiums earned in eligible lines in 2011, or \$217.7 million. In addition, federal reimbursement will only be paid under the Terrorism Act if the aggregate industry insured losses resulting from the covered act of terrorism exceed



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\$100.0 million for insured losses occurring in 2012, but no payment shall be made for any portion of aggregate industry insured losses that exceed \$100.0 billion in 2012.

AIHL's terrorism exposure is substantially attributable to RSUI. Approximately 3.7 percent of all policies and approximately 15.5 percent of property policies written by RSUI in 2011 contained coverage for domestic and foreign acts of terrorism. RSUI uses various underwriting strategies to mitigate its exposure to terrorism losses. In addition, its casualty reinsurance programs provide coverage for domestic and foreign acts of terrorism. The cost of property reinsurance for acts of terrorism has increased significantly in recent years and capacity is limited. RSUI's property reinsurance programs provide coverage only for domestic acts of terrorism; as a result, RSUI remains liable for losses under property policies that provide coverage for foreign acts of terrorism, subject to Terrorism Act reimbursement.

CATA uses reinsurance to protect against severity losses. In 2011, CATA reinsured with various reinsurers individual property and casualty and contract surety risks in excess of \$1.5 million. As of December 1, 2011, the commercial surety line was reinsured for individual losses above \$1.5 million. In addition, CATA purchases facultative reinsurance coverage for property and casualty risks in excess of \$6.0 million and for commercial surety risks in excess of \$15.0 million.

As of April 1, 2010, PCC ceased purchasing reinsurance as a result of its withdrawal from writing direct business. Prior to April 1, 2010, PCC used reinsurance to protect against catastrophe losses.

As of December 31, 2011, AIHL had total reinsurance recoverables of \$852.8 million, consisting of \$831.8 million of ceded outstanding loss and LAE and \$21.0 million of recoverables on paid losses. The reinsurance purchased by AIHL's insurance operating units does not relieve them from their obligations to their policyholders, and therefore, the financial strength of their reinsurers is important. Approximately 99.0 percent of AIHL's reinsurance recoverables balance as of December 31, 2011 was due from reinsurers having an A.M. Best financial strength rating of A (Excellent) or higher. AIHL had no allowance for uncollectible reinsurance as of December 31, 2011. Additional information regarding the risks faced by AIHL's insurance operating units with respect to their use of reinsurance can be found on page 33 of this Form 10-K Report.

AIHL's Reinsurance Security Committee, which includes certain of our officers and the chief financial officers of each of AIHL's operating units, meets to track, analyze and manage the use of reinsurance by AIHL's insurance operating units. The Reinsurance Security Committee considers the limits on the maximum amount of unsecured reinsurance recoverables that should be outstanding from any particular reinsurer, the lines of business that should be ceded to a particular reinsurer and, where applicable, the types of collateral that should be posted by reinsurers. Information related to concentration of reinsurance recoverables can be found in Note 5(b) to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report.

### *Investments*

The investment portfolios of RSUI, CATA and PCC are managed under the direction of Alleghany, with Alleghany Capital Partners primarily responsible for managing RSUI, CATA and PCC equity portfolios. For a discussion of AIHL investment results, please see pages 57 through 59 and pages 66 through 71 of this Form 10-K Report.

### *Competition*

The property and casualty businesses of RSUI, as well as the surety and non-admitted specialty businesses of CATA, compete on a national basis. CATA's admitted property and casualty businesses compete on a regional basis with a primary focus on the Midwestern and Plains states. PCC competes primarily in California. Our insurance operating units compete with a large number of other companies in their selected lines of business, including major U.S. and non-U.S. insurers, other regional companies, mutual companies, specialty insurance companies, underwriting agencies, state funds and diversified financial services companies. Many competitors have considerably greater financial resources and greater experience in the insurance industry and offer a broader line of insurance products than do AIHL's insurance operating units. Except for regulatory considerations, there are virtually no barriers to entry into the insurance industry. Competition may be domestic or foreign, and

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competitors are not necessarily required to be licensed by the various state insurance departments. Competition in the businesses of our insurance operating units is based on many factors, including the perceived financial strength of the company, premium charges, other terms and conditions offered, services provided, commissions paid to producers, ratings assigned by independent rating agencies, speed of claims payment and reputation and experience in the lines to be written.

Historically, insurers have experienced significant fluctuations in operating results due to competition, frequency or severity of catastrophic and other loss events, levels of capacity, general economic conditions, social trends and other factors. The supply of insurance is related to prevailing prices in relation to emerging loss experience, the level of insured losses and the level of industry capital which, in turn, may fluctuate in response to changes in rates of return on investments being earned in the insurance industry. As a result, the insurance business historically has been a cyclical business characterized by periods of intense price competition due to excessive underwriting capacity as well as periods when shortages of capacity permitted favorable price levels.

During periods of excessive underwriting capacity, in an attempt to use their capital, many insurance companies seek to write additional premiums without appropriate regard for ultimate profitability, and standard insurance companies are more willing to write specialty coverages. The opposite is typically true during periods when a shortage of capacity exists. In the past few years, our insurance operating units have faced increasing competition as a result of an increased flow of capital into the insurance industry, with both new entrants and existing insurers seeking to gain market share. This has resulted in decreased premium rates and less favorable contract terms and conditions. In particular, RSUI and CATA's specialty lines of business increasingly have encountered competition from standard market companies seeking to increase market share.

Although we continue to see a competitive property and casualty insurance market, we continue to be cautiously optimistic about the prospect for improvements, particularly in property insurance and workers' compensation pricing.

A discussion of the risks faced by our insurance operating units due to competition within, and the cyclical nature of, the insurance business can be found on pages 31 and 32 of this Form 10-K Report.

### *Regulation*

*U.S. Insurance Regulation.* The insurance companies within AIHL's insurance operating units conduct business in the United States and have no foreign operations. They are regulated in all U.S. jurisdictions in which they conduct business. The extent of this regulation varies, but state insurance laws and regulations generally govern the financial condition of insurers, including standards of solvency, types and concentrations of permissible investments, establishment and maintenance of reserves, credit for reinsurance and requirements of capital adequacy and the business conduct of insurers, including marketing and sales practices and claims handling. In addition, state insurance laws and regulations usually require the licensing of insurers and agents, and the approval of policy forms, related materials and the rates for certain lines of insurance. The insurance laws applicable to us or our insurance companies are described below.

*Insurance Holding Company Regulation.* As an insurance holding company, we and our insurance companies are subject to regulation under the insurance holding company laws enacted in those states where our insurance companies are domiciled or where they conduct business. Although the insurance holding company laws and regulations vary from jurisdiction to jurisdiction, such laws generally require an insurance holding company and its insurer subsidiaries (other than captive insurers) to register with their respective state insurance regulatory authorities and to file with those authorities certain reports, including information concerning their capital structure, ownership, financial condition, certain intercompany transactions, including dividends and distributions and general business operations. The insurance holding company laws of some states, including with respect to the payment of dividends and distributions, may be more restrictive than the insurance holding company laws of other states.

Under the insurance holding company laws and regulations to which we and our insurance companies are subject, our insurance companies may not pay an extraordinary dividend or distribution, or pay a dividend except out of earned surplus, without the approval of state insurance regulatory authorities. In general, an

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extraordinary dividend or distribution is defined as a dividend or distribution that, together with other dividends and distributions made within the preceding 12 months, exceeds the greater (or, in some jurisdictions, the lesser) of 10 percent of the insurer's statutory surplus as of the immediately prior year end, and the statutory net income during the prior calendar year.

In addition, insurance holding company laws and regulations to which we and our insurance companies are subject generally require prior notification and approval or non-disapproval by the applicable insurance regulatory authority of certain other significant transactions, including sales, loans, reinsurance agreements and service agreements between an insurer subsidiary and its holding company or other subsidiaries of the holding company.

The insurance holding company laws and regulations of the states in which our insurance companies are domiciled also require that, before a person can acquire direct or indirect control of an insurer domiciled in the state, prior written approval must be obtained from the insurer's domiciliary state insurance regulatory authority. The state insurance regulatory authorities are required to consider various factors, including the financial strength of the acquirer, the integrity and management experience of the acquirer's board of directors and executive officers, the acquirer's plans for the future operations of the insurer and any possible anti-competitive results that may arise from the proposed acquisition of control. Pursuant to applicable laws and regulations, control over an insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds the power to vote or holds proxies representing, 10 percent or more of the voting securities of that insurer. Indirect ownership includes ownership of the shares of our common stock. Thus, the insurance regulatory authorities of the states in which our insurance companies are domiciled are likely to apply these restrictions on acquisition of control to any proposed acquisition of 10 percent or more of our common stock.

Some states require a person seeking to acquire control of an insurer licensed but not domiciled in that state to make a filing prior to completing an acquisition if the acquirer and its affiliates, on the one hand, and the target insurer and its affiliates, on the other hand, have specified market shares in the same lines of insurance in that state. While these provisions may not require acquisition approval, they can lead to the imposition of conditions on an acquisition that could delay or prevent its consummation.

The acquisition of control laws described above may discourage potential acquisition proposals and may delay, deter or prevent an acquisition of control of us, including through transactions, and in particular unsolicited transactions, that some or all of our stockholders might consider to be desirable.

*Model Insurance Holding Company System Regulatory Act and Regulation.* In December 2010, the National Association of Insurance Commissioners, or NAIC, adopted amendments to the Model Insurance Holding Company System Regulatory Act and Regulation, or the Amended Model Act and Regulation. The Amended Model Act and Regulation introduce the concept of enterprise risk within an insurance holding company system. If and when adopted by a particular state, the Amended Model Act and Regulation would impose more extensive informational requirements on the insurance holding company and other affiliates of a licensed insurer with the purpose of protecting such insurer from enterprise risk, including requiring an annual enterprise risk report by the ultimate controlling person of the insurer that identifies the material risks within the insurance holding company system that could pose enterprise risk to the licensed insurer. The Amended Model Act and Regulation must be adopted by the individual states, and specifically the states in which our insurance companies are domiciled, for the new requirements to apply. To date, only three states (Rhode Island, Texas and West Virginia) have enacted legislation adopting the Amended Holding Company Model Act and Regulation. It is not clear if and when other states will adopt these changes; however, the NAIC is seeking to make the amendments part of its accreditation standards for state solvency regulation, which would motivate states to adopt the amendments promptly.

*Rates and Policy Forms.* Our insurance companies' policy forms and various premium rates and rates for property or casualty or surety insurance policies are subject to regulation in every state in which they conduct business. In many states, rates and policy forms must be filed with the applicable insurance regulatory authority prior to their use, and in some states, rates and forms must be approved by the applicable insurance regulatory authority prior to use.

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*Financial and Market Conduct Examinations.* The insurance laws and regulations to which our insurance companies are subject govern their marketplace activities, affecting the form and content of disclosure to consumers, product illustrations, advertising, product replacement, sales and underwriting practices and complaint and claims handling. These provisions are generally enforced through periodic market conduct examinations. Such insurance laws and regulations also govern the licensing of insurance companies and agents and regulate trade practices.

*Periodic Financial Reporting and Risk-Based Capital.* Insurance companies are required to report their financial condition and results of operations in accordance with statutory accounting principles prescribed or permitted by state insurance regulators in conjunction with the NAIC. State insurance regulators also prescribe the form and content of statutory financial statements, perform periodic financial examinations of insurers, set minimum reserve and loss ratio requirements, establish standards for permissible types and amounts of investments and require minimum capital and surplus levels. These statutory capital and surplus requirements include risk-based capital, or RBC, rules promulgated by the NAIC. These RBC standards are intended to assess the level of risk inherent in an insurance company's business and consider items such as asset risk, credit risk, underwriting risk and other business risks relevant to its operations. In accordance with RBC formulas, a company's RBC requirements are calculated and compared with its total adjusted capital to determine whether regulatory intervention is warranted. As of December 31, 2011, the total adjusted capital of each of AIHL's insurance subsidiaries exceeded the minimum levels required under RBC rules, and each had excess capacity to write additional premiums in relation to these requirements.

The NAIC annually calculates certain statutory financial ratios for most insurance companies in the United States. These calculations are known as the Insurance Regulatory Information System, or IRIS, ratios. There presently are thirteen IRIS ratios, with each ratio having an established usual range of results. The IRIS ratios assist state insurance departments in executing their statutory mandate to oversee the financial condition of insurance companies. A ratio falling outside the usual range is not considered a failing result; rather, unusual values are viewed as part of the regulatory early monitoring system. Furthermore, in some years, it may not be unusual for financially sound companies to have several ratios with results outside the usual ranges. The NAIC reports the ratios to state insurance departments who may then contact a company if four or more of its ratios fall outside the NAIC's usual ranges. Based upon calculations as of December 31, 2011, PCIC had five of its ratios falling outside the NAIC's usual ranges, with one falling outside the usual range due to PCIC's underwriting loss in 2011, two falling outside the usual range due to adverse reserve development, one falling outside the usual range due to a decline in gross premiums written by PCIC in 2011 and one falling outside the usual range due to a decline in investment yields.

*Guarantee Associations and Similar Arrangements.* Certain of AIHL's insurance operating units are required under the guaranty fund laws of most states in which they transact business to pay assessments up to certain prescribed limits to fund policyholder losses or liabilities of insolvent insurance companies. AIHL's insurance operating units also are required to participate in various involuntary pools, principally involving workers' compensation and windstorms. In most states, the involuntary pool participation of AIHL's insurance operating units is in proportion to their voluntary writings of related lines of business in such states.

*Statutory Accounting Principles.* State insurance regulatory authorities have developed SAP as a basis of accounting used to monitor and regulate the solvency of insurers. SAP is primarily concerned with measuring an insurer's surplus to policyholders. Accordingly, SAP focuses on valuing assets and liabilities of an insurer at financial reporting dates in accordance with applicable insurance laws and regulations in the state in which such insurer is domiciled. SAP determines, among other things, the amount of statutory surplus and statutory net income of our insurance companies and thus determines, in part, the amount of funds they have available to pay as dividends.

GAAP is concerned with a company's solvency, but it is also concerned with other financial measurements, such as income and cash flows. Accordingly, GAAP gives more consideration to appropriate matching of revenue and expenses and accounting for management's stewardship of assets than does SAP. Due to differences in methodology between SAP and GAAP, the values for assets, liabilities and equity reflected in financial statements prepared in accordance with GAAP are materially different from those reflected in financial statements prepared under SAP.

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The NAIC has indicated it will consider policy positions regarding the new International Financial Reporting Standard, or IFRS, and its inclusion/exclusion from the United States framework of insurance solvency regulation and on the regulatory impacts of non-regulatory uses of statutory financial statements after completion of the IASB/FASB Insurance Contracts project and the SEC has made a decision regarding IFRS as a U.S. accounting standard for public companies. The potential outcomes identified by the NAIC include but are not limited to replacement of SAP with GAAP with statutory adjustments or adoption of IFRS without adjustments. We will continue to monitor these developments and the impact they may have on our insurance operating units.

*Legislative and Regulatory Initiatives.* As discussed in more detail under *Reinsurance* above, the Terrorism Act established a federal assistance program to help the commercial property and casualty insurance industry cover claims arising from terrorism-related losses and regulates the terms of insurance relating to the terrorism coverage provided by AIHL's insurance operating units.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, was enacted in July 2010. The Dodd-Frank Act made extensive changes to the laws regulating financial services firms and requires various federal agencies to adopt a broad range of new implementing rules and regulations. In addition to introducing sweeping reform of the U.S. financial services industry, the Dodd-Frank Act adopts certain changes to U.S. insurance regulation in general, and to non-admitted insurance and reinsurance in particular. The Dodd-Frank Act incorporates the Non-Admitted and Reinsurance Reform Act, or the NRRRA, which became effective on July 21, 2011. Among other things, the NRRRA established national uniform standards on how states may regulate and tax surplus lines insurance (and also sets national standards concerning the regulation of reinsurance). In particular, the NRRRA gives regulators in the state where an insurer is domiciled exclusive authority to regulate and tax surplus lines insurance transactions, and regulators in a ceding insurer's state of domicile are given the sole responsibility for regulating the balance sheet credit that the ceding insurer may take for reinsurance recoverables. At the present time, it is unclear what effect the NRRRA changes specific to non-admitted insurance and reinsurance will have on AIHL's insurance operating units, and there is still significant uncertainty as to how these and other provisions of the Dodd-Frank Act will be implemented in practice.

The Dodd-Frank Act also creates the Federal Insurance Office within the Department of Treasury, which is designed to promote national coordination within the insurance sector and which has the authority, in part, to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system.

Federal agencies have been given significant discretion in drafting the rules and regulations that will implement the Dodd-Frank Act. In addition, the Dodd-Frank Act mandated multiple studies and reports for the U.S. Congress, which could in some cases result in additional legislative or regulatory action. We cannot predict the requirements of the regulations ultimately adopted under the Dodd-Frank Act or any related additional legislation, the additional costs resulting from compliance with such regulations or legislation, or any changes to our operations that may be necessary to comply with the Dodd-Frank Act.

In addition, a number of legislative and regulatory initiatives under consideration may significantly affect the insurance business in a variety of ways. These measures include, among other things, tort reform, consumer privacy requirements and proposals for the establishment of state or federal catastrophe funds.

### *Employees*

AIHL's insurance operating units employed 744 persons as of December 31, 2011, 361 of whom were at RSUI and its subsidiaries, 230 of whom were at CATA and its subsidiaries, and 153 of whom were at PCC and its subsidiaries. AIHL Re had no employees as of December 31, 2011.

## **Corporate Activities**

### *Alleghany Properties*

Headquartered in Sacramento, California, Alleghany Properties owns and manages properties in Sacramento, California. These properties include primarily improved and unimproved commercial land, as well

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as residential lots. The majority of these properties are located in the City of Sacramento in the planned community of North Natomas. A considerable amount of development activity had occurred in the North Natomas area from 1998 through 2008, including the construction of more than 13,500 single family homes, 4,000 apartment units, 1.1 million square feet of office buildings and 2.3 million square feet of retail space. Participating in this growth, Alleghany Properties sold over 387 acres of residential land and 92 acres of commercial property through December 31, 2008, when development activity within North Natomas was temporarily halted. The temporary halt in development activity was a result of new Federal Emergency Management Agency flood insurance maps for the area which revoked the area's previously certified 100-year flood protection. This action will limit development activity until late 2013 when it is anticipated that sufficient progress on the levee improvements will have occurred to restore the 100-year flood protection. As of December 31, 2011, Alleghany Properties owned approximately 320 acres of property in various land use categories ranging from multi-family residential to commercial. In late 2010, Alleghany Properties began making investments in California low income housing tax credit limited liability companies. As of December 31, 2011, Alleghany Properties held investments in three such companies.

### *Alleghany Capital Partners*

Primarily through our indirect, wholly-owned subsidiary, Alleghany Capital Partners, we manage our public equity investments, including those held by our insurance operating units, as well as conduct equity investment and non-insurance acquisition research. Alleghany Capital Partners employed 5 people as of December 31, 2011.

### *Parent Company Operations*

At the parent level, we seek out attractive investment opportunities, including strategic investments in operating companies, delegate responsibilities to competent and motivated managers at the operating business level, define risk parameters, set management goals for our operating businesses, ensure that operating business managers are provided with incentives to meet these goals and monitor their progress. Strategic investments currently include an approximately 33 percent stake in Homesite and an approximately 38 percent stake in ORX. As of December 31, 2011, we had 11 employees at the parent level.

## **Item 1A. Risk Factors.**

We face risks from our property and casualty and surety insurance businesses, our investments in debt and equity securities and our pending merger with Transatlantic. Discussed below are significant risks that our business faces. If any of the events or circumstances described as risks below actually occurs, our business, results of operations or financial condition could be materially and adversely affected. Our businesses may also be adversely affected by risks and uncertainties not currently known to us or that we currently consider immaterial.

### **Risk Factors Relating to our Operating Units**

**The reserves for loss and LAE of our insurance operating units are estimates and may not be adequate, which would require our insurance operating units to establish additional reserves.** Gross reserves for loss and LAE reported on our balance sheet as of December 31, 2011 were approximately \$2.3 billion. These loss and LAE reserves reflect our best estimates of the cost of settling all claims and related expenses with respect to insured events that have occurred. Reserves do not represent an exact calculation of liability, but rather an estimate of what management expects the ultimate settlement and claims administration will cost for claims that have occurred, whether known or unknown. These reserve estimates, which generally involve actuarial projections, are based on management's assessment of facts and circumstances currently known and assumptions about anticipated loss emergence patterns, including expected future trends in claims severity and frequency, inflation, judicial theories of liability, reinsurance coverage, legislative changes and other factors.

The inherent uncertainties of estimating reserves are greater for certain types of liabilities, where long periods of time elapse before a definitive determination of liability is made and settlement is reached. Our

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liabilities for loss and LAE can generally be categorized into two distinct groups, short-tail business and long-tail business. Short-tail business refers to lines of business, such as property, for which losses are usually known and paid shortly after the loss actually occurs. Long-tail business describes lines of business for which specific losses may not be known and reported for some period and losses take much longer to emerge. Given the time frame over which long-tail exposures are ultimately settled, there is greater uncertainty and volatility in these lines than in short-tail lines of business. Our long-tail coverages consist of most casualty lines including professional liability, D&O liability, general liability, umbrella/excess and certain workers' compensation exposures. Some factors that contribute to the uncertainty and volatility of long-tail casualty programs, and thus require a significant degree of judgment in the reserving process, include the inherent uncertainty as to the length of reporting and payment development patterns, the possibility of judicial interpretations or legislative changes that might impact future loss experience relative to prior loss experience and the potential lack of comparability of the underlying data used in performing loss reserve analyses.

In periods with increased economic volatility, it becomes more difficult to accurately predict claim costs. It is especially difficult to estimate the impact of inflation on loss reserves given the current economic environment and related regulatory and government actions. Reserve estimates are continually refined in an ongoing process as experience develops and further claims are reported and settled. Adjustments to reserves are reflected in the results of the periods in which the adjustments are made. Because setting reserves is inherently uncertain, we cannot assure you that our current reserves will prove adequate in light of subsequent events. Should our insurance operating units need to increase their reserves, our pre-tax income for the period would decrease by a corresponding amount. Although current reserves reflect our best estimate of the costs of settling claims, we cannot assure you that our reserve estimates will not need to be increased in the future.

**Significant competitive pressures may prevent our insurance operating units from retaining existing business or writing new business at adequate rates.** Our insurance operating units compete with a large number of other companies in their selected lines of business. They compete, and will continue to compete, with major U.S. and non-U.S. insurers, other regional companies, mutual companies, specialty insurance companies, underwriting agencies, state funds and diversified financial services companies. Many competitors have considerably greater financial resources and greater experience in the insurance industry and offer a broader line of insurance products than do AIHL's insurance operating units. Except for regulatory considerations, there are virtually no barriers to entry into the insurance industry. Competition may be domestic or foreign, and competitors are not necessarily required to be licensed by the various state insurance departments. Competition in the businesses of our insurance operating units is based on many factors, including the perceived financial strength of the company, premium charges, other terms and conditions offered, services provided, commissions paid to producers, ratings assigned by independent rating agencies, speed of claims payment and reputation and experience in the lines to be written. Such competition could cause the supply and/or demand for insurance to change, which could affect the ability of our insurance operating units to price their products at adequate rates. If our insurance operating units are unable to retain existing business or write new business at adequate rates, our results of operations could be materially and adversely affected.

In the past few years, our insurance operating units have faced increasing competition as a result of an increased flow of capital into the insurance industry, with both new entrants and existing insurers seeking to gain market share. This has resulted in decreased premium rates and less favorable contract terms and conditions. In particular, RSUI and CATA's specialty lines of business have increasingly encountered competition from standard market companies seeking to increase market share. We expect to continue to face strong competition in these and the other lines of business of our insurance operating units, and our insurance operating units may experience decreases in premium rates and/or premium volume and less favorable contract terms and conditions.

**Our results may fluctuate as a result of many factors, including cyclical changes in the insurance industry.** Historically, the performance of the property and casualty insurance industry has tended to fluctuate in cyclical periods of price competition and excess underwriting capacity, followed by periods of high premium rates and shortages of underwriting capacity. Although an individual insurance company's performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern. Further, this cyclical market pattern can be more pronounced in the excess and surplus market, in which RSUI primarily competes, than in the standard insurance

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market. When premium rates are high and there is a shortage of capacity in the standard insurance market, the same factors are present in the excess and surplus market, and growth in the excess and surplus market can be significantly more rapid than growth in the standard insurance market. Similarly, when there is price competition and excess underwriting capacity in the standard insurance market, many customers that were previously driven into the excess and surplus market may return to the standard insurance market, exacerbating the effects of price competition. Since cyclicalities is due in large part to the actions of our insurance operating units' competitors and general economic factors, we cannot predict the timing or duration of changes in the market cycle. These cyclical patterns cause our revenues and net earnings to fluctuate.

**Because our insurance operating units are property and casualty insurers, we face losses from natural and human-made catastrophes.**

Property and casualty insurers are subject to claims arising out of catastrophes that may have a significant effect on their results of operations, liquidity and financial condition. Catastrophe losses, or the absence thereof, have had a significant impact on our results. For example, RSUI's pre-tax catastrophe losses, net of reinsurance, were \$74.3 million in 2011, \$31.0 million in 2010, \$6.7 million in 2009 and \$97.9 million in 2008. Catastrophe losses in 2011 primarily reflect net losses from severe weather, particularly tornados, in the southeastern and midwestern U.S. in April and May 2011, as well as from Hurricane Irene, which affected the east coast of the U.S. in August 2011. Catastrophe losses in 2011 also include assumed catastrophe losses from international insurance carriers. Catastrophe losses in 2008 primarily reflect net losses from 2008 third quarter Hurricanes Ike, Gustav and Dolly. Several states, or underwriting organizations of which our insurance operating units are required to be members, may increase their mandatory assessments as a result of catastrophes and other events, and we may not be able to fully recoup these increased costs.

Natural or human-made catastrophes can be caused by various events, including hurricanes, other windstorms, earthquakes and floods, as well as terrorist activities. The incidence and severity of catastrophes in any short period of time are inherently unpredictable. The extent of gross losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes, other windstorms, earthquakes and floods may produce significant damage when those areas are heavily populated. The geographic distribution of AIHL's insurance operating units subjects them to catastrophe exposure in the United States from hurricanes in the Gulf coast regions, Florida, the Mid-Atlantic and the Northeast, from other windstorms in the Midwest and Southern regions, and earthquakes in California, the Pacific Northwest region and along the New Madrid fault line in the Midwest region. Catastrophes can cause losses in a variety of our property and casualty lines, and most of our past catastrophe-related claims have resulted from severe hurricanes. It is therefore possible that a catastrophic event or multiple catastrophic events could produce significant losses and have a material adverse effect on our financial condition and results of operations.

In addition, longer-term natural catastrophe trends may be changing due to climate change, a phenomenon that has been associated with extreme weather events linked to rising temperatures, and includes effects on global weather patterns, greenhouse gases, sea, land and air temperatures, sea levels, rain and snow. Climate change, to the extent it produces rising temperatures and changes in weather patterns, could impact the frequency or severity of weather events such as hurricanes. To the extent climate change increases the frequency and severity of such weather events, our insurance operating units, particularly RSUI, may face increased claims, particularly with respect to properties located in coastal areas. Our insurance operating units take certain measures to mitigate against the frequency and severity of such events by giving consideration to these risks in their underwriting and pricing decisions and through the purchase of reinsurance. To the extent broad environmental factors, exacerbated by climate change or otherwise, lead to increases in insured losses, particularly if those losses exceed the expectations, including reinsurance coverage, of our insurance operating units, our financial condition and results of operations could be materially and adversely affected.

With respect to terrorism, to the extent that reinsurers have excluded coverage for certain terrorist acts or have priced this coverage at rates that are not practical, our insurance operating units, particularly RSUI, would not have reinsurance protection and would be exposed to potential losses as a result of any terrorist acts. To the extent an act of terrorism is certified by the U.S. Secretary of the Treasury, we may be covered under the Terrorism Act. Information regarding the Terrorism Act and its impact on our insurance operating units can be found on pages 24 and 25 of this Form 10-K Report.



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**We cannot guarantee that the reinsurers used by our insurance operating units will pay in a timely fashion, if at all, and, as a result, we could experience losses even if reinsured.** As part of their overall risk and capacity management strategy, our insurance operating units purchase reinsurance by transferring, or ceding, part of the risk that they have underwritten to a reinsurance company in exchange for part of the premium received by our insurance operating units in connection with that risk. Although reinsurance makes the reinsurer liable to our insurance operating units to the extent the risk is transferred or ceded to the reinsurer, it does not relieve our insurance operating units of their liability to their policyholders. Reinsurers may not pay the reinsurance recoverables that they owe to our insurance operating units or they may not pay these recoverables on a timely basis. This risk may increase significantly if these reinsurers experience financial difficulties as a result of catastrophes and other events. Underwriting results and investment returns of some of the reinsurers used by our insurance operating units may affect their future ability to pay claims. Accordingly, we bear credit risk with respect to our insurance operating units' reinsurers, and if they fail to pay, our financial results would be adversely affected. As of December 31, 2011, the amount due from reinsurers reported on our balance sheet was \$0.9 billion, with approximately \$0.8 billion attributable to RSUI's reinsurers.

**If market conditions cause reinsurance to be more costly or unavailable, our insurance operating units may be required to bear increased risks or reduce the level of their underwriting commitments.** As part of our overall risk and capacity management strategy, our insurance operating units purchase reinsurance for certain amounts of risk underwritten by them, especially catastrophe risks. The reinsurance programs purchased by our insurance operating units are generally subject to annual renewal. Market conditions beyond their control determine the availability and cost of the reinsurance protection they purchase, which may affect the level of their business written and thus their profitability. If our insurance operating units are unable to renew their expiring facilities or to obtain new reinsurance facilities, either their net exposures on future policies would increase, which could increase the volatility of their results or, if they are unwilling to bear an increase in net exposures, they would have to reduce the level of their underwriting commitments, especially catastrophe-exposed risks, which may reduce their revenues and net earnings. Generally, under reinsurance contracts, an insured, to the extent it exhausts its original coverage under a reinsurance contract during a single coverage period (typically a single twelve-month period), can pay a reinsurance reinstatement premium to restore coverage during such coverage period. If our insurance operating units exhaust their original and reinstated coverage under their third-party catastrophic reinsurance contracts during a single coverage period, they will not have any reinsurance coverage available for losses incurred as a result of additional catastrophic events during that coverage period. The exhaustion of such reinsurance coverage could have a material adverse effect on the profitability of our insurance operating units in any given period and on our results of operations.

**RSUI attempts to manage its exposure to catastrophe risk partially through the use of catastrophe modeling software. The failure of this software to accurately gauge the catastrophe-exposed risks RSUI writes could have a material adverse effect on our financial condition and results of operations.** As part of its approach to managing catastrophe risk, RSUI has historically used a number of tools, including third-party catastrophe modeling software, to help evaluate potential losses. RSUI has used modeled loss scenarios to set its level of risk retention and help structure its reinsurance programs. Modeled loss estimates, however, have not always accurately predicted RSUI's ultimate losses with respect to hurricane activity. Accordingly, in an effort to better manage its accumulations of risk such that its loss exposure conforms to its established risk tolerances and fits within its reinsurance programs, RSUI periodically reviews its catastrophe exposure management approach, which may result in the implementation of new monitoring tools and a revision of its underwriting guidelines and procedures. However, these efforts may not be successful in sufficiently mitigating risk exposures and losses resulting from future catastrophes.

**Our insurance operating units are rated by A.M. Best and a decline in these ratings could affect the standing of our insurance operating units in the insurance industry and cause their premium volume and earnings to decrease.** Ratings have become an increasingly important factor in establishing the competitive position of insurance companies. Some of our insurance operating unit companies are rated by A.M. Best. A.M. Best's ratings reflect its opinion of an insurance company's financial strength, operating performance, strategic position and ability to meet its obligations to policyholders. These ratings are subject to periodic review, and we cannot assure you that any of our insurance operating unit companies will be able to retain those ratings. If the ratings of our insurance operating unit companies are reduced from their current levels by A.M. Best, their

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competitive positions in the insurance industry could suffer and it would be more difficult for them to market their products. A significant downgrade could result in a substantial loss of business as policyholders move to other companies with higher claims-paying and financial strength ratings.

**The businesses of our insurance operating units are heavily regulated, and changes in regulation may reduce their profitability and limit their growth.** Our insurance operating units are subject to extensive regulation and supervision in the jurisdictions in which they conduct business. This regulation is generally designed to protect the interests of policyholders, and not necessarily the interests of insurers, their stockholders or other investors. The regulation relates to authorization for lines of business, capital and surplus requirements, investment limitations, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, premium rates and a variety of other financial and nonfinancial components of an insurance company's business.

Virtually all states in which our insurance operating units conduct their business require them, together with other insurers licensed to do business in that state, to bear a portion of the loss suffered by some insureds as the result of impaired or insolvent insurance companies. In addition, in various states, our insurance operating units must participate in mandatory arrangements to provide various types of insurance coverage to individuals or other entities that otherwise are unable to purchase that coverage from private insurers. A few states require our insurance operating units to purchase reinsurance from a mandatory reinsurance fund. Such reinsurance funds can create a credit risk for insurers if not adequately funded by the state and, in some cases, the existence of a reinsurance fund could affect the prices charged for the policies issued by our insurance operating units. The effect of these and similar arrangements could reduce the profitability of our insurance operating units in any given period or limit the ability of our insurance operating units to grow their business.

In recent years, the state insurance regulatory framework has come under increased scrutiny, and some state legislatures have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. Further, the NAIC and state insurance regulators are continually reexamining existing laws and regulations, specifically focusing on modifications to statutory accounting principles, interpretations of existing laws and the development of new laws and regulations. On the federal level, the Dodd-Frank Act, enacted in July 2010, mandated significant changes to the regulation of U.S. insurance effective as of July 21, 2011. We cannot predict the requirements of the regulations ultimately adopted under the Dodd-Frank Act or the impact such regulation will have on our business. These regulations, and any proposed or future state or federal legislation or NAIC initiatives, if adopted, may be more restrictive on the ability of our insurance operating units to conduct business than current regulatory requirements or may result in higher costs.

**Laws and regulations of the jurisdictions in which we conduct business could delay, deter or prevent an attempt to acquire control of us that stockholders might consider to be desirable, and may restrict a stockholder's ability to purchase more than 10 percent of our common stock.** Generally, the insurance holding company laws require that, before a person can acquire control of an insurance company, prior written approval must be obtained from the insurance regulatory authorities in the state in which that insurance company is domiciled. Pursuant to applicable laws and regulations, control over an insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds the power to vote, or holds proxies representing, 10 percent or more of the voting securities of that insurer. Indirect ownership includes ownership of the shares of our common stock. Thus, the insurance regulatory authorities of the states in which our insurance operating units are domiciled are likely to apply these restrictions on acquisition of control to any proposed acquisition of 10 percent or more of our common stock.

Some states require a person seeking to acquire control of an insurer licensed but not domiciled in that state to make a filing prior to completing an acquisition if the acquirer and its affiliates, on the one hand, and the target insurer and its affiliates, on the other hand, have specified market shares in the same lines of insurance in that state. While these provisions may not require acquisition approval, they can lead to the imposition of conditions on an acquisition that could delay or prevent its consummation.

These laws may discourage potential acquisition proposals and may delay, deter or prevent an acquisition of control of us through transactions, and in particular unsolicited transactions, that some or all of our stockholders might consider to be desirable.

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**Legislative and judicial changes may have an effect on workers' compensation claims in California.** Benefit rights under workers' compensation laws in California continue to be subject to judicial decisions and legislative changes that may increase amounts payable by all workers' compensation insurers, including PCC.

**Risk Factors Relating to our Investments and Assets**

**A substantial amount of our assets is invested in debt securities and is subject to market fluctuations.** A substantial portion of our investment portfolio consists of debt securities. As of December 31, 2011, our investment in debt securities was approximately \$2.7 billion, or 55.5 percent of our total investment portfolio. The fair market value of these assets and the investment income from these assets fluctuate depending on general economic and market conditions. A rise in interest rates would decrease the net unrealized gain position of our investment portfolio and potentially produce a net unrealized loss position, offset by our ability to earn higher rates of return on funds reinvested. Conversely, a decline in interest rates would increase the net unrealized gain position of our investment portfolio, offset by lower rates of return on funds reinvested. Based upon the composition and duration of our investment portfolio as of December 31, 2011, a 100 basis point increase in interest rates would result in an approximate \$110.6 million decrease in the fair value of our debt security investments. In addition, some debt securities, such as mortgage-backed and other asset-backed securities, carry prepayment risk, or the risk that principal will be returned more rapidly or slowly than expected, as a result of interest rate fluctuations.

**Defaults, downgrades or other events impairing the value of our debt securities portfolio may reduce our earnings.** We are subject to the risk that the issuers of debt securities we own may default on principal and interest payments they owe us. The occurrence of a major economic downturn, acts of corporate malfeasance, widening risk spreads or other events that adversely affect the issuers of these debt securities could cause the value of our debt securities portfolio and our net earnings to decline and the default rate of the debt securities in our investment portfolio to increase. In addition, with economic uncertainty, the credit quality of issuers could be adversely affected and a ratings downgrade of the issuers of the debt securities we own could also cause the value of our debt securities portfolio and our net earnings to decrease. Any event reducing the value of these securities other than on a temporary basis could have a material adverse effect on our business, results of operations, and financial condition. We continually monitor the difference between cost and the estimated fair value of our investments in debt securities. If a decline in the value of a particular debt security is deemed to be temporary, we record the decline as an unrealized loss in stockholders' equity. If the decline is deemed to be other than temporary, we write it down to the carrying value of the investment and record an other-than-temporary impairment loss on our statement of earnings, which may be material to our operating results.

**We invest some of our assets in equity securities, which are subject to fluctuations in market value.** We invest a portion of our investment portfolio in equity securities which are subject to fluctuations in market value. As of December 31, 2011, our investments in equity securities had a fair market value of approximately \$0.9 billion, which represented 18.0 percent of our investment portfolio. We hold our equity securities as available for sale, and any changes in the fair value of these securities, net of tax, would be reflected in our accumulated other comprehensive income as a component of stockholders' equity. If a decline in the value of a particular equity security is deemed to be temporary, we record the decline as an unrealized loss in stockholders' equity. If the decline is deemed to be other than temporary, we write its cost-basis down to the fair value of the investment and record an other-than-temporary impairment loss on our statement of earnings, which may be material to our operating results, regardless of whether we continue to hold the equity security. A severe and/or prolonged downturn in equity markets could give rise to significant impairment charges.

In 2011, we recorded \$3.1 million of other-than-temporary impairment losses on equity securities, primarily based on the severity of the declines in fair value of such securities relative to their cost as of the balance sheet date. In 2010 and 2009, we recorded \$11.1 million and \$57.6 million, respectively, of other-than-temporary impairment losses on equity securities, which were primarily based on the severity of the declines in fair value of such securities relative to their cost as of the balance sheet date. The severe decline in 2009 was primarily related to a significant deterioration of U.S. equity market conditions during the latter part of 2008 and the first quarter of 2009, which abated somewhat during the remainder of 2009. If U.S. equity market conditions deteriorate in 2012, we may be required to record additional other-than-temporary impairment losses, which could have a material and adverse impact on our results of operations.

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As of December 31, 2011, our energy sector equity security holdings had an aggregate fair market value of \$573.3 million, which represented 65.8 percent of our equity portfolio. This investment concentration may lead to higher levels of short-term price volatility and variability in the level of unrealized investment gains or losses.

**If our business does not perform well, we may be required to recognize an impairment of our goodwill or other long-lived assets or to establish a valuation allowance against the deferred income tax asset, which could adversely affect our results of operations or financial condition.** Goodwill represents the excess of the amount we paid to acquire subsidiaries and other businesses over the fair value of their net assets at the date of acquisition. We test goodwill at least annually for impairment. Impairment testing is performed based upon estimates of the fair value of the operating unit to which the goodwill relates. The fair value of the operating unit is impacted by the performance of the business. The performance of our businesses may be adversely impacted by prolonged market declines. If it is determined that the goodwill has been impaired, we must write down the goodwill by the amount of the impairment, with a corresponding charge to net earnings. Such write-downs could have a material adverse effect on our results of operations or financial position. A decrease in the expected future earnings of RSUI and CATA could lead to an impairment of some or all of the goodwill associated with such operating units in future periods. The goodwill associated with PCC was fully written down in 2008.

Deferred income tax represents the tax effect of the differences between the book and tax basis of assets and liabilities. Deferred tax assets are assessed periodically by management to determine if they are recoverable. Factors in management's determination include the performance of the business including the ability to generate capital gains. If it is more likely than not that the deferred income tax asset will not be realized based on available information then a valuation allowance must be established with a corresponding charge to net earnings. Such charges could have a material adverse effect on our results of operations or financial position. Deterioration of financial market conditions could result in the impairment of long-lived assets and the establishment of a valuation allowance on our deferred income tax assets.

### **Risks Relating to our Senior Notes**

**Our failure to comply with restrictive covenants contained in the indenture governing the Senior Notes or any other indebtedness, including indebtedness under our revolving credit facility and any future indebtedness, could trigger prepayment obligations, which could adversely affect our business, financial condition and results of operations.** On September 9, 2010, we entered into a three-year credit agreement with a bank which provides for a two tranche revolving credit facility, or the Credit Agreement, in an aggregate principal amount of up to \$100.0 million. On September 20, 2010, we issued \$300.0 million of the 5.625% Senior Notes due September 15, 2020, or the Senior Notes. The indenture governing the Senior Notes contains covenants that impose restrictions on us with respect to, among other things, the incurrence of liens on the capital stock of certain of our subsidiaries. The indenture governing the Senior Notes requires us to file with the trustee copies of our annual, quarterly and current reports which we are required to file with the SEC, and the Credit Agreement requires us to comply with certain covenants. Our failure to comply with such covenants could result in an event of default under the indenture, under the Credit Agreement or under any other debt agreement we may enter into in the future, which could, if not cured or waived, result in us being required to repay the Senior Notes, the indebtedness under the Credit Agreement or any other future indebtedness. As a result, our business, financial condition and results of operations could be adversely affected.

**To service our debt, we will require a significant amount of cash, which may not be available to us.** Our ability to make payments on, or repay or refinance, our debt, including the Senior Notes, will depend largely upon the future performance and use of our Corporate activities investment portfolio, and our future operating performance, including the operating performance of our subsidiaries. Our future performance, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. In addition, our ability to borrow funds in the future will depend on the satisfaction of the covenants in the indenture governing the Senior Notes, in the Credit Agreement and in other debt agreements we may enter into in the future. Under the Credit Agreement, we also need to maintain certain financial ratios. We cannot assure you that our business, including the operating performance of our subsidiaries, will generate sufficient cash flow from operations or that future borrowings will be available to us under the Credit Agreement.

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or from other sources in an amount sufficient to enable us to pay our debt, including the Senior Notes, or to fund our other liquidity needs.

### **Risks Relating to our potential Merger with Transatlantic**

**Although we expect to realize certain benefits as a result of the merger, there is the possibility that following the merger, we may be unable to integrate successfully the businesses of Alleghany and Transatlantic in order to realize the anticipated benefits of the merger or do so within the intended timeframe.** The merger involves Transatlantic being operated as our wholly owned subsidiary. We will be required to devote significant management attention and resources to integrating the business practices and operations of Transatlantic with Alleghany. Due to legal restrictions, we and Transatlantic have been able to conduct limited planning regarding the integration of Transatlantic into us after completion of the merger and have not yet determined the exact nature of how the businesses and operations of Transatlantic will be run following the merger. Potential difficulties we may encounter as part of the integration process include the following:

the consequences of a change in tax treatment, including the costs of integration and compliance and the possibility that the full benefits anticipated to result from the merger will not be realized;

any delay in the integration of management teams, strategies, operations, products and services;

diversion of the attention of each company's management as a result of the merger;

differences in business backgrounds, corporate cultures and management philosophies that may delay successful integration;

the ability to retain key employees;

the ability to create and enforce uniform standards, controls, procedures, policies and information systems;

complexities associated with managing Transatlantic as a subsidiary of Alleghany, including the challenge of integrating complex systems, technology, networks and other assets of Transatlantic into those of Alleghany in a seamless manner that minimizes any adverse impact on customers, suppliers, brokers, employees and other constituencies;

potential unknown liabilities and unforeseen increased expenses or delays associated with the merger, including one-time cash costs to integrate Transatlantic beyond current estimates; and

the disruption of, or the loss of momentum in, each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies, any of which could adversely affect each company's ability to maintain relationships with customers, suppliers, brokers, employees and other constituencies or Alleghany's ability to achieve the anticipated benefits of the merger or could reduce each company's earnings or otherwise adversely affect our business and financial results after the merger.

**Our results after the merger may suffer if we do not effectively manage our expanded operations following the merger.** Following the merger, the size of our business will increase significantly beyond the current size of our existing business. Our future success depends, in part, upon our ability to manage this expanded business, which will pose substantial challenges for management, including challenges related to the management and monitoring of new global operations and associated increased costs and complexity. There can be no assurances that we will be successful after completion of the merger or that we will realize the expected benefits currently anticipated from the merger.

**We are expected to incur substantial expenses related to the merger.** Although we have assumed that a certain level of expenses would be incurred, there are many factors beyond our control that could affect the total amount or the timing of the expenses. Moreover, many of our expenses related to the merger that will be incurred are, by their nature, difficult to estimate accurately.

**The occurrence of severe catastrophic events may cause our financial results after completion of the merger to be volatile and may affect our financial results after completion of the merger differently than such an event would have affected our financial results prior to the merger.** Because we expect that we will,

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after completion of the merger, among other things, underwrite property catastrophe insurance and reinsurance and have large aggregate exposures to natural and man-made disasters, management expects that our loss experience generally will include infrequent events of great severity. Consequently, the occurrence of losses from catastrophic events is likely to cause substantial volatility in our financial results after completion of the merger. In addition, because catastrophes are an inherent risk of our business after completion of the merger, a major event or series of events can be expected to occur from time to time and to have a material adverse effect on our financial condition and results of operations, possibly to the extent of eliminating our stockholders' equity. Upon completion of the merger, our exposure to natural and man-made disasters will be different from our exposure prior to the merger.

**Item 1B. Unresolved Staff Comments.**

There are no unresolved written comments that were received from the SEC staff 180 days or more before the end of our fiscal year relating to our periodic or current reports under the Exchange Act.

**Item 3. Legal Proceedings.**

Our subsidiaries are parties to pending litigation and claims in connection with the ordinary course of their businesses. Each subsidiary makes provision on its books, in accordance with GAAP, for estimated losses to be incurred in connection with such litigation and claims, including legal costs. In the opinion of management, this provision is adequate under GAAP as of December 31, 2011.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities. Market Information, Holders and Dividends**

As of December 31, 2011, there were 943 holders of record of our common stock. The following table indicates quarterly high and low prices of our common stock on the New York Stock Exchange in 2011 and 2010. Our ticker symbol is Y.

Quarter Ended	2011		2010	
	High	Low	High	Low
March 31	\$ 333.50	\$ 298.09	\$ 296.91	\$ 246.20
June 30	337.36	324.20	301.79	272.34
September 30	334.83	279.88	304.90	298.92
December 31	321.57	277.15	304.90	298.92

In 2011 and 2010, our Board of Directors declared, as our dividend on our common stock for each such year, a stock dividend consisting of one share of our common stock for every 50 shares outstanding. In light of the pending merger with Transatlantic, our Board of Directors determined not to declare a stock dividend for 2012.

**Purchases of Equity Securities by Us**

The following table summarizes our common stock repurchases for the quarter ended December 31, 2011:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 to October 31	121,281	\$ 293.76		
November 1 to November 30	26,390	\$ 314.06		
December 1 to December 31		\$		
Total	147,671	\$ 297.39	147,671	\$

- (1) All shares represent shares repurchased pursuant to authorization of the Board of Directors. In July 2010, our Board of Directors authorized the repurchase of additional shares of our common stock, at such times and at prices as management may determine advisable, up to an aggregate of \$300.0 million, upon such full utilization. Such share repurchase program was terminated upon our entry into the merger agreement with Transatlantic in November 2011.



**Table of Contents****PERFORMANCE GRAPH**

The following graph compares for the years 2007 through 2011 the cumulative total stockholder return on our common stock, the cumulative total return on the Standard & Poor's 500 Stock Index (the S&P 500), and the cumulative total return on the Standard & Poor's 500 Property and Casualty Insurance Index (the P&C Index). The graph shows the value as of December 31 of each such year of \$100 invested on December 31, 2006 in our common stock, the S&P 500 and the P&C Index.

Company/Index	Base					
	Period	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11
<b>Alleghany</b>	<b>100</b>	112.77	80.69	80.55	91.21	86.63
<b>S&amp;P 500</b>	<b>100</b>	105.49	66.46	84.05	96.71	98.76
<b>P&amp;C Index</b>	<b>100</b>	86.04	60.73	68.23	74.33	74.14

This performance graph is based on the following assumptions: (i) cash dividends are reinvested on the ex-dividend date in respect of such dividend; and (ii) the two-percent stock dividends we have paid in each of the years 2007 through 2011 are included in the cumulative total stockholder return on our common stock.

**Table of Contents****Item 6. Selected Financial Data.***Alleghany Corporation and Subsidiaries\**

	2011	2010	Years Ended December 31,		2007
			2009	2008	
	(in millions, except for per share and share amounts)				
<b>Operating Data</b>					
Revenues from continuing operations	\$ 981.8	\$ 985.4	\$ 1,184.4	\$ 989.1	\$ 1,228.6
Earnings from continuing operations	\$ 143.3	\$ 198.5	\$ 271.0	\$ 40.6	\$ 287.6
Earnings from discontinued operations				107.4	11.5
Net earnings	\$ 143.3	\$ 198.5	\$ 271.0	\$ 148.0	\$ 299.1
Basic earnings per share of common stock**					
Continuing operations	\$ 16.26	\$ 21.85	\$ 29.25	\$ 2.65	\$ 30.66
Discontinued operations				12.18	1.30
Net earnings	\$ 16.26	\$ 21.85	\$ 29.25	\$ 14.83	\$ 31.96
Average number of shares of common stock**	8,807,487	9,081,535	9,055,920	8,822,449	8,818,589
<b>Balance Sheet</b>					
Total assets	\$ 6,478.1	\$ 6,431.7	\$ 6,192.8	\$ 6,181.8	\$ 6,942.1
Debt	\$ 299.0	\$ 298.9	\$	\$	\$
Common stockholders' equity	\$ 2,925.7	\$ 2,908.9	\$ 2,717.5	\$ 2,347.3	\$ 2,484.8
Common stockholders' equity per share of common stock**	\$ 342.12	\$ 325.31	\$ 294.79	\$ 267.37	\$ 281.36

\* On July 18, 2007, we acquired PCC. We sold Darwin on October 20, 2008. Darwin has been reclassified as discontinued operations for the two years ended 2008 and discontinued operations, net of minority interest expense, includes the gain on disposition in 2008.

\*\* Amounts have been adjusted for subsequent common stock dividends.

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**Item 7. Management Discussion and Analysis of Financial Condition and Results of Operations.**

Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk contain disclosures which are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all statements that do not relate solely to historical or current facts, and can be identified by the use of words such as may, will, expect, project, estimate, anticipate, plan, believe, potential, should, continue or the negative versions of comparable words. These forward-looking statements are based upon our current plans or expectations and are subject to a number of uncertainties and risks that could significantly affect current plans, anticipated actions and our future financial condition and results. These statements are not guarantees of future performance, and we have no specific intention to update these statements. The uncertainties and risks include, but are not limited to,

significant weather-related or other natural or human-made catastrophes and disasters;

the cyclical nature of the property and casualty insurance industry;

changes in market prices of our significant equity investments and changes in value of our debt securities portfolio;

adverse loss development for events insured by our insurance operating units in either the current year or prior year;

the long-tail and potentially volatile nature of certain casualty lines of business written by our insurance operating units;

the cost and availability of reinsurance;

exposure to terrorist acts;

the willingness and ability of our insurance operating units' reinsurers to pay reinsurance recoverables owed to our insurance operating units;

changes in the ratings assigned to our insurance operating units;

claims development and the process of estimating reserves;

legal and regulatory changes, including the new federal financial regulatory reform of the insurance industry mandated by the Dodd-Frank Act;

the uncertain nature of damage theories and loss amounts; and

increases in the levels of risk retention by our insurance operating units.

Additional risks and uncertainties include general economic and political conditions, including the effects of a prolonged U.S. or global economic downturn or recession; changes in costs; variations in political, economic or other factors; risks relating to conducting operations in a competitive environment; effects of acquisition and disposition activities, inflation rates, or recessionary or expansive trends; changes in interest rates; extended labor disruptions, civil unrest, or other external factors over which we have no control; and changes in our plans, strategies, objectives, expectations, or intentions, which may happen at any time at our discretion. As a consequence, current plans, anticipated actions, and future financial condition and results may differ from those expressed in any forward-looking statements made by us or on our behalf.

### **Critical Accounting Estimates**

#### *Loss and LAE*

*Overview.* Each of our insurance operating units establishes reserves on its balance sheet for unpaid loss and LAE related to its property and casualty insurance and surety contracts. As of any balance sheet date, historically there have been claims that have not yet been reported, and some claims may not be reported for many years after the date a loss occurs. As a result of this historical pattern, the liability for unpaid loss and LAE includes significant estimates for IBNR. Additionally, reported claims are in various stages of the settlement process. Each claim is settled individually based upon its merits, and certain claims may take years to settle,

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especially if legal action is involved. As a result, the liabilities for unpaid loss and LAE include significant judgments, assumptions and estimates made by management relating to the actual ultimate losses that will arise from the claims. Due to the inherent uncertainties in the process of establishing these liabilities, the actual ultimate loss from a claim is likely to differ, perhaps materially, from the liability initially recorded and could be material to the results of our operations. The accounting policies that our insurance operating units use in connection with the establishment of these liabilities include critical accounting estimates.

As noted above, as of any balance sheet date, not all claims that have occurred have been reported to our insurance operating units, and if reported may not have been settled. The time period between the occurrence of a loss and the time it is settled by the insurer is referred to as the claim tail. Property claims usually have a fairly short claim tail and, absent claim litigation, are reported and settled within no more than a few years of the date they occur. For short-tail lines, loss reserves consist primarily of reserves for reported claims. The process of recording quarterly and annual liabilities for unpaid loss and LAE for short-tail lines is primarily focused on maintaining an appropriate reserve level for reported claims and IBNR, rather than determining an expected loss ratio for the current business. Specifically, we assess the reserve adequacy of IBNR in light of such factors as the current levels of reserves for reported claims and expectations with respect to reporting lags, historical data, legal developments, and economic conditions, including the effects of inflation. As of December 31, 2011, the amount of IBNR for short-tail claims represented approximately 1.3 percent, or \$29.7 million, of our total gross loss and LAE liabilities of \$2.3 billion. In conformity with GAAP, our insurance operating units are not permitted to establish IBNR reserves for catastrophe losses that have not occurred. Therefore, losses related to a significant catastrophe, or accumulation of catastrophes, in any reporting period could have a material, negative impact on our results during that period.

Our insurance operating units provide coverage on both a claims-made and occurrence basis. Claims-made policies generally require that claims occur and be reported during the coverage period of the policy. Occurrence policies allow claims which occur during a policy's coverage period to be reported after the coverage period, and as a result, these claims can have a very long claim tail, occasionally extending for decades. Casualty claims can have a very long claim tail, in certain situations extending for many years. In addition, casualty claims are more susceptible to litigation and the legal environment and can be significantly affected by changing contract interpretations, all of which contribute to extending the claim tail. For long-tail casualty lines of business, estimation of ultimate liabilities for unpaid loss and LAE is a more complex process and depends on a number of factors, including the line and volume of the business involved. For these reasons, AIHL's insurance operating units will generally use actuarial projections in setting reserves for all casualty lines of business.

Although we are unable at this time to determine whether additional reserves, which could have a material impact upon our financial condition, results of operations, and cash flows, may be necessary in the future, we believe that the reserves for unpaid loss and LAE established by our insurance operating units are adequate as of December 31, 2011.

*Methodologies and Assumptions.* Our insurance operating units use a variety of techniques that employ significant judgments and assumptions to establish the liabilities for unpaid loss and LAE recorded at the balance sheet date. These techniques include detailed statistical analyses of past claim reporting, settlement activity, claim frequency, internal loss experience, changes in pricing or coverages and severity data when sufficient information exists to lend statistical credibility to the analyses. More subjective techniques are used when statistical data is insufficient or unavailable. These liabilities also reflect implicit or explicit assumptions regarding the potential effects of future inflation, judicial decisions, changes in laws and recent trends in such factors, as well as a number of actuarial assumptions that vary across our insurance operating units and across lines of business. This data is analyzed by line of business, coverage and accident year, as appropriate.

Our loss reserve review processes use actuarial methods that vary by insurance operating unit and line of business and produce point estimates for each class of business. The actuarial methods used by our insurance operating units include the following methods:

*Reported Loss Development Method:* a reported loss development pattern is calculated based on historical loss development data, and this pattern is then used to project the latest evaluation of cumulative reported losses for each accident year to ultimate levels;

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*Paid Development Method:* a paid loss development pattern is calculated based on historical development data, and this pattern is then used to project the latest evaluation of cumulative paid losses for each accident year to ultimate levels;

*Expected Loss Ratio Method:* expected loss ratios are applied to premiums earned, based on historical company experience, or historical insurance industry results when company experience is deemed not to be sufficient; and

*Bornhuetter-Ferguson Method:* the results from the Expected Loss Ratio Method are essentially blended with either the Reported Loss Development Method or the Paid Development Method.

The primary assumptions used by our insurance operating units include the following:

*Expected loss ratios* represent management’s expectation of losses, in relation to earned premium, at the time business is written, before any actual claims experience has emerged. This expectation is a significant determinant of the estimate of loss reserves for recently written business where there is little paid or incurred loss data to consider. Expected loss ratios are generally derived from historical loss ratios adjusted for the impact of rate changes, loss cost trends and known changes in the type of risks underwritten.

*Rate of loss cost inflation (or deflation)* represents management’s expectation of the inflation associated with the costs we may incur in the future to settle claims. Expected loss cost inflation is particularly important for claims with a substantial medical component, such as workers’ compensation.

*Reported and paid loss emergence patterns* represent management’s expectation of how losses will be reported and ultimately paid in the future based on the historical emergence patterns of reported and paid losses and are derived from past experience of our insurance operating units, modified for current trends. These emergence patterns are used to project current reported or paid loss amounts to their ultimate settlement value.

Each of the above actuarial assumptions may also incorporate data from the insurance industry as a whole, or peer companies writing substantially similar insurance coverages, in the absence of sufficiently credible internally-derived historical information. Data from external sources may be used to set expectations, as well as assumptions regarding loss frequency or severity relative to an exposure unit or claim, among other actuarial parameters. Assumptions regarding the application or composition of peer group or industry reserving parameters require substantial judgment. The use of data from external sources was most significant for PCC as of December 31, 2011.

*Sensitivity.* Loss frequency and severity are measures of loss activity that are considered in determining the key assumptions described above. Loss frequency is a measure of the number of claims per unit of insured exposure, and loss severity is a measure of the average size of claims. Factors affecting loss frequency include the effectiveness of loss controls and safety programs and changes in economic conditions or weather patterns. Factors affecting loss severity include changes in policy limits, retentions, rate of inflation and judicial interpretations. Another factor affecting estimates of loss frequency and severity is the loss reporting lag, which is the period of time between the occurrence of a loss and the date the loss is reported to our insurance operating units. The length of the loss reporting lag affects our ability to accurately predict loss frequency (loss frequencies are more predictable for lines with short reporting lags), as well as the amount of reserves needed for IBNR. If the actual level of loss frequency and severity is higher or lower than expected, the ultimate losses will be different than management’s estimates. A small percentage change in an estimate can result in a material effect on our reported earnings. The following table reflects the impact of changes, which could be favorable or unfavorable, in frequency and severity on our loss estimates for claims occurring in 2011 (dollars in millions):

Severity	Frequency		
	1.0%	5.0%	10.0%
1.0%	\$ 8.8	\$ 26.5	\$ 48.6
5.0%	\$ 26.5	\$ 44.9	\$ 67.9
10.0%	\$ 48.6	\$ 67.9	\$ 92.0



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Our net reserves for loss and LAE of \$1.5 billion as of December 31, 2011 relate to multiple accident years. Therefore, the impact of changes in frequency or severity for more than one accident year could be higher or lower than the amounts reflected above. We believe the above analysis provides a reasonable benchmark for sensitivity as we believe it is within historical variation for our reserves. Currently, none of the scenarios is believed to be more likely than the other. See Note 1(j) and Note 6 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report for additional information on our loss and LAE.

*Prior Year Development.* Our insurance operating units continually evaluate the potential for changes, both positive and negative, in their estimates of their loss and LAE liabilities and use the results of these evaluations to adjust both recorded liabilities and underwriting criteria. With respect to liabilities for unpaid loss and LAE established in prior years, these liabilities are periodically analyzed and their expected ultimate cost adjusted, where necessary, to reflect positive or negative development in loss experience and new information, including, for certain catastrophic events, revised industry estimates of the magnitude of a catastrophe. Adjustments to previously recorded liabilities for unpaid loss and LAE, both positive and negative, are reflected in our financial results in the periods in which these adjustments are made and are referred to as prior year reserve development. Each of RSUI, CATA and PCC adjusted its prior year loss and LAE reserve estimate during 2011 and 2010 based on current information that differed from previous assumptions made at the time such loss and LAE reserves were previously estimated. These reserve (decreases) increases to prior year net reserves are summarized as follows (in millions):

	2011	2010
<b>RSUI:</b>		
Net casualty reserve (releases)	\$ (56.2)	\$ (33.9)
Property and other, net	(3.3)	(9.3)
	\$ (59.5)	\$ (43.2)
<b>CATA:</b>		
Net insurance reserve increases (releases)	\$ 5.0	\$ (0.4)
Reinsurance assumed reserve release		(3.5)
	\$ 5.0	\$ (3.9)
<b>PCC:</b>		
Net workers compensation increases	\$ 28.4	\$ 12.5
All other, net	0.3	0.9
	\$ 28.7	\$ 13.4
<b>Total incurred related to prior years</b>	<b>\$ (25.8)</b>	<b>\$ (33.7)</b>

The more significant prior year adjustments affecting 2011 and 2010 are summarized as follows:

For RSUI, loss and LAE for 2011 reflect a net \$56.2 million release of prior accident year casualty loss reserves, compared with a net \$33.9 million release of prior accident year casualty loss reserves during 2010. The \$56.2 million release relates primarily to the umbrella/excess, general liability and professional liability lines of business, primarily for the 2003 through 2008 accident years, and reflects favorable loss emergence, compared with loss emergence patterns assumed in earlier periods for such lines of business. Specifically, cumulative losses for such lines of business, which include both loss payments and case reserves, in respect of prior accident years were expected to be higher through the balance sheet date than the actual cumulative losses through that date. The amount of lower cumulative losses, expressed as a percentage of carried loss and LAE reserves at the beginning of the year, was 2.3 percent. Such reduction did not impact the assumptions used in estimating RSUI's loss and LAE liabilities for its general liability and professional liability lines of business earned in 2011. Such reserve releases were partially offset by an increase in loss reserves in the D&O liability line of business in the 2011 third quarter, primarily reflecting adverse legal developments associated with a large claim from the 2007 accident year. Such increase did not impact the assumptions used in estimating RSUI's loss and LAE liabilities for its D&O liability line of business earned in 2011.

For RSUI, the \$33.9 million net release of prior accident year casualty loss reserves in 2010 consisted of a \$41.4 million reserve release, partially offset by a \$7.5 million reserve increase. The \$41.4 million reserve





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release relates primarily to the general liability and professional liability lines of business primarily for the 2003 through 2007 accident years and reflects favorable loss emergence, compared with loss emergence patterns assumed in earlier periods for such lines of business. The \$7.5 million reserve increase in loss reserves related to an increase in estimated ultimate 2007 accident year losses for the D&O liability line of business, reflecting, in part, unfavorable loss emergence on certain sub-prime mortgage industry claims.

For RSUI, loss and LAE for 2011 and 2010 also include a net \$3.3 million and \$9.3 million release of prior accident year loss reserves, respectively, primarily related to a re-estimation of case and IBNR reserves in the property line of business. For 2011, the net \$3.3 million reserve release primarily reflects significant net reserve releases in non-catastrophe property reserves and unallocated LAE, partially offset by reserve increases related to prior year catastrophes. For 2010, the net \$9.3 million reserve release primarily reflects significant net reserve releases in non-catastrophe property reserves, partially offset by a \$16.3 million reserve increase related to prior year catastrophes. Of the \$16.3 million, \$5.3 million was recorded in the 2010 second quarter and related to the third quarter 2008 hurricanes, and \$11.0 million was recorded throughout 2010 and related to the third quarter 2005 hurricanes.

For CATA, loss and LAE for 2011 reflect a net \$5.0 million increase of prior accident year loss reserves (related primarily to the casualty lines of business), compared with a \$0.4 million release of prior accident year loss reserves during 2010 (related primarily to the surety lines of business). The \$5.0 million net reserve increase consists of a \$14.6 million increase in reserves related to certain specialty property and casualty classes of business through a program administrator in connection with a program where notice of termination of such program has been given ( Terminated Program Business ), partially offset by a \$9.6 million of net reserve release in certain of CATA's casualty lines of business. The reserve increase in the Terminated Program Business reflects unfavorable loss emergence, primarily in the 2009 and 2010 accident years, compared with loss emergence patterns assumed in earlier periods for such business. The net \$5.0 million increase of prior accident year loss reserves did not impact the assumptions used in estimating CATA's loss and LAE liabilities for business earned in 2011.

For CATA, loss and LAE for 2010 reflect a \$3.5 million reserve release reflecting favorable loss emergence for asbestos and environmental impairment claims that arose from reinsurance assumed by a subsidiary of CATA between 1969 and 1976, based on a reserve study that was completed in the 2010 second quarter.

For PCC, loss and LAE for 2011 reflect a \$28.4 million increase of prior accident year workers' compensation loss reserves, compared with a \$12.5 million reserve increase of prior accident year workers' compensation loss reserves during 2010. Of the \$28.4 million increase, \$15.0 million was recorded in the 2011 second quarter and \$13.4 million was recorded in the 2011 fourth quarter, as follows (in millions):

	Three months ended:		Twelve months
	June 30, 2011	December 31, 2011	ended December 31, 2011
Adverse claims emergence	\$ 10.0	\$ 4.2	\$ 14.2
Increases in allocated LAE	3.0	6.4	9.4
Increases in unallocated LAE		2.8	2.8
Decrease in ceded loss and LAE reserves	2.0		2.0
	\$ 15.0	\$ 13.4	\$ 28.4

PCC's adverse claims emergence related to an unanticipated increase in medical claims emergence and an absence of anticipated favorable indemnity claims emergence. PCC had anticipated favorable indemnity claims emergence based upon prior claims development experience which indicated that injured workers would be returning to work, curtailing lost wage costs. PCC believes the weak California employment environment has hindered the ability of injured workers to return to work and indirectly influenced indemnity claims. Increases in allocated and unallocated LAE reserves primarily reflect increased use of outside counsel to assist in the settlement process and higher litigation costs caused by recent Workers' Compensation Appeals Board decisions. The decrease in ceded loss and LAE reserves was based on a



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second quarter 2011 review of reinsurance coverage estimates, which also resulted in a \$1.1 million decrease in ceded premiums earned, thereby increasing net premiums earned in the 2011 second quarter.

For PCC, the \$12.5 million increase in loss and LAE for 2010 relates primarily to a decrease in ceded loss and LAE reserves based on a fourth quarter 2010 review of reinsurance coverage estimates, and to a lesser extent, an increase in unallocated LAE reserves, which also resulted in a \$5.0 million decrease in ceded premiums earned, thereby increasing net premiums earned in 2010.

*Asbestos and Environmental Impairment Reserves.* Our reserve for unpaid loss and LAE includes \$13.7 million of gross and net reserves as of December 31, 2011 for asbestos and environmental impairment claims that arose from reinsurance of certain general liability and commercial multiple peril coverages assumed by Capitol Indemnity between 1969 and 1976. Reserves for asbestos and environmental impairment claims cannot be estimated with traditional loss reserving techniques because of uncertainties that are greater than those associated with other types of claims. Factors contributing to these uncertainties include a lack of historical data, the significant periods of time that often elapse between the occurrence of an insured loss and the reporting of that loss to the ceding company and the reinsurer, uncertainty as to the number and identity of insureds with potential exposure to these risks, unresolved legal issues regarding policy coverage, and the extent and timing of any such contractual liability. Loss reserve estimates for these asbestos and environmental impairment exposures include case reserves, which also reflect reserves for legal and other LAE and IBNR reserves. IBNR reserves are determined based upon CATA's historic general liability exposure base and policy language, asbestos liability law, judicial settlements of asbestos liabilities, previous environmental impairment loss experience, the assessment of current trends of environmental law and environmental cleanup costs.

For both asbestos and environmental impairment reinsurance claims, CATA establishes case reserves by receiving case reserve amounts from its ceding companies and verifies these amounts against reinsurance contract terms, analyzing from the first dollar of loss incurred by the primary insurer. In establishing the liability for asbestos and environmental impairment claims, CATA considers facts currently known and the current state of the applicable law and coverage litigation. Additionally, ceding companies often report potential losses on a precautionary basis to protect their rights under the reinsurance arrangement, which generally calls for prompt notice to the reinsurer. Ceding companies, at the time they report potential losses, advise CATA of the ceding companies' current estimate of the extent of the loss. CATA's claims department reviews each of the precautionary claims notices and, based upon current information, assesses the likelihood of loss to CATA. This assessment is one of the factors used in determining the adequacy of the recorded asbestos and environmental impairment reserves. Although we are unable at this time to determine whether additional reserves, which could have a material impact upon our results of operations, may be necessary in the future, we believe that CATA's asbestos and environmental impairment reserves are adequate as of December 31, 2011. Additional information regarding asbestos and environmental impairment claims can be found on pages 21 and 22 this Form 10-K Report.

*Reinsurance.* Recoverables recorded with respect to claims ceded by our insurance operating units to reinsurers under reinsurance contracts are predicated in large part on the estimates for unpaid losses and, therefore, are also subject to a significant degree of uncertainty. In addition to the factors cited above, reinsurance recoverables may prove uncollectible if the reinsurer is unable to perform under the contract. Reinsurance contracts purchased by our insurance operating units do not relieve them of their obligations to their own policyholders. Additional information regarding the use of, and risks related to, the use of reinsurance by our insurance operating units can be found on pages 23 through 25 and page 33 of this Form 10-K Report. Also see Note 1(e) and Note 5 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report for additional information on our reinsurance recoverables.

*Investments Impairment*

We hold our equity and debt securities as available-for-sale, and as such, these securities are recorded at fair value. We continually monitor the difference between cost and the estimated fair value of our investments, which involves uncertainty as to whether declines in value are temporary in nature. If a decline in the value of a particular investment is deemed temporary, we record the decline as an unrealized loss in stockholders' equity. If the decline is deemed to be other than temporary, we write its cost-basis down to the fair value of the investment and record an other-than-temporary impairment loss on our statement of earnings, regardless of whether we

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continue to hold the applicable security. In addition, under GAAP, any portion of such decline that relates to debt securities that is believed to arise from factors other than credit is recorded as a component of other comprehensive income.

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

- (i) there has been a negative news event with respect to the issuer of any such security that could indicate the existence of an other-than-temporary impairment;
- (ii) we have the ability and intent to hold an equity security for a period of time sufficient to allow for an anticipated recovery (generally considered to be less than one year from the balance sheet date); and
- (iii) it is more likely than not that we will sell a debt security before recovery of its amortized cost basis.

To the extent that an equity security in an unrealized loss position is not impaired based on the initial review described above, we then further evaluate such equity security and deem it to be other-than-temporarily impaired if its decline in fair value has existed for twelve months or more or if its decline in fair value from its cost is greater than 50 percent, absent compelling evidence to the contrary.

We then evaluate all remaining equity securities that are in an unrealized loss position the cost of which:

- (i) exceeds their fair value by 20 percent or more as of the balance sheet date; or
- (ii) has exceeded fair value continuously for six (6) months or more preceding the balance sheet date.

This evaluation takes into account quantitative and qualitative factors in determining whether such securities are other-than-temporarily impaired including:

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

To the extent that a debt security that is in an unrealized loss position is not impaired based on the initial review described above, and absent an intent to sell, we will consider a debt security to be impaired when we believe it to be probable that we will not be able to collect all amounts due under the security's contractual terms.

We may ultimately record a realized loss after having originally concluded that the decline in value was temporary. Risks and uncertainties are inherent in the methodology we use to assess other-than-temporary declines in value. Risks and uncertainties could include, but are not limited to, incorrect assumptions about financial condition, liquidity or future prospects, inadequacy of any underlying collateral, and unfavorable changes in economic conditions or social trends, interest rates or credit ratings.

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See Note 1(b) and Note 3 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report for additional information on our investments and investment impairments.

### *Goodwill and Other Intangible Assets*

Our consolidated balance sheet as of December 31, 2011 includes goodwill and other intangible assets, net of amortization, of \$139.0 million, and related to RSUI and CATA. This amount has been recorded as a result of business acquisitions. Other intangible assets that are not deemed to have an indefinite useful life are amortized over their estimated useful lives. Goodwill and other intangible assets deemed to have an indefinite useful life are tested annually in the fourth quarter of every calendar year for impairment and at such other times upon the occurrence of certain events. We also evaluate goodwill and other intangible assets whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. A significant amount of judgment is

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required in performing goodwill and other intangible asset impairment tests. These tests include estimating the fair value of our operating units and other intangible assets. With respect to goodwill, we compare the estimated fair value of our operating units with their respective carrying amounts including goodwill. Under GAAP, fair value refers to the amount for which the entire operating unit may be bought or sold. Our methods for estimating operating unit values include asset and liability fair values and other valuation techniques, such as discounted cash flows and multiples of earnings or revenues. All of these methods involve significant estimates and assumptions.

We recorded a pre-tax, non-cash impairment charge of \$11.2 million in 2009, which is classified as a net realized capital loss on our consolidated statement of earnings for the year ended December 31, 2009. The \$11.2 million pre-tax, non-cash impairment charge represents the entire carrying value of PCC's trade names, originally determined to have indefinite useful lives, renewal rights, distribution rights and database development, net of accumulated amortization. The impairment charge was due primarily to PCC's determination in June 2009 that it was unable to write business at rates it deemed adequate due to the state of the California workers' compensation market. As a result, PCC ceased soliciting new or renewal business on a direct basis commencing August 1, 2009 and took corresponding expense reduction steps, including staff reductions, in light of such determination. In addition, immaterial accruals were established related to terminated employee severance payments and other charges.

See Note 1(h), Note 1(o) and Note 4 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report for additional information on our goodwill and other intangible assets.

### *Deferred Taxes*

We file a consolidated federal income tax return with our subsidiaries. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. As of December 31, 2011, a net deferred tax asset of \$81.0 million was recorded, which included a valuation allowance of \$15.2 million for certain deferred state tax assets which we believe may not be realized. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax assets will not be realized. This determination is based upon a review of anticipated future earnings as well as all available evidence, both positive and negative.

See Note 1(i) and Note 8 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report for additional information on our deferred taxes.

In addition to the policies described above which contain critical accounting estimates, our other accounting policies are described in Note 1 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report. The accounting policies described in Note 1 require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities but do not meet the level of materiality required for a determination that the accounting policy includes critical accounting estimates. On an ongoing basis, we evaluate our estimates, including those related to the value of long-lived assets, deferred acquisition costs, incentive compensation, pension benefits and contingencies and litigation. Our estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Our actual results may differ from these estimates under different assumptions or conditions.

## **Consolidated Results of Operations**

### *Overview*

We are engaged, through AIHL and its subsidiaries, primarily in the property and casualty and surety insurance business. We also own and manage land in the Sacramento, California region through our subsidiary Alleghany Properties and seek out strategic investments and conduct other activities at the parent level. Primarily

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through our wholly-owned subsidiary, Alleghany Capital Partners, we manage our public equity investments, including those held by our insurance operating units, as well as conduct equity investment and non-insurance acquisition research. Strategic investments currently include an approximately 33 percent stake in Homesite, a national, full-service, mono-line provider of homeowners insurance, and an approximately 38 percent stake in ORX, a regional gas and oil exploration and production company. Our primary sources of revenues and earnings are our insurance operations and investments.

The profitability of our insurance operating units, and as a result, our profitability, is primarily impacted by the adequacy of premium rates, level of catastrophe losses, investment returns, intensity of competition and the cost of reinsurance. The adequacy of premium rates is affected mainly by the severity and frequency of claims, which are influenced by many factors, including natural disasters, regulatory measures and court decisions that define and expand the extent of coverage, and the effects of economic inflation on the amount of compensation due for injuries or losses. The ultimate adequacy of premium rates is not known with certainty at the time property and casualty insurance policies are issued because premiums are determined before claims are reported.

Catastrophe losses, or the absence thereof, have had a significant impact on our results. For example, RSUI's pre-tax catastrophe losses, net of reinsurance, were \$74.3 million in 2011, \$31.0 million in 2010, \$6.7 million in 2009 and \$97.9 million in 2008. Catastrophe losses in 2011 primarily reflect net losses from severe weather, particularly tornados, in the southeastern and midwestern U.S. in April and May 2011, as well as from Hurricane Irene, which affected the east coast of the U.S. in August 2011. Catastrophe losses in 2011 also include assumed catastrophe losses from international insurance carriers. Catastrophe losses in 2008 primarily reflect net losses from 2008 third quarter Hurricanes Ike, Gustav and Dolly. The incidence and severity of catastrophes in any short period of time are inherently unpredictable. Catastrophes can cause losses in a variety of our property and casualty lines of business, and most of our past catastrophe-related claims have resulted from severe hurricanes. Longer-term natural catastrophe trends may be changing due to climate change, a phenomenon that has been associated with extreme weather events linked to rising temperatures, and includes effects on global weather patterns, sea, land and air temperatures, sea levels, rain and snow. Climate change, to the extent it produces rising temperatures and changes in weather patterns, could impact the frequency or severity of weather events such as hurricanes. To the extent climate change increases the frequency and severity of such weather events, our insurance operating units, particularly RSUI, may face increased claims, particularly with respect to properties located in coastal areas. Our insurance operating units take certain measures to mitigate against the frequency and severity of such events by giving consideration to these risks in their underwriting and pricing decisions and through the purchase of reinsurance.

As of December 31, 2011, we had consolidated total investments of approximately \$4.8 billion, of which \$2.7 billion was invested in debt securities and \$0.9 billion was invested in equity securities, \$1.1 billion was invested in short-term investments and \$0.1 billion was invested in other invested assets. Net realized capital gains, other-than-temporary impairment losses and net investment income related to such investment assets are subject to market conditions and management investment decisions and as a result can have a significant impact on our results. Net realized capital gains were \$127.1 million in 2011, compared with \$97.4 million in 2010 and \$320.4 million in 2009, and other-than-temporary impairment losses were \$3.6 million in 2011, compared with \$12.3 million in 2010 and \$85.9 million in 2009.

The profitability of our insurance operating units is also impacted by competition generally and price competition in particular. Historically, the performance of the property and casualty insurance industry has tended to fluctuate in cyclical periods of price competition and excess underwriting capacity followed by periods of high premium rates and shortages of underwriting capacity. Although an individual insurance company's performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern. In the past few years, our insurance operating units have faced increasing competition as a result of an increased flow of capital into the insurance industry, with both new entrants and existing insurers seeking to gain market share. This resulted in decreased premium rates and less favorable contract terms and conditions. In particular, RSUI and CATA's specialty lines of business increasingly encountered competition from the standard market. Although we continue to see a competitive property and casualty insurance market, we continue to be cautiously optimistic about the prospect for improvements, particularly in property insurance and workers compensation pricing.



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As part of their overall risk and capacity management strategy, our insurance operating units purchase reinsurance for certain amounts of risk underwritten by them, especially catastrophe risks. The reinsurance programs purchased by our insurance operating units are generally subject to annual renewal. Market conditions beyond the control of our insurance operating units determine the availability and cost of the reinsurance protection they purchase, which may affect the level of business written and thus their profitability.

The following table summarizes our consolidated revenues, costs and expenses and earnings.

	2011	2010	2009
	(in millions)		
<b>Revenues</b>			
Net premiums earned	\$ 747.6	\$ 768.1	\$ 845.0
Net investment income	108.9	125.0	101.9
Net realized capital gains	127.1	97.4	320.4
Other than temporary impairment losses	(3.6)	(12.3)	(85.9)
Other income	1.8	7.2	3.0
<b>Total revenues</b>	<b>\$ 981.8</b>	<b>\$ 985.4</b>	<b>\$ 1,184.4</b>
<b>Costs and expenses</b>			
Loss and loss adjustment expenses	\$ 430.0	\$ 377.9	\$ 442.1
Commissions, brokerage and other underwriting expenses	268.1	259.3	273.7
Other operating expenses	34.5	37.2	45.6
Corporate administration	41.0	28.9	26.9
Interest expense	17.4	4.7	0.7
<b>Total costs and expenses</b>	<b>\$ 791.0</b>	<b>\$ 708.0</b>	<b>\$ 789.0</b>
<b>Earnings before income taxes</b>	<b>\$ 190.8</b>	<b>\$ 277.4</b>	<b>\$ 395.4</b>
Income taxes	47.5	78.9	124.4
<b>Net earnings</b>	<b>\$ 143.3</b>	<b>\$ 198.5</b>	<b>\$ 271.0</b>
<b>Revenues:</b>			
AIHL	\$ 941.8	\$ 978.2	\$ 996.9
Corporate activities*	40.0	7.2	187.5
<b>Earnings (loss) before income taxes:</b>			
AIHL	\$ 214.0	\$ 306.6	\$ 237.6
Corporate activities*	(23.2)	(29.2)	157.8

\* Corporate activities consist of Alleghany Properties, our investments in Homesite and ORX and corporate activities at the parent level. Our earnings before income taxes in 2011 decreased from 2010, primarily reflecting higher loss and LAE, lower net premiums earned and lower net investment income, partially offset by higher net realized capital gains. The increase in loss and LAE primarily reflects a \$28.4 million increase in PCC's prior year reserves and higher catastrophe and other large property losses at RSUI in the 2011 period, partially offset by a higher net release of prior year casualty reserves by RSUI. The decrease in net premiums earned reflects the impact of continuing competition at CATA, as well as a reduction in net premiums written in certain specialty classes of business by CATA. The decrease in net investment income is due primarily to an increase in catastrophe losses related to our investment in Homesite, partially offset by higher dividend income.

Our earnings before income taxes in 2010 decreased from 2009, primarily reflecting lower net realized capital gains and, to a lesser extent, a decline in net premiums earned, partially offset by lower other-than-temporary impairment losses and loss and LAE. The decrease in net realized capital gains primarily reflects the absence of sales of common stock of Burlington Northern Santa Fe Corporation, or Burlington Northern, in 2010, which were significant in 2009. The decrease in net premiums earned and loss and LAE in 2010 compared with 2009 reflects the impact of continuing competition at RSUI, as well as PCC's determination in June 2009 to cease soliciting new and renewal business on a direct basis commencing August 1, 2009. The decrease in other-than-temporary impairment losses was due to improvements in U.S. equity market

conditions since the 2009 first

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quarter when we incurred substantial losses primarily related to a significant deterioration of U.S. equity and, to a lesser extent, residential housing market conditions.

The effective income tax rate on earnings before income taxes was 24.9 percent in 2011, 28.4 percent in 2010 and 31.5 percent in 2009. The lower effective tax rate in 2011 primarily reflects the impact of higher dividends received deductions and lower pre-tax earnings in 2011, partially offset by the absence of a foreign tax benefit which was significant in 2010. The lower effective income tax rate in 2010 compared with 2009 primarily reflects the recognition of a permanent tax benefit in the 2010 first quarter. This permanent tax benefit related to a finalization of our unused foreign tax credits arising from our prior ownership of World Minerals, Inc. which was sold on July 14, 2005. The lower effective income tax rate in 2010 compared with 2009 also reflects increased tax benefits associated with dividends and tax-exempt income.

**Table of Contents***AIHL Operating Results***AIHL Operating Unit Pre-Tax Results**

	RSUI	CATA (in millions, except ratios)	PCC	AIHL
<b>2011</b>				
Gross premiums written	\$ 986.5	\$ 150.4	\$ 4.1	\$ 1,141.0
Net premiums written	627.9	141.6	5.2	774.7
Net premiums earned (1)	\$ 593.8	\$ 149.3	\$ 4.5	\$ 747.6
Loss and loss adjustment expenses	315.2	83.3	31.5	430.0
Commission, brokerage and other underwriting expenses (2)	170.8	72.7	24.6	268.1
<b>Underwriting profit (loss) (3)</b>	<b>\$ 107.8</b>	<b>\$ (6.7)</b>	<b>\$ (51.6)</b>	<b>\$ 49.5</b>
Net investment income (1)				117.4
Net realized capital gains (1)				79.7
Other than temporary impairment losses (1)				(3.6)
Other income (1)				0.7
Other expenses (2)				29.7
<b>Earnings before income taxes</b>				<b>\$ 214.0</b>
Loss ratio (4)	53.1%	55.7%	701.0%	57.5%
Expense ratio (5)	28.8%	48.7%	547.1%	35.9%
Combined ratio (6)	81.9%	104.4%	1248.1%	93.4%
<b>2010</b>				
Gross premiums written	\$ 933.6	\$ 168.9	\$ 1.5	\$ 1,104.0
Net premiums written	570.7	159.0	6.5	736.2
Net premiums earned (1)	\$ 593.6	\$ 164.3	\$ 10.2	\$ 768.1
Loss and loss adjustment expenses	271.0	89.4	17.5	377.9
Commission, brokerage and other underwriting expenses (2)	162.7	73.4	23.2	259.3
<b>Underwriting profit (loss) (3)</b>	<b>\$ 159.9</b>	<b>\$ 1.5</b>	<b>\$ (30.5)</b>	<b>\$ 130.9</b>
Net investment income (1)				128.9
Net realized capital gains (1)				92.9
Other than temporary impairment losses (1)				(12.3)
Other income (1)				0.6
Other expenses (2)				34.4
<b>Earnings before income taxes</b>				<b>\$ 306.6</b>
Loss ratio (4)	45.7%	54.4%	170.9%	49.2%
Expense ratio (5)	27.4%	44.7%	226.7%	33.8%
Combined ratio (6)	73.1%	99.1%	397.6%	83.0%
<b>2009</b>				
Gross premiums written	\$ 1,033.4	\$ 174.6	\$ 51.1	\$ 1,259.1
Net premiums written	621.1	165.3	44.4	830.8
Net premiums earned (1)	\$ 633.4	\$ 166.7	\$ 44.9	\$ 845.0
Loss and loss adjustment expenses	274.3	81.6	86.2	442.1

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Commission, brokerage and other underwriting expenses (2)	169.3	75.0	29.4	273.7
Underwriting profit (loss) (3)	\$ 189.8	\$ 10.1	\$ (70.7)	\$ 129.2
Net investment income (1)				116.7
Net realized capital gains (1)				119.8
Other than temporary impairment losses (1)				(85.9)
Other income (1)				1.3
Other expenses (2)				43.5
Earnings before income taxes				\$ 237.6
Loss ratio (4)	43.3%	48.9%	192.2%	52.3%
Expense ratio (5)	26.7%	45.0%	65.4%	32.4%
Combined ratio (6)	70.0%	93.9%	257.6%	84.7%

(1) Represent components of total revenues.

(2) Commission, brokerage and other underwriting expenses represent commission and brokerage expenses and that portion of salaries, administration and other operating expenses attributable primarily to underwriting activities, whereas the remainder constitutes other expenses.

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- (3) Represents net premiums earned less loss and LAE and commissions, brokerage and other underwriting expenses, all as determined in accordance with GAAP, and does not include net investment income, net realized capital gains, other-than-temporary impairment losses, other income or other expenses. Underwriting profit does not replace net earnings determined in accordance with GAAP as a measure of profitability; rather, we believe that underwriting profit, which does not include net investment income, net realized capital gains, other-than-temporary impairment losses, other income or other expenses, enhances the understanding of AIHL's insurance operating units operating results by highlighting net earnings attributable to their underwriting performance. With the addition of net investment income, net realized capital gains, other-than-temporary impairment losses, other income and other expenses, reported pre-tax net earnings (a GAAP measure) may show a profit despite an underlying underwriting loss. Where underwriting losses persist over extended periods, an insurance company's ability to continue as an ongoing concern may be at risk. Therefore, we view underwriting profit as an important measure in the overall evaluation of performance.
  - (4) Loss and LAE divided by net premiums earned, all as determined in accordance with GAAP.
  - (5) Commission, brokerage and other underwriting expenses divided by net premiums earned, all as determined in accordance with GAAP.
  - (6) The sum of the loss ratio and expense ratio, all as determined in accordance with GAAP, representing the percentage of each premium dollar an insurance company has to spend on loss and LAE, and commission, brokerage and other underwriting expenses.
- Discussion of individual AIHL operating unit results follows, and AIHL investment results are discussed below under AIHL Investment Results.

*RSUI*

The increase in gross premiums written by RSUI in 2011 from 2010 primarily reflects the impact of assumed premium writings from international insurance carriers, and, to a lesser extent, growth in binding authority business. Such increases were partially offset by the impact of reduced exposures of RSUI's customers and continuing competition in certain of RSUI's casualty lines of business. The slight increase in RSUI's net premiums earned in 2011 from 2010 primarily reflects the impact of a recent increase in gross premiums written, largely offset by the impact of lower gross premiums written during the third and fourth quarters of 2010 and the first quarter of 2011 as compared with gross premiums written in the third and fourth quarters of 2009 and the first quarter of 2010.

The decrease in gross premiums written by RSUI in 2010 from 2009 primarily reflects the impact of reduced exposures of RSUI's customers and continuing and increasing competition, particularly in RSUI's property, umbrella/excess and general liability lines of business, partially offset by growth in RSUI's binding authority business. RSUI's net premiums earned decreased in 2010 from 2009 primarily due to the decline in gross premiums written, partially offset by a decrease in ceded premiums written associated primarily with RSUI's property line of business.

The increase in loss and LAE in 2011 from 2010 primarily reflects the impact of higher catastrophe and other large property losses, partially offset by the impact of higher releases of prior accident year reserves in 2011 (as further described below). Catastrophe losses, net of reinsurance, were \$74.3 million in 2011, compared with \$31.0 million in 2010. Catastrophe losses in 2011 primarily reflect net losses from severe weather, particularly tornados, in the southeastern and midwestern U.S. in April and May 2011, as well as from Hurricane Irene, which affected the east coast of the U.S. in August 2011. Catastrophe losses in 2011 also include assumed catastrophe losses from international insurance carriers. In addition, RSUI incurred a net \$14.4 million property loss arising from the magnitude 5.8 earthquake that occurred in Northern Virginia in August 2011. This earthquake was not classified as a catastrophic event by the property and casualty industry.

The decrease in loss and LAE in 2010 from 2009 primarily reflects the impact of lower net premiums earned and lower non-catastrophe property losses incurred, partially offset by \$31.0 million of catastrophe losses

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in 2010, compared with \$6.7 million of catastrophe losses in 2009. The decrease in loss and LAE in 2010 from 2009 also reflects modestly lower net releases of prior accident year loss reserves in 2010 (as further described below).

For RSUI, loss and LAE for 2011 reflect a net \$56.2 million release of prior accident year casualty loss reserves, compared with a net \$33.9 million release during 2010 and a net \$38.4 million release during 2009. The \$56.2 million release relates primarily to the umbrella/excess, general liability and professional liability lines of business, primarily for the 2003 through 2008 accident years, and reflects favorable loss emergence, compared with loss emergence patterns assumed in earlier periods for such lines of business. Such reserve releases were partially offset by an increase in loss reserves in the D&O liability line of business in the 2011 third quarter, primarily reflecting adverse legal developments associated with a large claim from the 2007 accident year. The \$33.9 million net release of prior year casualty loss reserves in 2010 consisted of a \$41.4 million reserve release, partially offset by a \$7.5 million reserve increase. The \$41.4 million reserve release during 2010 and the net \$38.4 million reserve release during 2009 primarily reflect favorable loss emergence compared with loss emergence patterns assumed in earlier periods.

Loss and LAE in 2010 also reflect increases in prior accident year property loss reserves of \$5.3 million related to 2008 third quarter hurricanes and \$11.0 million related to 2005 third quarter hurricanes. Loss and LAE in 2009 also reflects a net \$9.9 million release of prior accident year property loss reserves related to 2008 third quarter hurricanes.

The increase in commissions, brokerage and other underwriting expenses in 2011 compared with 2010 is due primarily to growth in the binding authority business, which incurs higher commission and other underwriting expenses than other lines of business. The decrease in commissions, brokerage and other underwriting expenses in 2010 compared with 2009 primarily reflects the net effect of lower premium volumes described above, which caused premium taxes, commissions and related acquisition costs to decline.

The decrease in RSUI's underwriting profit in 2011 from 2010 primarily reflects an increase in loss and LAE. The decrease in RSUI's underwriting profit in 2010 from 2009 primarily reflects a decrease in net premiums earned, partially offset by the decrease in loss and LAE.

Additional information regarding RSUI's use of reinsurance and risks related to reinsurance recoverables can be found on pages 23 through 25 and page 33 of this Form 10-K Report. Additional information regarding RSUI's prior year reserve adjustments and releases can be found on pages 45 and 46 of this Form 10-K Report.

Although we continue to see a competitive property and casualty insurance market, we continue to be cautiously optimistic about the prospect for improvements, particularly in property insurance pricing.

*CATA*

The decrease in gross premiums written by CATA in 2011 from 2010 primarily reflects continuing price competition in CATA's property and casualty lines of business, including in excess and surplus markets, partially offset by higher gross premiums written in CATA's commercial surety line of business. The decrease in CATA's property and casualty lines of business also reflects reduced writings associated with CATA's Terminated Program Business. CATA's net premiums earned decreased in 2011 from 2010 primarily reflecting the decrease in gross premiums written.

The decrease in CATA's gross premiums written and net premiums earned in 2010 from 2009 primarily reflects price competition in CATA's property and casualty lines of business, partially offset by higher gross premiums written and net premiums earned in CATA's commercial surety and miscellaneous errors and omissions liability lines of business.

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The decrease in loss and LAE in 2011 from 2010 primarily reflects the impact of lower net premiums earned, partially offset by the impact of a net reserve increase of prior accident year loss reserves in 2011 compared with a net reserve release in 2010 (as further described below). The increase in loss and LAE in 2010 from 2009 primarily reflects a lower amount of prior year reserve releases in 2010 compared with 2009 (as further described below), and to a lesser extent, higher property and workers' compensation claims.

For CATA, loss and LAE for 2011 reflect a net \$5.0 million increase of prior accident year loss reserves (related primarily to the casualty lines of business), compared with a \$3.9 million release of prior accident year loss reserves during 2010 and a \$10.7 million release of prior accident year loss reserves during 2009. The \$5.0 million net reserve increase was due primarily to a \$14.6 million increase in reserves related to CATA's Terminated Program Business, partially offset by a \$9.6 million net reserve release in certain of CATA's casualty lines of business. The \$3.9 million release in 2010 includes \$3.5 million reserve release reflecting favorable loss emergence for asbestos and environmental impairment claims that arose from reinsurance assumed by a subsidiary of CATA between 1969 and 1976, based on a reserve study that was completed in the 2010 second quarter. The \$10.7 million reserve release in 2009 primarily reflects favorable emergence in the casualty and surety lines of business.

The decrease in net premiums earned, partially offset by the decrease in loss and LAE, was the primary cause of the decrease in CATA's underwriting profit in 2011 from 2010. The increase in loss and LAE was the primary cause for the decrease in CATA's underwriting profit in 2010 from 2009.

Additional information regarding CATA's prior year reserve releases can be found on pages 45 and 46 of this Form 10-K Report.

**PCC**

Commencing August 1, 2009, PCC ceased soliciting new or renewal business on a direct basis due to its determination that it was unable to write business at rates it deemed adequate due to the difficult state of the California workers' compensation market and took corresponding expense reduction steps, including staff reductions, in light of such determination. PCC also took steps to emerge as a brokerage carrier at such time as it determines rates are adequate. In 2011, PCC began writing a modest amount of new business through brokers.

PCC reported underwriting losses of \$51.6 million, \$30.5 million and \$70.7 million in 2011, 2010 and 2009, respectively. The underwriting losses primarily reflect an absence of premiums earned for the reasons described above (particularly with respect to the 2011 and 2010), combined with PCC's ongoing staffing and related expenses. The underwriting losses also reflect the impact of increases of prior accident year loss reserves in each period (as further described below).

For PCC, loss and LAE for 2011 reflect a \$28.4 million increase of prior accident year workers' compensation loss reserves, compared with a \$12.5 million reserve increase of prior accident year workers' compensation loss reserves during 2010. Of the \$28.4 million increase, \$15.0 million was recorded in the 2011 second quarter and \$13.4 million was recorded in the 2011 fourth quarter, as follows (in millions):

	Three months ended:		Twelve months ended
	June 30, 2011	December 31, 2011	December 31, 2011
Adverse claims emergence	\$10.0	\$4.2	\$14.2
Increases in allocated LAE	3.0	6.4	9.4
Increases in unallocated LAE		2.8	2.8
Decrease in ceded loss and LAE reserves	2.0		2.0
	\$15.0	\$13.4	\$28.4

PCC's adverse claims emergence relates to an unanticipated increase in medical claims emergence and an absence of anticipated favorable indemnity claims emergence. PCC had anticipated favorable indemnity claims emergence based upon prior claims development experience which indicated that injured workers would be returning to work, curtailing lost wage costs. PCC believes the weak California employment environment has hindered the ability of injured workers to return to work and indirectly influenced indemnity claims. The



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increases in allocated and unallocated LAE reserves primarily reflect increased use of outside counsel to assist in the settlement process and higher litigation costs caused by recent Workers' Compensation Appeals Board decisions. The decrease in ceded loss and LAE reserves was based on a second quarter 2011 review of reinsurance coverage estimates, which also resulted in a \$1.1 million decrease in ceded premiums earned, thereby increasing net premiums earned in the 2011 second quarter.

The \$12.5 million reserve increase in loss and LAE for 2010 relates primarily to a decrease in ceded loss and LAE reserves based on a fourth quarter 2010 review of reinsurance coverage estimates and, to a lesser extent, an increase in unallocated LAE reserves, which also resulted in a \$5.0 million decrease in ceded premiums earned, thereby increasing net premiums earned in 2010.

The \$26.5 million reserve increase during 2009 primarily reflects a significant acceleration in claims emergence and higher than anticipated increases in industry-wide severity, as well as the estimated impact of judicial decisions by the Workers' Compensation Appeals Board. Such decisions related to permanent disability determinations that have materially weakened prior workers' compensation reforms instrumental in reducing medical and disability costs in earlier years. Such increases impacted the assumptions used in estimating PCC's loss and LAE liabilities for business earned in 2009, causing an increase of the current accident year reserves of \$8.0 million in 2009.

The California Department of Insurance, or the CDI, is responsible for periodic financial and market conduct examinations of California-domiciled insurance companies. In September 2010, the CDI issued a financial examination report of PCIC for the period from July 1, 2004 through December 31, 2008. As part of its work for such financial examination report, the CDI produced an actuarial report, or the Actuarial Report, for the years ended December 31, 2009 and 2008. The Actuarial Report included an estimate of loss and LAE reserves on a statutory basis of accounting that was higher than that recorded by PCIC at such dates. We believed that PCIC's reserves for unpaid loss and LAE were adequate, and the CDI did not require PCIC to currently or retroactively increase its carried reserves to the estimates included in the Actuarial Report. AIHL did, however, contribute \$40.0 million of capital to PCC on September 27, 2010, and these funds were used by PCIC to increase its workers' compensation deposit, which is required to be maintained by PCIC under California workers' compensation regulations, to a level consistent with the estimated loss and LAE reserves included in the Actuarial Report. To the extent that PCIC's actual loss experience is less than the CDI's final estimate of PCIC's loss and LAE reserves, over time such additional workers' compensation deposit funds will be released back to PCIC.

Additional information regarding PCC's reserve increases can be found on pages 46 through 47 of this Form 10-K Report.

**AIHL Investment Results**

Following is information relating to AIHL's investment results.

	Years Ended December 31,		
	2011	2010	2009
	(in millions)		
Net investment income	\$ 117.4	\$ 128.9	\$ 116.7
Net realized capital gains	\$ 79.7	\$ 92.9	\$ 132.1*
Other than temporary impairment losses	\$ (3.6)	\$ (12.3)	\$ (85.9)

\* Excludes a non-cash impairment charge in 2009 related to the intangible assets associated with our acquisition of PCC which was classified as a net realized capital loss in our consolidated statements of earnings (see Note 4(a) to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report).

*Net Investment Income.* The decrease in AIHL's net investment income in 2011 from 2010 is due principally to the impact of ongoing negative cash flow at PCC and dividends paid to Alleghany, partially offset by higher dividend income. In addition, the decrease in AIHL's net investment income in 2011 as compared with 2010 reflects the absence of equity-method partnership income in 2011, as such partnerships were dissolved in the 2010 third quarter.

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The increase in AIHL's net investment income in 2010 from 2009 is due principally to higher dividend income resulting from a higher allocation of AIHL's investment portfolio to equity securities during 2010 compared with 2009.

Approximate yields of AIHL's debt securities for 2011, 2010 and 2009 are as follows (in millions, except for percentages):

Year	Average Investments (1)	Pre-Tax Net Investment Income(2)	After-Tax Net Investment Income(3)	Effective Yield(4)	After-Tax Yield(5)
2011	\$ 2,649.7	\$ 99.0	\$ 77.1	3.7%	2.9%
2010	\$ 2,887.3	\$ 102.1	\$ 80.2	3.5%	2.8%
2009	\$ 2,858.4	\$ 104.7	\$ 83.9	3.7%	2.9%

(1) Average of amortized cost of debt securities portfolio at beginning and end of period.

(2) After investment expenses, excluding net realized gains and other-than-temporary impairment losses.

(3) Pre-tax net investment income less income taxes.

(4) Pre-tax net investment income for the period divided by average investments for the same period.

(5) After-tax net investment income for the period divided by average investments for the same period.

*Net Realized Capital Gains.* Net realized capital gains in 2011, 2010 and 2009 relate primarily to sales of equity securities in the energy sector, some of which had their cost basis reduced in earlier periods for the recognition of unrealized losses through other-than-temporary impairment losses, particularly in 2009.

*Other-Than-Temporary Impairment Losses.* Other-than-temporary impairment losses reflect impairment charges related to unrealized losses that were deemed to be other than temporary and, as such, are required to be charged against earnings. Other-than-temporary impairment losses for 2011 reflect \$3.6 million of unrealized losses that were deemed to be other than temporary and, as such, were required to be charged against earnings. Of the \$3.6 million, \$3.1 million related to equity security holdings (primarily in the materials and financial services sectors), and \$0.5 million related to debt security holdings (all of which were deemed to be credit-related). The determination that unrealized losses on such securities were other than temporary was primarily based on the severity of the declines in fair value of such securities relative to their cost as of the balance sheet date.

Of the \$12.3 million of other-than-temporary impairment losses in 2010, \$11.1 million related to equity security holdings (primarily in the energy sector) and \$1.2 million related to debt security holdings (all of which were deemed to be credit-related). The determination that unrealized losses on such securities were other than temporary was primarily based on the severity and duration of the declines in fair value of such securities relative to their cost as of the balance sheet date.

Of the \$85.9 million of other-than-temporary impairment losses in 2009, \$57.6 million related to equity security holdings in the energy sector, \$16.5 million related to equity security holdings in various other sectors and \$11.8 million related to debt security holdings (all of which were deemed to be credit-related). The determination that unrealized losses on such securities were other than temporary in 2009 was primarily based on the severity of the declines in fair value of such securities relative to cost as of the balance sheet date. Such severe declines were primarily related to a significant deterioration of U.S. equity market conditions during the latter part of 2008 and the first quarter of 2009, which abated somewhat in the remainder of 2009.

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After adjusting the cost basis of securities for the recognition of other-than-temporary impairment losses, the gross unrealized investment losses for debt and equity securities as of December 31, 2011 were deemed to be temporary, based on, among other things:

the duration of time and the relative magnitude to which fair values of these investments has been below cost was not indicative of an other-than-temporary impairment loss (for example, no equity security was in a continuous unrealized loss position for twelve months or more as of December 31, 2011);

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the absence of compelling evidence that would cause us to call into question the financial condition or near-term prospects of the issuer of the investment; and

our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

See Note 3 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report for further details concerning gross unrealized investment losses for debt and equity securities as of December 31, 2011.

*Corporate Activities Operating Results*

The following table summarizes corporate activities results for 2011, 2010 and 2009 (in millions):

	Years Ended December 31,		
	2011	2010	2009
Net investment income	\$ (8.5)	\$ (3.9)	\$ (14.8)
Net realized capital gains	47.5	4.5	200.6
Other than temporary impairment losses			
Other income	1.0	6.6	1.7
<b>Total revenues</b>	<b>\$ 40.0</b>	<b>\$ 7.2</b>	<b>\$ 187.5</b>
Corporate administration and other expenses	45.9	31.4	29.1
Interest expense	17.3	5.0	0.6
(Losses) earnings before income taxes	\$ (23.2)	\$ (29.2)	\$ 157.8

The decrease in losses in 2011 from 2010 primarily reflects higher net realized capital gains, partially offset by higher corporate administration and other expenses, higher interest expenses, lower other income and higher negative net investment income. Net realized capital gains in 2011 primarily reflects net realized capital gains from the sale of equity securities, primarily common stock of Exxon Mobil Corporation in the fourth quarter of 2011. The proceeds from such sales were reinvested in short-term securities and cash, and will be used to fund Alleghany's cash consideration in connection with the pending merger with Transatlantic, which is expected to close in the first quarter of 2012. The higher corporate administration and other expenses is due primarily to \$19.3 million of due diligence, legal, investment bank and other costs incurred in the 2011 fourth quarter related to the pending merger with Transatlantic, partially offset by lower incentive compensation and pension accruals. The higher interest expenses are due to our Senior Notes, which were issued on September 20, 2010. The lower other income in 2011 reflects the absence of a non-recurring gain from Alleghany Properties that existed in 2010. As further explained below, the increase in negative net investment income is due primarily to higher catastrophe losses related to our investment in Homesite, partially offset by higher dividend income and higher interest income. Higher interest income reflects the investment of the proceeds from our Senior Notes and dividends received from subsidiaries. For more information on the merger, see Note 2 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report.

Corporate activities reported a loss before income taxes in 2010 compared with earnings before income taxes in 2009, primarily reflecting lower net realized capital gains which were not sufficient to offset corporate administration, interest and other expenses. The lower net realized capital gains primarily reflects the absence of sales of common stock of Burlington Northern in 2010, which were significant in 2009. As further explained below, negative net investment income in 2009 primarily reflects losses related to our investment in ORX.

Net investment income for Corporate activities includes our equity share of (losses) earnings in Homesite and ORX, as follows (in millions):

	2011	2010	2009
Homesite	\$ (20.2)	\$ (3.2)	\$ (1.1)
ORX	(1.6)	(2.0)	(21.9)
Interest, dividends and other net	13.3	1.3	8.2

Net investment income	\$ (8.5)	\$ (3.9)	\$ (14.8)
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Homesite losses in 2011 primarily reflect the impact of increased homeowners insurance claims from severe weather, particularly tornados, in the southeastern and midwestern U.S. in April and May 2011, as well as from Hurricane Irene, which affected the east coast of the U.S. in August 2011. Homesite losses in 2011 also reflect a tax valuation adjustment that Homesite recorded in the fourth quarter of 2011. Homesite losses in 2010 and 2009 primarily reflect the impact of increased homeowners insurance claims from severe weather and ongoing purchase accounting adjustments.

The \$21.9 million losses in 2009 for ORX were due primarily to asset impairment charges incurred as of December 31, 2008, but finalized in the 2009 third quarter, arising from relatively low energy prices as of December 31, 2008.

**Reserve Review Process**

AIHL's insurance operating units analyze, at least quarterly, liabilities for unpaid loss and LAE established in prior years and adjust their expected ultimate cost, where necessary, to reflect positive or negative development in loss experience and new information, including, for certain catastrophic events, revised industry estimates of the magnitude of a catastrophe. Adjustments to previously recorded liabilities for unpaid loss and LAE, both positive and negative, are reflected in our financial results in the periods in which these adjustments are made and are referred to as prior year reserve development. The following table presents the reserves established in connection with the loss and LAE of AIHL's insurance operating units on a gross and net basis by line of business. These reserve amounts represent the accumulation of estimates of ultimate loss (including for IBNR) and LAE.

	Property	Casualty(1)	CMP(2)	Surety (in millions)	Workers Comp(3)	All Other(4)	Total
<b>2011</b>							
Gross loss and LAE reserves	\$ 192.4	\$ 1,844.0	\$ 58.9	\$ 21.1	\$ 167.5	\$ 29.1	\$ 2,313.0
Reinsurance recoverables on unpaid losses	(62.3)	(741.7)	(0.3)	(0.1)	(12.0)	(15.4)	(831.8)
Net loss and LAE reserves	\$ 130.1	\$ 1,102.3	\$ 58.6	\$ 21.0	\$ 155.5	\$ 13.7	\$ 1,481.2
<b>2010</b>							
Gross loss and LAE reserves	\$ 150.1	\$ 1,883.6	\$ 58.9	\$ 17.1	\$ 186.7	\$ 32.3	\$ 2,328.7
Reinsurance recoverables on unpaid losses	(52.0)	(765.2)	(1.0)	(0.1)	(10.9)	(18.2)	(847.4)
Net loss and LAE reserves	\$ 98.1	\$ 1,118.4	\$ 57.9	\$ 17.0	\$ 175.8	\$ 14.1	\$ 1,481.3
<b>2009</b>							
Gross loss and LAE reserves	\$ 249.1	\$ 1,902.4	\$ 63.6	\$ 18.0	\$ 245.9	\$ 42.0	\$ 2,521.0
Reinsurance recoverables on unpaid losses	(104.5)	(799.5)	(0.2)	(0.1)	(20.2)	(23.2)	(947.7)
Net loss and LAE reserves	\$ 144.6	\$ 1,102.9	\$ 63.4	\$ 17.9	\$ 225.7	\$ 18.8	\$ 1,573.3

(1) Primarily consists of umbrella/excess, D&O liability, professional liability and general liability.

(2) Commercial multiple peril.

(3) Workers' compensation amounts include PCC, net of purchase accounting adjustments (see Note 4(a) to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report). Such adjustments include a minor reduction of gross and net loss and LAE for acquisition date discounting, as required under purchase accounting. Workers' compensation amounts also include minor balances from CATA.

- (4) Primarily consists of loss and LAE reserves for terminated lines of business and loss reserves acquired in connection with prior acquisitions for which the sellers provided loss reserve guarantees. The loss and LAE reserves are ceded 100 percent to the sellers. Additional information regarding the loss reserve guarantees can be found in Note 5(c) to the Consolidated Financial Statements set forth in Item 8 of this 10-K Report.

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*Changes in Loss and LAE Reserves between December 31, 2011 and December 31, 2010*

*Gross Reserves.* Gross loss and LAE reserves as of December 31, 2011 decreased slightly from December 31, 2010, primarily reflecting reserve decreases in the casualty and workers' compensation lines of business, largely offset by reserve increases in the property lines of business. The decrease in the casualty gross loss and LAE reserves primarily reflects the impact of releases in gross loss and LAE reserves by RSUI during 2011 related to prior accident years, partially offset by the impact of increases in gross loss and LAE reserves by CATA during 2011 related to prior accident years. The decrease in workers' compensation gross loss and LAE reserves primarily reflects the impact of PCC ceasing to solicit new or renewal business on a direct basis commencing August 1, 2009, partially offset by an increase in gross loss and LAE reserves by PCC as of June 30, 2011 and December 31, 2011 related to prior accident years. The increase in property gross loss and LAE reserves is due to increases in case reserves related primarily to significant catastrophe and other large losses incurred in 2011, partially offset by claim payments made by RSUI in 2011 related to catastrophe losses in prior years. Such claim payments caused RSUI to reduce its case reserves from prior accident years, primarily related to 2008 third quarter hurricane losses.

*Net Reserves.* Net loss and LAE reserves as of December 31, 2011 were essentially unchanged from December 31, 2010, primarily reflecting reserve decreases in the casualty and workers' compensation lines of business and offsetting reserve increases in the property lines of business. The decrease in the casualty net loss and LAE reserves primarily reflects the impact of releases in net loss and LAE reserves by RSUI during 2011 related to prior accident years, partially offset by the impact of increases in net loss and LAE reserves by CATA during 2011 related to prior accident years. The decrease in workers' compensation net loss and LAE reserves primarily reflects the impact of PCC ceasing to solicit new or renewal business on a direct basis commencing August 1, 2009, partially offset by an increase in net loss and LAE reserves by PCC as of June 30, 2011 and December 31, 2011 related to prior accident years. The increase in property net loss and LAE reserves is due to increases in case reserves related primarily to significant catastrophe and other large losses incurred in 2011, partially offset by claim payments made by RSUI in 2011 related to catastrophe losses in prior years. Such claim payments caused RSUI to reduce its case reserves from prior accident years, primarily related to 2008 third quarter hurricane losses, after reflecting any applicable ceded reinsurance.

*Changes in Loss and LAE Reserves between December 31, 2010 and December 31, 2009*

*Gross Reserves.* Gross loss and LAE reserves as of December 31, 2010 decreased from December 31, 2009 due primarily to reserve decreases in property and workers' compensation lines of business. The decrease in property gross loss and LAE reserves is mainly due to loss payments made by RSUI on hurricane related losses incurred in prior years. The decrease in workers' compensation gross loss and LAE reserves primarily reflects the impact of PCC's decision in June 2009 to cease soliciting new or renewal business on a direct basis commencing August 1, 2009.

*Net Reserves.* Net loss and LAE reserves as of December 31, 2010 decreased slightly from December 31, 2009 due primarily to reserve decreases in the workers' compensation and property lines of business, partially offset by a modest reserve increase in the casualty line of business. The decrease in workers' compensation net loss and LAE reserves primarily reflects the impact of PCC's decision in June 2009 to cease soliciting new or renewal business on a direct basis commencing August 1, 2009. This decrease was partially offset by a \$12.5 million increase of prior accident year workers' compensation net loss reserves recorded by PCC related primarily to a decrease in ceded loss and LAE based on a fourth quarter 2010 review of reinsurance coverage estimates, and to a lesser extent, an increase in unallocated LAE reserves. The decrease in property net loss and LAE reserves was mainly due to loss payments made by RSUI on hurricane related losses incurred in prior years, net of corresponding decreases in reinsurance recoverables on unpaid losses. The increase in the casualty line of business relates primarily to modest increases at CATA due to growth in certain specialty classes and its miscellaneous errors and omissions liability line of business.

Additional information regarding RSUI's net prior year reserve releases and PCC's current and prior year reserve increases can be found on pages 45 through 47 of this Form 10-K Report.



**Table of Contents****Reinsurance Recoverables**

As of December 31, 2011, AIHL had total reinsurance recoverables of \$852.8 million, consisting of \$831.8 million of ceded outstanding loss and LAE and \$21.0 million of recoverables on paid losses. RSUI's reinsurance recoverables totaled \$759.8 million of AIHL's \$852.8 million. The reinsurance purchased by AIHL's insurance operating units does not relieve them from their obligations to their policyholders, and therefore, the financial strength of their reinsurers is important. AIHL's Reinsurance Security Committee, which includes certain of our officers and the chief financial officer of each of AIHL's operating units and which manages the use of reinsurance by such operating units, has determined that reinsurers with a rating of A (Excellent) or higher have an ability to meet their ongoing obligations at a level that is acceptable to us.

Information regarding concentration of AIHL's reinsurance recoverables as of December 31, 2011 is as follows (dollars in millions):

Reinsurer(1)	Rating(2)	Dollar Amount	Percentage
Swiss Re	A+(Superior)	\$ 152.1	17.8%
Platinum Underwriters Holdings, Ltd.	A (Excellent)	95.3	11.2%
PartnerRe Ltd.	A+(Superior)	89.3	10.5%
All other reinsurers		516.1	60.5%
<b>Total</b>	(3)	\$ 852.8	100.0%

- (1) Reinsurance recoverables reflect amounts due from one or more reinsurance subsidiaries of the listed company.
- (2) Represents the A.M. Best rating for the applicable reinsurance subsidiary or subsidiaries from which the reinsurance recoverable is due.
- (3) Approximately 99.0 percent of AIHL's reinsurance recoverables balance as of December 31, 2011 was due from reinsurers having an A.M. Best financial strength rating of A (Excellent) or higher.

As of December 31, 2011, AIHL also had fully collateralized reinsurance recoverables of \$66.8 million due from Darwin, now a subsidiary of AWAC. The A.M. Best financial strength rating of Darwin was A (Excellent) as of December 31, 2011. AIHL had no allowance for uncollectible reinsurance as of December 31, 2011.

**Financial Condition***Parent Level*

*General.* In general, we follow a policy of maintaining a relatively liquid financial condition at the parent company. This policy has permitted us to expand our operations through internal growth at our subsidiaries and through acquisitions of, or substantial investments in, operating companies. As of December 31, 2011, we held marketable securities and cash of \$534.6 million at the parent company and \$700.3 million at AIHL, which totaled \$1,234.9 million. We anticipate that we will use an estimated \$846.7 million of these assets to fund cash commitments we made in connection with the merger. We currently believe that we have and will have adequate internally generated funds, cash resources and unused credit facilities to provide for the currently foreseeable needs of our business, and we had no material commitments for capital expenditures as of December 31, 2011.

Stockholders' equity increased to approximately \$2.93 billion as of December 31, 2011, compared with approximately \$2.91 billion as of December 31, 2010, representing an increase of 0.6 percent. The increase in stockholders' equity primarily reflects net earnings in 2011, partially offset by the repurchase of our common stock pursuant to our share repurchase program described below.

*Debt.* On September 20, 2010, we issued \$300.0 million of Senior Notes due September 15, 2020. The Senior Notes are unsecured and unsubordinated general obligations of Alleghany as the parent company. Interest is payable semi-annually on March 15 and September 15 of each year. The terms of the Senior Notes permit redemption prior to their maturity. The indenture under which the Senior Notes were issued contains covenants that impose conditions on our ability to create liens on the capital stock of AIHL or RSUI or to engage in sales of the capital

stock of AIHL or RSUI. The Senior Notes were issued at a discount of approximately 99.63 percent,

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resulting in proceeds before underwriting discount, commissions and other expenses of \$298.9 million, and an effective yield of approximately 5.67 percent. Approximately \$2.8 million of underwriting discount, commissions and other expenses was recorded as deferred charges, which are amortized over the life of the Senior Notes.

*Credit Agreement.* On September 9, 2010, we entered into the Credit Agreement, and a related security agreement, or the Security Agreement, with a bank syndicate. The Credit Agreement provides for a two tranche revolving credit facility in an aggregate principal amount of up to \$100.0 million, or the Commitments, consisting of (i) a secured credit facility, or Tranche A, subject to a borrowing base as set forth in the Credit Agreement, in an aggregate principal amount of up to \$50.0 million and (ii) an unsecured credit facility, or Tranche B, in an aggregate principal amount of up to \$50.0 million. The Commitments under the Credit Agreement are scheduled to terminate on September 9, 2013, or the Maturity Date, unless earlier terminated. Borrowings under the Credit Agreement are available for working capital and general corporate purposes.

Alternate Base Rate Borrowings under the Credit Agreement bear interest at (x) the greatest of (a) the administrative agent's prime rate, (b) the federal funds rate plus 0.5 percent or (c) an adjusted London Interbank Overnight, or LIBO, rate for a one month interest period on such day plus 1 percent, plus (y) a specified margin (currently 0 basis points for Tranche A and 125 basis points for Tranche B). Eurodollar Borrowings under the Credit Agreement bear interest at the Adjusted LIBO Rate for the interest period in effect plus a specified margin (currently 75 basis points for Tranche A and 225 basis points for Tranche B). The Credit Agreement requires that all loans be repaid in full no later than the Maturity Date. The Credit Agreement also requires us to pay a Commitment Fee each quarter in a range of between one fifth and one-half of one percent per annum, based upon our Moody's Rating and S&P Ratings Services, on the daily unused amount of the Commitments of the relevant Tranche.

The Credit Agreement contains representations, warranties and covenants customary for bank loan facilities of this nature. In this regard, the Credit Agreement requires us to, among other things, (i) maintain a consolidated net worth of not less than the sum of (x) approximately \$2.0 billion plus (y) 50 percent of our cumulative consolidated net income earned in each fiscal quarter (if positive) commencing on September 30, 2010 and (ii) maintain a ratio of consolidated total indebtedness to consolidated capital as of the end of each fiscal quarter of not greater than 0.25 to 1.0. Additionally, the Credit Agreement contains various negative covenants with which we must comply, including, but not limited to, limitations respecting the creation of liens on any property or asset; the incurrence of indebtedness; mergers, consolidations, liquidations and dissolutions; change of business; sales of assets; transactions with affiliates; and other provisions customary in similar types of agreements. In addition, at any time when a default has occurred and is continuing or would result therefrom, the Credit Agreement proscribes our ability to declare or pay, or permit certain of our subsidiaries to declare or pay, any dividend on, or make any payment on account of, or set apart assets for a sinking or other analogous fund for, the purchase, redemption, defeasance, retirement or acquisition of, any of our stock or any such subsidiaries.

Under the Credit Agreement, an Event of Default is defined as (i) a failure to pay any principal or interest on any of the loans or any fee or any other amount payable under the Credit Agreement or any other loan document within designated time periods; (ii) a breach of any representation or warranty made in the Credit Agreement or any other loan document; (iii) a failure to comply with certain specified covenants, conditions or agreements in the Credit Agreement; (iv) a failure to comply with any other conditions, covenants or agreements in the Credit Agreement or any other loan document within thirty days after knowledge or written notice of such failure; (v) a failure by us or any subsidiary to pay any indebtedness, other than loans under the Credit Agreement, or any obligation in respect of our or any subsidiary's hedging agreements in an aggregate amount exceeding \$25.0 million, or Material Indebtedness, when due or payable; (vi) any event or condition occurs that results in the acceleration of the maturity of Material Indebtedness or which enables or permits the holder of such Material Indebtedness to cause the acceleration of such indebtedness, except for secured indebtedness that becomes due as a result of the voluntary sale or transfer of the property or assets securing such indebtedness; (vii) the occurrence of certain involuntary or voluntary bankruptcy, insolvency or reorganization events relating to us or any of our

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material subsidiaries; (viii) the rendering of certain money judgments against us or any of our subsidiaries in an aggregate amount in excess of \$25.0 million; (ix) a failure by us or certain affiliates to pay any material amounts to the Pension Benefit Guaranty Corporation or to an employee pension benefit plan or the institution of an enforcement proceeding under ERISA (as defined in the Credit Agreement), the occurrence of certain ERISA events which would reasonably be expected to have a material adverse effect, or the occurrence of certain material events under ERISA covered plans; (x) the failure of any lien created by any of the security documents to constitute an enforceable first priority perfected lien on all of the collateral encumbered thereby; or (xi) the occurrence of certain events constituting a Change of Control relating to us.

If an Event of Default occurs, then, to the extent permitted in the Credit Agreement, the Lenders may, as applicable, terminate the Commitments, accelerate the repayment of any outstanding loans and exercise all rights and remedies available to such Lenders under the Credit Agreement, the Security Agreement and related documents and applicable law, including, without limitation, exercising rights and remedies with respect to the collateral for the benefit of the Tranche A Lenders. In the case of an Event of Default that exists due to the occurrence of certain involuntary or voluntary bankruptcy, insolvency or reorganization events relating to us, the Commitments will automatically terminate and the repayment of any outstanding loans shall be automatically accelerated.

The Security Agreement secures all of our obligations relating to the Tranche A Loans under the Credit Agreement, and grants to a collateral agent for the Lenders, or Collateral Agent, a continuing first priority lien on and security interest in, and assigns to the Collateral Agent (for the ratable benefit of the Lenders) as collateral security, all of our right, title and interest in and to: (i) all cash, securities, shares of stock, investment property, financial assets, equity interests, instruments and general intangibles which are from time to time held in or credited to a certain account, or the Account, maintained with the Collateral Agent, (ii) the Account itself, and (iii) all rights to which we now or hereafter become entitled by reason of our interest in any of the previously described collateral, and all security entitlements related to the Account and the financial assets credited to the Account, and the additions to, accessions to, substitutions of, products or proceeds of any or all of the foregoing.

There were no borrowings under the Credit Agreement during 2010 or 2011.

*Preferred Stock.* On June 23, 2006, we completed an offering of 1,132,000 shares of 5.75% Mandatory Convertible Preferred Stock, or the Preferred Stock, at a public offering price of \$264.60 per share, resulting in net proceeds of \$290.4 million. On June 15, 2009, all outstanding shares of Preferred Stock were mandatorily converted into shares of our common stock. Each outstanding share of Preferred Stock was automatically converted into 1.0139 shares of our common stock based on the arithmetic average of the daily volume-weighted average price per share of our common stock for each of the 20 consecutive trading days ending on June 10, 2009, or \$260.9733 per share. We issued 698,009 shares of our common stock for the 688,621 shares of Preferred Stock that were outstanding at the date of the mandatory conversion. All of the foregoing per share data has not been adjusted for subsequent Alleghany common stock dividends.

*Capital Contributions.* From time to time, we make capital contributions to our subsidiaries when third-party financing may not be attractive or available. In 2010, we made a capital contribution of \$40.0 million to provide capital support to PCIC in connection with an increase in its workers compensation deposit, which is required to be maintained by PCIC under California workers compensation regulations. In 2007, we made a capital contribution of \$50.0 million to provide additional capital support to PCC in connection with AIHL's acquisition of PCC. We expect that we will continue to make capital contributions to our subsidiaries from time to time in the future for similar or other purposes.

*Common Stock and Preferred Stock Repurchases.* In February 2008, our Board of Directors authorized the repurchase of shares of our common stock, at such times and at prices as management determined advisable, up to an aggregate of \$300.0 million. In November 2008, the authorization to repurchase our common stock was expanded to include repurchases of Preferred Stock. As of December 31, 2010, this program had been fully utilized. In July 2010, in anticipation of such full utilization, our Board of Directors authorized the repurchase of additional shares of our common stock, at such times and at prices as management may determine advisable, up to an aggregate of \$300.0 million, upon such full utilization. Such share repurchase program was terminated upon the entry into the merger agreement with Transatlantic in November 2011.

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During 2011, we repurchased an aggregate of 399,568 shares of our common stock in the open market for \$120.3 million, at an average price per share of \$301.14. During 2010, we repurchased an aggregate of 285,056 shares of our common stock in the open market for \$83.1 million, at an average price per share of \$291.64. During 2009, we repurchased an aggregate of 295,463 shares of our common stock in the open market for \$75.9 million, at an average price per share of \$256.73. Prior to the mandatory conversion date of June 15, 2009, we repurchased an aggregate of 442,998 shares of Preferred Stock in the open market for \$117.4 million, at an average price per share of \$264.92. All of the foregoing per share and average price data has not been adjusted for subsequent Alleghany common stock dividends.

As of December 31, 2011 and December 31, 2010, we had 8,551,646 and 8,941,885 shares of our common stock outstanding, respectively.

*Dividends.* We have declared stock dividends in lieu of cash dividends every year since 1987 except 1998 when our wholly-owned subsidiary, Chicago Title Corporation, was spun off to our stockholders. These stock dividends have helped to conserve our financial strength and, in particular, the liquid assets available to finance internal growth and operating company acquisitions and investments. In light of the pending merger with Transatlantic, our Board of Directors determined not to declare a stock dividend for 2012.

*Dividends from Subsidiaries.* As of December 31, 2011, approximately \$835.3 million of the equity of all of our subsidiaries was available for dividends or advances to us at the parent level. AIHL's insurance operating units are subject to various regulatory restrictions that limit the maximum amount of dividends available to be paid by them without prior approval of insurance regulatory authorities. Of the aggregate total equity of our insurance operating units as of December 31, 2011 of \$1.85 billion, a maximum of \$35.9 million was available for dividends without prior approval of the applicable insurance regulatory authorities. These limitations have not affected our ability to meet our obligations. In 2011, RSUI paid AIHL a cash dividend of \$100.0 million and CATA paid AIHL a cash dividend of \$15.0 million. In 2010, RSUI paid AIHL a cash dividend of \$100.0 million and CATA paid AIHL a cash dividend of \$25.0 million. In 2009, RSUI paid AIHL a cash dividend of \$150.0 million and CATA paid AIHL a cash dividend of \$15.0 million.

*Contractual Obligations.* We have certain obligations to make future payments under contracts and credit-related financial instruments and commitments. As of December 31, 2011, certain long-term aggregate contractual obligations and credit-related financial commitments were as follows (in millions):

Contractual Obligations	Total	Within 1 Year	More than	More than	More than 5 Years
			1 Year but Within 3 Years	3 Years but Within 5 Years	
Operating lease obligations	\$ 65.6	\$ 10.0	\$ 20.1	\$ 14.6	\$ 20.9
Investments	26.4	6.8	9.8	9.8	
Senior Notes	299.0				299.0
Interest on Senior Notes	147.9	16.9	34.0	34.0	63.0
Loss and LAE	2,313.0	556.4	795.1	408.2	553.3
Merger Agreement*	846.7	846.7			
Other long-term liabilities reflected on our consolidated balance sheet under GAAP**	144.4	57.9	40.2	12.2	34.1
Total	\$ 3,843.0	\$ 1,494.7	\$ 899.2	\$ 478.8	\$ 970.3

\* Represents cash commitments we made in connection with the pending merger with Transatlantic, consisting of \$816.0 million cash consideration payable to Transatlantic shareholders upon consummation of the merger, as well as \$30.7 million of estimated merger-related costs, which include \$18.0 million payable to our investment bankers (see Note 2 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report for further details). The merger is expected to close in the first quarter of 2012.

\*\* Other long-term liabilities primarily reflect employee pension obligations, certain retired executive pension obligations and obligations under certain incentive compensation plans.

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Our insurance operating units have obligations to make certain payments for loss and LAE pursuant to insurance policies they issue. These future payments are reflected as reserves on our consolidated financial statements. With respect to loss and LAE, there is typically no minimum contractual commitment associated with insurance contracts, and the timing and ultimate amount of actual claims related to these reserves is uncertain. Additional information regarding reserves for loss and LAE, including information regarding the timing of payments of these expenses, can be found on pages 19 through 22, pages 30 and 31, pages 42 through 47 and pages 60 and 61 of this Form 10-K Report.

*Off-Balance Sheet Arrangements.* In late 2010, Alleghany Properties commenced making investments in three California low income housing tax credit limited liability companies. The investments each took the form of a limited partnership interest in separate limited liability companies organized and managed by a third party real estate developer. Alleghany Properties expects that its investment in the limited liability companies will last for approximately 10 years. The developer is the general partner and retains the residual interest in the underlying real estate properties. The limited liability companies are consolidated by the third party real estate developer for accounting purposes. Funding for each low income housing project is provided principally by Alleghany Properties and various government-sponsored loans secured by the assets of the limited liability companies. As of December 31, 2011, Alleghany Properties invested a cumulative \$4.5 million in the three limited liability companies, and is committed to invest an additional \$1.7 million.

*Subsidiaries*

Financial strength is also a high priority of our subsidiaries, whose assets stand behind their financial commitments to their customers and vendors. We believe that our subsidiaries have and will have adequate internally generated funds, cash resources, and unused credit facilities to provide for the currently foreseeable needs of their businesses. Our subsidiaries have no material commitments for capital expenditures.

*AIHL.* The obligations and cash outflow of AIHL's insurance operating units include claim settlements, administrative expenses and purchases of investments. In addition to premium collections, cash inflow is obtained from interest and dividend income and maturities and sales of investments. Because cash inflow from premiums is received in advance of cash outflow required to settle claims, AIHL's insurance operating units accumulate funds which they invest pending the need for liquidity. As an insurance company's cash needs can be unpredictable due to the uncertainty of the claims settlement process, AIHL's portfolio, which includes those of its insurance operating units, is composed primarily of debt securities and short-term investments to ensure the availability of funds and maintain a sufficient amount of liquid securities. As of December 31, 2011, investments and cash represented 74.6 percent of the assets of AIHL and its insurance operating units.

As of December 31, 2011, AIHL had total unpaid loss and LAE of approximately \$2.3 billion and total reinsurance recoverables of \$852.8 million, consisting of \$831.8 million of ceded outstanding loss and LAE and \$21.0 million of recoverables on paid losses. As of December 31, 2011, AIHL's investment securities portfolio had a fair market value of approximately \$4.1 billion and consisted primarily of high quality debt securities. Additional information regarding AIHL's investment portfolio and the credit quality of AIHL's debt securities portfolio can be found on pages 66 through 71 of this Form 10-K Report.

*Alleghany Properties.* As of December 31, 2011, Alleghany Properties held properties having a total book value of \$19.9 million (excluding \$4.5 million invested in three California low income housing tax credit limited liability companies), compared with \$19.9 million as of December 31, 2010 and \$19.8 million as of December 31, 2009. These properties and loans had a total book value of \$90.1 million as of October 31, 1994, the date Alleghany Properties purchased the assets. The capital needs of Alleghany Properties consist primarily of various development costs relating to its owned land and corporate administration. Adequate funds to provide for the currently foreseeable needs of its business are expected to be generated by sales and, if needed, capital contributions by us.

*Consolidated Investment Holdings*

*Investment Strategy.* Our investment strategy seeks to preserve principal and maintain liquidity while trying to maximize our risk-adjusted, after-tax rate of return. Investment decisions are guided mainly by the nature and

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timing of expected liability payouts, management's forecast of cash flows and the possibility of unexpected cash demands, for example, to satisfy claims due to catastrophe losses. Our consolidated investment portfolio currently consists mainly of highly rated and liquid debt securities and equity securities listed on national securities exchanges. The overall debt securities portfolio credit quality is measured using the lower of either Standard & Poor's or Moody's rating. In this regard, the overall weighted-average credit quality rating of our debt securities portfolio as of December 31, 2011 was AA, with 16.3 percent of our consolidated debt securities portfolio invested in securities with the highest rating (Aaa/AAA), 63.0 percent invested in securities with the second highest rating (Aa/AA) and only 1.1 percent had either no rating or a rating below investment grade (below Baa3 / BBB-). The overall weighted-average credit quality rating of our debt securities portfolio was reduced from AA+ as of December 31, 2010 to AA as of December 31, 2011 as a result of Standard and Poor's downgrade of its long-term assessment of U.S. sovereign debt to AA+ from AAA on August 5, 2011, as well as the subsequent downgrade of U.S. agency and other debt backed by the U.S. Government. Although many of our debt securities, which consist predominantly of states, municipalities and political subdivision bonds, are insured by third-party financial guaranty insurance companies, the impact of such insurance was not significant to the debt securities credit quality rating as of December 31, 2011. As of December 31, 2011, we had \$83.5 million of foreign bonds, none of which were sovereign obligations of Portugal, Ireland, Italy, Greece or Spain.

Our debt securities portfolio has been designed to enable management to react to investment opportunities created by changing interest rates, prepayments, tax and credit considerations or other factors, or to circumstances that could result in a mismatch between the desired duration of debt securities and the duration of liabilities, and, as such, is classified as available for sale.

We produced positive cash flow in the three-year period ending December 31, 2011. Our positive cash flow from operations reduces the need to liquidate portions of our debt securities portfolio to pay for current claims of our insurance operating units. This positive cash flow also permits us, as attractive investment opportunities arise, to make investments in debt securities that have a longer duration than our liabilities. When attractive investment opportunities do not arise, we may maintain higher proportions of shorter duration debt securities to preserve our capital resources. Effective duration measures a portfolio's sensitivity to change in interest rates; a change within a range of plus or minus 1 percent in interest rates would be expected to result in an inverse change of approximately 4.1 percent in the fair market value of our debt securities portfolio. In this regard, as of December 31, 2011, our debt securities portfolio had an effective duration of approximately 4.0 years, with approximately \$0.7 billion, or 26.4 percent, of our debt securities portfolio in securities with maturities of five years or less and \$1.1 billion of short-term investments. See Note 3 to the Consolidated Financial Statements set forth in Item 8 of this Form 10-K Report for further details concerning the contractual maturities of our consolidated debt securities portfolio. We may modestly increase the proportion of our debt securities portfolio held in securities with maturities of more than five years should the yields of these securities provide, in our judgment, sufficient compensation for their increased risk. We do not believe that this strategy would reduce our ability, as necessary, to meet ongoing claim payments or to respond to significant catastrophe losses.

In the event paid losses accelerate beyond the ability of our insurance operating units to fund these paid losses from current cash balances, current operating cash flow, coupon receipts and security maturities, we would need to liquidate a portion of our investment portfolio, make capital contributions to our insurance operating units, and/or arrange for financing. Strains on liquidity could result from:

the occurrence of several significant catastrophic events in a relatively short period of time;

the sale of investments into a depressed marketplace to fund these paid losses;

the uncollectibility of reinsurance recoverables on these paid losses;

the significant decrease in the value of collateral supporting reinsurance recoverables; or

a significant reduction in our net premium collections.

We may, from time to time, make significant investments in the common stock of a public company, subject to limitations imposed by applicable regulations. Although the vast majority of our investment holdings are





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denominated in U.S. dollars, investments may be made in other currency denominations depending upon investment opportunities in those currencies, or as may be required by regulation or law.

*Overview.* On a consolidated basis, our invested asset portfolio was approximately \$4.8 billion as of December 31, 2011, an increase of 0.5 percent from December 31, 2010. The small increase is due primarily to positive cash flow at RSUI, largely offset by repurchases of our common stock pursuant to our share repurchase program, which was terminated in connection with our entry into the merger agreement, and negative cash flow at PCC. Negative cash flow at PCC was a result of PCC ceasing to solicit new or renewal business on a direct basis commencing August 1, 2009.

*Fair Value.* The estimated carrying values and fair values of our consolidated financial instruments as of December 31, 2011 and December 31, 2010 were as follows (in millions):

	December 31, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Assets</b>				
Investments (excluding equity method investments)*	\$ 4,670.6	\$ 4,670.6	\$ 4,622.7	\$ 4,622.7
<b>Liabilities</b>				
Senior Notes	\$ 299.0	\$ 314.8	\$ 298.9	\$ 291.8

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

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

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

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

**Level 2** Valuations are based on quoted market prices where such markets are not deemed to be sufficiently active. In such circumstances, additional valuation metrics will be used which involve direct or indirect observable market inputs. Our Level 2 assets generally include preferred stocks and debt securities other than debt issued directly by the U.S. Government. Our Level 2 liabilities include



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the Senior Notes. Substantially all of the determinations of value in this category are based on a single quote from third-party dealers and pricing services. As we generally do not make any adjustments thereto, such quote typically constitutes the sole input in our determination of the fair value of these types of securities. In developing a quote, such third parties will use the terms of the security and market-based inputs. Terms of the security include coupon, maturity date, and any special provisions that may, for example, enable the investor, at its election, to redeem the security prior to its scheduled maturity date. Market-based inputs include the level of interest rates applicable to comparable securities in the market place and current credit rating(s) of the security. Such quotes are generally non-binding.

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

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

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

	Level 1	Level 2	Level 3	Total
<b>As of December 31, 2011</b>				
Equity securities:				
Common stock(1)	\$ 871.0	\$	\$	\$ 871.0
Preferred stock				
Debt securities:				
U.S. Government obligations	267.8			267.8
Mortgage and asset-backed securities(2)		860.5		860.5
States, municipalities and political subdivision bonds		1,113.6		1,113.6
Foreign bonds		83.5		83.5
Corporate bonds and other		354.1		354.1
	267.8	2,411.7		2,679.5
Short-term investments	54.3	1,042.2		1,096.5
Other invested assets(3)			23.6	23.6
Investments (excluding equity method investments)	\$ 1,193.1	\$ 3,453.9	\$ 23.6	\$ 4,670.6
Senior Notes	\$	\$ 314.8	\$	\$ 314.8
<b>As of December 31, 2010</b>				
Equity securities:				
Common stock(1)	\$ 1,500.7	\$	\$	\$ 1,500.7
Preferred stock				
Debt securities:				
U.S. Government obligations	307.3	30.5		337.8
Mortgage and asset-backed securities(2)		866.5		866.5
States, municipalities and political subdivision bonds		1,068.5		1,068.5
Foreign bonds		114.2		114.2
Corporate bonds and other		445.4		445.4
	307.3	2,525.1		2,832.4
Short-term investments	86.4	178.4		264.8
Other invested assets(3)			24.8	24.8
Investments (excluding equity method investments)	\$ 1,894.4	\$ 2,703.5	\$ 24.8	\$ 4,622.7
Senior Notes	\$	\$ 291.8	\$	\$ 291.8

(1) Of the \$871.0 million of fair value as of December 31, 2011, \$573.3 million related to certain energy sector businesses. Of the \$1,500.7 million of fair value as of December 31, 2010, \$1,004.8 million related to certain energy sector businesses.

(2)

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Of the \$860.5 million of fair value as of December 31, 2011, \$497.3 million related to residential mortgage-backed securities, or RMBS, \$144.7 million related to commercial mortgage-backed securities, or CMBS, and \$218.5 million related to other asset-backed securities. Of the \$866.5 million of fair value as of December 31, 2010, \$499.9 million related to RMBS, \$173.4 million related to CMBS and \$193.2 million related to other asset-backed securities.

- (3) Level 3 securities consist of partnership investments. The carrying value of partnership investments of \$23.6 million as of December 31, 2011 decreased by \$1.2 million from the December 31, 2010 carrying value of \$24.8 million, due primarily to net return of capital during 2011.

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*Mortgage-and Asset-Backed Securities.* As of December 31, 2011, our mortgage-and asset-backed securities portfolio consisted of the following and was backed by the following types of underlying collateral (in millions):

Type of Underlying Collateral	Fair Value	Average Rating
RMBS: guaranteed by FNMA or FHLMC(1)	\$ 112.8	Aa1 /AA+
RMBS: guaranteed by GNMA(2)	326.3	Aa1 /AA+
RMBS: Alt A	9.0	Aa1 /AA-
RMBS: Sub-prime	2.0	Baa2 /AAA
All other	410.4	Aa1/AA+
Total	\$ 860.5	Aa1 /AA+

(1) FNMA refers to the Federal National Mortgage Association, and FHLMC refers to the Federal Home Loan Mortgage Corporation.

(2) GNMA refers to the Government National Mortgage Association.

All of our mortgage- and asset-backed securities are current as to principal and interest. Additional information regarding our holdings of securities backed by sub-prime and Alt-A collateral as of December 31, 2011 is as follows (in millions):

Type of Underlying Collateral	Gross Unrealized Gains	Gross Unrealized Losses	Weighted Average Life
Alt-A	\$ 0.5	\$ (0.3)	6.5 years
Sub-prime	\$	\$ (0.1)	4.4 years

*Municipal Bonds.* The following table details the top five state exposures of our municipal bond portfolio (in millions):

	General Obligation	Special Revenue	Total Fair Value
Texas	\$ 60.5	\$ 41.1	\$ 101.6
Massachusetts	4.7	67.5	72.2
New York	4.7	59.2	63.9
Colorado	43.8	18.9	62.7
Illinois			