DOT HILL SYSTEMS CORP
Form DEF 14A
March 21, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934 (Amendment No. __)

Filed by the Registrant þ

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement
¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Pursuant to § 240.14a-12

Dot Hill Systems Corp.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box)

þ No fee required.
¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(6) Amount Previously Paid:

(7) Form, Schedule or Registration Statement No.:

(8) Filing Party:

(9) Date Filed:

DOT HILL SYSTEMS CORP.

1351 South Sunset Street

Longmont, Colorado 80501

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held On May 2, 2011

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders of Dot Hill Systems Corp., a Delaware corporation (the Company). The meeting will be held on May 2, 2011 at 8:30 a.m. local time at our office located at 1351 South Sunset St., Longmont, Colorado, 80501 for the following purposes:

1. To elect the two nominees for director named herein to hold office until the 2014 Annual Meeting of Stockholders.

2. To approve the Company s 2009 Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under the plan by 8,000,000 shares.

3. To approve, on an advisory basis, the compensation of the Company s named executive officers, as disclosed in this proxy statement.

4. To indicate, on an advisory basis, the preferred frequency of stockholder advisory votes on the compensation of the Company s named executive officers.

5. To ratify the selection by the Audit Committee of our Board of Directors of Deloitte & Touche LLP, as independent registered public accounting firm of the Company for its fiscal year ending December 31, 2011.

6. To conduct any other business properly brought before the meeting.

These items of business are more fully described in the Proxy Statement accompanying this Notice.

The record date for the Annual Meeting is March 16, 2011. Only stockholders of record at the close of business on that date may vote at the meeting or any adjournment thereof.

Important Notice Regarding the Availability of Proxy Materials for the 2011 Annual Meeting of Stockholders to be held on May 2, 2011 at 8:30 a.m. local time at 1351 South Sunset St., Longmont, Colorado, 80501.

The proxy statement and annual report to stockholders are available at *http://www.proxyvote.com*. The Board of Directors recommends that you vote FOR three years as the preferred frequency of non-binding advisory votes to approve executive compensation and FOR each of the other proposals identified above.

By Order of the Board of Directors

/s/ DANA W. KAMMERSGARD

Dana W. Kammersgard

President and Chief Executive Officer

Longmont, Colorado

March 25, 2011

Our 2010 Annual Report, which includes financial statements, is being mailed with the proxy statement accompanying this notice. Kindly notify Dot Hill Systems Corp., Investor Relations Department, 1351 South Sunset Street, Longmont, CO 80501, telephone (800) 704-3171, if you did not receive a report and a copy will be sent to you.

You are cordially invited to attend the meeting in person. Whether or not you expect to attend the meeting, please complete, date, sign and return the enclosed proxy card as instructed in the proxy statement accompanying this notice as promptly as possible in order to ensure your representation at the meeting, or you may vote over the telephone or the internet by following the instructions in the proxy statement accompanying this notice on your proxy card. A return envelope (which is postage prepaid if mailed in the United States) has been provided for your convenience. Even if you have voted by proxy, you may still vote in person if you attend the meeting. Please note, however, that if your shares are held of record by a broker, bank or other nominee and you wish to vote at the meeting, you must obtain a proxy issued in your name from that record holder.

DOT HILL SYSTEMS CORP.

1351 South Sunset Street

Longmont, Colorado 80501

PROXY STATEMENT

FOR THE 2011 ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD ON MAY 2, 2011

Questions and Answers about these Proxy Materials and Voting

In this proxy statement, Dot Hill, the Company, we, us and our refer to Dot Hill Systems Corp. and its wholly-owned subsidiaries.

Why am I receiving these materials?

We have sent you these proxy materials because the Board of Directors of Dot Hill is soliciting your proxy to vote at the 2011 Annual Meeting of Stockholders, including at any adjournments or postponements of the meeting. You are invited to attend the annual meeting to vote on the proposals described in this proxy statement. However, you do not need to attend the meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card, or follow the instructions below to submit your proxy over the telephone or through the internet.

We intend to mail these proxy materials on or about March 25, 2011 to all stockholders of record entitled to vote at the annual meeting.

How do I attend the annual meeting?

The meeting will be held on May 2, 2011 at 8:30 am local time at our office located at 1351 South Sunset St., Longmont, Colorado, 80501. Directions to the annual meeting may be found at http://www.dothill.com/company/locations/ltc_directions.htm. Information on how to vote in person at the annual meeting is discussed below.

Who can vote at the annual meeting?

Only stockholders of record at the close of business on March 16, 2011, the record date for the annual meeting, will be entitled to vote at the annual meeting. On this record date, there were 56,404,151 shares of common stock outstanding and entitled to vote.

Stockholder of Record: Shares Registered in Your Name

If on March 16, 2011 your shares were registered directly in your name with Dot Hill s transfer agent, American Stock Transfer & Trust Company, then you are a stockholder of record. As a stockholder of record, you may vote in person at the meeting or vote by proxy. Whether or not you plan to attend the meeting, we urge you to fill out and return the enclosed proxy card, or vote by proxy over the telephone or on the internet as instructed below, to ensure your vote is counted.

Beneficial Owner: Shares Registered in the Name of a Broker, Bank or Other Agent

If on March 16, 2011 your shares were held, not in your name, but rather in an account at a brokerage firm, bank, dealer or other similar organization, then you are the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered to be the stockholder of record for purposes of voting at the annual meeting. As a beneficial owner, you have the right to direct your broker or other agent regarding how to vote the shares in your account. You are also invited to attend the annual meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent.

What am I voting on?

There are five matters scheduled for a vote:

- Election of the Board of Directors nominees, Dana W. Kammersgard and Richard Mejia, Jr., to hold office until the 2014 Annual Meeting of Stockholders;
- Approval of the proposed 8,000,000 share increase in the number of shares of common stock authorized for issuance under the Company s 2009 Equity Incentive Plan;
- Advisory approval of the compensation of the Company s named executive officers, as disclosed in this proxy statement in accordance with Securities and Exchange Commission, or SEC, rules;
- Advisory indication of the preferred frequency of stockholder advisory votes on the compensation of the Company s named executive officers; and
- Ratification of selection by the Audit Committee of the Board of Directors of Deloitte and Touche, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2011.

What if another matter is properly brought before the meeting?

The Board of Directors knows of no other matters that will be presented for consideration at the annual meeting. If any other matters are properly brought before the meeting, it is the intention of the persons named in the accompanying proxy to vote on those matters in accordance with their best judgment.

How do I vote?

You may either vote For all the nominees to the Board of Directors or you may Withhold your vote for any nominee you specify. With regard to your advisory vote on how frequently we should solicit stockholder advisory approval of executive compensation, you may vote for any one of the following: one year, two years or three years, or you may abstain from voting on that matter. For each of the other matters to be voted on, you may vote For or Against or abstain from voting.

Stockholder of Record: Shares Registered in Your Name

If you are a stockholder of record, you may vote in person at the annual meeting or vote by proxy using the enclosed proxy card, vote by proxy over the telephone, or vote by proxy through the internet. Whether or not you plan to attend the meeting, we urge you to vote by proxy to ensure your vote is counted. You may still attend the meeting and vote in person even if you have already voted by proxy.

- To vote in person, come to the annual meeting and we will give you a ballot when you arrive.
- To vote using the proxy card, simply complete, sign and date the enclosed proxy card and return it promptly in the envelope provided. If you return your signed proxy card to us before the annual meeting, we will vote your shares as you direct.
- To vote over the telephone, dial toll-free (800) 690-6903 using a touch-tone phone and follow the recorded instructions. You will be asked to provide the company number and control number from the enclosed proxy card. Your vote must be received by 11:59 p.m., Eastern Time on May 1, 2011 to be counted.

To vote through the internet, go to *http://www.proxyvote.com* to complete an electronic proxy card. You will be asked to provide the company number and control number from the enclosed proxy card. Your vote must be received by 11:59 p.m. Eastern Time on May 1, 2011 to be counted.

Beneficial Owner: Shares Registered in the Name of Broker or Bank

If you are a beneficial owner of shares registered in the name of your broker, bank, or other agent, you should have received a proxy card and voting instructions with these proxy materials from that organization rather than from Dot Hill. Simply complete and mail the proxy card to ensure that your vote is counted. Alternatively, you may vote by telephone or over the internet as instructed by your broker or bank. To vote in person at the annual meeting, you must obtain a valid proxy from your broker, bank or other agent. Follow the instructions from your broker or bank included with these proxy materials, or contact your broker or bank to request a proxy form.

Internet proxy voting may be provided to allow you to vote your shares online, with procedures designed to ensure the authenticity and correctness of your proxy vote instructions. However, please be aware that you must bear any costs associated with your internet access, such as usage charges from internet access providers and telephone companies.

How many votes do I have?

On each matter to be voted upon, you have one vote for each share of common stock you own as of March 16, 2011, the record date for the annual meeting.

What if I return a proxy card or otherwise vote but do not make specific choices?

If you return a signed and dated proxy card or otherwise vote without marking voting selections, your shares will be voted, as applicable, For the election of the two nominees for director; For the approval of a share increase in the number of shares of common stock authorized for issuance under the Company s 2009 Equity Incentive Plan; For the advisory approval of the compensation of our named executive officers and For three years as the preferred frequency of advisory votes to approve executive compensation; and For the ratification of the selection of Deloitte & Touche LLP as our independent auditors. If any other matter is properly presented at the meeting, one of the individuals named on your proxy card as your proxy will vote your shares using his or her best judgment.

Who is paying for this proxy solicitation?

We will pay for the entire cost of soliciting proxies. In addition to these proxy materials, our directors and employees may also solicit proxies in person, by telephone, or by other means of communication. Directors and employees will not be paid any additional compensation for soliciting proxies. We may also reimburse brokerage firms, banks and other agents for the cost of forwarding proxy materials to beneficial owners.

What does it mean if I receive more than one set of proxy materials?

If you receive more than one set of proxy materials, your shares may be registered in more than one name or in different accounts. Please follow the voting instructions on the proxy cards in the proxy materials to ensure that all of your shares are voted.

Can I change my vote after submitting my proxy?

Yes. You can revoke your proxy at any time before the final vote at the meeting. If you are the record holder of your shares, you may revoke your proxy in any one of the following ways:

You may submit another properly completed proxy card with a later date.

You may grant a subsequent proxy by telephone or through the internet.

You may send a timely written notice that you are revoking your proxy to the Company s Secretary at 1351 South Sunset Street, Longmont, Colorado 80501.

You may attend the annual meeting and vote in person. Simply attending the meeting will not, by itself, revoke your proxy. Your most current proxy card or telephone or internet proxy is the one that is counted.

If your shares are held by your broker or bank as a nominee or agent, you should follow the instructions provided by your broker or bank.

When are stockholder proposals due for next year s annual meeting?

To be considered for inclusion in next year s proxy materials, your proposal must be submitted in writing by November 26, 2011, to the Company s Secretary at 1351 South Sunset Street, Longmont, Colorado 80501. If you wish to submit a proposal that is not to be included in next year s proxy materials or nominate a director, you must do so no later than the close of business on December 26, 2011 and no earlier than November 26, 2011. You are also advised to review the Company s Bylaws, which contain additional requirements about advance notice of stockholder proposals and director nominations.

How are votes counted?

Votes will be counted by the inspector of election appointed for the meeting, who will separately count, for the proposal to elect directors, votes For, Withhold and broker non-votes; with respect to the proposal regarding frequency of stockholder advisory votes to approve executive compensation, votes for frequencies of one year, two years or three years, abstentions and broker non-votes; and, with respect to other proposals, votes For and Against, abstentions and, if applicable, broker non-votes. Abstentions will be counted towards the vote total for each proposal, and, except in the case of the proposal regarding frequency of stockholder advisory votes to approve executive compensation, will have the same effect as Against votes. Broker non-votes and, in the case of the proposal regarding frequency of stockholder advisory votes to approve executive compensation, abstentions will have no effect and will not be counted towards the vote total.

What are broker non-votes ?

Broker non-votes occur when a beneficial owner of shares held in street name does not give instructions to the broker or nominee holding the shares as to how to vote on matters deemed non-routine. Generally, if shares are held in street name, the beneficial owner of the shares is entitled to give voting instructions to the broker or nominee holding the shares. If the beneficial owner does not provide voting instructions, the broker or nominee can still vote the shares with respect to matters that are considered to be routine, but not with respect to non-routine matters. Under the rules and interpretations of the New York Stock Exchange, or NYSE, non-routine matters are matters that may substantially affect the rights or privileges of stockholders, such as mergers, stockholder proposals, elections of directors (even if not contested) and, for the first time, under a new amendment to the NYSE rules, executive compensation, including the advisory stockholder votes on executive compensation and on the frequency of stockholder votes on executive compensation.

How many votes are needed to approve each proposal?

For the election of directors, the two nominees receiving the most For votes from the holders of shares present in person or represented by proxy and entitled to vote on the election of directors will be elected. Only votes For or Withheld will affect the outcome.

To be approved, Proposal No. 2, the proposed 8,000,000 share increase in the number of shares of common stock authorized for issuance under the Company s 2009 Equity Incentive Plan must receive For votes from the holders of a majority of shares present and entitled to vote either in person or represented by proxy. If you mark your proxy to Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have the same effect as an Against vote.

Proposal No. 3, advisory approval of the compensation of the Company s named executive officers, will be considered to be approved if it receives For votes from the holders of a majority of shares either present in person or represented by proxy and entitled to vote. If you Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have no effect.

For Proposal No. 4, the advisory vote on the frequency of stockholder advisory votes on executive compensation, the frequency receiving the highest number of votes from the holders of shares present in person or represented by proxy and entitled to vote at the annual meeting will be considered the frequency preferred by the stockholders. Abstentions and Broker non-votes will have no effect.

To be approved, Proposal No. 5, ratification of the selection of Deloitte & Touche LLP as the Company s independent registered public accounting firm for fiscal 2011, must receive For votes from the holders of a majority of shares present in person or by proxy and entitled to vote. If you Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have no effect.

What is the quorum requirement?

A quorum of stockholders is necessary to hold a valid meeting. A quorum will be present if stockholders holding at least a majority of the outstanding shares entitled to vote are present at the meeting in person or represented by proxy. On the record date, there were 56,404,151 shares outstanding and entitled to vote. **Thus, the holders of 28,202,076 shares must be present in person or represented by proxy at the meeting to have a quorum.**

Your shares will be counted towards the quorum only if you submit a valid proxy (or one is submitted on your behalf by your broker, bank or other nominee) or if you vote in person at the meeting. Abstentions and broker non-votes will be counted towards the quorum requirement. If there is no quorum, the holders of a majority of shares present at the meeting in person or represented by proxy may adjourn the meeting to another date.

How can I find out the results of the voting at the annual meeting?

Preliminary voting results will be announced at the annual meeting. In addition, final voting results will be published in a current report on Form 8-K that we expect to file within four business days after the annual meeting. If final voting results are not available to us in time to file a Form 8-K within four business days after the meeting, we intend to file a Form 8-K to publish preliminary results and, within four business days after the final results are known to us, file an additional Form 8-K to publish the final results.

What proxy materials are available on the internet?

The proxy statement and annual report to stockholders are available at ***www.proxyvote.com.***

PROPOSAL NO. 1

ELECTION OF DIRECTORS

Our Certificate of Incorporation provides that our Board of Directors shall be divided into three classes. Each class consists, as nearly as possible, of one-third of the total number of directors, and each class has a three-year term. Vacancies on our Board may be filled only by persons elected by a majority of the remaining directors. A director elected by our Board to fill a vacancy in a class shall serve for the remainder of the full term of that class and until the director s successor is elected and qualified. This includes vacancies created by an increase in the number of directors.

Our Board of Directors currently consists of five members. There are two directors in the class whose term of office expires at the 2011 Annual Meeting of Stockholders, Dana W. Kammersgard and Richard Mejia, Jr. Each of the nominees named above is currently a director of the Company who was previously elected by our stockholders.

Directors are elected by a plurality of the votes present at the meeting or represented by proxy and they are entitled to vote at the meeting. The two nominees receiving the most For votes (from the holders of votes of shares present in person or represented by proxy and entitled to vote on the election of directors) will be elected. If no contrary indication is made, shares represented by executed proxies will be voted For the election of the two nominees named above or, if any nominee becomes unavailable for election as a result of an unexpected occurrence, For the election of a substitute nominee designated by our Board of Directors. Proxies cannot be voted for a greater number of persons than the number of nominees named in this proxy statement. The two nominees have consented to be named in this proxy statement and agreed to serve as directors if elected, and our management has no reason to believe that the two nominees will be unable to serve. We invite all of our directors and nominees for director to attend our annual meeting of stockholders. All of our then directors attended our 2010 Annual Meeting of Stockholders.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF EACH NOMINEE NAMED ABOVE.

The following is biographical information as of February 1, 2011 for the nominees for director and each director whose term will continue after the 2011 Annual Meeting of Stockholders.

The Nominating and Corporate Governance Committee seeks to assemble a Board that, as a whole, possesses the appropriate balance of professional and industry knowledge, financial expertise and high-level management experience necessary to oversee and direct the Company s business. To that end, the Nominating and Corporate Governance Committee has identified and evaluated nominees in the broader context of the Board s overall composition, with the goal of recruiting members who complement and strengthen the skills of other members and who also exhibit integrity, collegiality, sound business judgment and other qualities that the Nominating and Corporate Governance Committee views as critical to effective functioning of the Board. The brief biographies below include information, as of the date of this proxy statement, regarding the specific and particular experience, qualifications, attributes or skills of each director or nominee that led the Nominating and Corporate Governance Committee to recommend that person as a nominee. However, each of the members of the Nominating and Corporate Governance Committee may have a variety of reasons why he believes a particular person would be an appropriate nominee for the Board, and these views may differ from the views of other members.

Name	Age	Position
Charles F. Christ	71	Chairman of the Board
Dana W. Kammersgard	55	President, Chief Executive Officer and Director
Thomas H. Marmen	67	Director
Richard Mejia, Jr.	62	Director
Roderick M. Sherwood, III	57	Director

Nominees for Election for a Three-Year Term Expiring at our 2014 Annual Meeting of Stockholders

Dana W. Kammersgard has served as our President since August 2004. In March 2006, Mr. Kammersgard was appointed as a member of our Board of Directors and our Chief Executive Officer and President. From August 1999 to August 2004, Mr. Kammersgard served as our Chief Technical Officer. Mr. Kammersgard was a founder of Artecon, Inc., our predecessor company, and served as a director from its inception in 1984 until the merger of Artecon with Box Hill Systems Corp. to become Dot Hill in August 1999. At Artecon, Mr. Kammersgard served in various positions since 1984, including Secretary and Senior Vice President of Engineering from March 1998 until August 1999 and as Vice President of Sales and Marketing from March 1997 until March 1998. Prior to co-founding Artecon, Mr. Kammersgard was the Director of Software Development at CALMA, a division of General Electric Company. Mr. Kammersgard holds a B.A. in Chemistry from the University of California, San Diego. The Nominating and Corporate Governance Committee believes Mr. Kammersgard s experience as a founder of Artecon, his knowledge of storage technology and the storage industry, as well his experience of leading operations, sales and marketing and software and hardware development give him the breadth of knowledge and leadership capabilities to serve as the Company s Chief Executive Officer and President and as a member of the Board of Directors.

Richard Mejia, Jr. has served as a member of our Board of Directors since September 2008. In July 2008, Mr. Mejia retired from the San Diego office of Ernst & Young, LLP, a public accounting firm, after 38 years of service where he served as partner for the last 25 years. During his 20 years in San Diego, his focus was on technology and life sciences companies and he held practice leadership positions for the Pacific Southwest area of the firm. He has extensive experience with mergers and acquisitions, securities offerings and other private and public financings. He has also worked closely with public company boards in implementing corporate governance initiatives and compliance requirements. Mr. Mejia holds a B.S. in Accounting from the University of Southern California. The Nominating and Corporate Governance Committee believes that Mr. Mejia s vast experience in public accounting as a Certified Public Accountant and mergers and acquisitions and financings give him the financial expertise and breadth of knowledge to serve as a director of the Company and to provide direction and oversight to the Company s financial reporting and business controls and the governance framework established within the Company.

Directors Continuing in Office Until the 2012 Annual Meeting of Stockholders

Thomas H. Marmen has served as a member of our Board of Directors since November 2008. Mr. Marmen has over 30 years of experience in the storage and semiconductor manufacturing industries. During his career, he has been involved with various start ups, global enterprises and turnaround situations. Most recently, from April 2006 to April 2007, Mr. Marmen served as the President and Chief Executive officer of TimeLab Corporation, a semiconductor company. Prior to joining TimeLab, from January 2001 to December 2005, he was vice President and General Manager for Broadcom Corporation, a broad-based semiconductor provider, where he was responsible for all aspects of the storage line of business including marketing, engineering and technical support for end-users. Mr. Marmen has also held various positions at other companies including RAIDCore Corp. where he was the company s Chief Executive Officer, Quantum Corp. where he served as Senior Vice President and General Manager for the High End Storage Division, Adaptec Inc. as its Corporate Vice President in the Enterprise Solutions Group and Materials Research Corporation (a subsidiary of SONY Corp.) as President and Chief Executive officer. In addition he spent 18 years at Digital Equipment Corporation holding various management positions in the company s storage, memory, disk drive and semiconductor businesses. Mr. Marmen formerly served as the Lead Director at Ciprico Inc., which voluntarily filed for Chapter 11 bankruptcy in July 2008. The Nominating and Corporate Governance Committee believes that Mr. Marmen s storage and technology experience, including his prior Chief Executive Officer and other executive level operations experience, give him a breadth of knowledge and valuable understanding of our industry which qualify him to serve as a director.

Roderick M. Sherwood, III has served as a member of our Board of Directors since June 2006. Mr. Sherwood has served as President and Chief Financial Officer of Westwood One, Inc., a radio and TV content provider and broadcasting company, since 2008. From 2005 to 2008, Mr. Sherwood served as Chief

Financial Officer, Operations for The Gores Group, LLC, a private equity firm. From 2002 until 2005, Mr. Sherwood was Senior Vice President and Chief Financial Officer for Gateway, Inc. where he was responsible for corporate financial operations, processes and controls, treasury activities and cost reduction programs. He was also integrally involved in Gateway s acquisition of eMachines. Prior to his tenure with Gateway, Mr. Sherwood was Executive Vice President and Chief Financial Officer for Opsware, Inc. (formerly Loudcloud, Inc.). Mr. Sherwood has over 25 years experience in successful financial and operations capacities for companies such as Chrysler Corporation and Hughes Electronics Corporation. Mr. Sherwood received his MBA degree from Harvard Business School and holds an Honors Bachelor of Arts Degree, with Distinction, in Economics from Stanford University. The Nominating and Corporate Governance Committee believes that Mr. Sherwood s financial and operational experience in numerous roles including Chief Financial Officer for public companies in the technology industry, in private equity and more recently as President and Chief Financial Officer of a public company, give him the financial and operational expertise and breadth of knowledge to serve as a director of the Company and provide direction and oversight to the Company s financial reporting and business controls environment and operating functions of the Company.

Director Continuing in Office Until the 2013 Annual Meeting of Stockholders

Charles F. Christ has served as our Chairman of the Board since July 2000. From 1997 to 1998, Mr. Christ served as President, Chief Executive Officer and a director of Symbios, Inc. (acquired by LSI Logic in 1998), a designer, manufacturer and provider of storage systems, as well as client-server integrated circuits, cell-based applications-specific integrated circuits and host adapter boards. He was Vice President and General Manager of the Components Division of Digital Equipment Corp. (DEC), where he launched and managed StorageWorks, DEC s storage division. Mr. Christ received an M.B.A. degree from Harvard Business School, and completed his undergraduate degree earning a Bachelor in Industrial Engineering at General Motors Institute, now known as Kettering University. The Nominating and Corporate Governance Committee believes that Mr. Christ s storage technology experience, including his prior executive level leadership and Chief Executive Officer experience, give him the operational expertise, breadth of knowledge and valuable understanding of our industry which qualify him to serve as a director and to lead the Board of Directors as Chairman.

Named Executive Officers and Key Employees

The following is biographical information as of February 1, 2011 for our executive officers and key employees not discussed above.

Name	Age	Position	Officer or Key Employee Since
Hanif I. Jamal(1)	50	Senior Vice President, Chief Financial Officer, Treasurer and Corporate Secretary	July 2006
James Kuenzel(2)	57	Senior Vice President of Engineering	February 2006
Ernest Hafersat(2)	61	Senior Vice President of Worldwide Manufacturing, Operations and Supply Base Management	March 2008

(1) Named executive officer.

(2) Key employees.

All officers are elected by our Board of Directors and serve at the pleasure of our Board of Directors as provided in our bylaws.

Hanif I. Jamal has served as our Senior Vice President, Chief Financial Officer, Treasurer and Corporate Secretary since July 2006. Prior to joining Dot Hill, Mr. Jamal served as Vice President and Corporate Treasurer for Gateway Inc., a provider of computer related products and services, from 2004 to 2006. Prior to joining

Gateway in 2002, Mr. Jamal served in a number of leadership positions over 17 years with Hewlett-Packard Company in their customer financing division, HP Technology Finance. Mr. Jamal led HP s customer financing operations in North America, Latin America and Europe and was also Vice President and General Manager for HP s Commercial and Consumer Financing Division. In 1998, he established Hewlett-Packard International Bank in Dublin, Ireland, and served as Managing Director through 2000. Jamal holds an MBA from Stanford Graduate School of Business and a Bachelor of Science degree, with Honors, in Management Sciences from the University of Manchester Institute of Science and Technology in the United Kingdom.

James Kuenzel has served as our Senior Vice President of Engineering since February 2006. Mr. Kuenzel joined Dot Hill after leaving Maranti Networks Inc., a provider of storage networking products, where he began his tenure in 2002 as Vice President of Engineering and then was appointed to President and Chief Operating Officer. Mr. Kuenzel has also held Vice President of Engineering positions at McData Corporation, Cabletron Systems, Inc. and Digital Equipment Corporation. Mr. Kuenzel attended Georgetown University Extension, University of Wisconsin Extension, and holds an A.A. in Electronics from Philco Ford Technical Institute.

Ernest Hafersat has served as our Senior Vice President of Worldwide Manufacturing, Operations and Supply Base Management since November 2008 and previously served as our Vice President of Worldwide Manufacturing Operations and Supply Base Management since March 31, 2008. Mr. Hafersat joined Dot Hill after leaving Western Digital Corporation, a designer, manufacturer and provider of storage systems, where he held senior level positions in operations and engineering from 2005 to 2008. Prior to Western Digital, Mr. Hafersat was Vice President, Manufacturing Operations & Program Management for Carrier Access Corp. Previous positions include Vice President, Operations for Vari-l Corp., Vice President and General Manager at Read-Rite Corp., Philippines, Senior Director, Engineering/ NPI at Maxtor Corp. and Director of Engineering at Hyundai Semiconductor-Korea. Mr. Hafersat has overseen operations, supply base management, global supplier quality and engineering for both domestic and international multi-site facilities. His international experience includes China, Pacific Rim countries, Mexico and Costa Rica. Mr. Hafersat has a BSIE/BSEE from Waterbury State Technical University, and attended University of Hartford and Rennsslaer Polytechnic Institute with credits toward an MBA.

INFORMATION REGARDING THE BOARD OF DIRECTORS AND CORPORATE GOVERNANCE

Independence of the Board of Directors

As required under the NASDAQ Stock Market, or NASDAQ, listing standards, a majority of the members of a listed company s Board of Directors must qualify as independent, as affirmatively determined by the Board of Directors. The Board consults with the Company s counsel to ensure that the Board s determinations are consistent with relevant securities and other laws and regulations regarding the definition of independent, including those set forth in pertinent listing standards of the NASDAQ, as in effect from time to time.

Consistent with these considerations, after review of all relevant identified transactions or relationships between each director, or any of his family members, and the Company, its senior management and its independent auditors, the Board has affirmatively determined that our directors are independent directors within the meaning of the applicable NASDAQ listing standards, except for Mr. Kammersgard, our President and Chief Executive Officer, who is not an independent director by virtue of his employment with the Company. In making this determination, the Board found that none of the directors or the nominees for director, with the exception of Mr. Kammersgard, had a material or other disqualifying relationship with the Company.

Board Leadership Structure

Our Board of Directors has an independent chair, Mr. Christ, who has authority, among other things, to call and preside over Board meetings, including meetings of the independent directors, to set meeting agendas and to determine materials to be distributed to the Board. Accordingly, the Board Chair has substantial ability to shape

the work of the Board. The Company believes that separation of the positions of Board Chair and Chief Executive Officer reinforces the independence of the Board in its oversight of the business and affairs of the Company. However, the Board reserves the right to modify this policy based on changes in our organization or business environment. The Board believes continued flexibility with respect to separating or combining the roles is the best approach at this time so as to provide the most appropriate leadership structure as we continue to undergo rapid growth and are required to adapt and respond to new challenges and a rapidly changing business and regulatory environment.

In addition, the Company believes that having an independent Board Chair creates an environment that is more conducive to objective evaluation and oversight of management s performance, increasing management accountability and improving the ability of the Board to monitor whether management s actions are in the best interests of the Company and its stockholders. The Chairman of the Board also communicates with the Chief Executive Officer on a regular basis. This structure ensures a greater role of oversight for the independent directors with the Chairman of the Board serving as a key interface between the independent directors and our management. As a result, the Company believes that having an independent Board Chair can enhance the effectiveness of the Board as a whole.

Role of the Board in Risk Oversight

One of the board s key functions is informed oversight of the Company s risk management process. The Board does not have a standing risk management committee, but rather administers this oversight function directly through the Board as a whole, as well as through various Board standing committees that address risks inherent in their respective areas of oversight. In particular, our Board is responsible for monitoring and assessing strategic and operational risk exposure, our Audit Committee has the responsibility to consider and discuss our major financial risk exposures and the steps our management has taken to monitor and control these exposures, including guidelines and policies to govern the process by which risk assessment and management is undertaken. Our Nominating and Corporate Governance Committee monitors the effectiveness of our corporate governance guidelines and the selection of prospective Board members and their qualifications. Our Compensation Committee, in conjunction with the Audit Committee, assesses and monitors whether any of our compensation policies and programs has the potential to encourage excessive risk-taking. The board reviews typically on a quarterly basis, the most critical risks facing the company and associated mitigation plans and meets with management and the applicable Board committees at least annually to evaluate and monitor respective areas of oversight. The board also reviews at least annually a succession plan for the companies named executive officers. Both the Board as a whole and the various standing committees receive periodic reports from individuals responsible for risk management, as well as incidental reports as matters may arise. It is the responsibility of the committee chairs to report findings regarding material risk exposures to the Board as quickly as possible.

Meetings of the Board of Directors and Board and Committee Member Attendance

The Board of Directors met eight times during fiscal 2010. Each Board member attended 75% or more of the aggregate number of meetings of the Board and of the committees on which he served and held during the portion of fiscal 2010 for which he was a director or committee member.

As required under applicable NASDAQ listing standards, in fiscal 2010, the Company s independent directors met in regularly scheduled executive sessions at which only independent directors were present. All of the committees of our Board of Directors are comprised entirely of directors determined by the Board to be independent within the meaning of the applicable NASDAQ listing standards.

Information Regarding Committees of the Board of Directors

The Board has three regularly standing committees: an Audit Committee, a Compensation Committee and a Nominating and Corporate Governance Committee. The following table provides current membership and meeting information for fiscal 2010 for each of the Board committees:

Name	Audit	Compensation	Nominating and Corporate Governance
Charles Christ	X	X	(*)
Thomas H. Marmen		(*)	
Richard Mejia Jr.	X		X
Roderick M Sherwood, III	(*)	X	X
Total meetings in fiscal 2010	5	7	5

(*) Committee Chairperson

Below is a description of each committee of the Board of Directors. The Board of Directors has determined that each member of each committee meets the applicable NASDAQ rules and regulations regarding independence and that each member is free of any relationship that would impair his individual exercise of independent judgment with regard to the Company.

Audit Committee

The Audit Committee operates pursuant to a written charter that is available on our website at *http://www.dothill.com*. The Audit Committee met five times during the fiscal year ended December 31, 2010. During fiscal 2010, the Audit Committee consisted of Joe Markee and Messrs. Mejia and Sherwood and Kimberly Alexy, with Mr. Sherwood serving as Chair. Ms. Alexy and Mr. Markee ceased serving as directors and members of the Audit Committee after the 2010 Annual Meeting of Stockholders. Mr. Christ joined the Audit Committee in March 2011.

The functions of the Audit Committee include, among other things: overseeing our corporate accounting and financial reporting process, the quality and integrity of our financial statements and reports and the qualifications, independence and performance of the registered public accountants engaged as our independent auditors; providing oversight assistance with respect to ethical compliance programs as established by management and our Board of Directors; evaluating the performance of our independent auditors; determining whether to retain or terminate our existing independent auditors or to appoint and engage new independent auditors; reviewing and approving the retention of our independent auditors to perform any proposed permissible non-audit and audit-related services; monitoring the rotation of partners of our independent auditors on our engagement team as required by law; reviewing and approving the financial statements to be included in our Annual Report on Form 10-K; discussing with our management and our independent auditors the results of our annual audit and the results of our quarterly financial statements; reviewing and approving related party transactions; and providing oversight of the internal audit and risk advisory function, establishing an internal audit plan, and reviewing the results of our internal audits, process improvements and Sarbanes-Oxley testing of our internal controls. The committee reviews and monitors risks facing Dot Hill and management s approach to addressing these risks, including significant financial and liquidity risks and exposures and risks relating to litigation and other proceedings and regulatory matters that may have a significant impact on Dot Hill s financial statements. The committee reviews all significant financial press releases and management s earnings calls scripts to ensure that management is presenting a balanced perspective of the Company s historical and potential future performance. The charter of the Audit Committee grants the Audit Committee full access to all of our books, records, facilities and personnel, as well as authority to obtain, at our expense, advice and assistance from internal and external legal, accounting, tax or other advisors and consultants and other external resources that the Audit Committee considers necessary or appropriate in the performance of its duties.

The Board of Directors reviews the NASDAQ listing standards definition of independence for Audit Committee members on an annual basis and has determined that all members of the Company s Audit Committee are independent (meeting the requirements for independence currently set forth in Rule 5605(c)(2)(A)(i) of the NASDAQ Marketplace Rules). The Board of Directors has also determined that each of Messrs. Mejia and Sherwood qualifies as an audit committee financial expert, as defined in applicable Securities and Exchange Commission, or SEC, rules. The Board made a qualitative assessment of Messrs. Mejia s and Sherwood s level of knowledge and experience based on a number of factors, including their formal education and experience in financial investment firms, as a partner at Ernst & Young LLP and as a Chief Financial Officer for public reporting companies, respectively.

As part of our effort to continually improve the Company s risk management and internal processes and controls, with the support of the Audit Committee, management engaged KPMG Advisory Services, or KPMG, in 2008 to assist us with establishing an internal risk advisory function. The risk advisory group was tasked for 2010, to assist the Company with Sarbanes-Oxley Section 404 assistance. KPMG s appointment in 2008 was a proactive step that we took to create an internal risk advisory function, consolidate our Sarbanes-Oxley testing activities and enable us to better coordinate Sarbanes-Oxley testing with our external auditors.

Report of the Audit Committee of the Board of Directors

The material in this report is not soliciting material, is not deemed filed with the SEC and is not to be incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

The purpose of the Audit Committee is to assist the Board in its general oversight of our financial reporting, internal controls and audit functions. The Audit Committee charter describes in greater detail the full responsibilities of the Audit Committee. During 2010, the members of the Audit Committee were Messrs. Markee, Mejia, and Sherwood and Ms. Alexy. Ms. Alexy and Mr. Markee ceased serving as directors and members of the Audit Committee after the 2010 Annual Meeting of Stockholders. Mr. Christ joined the Audit Committee in March 2011.

The Board has determined that all members of the Audit Committee are independent (meeting the requirements for independence currently set forth in Rule 5605(c)(2)(A)(i) of the NASDAQ Marketplace Rules).

Management is responsible for the financial statements and reporting process, including the system of internal controls. Our independent auditors are responsible for performing an audit of our financial statements and expressing an opinion as to their conformity with generally accepted accounting principles. The Audit Committee oversees and reviews these processes and has reviewed and discussed the financial statements with management and our independent auditors. The Audit Committee is not, however, employed by Dot Hill, nor does it provide any expert assurance or professional certification regarding our financial statements. The Audit Committee relies, without independent verification, on the accuracy and integrity of the information provided, and representations made, by management.

In discharging its oversight responsibility as to the audit process, the Audit Committee obtained from the independent accountants a formal written statement describing all relationships between the accountants and us that might bear on the accountants independence consistent with applicable requirements of the Public Company Accounting Oversight Board, or PCAOB, regarding the independent accountants communications with the Audit Committee concerning independence. The Audit Committee discussed with the independent accountants any relationships that may impact their objectivity and independence, including fees paid relating to the audit and any non-audit services performed, and satisfied itself as to that firm s independence.

The Audit Committee discussed and reviewed with the independent accountants all communications required by generally accepted accounting standards, including those described in Statement on Auditing Standards No. 61, as amended (AICPA, *Professional Standards,* Vol. 1. AU section 380), as adopted by the

PCAOB in Rule 3200T. In addition, the Audit Committee, with and without management present, discussed and reviewed the scope, plan and results of the independent accountants examination of the financial statements. Based upon the Audit Committee s discussion with management and the independent accountants and the Audit Committee s review of the representation of management and the report of the independent accountants to the Audit Committee, subject to the limitations on the role and responsibility of the Audit Committee referred to in the written charter of the Audit Committee, the Audit Committee recommended to the Board that the audited financial statements be included in our Annual Report on Form 10-K for the year ended December 31, 2010 for filing with the SEC. The Audit Committee also approved the selection, subject to stockholder ratification, of the independent accountants and the Board concurred in such authorization.

Audit Committee

Roderick M. Sherwood, III, *Chairman*

Richard Mejia, Jr.

Charles Christ

Compensation Committee

The Compensation Committee operates pursuant to a written charter that is available on our website at *http://www.dothill.com*. The Compensation Committee met seven times and acted by written consent two times during the fiscal year ended December 31, 2010. During 2010, the members of the Compensation Committee were Ms. Alexy and Messrs. Christ, Markee, Marmen and Sherwood. Ms. Alexy served as Chair until she ceased serving as a director after the 2010 Annual Meeting of Stockholders, at which time Mr. Marmen began serving as Chair. Mr. Markee ceased serving as a director and a member of the Compensation Committee after the 2010 Annual Meeting of Stockholders, at which time Messrs. Christ and Sherwood joined the Compensation Committee. The functions of the Compensation Committee include, among other things: reviewing and approving our overall compensation strategy and policies; reviewing and approving corporate performance goals and objectives relevant to the compensation of our named executive officers; reviewing and approving the compensation and other terms of employment of our named executive officers; recommending the compensation of our non-employee directors; and administering our stock option and purchase plans, deferred compensation plans and other similar programs. The Compensation Committee also reviews and composes with management our Compensation Discussion and Analysis.

At minimum, the Compensation Committee meets once each quarter and with greater frequency as necessary. The agenda for each meeting is usually developed by the Chair of the Compensation Committee, in consultation with the Chief Executive Officer and the Chief Financial Officer. The Compensation Committee meets regularly in executive session. However, from time to time, various members of management and other employees as well as outside advisors or consultants may be invited by the Compensation Committee to make presentations, provide financial or other background information or advice or otherwise participate in Compensation Committee meetings. The Chief Executive Officer and the Chief Financial Officer may not participate in or be present during any deliberations or determinations of the Compensation Committee regarding their compensation or individual performance objectives. The charter of the Compensation Committee grants the Compensation Committee full access to all of our books, records, facilities and personnel, as well as authority to obtain, at our expense, advice and assistance from internal and external legal, accounting or other advisors and consultants and other external resources that the Compensation Committee considers necessary or appropriate in the performance of its duties. In particular, the Compensation Committee has the sole authority to retain compensation consultants to assist in its evaluation of executive and director compensation, including the authority to approve the consultant s reasonable fees and other retention terms.

During fiscal 2010, the Compensation Committee engaged Consult RJ as compensation consultants to review the compensation data for Chief Executive Officers and Chief Financial Officers of the following peer companies in the hardware industry: Adaptec Inc., Brocade Communications Systems, Inc., Emulex Corporation,

QLogic Corporation, Quantum Corporation, LSI Corporation, Compellent Technologies Inc., 3PAR Inc., Super Micro Computer Inc., Epicor Software Corporation, Rackable Systems Inc. (formerly Silicon Graphics Inc.) and Overland Storage Inc. In addition the compensation committee and RJ Consult reviewed compensation data from the Radford s Global Technology Survey for the following categories: Survey Totals Revenues of $200 million to $499.9 million, Semiconductors Revenues of $200 million to $1.0 billion, Software Revenues of $200 million to $1.0 billion, Northern California Revenues of $200 million to $1.0 billion, Total US except Northern California Revenues of $200 million to $1.0 billion and the average of these five indices.

We have adopted a stock option and grant policy pursuant to which the Compensation Committee approves all stock option grants to employees and officers to purchase shares of Dot Hill s common stock. Pursuant to the policy, the Compensation Committee generally will meet once a quarter prior to general public release of Dot Hill s annual or quarterly revenues and earnings for such period to approve recommended stock option grants. The effective date for the approved stock options will be the third business day after the general public release of Dot Hill s annual or quarterly revenues and earnings, as applicable, following the applicable Compensation Committee meeting. The Compensation Committee may vary this procedure if it determines those applicable circumstances, such as public disclosure requirements or other factors, justify doing so. The exercise price for the stock option grants will be set at the fair market value of our common stock on the effective date of grant. Under our current equity incentive plan, the fair market value of our common stock on a given date is deemed to be equal to the closing sales price for such stock as reported on the NASDAQ Stock Market on the last market trading day prior to such date.

Under the 2009 Plan, the fair market value of our common stock on a given date is deemed to be equal to the closing sales price for such stock as reported on the NASDAQ Stock Market on such date, or if such date is not a trading day, the last market trading day prior to such date. All stock option grants to directors under the Directors Plan are made automatically in accordance with the terms of the Directors Plan. In addition, the Compensation Committee approves all restricted stock awards to employees, officers and directors, which are generally approved at times consistent with our stock option grant policy, provided, however, that restricted stock awards are generally effective on the date of approval by the Compensation Committee.

Historically, the Compensation Committee has made adjustments to annual compensation, determined bonus and equity awards and established new performance objectives at one or more meetings held during the fourth fiscal quarter of the prior year and the first quarter of the current year. In establishing the compensation plans for the named executive officers and their performance objectives, the Compensation Committee evaluates how these plans may incent risk taking by management. Accordingly, most of the incentive based compensation for our named executive officers is based on the financial plan for the Company for the applicable fiscal year. The plan is targeted towards incentivizing management to appropriately balance short-term and long-term objectives, but not to encourage management to take unnecessary risk in achieving their objectives. However, the Compensation Committee also considers matters related to individual compensation, such as compensation for new executive hires and promotions, as well as high-level strategic issues, such as the efficacy of our compensation strategy, potential modifications to that strategy and new trends, plans or approaches to compensation, at various meetings throughout the year. Generally, the Compensation Committee s process comprises two related elements: the determination of compensation levels through the use of peer and industry benchmarking data as guidelines and the establishment of performance objectives for the current year. For named executives other than the Chief Executive Officer, the Compensation Committee solicits and considers evaluations and recommendations submitted to the Compensation Committee by the Chief Executive Officer. In the case of the Chief Executive Officer, the Compensation Committee considers the achievement of specific performance objectives, review of peer and industry benchmarking data and performance evaluations to determine any adjustments to compensation as well as awards to be granted. In February 2011, the board solicited feedback from all board members on the Chief Executive Officer s performance through a standardized questionnaire. For all executives and directors, as part of its deliberations, the Compensation Committee may review and consider, as appropriate, materials such as financial reports and projections, operational data, tax and accounting information, spreadsheets that set forth the total compensation that may become payable to executives

in various hypothetical scenarios, executive and director stock ownership information, company stock performance data, analyses of historical executive compensation levels and current company-wide compensation levels, and recommendations of the Compensation Committee s compensation consultant, including analyses of executive compensation paid at other companies identified by the consultant and in conjunction with the Compensation Committee.

The specific determinations of the Compensation Committee with respect to executive compensation are described in greater detail under the heading Compensation Discussion and Analysis.

Compensation Committee interlocks and Insider Participation

During 2010, the members of the Compensation Committee were Ms. Alexy and Messrs. Christ, Markee, Marmen and Sherwood. Ms. Alexy served as Chair until she ceased serving as a director after the 2010 Annual Meeting of Stockholders, at which time Mr. Marmen began serving as Chair. Mr. Markee ceased serving as a director and a member of the Compensation Committee after the 2010 Annual Meeting of Stockholders, at which time Messrs. Christ and Sherwood joined the Compensation Committee. No member of the Compensation Committee has ever been an officer or employee of ours. None of our executive officers currently serves, or has served during the last completed fiscal year, on the Compensation Committee or board of directors of any other entity that has one or more executive officers serving as a member of our Board of Directors or Compensation Committee.

Compensation Committee Report

The material in this report is not soliciting material, is not deemed filed with the SEC, and is not to be incorporated by reference into any filing of Dot Hill under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

The Compensation Committee has reviewed and discussed with management the Compensation Discussion and Analysis contained in this proxy statement. Based on this review and discussion, the Compensation Committee has recommended to our Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement and incorporated into our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

Compensation Committee

Thomas H. Marmen, *Chairman*

Charles Christ

Roderick M. Sherwood III

Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee operates pursuant to a written charter that is available on our website at *http://www.dothill.com*. The Nominating and Corporate Governance Committee met five times during the fiscal year ended December 31, 2010. During fiscal 2010, the Nominating and Corporate Governance Committee consisted of Messrs. Christ, Mejia and Sherwood and Ms. Alexy, with Mr. Christ serving as Chair. Ms. Alexy ceased serving as a director and a member of the Nominating and Corporate Governance Committee after the 2010 Annual Meeting of Stockholders. The functions of the Nominating and Corporate Governance Committee include, among other things: overseeing all aspects of our corporate governance functions on behalf of the Board, including procedures for compliance with significant applicable legal, ethical and regulatory requirements that affect corporate governance; making recommendations to the Board regarding corporate governance issues; identifying, reviewing and evaluating candidates to serve as our directors, including

candidates submitted by our stockholders; serving as a focal point for communication between such candidates, non-committee directors and our management; recommending candidates to the Board; reviewing and overseeing our management succession planning; and making such other recommendations to the Board regarding affairs relating to our directors as may be needed.

The Nominating and Corporate Governance Committee believes that candidates for director should have certain qualifications, including being able to read and understand basic financial statements and having the highest personal integrity and ethics. The Nominating and Corporate Governance Committee also intends to consider such factors as possessing relevant expertise upon which to be able to offer advice and guidance to management, having sufficient time to devote to our affairs, demonstrated excellence in his or her field, having the ability to exercise sound business judgment and having the commitment to rigorously represent the long-term interests of our stockholders. However, the Nominating and Corporate Governance Committee retains the right to modify these qualifications from time to time.

Candidates for director nominees are reviewed in the context of the current composition of our Board of Directors, our operating requirements and the long-term interests of our stockholders. In conducting this assessment, the Nominating and Corporate Governance Committee considers diversity, relevant business experience, skills and such other factors as it deems appropriate given the current needs of the Board of Directors and Dot Hill, to maintain a balance of knowledge, experience and capability. In the case of incumbent directors whose terms of office are set to expire, the Nominating and Corporate Governance Committee reviews such directors overall service to us during their term, including the number of meetings attended, level of participation, quality of performance and any other relevant considerations.

The Nominating and Corporate Governance Committee seeks nominees with a broad diversity of experience, professions, skills, geographic representation and backgrounds. The Nominating and Corporate Governance Committee also focuses on issues of diversity, such as diversity of gender, race and national origin, and differences in viewpoints. The Nominating and Corporate Governance Committee does not have a formal policy with respect to diversity and does not assign specific weights to particular criteria and no particular criterion is necessarily applicable to all prospective nominees; however, the Board of Directors and the Nominating and Corporate Governance Committee believe that it is essential that the members of the Board of Directors represent diverse viewpoints. In considering candidates for the Board of Directors, the Nominating and Corporate Governance Committee considers the entirety of each candidate s credentials in the context of these standards. With respect to the nomination of continuing directors for re-election, the individual s contributions to the Board of Directors are also considered.

When the Nominating and Corporate Governance Committee reviews a potential new candidate, the Nominating and Corporate Governance Committee looks specifically at the candidate s qualifications in light of the needs of the Board of Directors and the Company at that time, given the then current mix of director attributes.

In the case of new director candidates, the Nominating and Corporate Governance Committee also determines whether the nominee must be independent for NASDAQ purposes, which determination is based upon applicable NASDAQ listing standards, applicable SEC rules and regulations and the advice of counsel, if necessary. The Nominating and Corporate Governance Committee then uses its network of contacts to compile a list of potential candidates, but may also engage, if it deems appropriate, a professional search firm. The Nominating and Corporate Governance Committee conducts any appropriate and necessary inquiries into the backgrounds and qualifications of possible candidates after considering the function and needs of our Board of Directors. The Nominating and Corporate Governance Committee meets to discuss and consider such candidates qualifications and then selects a nominee for recommendation to the Board by majority vote. To date, the Nominating and Corporate Governance Committee has not paid a fee to any third party to assist in the process of identifying or evaluating director candidates.

At this time, the Nominating and Corporate Governance Committee has not adopted a policy to consider director candidates recommended by stockholders, in part because to date, the Nominating and Corporate Governance Committee has not received a director nominee from any stockholder, including any stockholder or stockholders holding more than five percent of our voting stock. The Nominating and Corporate Governance Committee believes that it is in the best position to identify, review, evaluate and select qualified candidates for Board membership, based on the comprehensive criteria for Board membership approved by the Board.

Stockholder Communications With The Board Of Directors

Persons interested in communicating their questions, concerns or issues to our Board of Directors or our independent directors may address correspondence to the Board of Directors, a particular director or to the independent directors generally, in care of Dot Hill Systems Corp. at 1351 South Sunset Street, Longmont, Colorado 80501. If no particular director is named, letters will be forwarded, depending on the subject matter, to the Chairman of the Board or the Chair of the Audit, Compensation, or Nominating and Corporate Governance Committee.

Code of Business Conduct and Ethics

We have adopted a Code of Business Conduct and Ethics that applies to all of our officers, directors and employees. The Code of Business Conduct and Ethics is available on our website at *http://www.dothill.com*. If we make any substantive amendments to the Code of Business Conduct and Ethics or grant any waiver from a provision of the Code of Business Conduct and Ethics to any executive officer or director, we will promptly disclose the nature of the amendment or waiver on our website, as well as via any other means then required by NASDAQ listing standards or applicable law.

Proposal No. 2

Approval of an Amendment to Our 2009 Equity Incentive Plan

Overview

Our Board of Directors is requesting stockholder approval of an amendment (the Amendment) to the Dot Hill Systems Corp. 2009 Equity Incentive Plan to, among other things; add an additional 8,000,000 shares to the number of shares of common stock authorized for issuance under the 2009 Plan.

On March 1, 2011, our Board of Directors unanimously approved the Amendment, subject to stockholder approval. The Board of Directors believes that the 2009 Plan is an integral part of our long-term compensation philosophy and the Amendment is necessary to continue providing the appropriate levels and types of equity compensation for our employees, consultants and directors. We refer to the 2009 Equity Incentive Plan herein as the 2009 Plan. We also maintain the Dot Hill Systems Corp. Amended and Restated 2000 Non-Employee Directors Stock Option Plan (the Director Plan), which we use to grant stock options to our directors.

Why we are asking our stockholders to approve the Amendment

Equity awards have been historically and, we believe, will continue to be an integral component of our overall compensation program for all of our employees, consultants and directors. Approval of the Amendment will allow us to continue to grant stock options and other equity awards at levels our Compensation Committee determines to be appropriate in order to attract new employees, consultants and directors, retain our existing employees, consultants and directors and to provide incentives for such persons to exert maximum efforts for our success and ultimately increase stockholder value. The Amendment allows us to continue to utilize a broad array of equity incentives with flexibility in designing equity incentives, including traditional stock option grants, stock appreciation rights, restricted stock awards, restricted stock unit awards and performance stock awards.

We believe it is critical for our long-term success that the interests of our employees, consultants and directors are tied to our success as owners of our business. The equity incentive programs we have in place have worked to build stockholder value by attracting and retaining extraordinarily talented employees, consultants and directors. We believe we must continue to offer a competitive equity compensation packages in order to attract and motivate the talent necessary for our continued growth and success.

Burn Rate

Over the last three years, we have maintained an average equity award burn rate of 6.36% per year. We calculate our burn rate as shares covered by new equity awards granted during each year as a percentage of the weighted average common shares outstanding during the year. Shares underlying performance-based or market condition-based equity awards are included in our burn rate in the year in which such awards are granted and deplete the share reserve of our equity incentive plans as of the end of such year. As shown in the following chart, in our three-year average burn rate calculation we apply a multiplier of 1.5 to stock awards other than stock options and stock appreciation rights (Full-Value Grants) so the Total Awards Granted is the sum of the number of Option Grants plus 1.5 times the number of Full-Value Grants each year:

Year Ended December 31,	Option Grants	Full-Value Award Grants	Total Awards Granted	Weighted Average Common Shares Outstanding	Burn Rate
2010	1,103,834	2,056,026	4,187,873	53,015,000	7.9%
2009	189,500	1,522,128	2,472,692	47,094,000	5.25%
2008	2,240,000	332,128	2,738,192	46,136,000	5.94%
Three year average burn rate					**6.36%**

Important Aspects of our 2009 Plan Designed to Protect our Stockholders Interests

The 2009 Plan was unanimously adopted by our Board of Directors on April 27, 2009 and approved by our stockholders on June 15, 2009 at our 2009 Annual Meeting. We included certain provisions in the 2009 Plan that were designed to protect our stockholders interests and to reflect corporate governance best practices including:

Flexibility in designing equity compensation scheme. The 2009 Plan allows us to provide a broad array of equity incentives, including traditional stock option grants, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance-based stock awards and performance-based cash awards. By providing this flexibility we can quickly and effectively react to trends in compensation practices and continue to offer competitive compensation arrangements to attract and retain the talent necessary for the success of our business.

Broad-based eligibility for equity awards. We grant equity awards to a significant number of our employees. By doing so, we tie our employees interests with stockholder interests and motivate our employees to act as owners of the business.

Stockholder approval is required for additional shares. The 2009 Plan does not contain an annual evergreen provision. Thus, stockholder approval is required each time we need to increase the share reserve allowing our stockholders the ability to have a say on our equity compensation programs.

Repricing is not allowed. The 2009 Plan prohibits the repricing of outstanding equity awards and the cancelation of any outstanding equity awards that have an exercise price or strike price greater than the current fair market value of our common stock in exchange for cash or other stock awards under the 2009 Plan.

Share counting provisions. The share reserve under the 2009 Plan is reduced one share for each share of common stock issued pursuant to a stock option or stock appreciation right and 1.2 shares (or, 1.5 shares, if this Proposal No. 2 is approved) for each share of common stock issued pursuant to restricted stock, restricted stock units, performance-based stock awards, or other stock awards. This helps to ensure that management and our Compensation Committee are using the share reserve effectively and with regard to the value of each type of equity award.

Seven Year Term. All equity awards granted under the 2009 Plan have a term of no more than seven years, thereby limiting the potential for unproductive overhang.

Submission of 2009 Plan amendments to stockholders. The 2009 Plan requires stockholder approval for material amendments to the 2009 Plan, including as noted above, any increase in the number of shares reserved for issuance under the 2009 Plan.

Reasonable limit on equity awards. The 2009 Plan limits the number of shares of common stock available for equity awards such that no employee may be granted an equity award covering more than to 2,000,000 shares in a calendar year.

General 2009 Plan Information

The 2009 Plan was the successor to and continuation of the Dot Hill Systems Corp. 2000 Amended and Restated Equity Incentive Plan and the Dot Hill Systems Corp. 1995 Incentive Program, as Amended and Restated (the *Prior Plans*). All outstanding stock awards granted under the Prior Plans continue to be subject to the terms and conditions as set forth in the agreements evidencing such stock awards and the terms of the Prior Plans, but no additional awards have been granted since June 15, 2009.

As of March 16, 2011, the total number of shares of our common stock available for issuance under the 2009 Plan is 1,746,907 shares *plus* the number of shares subject to stock awards outstanding under the Prior Plans that terminate prior to exercise and would otherwise be returned to the share reserves under the Prior Plans.

Vote Required and Board Recommendation

The affirmative vote of the holders of a majority of the votes cast in person or by proxy and entitled to vote at our Annual Meeting of Stockholders is required to adopt the amendment to the 2009 Plan. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted toward a quorum, but are not counted for any purpose in determining whether this matter has been approved. The Board of Directors recommends a vote For the amendment to the 2009 Plan.

Description of the 2009 Equity Incentive Plan

The material features of the 2009 Plan, as amended, are outlined below. This summary is qualified in its entirety by reference to the complete text of the 2009 Plan, as amended. Stockholders are urged to read the actual text of the 2009 Plan in its entirety, which is appended to this proxy statement as Appendix A and may be accessed from the SEC s website at www.sec.gov.

Background and Purpose

The 2009 Plan provides for the grant of stock options, restricted stock, restricted stock units, stock appreciation rights, other stock-related awards, and performance awards that may be settled in cash, stock or other property.

The purpose of the 2009 Plan is to provide a means by which employees, directors, and consultants may be given an opportunity to purchase our common stock to assist us in recruiting new employees, consultants and directors, retaining the services of current employees, consultants and directors, and to provide incentives for such persons to exert maximum efforts for our success.

Shares Available for Awards

If this Proposal No. 2 is approved, the total number of shares of our common stock reserved for issuance under the 2009 Plan will be 20,520,535. This share reserve consists of (a) 12,520,535 shares currently reserved for issuance under the 2009 Plan, plus (b) an additional 8,000,000 shares subject to approval of the stockholders at the Annual Meeting. In addition, the share reserve will be increased by the number of shares subject to stock awards outstanding under the Prior Plans that terminate prior to exercise and would otherwise be returned to the share reserves under the Prior Plans.

This aggregate number is referred to as the Share Reserve. The number of shares available for issuance under the 2009 Plan is reduced by (i) one share for each share of common stock issued pursuant to a stock option or stock appreciation right with a strike price of at least 100% of the fair market value of the underlying common stock on the date of grant, and (ii) 1.2 shares for each share of common stock issued pursuant to restricted stock, restricted stock units, performance stock awards, or other stock awards and, if this Proposal No. 2 is approved, after the date of the Annual Meeting, by 1.5 shares for each share of common stock issued pursuant to a restricted stock, restricted stock units, performance stock awards, or other stock awards granted under the 2009 Plan.

As of March 16, 2011, stock options to purchase approximately 6,349,986 shares were outstanding, awards other than stock options and stock appreciation rights covering an aggregate of 1,796,640 shares were outstanding and 523,124 shares were available for future grant under the Director Plan. The weighted average exercise price of all stock options outstanding as of March 16, 2011 was approximately $3.57 and the weighted average remaining term of such stock options was approximately 5.62 years. A total of 56,404,151 shares of our common stock were outstanding as of March 16, 2011.

If a stock award expires or otherwise terminates without having been exercised in full or is settled in cash, such expiration, termination or settlement shall not reduce (or otherwise offset) the number of shares of the common stock that may be issued pursuant to the 2009 Plan. If any shares of common stock issued pursuant to a stock award are forfeited back to us because of the failure to meet a contingency or condition required to vest such shares in the participant, then the shares which are forfeited shall revert to and again become available for issuance under the 2009 Plan. Any shares reacquired by us pursuant to our withholding obligations or as consideration for the exercise of a stock option or stock appreciation right shall not again become available for issuance under the 2009 Plan. In addition, if the exercise price of any award is satisfied by the tender of shares of common stock to us (whether by actual delivery or attestation), the shares tendered will not again be available for issuance under the 2009 Plan.

To the extent there is a share of common stock issued pursuant to a restricted stock award, restricted stock unit award, performance stock award or other stock award and such share of common stock again becomes available for issuance under the 2009 Plan, then the number of shares of common stock available for issuance under the 2009 Plan shall increase by 1.5 shares.

Eligibility

Incentive stock options may be granted under the 2009 Plan only to our employees and employees of our affiliates. Our employees, consultants and directors and employees and consultants of our affiliates are eligible to receive all other types of awards under the 2009 Plan. As of March 16, 2011, approximately 309 employees, directors and consultants were eligible to participate in the 2009 Plan.

Administration

The 2009 Plan is administered by the Board of Directors, which may in turn delegate authority to administer the plan to a committee. The Board of Directors has delegated administration of the 2009 Plan to the Compensation Committee. Subject to the terms of the 2009 Plan, the Compensation Committee determines the recipients, the numbers and types of stock awards to be granted, and the terms and conditions of the stock awards, including the period of their exercisability and vesting. Subject to the limitations set forth below, the Compensation Committee also determines the fair market value applicable to a stock award and the exercise price of stock options and stock appreciation rights granted under the 2009 Plan.

Repricing, Cancellation and Re-Grant of Stock Awards

The 2009 Plan expressly provides that, without the approval of the stockholders within 12 months prior to such event, the Compensation Committee shall not have the authority to reduce the exercise price of any outstanding stock awards under the plan or cancel any outstanding stock awards that have an exercise price or strike price greater than the current fair market value of the common stock in exchange for cash or other stock awards under the 2009 Plan.

Vesting

Stock options granted under the 2009 Plan may become exercisable in cumulative increments, or vest, as determined by our Compensation Committee at the rate specified in the stock option agreement. Shares covered by different stock options granted under the 2009 Plan may be subject to different vesting schedules as our Compensation Committee may determine. The Compensation Committee also has flexibility to provide for accelerated vesting of equity awards in certain events.

Stock Options

Stock options may be granted under the 2009 Plan pursuant to stock option agreements. The 2009 Plan permits the grant of stock options that qualify as incentive stock options, or ISOs, and non-statutory stock

options, or NSOs. Generally, the exercise price for a stock option cannot be less than 100% of the fair market value of the common stock subject to the stock option on the date of grant and, in some cases (see Limitations below) the exercise price for an ISO may not be less than 110% of such fair market value. As of March 16, 2011, the closing price of our common stock as reported on the NASDAQ Stock Market was $2.35 per share.

In general, the term of stock options granted under the 2009 Plan may not exceed seven years. Except as explicitly provided otherwise in an option holder s award agreement, stock options granted under the 2009 Plan generally terminate three months after termination of the participant s service unless (i) termination is due to the participant s disability, in which case the stock option may be exercised (to the extent the stock option was exercisable at the time of the termination of service) at any time within 12 months following termination; (ii) the participant dies before the participant s service has terminated, or within the period (if any) specified in the stock option agreement after termination of service for a reason other than death, in which case the stock option may be exercised (to the extent the stock option was exercisable at the time of the participant s death) within 18 months following the participant s death by the person or persons to whom the rights to such stock option have passed; (iii) the participant is terminated for cause in which case the stock option will cease to be exercisable immediately upon the participant s termination, or (iv) the stock option by its terms specifically provides otherwise. A stock option term may be extended in the event that exercise of the stock option following termination of service is prohibited by applicable securities laws. The amount of time allowable after termination to exercise a stock option may be extended if upon exercise the participant would be in violation of the registration requirements under the Securities Act. In such cases, the applicable period within which a participant may exercise a stock option after termination is extended to the time in which the exercise of the stock option would not be in violation of such laws or policies. In no event may a stock option be exercised after its expiration date.

Acceptable forms of consideration for the purchase of our common stock issued under the 2009 Plan will be determined by the Compensation Committee and may include cash, check, bank draft or money order made payable to us, common stock previously owned by the option holder, payment through a broker assisted exercise or, for NSOs only, a net exercise feature, or other legal consideration approved by the Compensation Committee.

Generally, an option holder may not transfer a stock option other than by will or the laws of descent and distribution or a domestic relations order. However, to the extent permitted under the terms of the applicable stock option agreement, an option holder may designate a beneficiary who may exercise the stock option following the option holder s death.

Limitations

The aggregate fair market value, determined at the time of grant, of shares of our common stock with respect to ISOs that are exercisable for the first time by an option holder during any calendar year under all of our equity compensation plans may not exceed $100,000. The stock options or portions of stock options that exceed this limit are treated as NSOs. No ISO may be granted to any person who, at the time of the grant, owns or is deemed to own stock possessing more than 10% of our total combined voting power or that of any affiliate of ours unless the following conditions are satisfied:

- the stock option exercise price must be at least 110% of the fair market value of the stock subject to the stock option on the date of grant; and
- the term of any ISO award must not exceed five years from the date of grant.

The aggregate maximum number of shares of common stock that may be issued pursuant to the exercise of ISOs shall be the number of shares of common stock in the Share Reserve. In addition, no employee may be granted stock options, stock appreciation rights, or other stock awards under the 2009 Plan covering more than 2,000,000 shares of our common stock in any calendar year.

Restricted Stock Awards

Restricted stock awards may be granted under the 2009 Plan pursuant to restricted stock award agreements. A restricted stock award may be granted in consideration for cash, check, bank draft or money order payable to us, the recipient s past or future services performed for us or an affiliate of ours, or any other form of legal consideration acceptable to the Compensation Committee. Shares of our common stock acquired under a restricted stock award may be subject to forfeiture to us in accordance with a vesting schedule to be determined by the Compensation Committee. Rights to acquire shares of our common stock under a restricted stock award may be transferred only upon such terms and conditions as are set forth in the restricted stock award agreement. Except as otherwise provided in the applicable restricted stock award agreement, restricted stock awards that have not vested will be forfeited upon the participant s termination of continuous service for any reason.

Restricted Stock Unit Awards

Restricted stock unit awards may be granted under the 2009 Plan pursuant to restricted stock unit award agreements. Payment of any purchase price may be made in any legal form acceptable to the Compensation Committee. We will settle a payment due to a recipient of a restricted stock unit award by delivery of shares of our common stock, by cash, by a combination of cash and stock as deemed appropriate by our Compensation Committee, or in any other form of consideration determined by the Compensation Committee and set forth in the restricted stock unit award agreement. Dividend equivalents may be credited in respect of shares of our common stock covered by a restricted stock unit award. Restricted stock unit awards may be subject to vesting in accordance with a vesting schedule to be determined by the Compensation Committee. Except as otherwise provided in the applicable restricted stock unit award agreement, restricted stock units that have not vested will be forfeited upon the participant s termination of continuous service for any reason.

Stock Appreciation Rights

Stock appreciation rights may be granted under the 2009 Plan pursuant to a stock appreciation rights agreement. Each stock appreciation right is denominated in common stock share equivalents. The strike price of each stock appreciation right is determined by the Compensation Committee, and shall in no event be less than 100% of the fair market value of the stock subject to the stock appreciation right at the time of grant. The Compensation Committee may also impose restrictions or conditions upon the vesting of stock appreciation rights that it deems appropriate. Stock appreciation rights may be paid in our common stock, in cash, in any combination of the two, or any other form of legal consideration approved by the Compensation Committee and contained in the stock appreciation rights agreement. Stock Appreciation Rights shall be subject to the same conditions upon termination and restrictions on transfer as stock options under the 2009 Plan.

Performance- Based Awards

The 2009 Plan provides for the grant of two types of performance awards: performance-based stock awards and performance-based cash awards. Performance-based awards may be granted, vest or be exercised based upon the attainment during a certain period of time of certain performance goals. The length of any performance period, the performance goals to be achieved during the performance period, and the measure of whether and to what degree such performance goals have been attained shall be determined by the Compensation Committee. The maximum amount to be granted to any individual in a calendar year attributable to such performance awards may not exceed 2,000,000 shares of our common stock in the case of performance-based stock awards, or $2,000,000 in the case of performance cash awards.

Performance goals under the 2009 Plan are determined by the Board or the Compensation Committee, based on any one or more performance criteria, including but not limited to: (i) earnings (including earnings per share and net earnings); (ii) earnings before interest, taxes and depreciation; (iii) earnings before interest, taxes, depreciation and amortization; (iv) total stockholder return; (v) return on equity or average stockholder s equity;

(vi) return on assets, investment, or capital employed; (vii) stock price; (viii) margin (including gross margin); (ix) income (before or after taxes); (x) operating income; (xi) operating income after taxes; (xii) pre-tax profit; (xiii) operating cash flow; (xiv) sales or revenue targets; (xv) increases in revenue or product revenue; (xvi) expenses and cost reduction goals; (xvii) improvement in or attainment of working capital levels; (xiii) economic value added (or an equivalent metric); (xix) market share; (xx) cash flow; (xxi) cash flow per share; (xxii) share price performance; (xxiii) debt reduction; (xxiv) implementation or completion of projects or processes; (xxv) customer satisfaction; (xxvi) stockholders equity; (xxvii) capital expenditures; (xxiii) debt levels; (xxix) operating profit or net operating profit; (xxx) workforce diversity; (xxxi) growth of net income or operating income; (xxxii) billings; and (xxiii) to the extent that an Award is not intended to comply with Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code), other measures of performance selected by the Board.

The Board is authorized to determine whether, when calculating the attainment of performance goals for a performance period, to exclude one or more of the following: (i) restructuring and/or other nonrecurring or non-cash charges; (ii) exchange rate effects, as applicable, for non-U.S. dollar denominated Performance Goals; (iii) the effects of changes to generally accepted accounting principles; (iv) the effects of any statutory adjustments to corporate tax rates; and (v) the effects of any extraordinary items as determined under generally accepted accounting principles. In addition, the Board retains the discretion to reduce or eliminate the compensation or economic benefit due upon attainment of performance goals and to define the manner of calculating the performance criteria it selects to use for a performance period.

Compensation attributable to performance-based awards under the 2009 Plan will qualify as performance-based compensation, provided that: (i) the award is granted by a compensation committee comprised solely of outside directors, (ii) the award is granted (or exercisable) only upon the achievement of an objective performance goal established in writing by the Compensation Committee while the outcome is substantially uncertain, and (iii) the Compensation Committee certifies in writing prior to the granting, payment or exercisability of the award that the performance goal has been satisfied.

Other Stock Awards

Other forms of stock awards valued in whole or in part with reference to our common stock may be granted either alone or in addition to other stock awards under the 2009 Plan. The Compensation Committee has sole and complete authority to determine the persons to whom and the time or times at which such other stock awards will be granted, the number of shares of our common stock to be granted and all other conditions of such other stock awards. Other forms of stock awards may be subject to vesting in accordance with a vesting schedule to be determined by the Compensation Committee.

Changes to Capital Structure

In the event that there is a specified type of change in our capital structure not involving the receipt of consideration by us, such as a stock split or stock dividend, the Board will appropriately adjust: (i) the class(es) and maximum number of securities subject to the 2009 Plan, (ii) the class(es) and maximum number of securities that may be issued pursuant to the exercise of incentive stock options, (iii) the class(es) and maximum number of securities that may be awarded to any person pursuant to Section 162(m) limits, and (iv) the class(es) and number of securities and price per share of stock subject to outstanding stock awards.

Corporate Transactions

In the event of a corporate transaction, unless otherwise provided in a written agreement between us or any of our affiliates and the holder of the stock award, or expressly provided by the Board or the Compensation Committee at the time of grant of a stock award, in the event of a corporate transaction (as specified in the 2009 Plan and described below), all outstanding stock awards under the 2009 Plan may be assumed, continued or

substituted for by any surviving or acquiring entity (or its parent company). If the surviving or acquiring entity (or its parent company) elects not to assume, continue or substitute for such stock awards, then (i) with respect to any such stock awards that are held by individuals whose continuous service with us or an affiliate has not terminated prior to the effective date of the corporate transaction, the vesting and exercisability provisions of such stock awards will be accelerated in full and such awards will terminate if not exercised prior to the effective date of the corporate transaction, and (ii) with respect to any stock awards that are held by individuals whose continuous service with us or an affiliate of ours has terminated prior to the effective date of the corporate transaction, the vesting and exercisability provisions of such stock awards will not be accelerated and such awards will terminate if not exercised prior to the effective date of the corporate transaction (except that any reacquisition or repurchase rights held by us with respect to such stock awards shall not terminate and may continued to be exercised notwithstanding the corporate transaction). In the event a stock award will terminate if not exercised, the Board or the Compensation Committee may provide, in its sole discretion, that the holder of such stock award may not exercise such stock award but will receive a payment equal to the excess of the value of the property the holder would have received (which may include any unvested portion of the stock award) upon exercise over any exercise price.

For purposes of the 2009 Plan, a corporate transaction will be deemed to occur in the event of the consummation of (i) a sale, lease or other disposition of all or substantially all of our assets, (ii) a sale or other disposition of more than 50% of our outstanding securities; (iii) a merger, consolidation or similar transaction in which we are not the surviving corporation, or (iv) a reverse merger, consolidation or similar transaction in which we are the surviving corporation but shares of our outstanding common stock are converted into other property by virtue of the transaction.

A stock award may be subject to additional acceleration of vesting and exercisability upon or after a change in control (as defined in the 2009 Plan), as provided in the stock award agreement or in any other written agreement between us or any affiliate of ours and the participant, but in the absence of such provision, no acceleration shall occur.

The acceleration of vesting of an award in the event of a corporate transaction or change in control under the 2009 Plan may be viewed as an anti-takeover provision, which may have the effect of discouraging a proposal to acquire or otherwise obtain control of Dot Hill.

Plan Amendments

The Compensation Committee has the authority to amend or terminate the 2009 Plan. However, no amendment or termination of the 2009 Plan will adversely affect any rights under awards already granted to a participant unless agreed to by the affected participant. We will obtain stockholder approval of any amendment to the 2009 Plan as required by applicable law and listing requirements.

Plan Termination

Unless sooner terminated by the Board or the Compensation Committee, the 2009 Plan shall automatically terminate on the day before the tenth anniversary of the date the 2009 Plan is adopted by the Board or approved by our stockholders, whichever is earlier.

U.S. Federal Income Tax Consequences

The information set forth below is a summary only and does not purport to be complete. The information is based upon current federal income tax rules and therefore is subject to change when those rules change. Because the tax consequences to any recipient may depend on his or her particular situation, each recipient should consult the recipient s tax adviser regarding the federal, state, local, and other tax consequences of the grant or exercise of an award or the disposition of stock acquired as a result of an award. The 2009 Plan is not qualified under the

provisions of Section 401(a) of the Code, and is not subject to any of the provisions of the Employee Retirement Income Security Act of 1974. Our ability to realize the benefit of any tax deductions described below depends on our generation of taxable income, as well as the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of our tax reporting obligations.

Non-statutory Stock Options

Generally, there is no taxation upon the grant of a NSO where the stock option is granted with an exercise price equal to the fair market value of the underlying stock on the grant date. On exercise, an option holder will recognize ordinary income equal to the excess, if any, of the fair market value on the date of exercise of the stock over the exercise price. If the option holder is employed by us or one of our affiliates, that income will be subject to withholding taxes. The option holder s tax basis in those shares will be equal to their fair market value on the date of exercise of the stock option, and the option holder s capital gain holding period for those shares will begin on that date.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the option holder.

Incentive Stock Options

The 2009 Plan provides for the grant of stock options that qualify as incentive stock options, as defined in Section 422 of the Code. Under the Code, an option holder generally is not subject to ordinary income tax upon the grant or exercise of an ISO. If the option holder holds a share received on exercise of an ISO for more than two years from the date the stock option was granted and more than one year from the date the stock option was exercised, which is referred to as the required holding period, the difference, if any, between the amount realized on a sale or other taxable disposition of that share and the holder s tax basis in that share will be long-term capital gain or loss.

If, however, an option holder disposes of a share acquired on exercise of an ISO before the end of the required holding period, which is referred to as a disqualifying disposition, the option holder generally will recognize ordinary income in the year of the disqualifying disposition equal to the excess, if any, of the fair market value of the share on the date the ISO was exercised over the exercise price. However, if the sales proceeds are less than the fair market value of the share on the date of exercise of the stock option, the amount of ordinary income recognized by the option holder will not exceed the gain, if any, realized on the sale. If the amount realized on a disqualifying disposition exceeds the fair market value of the share on the date of exercise of the stock option, that excess will be short-term or long-term capital gain, depending on whether the holding period for the share exceeds one year.

For purposes of the alternative minimum tax, the amount by which the fair market value of a share of stock acquired on exercise of an ISO exceeds the exercise price of that stock option generally will be an adjustment included in the option holder s alternative minimum taxable income for the year in which the stock option is exercised. If, however, there is a disqualifying disposition of the share in the year in which the stock option is exercised, there will be no adjustment for alternative minimum tax purposes with respect to that share. In computing alternative minimum taxable income, the tax basis of a share acquired on exercise of an ISO is increased by the amount of the adjustment taken into account with respect to that share for alternative minimum tax purposes in the year the stock option is exercised.

We are not allowed an income tax deduction with respect to the grant or exercise of an ISO or the disposition of a share acquired on exercise of an ISO after the required holding period. If there is a disqualifying disposition of a share, however, we are allowed a deduction in an amount equal to the ordinary income includible in income by the option holder, subject to Section 162(m) of the Code and provided that amount constitutes an ordinary and necessary business expense for us and is reasonable in amount, and either the employee includes that amount in income or we timely satisfy our reporting requirements with respect to that amount.

Restricted Stock Awards

Generally, the recipient of a restricted stock award will recognize ordinary compensation income at the time the stock is received equal to the excess, if any, of the fair market value of the stock received over any amount paid by the recipient in exchange for the stock. If, however, the stock is not vested when it is received (for example, if the employee is required to work for a period of time in order to have the right to sell the stock), the recipient generally will not recognize income until the stock becomes vested, at which time the recipient will recognize ordinary compensation income equal to the excess, if any, of the fair market value of the stock on the date it becomes vested over any amount paid by the recipient in exchange for the stock. A recipient may, however, file an election with the Internal Revenue Service, within 30 days following his or her receipt of the stock award, to recognize ordinary compensation income, as of the date the recipient receives the award, equal to the excess, if any, of the fair market value of the stock on the date the award is granted over any amount paid by the recipient in exchange for the stock.

The recipient s basis for the determination of gain or loss upon the subsequent disposition of shares acquired from stock awards will be the amount paid for such shares plus any ordinary income recognized either when the stock is received or when the stock becomes vested.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock award.

Restricted Stock Unit Awards

Generally, the recipient of a stock unit structured to conform to the requirements of Section 409A of the Code or an exception to Section 409A of the Code will recognize ordinary compensation income at the time the stock is delivered equal to the excess, if any, of the fair market value of the shares of our common stock received over any amount paid by the recipient in exchange for the shares of our common stock. To conform to the requirements of Section 409A of the Code, the shares of our common stock subject to a stock unit award may generally only be delivered upon one of the following events: a fixed calendar date (or dates), separation from service, death, disability or a change in control. If delivery occurs on another date, unless the stock units otherwise comply with or qualify for an exception to the requirements of Section 409A of the Code, in addition to the tax treatment described above, the recipient will owe an additional 20% federal tax and interest on any taxes owed.

The recipient s basis for the determination of gain or loss upon the subsequent disposition of shares acquired from stock units, will be the amount paid for such shares plus any ordinary income recognized when the stock is delivered.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock award.

Stock Appreciation Rights

We may grant under the 2009 Plan stock appreciation rights separate from any other award or in tandem with other awards under the 2009 Plan.

Where the rights are granted with a strike price equal to the fair market value of the underlying stock on the grant date and where the recipient may only receive the appreciation inherent in the stock appreciation rights in shares of our common stock, the recipient will recognize ordinary compensation income equal to the fair market value of the stock received upon such exercise. If the recipient may receive the appreciation inherent in the stock

appreciation rights in cash or other property and the stock appreciation right has been structured to conform to the requirements of Section 409A of the Code, then the cash will be taxable as ordinary compensation income to the recipient at the time that the cash is received.

Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code, and the satisfaction of a tax reporting obligation, we will generally be entitled to a tax deduction equal to the taxable ordinary income realized by the recipient of the stock appreciation right.

Section 162 Limitations

Compensation of persons who are covered employees of Dot Hill is subject to the tax deduction limits of Section 162(m) of the Code. Awards that qualify as performance-based compensation are exempt from Section 162(m), thereby permitting us to claim the full federal tax deduction otherwise allowed for such compensation. The 2009 Plan is intended to enable the Compensation Committee to grant awards, including cash performance-based awards that will be exempt from the deduction limits of Section 162(m).

Under Section 162(m), compensation attributable to stock options and stock appreciation rights will qualify as performance-based compensation if (i) such awards are approved by a compensation committee composed solely of outside directors, (ii) the plan contains a per-employee limitation on the number of shares for which such awards may be granted during a specified period, (iii) the per-employee limitation is approved by the stockholders, and (iv) the exercise or strike price of the award is no less than the fair market value of the stock on the date of grant. Compensation attributable to restricted stock awards, restricted stock unit awards, performance awards and other stock-based awards will qualify as performance-based compensation, provided that (i) the award is approved by a Compensation Committee composed solely of outside directors, (ii) the award is granted, becomes vested or is settled, as applicable, only upon the achievement of an objective performance goal established in writing by the compensation committee while the outcome is substantially uncertain, (iii) a committee of outside directors certifies in writing prior to the granting (or vesting or settlement) of the award that the performance goal has been satisfied, and (iv) prior to the granting (or vesting or settlement) of the award, the stockholders have approved the material terms of the award (including the class of employees eligible for such award, the business criteria on which the performance goal is based, and the maximum amount, or formula used to calculate the maximum amount, payable upon attainment of the performance goal).

Equity Compensation Plan Information

The following table provides certain information as of December 31, 2010, with respect to all of our equity compensation plans in effect on that date.

Plan Category	Number of securities to be issued upon exercise of outstanding stock options, warrants and rights (a)	Weighted-average exercise price of outstanding stock options, warrants and rights (b)	Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders(1)	6,179,547	$ 3.57	5,785,085
Equity compensation plans not approved by security holders(2)			
Total	6,179,547	$ 3.57	5,785,085

(1) Includes the 2000 Plan, the 2009 Plan, the Directors Plan, and the 2000 Amended and Restated Employee Stock Purchase Plan, as amended. 3,209,895 shares under column (c) are attributable to the Amended Purchase Plan.

(2) As of December 31, 2010, we did not have any equity compensation plans that were not approved by our stockholders. All of our equity compensation plans have been approved by our stockholders.

New Plan Benefits

Awards under the 2009 Plan are discretionary, and we have not approved any awards that are conditioned on stockholder approval of the Amendment. Accordingly, we cannot currently determine the benefits or number of shares subject to awards that may be granted in the future to executive officers, directors, and employees under the 2009 Plan, as amended. Information about awards granted under the 2009 Plan to the named executive officers in 2010 is reflected in the Summary Compensation Table included herein.

Required Vote and Recommendation of the Board of Directors

Approval of Proposal No. 2 requires the affirmative vote of a majority of the shares present in person or represented by proxy and entitled to vote at the Annual Meeting. Abstentions will be counted toward the tabulation of votes cast on Proposal No. 2 and will have the same effect as Against votes. Broker non-votes are counted towards a quorum, but will have no effect on the outcome of the vote.

The Board of Directors believes that approval of Proposal No. 2 is in our best interests and the best interests of our stockholders for the reasons stated above.

THE BOARD OF DIRECTORS RECOMMENDS

A VOTE FOR PROPOSAL NO. 2.

Proposal No. 3

Advisory Vote on Executive Compensation

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, and Section 14A of the Exchange Act, the Company s stockholders are now entitled to vote to approve, on an advisory basis, the compensation of the Company s Chief Executive Officer, Chief Financial Officer and its three other most highly compensated executive officers at December 31, 2010 (collectively, the Named Executive Officers) as disclosed in this proxy statement in accordance with SEC rules. This vote is not intended to address any specific item of compensation, but rather the overall compensation of the Company s Named Executive Officers and the philosophy, policies and practices described in this proxy statement.

The compensation of the Company s Named Executive Officers subject to the vote is disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related narrative disclosure contained in this proxy statement. As discussed in those disclosures, the Company believes that its compensation policies and decisions are focused on pay-for-performance principles, are strongly aligned with our stockholders interests and are consistent with current market practices. Compensation of the Company s Named Executive Officers is designed to enable the Company to attract and retain talented and experienced executives to lead the Company successfully in a competitive environment. Please read the Executive Compensation Compensation Discussion and Analysis beginning on page 36 of this proxy statement for additional details about our executive compensation programs, including information about the fiscal year 2010 compensation of our Named Executive Officers.

Accordingly, the Board is asking the stockholders to indicate their support for the compensation of the Company s Named Executive Officers as described in this proxy statement by casting a non-binding advisory vote FOR the following resolution:

RESOLVED, that the compensation paid to the Company s Named Executive Officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.

Because the vote is advisory, it is not binding on the Board of Directors or the Company. Nevertheless, the views expressed by the stockholders, whether through this vote or otherwise, are important to management and the Board and, accordingly, the Board and the Compensation Committee intend to consider the results of this vote in making determinations in the future regarding executive compensation arrangements.

Advisory approval of this proposal requires the vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the annual meeting. Abstentions will be counted toward the tabulation of votes cast on the proposal and will have the same effect as Against votes. Broker non-votes will have no effect and will not be counted towards the vote total.

The Board Of Directors Recommends

A Vote FOR Proposal NO. 3

PROPOSAL NO. 4

ADVISORY VOTE ON THE FREQUENCY OF SOLICITATION OF ADVISORY STOCKHOLDER APPROVAL OF EXECUTIVE COMPENSATION

The Dodd-Frank Act and Section 14A of the Exchange Act also enable the Company s stockholders to indicate their preference regarding how frequently the Company should solicit a non-binding advisory vote on the compensation of the Company s Named Executive Officers as disclosed in the Company s proxy statements. Accordingly, the Company is asking stockholders to indicate whether they would prefer an advisory vote every one year, every two years or every three years. Alternatively, stockholders may abstain from casting a vote. For the reasons described below, the Board recommends that the stockholders select a frequency of three years.

We value the opinion of our stockholders and welcome communication regarding our executive compensation policies and practices. After carefully taking into account various considerations described below, we believe that a triennial vote will provide stockholders with the ability to express their views on our executive compensation policies and practices while providing us with an appropriate amount of time to consult with our stockholders and to consider their input. Our executive compensation program is administered by our Compensation Committee, as described in this proxy statement. Compensation decisions are complex and, with respect to our Named Executive Officers, are disclosed in our proxy statement. We believe that establishing a three-year time frame for holding stockholder advisory votes on executive compensation will both enhance stockholder communication and provide the Company time to consider, engage with and respond to stockholders, in terms of expressed concerns or other feedback. In addition, we also believe that a triennial vote more closely aligns with the multi-year performance cycle that the Company uses to reward long-term performance and is consistent with our long-term business strategy.

Accordingly, the Board is asking stockholders to indicate their preferred voting frequency by voting for one, two or three years, or abstaining from voting on the proposal on the resolution below:

RESOLVED, that the alternative of soliciting advisory stockholder approval of the compensation of the Company s Named Executive Officers once every one, two or three calendar years that receives the highest number of votes from the holders of shares present in person or represented by proxy and entitled to vote at the annual meeting shall be considered the frequency preferred by the stockholders.

While the Board believes that its recommendation is appropriate at this time, the stockholders are not voting to approve or disapprove that recommendation, but are instead asked to indicate their preferences, on an advisory basis, as to whether the non-binding advisory vote on the approval of the Company s executive officer compensation practices should be held every one year, every two years or every three years. The option among those choices that receives the highest number of votes from the holders of shares present in person or represented by proxy and entitled to vote at the annual meeting will be deemed to be the frequency preferred by the stockholders.

The Board and the Compensation Committee value the opinions of the stockholders in this matter and, to the extent there is any significant vote in favor of one frequency over the other options, even if less than a majority, the Board will consider the stockholders concerns and evaluate any appropriate next steps. However, because this vote is advisory and therefore not binding on the Board of Directors or the Company, the Board may decide that it is in the best interests of the stockholders that the Company hold an advisory vote on executive compensation more or less frequently than the option preferred by the stockholders. The vote will not be construed to create or imply any change or addition to the fiduciary duties of the Company or the Board.

THE BOARD OF DIRECTORS RECOMMENDS

A VOTE IN FAVOR OF THREE YEARS ON PROPOSAL NO. 4.

PROPOSAL NO. 5.

RATIFICATION OF SELECTION OF INDEPENDENT AUDITORS

The Audit Committee of the Board of Directors has selected Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2011 and has further directed that management submit the selection of our independent registered public accounting firm for ratification by our stockholders at the annual meeting. Deloitte & Touche LLP has audited the Company s financial statements since 1999. Representatives of Deloitte & Touche LLP are expected to be present at the 2011 Annual Meeting of Stockholders. They will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

Neither the Company s Bylaws nor other governing documents or law require stockholder ratification of the selection of Deloitte & Touche LLP as the Company s independent registered public accounting firm. However, the Audit Committee is submitting the selection of Deloitte & Touche LLP to our stockholders for ratification as a matter of good corporate practice. If our stockholders fail to ratify the selection, the Audit Committee will reconsider whether or not to retain that firm. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of different independent auditors at any time during the year if they determine that such a change would be in the best interests of Dot Hill and our stockholders.

The affirmative vote of the holders of a majority of the shares present in person or represented by proxy entitled to vote at the annual meeting will be required to ratify the selection of Deloitte & Touche LLP. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum, but are not counted for any purpose in determining whether this matter has been approved.

Principal Accountant Fees and Services

In connection with the audit of the 2010 financial statements, and the review of the 2010 quarterly financial statements, the Company entered into an engagement agreement with Deloitte & Touche LLP which sets forth the terms by which Deloitte & Touche LLP will perform audit services for the Company. That agreement is subject to alternative dispute resolution procedures and an exclusion of punitive damages. The following table represents aggregate fees billed to the Company for the fiscal years ended December 31, 2010 and 2009 by Deloitte & Touche LLP, the Company s principal accountant, and its affiliates.

	Fiscal Year Ended December 31,	
	2010	**2009**
Audit Fees(1)	$ 724,111	$ 955,700
Audit-related Fees		
Tax Fees(2)	98,115	197,900
All Other Fees(3)	2,200	2,400
Total Fees	$ 824,426	$ 1,156,000

(1) Represents fees for services rendered for the audit and/or reviews of our financial statements. Also includes fees for services associated with SEC registration statements, periodic reports and other documents filed with the SEC or other documents issued in connection with securities offerings (e.g., consents), assistance in responding to SEC comment letters and audit services provided in connection with other statutory or regulatory filings.

(2) Represents fees for professional services rendered for tax compliance, tax advice and tax planning. The nature of these services was to prepare state and federal income tax returns and extensions for returns, to respond to requests related to various state and city audits and tax-related notices, to investigate various options related to international tax planning strategies, and to assist in determining appropriate structures for foreign branches and subsidiaries.

(3) Represents fees for a subscription to Deloitte & Touche LLP s accounting research tool during the fiscal years ended December 31, 2010 and 2009.

All fees described above were approved by the Audit Committee.

During the fiscal year ended December 31, 2010, none of the total hours expended on our financial audit by Deloitte & Touche LLP were provided by persons other than Deloitte & Touche LLP s full-time permanent employees.

Pre-Approval Policies and Procedures

The Audit Committee has adopted policies and procedures for the pre-approval of audit and non-audit services rendered by our independent auditor, Deloitte & Touche LLP. The Audit Committee s approval of the scope and fees of the engagement of the independent auditor is given on an individual explicit case-by-case basis before the independent auditor is engaged to provide each service. The pre-approval of services may be delegated to one or more of the Audit Committee s members, but the decision must be reported to the full Audit Committee at its next scheduled meeting.

The Audit Committee has determined that the rendering of the services other than audit services by Deloitte & Touche LLP is compatible with maintaining Deloitte & Touche LLP s independence.

The Board Of Directors Recommends A Vote For the Ratification of the Selection of Deloitte & Touche LLP as our Independent Auditors for the Fiscal Year Ending December 31, 2011.

Security Ownership of Certain Beneficial Owners and Management

The following table provides information regarding the beneficial ownership of our common stock as of February 1, 2011 by: (i) each of our directors and nominees, (ii) each of our Named Executive Officers, (iii) all of our directors, nominees and executive officers as a group and (iv) each person, or group of affiliated persons, known by us to beneficially own more than 5% of our common stock. The table is based upon information supplied by our officers, directors and principal stockholders and a review of Schedules 13D and 13G, if any, filed with the SEC. Unless otherwise indicated in the footnotes to the table and subject to community property laws where applicable, we believe that each of the stockholders named in the table has sole voting and investment power with respect to the shares indicated as beneficially owned.

Applicable percentages are based on 56,326,482 shares outstanding on February 1, 2011, adjusted as required by rules promulgated by the SEC. These rules generally attribute beneficial ownership of securities to persons who possess sole or shared voting power or investment power with respect to those securities. In addition, the rules include shares of common stock issuable pursuant to the exercise of stock options or warrants that are either immediately exercisable or exercisable on April 2, 2011, which is 60 days after February 1, 2011. These shares are deemed to be outstanding and beneficially owned by the person holding those options or warrants for the purpose of computing the percentage ownership of that person, but they are not treated as outstanding for the purpose of computing the percentage ownership of any other person. Certain of the options in this table are exercisable at any time but, if exercised, are subject to a lapsing right of repurchase until the options are fully vested.

	Beneficial Ownership(1)	
Beneficial Owner(1)	**Number of Shares**	**Percent of Total**
Goldman Capital Management, Inc. 767 Third Avenue, 25th Fl New York, NY 10017	6,087,965	10.81%
Royce & Associates, LLC 745 Fifth Avenue New York, NY 10151	3,016,832	5.36%
Dana Kammersgard(2)	1,526,575	2.66%
Hanif I. Jamal(3)	557,586	*
Charles Christ(4)	423,561	*
Richard Mejia, Jr.(5)	80,000	*
Roderick Sherwood, III(6)	120,000	*
Thomas H. Marmen(7)	80,000	*
All directors, nominees and executive officers as a group (six persons)(8)	2,787,722	4.94%

* Less than one percent.

(1) Except as otherwise noted above, the address for each person or entity listed in the table is c/o Dot Hill Systems Corp., 1351 South Sunset Street, Longmont, Colorado 80501.

(2) Includes 218 shares held by Lisa Kammersgard, the spouse of Mr. Kammersgard, as to which shares Mr. Kammersgard disclaims beneficial ownership, 75,000 shares of performance-based restricted stock and options to purchase 1,040,936 shares exercisable within 60 days of February 1, 2011.

(3) Includes 58,333 shares of performance-based restricted stock and options to purchase 452,603 shares exercisable within 60 days of February 1, 2011.

(4) Includes options to purchase 218,000 shares exercisable within 60 days of February 1, 2011.

(5) Includes options to purchase 70,000 shares exercisable within 60 days of February 1, 2011 (20,833 of which are unvested).

(6) Includes options to purchase 110,000 shares exercisable within 60 days of February 1, 2011.

(7) Includes options to purchase 70,000 shares exercisable within 60 days of February 1, 2011 (22,917 of which are unvested).

(8) Includes options to purchase 1,961,539 shares exercisable within 60 days of February 1, 2011 (43,750 of which are unvested).

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors and executive officers, and persons who own more than 10% of a registered class of our equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock and other equity securities. Officers, directors and greater than 10% stockholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file.

To our knowledge, based solely on a review of the copies of such reports furnished to us and written representations that no other reports were required, during the fiscal year ended December 31, 2010, all Section 16(a) filing requirements applicable to our officers, directors and greater than 10% beneficial owners were complied with.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

The following Compensation Discussion and Analysis describes the material elements of compensation for our Named Executive Officers for 2010 Dana W. Kammersgard, President and Chief Executive Officer and Hanif I. Jamal, Senior Vice President, Chief Financial Officer, Treasurer, and Corporate Secretary. Our Compensation Committee is primarily responsible for decisions regarding compensation of our Named Executive Officers.

Executive Summary

Our goal is to provide a competitive total compensation package with significant emphasis on pay-for-performance. Accordingly, a significant portion of our executive officers compensation is contingent on the Company s performance in order to drive accomplishments that enhance stockholder value and align the interests of our executives and our stockholders. This means that our executives will not realize the total potential value of their compensation package unless performance goals, the significant majority of which are directly tied to Company performance, are achieved. The Company remains committed to this philosophy of paying for performance, recognizing that the competitive market for talented executives and the volatility of its business may result in highly variable compensation in any particular time period. The Compensation Committee gives careful consideration to the Company s executive compensation program, including each element of compensation for each executive officer. The Compensation Committee believes our executive compensation program is reasonable in light of the programs of our peer group companies and the Company s current financial position. The Compensation Committee believes that the programs used by our peer group companies should serve as a guide, but should not necessarily be the exact program that is used to compensate our Named Executive Officers. Our Compensation Committee also believes that our compensation program gives the executive officers appropriate incentives, based on each officer s responsibilities, achievements and ability to contribute to the Company s performance. We also believe that our executive officers and senior management make significant contributions toward creating stockholder value. Finally, we believe that the Company s compensation structure and practices encourages management to work for real innovation, business improvements and outstanding stockholder returns, without taking unnecessary or excessive risks.

2010 Compensation Program Highlights:

A significant portion of our executive officers compensation is contingent on the Company s performance. We granted restricted stock to our Named Executive Officers which vests based on the achievement of specified corporate objectives. We also granted stock options and time-based restricted stock awards. The economic benefit of these awards is directly linked with the performance of the Company and increasing stockholder value.

In connection with expense reduction measures, we reduced base salaries during 2010 and we eliminated the annual cash bonus program and previously approved stretch cash bonus pool for our Named Executive Officers. The Compensation Committee recognizes that based on the peer group benchmarks and guidelines, total expected cash compensation (base salary plus bonus) for 2010 for our Named Executive Officers is below the 25th percentile of these established benchmark guidelines. Based on our financial condition and operating results and the individual performances of our Named Executive Officers, we intend to restore this compensation gradually to reach our target philosophy to compensate them around the 50th percentile of these benchmarks.

In line with our pay-for-performance philosophy, we offer reasonable employment agreements that do not contain multi-year guarantees for salary increases or non-performance-based guaranteed bonuses.

Each of the Named Executive Officers is employed at will and is expected to demonstrate exceptional performance in order to continue serving as a member of the executive team.

We grant stock options and restricted stock under our 2009 Plan. The 2009 Plan prohibits the re-pricing, exchange or cashing out of stock awards, including stock options, without stockholder approval within 12 months prior to such re-pricing. We did not re-price any stock options in 2010, despite the fact that our executives hold stock options which are underwater. This reflects our commitment to our pay-for-performance philosophy.

We do not provide excessive severance or change of control arrangements which provide for cash payments exceeding three times an executive s base salary and bonus. Our change of control arrangements with our Named Executive Officers provide for cash payments of up to a maximum of 1.25 times annual base salary (not including bonus) upon the occurrence of certain change of control events.

We do not provide any tax gross-up benefits for excise taxes associated with change of control compensation.

Our Compensation Committee regularly assesses the Company s individual and total compensation programs against peer companies, the general marketplace and other industry data points and the Compensation Committee utilizes an independent consultant to engage in ongoing independent review of all aspects of our executive compensation programs. These inputs and data serve as guidelines to our Compensation Committee in determining the compensation programs and levels for our Named Executive Officers.

General

Our executive compensation structure is designed to attract, motivate and retain the services of executive management and to align the interests of our executives with those of our stockholders. We aim to provide what we believe is a competitive total compensation package to our executive management team through a combination of base salary, annual performance-based bonus and long-term and performance-based equity incentives. We place significant emphasis on pay-for-performance-based incentive compensation programs. These programs are designed to reward the achievement of corporate and individual goals. This Compensation Discussion and Analysis explains our compensation philosophy, policies and practices with respect to our Named Executive Officers.

Our executive compensation program has been designed by the Compensation Committee of our Board of Directors to:

Attract and retain highly skilled and experienced team members by targeting a compensation structure that is competitive with those offered by other companies with whom we compete for management talent;

Closely align compensation for our executive management team with our short-term and long-term performance;

Build stockholder value by providing incentives based on achievement of corporate goals;

Establish compensation programs that are equitable internally within Dot Hill; and

Provide differentiated compensation based on individual performance.

The Compensation Committee is comprised of independent directors within the meaning of the applicable SEC and NASDAQ rules. The Compensation Committee responsibilities and duties are outlined in detail under the heading Information Regarding the Board of Directors and Corporate Governance Compensation Committee and the Compensation Committee charter, which is available on our website at www.dothill.com. A primary responsibility of the Compensation Committee is to determine compensation for our Named Executive Officers, including reviewing and approving annual corporate and individual goals.

To aid the Compensation Committee in performing its duties, our Chief Executive Officer provides recommendations concerning the compensation of the executive officers, excluding himself. The Compensation Committee deliberates and discusses the performance of the Chief Executive Officer with input from the Board of Directors and is solely responsible for determining the Chief Executive Officer s compensation. Additionally, each executive officer participates in establishing the key policies for Dot Hill as well as the objectives of our company as a whole. Likewise, our executive officers are asked to provide feedback on their own performance. We see this process both as the optimal means of assembling accurate information regarding the expectation and realization of performance, as well as an integral part of our culture of collaborative, team-oriented management.

We evaluate the achievement of our corporate and individual goals on a quarterly basis as well as at the end of the completed fiscal year. At the end of each quarter, we review the progress being made toward achievement of the corporate financial goals as well as each executive s overall ongoing performance, if necessary. At the end of the year, we review final results versus goals and establish performance goals for the next fiscal year.

Competitive Market Review

Our market for experienced management is highly competitive. We aim to attract and retain the most highly qualified executives to manage each of our business functions. In doing so, we attempt to draw upon a pool of talent that is highly sought after by both large and established high tech companies. We believe we have competitive advantages in our ability to offer significant upside potential through long-term and performance-based equity incentives. Nonetheless, we must recognize market cash compensation levels and satisfy the day to day financial requirements of our candidates through competitive base salaries and performance-based bonuses. For 2010, we examined market data from various sources including Radford s Global Technology Survey, proxy data from public competitors which includes storage and network companies, peer company data provided by Consult RJ, as well as information we generated internally as guidelines for establishing a compensation program and levels for our Named Executive Officers.

A comprehensive market review is conducted at least every other year, and in advance of determining compensation levels for key hires and promotions. Our management and Compensation Committee review survey data from these various sources prepared by Radford that analyzes various cross-sections of our industry, as well as relevant geographical areas. Barring extraordinary circumstances, our targeted guideline pay position to the market is around the 50th percentile for all compensation elements. Commencing in January 2011, the Compensation Committee engaged Radford, an Aon Consulting company, to provide an independent review of the peer group and to advise the Compensation Committee on any changes to be aligned with current best practices. Radford was then asked to independently collect and analyze market data to complete an analysis of our programs for the Named Executive Officers.

Role of our Independent Compensation Consultants

During fiscal 2010, the Compensation Committee directly engaged Consult RJ as compensation consultants to review the compensation data, including both cash and equity compensation, for Chief Executive Officers and Chief Financial Officers of the following companies in the hardware industry, with whom the Company competes for executive talent: Adaptec Inc., Brocade Communications Systems, Inc., Emulex Corporation, QLogic Corporation, Quantum Corporation, LSI Corporation, Compellent Technologies Inc., 3PAR Inc., Super Micro Computer Inc., Epicor Software Corporation, Rackable Systems Inc. (formerly Silicon Graphics, Inc.),

Falconstor Software, Inc., Double-Take Software, Inc. and Overland Storage Inc. In addition, the Compensation Committee reviewed compensation data from Radford s Global Technology Survey for the following categories of companies: Survey Totals Revenues of $200 million to $499.9 million, Semiconductors Revenues of $200 million to $1.0 billion, Software Revenues of $200 million to $1.0 billion, Northern California Revenues of $200 million to $1.0 billion, Total US except Northern California Revenues of $200 million to $1.0 billion and the average of these five indices.

As indicated above, in January 2011, the Compensation Committee engaged the services of Radford to conduct a competitive review and analysis of the current compensation arrangements for the Company s Named Executive Officers. The review included assessments of Dot Hill s compensation philosophy and peer group used to conduct compensation benchmarking assessments. In addition, the Compensation Committee asked Radford to perform a detailed examination and competitive assessment based on their recommended peer group for base salary, target total cash, actual total cash, long-term incentives, beneficial ownership, value of current executive holdings, overall equity usage and equity allocation.

In February 2011, Radford presented a recommended list of peer companies that included a broad group of technology companies. After discussion, the Compensation Committee decided that the peer list would include data storage companies, storage and systems management software companies, server and mainframe companies, a storage networking company, network access and communications devices companies, a computer networking company and a routing and switching company. Radford also suggested and the Compensation Committee agreed that these companies should have revenues generally in $100 million to $500 million range with some exceptions, with employee size between 150 and 1,000 with some exceptions to reflect organizational complexity and with market capitalization between $135 million and $500 million with some exceptions. Based on these parameters, the Compensation Committee elected to establish the following list of peer group companies that included: BigBand Networks, Inc., Communications Systems Inc., Digi International Inc., Echelon Corporation, Emulex Corporation., Extreme Networks Inc. Falconstor Inc., NetScout Systems Inc., OPNET Technologies, Quantum Corporation, Radisys Corporation, SeaChange International Inc., Silicon Graphics International Inc. STEC and Super Micro Computer Inc.

The Compensation Committee also elected to continue to target competitive positioning for base salary, target total cash which includes base salary and cash bonus and long-term equity incentives around the 50th percentile of the Company s peer companies for 2011. These companies range from below to above market levels to attract and retain talent based on individual performance, experience and position criticality.

In March 2011, Radford presented their assessment to the Compensation Committee with specific recommendations to the Compensation Committee on where to set salary, incentives and equity grants for the Named Executive Officers for 2011.

Market Benchmarks and Other Considerations

Fiscal 2010

In the fourth quarter of 2009 and the first quarter of 2010, the Compensation Committee reviewed compensation data with Consult RJ for fiscal 2007-2009 for the following companies with whom the Company competes for executive talent: Adaptec Inc., Brocade Communications Systems, Inc., Emulex Corporation, QLogic Corporation, Quantum Corporation, LSI Corporation, Compellent Technologies Inc., 3PAR Inc., Super Micro Computer Inc., Epicor Software Corporation, Silicon Graphics International, Inc. (formerly Rackable Systems Inc.), Falconstor Software, Inc., Double-Take Software, Inc. and Overland Storage Inc. In addition, the Compensation Committee reviewed compensation data from the Radford Global Technology Survey for the following categories of companies: Survey Totals Revenues of $200 million to $499.9 million, Semiconductors Revenues of $200 million to $1.0 billion, Software Revenues of $200 million to $1.0 billion, Northern California Revenues of $200 million to $1.0 billion, Total US except Northern California Revenues

of $200 million to $1.0 billion and the average of these five indices. This competitive group and survey data served as a reference point and guideline for compensation decisions, and along with a number of other factors, including corporate financial performance and individual performance, was used by the Compensation Committee to set executive compensation, particularly with respect to establishing base salaries and maximum payouts on the performance-based cash bonus programs (which were ultimately cancelled). Management also recommended and the Compensation Committee adopted management s recommendation, that it re-instate the performance-based cash bonus program for critical employees including the Named Executive Officers, but suggested that the target payout under this program be a maximum of 50% of the participating employees target cash bonus compensation. As with historical practice, performance-based cash bonuses were tied to both corporate financial performance as well as individual objectives for all employees other than the Chief Executive Officer. The Chief Executive Officer s cash bonus will only be tied to corporate financial performance. The corporate financial performance criteria were mostly based the company s 2010 Annual Operating Plan, which was approved by the Board of Directors.

In addition, management recommended and the Compensation Committee resolved to establish a stretch cash bonus pool of a maximum of $1 million that would only be funded if the Company achieved specific levels of non-GAAP EBITDA that exceeds the 2010 Annual Operating Plan. Any amounts earned from this stretch cash bonus pool would be shared by specified participants on a pro rata basis. The Named Executive Officers are among over 30 employees eligible to a cash distribution from this stretch cash bonus pool. The Chief Executive Officer s and the Chief Financial Officer s estimated share of this stretch bonus pool of a maximum of $1 million would have been 21% and 13% of the pool, respectively, if the plan had not been cancelled and had the company met the performance criteria for establishing the bonus pool.

The Compensation Committee also accepted management s recommendation to continue a practice first established in fiscal 2009 to issue performance-based restricted stock as part of the long-term incentive compensation plan. As such all employees at the Vice President or above level and other key employees in the Company, including the Named Executive Officers, would receive long-term incentive compensation in the form of performance-based restricted stock, as well as stock options. The performance criteria for vesting the restricted stock are based on corporate financial goals for fiscal 2010. The performance-based restricted stock vests in two equal installments over two years based on the achievement of specific corporate objectives, as determined by the Board or the Compensation Committee subsequent to December 31, 2010, but no later than the date that our Annual Report on Form 10-K is filed with the SEC for the year ending December 31, 2010. The stock options vest over four years in accordance with the 2009 Plan. The Compensation Committee elected to accept management s recommendation to issue stock options that vested over four years and to have the performance-based restricted stock vest over two years in order to create balance between short-term and long-term compensation.

In June 2010, management recommended and the Board and Compensation Committee approved expense reductions measures that included a 10% salary reduction for most employees at the Vice-President and above levels including our Named Executive Officers. In addition, most of the other employees were subject to a 5% reduction in base salary. Included in these expense reduction measures was the termination of the performance-based cash bonus program and the stretch cash bonus pool.

Components of Executive Compensation Program

To accomplish our executive compensation program objectives, compensation for our executive officers generally consists of the following components: base salary; annual bonus based on corporate and individual performance; and long-term equity incentives, such as stock options, restricted stock and performance-based restricted stock intended to provide long-term and performance-based incentives tied to corporate financial performance and increases in the value of our common stock and our performance generally. Prior to 2008, the Compensation Committee used stock options as the exclusive means to provide long-term equity incentives. However, in 2008, the Compensation Committee instituted the use of both time-based restricted stock and performance-based restricted stock tied to financial objectives.

In addition to the compensation set forth in our annual compensation programs, our executive officers are also entitled to potential payments upon specified terminations and in connection with a change of control event. Additionally, our executive officers are entitled to other benefits, such as medical insurance and 401(k) matching, that are generally available to our employees, and perquisites that may be available to select Named Executive Officers and key employees as well. Our Named Executive Officers and other key employees do not accrue vacation time. Instead, if they wish to take paid time off they are required to obtain agreement from their immediate supervisor.

Base Salary

Fiscal 2010

The amount of salary paid during 2010 to each of our Named Executive Officers is shown in the Summary Compensation Table below. The initial base salary for each executive officer was established after taking into account the officer s qualifications, experience, prior salary, competitive salary information and internal equity. Each executive officer s salary is reviewed annually by the Compensation Committee. In 2010, base salaries were determined by the Compensation Committee based on an assessment of the executive s performance against job responsibilities, overall company performance and competitive salary information. In assessing competitive salary information, the Compensation Committee reviews and considers peer group information as described above, as a guideline to establishing base salary for each of the Named Executive Officers. Furthermore, when considering annual base salary increases, the Compensation Committee also considers total cash compensation, which is comprised of both base salary and the annual performance-based cash bonus described below.

In January 2010, the Compensation Committee approved the 2010 Executive Compensation Plan, which set forth executive compensation for Messrs. Kammersgard and Jamal. Messrs. Kammersgard and Jamal had not received an increase to their base salary since they assumed their roles within the Company in 2006. The Compensation Committee reviewed benchmark compensation data as described above in relation to each of their contributions to the Company and the performance of the Company in 2009, and, pursuant to the 2010 Executive Compensation Plan, accordingly increased Mr. Kammersgard s base salary to $400,000 from $367,500 and Mr. Jamal s base salary to $310,000 from $270,000. Effective July 1, 2010, Mr. Kammersgard and Mr. Jamal s annual base salary were reduced by 10% to $360,000 and $279,000 respectively as part of the corporate wide expense reduction measures.

Fiscal 2011

In March 2011, the Compensation Committee approved the 2011 Executive Compensation Plan after reviewing the competitive assessment provided by Radford and specific recommendations from Radford with regard to compensation for Messrs. Kammersgard and Jamal. Given the Company s fiscal restraints and desire to return to sustained non-GAAP profitability, the Compensation Committee decided to defer reinstating the 10% base salary reduction that Messrs. Kammersgard and Jamal received effective July 1, 2010. Accordingly, Messrs. Kammersgard and Jamal s base salary levels remain unchanged at $360,000 and $279,000 respectively from their base salaries in effect since July 1, 2010. As a result, Mr. Kammersgard s base salary was below the 25th percentile of the new benchmark of peer companies established in March 2011 by the Compensation Committee with counsel from Radford and Mr. Jamal s annual base salary was between the 25th and 50th percentile of the new benchmark.

Annual Performance-Based Bonus

Annual bonuses may be awarded to our Named Executive Officers in accordance with the executive compensation plan for the applicable year, as established by the Compensation Committee.

Fiscal 2010

In January 2010, the Compensation Committee approved the 2010 Executive Compensation Plan, which re-instated the performance-based cash bonus program for the Named Executive Officers that had been suspended in 2009. The maximum target payout under this program was 50% of each of the Named Executive Officer s target cash bonus. The target cash bonus for Messrs. Kammersgard and Jamal was 80% and 65% of their base salaries and therefore the target cash bonus for 2010 was established as 40% and 32.5% of each of Messrs. Kammersgard and Jamal s base salary, respectively. As with historical practice, performance-based cash bonuses were tied to both corporate financial performance as well as individual objectives for all employees other than the Chief Executive Officer. The Chief Executive Officer s cash bonus was only tied to corporate financial performance. The Chief Financial Officer s cash bonus was tied 80% to corporate financial performance and 20% to achievement of specified goals related to the Company s Sarbanes Oxley compliance for fiscal 2010.

The corporate financial performance criteria were established to be largely consistent with the 2010 Annual Operating Plan. The specified corporate financial targets and weighting is as follows: 25% upon achievement of specified 2010 revenue targets relating to certain business units; 10% upon achievement of a specific 2010 product margin target; 20% upon achievement of a specified 2010 EBITDA target; 25% upon achievement of specified business unit specific EBITDA targets; and 20% upon achievement of a specified target cash balance at December 31, 2010. All of the financial targets are calculated in accordance with our methodologies for financial reporting purposes and, with the exception of cash, exclude the impact of stock-based compensation expense, intangible asset amortization, restructuring and severance charges, contingent consideration adjustments, Cloverleaf acquisition costs and the effects of foreign currency gains or losses and any other non-recurring, one-time charges or adjustments that the Compensation Committee, in its sole discretion, deems appropriate. The achievement of the financial targets and goals shall be determined by our Compensation Committee or our Board of Directors after the completion of fiscal 2010. The achievement of goals related to the Company s Sarbanes Oxley compliance shall be determined by the Audit Committee or the Board of Directors following the completion of our fiscal 2010 audit by our independent registered public accountants.

In addition, management recommended and the Compensation Committee resolved to establish a stretch cash bonus pool of a maximum of $1 million that would only be funded if the Company achieved certain levels of non-GAAP EBITDA that exceeds the 2010 Annual Operating Plan. Any amounts earned from this stretch cash bonus pool would be shared by specified participants on a pro rata basis. The Named Executive Officers were among over 30 employees eligible to a cash distribution from this stretch cash bonus pool. Messrs. Kammersgard and Jamal s estimated share of this stretch bonus pool of a maximum of $1 million would have been 21% and 13% of the pool, respectively.

The financial goals and individual objectives for the 2010 performance-based cash bonus program were established by the Compensation Committee and were weighted based on importance. The financial goals relate to revenue, product margin and EBITDA of our operating segments and cash and cash equivalents and the individual objectives are focused on each executive s respective area of responsibility and designed to support overall corporate goal achievement. These goals were collectively designed to be challenging, and similar goals for the Named Executive Officers were not all met in the three most recent fiscal years (2007, 2008, and 2009) when such plans were in effect.

In June 2010, management recommended and the Compensation Committee resolved to terminate the performance-based cash bonus program and stretch cash bonus pool for all employees including our Named Executive Officers, as a part of our corporate expense reduction measures.

Fiscal 2011

In March 2011, the Compensation Committee approved the 2011 Executive Compensation Plan and established an annual performance-based bonus program. In addition, the Compensation Committee determined

that the payout under such plan for 2011 shall be in the form of the Company s common stock rather than cash, due to the Company s fiscal restraints and desire to return to non-GAAP sustained profitability. The payout under the plan will be determined based upon the achievement of performance goals, with a maximum payout consisting of a number of shares of common stock with a value equal to 85% and 65% of Messrs. Kammersgard and Jamal s base salaries, respectively, as of the date of determination of the level of achievement of the performance goals. The price used to calculate the value of the common stock grants shall be the closing sales price for such stock as reported on the NASDAQ Stock Market on the date of determination of the level of achievement of the performance goals. The Compensation Committee established five equally weighted principal corporate financial goals. These financial goals were derived from the Company s internal operating plan that was approved by the Board in December 2010. The specified financial goals include two targets based on meeting or exceeding revenue targets for certain business lines, two targets based on meeting non-GAAP operating profits for certain business lines and meeting or exceeding a specific cash and cash equivalents goal as of December 31, 2011. All of the financial goals shall be calculated in accordance with our methodologies for financial reporting purposes and, with the exception of cash and cash equivalents, exclude the impact of stock-based compensation expense, intangible asset amortization, restructuring and severance charges, contingent consideration adjustments, Cloverleaf acquisition costs and the effects of foreign currency gains or losses and any other non-recurring, one-time charges or adjustments that the Compensation Committee, in its sole discretion, deems appropriate. Additionally, the Company has established internal methodologies for the allocation of common costs and overhead to the various business lines and the Compensation Committee in its sole discretion may alter these allocation methodologies for the purposes of determining the results for the five specified financial targets that will help determine the size of the common stock grant to awarded to our Named Executive Officers under the Annual Performance-Based Bonus program. Finally, the Compensation Committee will have the discretion to determine whether any of the financial goals are met and as such whether common stock shall be granted for achievement of a goal, notwithstanding the fact that a goal is not met, in extraordinary circumstances.

The Compensation Committee determined that 100% and 80% respectively of Messrs. Kammersgard and Jamal s annual performance-based bonus will tied to achieving the five equally weighted financial goals described above. In addition, 20% of Mr. Jamal s annual performance-based bonus will be tied to achievement of a specified goal related to the Company s Sarbanes Oxley compliance for fiscal 2011. The achievement of this Sarbanes Oxley goal, will be determined by the Audit Committee or the Board of Directors and the achievement of the financial goals will be determined by the Compensation Committee or the Board of Directors subsequent to December 31, 2011, but no later than the date that our Annual Report on Form 10-K is filed with the SEC for the year ending December 31, 2011.

Long-Term and Performance-Based Equity Incentives

Historically, our long-term and performance-based equity incentives were primarily in the form of stock options granted pursuant to our 2000 Amended and Restated Equity Incentive Plan, or the 2000 Plan. In 2008, we incorporated the use of both time-based restricted stock and performance-based restricted stock granted pursuant to the 2000 Plan. In 2009, our stockholders approved the 2009 Plan and we plan to continue to incorporate the use of stock options as well as both time-based restricted stock and performance-based restricted stock there-under. The objective of the stock option and restricted stock awards is to further enhance our executive officers long-term incentive to increase stockholder value, including our stock price, and company performance. We believe that stock option and restricted stock-based compensation achieves this objective by directly linking the economic benefit to recipients of stock option and restricted stock awards with the performance of the Company and its stock price. We also believe that the performance of the executive team has a direct effect on stock price and general company performance, and that time and performance-based stock option and performance-based restricted stock compensation encourages executive retention and performance because the awards are designed to vest over time and upon achievement of specific performance goals. The Compensation Committee first introduced the grant of performance-based restricted stock in addition to stock options in August 2008, so as to more clearly correlate financial performance to equity awards and incentives.

Stock options granted to our Named Executive Officers are approved by the Compensation Committee and are granted effective as of the third business day following the first general public release of our annual or quarterly revenues and/or earnings following the date of approval. The Compensation Committee may vary this procedure if it determines applicable circumstances, such as public disclosure requirements or other factors, justify doing so. In addition, the Compensation Committee approves all restricted stock awards to our Named Executive Officers, which are generally approved at times consistent with our stock option grant policy, provided, however, that restricted stock awards are generally effective on the date of approval by the Compensation Committee. Stock options granted to our Named Executive Officers are incentive stock options, to the extent permissible under the Code, and commence vesting upon the effective date of grant. In general and historically, 25% of the shares subject to the stock options vest one year from the effective date of grant and the remainder of the shares vest in equal monthly installments over the 36 months thereafter, subject to acceleration of vesting in certain circumstances described in Employment and Change of Control Agreements.

The equity awards granted to our Named Executive Officers in January 2010 consisted of both stock options and restricted stock grants. The stock options were subject to a time-based vesting requirement, while the restricted stock grants were subject to both time-based and performance-based vesting requirements approved by the Compensation Committee. Stock options granted under the 2000 Plan and the 1995 Incentive Program, as amended, or the Prior Plans expire 10 years from the effective date of grant, and stock options granted under the 2009 Plan expire seven years from the effective date of grant. The exercise price per share of each stock option granted to our Named Executive Officers is equal to the fair market value of our common stock on the effective date of grant. Under the Prior Plans, the fair market value of our common stock on a given date is deemed to be equal to the closing sales price for such stock as reported on the NASDAQ Stock Market on the last market trading day prior to such date. Under the 2009 Equity Incentive Plan, the fair market value of our common stock on a given date is deemed to be equal to the closing sales price for such stock as reported on the NASDAQ Stock Market on such date, or if such date is not a trading day the last market trading day prior to such date.

In general, each Named Executive Officer receives stock option and/or restricted stock grants in connection with his hire or promotion, and annually in the first quarter of each year. The size of each annual grant is based on an analysis of the following key factors for each executive:

- benchmarking against our peer group, including an analysis of equity plan utilization percentages;
- corporate and individual performance against goals; and
- individual stock ownership.

The Company does not currently maintain holding period requirements for stock options and stock awards and does not currently have stock ownership guidelines for its executive officers or directors.

Fiscal 2010

In January 2010, the Compensation Committee approved the following equity grants for our Named Executive Officers, Messrs. Kammersgard and Jamal.

Executive Officer	**Stock Options**
Dana W. Kammersgard	150,000
Hanif I. Jamal	116,667

The options were granted under the 2009 Plan and will terminate seven years after the effective grant date of March 9, 2010, or earlier in the event the executive officer s service to us is terminated, and have an exercise price per share of $1.44, the closing price of our common stock as reported on the NASDAQ Stock Market as of March 9, 2010. The options were awarded after taking into consideration tenure with Dot Hill, corporate and individual performance, competitive benchmarks and individual stock ownership. The options vest 25% on the first anniversary of the date of grant with the remaining shares vesting monthly over the following three years.

Also, in January 2010, as discussed above, the Compensation Committee approved the following grants of performance-based restricted stock to our Named Executive Officers.

Executive Officer	**Restricted Stock**
Dana W. Kammersgard	75,000
Hanif I. Jamal	58,333

The restricted stock granted to Messrs. Kammersgard and Jamal vest in two equal annual installments based on the achievement of specified corporate objectives for the fiscal year ending December 31, 2010, as determined the Board or the Compensation Committee subsequent to December 31, 2010 but no later than the date that our Annual Report on Form 10-K is filed with the SEC for the year ending December 31, 2010. The specified financial targets and weighting is as follows: 25% upon achievement of specified 2010 revenue targets relating to certain business units; 10% upon achievement of a specific 2010 product margin target; 20% upon achievement of a specified 2010 EBITDA target; 25% upon achievement of specified business unit specific EBITDA targets; and 20% upon achievement of a specified target cash balance at December 31, 2010. The Compensation Committee has the discretion to determine that a portion of the restricted stock grant should vest, notwithstanding the fact that a goal is not met, in extraordinary circumstances. All of the financial targets shall be calculated in accordance with our methodologies for financial reporting purposes and, with the exception of cash, exclude the impact of stock-based compensation expense, intangible asset amortization, restructuring and severance charges, contingent consideration adjustments, Cloverleaf acquisition costs and the effects of foreign currency gains or losses and any other non-recurring, one-time charges or adjustments that the Compensation Committee, in its sole discretion, deems appropriate.

In March 2011, the Compensation Committee decided that based on the financial results of the Company relative to the previously established goals, 28% of each of Messrs. Kammersgard and Jamal s 2010 performance-based restricted stock shall be eligible for vesting. The Compensation Committee determined that the Company exceeded one of its previously established goals for revenue for a specified business unit which warranted that 10% of the 2010 performance-based restricted stock grant shall be eligible for vesting. Furthermore, while the Company s performance with respect to the management of cash and cash equivalents was below the established goal, the Compensation Committee concluded that despite net losses in 2010, and cash associated with the acquisition in January 2010 of Cloverleaf Communications Inc. cash and cash equivalents was well managed due to improvements in working capital management processes and more disciplined capital and operating expense deployment. The December 31, 2010 cash and cash equivalent level was above the 2010 Annual Operating Plan target that the Board of Directors had approved in December 2009, but slightly below the goal established by the Compensation Committee for determining vesting eligibility for the performance-based restricted stock granted in 2010. Consequently, the Compensation Committee elected to use its discretion and decided to vest 90% of the 20% of the performance-based restricted stock tied to year end 2010 cash and cash equivalents balance. In accordance with the vesting provisions established at the grant date of the 2010 performance-based restricted stock grant, 50% of the stock eligible for vesting would vest immediately on March 1, 2011 and the remaining 50% would vest on March 1, 2012. Consequently, 10,500 and 8,167 of Messrs. Kammersgard and Jamal s performance-based restricted stock vested on March 1, 2011 and 10,500 and 8,166 will vest on March 1, 2012 as long as the respective executive remains employed by the Company and subject to acceleration of vesting pursuant to the change of control agreements described in Employment and Change of Control Agreements.

In March 2011, the Compensation Committee approved the following grants of restricted stock to our Named Executive Officers for their contributions to the improved financial performance of the Company in 2010 which resulted in the Company reporting its first profitable quarter since the fourth quarter of 2005. In addition, the Compensation Committee recognized that using data based on compensation data presented by Radford as a guideline, both Messrs. Kammersgard and Jamal were being compensated at below the 25th percentile in terms of total cash and equity based compensation which was also factored into the Compensation Committee s decision when establishing the grants for 2011.

Executive Officer	Restricted Stock
Dana W. Kammersgard	100,000
Hanif I. Jamal	75,000

The grant date of these restricted stock awards will be the third business day after the first general release of the Company s first quarter 2011 revenue and/or earnings and 50% of such grant shall vest immediately and the remaining 50% shall vest one year after the grant date.

Fiscal 2011

In March 2011, the Compensation Committee approved the following equity grants for our Named Executive Officers, Messrs. Kammersgard and Jamal.

Executive Officer	Stock Options
Dana W. Kammersgard	200,000
Hanif I. Jamal	80,000

The options will terminate seven years after the effective date of grant, or earlier in the event the executive officer s service to us is terminated. The grant date of these stock options will be the third business day after the general release of the Company s first quarter 2011 revenue and/or earnings. The exercise price per share of these stock options will be the closing price of our common stock as reported on the NASDAQ Stock Market on the grant date. The options were awarded after taking into consideration tenure with Dot Hill, corporate and individual performance, competitive benchmarks, recommendations from Radford and individual stock ownership. The options vest 25% on the first anniversary of the date of grant with the remaining shares vesting monthly over the following three years.

Also in March 2011, the Compensation Committee approved the following grants of restricted stock to our Named Executive Officers.

Executive Officer	Restricted Stock
Dana W. Kammersgard	75,000
Hanif I. Jamal	37,500

The grant date of this restricted stock will be the third business day after the general release of the Company s first quarter 2011 revenue and/or earnings. The restricted stock granted to Messrs. Kammersgard and Jamal vest in two equal annual installments commencing on the first anniversary of the grant date.

Change of Control Payments

We have entered into employment and change of control agreements with each of our Named Executive Officers, the terms of which are described under the headings Employment and Change of Control Agreements and Potential Payments Upon Termination or Change of Control. We believe that these change of control benefits are an essential element of our executive compensation package and assist us in recruiting and retaining talented individuals. We do not provide excessive severance or change of control arrangements which provide for

payments exceeding three times an executive s base salary and bonus. Our change of control agreements for our Named Executive Officers provide only for payments of 1.25 times the annual base salary (not including bonus) in the event of a change in control.

Employee Stock Purchase Plan

We have also established our 2000 Amended and Restated Employee Stock Purchase Plan, as amended, or the Amended Purchase Plan, available to all of our employees, including our Named Executive Officers, which is intended to encourage employees to continue in our employ and to motivate employees through an ownership interest in Dot Hill. Under the Amended Purchase Plan, employees may purchase shares of our common stock at a discount to the market price, subject to certain limits, with the objective of allowing employees to profit when the value of our common stock increases over time.

Other Benefits

We provide benefits such as an opportunity to participate in our 401(k) savings/retirement plan, medical, dental and life insurance and disability coverage to all our employees, including our Named Executive Officers. We also provide personal paid time off and other paid holidays to all employees, including our Named Executive Officers, which are comparable to those provided at similar companies. Effective January 26, 2009, we eliminated our vacation accrual policy for our executive officers and most of our management. Our Named Executive Officers and management are entitled to paid time-off based on approval of their immediate superior.

Accounting and Tax Considerations

Section 162(m) of the Code generally prohibits us from deducting any compensation over $1 million per taxable year paid to any of our Named Executive Officers unless such compensation is treated as performance-based compensation within the meaning of the Code. As the total compensation paid by us to our Named Executive Officers excluding performance-based compensation is expected to be below $1 million, the Compensation Committee believes that Section 162(m) will not affect the tax deductions available to Dot Hill with respect to the compensation of its Named Executive Officers. In determining the form and amount of compensation for our Named Executive Officers, the Compensation Committee will continue to consider all elements of the cost of such compensation, including the potential impact of Section 162(m).

Risk Analysis of Our Compensation Plans

The Compensation Committee has reviewed our compensation policies as generally applicable to our employees and believes that our policies do not encourage excessive and unnecessary risk-taking, and that the level of risk that they do encourage is not reasonably likely to have a material adverse effect on the Company. The design of our compensation policies and programs encourage our employees to remain focused on both the short-and long-term goals of the Company. For example, while our performance-based restricted stock programs measure performance on an annual basis, our other equity awards typically vest over a number of years, which we believe encourages our Named Executive Officers to focus on sustained stock price appreciation, thus limiting the potential value of excessive risk-taking.

Compensation of Directors

The following table sets forth in summary form information concerning the compensation that we paid or awarded during the year ended December 31, 2010 to each of our non-employee directors:

Director Compensation for Fiscal 2010

Name	Fees Earned or Paid in Cash ($)(1)	Stock Awards ($)(2)(3)	Option Awards ($)(2)(4)	Total ($)
Charles F. Christ(5)	$ 101,621	$ 79,604	$ 11,752	$ 192,977
Thomas H. Marmen	$ 43,667	$ 8,750	$ 11,752	$ 64,169
Richard Mejia, Jr.	$ 63,600	$ 8,750	$ 11,752	$ 84,102
Roderick M. Sherwood, III	$ 51,000	$ 8,750	$ 11,752	$ 71,502
Kimberly E. Alexy(6)	$ 23,400	$	$	$ 23,400
Joseph D. Markee(6)	$ 16,667	$	$	$ 16,667

(1) Cash amounts in this column represent the portion of the annual retainers, committee fees and meeting fees earned with respect to service during the Company s 2010 fiscal year.

(2) Amounts listed in this column represent the aggregate grant date fair value of the awards established in accordance with Financial Accounting Standards Board Statement ASC Topic 718 (ASC Topic 718). Assumptions made for the purpose of computing these amounts are discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 in Note 10 to Consolidated Financial Statements under the heading Stockholders Equity, Equity Incentive Plans and Warrants.

(3) The aggregate number of shares subject to stock awards as of December 31, 2010 was 205,561 for Mr. Christ and 10,000 for each of Mr. Marmen, Mr. Mejia and Mr. Sherwood. Each non-employee director was granted a stock award on May 3, 2010 in the amount of 5,000 shares. In addition, Mr. Christ was granted an additional stock award on July 15, 2010 in the amount of 56,683 shares for his service on the Operations Committee. The weighted average grant date fair value of Mr. Christ s 2010 stock awards was $1.29 per share and the grant date fair value of each of the 2010 stock awards granted to Mr. Marmen, Mr. Mejia and Mr. Sherwood was $1.75 per share.

(4) The aggregate number of shares subject to outstanding option awards as of December 31, 2010 was 218,000; 70,000; 70,000; and 110,000 for Mr. Christ, Mr. Marmen, Mr. Mejia, and Mr. Sherwood, respectively. Each non-employee director was granted an option award on May 3, 2010 in the amount of 10,000 shares, for which the grant date fair value was $1.18 per share.

(5) Compensation for Mr. Christ includes $5,621 which is included in the column entitled Fees Earned or Paid in Cash, and $70,854 which is included in the column entitled Stock Awards, for his service as a member of the Operations Committee. In July 2010, in further consideration for service on the Operations Committee, the Board approved additional director compensation for Mr. Christ, which included payment for services rendered in 2010 of $52,000 and payment for services rendered in prior fiscal years of $21,074. The Operations Committee compensation of $73,074, consisted of i) a grant of 56,683 shares of restricted stock valued at the closing price of our common stock on the NASDAQ Stock Market as of June 30, 2010 and ii) a cash payment equal to the difference between the $73,074 and the value of the restricted awards, resulting in cash consideration of $5,621.

(6) Ms. Alexy and Mr. Markee ceased serving as directors after the 2010 Annual Meeting of Stockholders.

Each of our non-employee directors, excluding the Chairman of the Board, receives an annual fee of $24,000 plus an additional fee of $1,000 for each scheduled regular meeting of the Board. The Chairman of the Board receives an annual fee of $72,000 plus an additional fee of $1,000 for each scheduled regular meeting of the Board.

Members of the Audit, Compensation and Nominating and Corporate Governance Committees of our Board of Directors also receive additional fees. Each Audit Committee member receives an annual fee of $5,000, with the exception of the Chair of the Audit Committee, who receives an annual fee of $7,000.

Each Compensation and Nominating and Corporate Governance Committee member receives an annual fee of $3,000 for each such committee on which they serve, with the exception of the Chair of each of the committees, who receives an annual fee of $4,000. Committee members also receive $1,000 for each committee meeting attended, independent of the particular committee.

Members of the Special Litigation Committee also receive $200 for each hour of committee service provided.

In addition, Mr. Christ received an additional fee for his service as a member of the Operations Committee. During the fiscal year ended December 31, 2010, Mr. Christ earned $52,000 for service on the Operations Committee pursuant to terms approved by the Board. In July 2010, in further consideration for service on the Operations Committee, the Board approved this additional director compensation for Mr. Christ, which included payment for services rendered in 2010 of $52,000 and payment for services rendered in prior fiscal years of $21,074. The Operations Committee compensation of $73,074, consisted of i) a grant of 56,683 shares of restricted stock valued at the closing price of our common stock on the NASDAQ Stock Market as of June 30, 2010 and ii) a cash payment equal to the difference between the $73,074 and the value of the restricted awards, resulting in cash consideration of $5,621. Subject to his continued service to us, 25% of the restricted stock award vests on each of the first, second, third and fourth anniversaries of the date of the grant, such that the restricted stock award will be fully vested four years from the date of the grant.

During the fiscal year ended December 31, 2010, the total cash compensation paid to non-employee directors was $407,150. All members of our Board of Directors are also eligible for reimbursement for their expenses incurred in connection with attendance at Board and committee meetings or other Board related functions in accordance with Dot Hill policy.

Each of our non-employee directors may receive discretionary equity award grants under our 2009 Plan and also receives non-discretionary stock option grants under the Directors Plan. Only our non-employee directors are eligible to receive options under the Directors Plan. Options granted under the Directors Plan are intended not to qualify as incentive stock options under the Code.

Option grants under the Directors Plan are non-discretionary. Each person who is elected or appointed as a director and who, for at least one year preceding such election or appointment, has at no time served as a non-employee director, is automatically granted under the Directors Plan, without further action by us, our Board of Directors or our stockholders, an option to purchase 50,000 shares of our common stock as of the date of such election or appointment. In addition, as of the date of the annual meeting each year, each member of our Board of Directors who is not an employee and has served as a non-employee director for at least four months is automatically granted under the Directors Plan and without further action by us, our Board of Directors or our stockholders, an option to purchase 10,000 shares of our common stock. During the 2009 Annual Meeting, the Board approved an amendment to the Directors Plan to reduce the number of shares available to the automatic annual grant from 20,000 to 10,000 stock options. The Board also approved an automatic grant under the 2009 Plan, as of the date of the annual meeting each year and without further action by us, of 5,000 shares of common stock to each of our non-employee directors. The first such automatic grant was effected on the date of our 2009 Annual Meeting of the Stockholders. No other options may be granted at any time under the Directors Plan.

The exercise price of options granted under the Directors Plan may not be less than 100% of the fair market value of the common stock subject to the option on the date of the option grant, which is deemed to be equal to the closing sales price of our common stock as reported on the NASDAQ Stock Market on the last market trading day prior to the effective date of grant. Initial option grants under the Directors Plan become exercisable, or vest,

over four years during the option holder s service as a director of the Company and any subsequent employment of the option holder by, and/or service by the option holder as a consultant to, us or an affiliate, collectively referred to as service. With respect to any initial grant of options, 25% of such options vest after one year of service and the remainder vest monthly over the next 36 months. Initial option grants under the Directors Plan permit exercise prior to vesting, but in such event, the option holder is required to enter into an early exercise stock purchase agreement that allows us to repurchase unvested shares, generally at their exercise price, should the option holder s service terminate. Annual option grants under the Directors Plan are fully vested on the date of grant. The term of options granted under the Directors Plan is 10 years. In the event of our merger with or into another corporation or a consolidation, acquisition of assets or other change of control transaction involving us, the vesting of each option will accelerate and the option will terminate if not exercised prior to the consummation of the transaction.

During 2010, we granted options under the Directors Plan covering 10,000 shares to each of our four non-employee directors as of our 2010 Annual Meeting of Stockholders, at an exercise price of $1.75 per share (based on the closing sales price reported on the NASDAQ Stock Market on the date of grant). During 2010, we also granted common stock under the 2009 Plan covering 5,000 shares to each of our four non-employee directors as of our 2010 Annual Meeting of Stockholders. The closing price of our common stock on the date of grant was $1.75 per share. In 2010, we also granted Mr. Christ 56,683 shares of restricted stock under the 2009 Plan for his service on the Operations Committee. The restricted stock is subject to vesting as follows: 25% of the restricted stock award vests on each of the first, second, third and fourth anniversaries of the date of the grant, such that the restricted stock award will be fully vested four years from the date of the grant. The term of options and restricted stock awards granted under the 2009 Plan is seven years.

Compensation of Executive Officers

Summary of Compensation

The following table sets forth in summary form information concerning the compensation that was earned during the fiscal years ended December 31, 2008, 2009 and 2010 by our Chief Executive Officer and Chief Financial Officer. We refer to these officers in this proxy statement as our Named Executive Officers.

Summary Compensation Table(1)

Name and Principal Position	Year	Salary	Bonus(2)	Stock Awards(3)	Option Awards(4)	All Other Compensation(5)	Total
Dana W. Kammersgard	2010	$ 380,000	$	$ 63,375	$ 140,625	$ 10,640(6)	$ 594,640
	2009	$ 367,500	$ 50,000	$ 40,250	$	$ 110,040(7)	$ 567,790
President and Chief Executive Officer	2008	$ 367,500	$	$	$ 259,300	$	$ 626,800
Hanif I. Jamal	2010	$ 294,500	$	$ 49,291	$ 109,375	$ 44,015(8)	$ 497,181
Senior Vice President, Chief Financial Officer,	2009	$ 270,000	$ 50,000	$ 34,500	$	$	$ 354,500
Treasurer, and Corporate Secretary	2008	$ 270,000	$	$	$ 259,300	$	$ 529,300

(1) In accordance with the rules of the SEC, the compensation described in this table does not include various perquisites and other personal benefits received by a Named Executive Officer which do not exceed $10,000 in the aggregate.

(2) The Compensation Committee approved discretionary cash bonuses of $50,000 to each Messrs. Kammersgard and Jamal on January 20, 2010 in consideration for services provided in 2009. There were no cash bonuses earned during the fiscal years ended December 31, 2010 and 2008, respectively.

(3) Amounts listed in this column represent the aggregate grant date fair value calculated in accordance with ASC Topic 718 during the applicable fiscal year. Assumptions made for the purpose of computing these

amounts are discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 in Note 10 to Consolidated Financial Statements under the heading Stockholders Equity, Equity Incentive Plans and Warrants.

Messrs. Kammersgard and Jamal received performance-based restricted stock awards in fiscal 2010 covering 75,000 and 58,333 shares, respectively, for which 50% of the performance target benchmarks were considered probable of occurring at the grant date for each of Mr. Kammersgard and Mr. Jamal. Assuming 100% of the performance target benchmarks were achieved, the grant date fair value would have been $126,750 and $98,583 for Mr. Kammersgard and Mr. Jamal, respectively. In March 2011, the Compensation Committee decided that based on the financial results of the Company relative to the previously established goals for fiscal year 2010, 28% of each of Messrs. Kammersgard and Jamal s 2010 performance based restricted stock was eligible for vesting. In accordance with the vesting provisions established at the grant date of the 2010 performance based restricted stock grant, 50% of the stock eligible for vesting vest immediately on March 1, 2011 and the remaining 50% vest on March 1, 2012. Consequently, 10,500 and 8,167 shares of the performance-based restricted stock granted to Messrs. Kammersgard and Jamal, respectively, vested on March 1, 2011 and 10,500 and 8,166 shares will vest on March 1, 2012 as long as the respective executive remains employed by the Company.

Messrs. Kammersgard and Jamal received performance-based restricted stock awards in fiscal 2009 covering 175,000 and 125,000 shares, respectively, for which 50% and 60%, respectively, of the performance target benchmarks were considered probable of occurring at the grant date. Assuming 100% of the performance target benchmarks were achieved, the grant date fair value would have been $80,500 and $57,500 for Mr. Kammersgard and Mr. Jamal, respectively. In March 2010, based on the financial results of the Company relative to the previously established goals, the Compensation Committee approved that 50% of Mr. Kammersgard s and 60% of Mr. Jamal s performance based restricted awards would vest.

Messrs. Kammersgard and Jamal received performance-based restricted stock awards in fiscal year 2008 covering 50,000 and 30,000 shares, respectively, for which we recognized no compensation expense during fiscal 2009 as we determined that it was not probable that the performance criteria would be met. Assuming 100% of the performance target benchmarks were achieved, the grant date fair value would have been $122,500 and $73,500 for Mr. Kammersgard and Mr. Jamal, respectively.

(4) Amounts listed in this column represent the aggregate grant date fair value calculated in accordance with ASC Topic 718 during the applicable fiscal year. Assumptions made for the purpose of computing these amounts are discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 in Note 10 to Consolidated Financial Statements under the heading Stockholders Equity, Equity Incentive Plans and Warrants. For financial statement reporting purposes, we recognize only the portion of the above values related to those awards which vested during the period.

(5) Amounts listed in this column represent perquisites and personal benefits in which the aggregate amount for any given individual exceeded $10,000 for the fiscal year.

(6) Includes $9,600 for an annual automobile allowance and $1,040 of company-paid life insurance premiums.

(7) Includes $101,000 paid by the Company to cover costs of relocating from California to Colorado, $8,000 for an annual automobile allowance, and $1,040 of company-paid life insurance premiums.

(8) Includes $12,958 paid by the Company to cover costs of relocating from California to Colorado, $20,417 of relocation allowance earned in 2010, $9,600 for an annual automobile allowance, and $1,040 of company-paid life insurance premiums.

As a result of Mr. Jamal relocating from California to Colorado, the Company will pay for all of his eligible household goods and family moving expenses in accordance with the Company s relocation policy. In addition, the Company will provide Mr. Jamal with a monthly relocation allowance over a 24 month period equal to $150,000 less the amount of costs paid by the Company for Mr. Jamal s household goods and family moving expenses.

Employment and Change of Control Agreements

In December 2008, we entered into an Amended and Restated Employment Agreement, or the CEO Agreement, with Mr. Kammersgard. The CEO Agreement replaced and superseded the Employment Agreement and Change of Control Agreement we entered into with Mr. Kammersgard on August 2, 1999 and April 6, 2006, respectively, referred to together as the Prior Agreements.

The Prior Agreements were replaced by the CEO Agreement primarily to address changes in the tax laws, including changes governing nonqualified deferred compensation arrangements (such as severance arrangements) under Section 409A of the Code. The CEO Agreement provides that any payments and benefits pursuant to the CEO Agreement, referred to as Severance Benefits, that constitute deferred compensation within the meaning of Section 409A of the Code and the regulations and other guidance thereunder and any state law of similar effect, referred to collectively as Section 409A, shall not commence following termination of employment unless and until Mr. Kammersgard has also incurred a separation from service (as such term is defined in Treasury Regulation Section 1.409A-1(h)), unless we reasonably determine that such amounts may be paid without causing Mr. Kammersgard to incur the additional 20% tax under Section 409A. However, if we determine that the Severance Benefits constitute deferred compensation under Section 409A and Mr. Kammersgard is, upon termination, a specified employee of ours (as such term is defined in Section 409A(a)(2)(B)(i) of the Code), then the timing of payment by us of Severance Benefits may be delayed solely to the extent necessary to avoid the incurrence of the adverse personal tax consequences under Section 409A.

Additionally, under the CEO Agreement, Mr. Kammersgard is eligible to receive, subject to approval by our Compensation Committee, an annual discretionary bonus pursuant to our executive compensation plans for each fiscal year. Consistent with his previous severance benefits, if Mr. Kammersgard is terminated without cause or terminates his employment for good reason prior to the effective date of a change of control, then he is entitled to a single lump sum cash payment equal to 100% of his then current base salary. If Mr. Kammersgard continues his employment through the effective date of a change of control, then he is entitled to a single lump sum cash payment equal to 125% of his annual base salary in effect immediately prior to the change of control, referred to as the CEO Change of Control Bonus. If Mr. Kammersgard is terminated without cause or terminates his employment for good reason following the effective date of a change of control, then he is entitled to a single lump sum cash payment equal to 100% of his annual base salary in effect at the time of termination, less any CEO Change of Control Bonus paid to Mr. Kammersgard and provided that his annual base salary at the time of termination exceeds his annual base salary in effect immediately prior to the change of control by at least 25%. Further, in the event Mr. Kammersgard continues his employment through the effective date of a change of control, all unvested equity awards granted to Mr. Kammersgard will accelerate in full. In the event his employment is terminated, other than for death or complete disability, we have the right to retain Mr. Kammersgard as a consultant during the 12 months following his termination, referred to as the CEO Consulting Period, for a period of up to 12 days during such CEO Consulting Period. In exchange for his availability during the CEO Consulting Period, Mr. Kammersgard is entitled to a cash payment equal to 25% of his annual base salary at the time of termination, payable in four equal quarterly installments commencing within five days of his termination.

In March 2009, we entered into an Amended and Restated Employment Agreement, or the CFO Agreement, with Mr. Jamal. The CFO Agreement replaces and supersedes the Employment Agreement entered into with Mr. Jamal on December 18, 2008.

Under the CFO Agreement, Mr. Jamal is eligible to receive, subject to approval by our Compensation Committee, an annual discretionary bonus pursuant to our executive compensation plans for each fiscal year. If Mr. Jamal is terminated without cause or terminates his employment for good reason prior to the effective date of a change of control, then he is entitled to a single lump sum cash payment equal to 100% of his then current base salary. If Mr. Jamal continues his employment through the effective date of a change of control, then he is

entitled to a single lump sum cash payment equal to 125% of his annual base salary in effect immediately prior to the change of control, referred to as the CFO Change of Control Bonus. If Mr. Jamal is terminated without cause or terminates his employment for good reason following the effective date of a change of control, then he is entitled to a single lump sum cash payment equal to 100% of his annual base salary in effect at the time of termination, less any CFO Change of Control Bonus paid to Mr. Jamal and provided that his annual base salary at the time of termination exceeds his annual base salary in effect immediately prior to the change of control by at least 25%. Further, in the event Mr. Jamal continues his employment through the effective date of a change of control, all unvested equity awards granted to Mr. Jamal will accelerate in full. In the event his employment is terminated, other than for death or complete disability, we have the right to retain Mr. Jamal as a consultant during the 12 months following his termination, referred to as the CFO Consulting Period, for a period of up to 12 days during such CFO Consulting Period. In exchange for his availability during the CFO Consulting Period, Mr. Jamal is entitled to a cash payment equal to 25% of his annual base salary at the time of termination, payable in four equal quarterly installments commencing within five days of his termination.

In establishing the triggering events for payment obligations in connection with termination and/or change of control events under our employment and change of control agreements with our Named Executive Officers, the Compensation Committee carefully considered a variety of factors. Payments upon termination by us without cause or by the employee for good reason are provided because we consider such a termination to be generally beyond the control of a terminated employee and a termination that under different circumstances would not have occurred. The termination benefits are intended to ease the consequences to an employee of an unexpected termination of employment. Dot Hill benefits by requiring a general release from terminated employees. In addition, Dot Hill may request non-compete and non-solicitation provisions in connection with individual separation agreements. Payments and option acceleration in connection with a change of control are intended to mitigate the distraction and loss of key management personnel that may occur in connection with rumored or actual fundamental corporate changes. Such payments protect stockholder interests by enhancing employee focus during rumored or actual change of control activity through providing incentives to remain with Dot Hill despite uncertainties while a transaction is under consideration and by encouraging the executives responsible for negotiating potential transactions to do so with independence and objectivity. Furthermore, these payments assist the Company in attracting and retaining highly valued executives.

Potential Payments Upon Termination or Change Of Control

The following table sets forth potential payments to our Named Executive Officers upon various termination or change of control events assuming such events occurred as of December 31, 2010.

Name	Benefit(1)	Termination Without Cause or Upon Good Reason	Change of Control	Termination Without Cause or Upon Good Reason after Change of Control
Dana W. Kammersgard	lump sum cash	$ 360,000	$ 450,000	(2)
	option vesting acceleration		$ 46,500	
	restricted stock vesting acceleration		$ 18,375	
Hanif I. Jamal	lump sum cash	$ 279,000	$ 348,750	(2)
	option vesting acceleration		$ 36,167	
	restricted stock vesting acceleration		$ 14,291	

(1) Amounts shown for option vesting acceleration represent the value of in-the-money unvested options that would have accelerated if the change of control occurred on December 31, 2010 based on the difference between the market value of our common stock on that date and the exercise price of the respective options.

(2) Each Named Executive Officer is entitled to a lump sum cash payment equal to 100% of his annual base salary in effect at the time of termination, less any lump sum cash payments previously made to the Named Executive Officer in connection with a change of control. Lump sum payments reflected in this column are

contingent upon the Named Executive Officer s annual base salary at the time of termination exceeding his annual base salary in effect immediately prior to the change of control by at least 25%. If following a change of control, the Named Executive Officer s termination without cause or resignation for good reason occurred on December 31, 2010, and assuming Messrs. Kammersgard and Jamal s annual base salaries were $360,000 and $279,000, respectively, as of such date, Messrs. Kammersgard and Jamal would not receive any payments in connection with such termination.

Grants of Plan-Based Awards During Fiscal Year Ended 2010

Historically, we granted stock awards to our executive officers under the 2000 Plan. On June 15, 2009, the stockholders approved the 2009 Plan, which both increased the number of shares available for future awards to both executives and non-executive employees, as well as modified certain terms of future awards.

Subsequent to the 2009 Annual Meeting of the Stockholders, we granted stock awards to our executive officers under the 2009 Plan. As of February 1, 2011, options to purchase a total of 978,500 shares were outstanding, awards other than stock options and stock appreciation rights covering an aggregate of 1,538,326 shares were outstanding and 2,087,866 shares were available for future grant under the 2009 Plan. As of February 1, 2011, options to purchase a total of 4,774,759 shares were outstanding under the 2000 Plan.

All stock options granted to our Named Executive Officers are incentive stock options, to the extent permissible under the Code. Generally, 25% of the shares subject to options vest one year from the date of grant and the remainder of the shares vest in equal monthly installments over the 36 months thereafter, subject to acceleration of vesting pursuant to the change of control agreements described in Employment and Change of Control Agreements. However, commencing with grants in February 2009 and thereafter, 25% of the shares subject to stock option and restricted stock awards typically vest on each anniversary from the effective date of grant, subject to acceleration of vesting pursuant to the change of control agreements described in Employment and Change of Control Agreements. Options under the Prior Plans expire 10 years from the date of grant, and options under the 2009 Plan expire seven years from the date of grant. The exercise price per share of each option granted to our Named Executive Officers was equal to the fair market value of our common stock on the date of the grant. Under the Prior Plans, the fair market value of our common stock on a given date is deemed to be equal to the closing sales price for such stock as reported on the NASDAQ Stock Market on the last market trading day prior to such date. Under the 2009 Plan, the fair market value of our common stock on a given date is deemed to be equal to the closing sales price for such stock as reported on the NASDAQ Stock Market on such date, or if such date is not a trading day, the last market trading day prior to such date.

The following table provides information regarding grants of plan-based awards to the Named Executive Officers in the fiscal year ended December 31, 2010.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1) Threshold ($)	Target ($)	Maximum ($)	Estimated Future Payouts Under Equity Incentive Plan Awards(2) Threshold (#)	Target (#)	Maximum (#)	All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($)(3)
Dana W. Kammersgard	1/20/10	$	$ 160,000	$		75,000				$	$ 126,750
	3/9/10	$	$	$				150,000		$ 1.44	$ 140,625
Hanif I. Jamal	1/20/10	$	$ 100,750	$		58,333				$	$ 98,583
	3/9/10	$	$	$				116,667		$ 1.44	$ 109,375

(1) In June 2010, the Compensation Committee terminated both the 2010 Executive Compensation Plan and the stretch cash bonus pool. Accordingly, no awards were granted, earned or paid under these plans. The target payout under the 2010 Executive Compensation Plan was 40% and 32.5% of each of Messrs. Kammersgard s and Jamal s base salary, respectively. There were no thresholds or maximums established under the 2010 Executive Compensation

Plan. The target payout under the stretch cash bonus pool was $205,662 and $129,503, respectively, for Messrs. Kammergard and Jamal. A description of the non-equity based compensation plans terminated in July 2010 can be found under the heading Compensation Discussion and Analysis Annual Performance-Based Bonus.

(2) The amounts shown in these columns represent the maximum and target vesting levels for the fiscal 2010 performance-based restricted stock awards. 28% of Mr. Kammersgard s and Mr. Jamal s performance-based restricted stock awards granted in 2010 were achieved during 2010, of which 50% of such shares vested on March 1, 2011 and 50% are scheduled to vest on March 1, 2012. Please see Compensation Discussion and Analysis Long-Term and Performance-Based Equity Incentives in this proxy statement for a detailed description of the vesting provisions applicable to these restricted stock awards.

(3) Amounts listed in this column represent the aggregate full grant date fair value computed in accordance with ASC Topic 718. Assumptions made for the purpose of computing these amounts are discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 in Note 10 to Consolidated Financial Statements under the heading Stockholders Equity, Equity Incentive Plans and Warrants.

Outstanding Equity Awards at Fiscal Year-End 2010

The following table provides information regarding all outstanding equity awards held by each of our Named Executive Officers as of December 31, 2010.

	Option Awards					Stock Awards			
Name	**Number of Securities Underlying Unexercised Options (#) Exercisable**	**Number of Securities Underlying Unexercised Options (#) Unexercisable**	**Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)**	**Option Exercise Price ($)**	**Option Expiration Date**	**Number of Shares or Units of Stock That Have Not Vested (#)**	**Market Value of Shares or Units of Stock That Have Not Vested ($)**	**Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)(3)**	**Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)**
Dana W. Kammersgard	100,000	(1)		$ 1.89	7/23/2011				
	50,000	(1)		$ 3.10	1/1/2013				
	50,000	(1)		$ 15.15	1/1/2014				
	250,000	(1)		$ 6.25	11/1/2014				
	80,000	(1)		$ 6.10	1/31/2015				
	150,000	(1)		$ 6.87	3/7/2016				
	191,667	8,333(1)		$ 3.57	2/27/2017				
	68,749	31,251(1)		$ 2.40	3/18/2018				
	43,749	31,251(1)		$ 2.36	8/11/2018				
		150,000(2)		$ 1.44	3/9/2017				
								75,000	$ 126,750
Hanif Jamal	225,000	(1)		$ 3.03	7/31/2016				
	71,875	3,125(1)		$ 3.57	2/27/2017				
	68,748	31,252(1)		$ 2.40	3/18/2018				
	43,750	31,250(1)		$ 2.36	8/11/2018				
		116,667(2)		$ 1.44	3/9/2017				
								58,333	$ 98,583

(1) Unvested options granted under the 2000 Plan. 25% of the shares subject to the options vest one year from the date of grant and the remainder of the shares vest in equal monthly installments over the 36 months thereafter, subject to acceleration of vesting pursuant to the

change of control agreements described in Employment and Change of Control Agreements.

(2) Unvested options granted under the 2009 Plan. 25% of the shares subject to the options vest one year from the date of grant and the remainder of the shares vest in equal monthly installments over the 36 months thereafter, subject to acceleration of vesting pursuant to the change of control agreements described in Employment and Change of Control Agreements.

(3) Shares appearing in this column are performance-based restricted stock awards for 2010. Please see Compensation Discussion and Analysis in this proxy statement for a detailed description of the vesting provisions applicable to these restricted stock awards.

Option Exercises and Stock Vested During Fiscal Year-End 2010

None of our Named Executive Officers exercised stock options during 2010. The following table shows, for the fiscal year ended December 31, 2010, certain information regarding stock vested during the last fiscal year with respect to the Named Executive Officers:

	Option Awards		Stock Awards	
Name	**Number of Shares Acquired on Exercise(#)**	**Value Realized on Exercise($)**	**Number of Shares Acquired on Vesting(#)**	**Value Realized on Vesting($)**
Dana W. Kammersgard			87,500	$ 147,875
Hanif Jamal			75,000	$ 126,750

Messrs. Kammersgard and Jamal received performance-based restricted stock awards in fiscal 2009 covering 175,000 and 125,000 shares, respectively, for which 87,500 shares granted to Mr. Kammersgard vested in 2010 and 75,000 shares granted to Mr. Jamal vested in 2010.

Pension Benefits at Fiscal Year-End 2010

We have no pension plans.

Nonqualified Defined Contribution and Other Nonqualified Deferred Compensation Plans at Fiscal Year-End 2010.

We have no nonqualified defined contribution or other nonqualified deferred compensation plans.

POLICIES AND PROCEDURES WITH RESPECT TO RELATED PARTY TRANSACTIONS

Our Board of Directors is committed to upholding the highest legal and ethical conduct in fulfilling its responsibilities and recognizes that related party transactions can present a heightened risk of potential or actual conflicts of interest. Accordingly, as a general matter, it is Dot Hill s preference to avoid related party transactions. Our Audit Committee Charter requires that members of the Audit Committee, all of whom are independent directors, review and approve all related party transactions for which such approval is required under applicable law, including SEC rules and NASDAQ listing standards. A related party transaction includes any transaction, arrangement or relationship involving an amount that exceeds $120,000 in which Dot Hill is a participant and in which any of the following persons has or will have a direct or indirect interest: any executive officer, director, or more than 5% stockholder of Dot Hill, including any of their immediate family members, and any entity owned or controlled by such persons.

In addition, the Audit Committee is responsible for reviewing and investigating any matters pertaining to the integrity of management, including conflicts of interest and adherence to our Code of Business Conduct and Ethics. Under our Code of Business Conduct and Ethics, directors, officers and all other members of the workforce are expected to avoid any relationship, influence or activity that would cause or even appear to cause a conflict of interest.

Transactions With Related Persons

Certain Relationships and Related Transactions

During the fiscal year ended December 31, 2010, we granted options to purchase an aggregate of 40,000 shares of our common stock to our non-employee directors, each with an exercise price per share of $1.75. During the fiscal year ended December 31, 2010, we also granted common stock covering an aggregate of 20,000 shares to our non-employee directors. The closing price of our common stock on the date of grant was $1.75 per share. During the fiscal year ended December 31, 2010, we also granted an aggregate of 56,683 shares of restricted stock to one non-employee director. The closing price of our common stock on the date of grant was $1.25 per share.

During the fiscal year ended December 31, 2010, we granted options to purchase an aggregate of 266,667 shares of our common stock to our Named Executive Officers, each with an exercise price per share of $1.44. Additionally, during the fiscal year ended December 31, 2010, we granted restricted stock awards to our Named Executive Officers covering an aggregate of 133,333 shares of our common stock. The closing price of our common stock on the date of grant was $1.69 per share.

Our bylaws provide that we will indemnify our directors and executive officers, and may indemnify other officers, employees and other agents, to the fullest extent permitted by law. Our bylaws also permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in connection with their services to us. We have obtained a policy of directors and officers liability insurance.

We have entered, and intend to continue to enter, into indemnification agreements with our directors and executive officers, in addition to the indemnification provided for in our bylaws. These agreements, among other things, require us to indemnify our directors and executive officers for certain expenses, including attorneys fees, judgments, fines and settlement amounts incurred by a director or executive officer in any action or proceeding arising out of their services as one of our directors or executive officers, or any of our subsidiaries or any other company or enterprise to which the person provides services at our request.

Please see Employment and Change of Control Agreements and Potential Payments Upon Termination or Change-in-Control.

Householding of Proxy Materials

The SEC has adopted rules that permit companies and intermediaries (e.g., brokers) to satisfy the delivery requirements for Annual Meeting materials with respect to two or more stockholders sharing the same address by delivering a single set of Annual Meeting materials addressed to those stockholders. This process, which is commonly referred to as householding, potentially means extra convenience for stockholders and cost savings for companies.

This year, a number of brokers with account holders who are Dot Hill common stockholders will be householding the Company s proxy materials. A single set of Annual Meeting materials will be delivered to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. Once you have received notice from your broker that they will be householding communications to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate set of Annual Meeting materials, please notify your broker or the Company. Direct your written request to Hanif Jamal (*Chief Financial Officer)*, 1351 South Sunset Street, Longmont, CO 80501 or contact Hanif Jamal at (303) 845-3200. Stockholders who currently receive multiple copies of the Annual Meeting materials at their addresses and would like to request householding of their communications should contact their brokers.

Other Matters

Our Board of Directors knows of no other matters that will be presented for consideration at the annual meeting. If any other matters are properly brought before the meeting, it is the intention of the persons named in the accompanying proxy to vote on such matters in accordance with their best judgment.

By Order of the Board of Directors

/s/ DANA W. KAMMERSGARD

Dana W. Kammersgard

President and Chief Executive Officer

Longmont, Colorado

March 25, 2011

A copy of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed with the SEC is available without charge upon written request to: 1351 South Sunset Street, Longmont, CO 80501, Attn: Secretary.

Appendix A

DOT HILL SYSTEMS CORP.

2009 EQUITY INCENTIVE PLAN

ADOPTED BY THE BOARD OF DIRECTORS: APRIL 27, 2009

APPROVED BY THE STOCKHOLDERS: JUNE 15, 2009

AMENDMENT ADOPTED BY THE BOARD OF DIRECTORS: MARCH 1, 2011

AMENDMENT APPROVED BY THE STOCKHOLDERS: MAY 2, 2011

TERMINATION DATE: APRIL 26, 2019

1. GENERAL.

(a) Successor to and Continuation of Prior Plans. The Plan is intended as the successor to and continuation of the Dot Hill Systems Corp. 2000 Amended and Restated Equity Incentive Plan and the Dot Hill Systems Corp. 1995 Incentive Program, as Amended and Restated (the ***Prior Plans***). Following the Effective Date, no additional stock awards shall be granted under the Prior Plans. Any shares remaining available for issuance pursuant to the exercise of options or settlement of stock awards under the Prior Plans as of the Effective Date (the ***Prior Plans Available Reserve***) shall become available for issuance pursuant to Stock Awards granted hereunder. From and after the Effective Date, all outstanding stock awards granted under the Prior Plans shall remain subject to the terms of the Prior Plans; *provided, however*, any shares subject to outstanding stock awards granted under the Prior Plans that expire or terminate for any reason prior to exercise or settlement (the ***Returning Shares***) shall become available for issuance pursuant to Awards granted hereunder. All Awards granted on or after the Effective Date of this Plan shall be subject to the terms of this Plan.

(b) Eligible Award Recipients. The persons eligible to receive Awards are Employees, Directors and Consultants.

(c) Available Awards. The Plan provides for the grant of the following Awards: (i) Incentive Stock Options, (ii) Nonstatutory Stock Options, (iii) Stock Appreciation Rights (iv) Restricted Stock Awards, (v) Restricted Stock Unit Awards, (vi) Performance Stock Awards, (vii) Performance Cash Awards, and (viii) Other Stock Awards.

(d) Purpose. The Company, by means of the Plan, seeks to secure and retain the services of the group of persons eligible to receive Awards as set forth in Section 1(b), to provide incentives for such persons to exert maximum efforts for the success of the Company and any Affiliate and to provide a means by which such eligible recipients may be given an opportunity to benefit from increases in value of the Common Stock through the granting of Awards.

2. ADMINISTRATION.

(a) Administration by Board. The Board shall administer the Plan unless and until the Board delegates administration of the Plan to a Committee or Committees, as provided in Section 2(c).

(b) Powers of Board. The Board shall have the power, subject to, and within the limitations of, the express provisions of the Plan:

(i) To determine from time to time (A) which of the persons eligible under the Plan shall be granted Awards; (B) when and how each Award shall be granted; (C) what type or combination of types of Award shall be granted; (D) the provisions of each Award granted (which need not be identical), including the time or times when a person shall be permitted to receive cash or Common Stock pursuant to a Stock Award; (E) the number of shares of Common Stock with respect to which a Stock Award shall be granted to each such person; and (F) the Fair Market Value applicable to a Stock Award.

1.

(ii) To construe and interpret the Plan and Awards granted under it, and to establish, amend and revoke rules and regulations for its administration. The Board, in the exercise of this power, may correct any defect, omission or inconsistency in the Plan or in any Stock Award Agreement or in the written terms of a Performance Cash Award, in a manner and to the extent it shall deem necessary or expedient to make the Plan or Award fully effective.

(iii) To settle all controversies regarding the Plan and Awards granted under it.

(iv) To accelerate the time at which an Award may first be exercised or the time during which an Award or any part thereof will vest in accordance with the Plan, notwithstanding the provisions in the Award stating the time at which it may first be exercised or the time during which it will vest.

(v) To suspend or terminate the Plan at any time. Suspension or termination of the Plan shall not impair rights and obligations under any Award granted while the Plan is in effect except with the written consent of the affected Participant.

(vi) To amend the Plan in any respect the Board deems necessary or advisable, including, without limitation, by adopting amendments relating to Incentive Stock Options and certain nonqualified deferred compensation under Section 409A of the Code and/or to bring the Plan or Awards granted under the Plan into compliance therewith, subject to the limitations, if any, of applicable law. However, except as provided in Section 9(a) relating to Capitalization Adjustments, to the extent required by applicable law or listing requirements, stockholder approval shall be required for any amendment of the Plan that either (A) materially increases the number of shares of Common Stock available for issuance under the Plan, (B) materially expands the class of individuals eligible to receive Awards under the Plan, (C) materially increases the benefits accruing to Participants under the Plan or materially reduces the price at which shares of Common Stock may be issued or purchased under the Plan, (D) materially extends the term of the Plan, or (E) expands the types of Awards available for issuance under the Plan. Except as provided above, rights under any Award granted before amendment of the Plan shall not be impaired by any amendment of the Plan unless (1) the Company requests the consent of the affected Participant, and (2) such Participant consents in writing.

(vii) To submit any amendment to the Plan for stockholder approval, including, but not limited to, amendments to the Plan intended to satisfy the requirements of (A) Section 162(m) of the Code regarding the exclusion of performance-based compensation from the limit on corporate deductibility of compensation paid to Covered Employees, (B) Section 422 of the Code regarding incentive stock options or (C) Rule 16b-3.

(viii) To approve forms of Award Agreements for use under the Plan and to amend the terms of any one or more Awards, including, but not limited to, amendments to provide terms more favorable to the Participant than previously provided in the Award Agreement, subject to any specified limits in the Plan that are not subject to Board discretion; *provided however*, that except with respect to amendments that disqualify or impair the status of an Incentive Stock Option, a Participant s rights under any Award shall not be impaired by any such amendment unless (A) the Company requests the consent of the affected Participant, and (B) such Participant consents in writing. Notwithstanding the foregoing, subject to the limitations of applicable law, if any, the Board may amend the terms of any one or more Awards without the affected Participant s consent if necessary to maintain the qualified status of the Award as an Incentive Stock Option or to bring the Award into compliance with Section 409A of the Code.

(ix) Generally, to exercise such powers and to perform such acts as the Board deems necessary or expedient to promote the best interests of the Company and that are not in conflict with the provisions of the Plan or Awards.

(x) To adopt such procedures and sub-plans as are necessary or appropriate to permit participation in the Plan by Employees, Directors or Consultants who are foreign nationals or employed outside the United States.

(c) Delegation to Committee.

(i) General. The Board may delegate some or all of the administration of the Plan to a Committee or Committees. If administration of the Plan is delegated to a Committee, the Committee shall have, in connection with the administration of the Plan, the powers theretofore possessed by the Board that have been delegated to the Committee, including the power to delegate to a subcommittee of the Committee any of the administrative powers the Committee is authorized to exercise (and references in this Plan to the Board shall thereafter be to the Committee or subcommittee), subject, however, to such resolutions, not inconsistent with the provisions of the Plan, as may be adopted from time to time by the Board. The Board may retain the authority to concurrently administer the Plan with the Committee and may, at any time, revest in the Board some or all of the powers previously delegated.

(ii) Section 162(m) and Rule 16b-3 Compliance. The Committee may consist solely of two or more Outside Directors, in accordance with Section 162(m) of the Code, or solely of two or more Non-Employee Directors, in accordance with Rule 16b-3.

(d) Effect of Board s Decision. All determinations, interpretations and constructions made by the Board in good faith shall not be subject to review by any person and shall be final, binding and conclusive on all persons.

(e) Cancellation and Re-Grant of Stock Awards. Neither the Board nor any Committee shall have the authority to: (i) reduce the exercise price of any outstanding Options or Stock Appreciation Rights under the Plan, or (ii) cancel any outstanding Options or Stock Appreciation Rights that have an exercise price or strike price greater than the current Fair Market Value of the Common Stock in exchange for cash or other Stock Awards under the Plan, unless the stockholders of the Company have approved such an action within twelve (12) months prior to such an event.

3. Shares Subject to the Plan.

(a) Share Reserve. Subject to Section 9(a) relating to Capitalization Adjustments, the aggregate number of shares of Common Stock that may be issued pursuant to Stock Awards from and after the Effective Date shall not exceed 20,520,535 shares (the ***Share Reserve***), which number is the sum of (i) the number of shares subject to the Prior Plans Available Reserve, (ii) an additional 12,500,000 new shares, plus (iii) an additional number of shares in an amount not to exceed 7,112,217 shares (which number consists of the Returning Shares, if any, as such shares become available from time to time). For clarity, the Share Reserve in this Section 3(a) is a limitation on the number of shares of the Common Stock that may be issued pursuant to the Plan and does not limit the granting of Stock Awards except as provided in Section 7(a). Shares may be issued in connection with a merger or acquisition as permitted by, as applicable, NASDAQ Marketplace Rule 4350(i)(1)(A)(iii), NYSE Listed Company Manual Section 303A.08, AMEX Company Guide Section 711 or other applicable stock exchange rules, and such issuance shall not reduce the number of shares available for issuance under the Plan. Furthermore, if a Stock Award or any portion thereof (i) expires or otherwise terminates without all of the shares covered by such Stock Award having been issued or (ii) is settled in cash (*i.e.*, the Participant receives cash rather than stock), such expiration, termination or settlement shall not reduce (or otherwise offset) the number of shares of Common Stock that may be available for issuance under the Plan.

(b) Subject to subsection 3(c), the number of shares available for issuance under the Plan shall be reduced by: (i) one (1) share for each share of stock issued pursuant to (A) an Option granted under Section 5, or (B) a Stock Appreciation Right granted under Section 5 with respect to which the strike price is at least one hundred percent (100%) of the Fair Market Value of the underlying Common Stock on the date of grant; and (ii) 1.5 shares for each share of Common Stock issued pursuant to a Restricted Stock Award, Restricted Stock Unit Award, Performance Stock Award or Other Stock Award.

(c) Reversion of Shares to the Share Reserve.

(i) Shares Available For Subsequent Issuance. If any shares of common stock issued pursuant to a Stock Award are forfeited back to the Company because of the failure to meet a contingency or condition required to vest such shares in the Participant, then the shares that are forfeited shall revert to and again become available for issuance under the Plan. Notwithstanding the provisions of this Section 3(c)(i), any such shares shall not be subsequently issued pursuant to the exercise of Incentive Stock Options. To the extent there is issued a share of Common Stock pursuant to a Restricted Stock Award, Restricted Stock Unit Award, Performance Stock Award or Other Stock Award, and such share of Common Stock again becomes available for issuance under the Plan pursuant to this Section 3(c), then the number of shares of Common Stock available for issuance under the Plan shall increase by 1.5 shares.

(ii) Shares Not Available For Subsequent Issuance. If any shares subject to a Stock Award are not delivered to a Participant because the Stock Award is exercised through a reduction of shares subject to the Stock Award (*i.e.*, net exercised), the number of shares that are not delivered to the Participant shall not remain available for issuance under the Plan. Also, any shares reacquired by the Company pursuant to Section 8(g) or as consideration for the exercise of an Option shall not again become available for issuance under the Plan.

(d) Incentive Stock Option Limit. Notwithstanding anything to the contrary in this Section 3 and, subject to the provisions of Section 9(a) relating to Capitalization Adjustments, the aggregate maximum number of shares of Common Stock that may be issued pursuant to the exercise of Incentive Stock Options shall be the number of shares in the Share Reserve.

(e) Source of Shares. The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock, including shares repurchased by the Company on the open market or otherwise.

4. Eligibility.

(a) Eligibility for Specific Stock Awards. Incentive Stock Options may be granted only to employees of the Company or a parent corporation or subsidiary corporation thereof (as such terms are defined in Sections 424(e) and (f) of the Code). Stock Awards other than Incentive Stock Options may be granted to Employees, Directors and Consultants; *provided, however*, Nonstatutory Stock Options and SARs may not be granted to Employees, Directors, and Consultants who are providing Continuous Services only to any parent of the Company, as such term is defined in Rule 405 promulgated under the Securities Act, unless such Stock Awards comply with the distribution requirements of Section 409A of the Code.

(b) Ten Percent Stockholders. A Ten Percent Stockholder shall not be granted an Incentive Stock Option unless the exercise price of such Option is at least one hundred ten percent (110%) of the Fair Market Value on the date of grant and the Option is not exercisable after the expiration of five (5) years from the date of grant.

(c) Section 162(m) Limitation on Annual Grants. Subject to the provisions of Section 9(a) relating to Capitalization Adjustments, at such time as the Company may be subject to the applicable provisions of Section 162(m) of the Code, no Participant shall be eligible to be granted during any calendar year Options, Stock Appreciation Rights and Other Stock Awards whose value is determined by reference to an increase over an exercise or strike price of at least one hundred percent (100%) of the Fair Market Value on the date the Stock Award is granted covering more than 2,000,000 shares of Common Stock.

5. Provisions relating to Options and Stock Appreciation Rights.

Each Option or SAR shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. All Options shall be separately designated Incentive Stock Options or Nonstatutory Stock Options at the time of grant, and, if certificates are issued, a separate certificate or certificates shall be issued for

shares of Common Stock purchased on exercise of each type of Option. If an Option is not specifically designated as an Incentive Stock Option, then the Option shall be a Nonstatutory Stock Option. The provisions of separate Options or SARs need not be identical; *provided, however*, that each Option Agreement or Stock Appreciation Right Agreement shall conform to (through incorporation of provisions hereof by reference in the applicable Award Agreement or otherwise) the substance of each of the following provisions:

(a) Term. Subject to the provisions of Section 4(b) regarding Ten Percent Stockholders, no Option or SAR shall be exercisable after the expiration of seven (7) years from the date of its grant or such shorter period specified in the Award Agreement.

(b) Exercise Price. Subject to the provisions of Section 4(b) regarding Ten Percent Stockholders, the exercise price (or strike price) of each Option or SAR shall be not less than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option or SAR on the date the Option or SAR is granted. Notwithstanding the foregoing, an Option or SAR may be granted with an exercise price (or strike price) lower than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option or SAR if such Option or SAR is granted pursuant to an assumption of or substitution for another option or stock appreciation right pursuant to a Corporate Transaction and in a manner consistent with the provisions of Sections 409A and, if applicable, 424(a) of the Code. Each SAR will be denominated in shares of Common Stock equivalents.

(c) Purchase Price for Options. The purchase price of Common Stock acquired pursuant to the exercise of an Option shall be paid, to the extent permitted by applicable law and as determined by the Board in its sole discretion, by any combination of the methods of payment set forth below. The Board shall have the authority to grant Options that do not permit all of the following methods of payment (or otherwise restrict the ability to use certain methods) and to grant Options that require the consent of the Company to utilize a particular method of payment. The permitted methods of payment are as follows:

(i) by cash, check, bank draft or money order payable to the Company;

(ii) pursuant to a program developed under Regulation T as promulgated by the Federal Reserve Board that, prior to the issuance of the stock subject to the Option, results in either the receipt of cash (or check) by the Company or the receipt of irrevocable instructions to pay the aggregate exercise price to the Company from the sales proceeds;

(iii) by delivery to the Company (either by actual delivery or attestation) of shares of Common Stock;

(iv) if the option is a Nonstatutory Stock Option, by a net exercise arrangement pursuant to which the Company will reduce the number of shares of Common Stock issuable upon exercise by the largest whole number of shares with a Fair Market Value that does not exceed the aggregate exercise price; *provided, however*, that the Company shall accept a cash or other payment from the Participant to the extent of any remaining balance of the aggregate exercise price not satisfied by such reduction in the number of whole shares to be issued; *provided, further,* that shares of Common Stock will no longer be subject to an Option and will not be exercisable thereafter to the extent that (A) shares issuable upon exercise are reduced to pay the exercise price pursuant to the net exercise, (B) shares are delivered to the Participant as a result of such exercise, and (C) shares are withheld to satisfy tax withholding obligations; or

(v) in any other form of legal consideration that may be acceptable to the Board.

(d) Exercise and Payment of a SAR. To exercise any outstanding Stock Appreciation Right, the Participant must provide written notice of exercise to the Company in compliance with the provisions of the Stock Appreciation Right Agreement evidencing such Stock Appreciation Right. The appreciation distribution payable on the exercise of a Stock Appreciation Right will be not greater than an amount equal to the excess of (A) the aggregate Fair Market Value (on the date of the exercise of the Stock Appreciation Right) of a number of

shares of Common Stock equal to the number of Common Stock equivalents in which the Participant is vested under such Stock Appreciation Right, and with respect to which the Participant is exercising the Stock Appreciation Right on such date, over (B) the strike price that will be determined by the Board at the time of grant of the Stock Appreciation Right. The appreciation distribution in respect to a Stock Appreciation Right may be paid in Common Stock, in cash, in any combination of the two or in any other form of consideration, as determined by the Board and contained in the Stock Appreciation Right Agreement evidencing such Stock Appreciation Right.

(e) Transferability of Options and SARs. The Board may, in its sole discretion, impose such limitations on the transferability of Options and SARs as the Board shall determine. In the absence of such a determination by the Board to the contrary, the following restrictions on the transferability of Options and SARs shall apply:

(i) Restrictions on Transfer. An Option or SAR shall not be transferable except by will or by the laws of descent and distribution and shall be exercisable during the lifetime of the Participant only by the Participant; *provided, however*, that the Board may, in its sole discretion, permit transfer of the Option or SAR in a manner that is not prohibited by applicable tax and securities laws upon the Participant s request. Except as explicitly provided herein, neither an Option nor a SAR may be transferred for consideration.

(ii) Domestic Relations Orders. Notwithstanding the foregoing, an Option or SAR may be transferred pursuant to a domestic relations order; *provided, however*, that if an Option is an Incentive Stock Option, such Option may be deemed to be a Nonstatutory Stock Option as a result of such transfer.

(iii) Beneficiary Designation. Notwithstanding the foregoing, the Participant may, by delivering written notice to the Company, in a form provided by or otherwise satisfactory to the Company and any broker designated by the Company to effect Option exercises, designate a third party who, in the event of the death of the Participant, shall thereafter be entitled to exercise the Option or SAR and receive the Common Stock or other consideration resulting from such exercise. In the absence of such a designation, the executor or administrator of the Participant s estate shall be entitled to exercise the Option or SAR and receive the Common Stock or other consideration resulting from such exercise.

(f) Vesting Generally. The total number of shares of Common Stock subject to an Option or SAR may vest and therefore become exercisable in periodic installments that may or may not be equal. The Option or SAR may be subject to such other terms and conditions on the time or times when it may or may not be exercised (which may be based on the satisfaction of Performance Goals or other criteria) as the Board may deem appropriate. The vesting provisions of individual Options or SARs may vary. The provisions of this Section 5(f) are subject to any Option or SAR provisions governing the minimum number of shares of Common Stock as to which an Option or SAR may be exercised.

(g) Termination of Continuous Service. Except as otherwise provided in the applicable Award Agreement or other agreement between the Participant and the Company, if a Participant s Continuous Service terminates (other than for Cause or upon the Participant s death or Disability), the Participant may exercise his or her Option or SAR (to the extent that the Participant was entitled to exercise such Award as of the date of termination of Continuous Service) but only within such period of time ending on the earlier of (i) the date three (3) months following the termination of the Participant s Continuous Service (or such longer or shorter period specified in the applicable Award Agreement), or (ii) the expiration of the term of the Option or SAR as set forth in the Award Agreement. If, after termination of Continuous Service, the Participant does not exercise his or her Option or SAR within the time specified herein or in the Award Agreement (as applicable), the Option or SAR shall terminate.

(h) Extension of Termination Date. If the exercise of an Option or SAR following the termination of the Participant s Continuous Service (other than for Cause or upon the Participant s death or Disability) would be prohibited at any time solely because the issuance of shares of Common Stock would violate the registration requirements under the Securities Act, then the Option or SAR shall terminate on the earlier of (i) the expiration

of a total period of three (3) months (that need not be consecutive) after the termination of the Participant s Continuous Service during which the exercise of the Option or SAR would not be in violation of such registration requirements, or (ii) the expiration of the term of the Option or SAR as set forth in the applicable Award Agreement. In addition, unless otherwise provided in a Participant s Award Agreement, if the sale of any Common Stock received upon exercise of an Option or SAR following the termination of the Participant s Continuous Service (other than for Cause) would violate the Company s insider trading policy, then the Option or SAR shall terminate on the earlier of (i) the expiration of a period equal to the applicable post-termination exercise period after the termination of the Participant s Continuous Service during which the exercise of the Option or SAR would not be in violation of the Company s insider trading policy, or (ii) the expiration of the term of the Option or SAR as set forth in the applicable Award Agreement.

(i) Disability of Participant. Except as otherwise provided in the applicable Award Agreement or other agreement between the Participant and the Company, if a Participant s Continuous Service terminates as a result of the Participant s Disability, the Participant may exercise his or her Option or SAR (to the extent that the Participant was entitled to exercise such Option or SAR as of the date of termination of Continuous Service), but only within such period of time ending on the earlier of (i) the date twelve (12) months following such termination of Continuous Service (or such longer or shorter period specified in the Award Agreement), or (ii) the expiration of the term of the Option or SAR as set forth in the Award Agreement. If, after termination of Continuous Service, the Participant does not exercise his or her Option or SAR within the time specified herein or in the Award Agreement (as applicable), the Option or SAR (as applicable) shall terminate.

(j) Death of Participant. Except as otherwise provided in the applicable Award Agreement or other agreement between the Participant and the Company, if (i) a Participant s Continuous Service terminates as a result of the Participant s death, or (ii) the Participant dies within the period (if any) specified in the Award Agreement after the termination of the Participant s Continuous Service for a reason other than death, then the Option or SAR may be exercised (to the extent the Participant was entitled to exercise such Option or SAR as of the date of death) by the Participant s estate, by a person who acquired the right to exercise the Option or SAR by bequest or inheritance or by a person designated to exercise the Option or SAR upon the Participant s death, but only within the period ending on the earlier of (i) the date eighteen (18) months following the date of death (or such longer or shorter period specified in the Award Agreement), or (ii) the expiration of the term of such Option or SAR as set forth in the Award Agreement. If, after the Participant s death, the Option or SAR is not exercised within the time specified herein or in the Award Agreement (as applicable), the Option or SAR shall terminate.

(k) Termination for Cause. Except as explicitly provided otherwise in a Participant s Award Agreement, if a Participant s Continuous Service is terminated for Cause, the Option or SAR shall terminate upon the date on which the event giving rise to the termination occurred, and the Participant shall be prohibited from exercising his or her Option or SAR from and after the time of such termination of Continuous Service.

(l) Non-Exempt Employees. No Option or SAR granted to an Employee who is a non-exempt employee for purposes of the Fair Labor Standards Act of 1938, as amended, shall be first exercisable for any shares of Common Stock until at least six months following the date of grant of the Option or SAR. Notwithstanding the foregoing, consistent with the provisions of the Worker Economic Opportunity Act, (i) in the event of the Participant s death or Disability, (ii) upon a Corporate Transaction in which such Option or SAR is not assumed, continued, or substituted, (iii) upon a Change in Control, or (iv) upon the Participant s retirement (as such term may be defined in the Participant s Award Agreement or in another applicable agreement or in accordance with the Company s then current employment policies and guidelines), any such vested Options and SARs may be exercised earlier than six months following the date of grant. The foregoing provision is intended to operate so that any income derived by a non-exempt employee in connection with the exercise or vesting of an Option or SAR will be exempt from his or her regular rate of pay.

6. Provisions of Stock Awards other than Options and SARs.

(a) Restricted Stock Awards. Each Restricted Stock Award Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. To the extent consistent with the Company s Bylaws, at the Board s election, shares of Common Stock may be (x) held in book entry form subject to the Company s instructions until any restrictions relating to the Restricted Stock Award lapse; or (y) evidenced by a certificate, which certificate shall be held in such form and manner as determined by the Board. The terms and conditions of Restricted Stock Award Agreements may change from time to time, and the terms and conditions of separate Restricted Stock Award Agreements need not be identical; *provided, however,* that each Restricted Stock Award Agreement shall conform to (through incorporation of the provisions hereof by reference in the agreement or otherwise) the substance of each of the following provisions:

(i) Consideration. A Restricted Stock Award may be awarded in consideration for (A) cash, check, bank draft or money order payable to the Company, (B) past services to the Company or an Affiliate, or (C) any other form of legal consideration (including future services) that may be acceptable to the Board, in its sole discretion, and permissible under applicable law.

(ii) Vesting. Shares of Common Stock awarded under the Restricted Stock Award Agreement may be subject to forfeiture to the Company in accordance with a vesting schedule to be determined by the Board.

(iii) Termination of Participant s Continuous Service. If a Participant s Continuous Service terminates, the Company may receive through a forfeiture condition or a repurchase right any or all of the shares of Common Stock held by the Participant that have not vested as of the date of termination of Continuous Service under the terms of the Restricted Stock Award Agreement.

(iv) Transferability. Rights to acquire shares of Common Stock under the Restricted Stock Award Agreement shall be transferable by the Participant only upon such terms and conditions as are set forth in the Restricted Stock Award Agreement, as the Board shall determine in its sole discretion, so long as Common Stock awarded under the Restricted Stock Award Agreement remains subject to the terms of the Restricted Stock Award Agreement.

(v) Dividends. A Restricted Stock Award Agreement may provide that any dividends paid on Restricted Stock will be subject to the same vesting and forfeiture restrictions as apply to the shares subject to the Restricted Stock Award to which they relate.

(b) Restricted Stock Unit Awards. Each Restricted Stock Unit Award Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. The terms and conditions of Restricted Stock Unit Award Agreements may change from time to time, and the terms and conditions of separate Restricted Stock Unit Award Agreements need not be identical; *provided, however*, that each Restricted Stock Unit Award Agreement shall conform to (through incorporation of the provisions hereof by reference in the Agreement or otherwise) the substance of each of the following provisions:

(i) Consideration. At the time of grant of a Restricted Stock Unit Award, the Board will determine the consideration, if any, to be paid by the Participant upon delivery of each share of Common Stock subject to the Restricted Stock Unit Award. The consideration to be paid (if any) by the Participant for each share of Common Stock subject to a Restricted Stock Unit Award may be paid in any form of legal consideration that may be acceptable to the Board, in its sole discretion, and permissible under applicable law.

(ii) Vesting. At the time of the grant of a Restricted Stock Unit Award, the Board may impose such restrictions on or conditions to the vesting of the Restricted Stock Unit Award as it, in its sole discretion, deems appropriate.

(iii) Payment. A Restricted Stock Unit Award may be settled by the delivery of shares of Common Stock, their cash equivalent, any combination thereof or in any other form of consideration, as determined by the Board and contained in the Restricted Stock Unit Award Agreement.

(iv) Additional Restrictions. At the time of the grant of a Restricted Stock Unit Award, the Board, as it deems appropriate, may impose such restrictions or conditions that delay the delivery of the shares of Common Stock (or their cash equivalent) subject to a Restricted Stock Unit Award to a time after the vesting of such Restricted Stock Unit Award.

(v) Dividend Equivalents. Dividend equivalents may be credited in respect of shares of Common Stock covered by a Restricted Stock Unit Award, as determined by the Board and contained in the Restricted Stock Unit Award Agreement. At the sole discretion of the Board, such dividend equivalents may be converted into additional shares of Common Stock covered by the Restricted Stock Unit Award in such manner as determined by the Board. Any additional shares covered by the Restricted Stock Unit Award credited by reason of such dividend equivalents will be subject to all of the same terms and conditions of the underlying Restricted Stock Unit Award Agreement to which they relate.

(vi) Termination of Participant s Continuous Service. Except as otherwise provided in the applicable Restricted Stock Unit Award Agreement, such portion of the Restricted Stock Unit Award that has not vested will be forfeited upon the Participant s termination of Continuous Service.

(c) Performance Awards.

(i) Performance Stock Awards. A Performance Stock Award is a Stock Award that may vest or may be exercised contingent upon the attainment during a Performance Period of certain Performance Goals. A Performance Stock Award may, but need not, require the completion of a specified period of Continuous Service. The length of any Performance Period, the Performance Goals to be achieved during the Performance Period, and the measure of whether and to what degree such Performance Goals have been attained shall be conclusively determined by the Committee, in its sole discretion. The maximum number of shares covered by an Award that may be granted to any Participant in a calendar year attributable to Stock Awards described in this Section 6(c)(i) (whether the grant, vesting or exercise is contingent upon the attainment during a Performance Period of the Performance Goals) shall not exceed 2,000,000 shares of Common Stock. The Board may provide for or, subject to such terms and conditions as the Board may specify, may permit a Participant to elect for, the payment of any Performance Stock Award to be deferred to a specified date or event. In addition, to the extent permitted by applicable law and the applicable Award Agreement, the Board may determine that cash may be used in payment of Performance Stock Awards.

(ii) Performance Cash Awards. A Performance Cash Award is a cash award that may be paid contingent upon the attainment during a Performance Period of certain Performance Goals. A Performance Cash Award may also require the completion of a specified period of Continuous Service. At the time of grant of a Performance Cash Award, the length of any Performance Period, the Performance Goals to be achieved during the Performance Period, and the measure of whether and to what degree such Performance Goals have been attained shall be conclusively determined by the Committee, in its sole discretion. In any calendar year, the Committee may not grant a Performance Cash Award that has a maximum value that may be paid to any Participant in excess of $2,000,000. The Board may provide for or, subject to such terms and conditions as the Board may specify, may permit a Participant to elect for, the payment of any Performance Cash Award to be deferred to a specified date or event. The Committee may specify the form of payment of Performance Cash Awards, which may be cash or other property, or may provide for a Participant to have the option for his or her Performance Cash Award, or such portion thereof as the Board may specify, to be paid in whole or in part in cash or other property.

(iii) Section 162(m) Compliance. Unless otherwise permitted in compliance with the requirements of Section 162(m) of the Code with respect to an Award intended to qualify as performance-based

compensation thereunder, the Committee shall establish the Performance Goals applicable to, and the formula for calculating the amount payable under, the Award no later than the earlier of (a) the date ninety (90) days after the commencement of the applicable Performance Period, or (b) the date on which twenty-five (25%) of the Performance Period has elapsed, and in any event at a time when the achievement of the applicable Performance Goals remains substantially uncertain. Prior to the payment of any compensation under an Award intended to qualify as performance-based compensation under Section 162(m) of the Code, the Committee shall certify the extent to which any Performance Goals and any other material terms under such Award have been satisfied (other than in cases where such relate solely to the increase in the value of the Common Stock). Notwithstanding satisfaction of any completion of any Performance Goals, to the extent specified at the time of grant of an Award to covered employees within the meaning of Section 162(m) of the Code, the number of Shares, Options, cash or other benefits granted, issued, retainable and/or vested under an Award on account of satisfaction of such Performance Goals may be reduced by the Committee on the basis of such further considerations as the Committee, in its sole discretion, shall determine.

(d) Other Stock Awards. Other forms of Stock Awards valued in whole or in part by reference to, or otherwise based on, Common Stock, including the appreciation in value thereof (e.g., options or stock rights with an exercise price or strike price less than 100% of the Fair Market Value of the Common Stock at the time of grant) may be granted either alone or in addition to Stock Awards provided for under Section 5 and the preceding provisions of this Section 6. Subject to the provisions of the Plan, the Board shall have sole and complete authority to determine the persons to whom and the time or times at which such Other Stock Awards will be granted, the number of shares of Common Stock (or the cash equivalent thereof) to be granted pursuant to such Other Stock Awards and all other terms and conditions of such Other Stock Awards.

7. Covenants of the Company.

(a) Availability of Shares. During the terms of the Stock Awards, the Company shall keep available at all times the number of shares of Common Stock reasonably required to satisfy such Stock Awards.

(b) Securities Law Compliance. The Company shall seek to obtain from each regulatory commission or agency having jurisdiction over the Plan such authority as may be required to grant Stock Awards and to issue and sell shares of Common Stock upon exercise of the Stock Awards; *provided, however*, that this undertaking shall not require the Company to register under the Securities Act the Plan, any Stock Award or any Common Stock issued or issuable pursuant to any such Stock Award. If, after reasonable efforts, the Company is unable to obtain from any such regulatory commission or agency the authority that counsel for the Company deems necessary for the lawful issuance and sale of Common Stock under the Plan, the Company shall be relieved from any liability for failure to issue and sell Common Stock upon exercise of such Stock Awards unless and until such authority is obtained. A Participant shall not be eligible for the grant of a Stock Award or the subsequent issuance of Common Stock pursuant to the Stock Award if such grant or issuance would be in violation of any applicable securities law.

(c) No Obligation to Notify or Minimize Taxes. The Company shall have no duty or obligation to any Participant to advise such holder as to the time or manner of exercising such Stock Award. Furthermore, the Company shall have no duty or obligation to warn or otherwise advise such holder of a pending termination or expiration of a Stock Award or a possible period in which the Stock Award may not be exercised. The Company has no duty or obligation to minimize the tax consequences of a Stock Award to the holder of such Stock Award.

8. Miscellaneous.

(a) Use of Proceeds from Sales of Common Stock. Proceeds from the sale of shares of Common Stock pursuant to Stock Awards shall constitute general funds of the Company.

(b) Corporate Action Constituting Grant of Stock Awards. Corporate action constituting a grant by the Company of a Stock Award to any Participant shall be deemed completed as of the date of such corporate action, unless otherwise determined by the Board, regardless of when the instrument, certificate, or letter evidencing the Stock Award is communicated to, or actually received or accepted by, the Participant.

(c) Stockholder Rights. No Participant shall be deemed to be the holder of, or to have any of the rights of a holder with respect to, any shares of Common Stock subject to such Stock Award unless and until (i) such Participant has satisfied all requirements for exercise of the Stock Award pursuant to its terms, if applicable, and (ii) the issuance of the Common Stock subject to such Stock Award has been entered into the books and records of the Company.

(d) No Employment or Other Service Rights. Nothing in the Plan, any Stock Award Agreement or any other instrument executed thereunder or in connection with any Award granted pursuant thereto shall confer upon any Participant any right to continue to serve the Company or an Affiliate in the capacity in effect at the time the Stock Award was granted or shall affect the right of the Company or an Affiliate to terminate (i) the employment of an Employee with or without notice and with or without cause, (ii) the service of a Consultant pursuant to the terms of such Consultant s agreement with the Company or an Affiliate, or (iii) the service of a Director pursuant to the Bylaws of the Company or an Affiliate, and any applicable provisions of the corporate law of the state in which the Company or the Affiliate is incorporated, as the case may be.

(e) Incentive Stock Option $100,000 Limitation. To the extent that the aggregate Fair Market Value (determined at the time of grant) of Common Stock with respect to which Incentive Stock Options are exercisable for the first time by any Optionholder during any calendar year (under all plans of the Company and any Affiliates) exceeds one hundred thousand dollars ($100,000), the Options or portions thereof that exceed such limit (according to the order in which they were granted) shall be treated as Nonstatutory Stock Options, notwithstanding any contrary provision of the applicable Option Agreement(s).

(f) Investment Assurances. The Company may require a Participant, as a condition of exercising or acquiring Common Stock under any Stock Award, (i) to give written assurances satisfactory to the Company as to the Participant s knowledge and experience in financial and business matters and/or to employ a purchaser representative reasonably satisfactory to the Company who is knowledgeable and experienced in financial and business matters and that he or she is capable of evaluating, alone or together with the purchaser representative, the merits and risks of exercising the Stock Award; and (ii) to give written assurances satisfactory to the Company stating that the Participant is acquiring Common Stock subject to the Stock Award for the Participant s own account and not with any present intention of selling or otherwise distributing the Common Stock. The foregoing requirements, and any assurances given pursuant to such requirements, shall be inoperative if (A) the issuance of the shares upon the exercise or acquisition of Common Stock under the Stock Award has been registered under a then currently effective registration statement under the Securities Act, or (B) as to any particular requirement, a determination is made by counsel for the Company that such requirement need not be met in the circumstances under the then applicable securities laws. The Company may, upon advice of counsel to the Company, place legends on stock certificates issued under the Plan as such counsel deems necessary or appropriate in order to comply with applicable securities laws, including, but not limited to, legends restricting the transfer of the Common Stock.

(g) Withholding Obligations. Unless prohibited by the terms of a Stock Award Agreement, the Company may, in its sole discretion, satisfy any federal, state or local tax withholding obligation relating to an Award by any of the following means or by a combination of such means: (i) causing the Participant to tender a cash payment; (ii) withholding shares of Common Stock from the shares of Common Stock issued or otherwise issuable to the Participant in connection with the Award; *provided, however,* that no shares of Common Stock are withheld with a value exceeding the minimum amount of tax required to be withheld by law (or such lesser amount as may be necessary to avoid classification of the Stock Award as a liability for financial accounting purposes); (iii) withholding cash from an Award settled in cash; (iv) withholding payment from any amounts otherwise payable to the Participant; or (v) by such other method as may be set forth in the Award Agreement.

(h) Electronic Delivery. Any reference herein to a written agreement or document shall include any agreement or document delivered electronically or posted on the Company s intranet.

(i) Deferrals. To the extent permitted by applicable law, the Board, in its sole discretion, may determine that the delivery of Common Stock or the payment of cash, upon the exercise, vesting or settlement of all or a portion of any Award may be deferred and may establish programs and procedures for deferral elections to be made by Participants. Deferrals by Participants will be made in accordance with Section 409A of the Code. Consistent with Section 409A of the Code, the Board may provide for distributions while a Participant is still an employee or otherwise providing services to the Company. The Board is authorized to make deferrals of Awards and determine when, and in what annual percentages, Participants may receive payments, including lump sum payments, following the Participant s termination of Continuous Service, and implement such other terms and conditions consistent with the provisions of the Plan and in accordance with applicable law.

(j) Compliance with Section 409A. To the extent that the Board determines that any Award granted hereunder is subject to Section 409A of the Code, the Award Agreement evidencing such Award shall incorporate the terms and conditions necessary to avoid the consequences specified in Section 409A(a)(1) of the Code. To the extent applicable, the Plan and Award Agreements shall be interpreted in accordance with Section 409A of the Code. Notwithstanding anything to the contrary in this Plan (and unless the Award Agreement specifically provides otherwise), if the Shares are publicly traded and a Participant holding an Award that constitutes deferred compensation under Section 409A of the Code is a specified employee for purposes of Section 409A of the Code, no distribution or payment of any amount shall be made before a date that is six (6) months following the date of such Participant s separation from service (as defined in Section 409A of the Code without regard to alternative definitions thereunder) or, if earlier, the date of the Participant s death.

9. Adjustments upon Changes in Common Stock; Other Corporate Events.

(a) Capitalization Adjustments. In the event of a Capitalization Adjustment, the Board shall appropriately and proportionately adjust: (i) the class(es) and maximum number of securities subject to the Plan pursuant to Section 3(a), (ii) the class(es) and maximum number of securities that may be issued pursuant to the exercise of Incentive Stock Options pursuant to Section 3(d), (iii) the class(es) and maximum number of securities that may be awarded to any person pursuant to Sections 4(c) and 6(c)(i) , and (iv) the class(es) and number of securities and price per share of stock subject to outstanding Stock Awards. The Board shall make such adjustments, and its determination shall be final, binding and conclusive.

(b) Dissolution or Liquidation. Except as otherwise provided in the Stock Award Agreement, in the event of a dissolution or liquidation of the Company, all outstanding Stock Awards (other than Stock Awards consisting of vested and outstanding shares of Common Stock not subject to a forfeiture condition or the Company s right of repurchase) shall terminate immediately prior to the completion of such dissolution or liquidation, and the shares of Common Stock subject to the Company s repurchase rights or subject to a forfeiture condition may be repurchased or reacquired by the Company notwithstanding the fact that the holder of such Stock Award is providing Continuous Service, *provided, however*, that the Board may, in its sole discretion, cause some or all Stock Awards to become fully vested, exercisable and/or no longer subject to repurchase or forfeiture (to the extent such Stock Awards have not previously expired or terminated) before the dissolution or liquidation is completed but contingent on its completion.

(c) Corporate Transaction. The following provisions shall apply to Stock Awards in the event of a Corporate Transaction unless otherwise provided in the instrument evidencing the Stock Award or any other written agreement between the Company or any Affiliate and the Participant or unless otherwise expressly provided by the Board at the time of grant of a Stock Award:

(i) Stock Awards May Be Assumed. In the event of a Corporate Transaction, any surviving corporation or acquiring corporation (or the surviving or acquiring corporation s parent company) may assume or continue any or all Stock Awards outstanding under the Plan or may substitute similar stock

awards for Stock Awards outstanding under the Plan (including but not limited to, awards to acquire the same consideration paid to the stockholders of the Company pursuant to the Corporate Transaction), and any reacquisition or repurchase rights held by the Company in respect of Common Stock issued pursuant to Stock Awards may be assigned by the Company to the successor of the Company (or the successor s parent company, if any), in connection with such Corporate Transaction. A surviving corporation or acquiring corporation (or its parent) may choose to assume or continue only a portion of a Stock Award or substitute a similar stock award for only a portion of a Stock Award, or may choose to assume or continue the Stock Awards held by some, but not all Participants. The terms of any assumption, continuation or substitution shall be set by the Board.

(ii) Stock Awards Held by Current Participants. In the event of a Corporate Transaction in which the surviving corporation or acquiring corporation (or its parent company) does not assume or continue such outstanding Stock Awards or substitute similar stock awards for such outstanding Stock Awards, then with respect to Stock Awards that have not been assumed, continued or substituted and that are held by Participants whose Continuous Service has not terminated prior to the effective time of the Corporate Transaction (referred to as the ***Current Participants***), the vesting of such Stock Awards (and, with respect to Options and Stock Appreciation Rights, the time when such Stock Awards may be exercised) shall be accelerated in full to a date prior to the effective time of such Corporate Transaction (contingent upon the effectiveness of the Corporate Transaction) as the Board shall determine (or, if the Board shall not determine such a date, to the date that is five (5) days prior to the effective time of the Corporate Transaction), and such Stock Awards shall terminate if not exercised (if applicable) at or prior to the effective time of the Corporate Transaction, and any reacquisition or repurchase rights held by the Company with respect to such Stock Awards shall lapse (contingent upon the effectiveness of the Corporate Transaction).

(iii) Stock Awards Held by Persons other than Current Participants. In the event of a Corporate Transaction in which the surviving corporation or acquiring corporation (or its parent company) does not assume or continue such outstanding Stock Awards or substitute similar stock awards for such outstanding Stock Awards, then with respect to Stock Awards that have not been assumed, continued or substituted and that are held by persons other than Current Participants, such Stock Awards shall terminate if not exercised (if applicable) prior to the effective time of the Corporate Transaction; *provided, however*, that any reacquisition or repurchase rights held by the Company with respect to such Stock Awards shall not terminate and may continue to be exercised notwithstanding the Corporate Transaction.

(iv) Payment for Stock Awards in Lieu of Exercise. Notwithstanding the foregoing, in the event a Stock Award will terminate if not exercised prior to the effective time of a Corporate Transaction, the Board may provide, in its sole discretion, that the holder of such Stock Award may not exercise such Stock Award but will receive a payment, in such form as may be determined by the Board, equal in value, at the effective time, to the excess, if any, of (A) the value of the property the Participant would have received upon the exercise of the Stock Award (including, at the discretion of the Board, any unvested portion of such Stock Award), over (B) any exercise price payable by such holder in connection with such exercise.

The Board need not take the same action or actions with respect to all Stock Awards, portions thereof, or with respect to all Participants. Notwithstanding the foregoing, stock awards granted under the Prior Plans may provide for different treatment upon a Corporate Transaction or similar event, and the provisions of the Prior Plans will be controlling.

(d) Change in Control. A Stock Award may be subject to additional acceleration of vesting and exercisability upon or after a Change in Control as may be provided in the Stock Award Agreement for such Stock Award or as may be provided in any other written agreement between the Company or any Affiliate and the Participant, but in the absence of such provision, no such acceleration shall occur.

10. Termination or Suspension of the Plan.

(a) Plan Term. The Board may suspend or terminate the Plan at any time. Unless terminated sooner by the Board, the Plan shall automatically terminate on the day before the tenth (10th) anniversary of the earlier of (i) the date the Plan is adopted by the Board, or (ii) the date the Plan is approved by the stockholders of the Company. No Awards may be granted under the Plan while the Plan is suspended or after it is terminated.

(b) No Impairment of Rights. Suspension or termination of the Plan shall not impair rights and obligations under any Award granted while the Plan is in effect except with the written consent of the affected Participant.

11. Effective Date of Plan.

This Plan shall become effective on the Effective Date.

12. Choice of Law.

The law of the State of California shall govern all questions concerning the construction, validity and interpretation of this Plan, without regard to that state s conflict of laws rules.

13. Definitions. As used in the Plan, the following definitions shall apply to the capitalized terms indicated below:

(a) ***Affiliate*** means, at the time of determination, any parent or subsidiary of the Company as such terms are defined in Rule 405 of the Securities Act. The Board shall have the authority to determine the time or times at which parent or subsidiary status is determined within the foregoing definition.

(b) ***Award*** means a Stock Award or a Performance Cash Award.

(c) ***Award Agreement*** means a written agreement between the Company and a Participant evidencing the terms and conditions of an Award.

(d) ***Board*** means the Board of Directors of the Company.

(e) ***Capitalization Adjustment*** means any change that is made in, or other events that occur with respect to, the Common Stock subject to the Plan or subject to any Stock Award after the Effective Date without the receipt of consideration by the Company (through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend, dividend in property other than cash, large nonrecurring cash dividend, stock split, liquidating dividend, combination of shares, exchange of shares, change in corporate structure or any similar equity restructuring transaction (as that term is used in Statement of Financial Accounting Standards No. 123 (revised). Notwithstanding the foregoing, the conversion of any convertible securities of the Company shall not be treated as a Capitalization Adjustment.

(f) ***Cause*** shall have the meaning ascribed to such term in any written agreement between the Participant and the Company defining such term and, in the absence of such agreement, such term shall mean, with respect to a Participant, the occurrence of any of the following events that has a material negative impact on the business or reputation of the Company: (i) such Participant s attempted commission of, or participation in, a fraud or act of dishonesty against the Company; (ii) such Participant s intentional, material violation of any contract or agreement between the Participant and the Company or of any statutory duty owed to the Company; (iii) such Participant s unauthorized use or disclosure of the Company s confidential information or trade secrets; or (iv) such Participant s gross misconduct. The determination that a termination of the Participant s Continuous Service is either for Cause or without Cause shall be made by the Company, in its sole discretion. Any

determination by the Company that the Continuous Service of a Participant was terminated with or without Cause for the purposes of outstanding Awards held by such Participant shall have no effect upon any determination of the rights or obligations of the Company or such Participant for any other purpose.

(g) ***Change in Control*** means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

(i) any Exchange Act Person becomes the Owner, directly or indirectly, of securities of the Company representing more than fifty percent (50%) of the combined voting power of the Company s then outstanding securities other than by virtue of a merger, consolidation or similar transaction;

(ii) there is consummated a merger, consolidation or similar transaction involving (directly or indirectly) the Company and, immediately after the consummation of such merger, consolidation or similar transaction, the stockholders of the Company immediately prior thereto do not Own, directly or indirectly, either (A) outstanding voting securities representing more than fifty percent (50%) of the combined outstanding voting power of the surviving Entity in such merger, consolidation or similar transaction or (B) more than fifty percent (50%) of the combined outstanding voting power of the parent of the surviving Entity in such merger, consolidation or similar transaction, in each case in substantially the same proportions as their Ownership of the outstanding voting securities of the Company immediately prior to such transaction; or

(iii) there is consummated a sale, lease, exclusive license or other disposition of all or substantially all of the consolidated assets of the Company and its Subsidiaries, other than a sale, lease, license or other disposition of all or substantially all of the consolidated assets of the Company and its Subsidiaries to an Entity, more than fifty percent (50%) of the combined voting power of the voting securities of which are Owned by stockholders of the Company in substantially the same proportions as their Ownership of the outstanding voting securities of the Company immediately prior to such sale, lease, license or other disposition.

Notwithstanding the foregoing or any other provision of this Plan, the term Change in Control shall not include a sale of assets, merger or other transaction effected exclusively for the purpose of changing the domicile of the Company.

(h) ***Code*** means the Internal Revenue Code of 1986, as amended, including any applicable regulations and guidance thereunder.

(i) ***Committee*** means a committee of one or more Directors to whom authority has been delegated by the Board in accordance with Section 2(c).

(j) ***Common Stock*** means the common stock of the Company.

(k) ***Company*** means Dot Hill Systems Corp., a Delaware corporation.

(l) ***Consultant*** means any person, including an advisor, who is (i) engaged by the Company or an Affiliate to render consulting or advisory services and is compensated for such services, or (ii) serving as a member of the board of directors of an Affiliate and is compensated for such services. However, service solely as a Director, or payment of a fee for such service, shall not cause a Director to be considered a Consultant for purposes of the Plan. Notwithstanding the foregoing, a person is treated as a Consultant under this Plan only if a Form S-8 Registration Statement under the Securities Act is available to register either the offer or the sale of the Company s securities to such person.

(m) ***Continuous Service*** means that the Participant s service with the Company or an Affiliate, whether as an Employee, Director or Consultant, is not interrupted or terminated. A change in the capacity in which the

Participant renders service to the Company or an Affiliate as an Employee, Consultant or Director or a change in the entity for which the Participant renders such service, provided that there is no interruption or termination of the Participant s service with the Company or an Affiliate, shall not terminate a Participant s Continuous Service; *provided, however,* if the Entity for which a Participant is rendering services ceases to qualify as an Affiliate, as determined by the Board, in its sole discretion, such Participant s Continuous Service shall be considered to have terminated on the date such Entity ceases to qualify as an Affiliate. To the extent permitted by law, the Board or the chief executive officer of the Company, in that party s sole discretion, may determine whether Continuous Service shall be considered interrupted in the case of (i) any leave of absence approved by the Board or Chief Executive Officer, including sick leave, military leave or any other personal leave, or (ii) transfers between the Company, an Affiliate, or their successors. Notwithstanding the foregoing, a leave of absence shall be treated as Continuous Service for purposes of vesting in a Stock Award only to such extent as may be provided in the Company s leave of absence policy, in the written terms of any leave of absence agreement or policy applicable to the Participant, or as otherwise required by law.

(n) ***Corporate Transaction*** means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

(i) the consummation of a sale or other disposition of all or substantially all, as determined by the Board, in its sole discretion, of the consolidated assets of the Company and its Subsidiaries;

(ii) the consummation of a sale or other disposition of more than fifty (50%) of the outstanding securities of the Company;

(iii) the consummation of a merger, consolidation or similar transaction following which the Company is not the surviving corporation; or

(iv) the consummation of a merger, consolidation or similar transaction following which the Company is the surviving corporation but the shares of Common Stock outstanding immediately preceding the merger, consolidation or similar transaction are converted or exchanged by virtue of the merger, consolidation or similar transaction into other property, whether in the form of securities, cash or otherwise.

(o) ***Covered Employee*** shall have the meaning provided in Section 162(m)(3) of the Code.

(p) ***Director*** means a member of the Board.

(q) ***Disability*** means, with respect to a Participant, the inability of such Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve (12) months, as provided in Sections 22(e)(3) and 409A(a)(2)(c)(i) of the Code, and shall be determined by the Board on the basis of such medical evidence as the Board deems warranted under the circumstances.

(r) ***Effective Date*** means the effective date of this Plan document, which is the date of the annual meeting of stockholders of the Company held in 2009 provided this Plan is approved by the Company s stockholders at such meeting.

(s) ***Employee*** means any person employed by the Company or an Affiliate. However, service solely as a Director, or payment of a fee for such services, shall not cause a Director to be considered an Employee for purposes of the Plan.

(t) ***Entity*** means a corporation, partnership, limited liability company or other entity.

(u) ***Exchange Act*** means the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

(v) ***Exchange Act Person*** means any natural person, Entity or group (within the meaning of Section 13(d) or 14(d) of the Exchange Act), except that Exchange Act Person shall not include (i) the Company or any Subsidiary of the Company, (ii) any employee benefit plan of the Company or any Subsidiary of the Company or any trustee or other fiduciary holding securities under an employee benefit plan of the Company or any Subsidiary of the Company, (iii) an underwriter temporarily holding securities pursuant to a registered public offering of such securities, (iv) an Entity Owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their Ownership of stock of the Company; or (v) any natural person, Entity or group (within the meaning of Section 13(d) or 14(d) of the Exchange Act) that, as of the Effective Date, is the Owner, directly or indirectly, of securities of the Company representing more than fifty percent (50%) of the combined voting power of the Company s then outstanding securities.

(w) ***Fair Market Value*** means, as of any date, the value of the Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or traded on any established market, the Fair Market Value of a share of Common Stock shall be the closing sales price for such stock as quoted on such exchange or market (or the exchange or market with the greatest volume of trading in the Common Stock) on the date of determination, as reported in a source the Board deems reliable.

(ii) Unless otherwise provided by the Board, if there is no closing sales price for the Common Stock on the date of determination, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(iii) In the absence of such markets for the Common Stock, the Fair Market Value shall be determined by the Board in good faith and in a manner that complies with Sections 409A and 422 of the Code.

(x) ***Incentive Stock Option*** means an option granted pursuant to Section 5 of the Plan that is intended to be, and qualifies as, an incentive stock option within the meaning of Section 422 of the Code.

(y) ***Non-Employee Director*** means a Director who either (i) is not a current employee or officer of the Company or an Affiliate, does not receive compensation, either directly or indirectly, from the Company or an Affiliate for services rendered as a consultant or in any capacity other than as a Director (except for an amount as to which disclosure would not be required under Item 404(a) of Regulation S-K promulgated pursuant to the Securities Act (***Regulation S-K***)), does not possess an interest in any other transaction for which disclosure would be required under Item 404(a) of Regulation S-K, and is not engaged in a business relationship for which disclosure would be required pursuant to Item 404(b) of Regulation S-K; or (ii) is otherwise considered a non-employee director for purposes of Rule 16b-3.

(z) ***Nonstatutory Stock Option*** means any option granted pursuant to Section 5 of the Plan that does not qualify as an Incentive Stock Option.

(aa) ***Officer*** means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act.

(bb) ***Option*** means an Incentive Stock Option or a Nonstatutory Stock Option to purchase shares of Common Stock granted pursuant to the Plan.

(cc) ***Option Agreement*** means a written agreement between the Company and an Optionholder evidencing the terms and conditions of an Option grant. Each Option Agreement shall be subject to the terms and conditions of the Plan.

(dd) ***Optionholder*** means a person to whom an Option is granted pursuant to the Plan or, if applicable, such other person who holds an outstanding Option.

(ee) ***Other Stock Award*** means an award based in whole or in part by reference to the Common Stock which is granted pursuant to the terms and conditions of Section 6(d).

(ff) ***Other Stock Award Agreement*** means a written agreement between the Company and a holder of an Other Stock Award evidencing the terms and conditions of an Other Stock Award grant. Each Other Stock Award Agreement shall be subject to the terms and conditions of the Plan.

(gg) ***Outside Director*** means a Director who either (i) is not a current employee of the Company or an affiliated corporation (within the meaning of Treasury Regulations promulgated under Section 162(m) of the Code), is not a former employee of the Company or an affiliated corporation who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year, has not been an officer of the Company or an affiliated corporation, and does not receive remuneration from the Company or an affiliated corporation, either directly or indirectly, in any capacity other than as a Director, or (ii) is otherwise considered an outside director for purposes of Section 162(m) of the Code.

(hh) ***Own, Owned, Owner, Ownership*** A person or Entity shall be deemed to Own, to have Owned, to be the Owner of, or to have acq Ownership of securities if such person or Entity, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power, which includes the power to vote or to direct the voting, with respect to such securities.

(ii) ***Participant*** means a person to whom an Award is granted pursuant to the Plan or, if applicable, such other person who holds an outstanding Stock Award.

(jj) ***Performance Cash Award*** means an award of cash granted pursuant to the terms and conditions of Section 6(c)(ii).

(kk) ***Performance Criteria*** means the one or more criteria that the Board shall select for purposes of establishing the Performance Goals for a Performance Period. The Performance Criteria that shall be used to establish such Performance Goals may be based on any one of, or combination of, the following as determined by the Board: (i) earnings (including earnings per share and net earnings); (ii) earnings before interest, taxes and depreciation; (iii) earnings before interest, taxes, depreciation and amortization; (iv) total stockholder return; (v) return on equity or average stockholder s equity; (vi) return on assets, investment, or capital employed; (vii) stock price; (viii) margin (including gross margin); (ix) income (before or after taxes); (x) operating income; (xi) operating income after taxes; (xii) pre-tax profit; (xiii) operating cash flow; (xiv) sales or revenue targets; (xv) increases in revenue or product revenue; (xvi) expenses and cost reduction goals; (xvii) improvement in or attainment of working capital levels; (xiii) economic value added (or an equivalent metric); (xix) market share; (xx) cash flow; (xxi) cash flow per share; (xxii) share price performance; (xxiii) debt reduction; (xxiv) implementation or completion of projects or processes; (xxv) customer satisfaction; (xxvi) stockholders equity; (xxvii) capital expenditures; (xxiii) debt levels; (xxix) operating profit or net operating profit; (xxx) workforce diversity; (xxxi) growth of net income or operating income; (xxxii) billings; and (xxxiii) to the extent that an Award is not intended to comply with Section 162(m) of the Code, other measures of performance selected by the Board.

(ll) ***Performance Goals*** means, for a Performance Period, the one or more goals established by the Board for the Performance Period based upon the Performance Criteria. Performance Goals may be based on a Company-wide basis, with respect to one or more business units, divisions, Affiliates, or business segments, and in either absolute terms or relative to the performance of one or more comparable companies or the performance of one or more relevant indices. Unless specified otherwise by the Board (i) in the Award Agreement at the time the Award is granted or (ii) in such other document setting forth the Performance Goals at the time the Performance Goals are established, the Board shall appropriately make adjustments in the method of calculating the attainment of Performance Goals for a Performance Period as follows: (1) to exclude restructuring and/or other nonrecurring charges; (2) to exclude exchange rate effects, as applicable, for non-U.S. dollar denominated Performance Goals; (3) to exclude the effects of changes to generally accepted accounting principles; (4) to

exclude the effects of any statutory adjustments to corporate tax rates; and (5) to exclude the effects of any extraordinary items as determined under generally accepted accounting principles. In addition, the Board retains the discretion to reduce or eliminate the compensation or economic benefit due upon attainment of Performance Goals and to define the manner of calculating the Performance Criteria it selects to use for such Performance Period. Partial achievement of the specified criteria may result in the payment or vesting corresponding to the degree of achievement as specified in the Stock Award Agreement or the written terms of a Performance Cash Award.

(mm) ***Performance Period*** means the period of time selected by the Board over which the attainment of one or more Performance Goals will be measured for the purpose of determining a Participant s right to and the payment of a Stock Award or a Performance Cash Award. Performance Periods may be of varying and overlapping duration, at the sole discretion of the Board.

(nn) ***Performance Stock Award*** means a Stock Award granted under the terms and conditions of Section 6(c)(i).

(oo) ***Plan*** means this Dot Hill Systems Corp. 2009 Equity Incentive Plan.

(pp) ***Restricted Stock Award*** means an award of shares of Common Stock which is granted pursuant to the terms and conditions of Section 6(a).

(qq) ***Restricted Stock Award Agreement*** means a written agreement between the Company and a holder of a Restricted Stock Award evidencing the terms and conditions of a Restricted Stock Award grant. Each Restricted Stock Award Agreement shall be subject to the terms and conditions of the Plan.

(rr) ***Restricted Stock Unit Award*** means a right to receive shares of Common Stock which is granted pursuant to the terms and conditions of Section 6(b).

(ss) ***Restricted Stock Unit Award Agreement*** means a written agreement between the Company and a holder of a Restricted Stock Unit Award evidencing the terms and conditions of a Restricted Stock Unit Award grant. Each Restricted Stock Unit Award Agreement shall be subject to the terms and conditions of the Plan.

(tt) ***Rule 16b-3*** means Rule 16b-3 promulgated under the Exchange Act or any successor to Rule 16b-3, as in effect from time to time.

(uu) ***Securities Act*** means the Securities Act of 1933, as amended.

(vv) ***Stock Appreciation Right*** or ***SAR*** means a right to receive the appreciation on Common Stock that is granted pursuant to the terms and conditions of Section 5.

(ww) ***Stock Appreciation Right Agreement*** means a written agreement between the Company and a holder of a Stock Appreciation Right evidencing the terms and conditions of a Stock Appreciation Right grant. Each Stock Appreciation Right Agreement shall be subject to the terms and conditions of the Plan.

(xx) ***Stock Award*** means any right to receive Common Stock granted under the Plan, including an Incentive Stock Option, a Nonstatutory Stock Option, a Restricted Stock Award, a Restricted Stock Unit Award, a Stock Appreciation Right, a Performance Stock Award or any Other Stock Award.

(yy) ***Stock Award Agreement*** means a written agreement between the Company and a Participant evidencing the terms and conditions of a Stock Award grant. Each Stock Award Agreement shall be subject to the terms and conditions of the Plan.

(zz) ***Subsidiary*** means, with respect to the Company, (i) any corporation of which more than fifty percent (50%) of the outstanding capital stock having ordinary voting power to elect a majority of the board of directors of such corporation (irrespective of whether, at the time, stock of any other class or classes of such corporation shall have or might have voting power by reason of the happening of any contingency) is at the time, directly or indirectly, Owned by the Company, and (ii) any partnership, limited liability company or other entity in which the Company has a direct or indirect interest (whether in the form of voting or participation in profits or capital contribution) of more than fifty percent (50%).

(aaa) ***Ten Percent Stockholder*** means a person who Owns (or is deemed to Own pursuant to Section 424(d) of the Code) stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any Affiliate.

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time on May 1, 2011. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time on May 1, 2011. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS: x

KEEP THIS PORTION FOR YOUR RECORDS
DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

	For All	Withhold All	For All Except	To withhold authority to vote for any individual nominee(s), mark For All Except and write the number(s) of the nominee(s) on the line below.
The Board of Directors recommends that you vote FOR the following:	..	..	..	

1. Election of Directors
Nominees:

01 Dana W. Kammersgard 02 Richard Mejia, Jr.

The Board of Directors recommends you vote FOR proposals 2 and 3.	**For**	**Against**	**Abstain**
2 To approve the Company s 2009 Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under the plan by 8,000,000 shares.	..	..	..
3 To approve the following resolution:	..	..	..

RESOLVED, that the compensation paid to the Company s Named Executive Officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.

The Board of Directors recommends you vote 3 YEARS on the following proposal:		**1 year**	**2 years**	**3 years**	**Abstain**
4	An advisory vote on the frequency of holding an advisory vote on executive compensation.	..	..	..	..

The Board of Directors recommends you vote FOR the following proposal:		**For**	**Against**	**Abstain**
5	To ratify the selection by the Audit Committee of the Board of Directors of Deloitte & Touche LLP as independent registered public accounting firm of the Company for its fiscal year ending December 31, 2011.	..	..	..

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name, by authorized officer.

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting: The Notice & Proxy Statement, 10K Wrap is/are available at **www.proxyvote.com**.

DOT HILL SYSTEMS CORP.

PROXY SOLICITED BY THE BOARD OF DIRECTORS

FOR THE ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD ON MAY 2, 2011

The undersigned hereby appoints Dana W. Kammersgard and Hanif I. Jamal, and each of them, as attorneys and proxies of the undersigned, with full power of substitution, to vote all of the shares of stock of Dot Hill Systems Corp. which the undersigned may be entitled to vote at the Annual Meeting of Stockholders of Dot Hill Systems Corp. to be held at 1351 S. Sunset Street, Longmont, Colorado, on Monday, May 2, 2011, at 8:30 a.m. (Mountain Time), and at any and all postponements, continuations and adjournments thereof, with all powers that the undersigned would possess if personally present, upon and in respect of the following matters and in accordance with the following instructions, and with discretionary authority as to any and all other matters that may properly come before the meeting.

Unless a contrary direction is indicated, this Proxy will be voted For the nominees listed in Proposal 1 and For Proposal 2, Proposal 3 and Proposal 5 and 3 years for Proposal 4, all as more specifically described in the Proxy Statement. If specific instructions are indicated, this Proxy will be voted in accordance therewith.

Continued and to be signed on reverse side

elvetica; color: #000000; background: #FFFFFF"> **Net Premiums Earned**

Net premiums earned for the three months ended December 31, 2009 were $427.9 million compared to $316.0 million for the three months ended December 31, 2008, an increase of $111.9 million or 35.4%. The increase in net premiums earned was driven by increased net premiums earned of $93.3 million and $18.6 million in the Validus Re and Talbot segments, respectively.

The increase in net premiums earned was due primarily to $93.3 million of net premiums earned resulting from the acquisition of IPC.

	Three Months Ended December 31, 2009(a)		Three Months Ended December 31, 2008		
(Dollars in thousands)	**Net Premiums Earned**	**Net Premiums Earned (%)**	**Net Premiums Earned**	**Net Premiums Earned (%)**	**% Change**
Property	$ 240,787	56.3%	$ 145,752	46.2%	65.2%
Marine	93,693	21.9%	93,339	29.5%	0.4%
Specialty	93,421	21.8%	76,940	24.3%	21.4%

Total	$ 427,901	100.0%	$ 316,031	100.0%	35.4%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Validus Re. Validus Re net premiums earned for the three months ended December 31, 2009 were $257.6 million compared to $164.4 million for the three months ended December 31, 2008, an increase of $93.3 million or, 56.7%. The increase in net premiums earned was due primarily to $93.3 million of net premiums earned resulting from the acquisition of IPC.

	Three Months Ended December 31, 2009(a)		Three Months Ended December 31, 2008		
(Dollars in thousands)	**Net Premiums Earned**	**Net Premiums Earned (%)**	**Net Premiums Earned**	**Net Premiums Earned (%)**	**% Change**
Property	$ 204,255	79.3%	$ 117,496	71.5%	73.8%
Marine	28,888	11.2%	29,371	17.9%	(1.6)%
Specialty	24,495	9.5%	17,501	10.6%	40.0%
Total	$ 257,638	100.0%	$ 164,368	100.0%	56.7%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

The increase in Validus Re net premiums earned was driven by an increase in the property lines of $86.8 million due primarily to $93.3 million of property net premiums earned resulting from the acquisition of IPC, as discussed above. The increase in specialty net premiums earned of $7.0 million was due to proportional risks attaching premiums from prior years which is generally earned over 24 months.

Talbot. Talbot net premiums earned for the three months ended December 31, 2009 were $170.3 million compared to $151.7 million for the three months ended December 31, 2008, an increase of $18.6 million or 12.3%.

	Three Months Ended December 31, 2009		Three Months Ended December 31, 2008		
(Dollars in thousands)	**Net Premiums Earned**	**Net Premiums Earned (%)**	**Net Premiums Earned**	**Net Premiums Earned (%)**	**% Change**
Property	$ 36,532	21.5%	$ 28,256	18.6%	29.3%
Marine	64,805	38.1%	63,968	42.2%	1.3%
Specialty	68,926	40.4%	59,439	39.2%	16.0%
Total	$ 170,263	100.0%	$ 151,663	100.0%	12.3%

The increase in net premiums earned is due primarily to the contribution of net premiums written by the new aviation and onshore energy underwriting teams over the three months ended December 31, 2009, as compared with the three months ended December 31, 2008.

Losses and Loss Expenses

Losses and loss expenses for the three months ended December 31, 2009 were $133.0 million compared to $191.6 million for the three months ended December 31, 2008, a decrease of $58.6 million or 30.6%. The loss ratios, defined as losses and loss expenses divided by net premiums earned, for the three months ended December 31, 2009 and 2008 were 31.1% and 60.6%, respectively. Details of loss ratios by line of business are provided below.

	Three Months Ended December 31, 2009(a)	**Three Months Ended December 31, 2008**	**Percentage Point Change**
Property	12.5%	73.7%	(61.2)
Marine	58.0%	50.4%	7.6
Specialty	52.0%	48.3%	3.7
All lines	31.1%	60.6%	(29.5)

68

Table of Contents

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. Consequently, 2008 data does not include IPC financial results.

The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the three months ended December 31, 2009:

	Three Months Ended December 31, 2009			
(Dollars in thousands)	Validus	Talbot	Eliminations	Total
Gross reserves at period beginning	$ 783,235	$ 870,079	$ (28,571)	$ 1,624,743
Losses recoverable at period beginning	(57,608)	(143,064)	28,571	(172,101)
Net reserves at period beginning	725,627	727,015		1,452,642
Incurred losses current year	73,013	108,730		181,743
Incurred losses change in prior accident years	(28,879)	(19,844)		(48,723)
Incurred losses	44,134	88,886		133,020
Paid losses	(76,764)	(67,286)		(144,050)
Foreign exchange	(295)	(948)		(1,243)
Net reserves at period end	692,702	747,667		1,440,369
Losses recoverable	49,808	156,319	(24,362)	181,765
Gross reserves at period end	$ 742,510	$ 903,986	$ (24,362)	$ 1,622,134

The amount of recorded reserves represents management s best estimate of expected losses and loss expenses incurred. Prior years favorable loss development totaled $48.7 million. The Company s loss ratio benefited by 11.4 percentage points as a result of favorable loss development for the three months ended December 31, 2009. For the three months ended December 31, 2009, the Company incurred $5.7 million of losses attributable to the Dublin floods, which represented 1.3 percentage points of the loss ratio. For the three months ended December 31, 2008, the Company incurred $77.2 million of loss expense attributable to development of previously announced Hurricane Ike, which represented 24.4 percentage points of the loss ratio.

Management of insurance and reinsurance companies use significant judgment in the estimation of reserves for losses and loss expenses. Given the magnitude of recent loss events and other uncertainties inherent in loss estimation, meaningful uncertainty remains regarding the estimation of recent losses. The Company s actual ultimate net loss may vary materially from estimates.

At December 31, 2009 and 2008, gross and net reserves for losses and loss expenses were estimated using the methodology as outlined in the Critical Accounting Policies and Estimates section. The Company did not make any significant changes in the assumptions or methodology used in its reserving process for the three months ended December 31, 2009.

As at December 31, 2009	
Gross	Total Gross

(Dollars in thousands)	**Case Reserves**	**Gross IBNR**	**Reserve for Losses and Loss Expenses**
Property	$ 365,858	$ 338,795	$ 704,653
Marine	321,844	254,056	575,900
Specialty	143,623	197,958	341,581
Total	$ 831,325	$ 790,809	$ 1,622,134

Table of Contents

(Dollars in thousands)	As at December 31, 2009 Net Case Reserves	Net IBNR	Total Net Reserve for Losses and Loss Expenses
Property	$ 359,657	$ 306,745	$ 666,402
Marine	259,617	232,105	491,722
Specialty	127,502	154,743	282,245
Total	$ 746,776	$ 693,593	$ 1,440,369

During the three months ended December 31, 2008, the Company incurred losses of $77.2 million related to the development of previously announced Hurricane Ike reserves, as detailed in the table below.

(Dollars in thousands)	Net Losses and Loss Expenses(a)	Net Reinstatement Premiums	Net Effect on Net Income(b)
Hurricane Ike			
Validus Re			
Property	$ 38,229	$ (4,205)	$ 34,024
Marine	20,834	(2,387)	18,447
Specialty	(125)		(125)
All lines	58,938	(6,592)	52,346
Talbot			
Property	16,354	(289)	16,065
Marine	1,903	(216)	1,687
All lines	18,257	(505)	17,752
Total			
Property	54,583	(4,494)	50,089
Marine	22,737	(2,603)	20,134
Specialty	(125)		(125)
All lines	$ 77,195	$ (7,097)	$ 70,098

(a) Net of reinsurance.

(b)

Net effect on net income includes the sum of estimates of net claims and claim expenses incurred, and earned reinstatement premiums assumed and ceded.

Validus Re. Validus Re losses and loss expenses for the three months ended December 31, 2009 were $44.1 million compared to $96.0 million for the three months ended December 31, 2008, a decrease of $51.8 million or 54.0%. The loss ratio, defined as losses and loss expenses divided by net premiums earned, was 17.1% and 58.4% for the three months ended December 31, 2009 and 2008, respectively. For the three months ended December 31, 2009, Validus Re incurred $5.7 million of losses attributable to the Dublin floods, which represents 2.2 percentage points of the loss ratio. For the three months ended December 31, 2008, Validus Re incurred $58.9 million of losses attributable to Hurricane Ike, which represented 35.9 percentage points of the segment loss ratio. Validus Re segment loss ratios, excluding prior year development and loss events identified above, for the three months ended

Table of Contents

December 31, 2009 and 2008 were 26.1% and 26.2%, respectively. Details of loss ratios by line of business and period of incurrence are provided below.

	Three Months Ended December 31,		Percentage
	2009(a)	2008	Point Change
Property current year	21.4%	59.4%	(38.0)
Property change in prior accident years	(11.8)%	(2.9)%	(8.9)
Property loss ratio	9.6%	56.5%	(46.9)
Marine current year	53.3%	84.1%	(30.8)
Marine change in prior accident years	(7.8)%	(10.8)%	3.0
Marine loss ratio	45.5%	73.3%	(27.8)
Specialty current year	56.9%	43.5%	13.4
Specialty change in prior accident years	(10.4)%	2.5%	(12.9)
Specialty loss ratio	46.5%	46.0%	0.5
All lines current year	28.3%	62.1%	(33.8)
All lines change in prior accident years	(11.2)%	(3.7)%	(7.5)
All lines loss ratio	17.1%	58.4%	(41.3)

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

For the three months ended December 31, 2009, the property lines include $43.7 million related to current year losses and $24.1 million of favorable development relating to prior accident years. This favorable development is attributable principally to lower than expected claim development in the property classes, as well as reduced loss estimates for a number of catastrophe loss events. For the three months ended December 31, 2009, Validus Re s property lines incurred $5.7 million of losses attributable to the Dublin floods, which represents 2.8 percentage points of the property lines loss ratio. For the three months ended December 31, 2008, Validus Re s property line incurred $38.2 million losses attributable to Hurricane Ike, which represented 32.5 percentage points of the property lines loss ratio. Validus Re property line loss ratios, excluding prior year development and loss events identified above, for the three months ended December 31, 2009 and 2008 were 18.6% and 26.9%, respectively.

For the three months ended December 31, 2009, the marine lines include $15.4 million related to current year losses and $2.2 million of favorable development relating to prior accident years. This favorable development is primarily attributable to lower than expected claims development. For the three months ended December 31, 2008, Validus Re s marine lines incurred $20.8 million of losses attributable to Hurricane Ike, which represented 70.9 percentage points of the marine lines loss ratio. Validus Re marine line loss ratios, excluding prior year development and loss events identified above, for the three months ended December 31, 2009 and 2008 were 53.3% and 13.2%, respectively.

For the three months ended December 31, 2009, the specialty lines include $13.9 million related to current year losses and $2.5 million of favorable development relating to prior accident years. Validus Re specialty lines loss ratios, excluding prior year development, for the three months ended December 31, 2009 and 2008 were 56.9% and 43.5%,

respectively.

Talbot. Talbot losses and loss expenses for the three months ended December 31, 2009 were $88.9 million compared to $95.6 million for the three months ended December 31, 2008, a decrease of $6.7 million, or 7.0%. The loss ratio was 52.2% and 63.0% for the three months ended December 31, 2009 and 2008, respectively. For the three months ended December 31, 2009, Talbot did not experience any notable loss events. For the three months ended December 31, 2008, Talbot incurred $18.3 million of losses attributable to Hurricane Ike, which represented 12.1 percentage points of the segment loss ratio. For the three months ended December 31, 2009, $108.7 million of losses and loss expenses related to current year losses and $19.8 million related to favorable development of prior accident years. Talbot segment loss ratios, excluding the prior year development and loss events identified above,

Table of Contents

for the three months ended December 31, 2009 and 2008 were 63.9 and 59.9, respectively. Details of loss ratios by line of business and calendar period are provided below.

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008	Percentage Point Change
Property current year	51.0%	142.5%	(91.5)
Property change in prior accident years	(22.2)%	2.5%	(24.7)
Property loss ratio	28.8%	145.0%	(116.2)
Marine current year	81.3%	54.7%	26.6
Marine change in prior accident years	(17.8)%	(14.9)%	(2.9)
Marine loss ratio	63.5%	39.8%	23.7
Specialty current year	54.2%	57.0%	(2.8)
Specialty change in prior accident years	(0.3)%	(8.0)%	7.7
Specialty loss ratio	53.9%	49.0%	4.9
All lines current year	63.9%	72.0%	(8.1)
All lines change in prior accident years	(11.7)%	(9.0)%	(2.7)
All lines loss ratio	52.2%	63.0%	(10.8)

For the three months ended December 31, 2009, the property lines include $18.6 million related to current year losses and $8.1 million of favorable development relating to prior accident years. For the three months ended December 31, 2008, Talbot s property lines incurred $16.4 million of losses attributable to Hurricane Ike, which represented 57.9 percentage points of the property lines loss ratio. Talbot property line loss ratio, excluding prior year development and the loss events identified above, for the three months ended December 31, 2009 and 2008 were 51.0% and 84.6%, respectively.

For the three months ended December 31, 2009, the marine lines include $52.7 million related to current year and $11.6 million of favorable development relating to prior accident years. For the three months ended December 31, 2008, Talbot s marine lines incurred $2.0 million of losses attributable to Hurricane Ike, which represented 3.0 percentage points of the marine lines loss ratio. Talbot marine line loss ratios, excluding prior year development and the loss events identified above, for the three months ended December 31, 2009 and 2008 were 81.3% and 51.8%, respectively.

For the three months ended December 31, 2009, the specialty lines include $37.4 million relating to current year losses and $0.2 million due to favorable development on prior accident years. Talbot specialty lines loss ratios, excluding prior year development, for the three months ended December 31, 2009 and 2008 were 54.2% and 57.0%, respectively.

Policy Acquisition Costs

Policy acquisition costs for the three months ended December 31, 2009 were $72.8 million compared to $61.4 million for the three months ended December 31, 2008, an increase of $11.4 million or 18.6%. Policy acquisition costs as a percent of net premiums earned for the three months ended December 31, 2009 and 2008 were 17.0% and 19.4%,

respectively.

Table of Contents

(Dollars in thousands)	Three Months Ended December 31, 2009(a) Policy Acquisition Costs	Policy Acquisition Costs (%)	Acquisition Cost Ratio	Three Months Ended December 31, 2008 Policy Acquisition Costs	Policy Acquisition Costs (%)	Acquisition Cost Ratio	% Change
Property	$ 31,694	43.5%	13.2%	$ 26,197	42.7%	18.0%	21.0%
Marine	21,780	29.9%	23.2%	18,432	30.0%	19.7%	18.2%
Specialty	19,369	26.6%	20.7%	16,778	27.3%	21.8%	15.4%
Total	$ 72,843	100.0%	17.0%	$ 61,407	100.0%	19.4%	18.6%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Validus Re. Validus Re policy acquisition costs for the three months ended December 31, 2009 were $37.1 million compared to $28.0 million for the three months ended December 31, 2008, an increase of $9.1 million or 32.4%.

(Dollars in thousands)	Three Months Ended December 31, 2009(a) Policy Acquisition Costs	Policy Acquisition Costs (%)	Acquisition Cost Ratio	Three Months Ended December 31, 2008 Policy Acquisition Costs	Policy Acquisition Costs (%)	Acquisition Cost Ratio	% Change
Property	$ 27,463	74.0%	13.4%	$ 21,279	75.9%	18.1%	29.1%
Marine	5,257	14.2%	18.2%	4,222	15.1%	14.4%	24.5%
Specialty	4,368	11.8%	17.8%	2,510	9.0%	14.3%	74.0%
Total	$ 37,088	100.0%	14.4%	$ 28,011	100.0%	17.0%	32.4%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Policy acquisition costs include brokerage, commission and excise tax and are generally driven by contract terms. They are normally a set percentage of premiums and are also net of ceding commission income on retrocessions. Policy acquisition costs as a percent of net premiums earned for the three months ended December 31, 2009 and 2008 were 14.4% and 17.0%, respectively. The policy acquisition ratio decreased on the property line as a result on non renewal of a few proportional loss contracts with a high portion of policy acquisition costs. The policy acquisition ratio increased on the marine and specialty lines due primarily to the effects of Hurricanes Ike and Gustav reinstatement premiums earned without related policy acquisition costs for three months ended December 31, 2008.

Talbot. Talbot policy acquisition costs for the three months ended December 31, 2009 were $37.6 million compared to $33.6 million for the three months ended December 31, 2008, an increase of $4.0 million or 11.9%.

	Three Months Ended December 31, 2009			Three Months Ended December 31, 2008			
(Dollars in thousands)	**Policy Acquisition Costs**	**Policy Acquisition Costs (%)**	**Acquisition Cost Ratio**	**Policy Acquisition Costs**	**Policy Acquisition Costs (%)**	**Acquisition Cost Ratio**	**% Change**
Property	$ 6,031	16.1%	16.5%	$ 5,082	15.2%	18.0%	18.7%
Marine	16,523	44.0%	25.5%	14,210	42.3%	22.2%	16.3%
Specialty	15,001	39.9%	21.8%	14,268	42.5%	24.0%	5.1%
Total	$ 37,555	100.0%	22.1%	$ 33,560	100.0%	22.1%	11.9%

Policy acquisition costs as a percent of net premiums earned were 22.1% and 22.1%, respectively, for the three months ended December 31, 2009 and 2008.

Table of Contents

General and Administrative Expenses

General and administrative expenses for the three months ended December 31, 2009 were $60.3 million compared to $22.8 million for the three months ended December 31, 2008, an increase of $37.4 million or 164.2%. The increase was a result of increased expenses in both the Validus Re and Talbot segments.

	Three Months Ended December 31, 2009(a)		Three Months Ended December 31, 2008		
(Dollars in thousands)	General and Administrative Expenses(a)	General and Administrative Expenses (%)	General and Administrative Expenses	General and Administrative Expenses (%)	% Change
Validus Re	$ 19,782	32.8%	$ 7,301	32.0%	170.9%
Talbot	30,787	51.1%	12,882	56.5%	139.0%
Corporate & Eliminations	9,684	16.1%	2,626	11.5%	268.8%
Total	$ 60,253	100.0%	$ 22,809	100.0%	164.2%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

General and administrative expense ratios for the three months ended December 31, 2009 and 2008 was 16.0% and 9.5%, respectively. General and administrative expense ratio is the sum of general and administrative expenses and share compensation expense divided by net premiums earned.

	Three Months Ended December 31, 2009(a)		Three Months Ended December 31, 2008	
(Dollars in thousands)	Expenses	Expenses as% of Net Earned Premiums	Expenses	Expenses as% of Net Earned Premiums
General and Administrative	$ 60,253	14.1%	$ 22,809	7.2%
Share Compensation	8,189	1.9%	7,279	2.3%
Total	$ 68,442	16.0%	$ 30,088	9.5%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

General and administrative expenses of $60.3 million in the three months ended December 31, 2009 represents 14.1 percentage points of the expense ratio. Share compensation expense is discussed in the following section.

Validus Re. Validus Re general and administrative expenses for the three months ended December 31, 2009 were $19.8 million compared to $7.3 million for the three months ended December 31, 2008, an increase of $12.5 million or 170.9%. General and administrative expenses have increased primarily as a result of the associated costs from the acquisition of IPC, including increased headcount as well as additional rent and office costs. The Validus Re segment headcount increased to 133 at December 31, 2009 from 91 at December 31, 2008. General and administrative expenses are generally comprised of salaries and benefits, professional fees, rent and office expenses. Validus Re s general and administrative expenses as a percent of net premiums earned for the three months ended December 31, 2009 and 2008 were 7.7% and 4.4%, respectively.

Talbot. Talbot general and administrative expenses for the three months ended December 31, 2009 were $30.8 million compared to $12.9 million for the three months ended December 31, 2008, an increase of $17.9 million or 139.0%. General and administrative expenses have increased primarily as a result of the increase in staff to 238 at December 31, 2009 from 182 at December 31, 2008 and expenses related to the new onshore energy and aviation underwriting teams. In addition to increased staff costs, Talbot rent and office expenses increased by $5.9 million for three months ended December 31, 2009 due to a 2009 office move, including a $4.2 million

Table of Contents

provision for the deficiency between the expected costs incurred up to the expiry of the previous office lease and any recoveries under potential sub-leases. Talbot s general and administrative expenses as a percent of net premiums earned for the three months ended December 31, 2009 and 2008 were 18.1% and 8.5%, respectively.

Corporate & Eliminations. Corporate general and administrative expenses for the three months ended December 31, 2009 were $9.7 million compared to $2.6 million for the three months ended December 31, 2008, an increase of $7.1 million or 268.8%. General and administrative expenses have increased primarily as a result of an additional accrual for the performance bonus for the three months ended December 31, 2009 compared to a reduction in the performance bonus accrual for the three months ended December 31, 2008. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other costs relating to the Company as a whole.

Share Compensation Expense

Share compensation expense for the three months ended December 31, 2009 was $8.2 million compared to $7.3 million for the three months ended December 31, 2008, an increase of $0.9 million or 12.5%. This expense is non-cash and has no net effect on total shareholders equity, as it is balanced by an increase in additional paid-in capital.

	Three Months Ended December 31, 2009(a)		Three Months Ended December 31, 2008		
(Dollars in thousands)	**Shared Compensation Expense**	**Shared Compensation Expense (%)**	**Shared Compensation Expense**	**Shared Compensation Expense (%)**	**% Change**
Validus Re	$ 2,590	31.6%	$ 2,197	30.2%	17.9%
Talbot	1,367	16.7%	1,436	19.7%	(4.8)%
Corporate & Eliminations	4,232	51.7%	3,646	50.1%	16.1%
Total	$ 8,189	100.0%	$ 7,279	100.0%	12.5%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Share compensation expense of $8.2 million in the three months ended December 31, 2009 represents 1.9 percentage points of the general and administrative expense ratio.

Validus Re. Validus Re share compensation expense for the three months ended December 31, 2009 was $2.6 million compared to $2.2 million for the three months ended December 31, 2008. Share compensation expense as a percent of net premiums earned for the three months ended December 31, 2009 and 2008 were 1.0% and 1.3%, respectively.

Talbot. Talbot share compensation expense for the three months ended December 31, 2009 was $1.4 million compared to $1.4 million for the three months ended December 31, 2008. Share compensation expense as a percent of net premiums earned for the three months ended December 31, 2009 and 2008 was 0.8% and 0.9%, respectively.

Corporate & Eliminations. Corporate share compensation expense for the three months ended December 31, 2009 was $4.2 million compared to $3.6 million for the three months ended December 31, 2008, an increase of $0.6 million or 16.1%. This increase was due primarily to several share award issuances that vested during the three months ended December 31, 2008 and therefore had no further amortization expense during the three months ended December 31, 2009.

Selected Ratios

The underwriting results of an insurance or reinsurance company are often measured by reference to its combined ratio, which is the sum of the loss ratio and the expense ratio. The net loss ratio is calculated by dividing losses and loss expenses incurred (including estimates for incurred but not reported losses) by net premiums earned. The expense ratio is calculated by dividing acquisition costs combined with general and administrative expenses by net premiums earned. The following table presents the losses and loss expenses ratio, policy acquisition cost ratio,

Table of Contents

general and administrative expense ratio, expense ratio and combined ratio for the three months ended December 31, 2009 and 2008:

	Three Months Ended December 31, 2009(a)	Three Months Ended December 31, 2008	Percentage Point Change
Losses and loss expenses ratio	31.1%	60.6%	(29.5)
Policy acquisition cost ratio	17.0%	19.4%	(2.4)
General and administrative expense ratio(b)	16.0%	9.5%	6.5
Expense ratio	33.0%	28.9%	4.1
Combined ratio	64.1%	89.5%	(25.4)

	Three Months Ended December 31, 2009(a)	Three Months Ended December 31, 2008	Percentage Point Change
Validus Re			
Losses and loss expenses ratio	17.1%	58.4%	(41.3)
Policy acquisition cost ratio	14.4%	17.0%	(2.6)
General and administrative expense ratio(b)	8.7%	5.8%	2.9
Expense ratio	23.1%	22.8%	0.3
Combined ratio	40.2%	81.2%	(41.0)

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008	Percentage Point Change
Talbot			
Losses and loss expenses ratio	52.2%	63.0%	(10.8)
Policy acquisition cost ratio	22.1%	22.1%	(0.0)
General and administrative expense ratio(b)	18.9%	9.4%	9.5
Expense ratio	41.0%	31.5%	9.5
Combined ratio	93.2%	94.5%	(1.3)

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) Includes general and administrative expense and share compensation expense.

Underwriting Income

Underwriting income for the three months ended December 31, 2009 was $153.6 million compared to $33.0 million for the three months ended December 31, 2008, an increase of $120.6 million, or 366.0%.

	Three Months Ended December 31,				
(Dollars in thousands)	**2009(a)**	**% of Sub Total**	**2008**	**% of Sub Total**	**% Change**
Validus Re	$ 154,044	93.0%	$ 30,887	79.1%	398.7%
Talbot	11,668	7.0%	8,181	20.9%	42.6%
Sub total	165,712	100.0%	39,068	100.0%	324.2%
Corporate & Eliminations	(12,116)		(6,108)		(98.4)%
Total	$ 153,596		$ 32,960		366.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

The underwriting results of an insurance or reinsurance company are also often measured by reference to its underwriting income, which is a non-GAAP measure as previously defined. Underwriting income, as set out in the table below, is reconciled to net income (the most directly comparable GAAP financial measure) by the addition or subtraction of certain Consolidated Statement of Operations and Comprehensive Income line items, as described below.

(Dollars in thousands)	Three Months Ended December 31, 2009(a)		Three Months Ended December 31, 2008	
Underwriting income	$	153,596	$	32,960
Net investment income		35,506		30,671
Other income		1,759		1,598
Finance expenses		(14,398)		(8,522)
Realized gain on repurchase of debentures		4,444		
Net realized gains on investments		9,099		6,757
Net unrealized (losses) on investments		(25,043)		(7,099)
Foreign exchange gains (losses)		338		(13,554)
Net income before taxes	$	165,301	$	42,811

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Underwriting income indicates the performance of the Company s core underwriting function, excluding revenues and expenses such as the reconciling items in the table above. The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company s core insurance and reinsurance business. Underwriting profitability is influenced significantly by earned premium growth, adequacy of the Company s pricing and loss frequency and severity. Underwriting profitability over time is also influenced by the Company s underwriting discipline, which seeks to manage exposure to loss through favorable risk selection and diversification, its management of claims, its use of reinsurance and its ability to manage its expense ratio, which it accomplishes through its management of acquisition costs and other underwriting expenses. The Company believes that underwriting income provides investors with a valuable measure of profitability derived from underwriting activities.

The Company excludes the U.S. GAAP measures noted above, in particular net realized and unrealized gains and losses on investments, from its calculation of underwriting income because the amount of these gains and losses is heavily influenced by, and fluctuates in part, according to availability of investment market opportunities. The Company believes these amounts are largely independent of its underwriting business and including them distorts the analysis of trends in its operations. In addition to presenting net income determined in accordance with U.S. GAAP, the Company believes that showing underwriting income enables investors, analysts, rating agencies and other users of its financial information to more easily analyze the Company s results of operations in a manner similar to how management analyzes the Company s underlying business performance. The Company uses underwriting income as a primary measure of underwriting results in its analysis of historical financial information and when performing its

budgeting and forecasting processes. Analysts, investors and rating agencies who follow the Company request this non-GAAP financial information on a regular basis. In addition, underwriting income is one of the factors considered by the compensation committee of our Board of Directors in determining the bonus component of the total annual incentive compensation.

Underwriting income should not be viewed as a substitute for U.S. GAAP net income as there are inherent material limitations associated with the use of underwriting income as compared to using net income, which is the most directly comparable U.S. GAAP financial measure. The most significant limitation is the ability of users of the financial information to make comparable assessments of underwriting income with other companies, particularly as underwriting income may be defined or calculated differently by other companies. Therefore, the Company provides more prominence in this filing to the use of the most comparable U.S. GAAP financial measure, net income, which includes the reconciling items in the table above. The Company compensates for these limitations by

Table of Contents

providing both clear and transparent disclosure of net income and reconciliation of underwriting income to net income.

Net Investment Income

Net investment income for the three months ended December 31, 2009 was $35.5 million compared to $30.7 million for the three months ended December 31, 2008, an increase of $4.8 million or 15.8%. Net investment income increased due primarily to a larger fixed maturity portfolio post-IPC acquisition. Net investment income is comprised of accretion of premium or discount on fixed maturities, interest on coupon-paying bonds, short-term investments and cash and cash equivalents, partially offset by investment management fees. The components of net investment income for the three months ended December 31, 2009 and 2008 are as presented below.

(Dollars in thousands)	Three Months Ended December 31, 2009(a)	Three Months Ended December 31, 2008	% Change
Fixed maturities and short-term investments	$ 35,290	$ 29,035	21.5%
Cash and cash equivalents	751	1,892	(60.3)%
Securities lending income	89	625	(85.8)%
Gross investment income	36,130	31,552	14.5%
Investment expenses	(624)	(881)	(29.2)%
Net investment income	$ 35,506	$ 30,671	15.8%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Investment management fees incurred relate to BlackRock Financial Management, Inc. (BlackRock) and Goldman Sachs Asset Management L.P. and its affiliates (GSAM). Each of Merrill Lynch & Co, Inc. (Merrill Lynch), a wholly owned subsidiary of Bank of America Corp., and Goldman Sachs are major shareholders of the Company. BlackRock is considered a related party due to its merger in February 2006 with Merrill Lynch Investment Managers. Investment management fees earned by BlackRock for the three months ended December 31, 2009 and 2008 were $0.5 million and $0.4 million, respectively. Investment management fees earned by GSAM for the three months ended December 31, 2009 and 2008 were $0.2 million and $0.4 million, respectively. The Company entered into investment management agreements during the three months ended December 31, 2009 with each of Conning, Inc. (Conning) and Pinebridge Investments Europe Ltd. On June 16, 2009, Aquiline Capital Partners LLC (Aquiline), a major shareholder of the Company, acquired Conning. Management believes that the fees charged were consistent with those that would have been charged in arm s-length transactions with unrelated third parties.

Annualized effective investment yield is based on the weighted average investments held calculated on a simple period average and excludes net unrealized gains (losses), foreign exchange gains (losses) on investments and the foreign exchange effect of insurance balances. The Company s annualized effective investment yield was 2.47% and 3.75% for the three months ended December 31, 2009 and 2008, respectively, and the average duration at December 31, 2009 was 2.2 years (December 31, 2008 1.8 years).

Other Income

Other income for the three months ended December 31, 2009 was $1.8 million compared to $1.6 million for the three months ended December 31, 2008, an increase of $0.2 million or 10.1%.

Finance Expenses

Finance expenses for the three months ended December 31, 2009 were $14.4 million compared to $8.5 million for the three months ended December 31, 2008, an increase of $5.9 million or 69.0%. The increase was primarily a result of a $5.1 million increase in Talbot third party FAL expense.

Table of Contents

Finance expenses also include the amortization of debt offering costs and discounts and fees related to our credit facilities.

(Dollars in thousands)	Three Months Ended December 31, 2009(a)	2008	% Change
9.069% Junior Subordinated Deferrable Debentures	$ 3,589	$ 3,589	0.0%
8.480% Junior Subordinated Deferrable Debentures	2,688	3,187	(15.7)%
Credit facilities	1,084	218	397.2%
Talbot FAL facilities	375	86	336.0%
Talbot other interest		(105)	NM
Talbot third party FAL facility	6,662	1,547	330.6%
Finance expenses	$ 14,398	$ 8,522	69.0%

NM: Not Meaningful

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Capital in Lloyd s entities, whether personal or corporate, is required to be set annually for the prospective year and held by Lloyd s in trust (Funds at Lloyd s or FAL). In underwriting years up to and including 2007, Talbot s FAL has been provided both by Talbot and by third parties, thereafter Talbot s FAL has been provided exclusively by the Company. Because the third party FAL providers remain on risk until each year of account that their support closes (normally after three years). Talbot must retain third party FAL even if a third party FAL provider has ceased to support the active underwriting year. This is achieved by placing such FAL in escrow outside Lloyd s. Thus the total FAL facility available to the Company is the total FAL for active and prior underwriting years, although the Company can only apply specific FAL against losses incurred by an underwriting year that such FAL is contracted to support.

For each year of account up to and including the 2007 year of account, between 30% and 40% of an amount equivalent to each underwriting years profit is payable to Talbot third party FAL providers. However, some of these costs are fixed. There are no FAL finance charges related to the 2008 and 2009 years of account as there were no third party FAL providers in those periods.

The FAL finance charges relate to total syndicate profit (underwriting income, investment income and realized and unrealized capital gains and losses). FAL finance charges and total syndicate profits are analyzed by underwriting year of account as follows:

	Three Months Ended December 31,		
	FAL Finance Charges	Total Syndicate Profit	FAL Finance Charges as % of Total Syndicate Profit

Underwriting Year of Account (Dollars in thousands)	2009	2008	2009	2008	2009	2008(1)
2006(1)	$	$ 3,873	$	$ 14,765	NM	26.2%
2007	5,203	(2,326)	17,302	372	30.1%	(625.3)%
2008			(5,265)	10,495	NM	NM
2009			10,420		NM	NM
NIC Capital agreement	1,459				NM	NM
Total	$ 6,662	$ 1,547	$ 22,457	$ 25,632	29.7%	6.0%
Percentage excluding years in deficit					24.0%	6.0%

(1) The earliest year of account includes the run-off of prior (closed) years of account.

NM: Not Meaningful

79

Table of Contents

FAL finance charges are based on syndicate profit but include fixed elements. FAL finance charges for the three months ended December 31, 2009 were $6.7 million compared to $1.5 million for the three months ended December 31, 2008, an increase of $5.1 million. This increase was due to the increase of FAL finance charges related to the 2007 year of account, which was closed in the three months ended December 31, 2009. The Talbot group has entered into an agreement with National Indemnity Corporation (NIC), whereby NIC, in the past, provided letters of credit to support the group s underwriting. Part of the agreement stipulates that part of the reinsurance to close premium in respect of the 2006 year of account will be made available to NIC, at NIC s option, as a limited quota share agreement. The portion that shall be offered is the amount of support provided by NIC for the 2006 year of account divided by the overall support provided for that year.

Total syndicate profit, as set out in the table below, is reconciled to the Talbot segment net income by the addition or subtraction of items noted below.

(Dollars in thousands)	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008
Total syndicate profit	$ 22,457	$ 25,632
FAL Finance expenses	(6,662)	(1,547)
Managing agent s fee(1)	2,727	1,889
Managing agent s profit commission(2)	3,567	8,892
Investment income(3)	5,281	(468)
Other segment operating expenses, net	(13,460)	(7,335)
Share compensation expenses	(1,367)	(1,436)
Intangible amortization expenses	(1,040)	(1,041)
Income tax benefit (expense)	514	(5,786)
Talbot segment net income	$ 12,017	$ 18,800

(1) 1.5% of syndicate capacity; corresponding syndicate expense reflected in total syndicate profit, above.

(2) 15.0% of syndicate profit; corresponding syndicate expense reflected in total syndicate profit, above.

(3) On FAL and on non-syndicate cash balances.

Tax Benefit (Expense)

Tax benefit for the three months ended December 31, 2009 was $0.5 million compared to an (expense) of ($5.8) million for the three months ended December 31, 2008, a change of $6.3 million. The tax benefit is primarily due to the Talbot segment and was due to expenses incurred in the fourth quarter in respect of the performance related bonus together with tax relief on stock compensation costs. This was offset by tax on profit commission earned by the managing agent. The tax charge in 2008 was largely due to tax on profit commissions.

Realized Gain on Repurchase of Debentures

On December 1, 2009, the Company repurchased from an unaffiliated financial institution $14.5 million principal amount of its 8.480% Junior Subordinated Deferrable Debentures due 2037 at an aggregate price of $9.9 million plus accrued and unpaid interest of $0.3 million. The repurchase resulted in the recognition of a realized gain of $4.4 million for the three months ended December 31, 2009.

Net Realized Gains (Losses) on Investments

Net realized gains on investments for the three months ended December 31, 2009 were $9.1 million compared to gains of $6.8 million for the three months ended December 31, 2008. The net realized gains for the three months ended December 31, 2009 resulted primarily from the disposition of fixed maturities during the restructure of the IPC investment portfolio.

Table of Contents

Net Unrealized (Losses) Gains on Investments

Net unrealized losses on investments for the three months ended December 31, 2009 were ($25.0) million compared to losses of ($7.1) million for the three months ended December 31, 2008. The net unrealized losses in the three months ended December 31, 2009 were due to an upward shift in the yield curve during the three months ended December 31, 2009. The shift negatively affected the performance of the fixed maturity portfolio.

The net unrealized gains on investments for the three months ended December 31, 2009 included a $0.7 million unrealized gain on the fund of hedge funds purchased in the IPC Acquisition. The fund of hedge funds was included in other investments on the balance sheet as at December 31, 2009.

Net unrealized gains on investments are recorded as a component of net income. The Company has adopted all authoritative guidance on U.S. GAAP fair value measurements in effect as of the balance sheet date. Consistent with these standards, certain market conditions allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable. Certain non-Agency RMBS securities were identified as trading in inactive markets. The change in fair value for the identified non-Agency RMBS securities was a $6.4 million increase in net unrealized loss on investments for the three months ended December 31, 2009. Further details are provided in the Investments section below.

Foreign Exchange Gains (Losses)

Foreign exchange gains (losses) for the three months ended December 31, 2009 were $0.3 million compared to ($13.6) million for the three months ended December 31, 2008, an increase of $13.9 million. The decrease in foreign exchange (losses) was due primarily to the stable major currency movements during the three months ended December 31, 2009, compared to fluctuations resulting in a decline in the value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency for the three months ended December 31, 2008. For the three months ended December 31, 2009, Validus Re recognized foreign exchange losses of $0.8 million. For the three months ended December 31, 2009, Talbot segment foreign exchange gains were $1.1 million compared to losses of $12.5 million for the three months ended December 31, 2008, an increase of $13.6 million. The British pound sterling to U.S. dollar exchange rates were 1.60 and 1.59 at September 30, 2009 and December 31, 2009, respectively. In the prior year, the British pound sterling to U.S. dollar exchange rates were 1.78 and 1.44 at September 30, 2008 and December 31, 2008, respectively. Certain premiums receivable and liabilities for losses incurred in currencies other than the U.S. dollar are exposed to the risk of changes in value resulting from fluctuations in foreign exchange rates and may affect financial results in the future.

At December 31, 2009, Talbot s balance sheet includes net unearned premiums and deferred acquisition costs denominated in foreign currencies of approximately $81.4 million and $17.5 million. This net balance of $63.9 million consisted of British pounds sterling and Canadian dollars of $56.8 million and $7.1 million, respectively. Net unearned premiums and deferred acquisition costs are classified as non-monetary items and are translated at historic exchange rates. All of Talbot s other balance sheet items are classified as monetary items and are translated at period end exchange rates. Additional foreign exchange (losses) gains may be incurred on the translation of net unearned premiums and deferred acquisition costs arising from insurance and reinsurance premiums written in future periods.

Table of Contents

The following table presents results of operations for the three months ended December 31, 2009 and 2008 and years ended December 31, 2009, 2008 and 2007:

	Three Months Ended December 31,		Year Ended December 31,		
(Dollars in thousands)	2009(a)	2008	2009(a)	2008	2007(b)
Gross premiums written	$ 255,289	$ 191,736	$ 1,621,241	$ 1,362,484	$ 988,637
Reinsurance premiums ceded	(30,393)	(2,722)	(232,883)	(124,160)	(70,210)
Net premiums written	224,896	189,014	1,388,358	1,238,324	918,427
Change in unearned premiums	203,005	127,017	61,219	18,194	(60,348)
Net premiums earned	427,901	316,031	1,449,577	1,256,518	858,079
Losses and loss expenses	133,020	191,576	523,757	772,154	283,993
Policy acquisition costs	72,843	61,407	262,966	234,951	134,277
General and administrative expenses	60,253	22,809	185,568	123,948	97,765
Share compensation expenses	8,189	7,279	27,037	27,097	16,189
Total underwriting deductions	274,305	283,071	999,328	1,158,150	532,224
Underwriting income(c)	153,596	32,960	450,249	98,368	325,855
Net investment income	35,506	30,671	118,773	139,528	112,324
Other income	1,759	1,598	4,634	5,264	3,301
Finance expenses	(14,398)	(8,522)	(44,130)	(57,318)	(51,754)
Operating income before taxes(c)	176,463	56,707	529,526	185,842	389,726
Tax benefit (expense)	458	(5,796)	3,759	(10,788)	(1,505)
Net operating income(c)	176,921	50,911	533,285	175,054	388,221
Gain on bargain purchase, net of expenses			287,099		
Realized gain on repurchase of debentures	4,444		4,444	8,752	
Net realized gains (losses) on investments	9,099	6,757	(11,543)	(1,591)	1,608
Net unrealized (losses) gains on investments	(25,043)	(7,099)	84,796	(79,707)	12,364
Fair value of warrants issued					(2,893)
Aquiline termination fee					(3,000)
Foreign exchange gains (losses)	338	(13,554)	(674)	(49,397)	6,696
Net income	$ 165,759	$ 37,015	$ 897,407	$ 53,111	$ 402,996
Net premiums written / Gross premiums written	88.1%	98.6%	85.6%	90.9%	92.9%
Losses and loss expenses	31.1%	60.6%	36.1%	61.5%	33.1%
Policy acquisition costs	17.0%	19.4%	18.1%	18.7%	15.6%

General and administrative expenses	16.0%	9.5%	14.7%	12.0%	13.3%
Expense ratio	33.0%	28.9%	32.8%	30.7%	28.9%
Combined ratio	64.1%	89.5%	68.9%	92.2%	62.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

(c) Non-GAAP Financial Measures. In presenting the Company s results, management has included and discussed underwriting income (loss) and operating income that are not calculated under standards or rules that comprise

Table of Contents

U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation underwriting income (loss) measure to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled Underwriting Income.

	Three Months Ended December 31,		Year Ended December 31,		
	2009(a)	2008	2009(a)	2008	2007(b)
Validus Re					
Gross premiums written	$ 33,694	$ 43,873	$ 768,084	$ 687,771	$ 702,098
Reinsurance premiums ceded	(652)	(1,696)	(95,446)	(62,933)	(68,842)
Net premiums written	33,042	42,177	672,638	624,838	633,256
Change in unearned premiums	224,596	122,191	122,912	28,693	(74,227)
Net premiums earned	257,638	164,368	795,550	653,531	559,029
Losses and loss expenses	44,134	95,972	186,704	420,645	175,538
Policy acquisition costs	37,088	28,011	127,433	100,243	70,323
General and administrative expenses	19,782	7,301	65,710	34,607	31,412
Share compensation expenses	2,590	2,197	7,576	6,829	4,013
Total underwriting deductions	103,594	133,481	387,423	562,324	281,286
Underwriting income(c)	154,044	30,887	408,127	91,207	277,743
Talbot					
Gross premiums written	$ 229,548	$ 152,662	$ 919,906	$ 708,996	$ 286,539
Reinsurance premiums ceded	(37,694)	(5,825)	(204,186)	(95,510)	(1,368)
Net premiums written	191,854	146,837	715,720	613,486	285,171
Change in unearned premiums	(21,591)	4,826	(61,693)	(10,499)	13,879
Net premiums earned	170,263	151,663	654,027	602,987	299,050
Losses and loss expenses	88,886	95,604	337,053	351,509	108,455
Policy acquisition costs	37,555	33,560	139,932	135,017	63,954
General and administrative expenses	30,787	12,882	96,352	71,443	48,886
Share compensation expenses	1,367	1,436	7,171	4,702	1,709
Total underwriting deductions	158,595	143,482	580,508	562,671	223,004
Underwriting income(c)	11,668	8,181	73,519	40,316	76,046
Corporate & Eliminations					
Gross premiums written	$ (7,953)	$ (4,799)	$ (66,749)	$ (34,283)	$
Reinsurance premiums ceded	7,953	4,799	66,749	34,283	
Net premiums written					

Change in unearned premiums					
Net premiums earned					
Losses and loss expenses					
Policy acquisition costs	(1,800)	(164)	(4,399)	(309)	
General and administrative expenses	9,684	2,626	23,506	17,898	17,467
Share compensation expenses	4,232	3,646	12,290	15,566	10,467
Total underwriting deductions	12,116	6,108	31,397	33,155	27,934
Underwriting (loss)(c)	(12,116)	(6,108)	(31,397)	(33,155)	(27,934)
Total underwriting income(c)	$ 153,596	$ 32,960	$ 450,249	$ 98,368	$ 325,855

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

(c) Non-GAAP Financial Measures. In presenting the Company s results, management has included and discussed underwriting income (loss) that is not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S.

Table of Contents

GAAP. A reconciliation of this measure to net income, the most comparable U.S. GAAP financial measure, is presented in the section below entitled Underwriting Income.

Year ended December 31, 2009 compared to year ended December 31, 2008

Net income for the year ended December 31, 2009 was $897.4 million compared to net income of $53.1 million for the year ended December 31, 2008, an increase of $844.3 million. The primary factors driving the increase in net income were:

Increase in underwriting income of $351.9 million due primarily to reduced losses and loss expenses of $248.4 million and increased net premiums earned of $193.1 million. For the year ended December 31, 2008, the Company incurred losses of $260.6 million and $22.1 million, respectively, as a result of Hurricanes Ike and Gustav;

Gain on bargain purchase, net of expenses of $287.1 million on the IPC Acquisition;

Increase in net unrealized gains on investments of $164.5 million due to improved market conditions for fixed income securities;

Decreased in foreign exchange (losses) of $48.7 million was due to the increased value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency for the year ended December 31, 2009, as compared to the year ended December 31, 2008. Foreign exchange (losses) for the year ended December 31, 2009 were ($0.7) million, as compared to ($49.4) million for the year ended December 31, 2008; and

Reduced finance expenses of $13.2 million due to reduced FAL costs.

The items above were partially offset by the following factor:

Decrease in net investment income of $20.8 million due to lower yields on cash and fixed income investments.

Table of Contents

The change in net income for the year ended December 31, 2009 of $844.3 million is described in the following table:

	Year Ended December 31, 2009 Increase (decrease) over the Year Ended December 31, 2008(a)			
(Dollars in thousands)	**Validus Re**	**Talbot**	**Corporate and Other Reconciling Items**	**Total**
Hurricanes Ike and Gustav net losses and loss expenses	$ 231,573	$ 51,135	$	$ 282,708
Hurricanes Ike and Gustav net reinstatement premiums	(25,860)	(897)		(26,757)
Other underwriting income	111,207	(17,035)	1,758	95,930
Underwriting income	316,920	33,203	1,758	351,881
Net investment income	(7,021)	(11,406)	(2,328)	(20,755)
Other income	4,840	(39)	(5,431)	(630)
Finance expenses	(895)	12,626	1,457	13,188
	313,844	34,384	(4,544)	343,684
Taxes	(75)	14,622		14,547
	313,769	49,006	(4,544)	358,231
Gain on bargain purchase, net of expenses(b)			287,099	287,099
Realized gain on repurchase of debentures			(4,308)	(4,308)
Net realized gains (losses) on investments	4,290	(14,242)		(9,952)
Net unrealized gains on investments	159,923	4,580		164,503
Foreign exchange gains	15,295	33,372	56	48,723
Change in net income	$ 493,277	$ 72,716	$ 278,303	$ 844,296

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) Hurricanes Ike and Gustav net losses and loss expenses and net reinstatement premiums recognized for the year ended December 31, 2008; therefore, figures exclude loss development in subsequent periods.

(c) Non-GAAP Financial Measures. In presenting the Company s results, management has included and discussed underwriting income (loss) that is not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. A reconciliation of this measure to net income, the most comparable U.S. GAAP financial measure, is

presented in the section below entitled Underwriting Income.

Gross Premiums Written

Gross premiums written for the year ended December 31, 2009 were $1,621.2 million compared to $1,362.5 million for the year ended December 31, 2008, an increase of $258.8 million or 19.0%. The increase in gross premiums written was driven primarily by the property and specialty lines which increased by $121.3 million and $87.4 million, respectively. Both the Validus Re and Talbot segments saw increases in gross premiums written in all three lines. Details of gross premiums written by line of business are provided below.

(Dollars in thousands)	Year Ended December 31, 2009(a) Gross Premiums Written	Year Ended December 31, 2009(a) Gross Premiums Written (%)	Year Ended December 31, 2008 Gross Premiums Written	Year Ended December 31, 2008 Gross Premiums Written (%)	Year Ended December 31, 2007(b) Gross Premiums Written	Year Ended December 31, 2007(b) Gross Premiums Written (%)
Property	$ 744,660	45.9%	$ 623,386	45.8%	$ 547,552	55.3%
Marine	446,962	27.6%	396,897	29.1%	250,732	25.4%
Specialty	429,619	26.5%	342,201	25.1%	190,353	19.3%
Total	$ 1,621,241	100.0%	$ 1,362,484	100.0%	$ 988,637	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Validus Re. Validus Re gross premiums written for the year ended December 31, 2009 were $768.1 million compared to $687.8 million for the year ended December 31, 2008, an increase of $80.3 million or 11.7%. Details of Validus Re gross premiums written by line of business are provided below.

(Dollars in thousands)	Year Ended December 31, 2009(a) Gross Premiums Written	Year Ended December 31, 2009(a) Gross Premiums Written (%)	Year Ended December 31, 2008 Gross Premiums Written	Year Ended December 31, 2008 Gross Premiums Written (%)	Year Ended December 31, 2007 Gross Premiums Written	Year Ended December 31, 2007 Gross Premiums Written (%)
Property	$ 520,347	67.7%	$ 492,967	71.7%	$ 498,375	71.0%
Marine	152,853	19.9%	117,744	17.1%	136,710	19.5%
Specialty	94,884	12.4%	77,060	11.2%	67,013	9.5%
Total	$ 768,084	100.0%	$ 687,771	100.0%	$ 702,098	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Validus Re gross premiums written increased across the property, marine and specialty lines by $27.4 million, $35.1 million and $17.8 million, respectively. The increase in the property line was due primarily to gross premiums written on various new contracts where favorable changes in risk adjusted pricing met Validus Re s thresholds and rate increases on existing business, offset by a $19.4 million decrease in reinstatement premiums relating to Hurricanes Ike and Gustav. The increase in the marine line was due primarily to additional gross premiums written on proportional contracts where underlying insurance coverage terms have become more favorable. The gross and net amount of

reinsurance limits exposed in the Gulf of Mexico have been reduced in 2009 despite the increased gross premiums written, due to more restrictive coverage terms and, in the case of gross limits, the non-renewal of the Company s collateralized quota share facility. The property, marine and specialty lines also benefited from $23.9 million, $5.6 million and $3.0 million, respectively, of increased gross premiums written as a result of Talbot quota share, surplus treaty and excess of loss contracts. The quota share, surplus treaty and excess of loss contracts with Talbot are eliminated upon consolidation.

86

Table of Contents

Talbot. Talbot gross premiums written for the year ended December 31, 2009 were $919.9 million compared to $709.0 million for the year ended December 31, 2008, an increase of $210.9 million or 29.7%. Details of Talbot gross premiums written are provided below:

(Dollars in thousands)	Year Ended December 31, 2009 Gross Premiums Written	Year Ended December 31, 2009 Gross Premiums Written (%)	Year Ended December 31, 2008 Gross Premiums Written	Year Ended December 31, 2008 Gross Premiums Written (%)	Year Ended December 31, 2007(a) Gross Premiums Written	Year Ended December 31, 2007(a) Gross Premiums Written (%)
Property	$ 269,583	29.3%	$ 152,143	21.5%	$ 151,245	22.0%
Marine	307,385	33.4%	287,696	40.5%	264,008	38.4%
Specialty	342,938	37.3%	269,157	38.0%	272,472	39.6%
Total	$ 919,906	100.0%	$ 708,996	100.0%	$ 687,725	100.0%

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

The increase in the property lines was due primarily to $96.8 million of gross premiums written in the onshore energy lines and a $24.0 million increase in premiums written by Validus Reaseguros, Inc., which acts as an approved Lloyd s coverholder for Syndicate 1183 targeting the Latin American and Caribbean markets, and commenced operations during 2008. The increase in the marine lines was primarily due to $10.0 million in additional gross premiums written on the offshore energy lines and $10.2 million in additional gross premiums written on marine treaty resulting from an increase in clients in new territories. The increase in the specialty lines was due primarily to $55.0 million of additional gross premiums written by the new aviation team.

Reinsurance Premiums Ceded

Reinsurance premiums ceded for the year ended December 31, 2009 were $232.9 million compared to $124.2 million for the year ended December 31, 2008, an increase of $108.7 million, or 87.6%. This was due primarily to an increase of $103.6 million on the property lines retrocession as described below.

(Dollars in thousands)	Year Ended December 31, 2009(a) Reinsurance Premiums Ceded	Year Ended December 31, 2009(a) Reinsurance Premiums Ceded (%)	Year Ended December 31, 2008 Reinsurance Premiums Ceded	Year Ended December 31, 2008 Reinsurance Premiums Ceded (%)	Year Ended December 31, 2007(b) Reinsurance Premiums Ceded	Year Ended December 31, 2007(b) Reinsurance Premiums Ceded (%)
Property	$ 149,979	64.4%	$ 46,360	37.4%	$ 35,689	50.9%
Marine	31,140	13.4%	39,406	31.7%	32,808	46.7%
Specialty	51,764	22.2%	38,394	30.9%	1,713	2.4%
Total	$ 232,883	100.0%	$ 124,160	100.0%	$ 70,210	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Validus Re. Validus Re reinsurance premiums ceded for the year ended December 31, 2009 were $95.4 million compared to $62.9 million for the year ended December 31, 2008, an increase of $32.5 million, or 51.7%.

Table of Contents

	Year Ended December 31, 2009(a)		Year Ended December 31, 2008		Year Ended December 31, 2007	
(Dollars in thousands)	**Reinsurance Premiums Ceded**	**Reinsurance Premiums Ceded (%)**	**Reinsurance Premiums Ceded**	**Reinsurance Premiums Ceded (%)**	**Reinsurance Premiums Ceded**	**Reinsurance Premiums Ceded (%)**
Property	$ 80,475	84.3%	$ 34,712	55.2%	$ 34,609	50.3%
Marine	13,120	13.7%	27,652	43.9%	31,768	46.1%
Specialty	1,851	2.0%	569	0.9%	2,465	3.6%
Total	$ 95,446	100.0%	$ 62,933	100.0%	$ 68,842	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Reinsurance premiums ceded on the property lines increased by $45.8 million, due primarily to the purchase of an additional $34.0 million of catastrophe retrocessional coverage for IPC s U.S. property exposures. The $14.5 million decrease in the marine line was due primarily to the nonrenewal during 2009 of a collateralized quota share retrocession treaty, pursuant to which Validus Re ceded $27.7 million for the year ended December 31, 2008.

Talbot. Talbot reinsurance premiums ceded for the year ended December 31, 2009 were $204.2 million compared to $95.5 million for the year ended December 31, 2008, an increase of $108.7 million.

	Year Ended December 31, 2009		Year Ended December 31, 2008		Year Ended December 31, 2007(a)	
(Dollars in thousands)	**Reinsurance Premiums Ceded**	**Reinsurance Premiums Ceded (%)**	**Reinsurance Premiums Ceded**	**Reinsurance Premiums Ceded (%)**	**Reinsurance Premiums Ceded**	**Reinsurance Premiums Ceded (%)**
Property	$ 114,774	56.2%	$ 33,372	34.9%	$ 24,497	27.2%
Marine	31,296	15.3%	20,297	21.3%	21,001	23.4%
Specialty	58,116	28.5%	41,841	43.8%	44,369	49.4%
Total	$ 204,186	100.0%	$ 95,510	100.0%	$ 89,867	100.0%

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

Property reinsurance premiums ceded on the onshore energy lines increased by $58.0 million. Reinsurance ceded under the third party quota share, surplus treaty and excess of loss contracts on the property lines increased by $59.4 million compared to the twelve months ended December 31, 2008. Reinsurance premiums ceded under the quota share, surplus treaty and excess of loss contracts with Validus Re for the twelve months ended December 31,

2009 were $66.7 million compared to $35.1 million for the twelve months ended December 31, 2008, an increase of $31.6 million. The quota share, surplus treaty and excess of loss contracts with Validus Re are eliminated upon consolidation.

Net Premiums Written

Net premiums written for the year ended December 31, 2009 were $1,388.4 million compared to $1,238.3 million for the year ended December 31, 2008, an increase of $150.0 million, or 12.1%. The ratios of net premiums written to gross premiums written for the year ended December 31, 2009 and 2008 were 85.6% and 90.9%, respectively. Details of net premiums written by line of business are provided below.

Table of Contents

(Dollars in thousands)	Year Ended December 31, 2009(a) Net Premiums Written	Net Premiums Written (%)	Year Ended December 31, 2008 Net Premiums Written	Net Premiums Written (%)	Year Ended December 31, 2007(b) Net Premiums Written	Net Premiums Written (%)
Property	$ 594,681	42.8%	$ 577,026	46.6%	$ 511,863	55.8%
Marine	415,822	30.0%	357,491	28.9%	217,924	23.7%
Specialty	377,855	27.2%	303,807	24.5%	188,640	20.5%
Total	$ 1,388,358	100.0%	$ 1,238,324	100.0%	$ 918,427	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Premium rates in most lines have increased during the year ended December 31, 2009 as compared to the same period in 2008. As a result of the Company s strategy to grow premiums written only when returns meet or exceed internal requirements, net premiums written have increased compared with the year ended December 31, 2008.

Validus Re. Validus Re net premiums written for the year ended December 31, 2009 were $672.6 million compared to $624.8 million for the year ended December 31, 2008, an increase of $47.8 million or 7.6%. Details of net premiums written by line of business are provided below.

(Dollars in thousands)	Year Ended December 31, 2009(a) Net Premiums Written	Net Premiums Written (%)	Year Ended December 31, 2008 Net Premiums Written	Net Premiums Written (%)	Year Ended December 31, 2007 Net Premiums Written	Net Premiums Written (%)
Property	$ 439,872	65.4%	$ 458,255	73.4%	$ 463,766	73.2%
Marine	139,733	20.8%	90,092	14.4%	104,942	16.6%
Specialty	93,033	13.8%	76,491	12.2%	64,548	10.2%
Total	$ 672,638	100.0%	$ 624,838	100.0%	$ 633,256	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

The increase in Validus Re net premiums written was driven by an increase in the marine line of $49.6 million. This increase was a result of increased gross premiums written and decreased reinsurance premium ceded in the marine

line, as discussed above. The ratios of net premiums written to gross premiums written were 87.6% and 90.8% for the year ended December 31, 2009 and 2008, respectively.

Talbot. Talbot net premiums written for the year ended December 31, 2009 were $715.7 million compared to $613.5 million for the year ended December 31, 2008, an increase of $102.2 million or 16.7%. Details of net premiums written by line of business are provided below:

	Year Ended December 31, 2009		**Year Ended December 31, 2008**		**Year Ended December 31, 2007(a)**	
(Dollars in thousands)	**Net Premiums Written**	**Net Premiums Written (%)**	**Net Premiums Written**	**Net Premiums Written (%)**	**Net Premiums Written**	**Net Premiums Written (%)**
Property	$ 154,809	21.6%	$ 118,771	19.3%	$ 126,748	21.2%
Marine	276,089	38.6%	267,399	43.6%	243,007	40.6%
Specialty	284,822	39.8%	227,316	37.1%	228,102	38.2%
Total	$ 715,720	100.0%	$ 613,486	100.0%	$ 597,857	100.0%

Table of Contents

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

The increase in net premiums written was driven by the factors highlighted above in respect of gross premiums written and reinsurance premiums ceded. The ratios of net premiums written to gross premiums written for the year ended December 31, 2009 and 2008 were 77.8% and 86.5%, respectively, reflecting the significant increase in reinsurance costs and quota share costs on the new onshore energy account.

Change in Unearned Premiums

Change in unearned premiums for the year ended December 31, 2009 was $61.2 million compared to $18.2 million for the year ended December 31, 2008, a change of $43.0 million or 236.5%.

	Change in Unearned Premiums		
(Dollars in thousands)	**Year Ended December 31, 2009(a)**	**Year Ended December 31, 2008**	**Year Ended December 31, 2007(b)**
Change in gross unearned premium	$ 2,258	$ 7,164	$ (23,657)
Change in prepaid reinsurance premium	58,961	11,030	(36,691)
Net change in unearned premium	$ 61,219	$ 18,194	$ (60,348)

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Validus Re. Validus Re s change in unearned premiums for the year ended December 31, 2009 was $122.9 million compared to $28.7 million for the year ended December 31, 2008, a change of $94.2 million, or 328.4%.

	Change in Unearned Premiums		
(Dollars in thousands)	**Year Ended December 31, 2009(a)**	**Year Ended December 31, 2008**	**Year Ended December 31, 2007**
Change in gross unearned premium	$ 112,349	$ 27,482	$ (80,768)
Change in prepaid reinsurance premium	10,563	1,211	6,541
Net change in unearned premium	$ 122,912	$ 28,693	$ (74,227)

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

The change in unearned premiums was due primarily to $130.2 million additional change in unearned premiums resulting from the acquisition of IPC. This was partially offset by the effect of non-recurring reinstatement premiums from notable loss events compared to the year ended December 31, 2008. The difference in gross unearned premiums also reflects the benefit of earning premiums on the increased gross premiums written of $80.3 million, or 11.7%, from $687.8 million for the year ended December 31, 2008 to $768.1 million for the year ended December 31, 2009. In respect of prepaid reinsurance premiums, the change is a result primarily of the additional retrocessional coverage for the year ended December 31, 2009, as discussed above.

Talbot. The Talbot change in unearned premiums for the year ended December 31, 2009 was ($61.7) million compared to ($10.5) million for the year ended December 31, 2008, a change of $51.2 million, or 487.6%.

(Dollars in thousands)	Change in Unearned Premiums Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007(a)
Change in gross unearned premium	$ (110,091)	$ (20,318)	$ 57,111
Change in prepaid reinsurance premium	48,398	9,819	(43,232)
Net change in unearned premium	$ (61,693)	$ (10,499)	$ 13,879

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

The difference in gross unearned premiums arises principally from the increased gross premiums written in the property lines, specifically onshore energy exposures and premiums written by Validus Reaseguros, Inc. on the property treaty lines, for the year ended December 31, 2009, as compared to the year ended December 31, 2008. In addition, gross unearned premium increased as a result of the new aviation team. The increase in the change in prepaid reinsurance is reflective of the higher levels of ceded reinsurance, principally in the property line for the year ended December 31, 2009, as compared to the year ended December 31, 2008.

Net Premiums Earned

Net premiums earned for the year ended December 31, 2009 were $1,449.6 million compared to $1,256.5 million for the year ended December 31, 2008, an increase of $193.1 million or 15.4%. The increase in net premiums earned was driven primarily by increased premiums earned at Validus Re of $142.0 million. The increase in net premiums earned was due primarily to $125.1 million of property net premiums earned resulting from the acquisition of IPC.

(Dollars in thousands)	Year Ended December 31, 2009(a)		Year Ended December 31, 2008		Year Ended December 31, 2007(b)	
	Net Premiums Earned	Net Premiums Earned (%)	Net Premiums Earned	Net Premiums Earned (%)	Net Premiums Earned	Net Premiums Earned (%)
Property	$ 712,662	49.2%	$ 598,407	47.7%	$ 488,591	56.9%
Marine	397,061	27.4%	367,449	29.2%	199,571	23.3%
Specialty	339,854	23.4%	290,662	23.1%	169,917	19.8%
Total	$ 1,449,577	100.0%	$ 1,256,518	100.0%	$ 858,079	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Validus Re. Validus Re net premiums earned for the year ended December 31, 2009 were $795.6 million compared to $653.5 million for the year ended December 31, 2008, an increase of $142.0 million or 21.7%.

Table of Contents

	Year Ended December 31, 2009(a)		Year Ended December 31, 2008		Year Ended December 31, 2007	
(Dollars in thousands)	**Net Premiums Earned**	**Net Premiums Earned (%)**	**Net Premiums Earned**	**Net Premiums Earned (%)**	**Net Premiums Earned**	**Net Premiums Earned (%)**
Property	$ 578,452	72.7%	$ 478,523	73.2%	$ 423,977	75.8%
Marine	123,273	15.5%	104,479	16.0%	78,684	14.1%
Specialty	93,825	11.8%	70,529	10.8%	56,368	10.1%
Total	$ 795,550	100.0%	$ 653,531	100.0%	$ 559,029	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

The increase in net premiums earned was due primarily to $125.1 million of property net premiums earned resulting from the acquisition of IPC. The remaining increase in net premiums earned reflects the benefit of earning premiums on business written in 2008 and 2007. Contracts written on a risks-attaching basis are generally earned over twenty four months and therefore have less immediate effect on premiums earned than contracts written on a losses-occurring basis which are generally earned on a twelve month basis.

Talbot. Talbot net premiums earned for the year ended December 31, 2009 were $654.0 million compared to $603.0 million for the year ended December 31, 2008, an increase of $51.0 million or 8.5%.

	Year Ended December 31, 2009		Year Ended December 31, 2008		Year Ended December 31, 2007(a)	
(Dollars in thousands)	**Net Premiums Earned**	**Net Premiums Earned (%)**	**Net Premiums Earned**	**Net Premiums Earned (%)**	**Net Premiums Earned**	**Net Premiums Earned (%)**
Property	$ 134,210	20.5%	$ 119,884	19.9%	$ 134,435	23.0%
Marine	273,788	41.9%	262,970	43.6%	235,428	40.3%
Specialty	246,029	37.6%	220,133	36.5%	214,021	36.7%
Total	$ 654,027	100.0%	$ 602,987	100.0%	$ 583,884	100.0%

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

The increase in net premiums earned is primarily due to the increased levels of net premiums written by the new onshore energy and aviation teams over the twelve months ended December 31, 2009, as compared with the twelve months ended December 31, 2008.

Losses and Loss Expenses

Losses and loss expenses for the year ended December 31, 2009 were $523.8 million compared to $772.2 million for the year ended December 31, 2008, a decrease of $248.4 million or 32.2%. The loss ratios, defined as losses and loss expenses divided by net premiums earned, for the year ended December 31, 2009 and 2008 were 36.1% and 61.5%, respectively. Details of loss ratios by line of business are provided below.

	Year Ended December 31, 2009(a)	**Year Ended December 31, 2008**	**Year Ended December 31, 2007(b)**
Property	15.9%	69.7%	31.0%
Marine	61.1%	68.7%	45.5%
Specialty	49.4%	35.2%	23.5%
All lines	36.1%	61.5%	33.1%

Table of Contents

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

In each year ended December 31, 2009 and 2008, loss events impacting the worldwide insurance and reinsurance markets affected the Company s loss ratio. The frequency and severity of worldwide losses for the year ended December 31, 2009 that materially affected the Company s loss ratio were significantly lower than in the year ended December 31, 2008. The following table reflects losses and loss expenses, net of reinsurance, for each segment and includes the impact of catastrophe losses and other notable loss events, expressed as a percentage of net premiums earned (NPE), for the years ended December 31, 2009 and 2008:

		Year Ended December 31,					
		Validus Re		Talbot		Total	
Event	**Description**	**Losses and Loss Expenses**	**% of NPE**	**Losses and Loss Expenses**	**% of NPE**	**Losses and Loss Expenses**	**% of NPE**
(Dollars in thousands)							
2009 losses and loss expenses		$ 186,704	23.5%	$ 337,053	51.5%	$ 523,757	36.1%
2009 notable loss events							
Windstorm Klaus	Windstorm	17,731	2.2%	316	0.0%	18,047	1.2%
Commercial flight loss	Aviation loss	2,056	0.3%	6,406	1.0%	8,462	0.6%
Dublin floods	Flood	5,732	0.7%			5,732	0.4%
Total		$ 25,519	3.2%	$ 6,722	1.0%	$ 32,241	2.2%
2008 losses and loss expenses		$ 420,645	64.4%	$ 351,509	58.3%	$ 772,154	61.5%
2008 notable loss events							
Hurricane Ike	Hurricane	216,127	33.1%	44,440	7.4%	260,567	20.7%
Hurricane Gustav	Hurricane	15,446	2.4%	6,695	1.1%	22,141	1.8%
ALON USA	Petroleum refinery explosion	12,500	1.9%			12,500	1.0%
NORSUL	Tug and barge grounded	341	0.1%	8,569	1.4%	8,910	0.7%
U.S. Tornado (Cat 42)	Tornado	8,549	1.3%	77		8,626	0.7%
Apache Varanus	Fire	713	0.1%	7,541	1.3%	8,254	0.7%
U.S. Tornado (Cat 27)	Tornado	6,000	0.9%	1,605	0.3%	7,605	0.6%
Total		$ 259,676	39.8%	$ 68,927	11.5%	$ 328,603	26.2%

Table of Contents

The following table sets forth a reconciliation of gross and net reserves for losses and loss expenses by segment for the year ended December 31, 2009:

	Year Ended December 31, 2009			
(Dollars in thousands)	**Validus**	**Talbot**	**Eliminations**	**Total**
Gross reserves at period beginning	$ 535,888	$ 790,199	$ (20,784)	$ 1,305,303
Losses recoverable	(84,523)	(145,057)	20,784	(208,796)
Net reserves at period beginning	451,365	645,142		1,096,507
Net reserves acquired from IPC acquisition	304,957			304,957
Incurred losses - current year	239,676	386,134		625,810
Incurred losses - change in prior accident years	(52,972)	(49,081)		(102,053)
Incurred losses	186,704	337,053		523,757
Paid losses	(254,996)	(252,439)		(507,435)
Foreign exchange	4,672	17,911		22,583
Net reserves at period end	692,702	747,667		1,440,369
Losses recoverable	49,808	156,319	(24,362)	181,765
Gross reserves at period end	$ 742,510	$ 903,986	$ (24,362)	$ 1,622,134

The amount of recorded reserves represents management s best estimate of expected losses and loss expenses on premiums earned. Prior years favorable loss development totaled $102.1 million. The Company s loss ratio benefited by 7.0 percentage points as a result of favorable loss development for the year ended December 31, 2009. For the year ended December 31, 2009, the Company incurred $18.0 million, $8.5 million and $5.7 million of losses attributable to windstorm Klaus, a commercial flight loss, and the Dublin floods, which represent 1.2, 0.6 and 0.4 percentage points of the loss ratio, respectively. For the year ended December 31, 2008, the Company incurred $260.6 million and $22.1 million of losses attributable to Hurricanes Ike and Gustav, which represent 20.7 and 1.8 percentage points of the loss ratio, respectively. In addition, Item 2 of the Company s Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses $41.5 million of losses attributable to separately identified losses, which, for the year ended December 31, 2008, represented 3.3 percentage points of the loss ratio.

Management of insurance and reinsurance companies use significant judgment in the estimation of reserves for losses and loss expenses. Given the magnitude of recent loss events and other uncertainties inherent in loss estimation, meaningful uncertainty remains regarding the estimation of recent losses. The Company s actual ultimate net loss may vary materially from estimates.

At December 31, 2009 and 2008, gross and net reserves for losses and loss expenses were estimated using the methodology as outlined in the Critical Accounting Policies and Estimates section. The Company did not make any significant changes in the assumptions or methodology used in its reserving process for the year ended December 31, 2009.

	As at December 31, 2009
	Total Gross

(Dollars in thousands)	**Gross Case Reserves**	**Gross IBNR**	**Reserve for Losses and Loss Expenses**
Property	$ 365,858	$ 338,795	$ 704,653
Marine	321,844	254,056	575,900
Specialty	143,623	197,958	341,581
Total	$ 831,325	$ 790,809	$ 1,622,134

Table of Contents

(Dollars in thousands)	As at December 31, 2009 Net Case Reserves	Net IBNR	Total Net Reserve for Losses and Loss Expenses
Property	$ 359,657	$ 306,745	$ 666,402
Marine	259,617	232,105	491,722
Specialty	127,502	154,743	282,245
Total	$ 746,776	$ 693,593	$ 1,440,369

During the year ended December 31, 2008, the Company incurred losses related to Hurricanes Ike and Gustav of $260.6 million and $22.1 million, respectively, as detailed in the table below.

(Dollars in thousands)	Net Losses and Loss Expenses(a)	Net Reinstatement Premiums	Net Effect on Net Income(b)
Hurricane Ike			
Validus Re Hurricane Ike			
Property	$ 158,515	$ (18,072)	$ 140,443
Marine	57,612	(6,485)	51,127
All lines	216,127	(24,557)	191,570
Talbot Hurricane Ike			
Property	31,515	(675)	30,840
Marine	12,381	(222)	12,159
Specialty	544		544
All lines	44,440	(897)	43,543
Total Hurricane Ike			
Property	190,030	(18,747)	171,283
Marine	69,993	(6,707)	63,286
Specialty	544		544
All lines	$ 260,567	$ (25,454)	$ 235,113
Hurricane Gustav			
Validus Re Hurricane Gustav			
Property	$ 13,946	$ (1,303)	$ 12,643
Marine	1,500		1,500

All lines	15,446	(1,303)	14,143
Talbot Hurricane Gustav			
Property	3,695		3,695
Marine	2,500		2,500
Specialty	500		500
All lines	6,695		6,695
Total Hurricane Gustav			
Property	17,641	(1,303)	16,338
Marine	4,000		4,000
Specialty	500		500
All lines	$ 22,141	$ (1,303)	$ 20,838

(Dollars in thousands)	Net Losses and Loss Expenses(a)	Net Reinstatement Premiums	Net Effect on Net Income(b)
Hurricanes Ike and Gustav			
Property	$ 207,671	$ (20,050)	$ 187,621
Marine	73,993	(6,707)	67,286
Specialty	1,044		1,044
All lines	$ 282,708	$ (26,757)	$ 255,951

(a) Net of reinsurance.

(b) Net effect on net income includes the sum of estimates of net claims and claim expenses incurred, and earned reinstatement premiums assumed and ceded.

Validus Re. Validus Re losses and loss expenses for the year ended December 31, 2009 were $186.7 million compared to $420.6 million for the year ended December 31, 2008, a decrease of $233.9 million or 55.6%. The loss ratio, defined as losses and loss expenses divided by net premiums earned, was 23.5% and 64.4% for the year ended December 31, 2009 and 2008, respectively. For the year ended December 31, 2009, Validus Re incurred $17.7 million, $2.1 million and $5.7 million of losses attributable to windstorm Klaus, a commercial flight loss and the Dublin floods, which represent 2.2, 0.3 and 0.7 percentage points of the segment loss ratio, respectively. For the year ended December 31, 2008, Validus Re incurred $216.1 million, and $15.4 million of losses attributable to Hurricanes Ike and Gustav, which represented 33.1 and 2.4 percentage points of the segment loss ratio, respectively. In addition, Item 2 of the Company s Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses $30.2 million of Validus Re losses attributable to separately identified losses, which, for the year ended December 31, 2008, represented 4.6 percentage points of the loss ratio.

	Year Ended December 31,		
	2009(a)	2008	2007
Property current year	24.0%	65.8%	32.6%
Property change in prior accident years	(11.3)%	(3.7)%	(3.2)%
Property loss ratio	12.7%	62.1%	29.4%
Marine current year	49.1%	90.5%	36.0%
Marine change in prior accident years	15.9%	3.9%	(2.6)%
Marine loss ratio	65.0%	94.4%	33.4%
Specialty current year	43.2%	37.1%	46.9%
Specialty change in prior accident years	(8.0)%	(2.3)%	(3.5)%

Specialty loss ratio	35.2%	34.8%	43.4%
All lines current year	30.2%	66.7%	34.5%
All lines change in prior accident years	(6.7)%	(2.3)%	(3.1)%
All lines loss ratio	23.5%	64.4%	31.4%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

For the year ended December 31, 2009, the property lines include $138.6 million related to current year losses and $65.1 million of favorable development relating to prior accident years. The favorable development is attributable principally to the reclassification of losses from onshore energy exposures during the 2007 California wildfires to the marine line and reduced loss estimates for Hurricane Ike, the June 2008 Midwest flood event and October 2007 Peruvian mining loss, as well as lower than expected claim development in the property class. For the year ended December 31, 2009, Validus Re s property lines incurred $17.7 million and $5.7 million of losses

attributable to windstorm Klaus and the Dublin floods, which represented 3.1 and 1.0 percentage points of the property lines loss ratio, respectively. For the year ended December 31, 2008, Validus Re s property lines incurred $158.5 million and $13.9 million of losses attributable to Hurricanes Ike and Gustav which represented 33.1 and 2.9 percentage points of the property lines loss ratio, respectively. In addition, Item 2 of the Company s Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses $30.2 million of Validus Re s property lines losses attributable to separately identified losses, which, for the year ended December 31, 2008, represented 6.3 percentage points of the property lines loss ratio. Validus Re property line s loss ratios, excluding prior year development and loss events identified above, for the year ended December 31, 2009 and 2008 were 19.9% and 24.0%, respectively.

For the year ended December 31, 2009, the marine lines include $60.5 million related to current year losses and $19.6 million of adverse development relating to prior accident years due primarily to the reclassification of losses from the property line and increased loss estimates for Hurricanes Ike and Gustav. For the year ended December 31, 2008, Validus Re marine lines incurred $57.6 million and $1.5 million of losses attributable to Hurricanes Ike and Gustav, which represented 55.1 and 1.4 percentage points of the marine lines loss ratio, respectively. Validus Re marine line s loss ratios, excluding prior year development and loss events identified above, for the year ended December 31, 2009 and 2008 were 49.1% and 33.3%, respectively.

For the year ended December 31, 2009, the specialty lines include $40.5 million related to current year losses and $7.5 million of favorable development relating to prior accident years. For the year ended December 31, 2009, Validus Re s specialty lines incurred $2.1 million of losses attributable to a commercial flight loss, which represented 2.2 percentage points of the specialty lines loss ratio. Validus Re specialty lines loss ratios, excluding prior year development and loss events identified above, for the year ended December 31, 2009 and 2008 were 41.0% and 37.1%, respectively.

Talbot. Talbot losses and loss expenses for the year ended December 31, 2009 were $337.1 million compared to $351.5 million for the year ended December 31, 2008, a decrease of $14.5 million, or 4.1%. The loss ratio was 51.5% and 58.3% for the year ended December 31, 2009 and 2008, respectively. For the year ended December 31, 2009, Talbot incurred $14.8 million or 2.3% of the loss ratio attributable to four default claims on the political risks line. For the year ended December 31, 2009, $386.1 million of losses and loss expenses related to current year losses and $49.1 million related to favorable development of prior accident years. Details of loss ratios by line of business and calendar period are provided below. Favorable loss reserve development benefitted the segment loss ratio by 7.5 percentage points for the year ended December 31, 2009. For the year ended December 31, 2009, Talbot incurred $6.4 million of losses attributable to a commercial flight loss, which represented 1.0 percentage point of the segment loss ratio. For the year ended December 31, 2008, Talbot incurred $44.4 million and $6.7 million of losses attributable to Hurricanes Ike and Gustav, which represented 7.4 and 1.1 percentage points of the segment loss ratio, respectively. In addition, Item 2 of the Company s Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses $11.3 million of losses attributable to separately identified losses, which, for the year ended December 31, 2008, represented 1.9 percentage points of the segment loss ratio. Details of loss ratios by line of business and calendar period are provided below.

Table of Contents

	Year Ended December 31,		
	2009	2008	2007(a)
Property current year	50.0%	104.9%	49.5%
Property change in prior accident years	(20.6)%	(4.9)%	(4.4)%
Property loss ratio	29.4%	100.0%	45.1%
Marine current year	65.0%	64.8%	58.1%
Marine change in prior accident years	(5.6)%	(6.3)%	(3.1)%
Marine loss ratio	59.4%	58.5%	55.0%
Specialty current year	57.4%	50.0%	46.0%
Specialty change in prior accident years	(2.5)%	(14.6)%	(17.5)%
Specialty loss ratio	54.9%	35.4%	28.5%
All lines current year	59.0%	67.4%	51.6%
All lines change in prior accident years	(7.5)%	(9.1)%	(8.7)%
All lines loss ratio	51.5%	58.3%	42.9%

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

For the year ended December 31, 2009, the property lines include $67.1 million related to current year losses and $27.6 million of favorable loss development relating to prior accident years. This favorable development is primarily attributable to lower than expected claims development. For the year ended December 31, 2008, the property lines incurred $31.5 million and $3.7 million of losses attributable to Hurricanes Ike and Gustav, which represented 26.3 and 3.1 percentage points of the loss ratio, respectively. In addition, Item 2 of the Company s Quarterly Report on Form 10-Q for the three months ended March 31, 2008 discloses $11.3 million of losses attributable to separately identified losses, which, for the year ended December 31, 2008, represented 9.4 percentage points of Talbot s property lines loss ratio. Talbot property line loss ratio, excluding prior year development and the loss events identified above, for the year ended December 31, 2009 and 2008 were 50.0% and 68.7%, respectively.

For the year ended December 31, 2009, the marine lines include $177.9 million related to current year losses and $15.3 million of favorable development relating to prior accident years. For the year ended December 31, 2008, the marine lines incurred $12.4 million and $2.5 million of losses attributable to Hurricanes Ike and Gustav, which represented 4.7 and 1.0 percentage points of the marine lines loss ratio, respectively. Talbot marine lines loss ratios, excluding prior year development and the loss events identified above, for the year ended December 31, 2009 and 2008 were 65.0% and 55.5%, respectively.

For the year ended December 31, 2009, the specialty lines include $141.1 million relating to current year losses and $6.1 million of favorable development on prior accident years. This favorable development is primarily due to further favorable development on the Financial Institutions line. For the year ended December 31, 2009, Talbot incurred $6.4 million of losses attributable to a commercial flight loss, which represents 2.6 percentage points of the specialty lines loss ratio. For the year ended December 31, 2008, the specialty lines incurred $0.5 million and $0.5 million of losses attributable to Hurricanes Ike and Gustav, which represented 0.2 and 0.2 percentage points of the specialty lines

loss ratio, respectively. Talbot specialty lines loss ratios, excluding prior year development and the loss events identified above, for the year ended December 31, 2009 and 2008 were 54.8% and 49.5%, respectively.

Policy Acquisition Costs

Policy acquisition costs for the year ended December 31, 2009 were $263.0 million compared to $235.0 million for the year ended December 31, 2008, an increase of $28.0 million or 11.9%. Policy acquisition costs as a percent of net premiums earned for the year ended December 31, 2009 and 2008 were 18.1% and 18.7%, respectively.

Table of Contents

	Year Ended December 31, 2009(a)			Year Ended December 31, 2008			Year Ended December 31, 2007(b)		
llars in thousands)	Policy Acquisition Cost	Policy Acquisition Cost (%)	Acquisition Cost Ratio	Policy Acquisition Cost	Policy Acquisition Cost (%)	Acquisition Cost Ratio	Policy Acquisition Cost	Policy Acquisition Cost (%)	Acquisition Cost Ratio
perty	$ 104,912	39.9%	14.7%	$ 97,345	41.4%	16.3%	$ 68,645	51.1%	14.0%
ine	86,295	32.8%	21.7%	74,372	31.7%	20.2%	33,391	24.9%	16.7%
cialty	71,759	27.3%	21.1%	63,234	26.9%	21.8%	32,241	24.0%	19.0%
al	$ 262,966	100.0%	18.1%	$ 234,951	100.0%	18.7%	$ 134,277	100.0%	15.6%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Validus Re. Validus Re policy acquisition costs for the year ended December 31, 2009 were $127.4 million compared to $100.2 million for the year ended December 31, 2008, an increase of $27.2 million or 27.1%.

	Year Ended December 31, 2009(a)			Year Ended December 31, 2008			Year Ended December 31, 2007		
llars in thousands)	Policy Acquisition Cost	Policy Acquisition Cost (%)	Acquisition Cost Ratio	Policy Acquisition Cost	Policy Acquisition Cost (%)	Acquisition Cost Ratio	Policy Acquisition Cost	Policy Acquisition Cost (%)	Acquisition Cost Ratio
perty	$ 88,589	69.5%	15.3%	$ 75,717	75.5%	15.8%	$ 55,472	78.9%	13.1%
rine	25,311	19.9%	20.5%	14,718	14.7%	14.1%	7,410	10.5%	9.4%
cialty	13,533	10.6%	14.4%	9,808	9.8%	13.9%	7,441	10.6%	13.2%
al	$ 127,433	100.0%	16.0%	$ 100,243	100.0%	15.3%	$ 70,323	100.0%	12.6%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

Policy acquisition costs include brokerage, commission and excise tax and are generally driven by contract terms and are normally a set percentage of premiums and are also net of ceding commission income on retrocessions. Policy acquisition costs as a percent of net premiums earned for the year ended December 31, 2009 and 2008 were 16.0% and 15.3%, respectively. The policy acquisition ratio increased largely due to a 6.4 percentage point increase on the marine policy acquisition ratio. The increase in the marine policy acquisition ratio was due to an increased portion of

gross premiums written being earned on proportional contracts, which generally experience higher acquisition costs.

Talbot. Talbot policy acquisition costs for the year ended December 31, 2009 were $139.9 million compared to $135.0 million for the year ended December 31, 2008, an increase of $4.9 million or 3.6%.

	Year Ended December 31, 2009			Year Ended December 31, 2008			Year Ended December 31, 2007(a)		
llars in thousands)	**Policy Acquisition Cost**	**Policy Acquisition Cost (%)**	**Acquisition Cost Ratio**	**Policy Acquisition Cost**	**Policy Acquisition Cost (%)**	**Acquisition Cost Ratio**	**Policy Acquisition Cost**	**Policy Acquisition Cost (%)**	**Acquisition Cost Ratio**
perty	$ 20,722	14.8%	15.4%	$ 21,937	16.2%	18.3%	$ 25,356	20.2%	18.9%
rine	60,984	43.6%	22.3%	59,654	44.2%	22.7%	51,387	41.0%	21.8%
cialty	58,226	41.6%	23.7%	53,426	39.6%	24.3%	48,676	38.8%	22.7%
al	$ 139,932	100.0%	21.4%	$ 135,017	100.0%	22.4%	$ 125,419	100.0%	21.4%

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

Table of Contents

Policy acquisition costs as a percent of net premiums earned were 21.4% and 22.4%, respectively, for the year ended December 31, 2009 and 2008.

General and Administrative Expenses

General and administrative expenses for the year ended December 31, 2009 were $185.6 million compared to $123.9 million for the year ended December 31, 2008, an increase of $61.6 million or 49.7%. The increase was primarily a result of increased Validus Re expenses in addition to increases in the Talbot and Corporate segments.

	General and Administrative Expenses					
	Year Ended December 31, 2009(a)		Year Ended December 31, 2008		Year Ended December 31, 2007(b)	
(Dollars in thousands)	General and Administrative Expenses	General and Administrative Expenses (%)	General and Administrative Expenses	General and Administrative Expenses (%)	General and Administrative Expenses	General and Administrative Expenses (%)
Validus Re	$ 65,710	35.4%	$ 34,607	28.0%	$ 31,412	32.1%
Talbot	96,352	51.9%	71,443	57.6%	48,886	50.0%
Corporate & Eliminations	23,506	12.7%	17,898	14.4%	17,467	17.9%
Total	$ 185,568	100.0%	$ 123,948	100.0%	$ 97,765	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

General and administrative expense ratios for the year ended December 31, 2009 and 2008 were 14.7% and 12.0%, respectively. General and administrative expense ratio is the sum of general and administrative expenses and share compensation expense divided by net premiums earned.

	Year Ended December 31, 2009(a)		Year Ended December 31, 2008		Year Ended December 31, 2007(b)	
(Dollars in thousands)	Expenses	Expenses as % of Net Earned Premiums	Expenses	Expenses as % of Net Earned Premiums	Expenses	Expenses as % of Net Earned Premiums
General and Administrative	$ 185,568	12.8%	$ 123,948	9.8%	$ 97,765	11.4%
Share Compensation	27,037	1.9%	27,097	2.2%	16,189	1.9%

Total	$ 212,605	14.7%	$ 151,045	12.0%	$ 113,954	13.3%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

General and administrative expenses of $185.6 million in the year ended December 31, 2009 represents 12.8 percentage points of the expense ratio. Share compensation expense is discussed in the following section.

Validus Re. Validus Re general and administrative expenses for the year ended December 31, 2009 were $65.7 million compared to $34.6 million for the year ended December 31, 2008, an increase of $31.1 million or 89.9%. General and administrative expenses have increased primarily as a result of the increase in staff to 133 at December 31, 2009 from 91 at December 31, 2008. In addition to the increased headcount, due in part to the IPC acquisition, there were also additional rent and other office expenses. General and administrative expenses are

Table of Contents

generally comprised of salaries and benefits, professional fees, rent and office expenses. Validus Re s general and administrative expenses as a percent of net premiums earned for the year ended December 31, 2009 and 2008 were 8.3% and 5.3%, respectively.

Talbot. Talbot general and administrative expenses for the year ended December 31, 2009 were $96.4 million compared to $71.4 million for the year ended December 31, 2008, an increase of $24.9 million or 34.9%. General and administrative expenses have increased primarily as a result of the increase in staff to 238 at December 31, 2009 from 182 at December 31, 2008 and expenses related to the new onshore energy and aviation underwriting teams. In addition to increased staff costs, Talbot rent and office expenses increased by $6.6 million for year ended December 31, 2009, due to a 2009 office move, including a $4.2 million provision for the deficiency between the expected costs incurred up to the expiry of the previous office lease and any recoveries under potential sub-leases. Talbot s general and administrative expenses as a percent of net premiums earned for the year ended December 31, 2009 and 2008 were 14.7% and 11.8%, respectively.

Corporate & Eliminations. Corporate general and administrative expenses for the year ended December 31, 2009 were $23.5 million compared to $17.9 million for the year ended December 31, 2008, an increase of $5.6 million or 31.3%. Corporate general and administrative expenses are comprised of executive and board expenses, internal and external audit expenses and other costs relating to the Company as a whole.

Share Compensation Expense

Share compensation expense for the year ended December 31, 2009 was $27.0 million compared to $27.1 million for the year ended December 31, 2008, a decrease of $0.1 million or 0.2%. This expense is non-cash and has no net effect on total shareholders equity, as it is balanced by an increase in additional paid-in capital.

	Share Compensation Expense					
	Year Ended December 31, 2009(a)		Year Ended December 31, 2008		Year Ended December 31, 2007(b)	
(Dollars in thousands)	**Share Compensation Expense**	**Share Compensation Expense (%)**	**Share Compensation Expense**	**Share Compensation Expense (%)**	**Share Compensation Expense**	**Share Compensation Expense (%)**
Validus Re	$ 7,576	28.0%	$ 6,829	25.2%	$ 4,013	24.7%
Talbot	7,171	26.5%	4,702	17.4%	1,709	10.6%
Corporate & Eliminations	12,290	45.5%	15,566	57.4%	10,467	64.7%
Total	$ 27,037	100.0%	$ 27,097	100.0%	$ 16,189	100.0%

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Share compensation expense of $27.0 million in the year ended December 31, 2009 represents 1.9 percentage points of the general and administrative expense ratio.

Validus Re. Validus Re share compensation expense for the year ended December 31, 2009 was $7.6 million compared to $6.8 million for the year ended December 31, 2008, an increase of $0.7 million or 10.9%. The increase was due to the impact of grants made during 2008. Share compensation expense as a percent of net premiums earned for the year ended December 31, 2009 and 2008 were 1.0% and 1.0%, respectively.

Talbot. Talbot share compensation expense for the year ended December 31, 2009 was $7.2 million compared to $4.7 million for the year ended December 31, 2008. The increase was due to additional grants for the year ended December 31, 2009, accelerated vesting and increased staff. Share compensation expense as a percent of net premiums earned for the year ended December 31, 2009 and 2008 were 1.1% and 0.8%, respectively.

Corporate & Eliminations. Corporate share compensation expense for the year ended December 31, 2009 was $12.3 million compared to $15.6 million for the year ended December 31, 2008, a decrease of $3.3 million or

Table of Contents

21.0%. This decrease was due primarily to several share award issuances with vesting periods greater than one year that vested during the year ended December 31, 2008 and therefore had no further amortization expense during the year ended December 31, 2009.

Selected Ratios

The underwriting results of an insurance or reinsurance company are often measured by reference to its combined ratio, which is the sum of the loss ratio and the expense ratio. The net loss ratio is calculated by dividing losses and loss expenses incurred (including estimates for incurred but not reported losses) by net premiums earned. The expense ratio is calculated by dividing acquisition costs combined with general and administrative expenses by net premiums earned. The following table presents the losses and loss expenses ratio, policy acquisition cost ratio, general and administrative expense ratio, expense ratio and combined ratio for the year ended December 31, 2009, 2008 and 2007.

	Year Ended December 31, 2009(b)	**Year Ended December 31, 2008**	**Year Ended December 31, 2007(c)**
Losses and loss expenses ratio	36.1%	61.5%	33.1%
Policy acquisition cost ratio	18.1%	18.7%	15.6%
General and administrative expense ratio(a)	14.7%	12.0%	13.3%
Expense ratio	32.8%	30.7%	28.9%
Combined ratio	68.9%	92.2%	62.0%

Validus Re	**Year Ended December 31, 2009(b)**	**Year Ended December 31, 2008**	**Year Ended December 31, 2007**
Losses and loss expenses ratio	23.5%	64.4%	31.4%
Policy acquisition cost ratio	16.0%	15.3%	12.6%
General and administrative expense ratio(a)	9.2%	6.3%	6.3%
Expense ratio	25.2%	21.6%	18.9%
Combined ratio	48.7%	86.0%	50.3%

Talbot	**Year Ended December 31, 2009**	**Year Ended December 31, 2008**	**Year Ended December 31, 2007(c)**
Losses and loss expenses ratio	51.5%	58.3%	43.0%
Policy acquisition cost ratio	21.4%	22.4%	21.4%
General and administrative expense ratio(a)	15.8%	12.6%	16.9%

Expense ratio	37.2%	35.0%	38.3%
Combined ratio	88.7%	93.3%	81.3%

(a) Includes general and administrative expense and share compensation expense.

(b) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(c) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

Underwriting Income

Underwriting income for the year ended December 31, 2009 was $450.2 million compared to $98.4 million for the year ended December 31, 2008, an increase of $351.9 million or 357.7%.

Table of Contents

(Dollars in thousands)	Year Ended December 31, 2009(a)	% of Sub total	2008	% of Sub total	2007(b)	% of Sub total
Validus Re	$ 408,127	84.7%	$ 91,207	69.3%	$ 277,743	78.5%
Talbot	73,519	15.3%	40,316	30.7%	76,046	21.5%
Sub total	481,646	100.0%	131,523	100.0%	353,789	100.0%
Corporate & Eliminations	(31,397)		(33,155)		(27,934)	
Total	$ 450,249		$ 98,368		$ 325,855	

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above. For segmental reporting purposes, the results of IPC s operations since the acquisition date have been included within the Validus Re segment in the consolidated financial statements.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

The underwriting results of an insurance or reinsurance company are also often measured by reference to its underwriting income, which is a non-GAAP measure as previously defined. Underwriting income, as set out in the table below, is reconciled to net income (the most directly comparable GAAP financial measure) by the addition or subtraction of certain Consolidated Statement of Operations and Comprehensive Income line items, as described below.

(Dollars in thousands)	Year Ended December 31, 2009(a)	Year Ended December 31, 2008	Year Ended December 31, 2007(b)
Underwriting income (loss)	$ 450,249	$ 98,368	$ 325,855
Net investment income	118,773	139,528	112,324
Other income	4,634	5,264	3,301
Finance expenses	(44,130)	(57,318)	(51,754)
Gain on bargain purchase, net of expenses	287,099		
Realized gain on repurchase of debentures	4,444	8,752	
Net realized (losses) gains on investments	(11,543)	(1,591)	1,608
Net unrealized gains (losses) on investments	84,796	(79,707)	12,364
Foreign exchange (losses) gains	(674)	(49,397)	6,696
Fair value of warrants issued			(2,893)
Aquiline termination fee			(3,000)
Net income before taxes	$ 893,648	$ 63,899	$ 404,501

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Underwriting income indicates the performance of the Company s core underwriting function, excluding revenues and expenses such as the reconciling items in the table above. The Company believes the reporting of underwriting income enhances the understanding of our results by highlighting the underlying profitability of the Company s core insurance and reinsurance business. Underwriting profitability is influenced significantly by earned premium growth, adequacy of the Company s pricing and loss frequency and severity. Underwriting profitability over time is also influenced by the Company s underwriting discipline, which seeks to manage exposure to loss through favorable risk selection and diversification, its management of claims, its use of

reinsurance and its ability to manage its expense ratio, which it accomplishes through its management of acquisition costs and other underwriting expenses. The Company believes that underwriting income provides investors with a valuable measure of profitability derived from underwriting activities.

The Company excludes the U.S. GAAP measures noted above, in particular net realized and unrealized gains and losses on investments, from its calculation of underwriting income because the amount of these gains and losses is heavily influenced by, and fluctuates in part, according to availability of investment market opportunities. The Company believes these amounts are largely independent of its underwriting business and including them distorts the analysis of trends in its operations. In addition to presenting net income determined in accordance with U.S. GAAP, the Company believes that showing underwriting income enables investors, analysts, rating agencies and other users of its financial information to more easily analyze the Company s results of operations in a manner similar to how management analyzes the Company s underlying business performance. The Company uses underwriting income as a primary measure of underwriting results in its analysis of historical financial information and when performing its budgeting and forecasting processes. Analysts, investors and rating agencies who follow the Company request this non-GAAP financial information on a regular basis. In addition, underwriting income is one of the factors considered by the compensation committee of our Board of Directors in determining the bonus component of the total annual incentive compensation.

Underwriting income should not be viewed as a substitute for U.S. GAAP net income as there are inherent material limitations associated with the use of underwriting income as compared to using net income, which is the most directly comparable U.S. GAAP financial measure. The most significant limitation is the ability of users of the financial information to make comparable assessments of underwriting income with other companies, particularly as underwriting income may be defined or calculated differently by other companies. Therefore, the Company provides more prominence in this filing to the use of the most comparable U.S. GAAP financial measure, net income, which includes the reconciling items in the table above. The Company compensates for these limitations by providing both clear and transparent disclosure of net income and reconciliation of underwriting income to net income.

Net Investment Income

Net investment income for the year ended December 31, 2009 was $118.8 million compared to $139.5 million for the year ended December 31, 2008, a decrease of $20.8 million or 14.9%. Net investment income decreased as a result of reduced market yields and higher quarterly average cash balances. Net investment income is comprised of accretion of premium or discount on fixed maturities, interest on coupon-paying bonds, short-term investments and cash and cash equivalents, partially offset by investment management fees. The components of net investment income are presented below.

(Dollars in thousands)	Year Ended December 31, 2009(a)	Year Ended December 31, 2008	Year Ended December 31, 2007(b)
Fixed maturities and short-term investments	$ 117,631	$ 127,689	$ 98,559
Cash and cash equivalents	3,374	13,416	16,111
Securities lending income	772	1,775	242
Total investment income	121,777	142,880	114,912
Investment expenses	(3,004)	(3,352)	(2,588)
Net investment income	$ 118,773	$ 139,528	$ 112,324

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Investment management fees incurred relate to BlackRock Financial Management, Inc. (BlackRock) and Goldman Sachs Asset Management L.P. and its affiliates (GSAM). Each of Merrill Lynch & Co, Inc. (Merrill

Lynch), a wholly owned subsidiary of Bank of America Corp., and Goldman Sachs are major shareholders of the Company. BlackRock is considered a related party due to its merger in February 2006 with Merrill Lynch Investment Managers. Investment management fees earned by BlackRock for the year ended December 31, 2009 and 2008 were $1.4 million and $1.7 million, respectively. Investment management fees earned by GSAM for the year ended December 31, 2009 and 2008 were $1.3 million and $1.4 million, respectively. The Company entered into investment management agreements during the year ended December 31, 2009 with each of Conning, Inc. (Conning) and Pinebridge Investments Europe Ltd. On June 16, 2009, Aquiline, a major shareholder of the Company, acquired Conning. Management believes that the fees charged were consistent with those that would have been charged in arm s-length transactions with unrelated third parties.

Annualized effective investment yield is based on the weighted average investments held calculated on a simple period average and excludes net unrealized gains (losses), foreign exchange gains (losses) on investments and the foreign exchange effect of insurance balances. The Company s annualized effective investment yield was 2.73% and 4.37% for the year ended December 31, 2009 and 2008, respectively, and the average duration at December 31, 2009 was 2.2 years (December 31, 2008 1.8 years).

Other Income

Other income for the year ended December 31, 2009 was $4.6 million compared to $5.3 million for the year ended December 31, 2008, a decrease of $0.6 million or 12.0%.

Finance Expenses

Finance expenses for the year ended December 31, 2009 were $44.1 million compared to $57.3 million for the year ended December 31, 2008, a decrease of $13.2 million or 23.0%. The decrease was primarily a result of an $13.1 million decrease on Talbot third party FAL facility.

Finance expenses also include the amortization of debt offering costs and discounts and fees related to our credit facilities.

	Year Ended December 31,		
(Dollars in thousands)	**2009(a)**	**2008**	**2007(b)**
9.069% Junior Subordinated Deferrable Debentures	$ 14,354	$ 14,354	14,398
8.480% Junior Subordinated Deferrable Debentures	12,732	14,704	8,938
Credit facilities	2,319	910	2,332
Talbot FAL facilities	542	255	658
Talbot other interest		(186)	620
Talbot third party FAL facility	14,183	27,281	24,808
Finance expenses	$ 44,130	$ 57,318	51,754

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b)

The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Capital in Lloyd s entities, whether personal or corporate, is required to be set annually for the prospective year and held by Lloyd s in trust (Funds at Lloyd s or FAL). In underwriting years up to and including 2007, Talbot s FAL has been provided both by Talbot and by third parties, thereafter Talbot s FAL has been provided exclusively by the Company. Because the third party FAL providers remain on risk until each year of account that their support closes (normally after three years). Talbot must retain third party FAL even if a third party FAL provider has ceased to support the active underwriting year. This is achieved by placing such FAL in escrow outside Lloyd s. Thus the total FAL facility available to the Company is the total FAL for active and prior underwriting years, although the Company can only apply specific FAL against losses incurred by an underwriting year that such FAL is contracted to support.

105

Table of Contents

For each year of account up to and including the 2007 year of account, between 30% and 40% of an amount equivalent to each underwriting years profit is payable to Talbot third party FAL providers. However, some of these costs are fixed. There are no FAL finance charges related to the 2008 and 2009 years of account as there were no third party FAL providers in those periods.

The FAL finance charges relate to total syndicate profit (underwriting income, investment income and realized and unrealized capital gains and losses). FAL finance charges and total syndicate profits are analyzed by underwriting year of account as follows:

	Year Ended December 31,								
							FAL Finance Charges as% of Total Syndicate Profit		
rwriting Year of Account ars in thousands)	FAL Finance Charges 2009	2008	2007(a)	Total Syndicate Profit 2009	2008	2007(a)	2009	2008	2007
(b)	$	$	$ 16,335	$	$	$ 76,677	NM	NM	2
(b)		18,160	19,202		54,845	54,484	NM	33.1%	3
	12,000	9,121	6,299	38,913	35,986	20,864	30.8%	25.3%	3(
				33,532	(28,724)		NM	NM	N
				23,472			NM	NM	N
capital agreement	2,183						NM	NM	N
	$ 14,183	$ 27,281	$ 41,836	$ 95,917	62,107	$ 152,025	14.8%	43.9%	2
ntage excluding years in t							14.8%	30.0%	2

NM Not meaningful

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only.

(b) The earliest year of account includes the run-off of prior (closed) years of account.

FAL finance charges are based on syndicate profit but include fixed elements. FAL finance charges for the year ended December 31, 2009 were $14.2 million compared to $27.3 million for the year ended December 31, 2008, a decrease of $13.1 million. This decrease was due to the absence of FAL finance charges related to the 2006 year of account, which has now closed. The Talbot group has entered into an agreement with National Indemnity Corporation (NIC) whereby NIC, in the past, provided letters of credit to support the group s underwriting. Part of that agreement stipulates that part of the reinsurance to close premium in respect of the 2006 year of account will be made available to NIC, at NIC s option, as a limited quota share agreement. The portion that shall be offered is the amount of support provided by NIC for the 2006 year of account divided by the overall support provided for that year.

Total syndicate profit, as set out in the table below, is reconciled to the Talbot segment net income by the addition or subtraction of items noted below.

(Dollars in thousands)	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007(a)
Total syndicate profit	$ 95,917	$ 62,108	$ 152,025
FAL Finance expenses	(14,183)	(27,281)	(41,836)
Managing agent s fee(b)	9,657	9,019	9,750
Managing agent s profit commission(c)	11,888	22,286	23,625
Investment income(d)	14,205	7,433	13,512
Other segment operating expenses, net	(7,870)	(24,515)	(30,692)
Share compensation expenses	(7,171)	(4,702)	(1,469)
Intangible amortization expenses	(4,162)	(4,161)	(2,081)
Income tax benefit expense	3,922	(10,700)	(2,638)
Talbot segment net income	$ 102,203	$ 29,487	$ 120,196

Table of Contents

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. The pre-acquisition and post-acquisition results of operations for Talbot are presented on a combined basis for the year ended December 31, 2007 for comparative purposes only

(b) 1.5% of syndicate capacity; corresponding syndicate expense reflected in total syndicate profit, above.

(c) 15.0% of syndicate profit; corresponding syndicate expense reflected in total syndicate profit, above.

(d) On FAL and on non-syndicate cash balances.

Tax Benefit (Expense)

Tax benefit for the year ended December 31, 2009 was $3.8 million compared to an (expense) of ($10.8) million for the year ended December 31, 2008, a change of $14.5 million. The tax benefit was due primarily to an $8.7 million adjustment relating to a change in the functional currency of the U.K. statutory accounts of a subsidiary which resulted in unearned premiums and deferred acquisition costs being valued at historic rates, and the associated foreign exchange movements through its profit and loss account being subject to U.K. tax. This was offset by a current year tax expense of $5.0 million as a result of items arising in the current year also falling subject to U.K. tax under the new functional currency.

Gain on Bargain Purchase, Net of Expenses

On September 4, 2009, the Company acquired all of the outstanding shares of IPC from a group of institutional and other investors. Pursuant to the Amalgamation Agreement, the Company acquired all of IPC s outstanding common shares in exchange for the Company s common shares and cash. The purchase price paid by the Company was $1,746.2 million for net assets acquired of $2,076.9 million. The Company expensed as incurred $29.4 million of transaction expenses, $21.7 million for amortization of intangibles and $14.1 million of termination expenses related to the acquisition for the year ended December 31, 2009, resulting in a gain on bargain purchase of $287.1 million for the year ended December 31, 2009. Transaction expenses are comprised of primarily legal, corporate advisory, IPC employee termination benefits and audit related services.

Realized Gain on Repurchase of Debentures

On December 1, 2009, the Company repurchased from an unaffiliated financial institution $14.5 million principal amount of its 8.480% Junior Subordinated Deferrable Debentures due 2037 at an aggregate price of $9.9 million plus accrued and unpaid interest of $0.3 million. The repurchase resulted in the recognition of a realized gain of $4.4 million for the year ended December 31, 2009.

Net Realized (Losses) on Investments

Net realized (losses) on investments for the year ended December 31, 2009 were ($11.5) million compared to (losses) of ($1.6) million for the year ended December 31, 2008. Net realized losses resulted primarily from the sale of $98.6 million of CMBS with relatively long weighted average lives, resulting in realized losses of $19.5 million, which resulted in a corresponding offset in net unrealized gains (losses). The decision to reduce the Company s exposure to CMBS was made in light of deteriorating fundamentals in the sector.

On August 28, 2009, the Company sold short equity index futures contracts with a goal of hedging IPC s mutual fund equity portfolio exposure. The contracts were closed when the equity positions were fully redeemed on September 9,

2009. The Company experienced a $3.3 million realized investment loss as a result of the futures contracts.

Net Unrealized Gains (Losses) on Investments

Net unrealized gains on investments for the year ended December 31, 2009 were $84.8 million compared to losses of ($79.7) million for the year ended December 31, 2008. The net unrealized gains in the year ended December 31, 2009 resulted from improved market conditions for fixed income securities.

The net unrealized gains on investments for the year ended December 31, 2009 included a $0.7 million unrealized gain on the fund of hedge funds purchased in the IPC Acquisition. The fund of hedge funds was included in other investments on the balance sheet as at December 31, 2009.

Net unrealized gains on investments are recorded as a component of net income. The Company has adopted all authoritative guidance on U.S. GAAP fair value measurements in effect as of the balance sheet date. Consistent with these statements, certain market conditions allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable. Certain non-Agency RMBS securities were identified as trading in inactive markets. The change in fair value for the identified non-Agency RMBS securities was a $6.4 million increase in net unrealized loss on investments for the year ended December 31, 2009. Further details are provided in the Investments section below.

Foreign Exchange (Losses)

Foreign exchange (losses) for the year ended December 31, 2009 were ($0.7) million compared to (losses) of ($49.4) million for the year ended December 31, 2008, a decrease of $48.7 million. The decrease in foreign exchange (losses) was due primarily to the increased value of assets denominated in foreign currencies relative to the U.S. Dollar reporting currency for the year ended December 31, 2009 as compared to the year ended December 31, 2008. The British pound sterling to U.S. Dollar exchange rates were 1.44 and 1.59 at December 31, 2008 and December 31, 2009, respectively. Certain premiums receivable and liabilities for losses incurred in currencies other than the U.S. dollar are exposed to the risk of changes in value resulting from fluctuations in foreign exchange rates and may affect financial results in the future.

At December 31, 2009, Talbot s balance sheet includes net unearned premiums and deferred acquisition costs denominated in foreign currencies of approximately $81.4 million and $17.5 million, respectively. This net balance of $63.9 million consisted of British pounds sterling and Canadian dollars of $56.8 million and $7.1 million, respectively. Net unearned premiums and deferred acquisition costs are classified as non-monetary items and are translated at historic exchange rates. All of Talbot s other balance sheet items are classified as monetary items and are translated at period end exchange rates. Additional foreign exchange (losses) gains may be incurred on the translation of net unearned premiums and deferred acquisition costs arising from insurance and reinsurance premiums written in future periods.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

Net income for the year ended December 31, 2008 was $53.1 million compared to net income of $403.0 million for the year ended December 31, 2007, a decrease of $349.9 million or 86.8%. The primary factors driving the change in net income were:

Decrease in underwriting income of $227.5 million due primarily to losses and loss expense, as a result of Hurricanes Ike and Gustav, of $260.6 million and $22.1 million, respectively. These losses were offset by increased earned reinstatement premiums of $26.8 million as a result of Hurricanes Ike and Gustav and $28.7 million of other income items including the benefit of earning premiums on business written in 2007 and 2006;

Decrease in net unrealized (losses) gains on investments of $92.1 million as a result of market value declines due to interest rate movements and widening credit spreads resulting from the extreme volatility in the financial markets;

Decrease in foreign exchange (losses) gains of $56.1 million due principally to third quarter declines in the value of assets denominated in foreign currencies relative to the U.S. dollar reporting currency; and

Increased finance expenses of $5.6 million, resulting primarily from an increase of $5.8 million in finance expense on the 8.480% Junior Subordinated Deferrable Debentures and $2.5 million of Talbot Funds at Lloyd s (FAL) finance expense.

Table of Contents

The changes noted above were partially offset by increased net investment income of $27.2 million as a result of growth in the Validus Re investment portfolio and the addition of the Talbot portfolio.

The decrease in net income for the year ended December 31, 2008 of $349.9 million is described in the following table:

	Year Ended December 31, 2008 Increase (Decrease) over The Year Ended December 31, 2007(a)			
(Dollars in thousands)	**Validus Re**	**Talbot**	**Corporate and Other Reconciling Items**	**Total**
Hurricanes Ike and Gustav net losses and loss expenses	$ (231,573)	$ (51,135)	$	$ (282,708)
Hurricanes Ike and Gustav net reinstatement premiums	25,860	897		26,757
Other underwriting income	19,177	14,508	(5,221)	28,464
Underwriting income	(186,536)	(35,730)	(5,221)	(227,487)
Net investment income	16,013	15,715	(4,524)	27,204
Other income	309	1,963	(309)	1,963
Finance expenses	499	(1,265)	(4,798)	(5,564)
	(169,715)	(19,317)	(14,852)	(203,884)
Taxes	(27)	(9,256)		(9,283)
	(169,742)	(28,573)	(14,852)	(213,167)
Realized gain on repurchase of debentures			8,752	8,752
Net realized (losses) gains on investments	(10,161)	6,962		(3,199)
Net unrealized (losses) gains on investments	(93,270)	1,199		(92,071)
Foreign exchange (losses)	(24,196)	(31,897)		(56,093)
Fair value of warrants issued			2,893	2,893
Aquiline termination fee			3,000	3,000
Net income	$ (297,369)	$ (52,309)	$ (207)	$ (349,885)

(a) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

Other Non-GAAP Financial Measures

In presenting the Company s results, management has included and discussed certain schedules containing net operating income (loss), underwriting income, annualized return on average equity and diluted book value per

common share that are not calculated under standards or rules that comprise U.S. GAAP. Such measures are referred to as non-GAAP. Non-GAAP measures may be defined or calculated differently by other companies. These measures should not be viewed as a substitute for those determined in accordance with U.S. GAAP. The calculation of annualized return on average equity is discussed in the section above entitled Financial Measures. A reconciliation of underwriting income to net income, the most comparable U.S. GAAP financial measure, is presented above in the section entitled Underwriting Income. A reconciliation of diluted book value per share to book value per share, the most comparable U.S. GAAP financial measure, is presented below. Operating income is calculated based on net income (loss) excluding net realized gains (losses), net unrealized gains (losses) on investments, gains (losses) arising from translation of non-US$ denominated balances and non-recurring items. A reconciliation of operating income to net income, the most comparable U.S. GAAP financial measure, is embedded in the table presenting results of operations for the three months and years ended December 31, 2009 and 2008 in the section above entitled Results of Operations. Realized gains (losses) from the sale of investments are driven by the timing of the disposition of investments, not by our operating performance. Gains (losses) arising from translation of non-US$ denominated balances are unrelated to our underlying business.

Table of Contents

The following tables present reconciliations of diluted book value per share to book value per share, the most comparable U.S. GAAP financial measure, at December 31, 2009 and 2008.

	As at December 31, 2009			
	Equity Amount	Shares	Exercise Price	Book Value Per Share
Book value per common share				
Total shareholders equity	$ 4,031,120	128,459,478		$ 31.38
Diluted book value per common share				
Total shareholders equity	4,031,120	128,459,478		
Assumed exercise of outstanding warrants	139,576	7,952,138	$ 17.55	
Assumed exercise of outstanding stock options	65,159	3,278,015	$ 19.88	
Unvested restricted shares		3,020,651		
Diluted book value per common share	$ 4,235,855	142,710,282		$ 29.68

	As at December 31, 2008			
	Equity Amount	Shares	Exercise Price	Book Value Per Share
Book value per common share				
Total shareholders equity	$ 1,938,734	75,624,697		$ 25.64
Diluted book value per common share				
Total shareholders equity	1,938,734	75,624,697		
Assumed exercise of outstanding warrants	152,316	8,680,149	$ 17.55	
Assumed exercise of outstanding stock options	51,043	2,799,938	$ 18.23	
Unvested restricted shares		2,986,619		
Diluted book value per common share	$ 2,142,093	90,091,403		$ 23.78

Financial Condition and Liquidity

Validus Holdings, Ltd. is a holding company and conducts no operations of its own. The Company relies primarily on cash dividends and other permitted payments from Validus Re and Talbot to pay finance expenses and other holding company expenses. There are restrictions on the payment of dividends from Validus Re and Talbot to the Company. Please refer to Part II, Item 5, Market for Registrants, Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities for further discussion of the Company s dividend policy.

Three main sources provide cash flows for the Company: operating activities, investing activities and financing activities. Cash flow from operating activities is derived primarily from the net receipt of premiums less claims and expenses related to underwriting activities. Cash flow from investing activities is derived primarily from the receipt of net proceeds on the Company s total investment portfolio. Cash flow from financing activities is derived primarily from the issuance of common shares and notes and debentures payable. The movement in net cash provided by operating activities, net cash (used in) provided by investing activities, net cash (used in) provided by

financing activities and the effect of foreign currency rate changes on cash and cash equivalents is described in the following table:

	Year Ended December 31,				
(Dollars in thousands)	**2009(a)**	**% Change**	**2008**	**% Change**	**2007(b)**
Net cash provided by operating activities	$ 555,116	14.2%	$ 485,983	(13.7)%	$ 563,378
Net cash (used in) investing activities	(442,633)	(64.1)%	(269,810)	68.6%	(860,522)
Net cash (used in) provided by financing activities	(187,067)	(15.2)%	(162,334)	(124.2)%	670,246
Effect of foreign currency rate changes on cash and cash equivalents	12,321	125.3%	(48,689)	(712.2)%	7,953
Net (decrease) increase in cash	$ (62,263)		$ 5,150		$ 381,055

(a) The results of operations for IPC are consolidated only from the September 4, 2009 date of acquisition. No pre-acquisition results of operations for IPC are presented in the analysis above.

(b) The results of operations for Talbot are consolidated only from the July 2, 2007 date of acquisition. No pre-acquisition results of operations for Talbot are presented in the analysis above.

During the year ended December 31, 2009, net cash provided by operating activities was driven primarily by net income of $897.4 million. Cash provided by operating activities, as compared to the year ended December 31, 2008, was affected by the relative movement in change in reserves for losses and loss expenses for the year ended December 31, 2009, due primarily to the settlement of 2008 loss reserves. Net cash used in investing activities was driven primarily by the proceeds on sales of investments to finance the IPC acquisition and the investment of operating surpluses. Net cash used in financing activities was driven primarily by share repurchases of $84.2 million and aggregate quarterly dividend payments of $78.5 million. The decrease in the effect of foreign currency rate changes in cash and cash equivalents is due to relatively stable major currency exchange rates for the year ended December 31, 2009 compared to the year ended December 31, 2008.

On September 4, 2009, pursuant to an Amalgamation Agreement, the Company acquired all of IPC s outstanding common shares in exchange for 0.9727 Company common shares and $7.50 cash per IPC common share. The IPC Acquisition resulted in the payment of $420.8 million in cash to IPC shareholders.

During the year ended December 31, 2008, net cash provided by operating activities was driven primarily by an increase in reserves for losses and loss expenses of $444.1 million as a result of the high frequency and severity of worldwide losses, net cash used in investing activities was driven primarily by steady growth in the investment portfolio, net cash used in financing activities was driven primarily by aggregate quarterly dividend payments of $67.9 million and the $36.9 million paid to repurchase debentures. The effect of foreign currency rate changes on cash and cash equivalents was driven primarily by the devaluation of the British pound sterling relative to the U.S. dollar and the related effects on the translation of the Talbot segment on consolidation.

As at December 31, 2009, the Company s portfolio was composed of fixed income investments including: cash, short-term investments, agency securities and sovereign securities amounting to $4,013.5 million or 69.5% of total cash and investments. Details of the Company s debt and financing arrangements at December 31, 2009 are provided below.

(Dollars in thousands)	Maturity Date / Term	In Use/ Outstanding
9.069% Junior Subordinated Deferrable Debentures	June 15, 2036	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	June 15, 2037	139,800
$500,000 secured letter of credit facility	March 12, 2012	225,823
Talbot FAL facility	April 13, 2011	25,000
$250,000 IPC Syndicated Facility	April 13, 2011	16,537
$350,000 IPC Bi-Lateral Facility	December 31, 2010	96,047
Total		$ 653,207

The capital and credit markets have been experiencing extreme volatility and disruption for more than one year. In some cases, the markets have exerted downward pressure on the availability of liquidity and credit capacity for certain issuers. However, management believes that liquidity is not a key constraint for the Company due to its highly liquid investment portfolio and the maturity dates of debt and facilities reflected in the table above. Management s belief is based on the following considerations:

The Talbot third party FAL facility represents cash, investments and undrawn letters of credit provided by various third parties for the 2007 year of account. These third party funds have been replaced by the Company effective January 1, 2008;

The Talbot FAL facility is a facility currently secured by assets of Validus Reinsurance, Ltd. and the Company could choose to provide FAL in the form of cash should the Talbot FAL facility not be renewed;

The $200 million unsecured letter of credit facility is not utilized by the Company currently and has been used in the past only as part of the Talbot acquisition.

Capital Resources

Shareholders equity at December 31, 2009 was $4,031.1 million.

On February 17, 2010, the company announced that its Board of Directors had increased the Company s annual dividend by 10% from $0.80 to $0.88 per common share and common share equivalent for which each outstanding warrant is exercisable. On February 17, 2010, the Company announced a quarterly cash dividend of $0.22 per each common share and $0.22 per common share equivalent for which each outstanding warrant is exercisable, payable on March 31, 2010 to holders of record on March 15, 2010. During 2009, the Company paid quarterly cash dividends of $0.20 per each common share and $0.20 per common share equivalent, for which each outstanding warrant is then exercisable, on March 31, June 30, September 30 and December 31 to holders of record on March 16, June 15, August 20 and December 15, 2009, respectively. The timing and amount of any future cash dividends, however, will be at the discretion of our Board of Directors and will depend upon our results of operations and cash flows, our financial position and capital requirements, general business conditions, legal, tax, regulatory, rating agency and contractual constraints or restrictions and any other factors that our Board of Directors deems relevant.

The Company may from time to time repurchase its securities, including common shares and Junior Subordinated Deferrable Debentures. On February 17, 2010, the Board of Directors of the Company authorized the Company to return up to $750.0 million to shareholders. To this end, the Board expanded the Company s share repurchase program

authorizing the Company to repurchase up to $750.0 million of common shares. This amount is in addition to, and in excess of, the $135.5 million of common shares repurchased by the Company through February 17, 2010 under its previously authorized $400.0 million share repurchase program announced in November 2009. The Company expects the purchases to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company s capital position relative to internal and rating agency targets, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of Directors at any time. For the period November 4, 2009 through February 26, 2010 the Company repurchased 5,715,071 shares at a cost of $152.4 million under the share repurchase program.

On August 7, 2008, the Company filed a shelf registration statement on Form S-3 (No. 333-152856) with the U.S. Securities Exchange Committee in which we may offer from time to time common shares, preference shares, depository shares representing common shares or preference shares, senior or subordinated debt securities, warrants to purchase common shares, preference shares and debt securities, share purchase contracts, share purchase units and units which may consist of any combination of the securities listed above. In addition, the shelf registration statement will provide for secondary sales of common shares sold by the Company s shareholders. The registration statement is intended to provide the Company with additional flexibility to access capital markets for general corporate purposes, subject to market conditions and the Company s capital needs.

The Company s contractual obligations and commitments as at December 31, 2009 are set out below:

		Payment Due by Period			
(Dollars in thousands)	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**
Reserve for losses and loss expenses(1)	$ 1,622,134	$ 784,735	$ 564,885	$ 188,389	84,125
Junior Subordinated Deferrable Debentures (including interest payments)(2)	339,843	25,459	314,384		
Operating lease obligations	43,761	2,787	5,013	7,452	28,509
Total	$ 2,005,738	$ 812,981	$ 884,282	$ 195,841	$ 112,634

(1) The reserve for losses and loss expenses represents an estimate, including actuarial and statistical projections at a given point in time, of an insurer s or reinsurer s expectations of the ultimate settlement and administration costs of claims incurred. As a result, it is likely that the ultimate liability will differ from such estimates, perhaps significantly. Such estimates are not precise in that, among other things, they are based on predictions of future developments and estimates of future trends in loss severity and frequency and other variable factors such as inflation, litigation and tort reform. This uncertainty is heightened by the short time in which the Company has operated, thereby providing limited claims loss emergence patterns specifically for the Company. The lack of historical information for the Company has necessitated the use of industry loss emergence patterns in deriving IBNR. Further, expected losses and loss ratios are typically developed using vendor and proprietary computer models and these expected loss ratios are a material component in the calculation deriving IBNR. Actual loss ratios will deviate from expected loss ratios and ultimate loss ratios will be greater or less than expected loss ratios. During the loss settlement period, it often becomes necessary to refine and adjust the estimates of liability on a claim either upward or downward. Even after such adjustments, ultimate liability will exceed or be less than the revised estimates. The actual payment of the reserve for losses and loss expenses will differ from estimated payouts.

(2) The 9.069% Junior Subordinated Deferrable Debentures and the 8.480% Junior Subordinated Deferrable Debentures mature on June 15, 2036 and June 15, 2037, respectively.

The following table details the capital resources of the Company s more significant subsidiaries on an unconsolidated basis:

(Dollars in thousands)		Capital at December 31, 2009
Validus Reinsurance, Ltd. (consolidated), excluding IPCRe Limited	$	1,829,018
IPCRe Limited		1,885,496
Total Validus Reinsurance, Ltd. (consolidated)		3,714,514
Talbot Holdings, Ltd		606,406
Total consolidated capitalization		4,320,920
Debentures payable		(289,800)
Total shareholders equity	$	4,031,120

113

Table of Contents

Recent Accounting Pronouncements

Please refer to Note 4 to the consolidated financial statements (Part II, Item 8) for further discussion of relevant recent accounting pronouncements.

Debt and Financing Arrangements

The following table details the Company s borrowings and credit facilities as at December 31, 2009:

(Dollars in thousands)	Commitments	Outstanding
9.069% Junior Subordinated Deferrable Debentures	$ 150,000	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	200,000	139,800
$200,000 unsecured letter of credit facility	200,000	
$500,000 secured letter of credit facility	500,000	225,823
Talbot FAL facility	25,000	25,000
$250,000 IPC Syndicated Facility	16,537	16,537
$350,000 IPC Bi-Lateral Facility	350,000	96,047
Total	$ 1,441,537	$ 653,207

Please refer to Note 15 to the Consolidated Financial Statements (Part II, Item 8) for further discussion of the Company s debt and financing arrangements.

On July 24, 2009, the Company announced that it has entered into the Second Amendment to each of its $500.0 million five-year secured letter of credit facility, $200.0 million three-year unsecured facility and the First Amendment to its $100.0 million Talbot FAL facility to amend a specific investment restriction clause to permit the completion of the IPC Acquisition. The amendment also modifies and updates certain pricing and covenant terms.

The Company is currently in the process of renewing the $200.0 million unsecured letter of credit facility and expects to complete the process in March 2010.

IPCRe Limited obtains letters of credit through a $250.0 million Credit Agreement between IPC Holdings, Ltd., IPCRe Limited, the Lenders party thereto and Wachovia Bank, National Association (the IPC Syndicated Facility) and a $350.0 million Letters of Credit Master Agreement between Citibank N.A. and IPCRe Limited (the IPC Bi-Lateral Facility). In July, 2009, certain terms of these credit facilities were amended including suspending IPCRe s ability to increase existing letters of credit or to issue new letters of credit. With respect of the IPC Syndicated Facility, IPCRe Limited provides the banks security by depositing cash in the amount of 103% of the aggregate letters of credit outstanding. Effective December 31, 2009 and December 31, 2008, there were outstanding letters of credit of $112.8 million and $166.3 million, respectively, of which $16.8 million and $65.9 million were issued from the IPC Syndicated Facility with $96.0 million and $100.4 million issued from the IPC Bi-Lateral Facility.

On January 21, 2010, the Company offered and sold $250.0 million of Senior Notes due 2040 (the 8.875% Senior Notes) in a registered public offering. The 8.875% Senior Notes mature on January 26, 2040, and are redeemable at the Company s option in whole any time or in part from time to time at a make-whole redemption price. Interest on the 8.875% Senior Notes is payable at 8.875% per annum through January 26, 2040. Interest on the Notes is payable semi-annually in arrears on January 26 and July 26 of each year, commencing on July 26, 2010. The net proceeds of

$244.3 million from the sale of the 8.875% Senior Notes, after the deduction of commissions paid to the underwriters in the transaction and other expenses, will be used by the Company for general corporate purposes, which may include the repurchase of our outstanding capital stock, dividends to our shareholders and/or potential acquisitions.

Regulation

Validus Re, IPCRe Limited and a Talbot subsidiary (the Bermuda registered companies) are registered under the Insurance Act 1978 of Bermuda (the Act). Under the Act, the Bermuda registered companies are required annually to prepare and file Statutory Financial Statements and a Statutory Financial Return. The Act also requires

the Bermuda registered companies to meet minimum solvency requirements. For the year ended December 31, 2009, the Bermuda registered companies satisfied these requirements. Please refer to the Notes to the Consolidated Financial Statements (Part II, Item 8) for further discussion of statutory and regulatory requirements.

Bermuda law limits the maximum amount of annual dividends or distributions payable by Bermuda registered companies to the Company and in certain cases requires the prior notification to, or the approval of, the Bermuda Monetary Authority. Subject to such laws, the directors of the Bermuda registered companies have the unilateral authority to declare or not declare dividends to the Company. There is no assurance that dividends will be declared or paid in the future.

Talbot s underwriting activities are regulated by the FSA. The FSA has substantial powers of intervention in relation to the Lloyd s managing agents which it regulates including the power to remove their authorization to manage Lloyd s syndicates. In addition, Talbot s managing agent operates under the Lloyd s franchise. Lloyd s approves annually Syndicate 1183 s business plan and any subsequent material changes, and the amount of capital required to support that plan. Lloyd s may require changes to any business plan presented to it or additional capital to be provided to support the underwriting (known as Funds at Lloyd s).

Ratings

Validus Reinsurance, Ltd.

A.M. Best. On September 9, 2009, following the completion of the IPC acquisition, A.M. Best removed from under review and affirmed the financial strength rating of A- (Excellent) for Validus Reinsurance, Ltd. IPCRe Limited, and IPCRe Europe. The outlook on these ratings is stable. A.M. Best also removed from under review and affirmed the Company s bbb- issuer credit and indicative senior debt ratings as well as the bb+ subordinated debt and bb preferred stock ratings. The outlook on these ratings is stable.

Standard & Poor s. On July 10, 2009, Standard & Poor s (S&P) revised its outlook on the Company to positive from stable and affirmed the counterparty credit rating of BBB-. According to S&P, the Company s ratings are based on the group s good and expanding competitive position; strong capitalization; strong risk controls around exposure management, underwriting and modeling; and very strong operating performance since its inception, partially offset by the potential integration risk related to the expected IPC transaction.

Moody s Investors Service. On September 9, 2009, Moody s affirmed the Company s ratings and changed the ratings outlook to stable from negative. The Baa2 long-term issuer rating was affirmed for Validus Holdings, Ltd. and the A3 insurance financial strength rating was affirmed for Validus Reinsurance, Ltd.

Talbot Underwriting, Ltd.

Talbot s subsidiary, Talbot Underwriting Ltd., which manages Syndicate 1183 at Lloyd s, relies on the ratings assigned to Lloyd s insurance market.

Lloyd s as a market is rated as follows:

AM Best	A	Excellent	Stable Outlook
Fitch Ratings	A+	Strong	Stable Outlook
S&P	A+	Strong	Stable Outlook

The syndicate benefits from these ratings and the Company believes that ratings impairments below A- would materially impair the syndicate s ability to write business.

Off-Balance Sheet Arrangements

The Company is not party to any off-balance sheet transaction, agreement or other contractual arrangement as defined by Item 303(a) (4) of Regulation S-K to which an entity unconsolidated with the Company is a party that management believes is reasonably likely to have a current or future effect on its financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that the Company believes is material to investors.

Table of Contents

Investments

A significant portion of contracts written provide short-tail reinsurance coverage for losses resulting mainly from natural and man-made catastrophes, which could result in a significant amount of losses on short notice. Accordingly, the Company s investment portfolio is structured to provide significant liquidity and preserve capital, which means the investment portfolio contains a significant amount of relatively short-term fixed maturity investments, such as U.S. government securities, U.S. government-sponsored enterprises securities, corporate debt securities and mortgage-backed and asset-backed securities.

Substantially all of the fixed maturity investments held at December 31, 2009 were publicly traded. At December 31, 2009, the average duration of the Company s fixed maturity portfolio was 2.24 years (December 31, 2008: 1.82 years) and the average rating of the portfolio was AA+ (December 31, 2008: AAA). At December 31, 2009, the total fixed maturity portfolio was $4,869.4 million (December 31, 2008: $2,454.5 million), of which $3,287.9 million (December 31, 2008: $1,941.3 million) were rated AAA. At December 31, 2009, fair value measurements of certain non-Agency RMBS securities, representing 1.2% of the Company s total assets, have primarily unobservable inputs (December 31, 2008: 2.6%).

On September 4, 2009, as part of the acquisition of IPC, the Company assumed IPC s investment portfolio containing $1,820.9 million of corporate bonds, $112.9 million of agency residential mortgage-backed securities, $234.7 million of equity mutual funds, $114.8 million fund of hedge funds and $11.0 million of equity mutual funds contained within a deferred compensation trust. On September 9, 2009, the Company realized a gain of $4.5 million on the disposition of $234.7 million of equity mutual funds. A redemption request for the fund of hedge funds was submitted for value as at October 31, 2009. The redemption amounted to $89.4 million. As of December 31, 2009 the Company had received $59.6 million and accordingly, a receivable exists for the remaining $29.8 million. Subsequent to year-end, an additional $20.9 million was received, leaving $8.9 million receivable with ultimate collection expected upon the funds 2009 audit completion deadline of June 30, 2010. As of December 31, 2009, the Company held a fund of hedge fund side pocket of $25.7 million. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is indeterminable. During the fourth quarter of 2009, the Company received distribution proceeds of $2.6 million from the side pocket. Subsequent to year-end, an additional $4.4 million was received from the side pocket.

On August 28, 2009, the Company sold short equity index futures contracts with a goal of hedging until closing of the IPC Acquisition and liquidation of IPC s mutual fund equity portfolio exposure. The contracts were closed when the equity positions were fully redeemed on September 9, 2009. The Company experienced a $3.3 million realized investment loss as a result of the futures contracts.

The Company s investment guidelines require that investments be rated A- or higher at the time of purchase. During the year ended December 31, 2009, Moody s downgraded a substantial number of non-agency mortgage backed securities issues, including several securities held by the Company. The Company reports the ratings of its investment portfolio securities at the lower of Moody s or Standard & Poor s rating for each investment security and, as a result, the Company s investment portfolio now has $89.8 million of non-agency mortgage backed securities rated less than investment grade. The other components of less than investment grade securities held by the Company at December 31, 2009 were $52.4 million of catastrophe bonds and $12.1 million of corporate bonds.

Cash and cash equivalents and investments in Talbot of $1,408.1 million at December 31, 2009 were held in trust for the benefit of cedants and policyholders, and to facilitate the accreditation as an alien insurer/reinsurer by certain regulators (December 31, 2008: $1,032.3 million). Total cash and cash equivalents and investments in Talbot were $1,420.4 million at December 31, 2009 (December 31, 2008: $1,142.0 million).

As of December 31, 2009, the Company had approximately $4.2 million of asset-backed securities with sub-prime collateral (December 31, 2008: $6.4 million) and $82.3 million of Alt-A RMBS (December 31, 2008: $103.8 million).

As described more fully under the Critical Accounting Policies and Estimates in Item 7, *Management s Discussion and Analysis of Results of Operations and Financial Condition*, the Company identified certain non-Agency RMBS securities trading in inactive markets. During the three months ended December 31, 2009, the change in fair value for the identified RMBS securities resulted in a $6.4 million increase in net unrealized loss on

116

investments. This increase in net unrealized losses on investments resulted in a $6.4 million decrease in shareholders equity as at December 31, 2009.

Goodwill and Intangible Assets

The Company has performed an impairment analysis of its carried goodwill and indefinite lived intangible assets as required by U.S. GAAP. The analysis included a comparison of the Company s market capitalization to book value ratio. Management has also evaluated the fair value of Talbot relative to its book value on the following basis:

1) Gross premium written for 2008 and 2009;

2) Internal demand for and valuation of syndicate capacity, and utilization of Lloyd s licenses; and

3) External demand for syndicate capacity.

Reporting units are consistent with the segmental basis. Based on its analysis, management has concluded that an impairment valuation is not required against the carried goodwill and indefinite lived intangible assets.

Cash Flows

During the three months ended December 31, 2009 and 2008, the Company generated net cash from operating activities of $206.7 million and $88.6 million, respectively. During the year ended December 31, 2009 and 2008, the Company generated net cash from operating activities of $555.1 million and $486.0 million, respectively. Cash flows from operations generally represent premiums collected, investment earnings realized and investment gains realized less losses and loss expenses paid and underwriting and other expenses paid. Cash flows from operations may differ substantially, however, from net income.

Pursuant to an Amalgamation Agreement dated July 9, 2009 among IPC, Validus Holdings, Ltd. and Validus, Ltd., on September 4, 2009, the Company acquired all of IPC s outstanding common shares in exchange for a combination of the Company s common shares and cash (the IPC Acquisition). Each outstanding IPC common share (including any shares held by IPC shareholders that did not vote in favor of the amalgamation, but excluding shares owned by the Company), have been cancelled and converted into the right to receive 0.9727 of the Company s common shares, $7.50 in cash (less any applicable withholding tax and without interest) and cash in lieu of fractional shares. The IPC Acquisition resulted in the issuance by the Company of 54,556,762 common shares valued at $24.10 per share and the payment of $420.8 million in cash to IPC shareholders. IPC s operations are focused on short-tail lines of reinsurance. The primary lines in which IPC conducted business were property catastrophe reinsurance and, to a limited extent, property-per-risk excess, aviation (including satellite) and other short-tail reinsurance on a worldwide basis. The acquisition of IPC was undertaken to gain a strategic advantage in the current reinsurance market and increase the Company s capital base. Sources of funds consist primarily of the receipt of premiums written, investment income and proceeds from sales and redemptions of investments. In addition, cash will also be received from financing activities. Cash is used to pay primarily losses and loss expenses, brokerage commissions, excise taxes, general and administrative expenses, purchase new investments, payment of premiums retroceded and payment of dividends. The Company has had sufficient resources to meet its liquidity requirements.

As of December 31, 2009 and December 31, 2008, the Company had cash and cash equivalents of $387.6 million and $449.8 million, respectively.

The Company has written certain business that has loss experience generally characterized as having low frequency and high severity. This results in volatility in both results and operational cash flows. The potential for large claims or

a series of claims under one or more reinsurance contracts means that substantial and unpredictable payments may be required within relatively short periods of time. As a result, cash flows from operating activities may fluctuate, perhaps significantly, between individual quarters and years. Management believes the Company s unused credit facility amounts and highly liquid investment portfolio are sufficient to support any potential operating cash flow deficiencies. Please refer to the table detailing the Company s borrowings and credit facilities as at December 31, 2009, presented above.

Table of Contents

In addition to relying on premiums received and investment income from the investment portfolio, the Company intends to meet these cash flow demands by carrying a substantial amount of short and medium term investments that would mature, or possibly be sold, prior to the settlement of expected liabilities. The Company cannot provide assurance, however, that it will successfully match the structure of its investments with its liabilities due to uncertainty related to the timing and severity of loss events.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (PSLRA) provides a safe harbor for forward-looking statements. Any prospectus, prospectus supplement, the Company s Annual Report to shareholders, any proxy statement, any other Form 10-K, Form 10-Q or Form 8-K of the Company or any other written or oral statements made by or on behalf of the Company may include forward-looking statements that reflect the Company s current views with respect to future events and financial performance. Such statements include forward-looking statements both with respect to the Company in general, and to the insurance and reinsurance sectors in particular. Statements that include the words expect , intend , plan , believe , project , anticipate , will , may , and similar statements of a future or forward nature identify forward-looking statements for purposes of the PSLRA or otherwise. All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements and, therefore, you should not place undue reliance on any such statement.

We believe that these factors include, but are not limited to, the following:

unpredictability and severity of catastrophic events;

our ability to obtain and maintain ratings, which may be affected by our ability to raise additional equity or debt financings, as well as other factors described herein;

adequacy of the Company s and IPC s risk management and loss limitation methods;

cyclicality of demand and pricing in the insurance and reinsurance markets;

the Company s limited operating history;

the Company s ability to implement its business strategy during soft as well as hard markets;

adequacy of the Company s loss reserves;

continued availability of capital and financing;

the Company s ability to identify, hire and retain, on a timely and unimpeded basis and on anticipated economic and other terms, experienced and capable senior management, as well as underwriters, claims professionals and support staff;

acceptance of our business strategy, security and financial condition by rating agencies and regulators, as well as by brokers and (re)insureds;

competition, including increased competition, on the basis of pricing, capacity, coverage terms or other factors;

potential loss of business from one or more major insurance or reinsurance brokers;

the Company s ability to implement, successfully and on a timely basis, complex infrastructure, distribution capabilities, systems, procedures and internal controls, and to develop accurate actuarial data to support the business and regulatory and reporting requirements;

general economic and market conditions (including inflation, volatility in the credit and capital markets, interest rates and foreign currency exchange rates) and conditions specific to the insurance and reinsurance markets in which we expect to operate;

the integration of businesses we may acquire or new business ventures, including overseas offices, we may start;

accuracy of those estimates and judgments used in the preparation of our financial statements, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables, investment valuations, intangible assets, bad debts, taxes, contingencies, litigation and any determination to use the deposit method of accounting, which, for a relatively new insurance and reinsurance company like our company, are even more difficult to make than those made in a mature company because of limited historical information;

the effect on the Company s or IPC s investment portfolio of changing financial market conditions including inflation, interest rates, liquidity and other factors;

acts of terrorism, political unrest, outbreak of war and other hostilities or other non-forecasted and unpredictable events;

availability and cost of reinsurance and retrocession coverage;

the failure of reinsurers, retrocessionaires, producers or others to meet their obligations to us;

the timing of loss payments being faster or the receipt of reinsurance recoverables being slower than anticipated by us;

changes in domestic or foreign laws or regulations, or their interpretations;

changes in accounting principles or the application of such principles by regulators;

statutory or regulatory or rating agency developments, including as to tax policy and matters and reinsurance and other regulatory matters such as the adoption of proposed legislation that would affect Bermuda-headquartered companies and/or Bermuda-based insurers or reinsurers; and

the other factors set forth herein under Part I Item 1A Risk Factors and under Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and the other sections of this Annual Report on Form 10-K for the year ended December 31, 2009, as well as the risk and other factors set forth in the Company s other filings with the SEC, as well as management s response to any of the aforementioned factors.

In addition, other general factors could affect our results, including: (a) developments in the world s financial and capital markets and our access to such markets; (b) changes in regulations or tax laws applicable to us, including, without limitation, any such changes resulting from the recent investigations relating to the insurance industry and any attendant litigation; and (c) the effects of business disruption or economic contraction due to terrorism or other hostilities.

The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included herein or elsewhere. Any forward-looking statements made in this report are qualified by these cautionary statements, and there can be no assurance that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, us or our business or operations. We undertake no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future developments or otherwise.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

We believe we are principally exposed to five types of market risk:

- interest rate risk;
- foreign currency risk;
- credit risk;
- liquidity risk; and
- effects of inflation.

Interest Rate Risk: The Company s primary market risk exposure is to changes in interest rates. The Company s fixed maturity portfolio is exposed to interest rate risk. Fluctuations in interest rates have a direct impact on the market valuation of these investments. As interest rates rise, the market value of the Company s fixed maturity portfolio falls and the Company has the risk that cash outflows will have to be funded by selling assets, which will be trading at depreciated values. As interest rates decline, the market value of the Company s fixed income portfolio increases and the Company has reinvestment risk, as funds reinvested will earn less than is necessary to match anticipated liabilities. We manage interest rate risk by selecting investments with characteristics such as duration, yield, currency and liquidity tailored to the anticipated cash outflow characteristics of the insurance and reinsurance liabilities the Company assumes.

As at December 31, 2009, the impact on the Company s fixed maturity and short-term investments from an immediate 100 basis point increase in market interest rates (based on U.S. treasury yield) would have resulted in an estimated decrease in market value of 2.3%, or approximately $123.8 million. As at December 31, 2009, the impact on the Company s fixed maturity portfolio from an immediate 100 basis point decrease in market interest rates would have resulted in an estimated increase in market value of 2.1% or approximately $111.9 million.

As at December 31, 2008, the impact on the Company s fixed maturity and short-term investments from an immediate 100 basis point increase in market interest rates would have resulted in an estimated decrease in market value of 1.9%, or approximately $54.6 million. As at December 31, 2008, the impact on the Company s fixed maturity portfolio from an immediate 100 basis point decrease in market interest rates would have resulted in an estimated increase in market value of 1.7% or approximately $49.2 million.

As at December 31, 2009, the Company held $768.6 million (December 31, 2008: $994.1 million), or 15.8% (December 31, 2008: 40.5%), of the Company s fixed maturity portfolio in asset-backed and mortgage-backed securities. These assets are exposed to prepayment risk, which occurs when holders of underlying loans increase the frequency with which they prepay the outstanding principal before the maturity date and refinance at a lower interest rate cost. The adverse impact of prepayment is more evident in a declining interest rate environment. As a result, the Company will be exposed to reinvestment risk, as cash flows received by the Company will be accelerated and will be reinvested at the prevailing interest rates.

Foreign Currency Risk: Certain of the Company s reinsurance contracts provide that ultimate losses may be payable in foreign currencies depending on the country of original loss. Foreign currency exchange rate risk exists to the extent that there is an increase in the exchange rate of the foreign currency in which losses are ultimately owed. Therefore, we attempt to manage our foreign currency risk by seeking to match our liabilities under insurance and reinsurance policies that are payable in foreign currencies with cash and investments that are denominated in such currencies. As of December 31, 2009, $405.4 million, or 5.8% of our total assets and $413.9 million, or 13.9% of our total liabilities was held in foreign currencies. As of December 31, 2009, $81.2 million, or 2.7% of our total liabilities held in foreign currencies was non-monetary items which do not require revaluation at each reporting date. As of December 31, 2008, $303.2 million, or 7.0% of our total assets and $308.3 million, or 12.9% of our total liabilities was held in foreign currencies. As of December 31, 2008, $62.3 million, or 2.6% of our total liabilities held in foreign currencies was non-monetary items which do not require revaluation at each reporting date. The Company does not transact in foreign exchange markets to hedge its foreign currency exposure. To the extent foreign currency exposure is not hedged, the Company may experience exchange losses, which in turn would adversely affect the results of operations and financial condition.

Credit Risk: We are exposed to credit risk primarily from the possibility that counterparties may default on their obligations to us. We attempt to limit our credit exposure by purchasing high quality fixed income investments to maintain an average portfolio credit quality of AA- or higher with mortgage and commercial mortgage-backed issues

having an aggregate weighted average credit quality of AAA. In addition, we have limited our exposure to any single issuer to 3.0% or less of total investments, excluding treasury and agency securities. The minimum credit rating of any security purchased is A-/A3 and where investments are downgraded below A-/A3, we permit our investment managers to hold up to 2.0% in aggregate market value, or up to 10.0% with written authorization of the Company. At December 31, 2009, 3.2% of the portfolio was below A-/A3 and we did not have an aggregate exposure to any single issuer of more than 1.5% of total investments, other than with respect to government securities.

Table of Contents

The amount of the maximum exposure to credit risk is indicated by the carrying value of the Company s financial assets. The Company s primary credit risks reside in investment in U.S. corporate bonds and recoverables from reinsurers at the Talbot segment. The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- or better rated by S & P or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. At December 31, 2009, 99.3% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A-, (December 31, 2008 rated A- or better) or from reinsurers posting full collateral. Validus Re does not have any reinsurance recoverable balances that are not fully collateralized.

Liquidity risk: Certain of the Company s investments may become illiquid. The current disruption in the credit markets may materially affect the liquidity of the Company s investments, including residential mortgage-backed securities which at December 31, 2009 represent 11.9% (December 31, 2008: 20.3%) of total cash and investments. If the Company requires significant amounts of cash on short notice in excess of normal cash requirements (which could include claims on a major catastrophic event) in a period of market illiquidity, the investments may be difficult to sell in a timely manner and may have to be disposed of for less than what may otherwise have been possible under other conditions. At December 31, 2009, the Company had $2,636.8 million of unrestricted, liquid assets, defined as unpledged cash and cash equivalents, short term investments, government and government agency securities. Details of the Company s debt and financing arrangements at December 31, 2009 are provided below.

On September 4, 2009, as part of the acquisition of IPC the Company assumed IPC s investment portfolio containing $1,820.9 million of corporate bonds, $112.9 million of agency residential mortgage-backed securities, $234.7 million of equity mutual funds, $114.8 million fund of hedge funds and $11.0 million of equity mutual funds contained within a deferred compensation trust. On September 9, 2009, the Company realized a gain of $4.5 million on the disposition of $234.7 million of equity mutual funds. A redemption request for the fund of hedge funds was submitted for value as at October 31, 2009. The redemption amounted to $89.4 million. As of December 31, 2009 the Company had received $59.6 million and accordingly, a receivable exists for the remaining $29.8 million. Subsequent to year-end, an additional $20.9 million was received, leaving $8.9 million receivable with ultimate collection expected upon the funds 2009 audit completion deadline of June 30, 2010. As of December 31, 2009, the Company held a fund of hedge fund side pocket of $25.7 million. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is indeterminable. During the fourth quarter, the Company received distribution proceeds of $2.6 million from the side pocket. Subsequent to year end, an additional $4.4 million was received from the side pocket.

(Dollars in thousands)	**Maturity Date/ Term**	**In Use/ Outstanding**
9.069% Junior Subordinated Deferrable Debentures	June 15, 2036	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	June 15, 2037	139,800
$500,000 secured letter of credit facility	March 12, 2012	225,823
Talbot FAL facility	April 13, 2011	25,000
$250,000 IPC Syndicated Facility	April 13, 2011	16,537
$350,000 IPC Bi-Lateral Facility	December 31, 2010	96,047
Total		$ 653,207

Effects of Inflation: We do not believe that inflation has had or will have a material effect on our combined results of operations, except insofar as (a) inflation may affect interest rates, and (b) losses and loss expenses may be affected by inflation.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data***

Reference is made to Item 15 (a) of this Report for the Consolidated Financial Statements of Validus Holdings, Ltd. and the Notes thereto, as well as the Schedules to the Consolidated Financial Statements.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of disclosure controls and procedures pursuant to Rules 13a-15 and 15d-15 promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective to provide reasonable assurance that all material information relating to the Company required to be filed in this report has been made known to them in a timely fashion.

Management s Report on Internal Control Over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended.

The Company s internal control over financial reporting was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2009. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (the Framework). Based on its assessment, management concluded that, as of December 31, 2009, the Company s internal control over financial reporting was effective based on the Framework criteria.

The Company acquired all of the outstanding shares of IPC on September 4, 2009. IPC s assets represented approximately 8.0% of total revenue and 33.0% of the Company s total assets as at December 31, 2009. Consistent with the SEC s general guidance, IPC has been omitted from the Company s assessment scope for the effectiveness of internal control over financial reporting in the year of acquisition.

The effectiveness of the Company s internal control over financial reporting as of December 31, 2009 has been audited by PricewaterhouseCoopers, an independent registered public accounting firm, as stated in their report included in this filing.

Changes in Internal Control Over Financial Reporting

There have been no changes in internal control over financial reporting identified in connection with the Company s evaluation required pursuant to Rules 13a-15 and 15d-15 promulgated under the Securities Exchange Act of 1934, as

amended, that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

Item 9B. ***Other Information***

None.

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***

Certain of the information required by this item relating to the executive officers of the Company may be found at page 38. The balance of the information required by this item is omitted because a definitive proxy statement that involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A, which proxy statement is incorporated herein by reference.

Item 11. ***Executive Compensation***

This item is omitted because a definitive proxy statement that involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A, which proxy statement is incorporated herein by reference.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters***

Equity Compensation Plan Information

The following table displays certain information regarding our equity compensation plan at December 31, 2009:

(Dollars in thousands)	Number of Securities to be Issued Upon Exercise of Outstanding Options and Restricted Stock	Weighted-Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
2005 Amended and Restated Long-Term Incentive Plan	5,280,169	$ 17.83	$ 7,846,727
Share Sale Agreement	410,667		
Director Stock Compensation Plan	4,577		52,566
IPC Holdings Ltd. 2007 Incentive Plan	603,253	28.16	621,747

The balance of the information required by this item is omitted because a definitive proxy statement that involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A, which proxy statement is incorporated herein by reference.

Item 13. ***Certain Relationships and Related Transactions, and Director Independence***

This item is omitted because a definitive proxy statement that involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A, which proxy statement is incorporated herein by reference.

Item 14. ***Principal Accountant Fees and Services***

This item is omitted because a definitive proxy statement that involves the election of directors will be filed with the Securities and Exchange Commission not later than 120 days after the close of the fiscal year pursuant to Regulation 14A, which proxy statement is incorporated herein by reference.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

Financial Statements, Financial Statement Schedules and Exhibits.

a) Financial Statements and Financial Statement Schedules are included as pages F-1 to F-62.

b) The exhibits numbers followed by an asterisk (*) indicate exhibits physically filed with this Annual Report on Form 10-K. All other exhibit numbers indicate exhibits filed by incorporation by reference.

EXHIBITS

Exhibit Number	Description of Document
3.1	Memorandum of Association dated October 10, 2005 (Incorporated by Reference from S-1 SEC File No. 333-139989)
3.2	Amended and Restated Bye-laws (Incorporated by Reference from S-1 SEC File No. 333-139989)
4.1	Specimen Common Share Certificate (Incorporated by Reference from S-1 SEC File No. 333-139989)
4.2	Certificate of Deposit of Memorandum of Increase of Share Capital dated October 28, 2005 (Incorporated by Reference from S-1 SEC File No. 333-139989)
4.3	9.069% Junior Subordinated Deferrable Debentures Indenture dated as of June 15, 2006 (Incorporated by Reference from S-1 SEC File No. 333-139989)
4.4	Form of 9.069% Junior Subordinated Deferrable Debentures (Included in Exhibit 10.8 hereto) (Incorporated by Reference from S-1 SEC File No. 333-139989)
4.5	First Supplemental Indenture to the above Indenture dated as of September 15, 2006 (Incorporated by Reference from S-1 SEC File No. 333-139989)
4.6	8.480% Junior Subordinated Deferrable Debentures Indenture dated as of June 29, 2007 (Incorporated by Reference from S-1 SEC File No. 333-139989)
4.7	Form 8.480% Junior Subordinated Deferrable Debentures (Included in Exhibit 10.8 hereto) (Incorporated by Reference from S-1 SEC File No. 333-139989)
4.8	Senior Note Indenture, by and between Validus Holdings, Ltd. and The Bank of New York Mellon, dated January 26, 2010 (Incorporated by reference to the Company s Current Report on Form 8-K filed with the SEC on January 26, 2010)
4.9	8.875% Senior Notes Supplemental Indenture, by and between Validus Holdings, Ltd. and The Bank of New York Mellon, dated January 26, 2010 (Incorporated by reference to the Company s Current Report on Form 8-K filed with the SEC on January 26, 2010)
4.10	Form of 8.875% Senior Note (Included in Exhibit 4.9 hereto) (Incorporated by reference to the Company s Current Report on Form 8-K filed with the SEC on January 26, 2010)
10.1	Shareholders Agreement dated as of December 12, 2005 among Validus Holdings, Ltd. and the Shareholders Named Therein (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.2	Advisory Agreement with Aquiline Capital Partners LLC dated December 7, 2005 (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.3	Form of Warrant (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.4	Form of Amendment to Warrants dated as of December 21, 2007 (Incorporated by Reference from 8-K filed with the SEC on December 1, 2007)
10.5	Five-Year Secured Letter of Credit Facility Agreement (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.6	Three-Year Unsecured Letter of Credit Facility Agreement (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.7	First Amendment to each of the Three-Year Unsecured Letter of Credit Facility Agreement and the Five-Year Secured Letter of Credit Facility Agreement (Incorporated by Reference from 8-K filed with the SEC on October 26, 2007)
10.8	Second Amendment, dated as of July 24, 2009, to each of the Three-Year Unsecured Letter of Credit Facility Agreement dated as of March 12, 2007, as amended by the First Amendment dated October 25, 2007, and the Five-Year Secured Letter of Credit Facility Agreement dated as of March 12, 2007, as amended by the First Amendment dated October 25, 2007, among Validus Holdings, Ltd., Validus Reinsurance, Ltd., the Lenders party thereto and JPMorgan Chase Bank, National Association, as

	administrative agent for the Lenders (Incorporated by reference to the Company s Current Report on Form 8-K filed with the SEC on July 23, 2009).
10.9	Talbot Standby Letter of Credit Facility dated as of November 28, 2007 (Incorporated by Reference from 8-K filed with the SEC on December 4, 2007)

Exhibit Number	Description of Document
10.10	Amendment No. 1, dated as of July 23, 2009, to the $100 million Standby Letter of Credit Facility dated as of 28 November 2007, among Talbot Holdings Ltd., Validus Holdings, Ltd., the Lenders party thereto and Lloyds TSB Bank plc, as Agent (Incorporated by reference to the Company s Current Report on Form 8-K filed with the SEC on July 23, 2009)
10.11	Amendment and Restatement Agreement dated as of November 19, 2009 relating to a $100 million Standby Letter of Credit Facility dated as of 28 November 2007, among Talbot Holdings Ltd., as Borrower, Validus Holdings, Ltd., as Guarantor, Lloyds TSB Bank plc, as joint Mandated Lead Arranger, Agent, and Security Trustee, and ING Bank N.V., London Branch, as joint Mandated Lead Arranger (Incorporated by reference to the Company s Current Report on Form 8-K filed with the SEC on November 20, 2009)
10.12	Amended and Restated Employment Agreement between Validus Holdings, Ltd. and Edward J. Noonan (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.12.1	Amendment to Amended and Restated Employment Agreement between Validus Holdings, Ltd. and Edward J. Noonan (Incorporated by Reference from Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the SEC on November 13, 2008)
10.13	Amended and Restated Employment Agreement between Validus Holdings, Ltd. and George P. Reeth (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.13.1	Amendment to Amended and Restated Employment Agreement between Validus Holdings, Ltd. and George P. Reeth (Incorporated by Reference from Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the SEC on November 13, 2008)
10.14	Amended and Restated Employment Agreement between Validus Holdings, Ltd. and Joseph E. (Jeff) Consolino (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.14.1	Amendment to Amended and Restated Employment Agreement between Validus Holdings, Ltd. and Joseph E. (Jeff) Consolino (Incorporated by Reference from Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the SEC on November 13, 2008)
10.15	Amended and Restated Employment Agreement between Validus Holdings, Ltd. and Stuart W. Mercer (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.15.1	Amendment to Amended and Restated Employment Agreement between Validus Holdings, Ltd. and Stuart W. Mercer (Incorporated by Reference from Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the SEC on November 13, 2008)
10.16	Amended and Restated Employment Agreement between Validus Reinsurance, Ltd. and Conan M. Ward (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.16.1	Amendment to Amended and Restated Employment Agreement between Validus Reinsurance, Ltd. and Conan M. Ward (Incorporated by Reference from Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the SEC on November 13, 2008)
10.17	Employment Agreement between Validus Holdings, Ltd. and Jerome Dill (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.18	Amended and Restated Employment Agreement between Validus Holdings, Ltd. and Michael J. Belfatti (Incorporated by Reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 6, 2008.)
10.18.1	Amendment to Amended and Restated Employment Agreement between Validus Holdings, Ltd and Michael J. Belfatti (Incorporated by Reference from Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the SEC on November 13, 2008)
10.19	Service Agreement between Talbot Underwriting Services, Ltd. and Charles Neville Rupert Atkin (Incorporated by Reference from the Company s Annual Report on Form 10-K for the year ended

	December 31, 2007, filed with the SEC on March 6, 2008.)
10.20	Service Agreement between Talbot Underwriting Services, Ltd. and Gilles Alex Maxime Bonvarlet (Incorporated by Reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 6, 2008.)

126

Table of Contents

Exhibit Number	Description of Document
10.21	Service Agreement between Talbot Underwriting Services, Ltd. and Michael Edward Arscott Carpenter (Incorporated by Reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 6, 2008.)
10.21.1	Amendment No. 1 to Service Agreement between Talbot Underwriting Services, Ltd. and Michael Edward Arscott Carpenter (Incorporated by reference from the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2008, filed with the SEC on August 13, 2008.)
10.22	Investment Manager Agreement with BlackRock Financial Management, Inc. (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.23	Risk Reporting & Investment Accounting Services Agreement with BlackRock Financial Management, Inc. (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.24	Discretionary Advisory Agreement with Goldman Sachs Asset Management (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.25	Validus Holdings, Ltd. 2005 Amended & Restated Long-Term Incentive Plan (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.26	Form of Pre-IPO Restricted Share Agreement for Executive Officers (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.27.1	Form of Post-IPO Restricted Share Agreement for Executive Officers (bonus shares) (Incorporated by Reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 6, 2008.)
10.27.2	Form of Post-IPO Restricted Share Agreement for Executive Officers (LTIP grant) (Incorporated by Reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 6, 2008.)
10.28	Form of Restricted Share Agreement at Talbot Acquisition Date for Messrs. Atkin, Bonvarlet and Carpenter (Incorporated by Reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 6, 2008.)
10.29	Amended and Restated Restricted Share Agreement between Validus Holdings, Ltd. and Edward J. Noonan (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.30	Amended and Restated Restricted Share Agreement between Validus Holdings, Ltd. and George P. Reeth (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.31	Stock Option Agreement between Validus Holdings, Ltd. and Edward J. Noonan (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.32	Stock Option Agreement between Validus Holdings, Ltd. and George P. Reeth (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.33	Form of Stock Option Agreement for Executive Officers prior to 2008 (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.34	Form of Stock Option Agreement for Executive Officers commencing in 2008 (Incorporated by Reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the SEC on March 6, 2008.)
10.35	Nonqualified Supplemental Deferred Compensation Plan (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.36	Director Stock Compensation Plan (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.36.1	Amendment No. 1 to Validus Holdings, Ltd. Directors Stock Compensation Plan dated as of January 5, 2009 (Incorporated by Reference from the Company s Annual Report on Form 10-K for year ended December 31, 2008 filed with the SEC on February 27, 2009)
10.37	

	Share Sale Agreement between Validus Holdings, Ltd. and the Shareholders of Talbot Holdings Ltd. (Incorporated by Reference from S-1 SEC File No. 333-139989)
10.38	Agreement to Provide Information between Validus Holdings, Ltd. and Talbot Holdings Ltd. (Incorporated by Reference from S-1 SEC File No. 333-139989)

127

Table of Contents

Exhibit Number	Description of Document
10.39	Form of Restricted Share Agreement for Talbot Executive Officers (Incorporated by Reference from the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2008, filed with the SEC on August 13, 2008.)
10.40	Agreement and Plan of Amalgamation, dated as of July 9, 2009, among IPC Holdings, Ltd., Validus Holdings, Ltd. and Validus Ltd. (Incorporated by reference from the Company s Current Report on Form 8-K filed with the SEC on July 9, 2009)
21*	Subsidiaries of the Registrant
23*	Consent of PricewaterhouseCoopers
24	Power of attorney (Incorporated by Reference from signature page)
31*	Rule 13a-14(a)/15d-14(a) Certifications
32*	Section 1350 Certification

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Hamilton, Bermuda, on March 1, 2010.

Validus Holdings, Ltd.

By: /s/ Edward J. Noonan

Name: Edward J. Noonan

Title: Chief Executive Officer

POWER OF ATTORNEY

We, the undersigned directors and executive officers of Validus Holdings, Ltd. hereby severally constitute Edward J. Noonan and Joseph E. (Jeff) Consolino, and each of them singly, our true and lawful attorneys with full power to them and each of them to sign for us, and in our names in the capacities indicated below, any and all amendments to the Annual Report on Form 10-K filed with the Securities and Exchange Commission, hereby ratifying and confirming our signatures as they may be signed by our said attorneys to any and all amendments to said Annual Report on Form 10-K.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Annual Report on Form 10-K has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Edward J. Noonan Name: Edward J. Noonan	Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer)	March 1, 2010
/s/ Joseph E. (Jeff) Consolino Name: Joseph E. (Jeff) Consolino	Chief Financial Officer and Executive Vice President (Principal Financial Officer and Principal Accounting Officer)	March 1, 2010
/s/ George P. Reeth Name: George P. Reeth	Director and President	March 1, 2010
/s/ Matthew J. Grayson Name: Matthew J. Grayson	Director	March 1, 2010
/s/ Jeffrey W. Greenberg	Director	March 1, 2010

Name: Jeffrey W. Greenberg

/s/ John J. Hendrickson	Director	March 1, 2010
Name: John J. Hendrickson		
/s/ Jean-Marie Nessi	Director	March 1, 2010
Name: Jean-Marie Nessi		

Table of Contents

Signature	Title	Date
/s/ Sumit Rajpal	Director	March 1, 2010
Name: Sumit Rajpal		
/s/ Alok Singh	Director	March 1, 2010
Name: Alok Singh		
/s/ Christopher E. Watson	Director	March 1, 2010
Name: Christopher E. Watson		

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

Consolidated Financial Statements	Page No.
Report of Independent Registered Public Accounting Firm	132
Consolidated Balance Sheets as at December 31, 2009 and 2008	F-1
Consolidated Statements of Operations and Comprehensive Income (Loss) for the Years Ended December 31, 2009, 2008 and 2007	F-2
Consolidated Statements of Shareholders Equity for the Years Ended December 31, 2009, 2008 and 2007	F-3
Consolidated Statements of Cash Flows for the Years Ended December 31, 2009, 2008 and 2007	F-4
Notes to Consolidated Financial Statements	F-5
Financial Statement Schedules:	
I. Summary of Investments Other than Investments in Related Parties	F-56
II. Condensed Financial Information Parent Only	F-57
III. Supplementary Insurance Information	F-60
IV. Supplementary Reinsurance Information	F-61
VI. Supplementary Information Concerning Property/Casualty (Re)insurance Operations	F-62

Schedules other than those listed are omitted for the reason that they are not required, are not applicable or that equivalent information has been included in the financial statements, notes thereto, or elsewhere herein.

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Validus Holdings, Ltd.

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Validus Holdings, Ltd. and its subsidiaries at December 31, 2009 and December 31, 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company s internal control over financial reporting based on our audits (which were integrated audits in 2008 and 2009). We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with such generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management s Report on Internal Control over Financial Reporting, management has excluded IPC from its assessment of internal control over financial reporting as of December 31, 2009 because it was acquired by the Company in a business combination during 2009. We have also excluded IPC from our audit of internal control over financial reporting. IPC is a wholly-owned subsidiary whose total assets and total revenues represent 33% and 8%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2009.

/s/ PricewaterhouseCoopers
PricewaterhouseCoopers
Hamilton, Bermuda
March 1, 2010

132

Validus Holdings, Ltd.

Consolidated Balance Sheets
As at December 31, 2009 and 2008
(Expressed in thousands of U.S. dollars, except share and per share information)

	December 31, 2009	December 31, 2008
ASSETS		
Fixed maturities, at fair value (amortized cost: 2009 $4,870,395; 2008 $2,553,018)	$ 4,869,378	$ 2,454,501
Short-term investments, at fair value (amortized cost: 2009 $482,632; 2008 $379,537)	481,766	377,036
Other investments, at fair value (amortized cost: 2009 $35,941; 2008 $nil)	37,615	
Cash and cash equivalents	387,585	449,848
Total investments and cash	5,776,344	3,281,385
Premiums receivable	551,616	408,259
Deferred acquisition costs	112,329	108,156
Prepaid reinsurance premiums	73,164	22,459
Securities lending collateral	90,350	98,954
Loss reserves recoverable	181,765	208,796
Paid losses recoverable	14,782	1,388
Net receivable for investments sold		490
Income taxes recoverable	2,043	1,365
Intangible assets	123,055	127,217
Goodwill	20,393	20,393
Accrued investment income	38,077	20,433
Other assets	35,222	23,185
Total assets	$ 7,019,140	$ 4,322,480
LIABILITIES		
Reserve for losses and loss expenses	$ 1,622,134	$ 1,305,303
Unearned premiums	724,104	539,450
Reinsurance balances payable	65,414	33,042
Securities lending payable	90,106	105,688
Deferred income taxes	24,508	21,779
Net payable for investments purchased	44,145	
Accounts payable and accrued expenses	127,809	74,184
Debentures payable	289,800	304,300
Total liabilities	2,988,020	2,383,746
Shareholders equity		

Common shares, 571,428,571 authorized, par value $0.175 Issued and outstanding (2009 128,459,478; 2008 75,624,697)		23,033		13,235
Treasury shares		(553)		
Additional paid-in-capital		2,675,680		1,412,635
Accumulated other comprehensive (loss)		(4,851)		(7,858)
Retained earnings		1,337,811		520,722
Total shareholders equity		4,031,120		1,938,734
Total liabilities and shareholders equity	$	7,019,140	$	4,322,480

The accompanying notes are an integral part of these consolidated financial statements.

F-1

Table of Contents

Validus Holdings, Ltd.

Consolidated Statements of Operations and Comprehensive Income (Loss)
For the Years Ended December 31, 2009, 2008 and 2007
(Expressed in thousands of U.S. dollars, except share and per share information)

	December 31, 2009	December 31, 2008	December 31, 2007
Revenues			
Gross premiums written	$ 1,621,241	$ 1,362,484	$ 988,637
Reinsurance premiums ceded	(232,883)	(124,160)	(70,210)
Net premiums written	1,388,358	1,238,324	918,427
Change in unearned premiums	61,219	18,194	(60,348)
Net premiums earned	1,449,577	1,256,518	858,079
Gain on bargain purchase, net of expenses	287,099		
Net investment income	118,773	139,528	112,324
Realized gain on repurchase of debentures	4,444	8,752	
Net realized (losses) gains on investments	(11,543)	(1,591)	1,608
Net unrealized gains (losses) on investments	84,796	(79,707)	12,364
Other income	4,634	5,264	3,301
Foreign exchange (losses) gains	(674)	(49,397)	6,696
Total revenues	1,937,106	1,279,367	994,372
Expenses			
Losses and loss expenses	523,757	772,154	283,993
Policy acquisition costs	262,966	234,951	134,277
General and administrative expenses	185,568	123,948	100,765
Share compensation expenses	27,037	27,097	16,189
Finance expenses	44,130	57,318	51,754
Fair value of warrants issued			2,893
Total expenses	1,043,458	1,215,468	589,871
Net income before taxes	893,648	63,899	404,501
Tax benefit (expense)	3,759	(10,788)	(1,505)
Net income	$ 897,407	$ 53,111	$ 402,996
Comprehensive income			
Foreign currency translation adjustments	3,007	(7,809)	(49)
Comprehensive income	$ 900,414	$ 45,302	$ 402,947

Earnings per share						
Weighted average number of common shares and common share equivalents outstanding						
Basic		93,697,194		74,677,903		65,068,093
Diluted		97,168,409		75,819,413		67,786,673
Basic earnings per share	$	9.51	$	0.62	$	6.19
Diluted earnings per share	$	9.24	$	0.61	$	5.95
Cash dividends declared per share	$	0.80	$	0.80	$	

The accompanying notes are an integral part of these consolidated financial statements.

F-2

Table of Contents

Validus Holdings, Ltd.

Consolidated Statements of Shareholders Equity
For the Years Ended December 31, 2009, 2008 and 2007
(Expressed in thousands of U.S. dollars, except share and per share information)

	December 31, 2009	December 31, 2008	December 31, 2007
Common shares			
Balance Beginning of period	$ 13,235	$ 12,985	$ 10,234
Issue of common shares	9,798	250	2,751
Balance End of period	$ 23,033	$ 13,235	$ 12,985
Treasury shares			
Balance Beginning of period	$	$	$
Repurchase of common shares	(553)		
Balance End of period	$ (553)	$	$
Additional paid-in capital			
Balance Beginning of period	$ 1,412,635	$ 1,384,604	$ 1,048,025
Issue of common shares, net of expenses	1,314,188	934	317,497
Repurchase of common shares	(83,611)		
Fair value of warrants qualifying as equity			2,893
Share compensation expenses	32,468	27,097	16,189
Balance End of period	$ 2,675,680	$ 1,412,635	$ 1,384,604
Accumulated other comprehensive (loss) income			
Balance Beginning of period	$ (7,858)	$ (49)	$ 875
Foreign currency translation adjustments	3,007	(7,809)	(49)
Cumulative effect of adoption of fair value option			(875)
Balance End of period	$ (4,851)	$ (7,858)	$ (49)
Retained earnings			
Balance Beginning of period	$ 520,722	$ 537,260	$ 133,389
Cumulative effect of adoption of fair value option			875
Dividends	(80,318)	(69,649)	
Net income	897,407	53,111	402,996
Balance End of period	$ 1,337,811	$ 520,722	$ 537,260
Total shareholders equity	$ 4,031,120	$ 1,938,734	$ 1,934,800

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

Validus Holdings, Ltd.

Consolidated Statements of Cash Flows
For the Years Ended December 31, 2009, 2008 and 2007
(Expressed in thousands of U.S. dollars, except share and per share information)

	December 31, 2009	December 31, 2008	December 31, 2007
Cash flows provided by (used in) operating activities			
Net income	$ 897,407	$ 53,111	$ 402,996
Adjustments to reconcile net income to cash provided by (used in) operating activities:			
Share compensation expenses	32,468	27,097	16,189
Realized gain on repurchase of debentures	(4,444)	(8,752)	
Bargain purchase gain	(352,349)		
Net realized losses (gains) on investments	11,543	1,591	(1,608)
Net unrealized (gains) losses on investments	(84,796)	79,707	(12,364)
Fair value of warrants expensed			2,893
Amortization of intangible assets	25,833	4,162	2,081
Foreign exchange (gains) losses on cash and cash equivalents included in net income	(9,579)	40,474	(5,975)
Amortization of premium on fixed maturities	16,277	3,710	(10,739)
Change in:			
Premiums receivable	37,163	(23,833)	(7,035)
Deferred acquisition costs	17,914	(2,790)	(10,900)
Prepaid reinsurance premiums	(47,070)	(1,162)	36,690
Loss reserves recoverable	32,922	(82,685)	32,519
Paid losses recoverable	(13,424)	6,281	16,820
Income taxes recoverable	(546)	1,845	2,438
Accrued investment income	5,176	(473)	(5,812)
Other assets	(3,622)	12,908	3,955
Reserve for losses and loss expenses	(10,238)	444,149	94,313
Unearned premiums	(20,846)	(17,032)	23,657
Reinsurance balances payable	28,733	(1,401)	(37,665)
Deferred income taxes	3,089	11,921	(1,027)
Accounts payable and accrued expenses	(6,495)	(62,845)	21,952
Net cash provided by operating activities	555,116	485,983	563,378
Cash flows provided by (used in) investing activities			
Proceeds on sales of investments	3,481,772	2,266,000	1,346,874
Proceeds on maturities of investments	568,030	799,775	67,650
Purchases of fixed maturities	(4,421,787)	(3,284,971)	(2,545,787)
Sales (purchases) of short-term investments, net	200,253	(109,250)	441,548
Sales of other investments, net	90,395		
Decrease (increase) in securities lending collateral	15,582	58,636	(151,998)

Purchase of subsidiary, net of cash acquired		(376,878)				(18,809)
Net cash (used in) investing activities		(442,633)		(269,810)		(860,522)
Cash flows provided by (used in) financing activities						
Net proceeds on issuance of debentures payable						198,000
Repurchase of debentures		(10,056)		(36,948)		
Issue of common shares, net of expenses		1,250		1,184		320,248
Purchases of common shares under share repurchase program		(84,164)				
Dividends paid		(78,515)		(67,934)		
(Decrease) increase in securities lending payable		(15,582)		(58,636)		151,998
Net cash (used in) provided by financing activities		(187,067)		(162,334)		670,246
Effect of foreign currency rate changes on cash and cash equivalents		12,321		(48,689)		7,953
Net (decrease) increase in cash		(62,263)		5,150		381,055
Cash and cash equivalents beginning of period	$	449,848	$	444,698	$	63,643
Cash and cash equivalents end of period	$	387,585	$	449,848	$	444,698
Taxes paid (recovered) during the period	$	1,673	$	(2,510)	$	57
Interest paid during the period	$	26,575	$	27,474	$	22,577

The accompanying notes are an integral part of these consolidated financial statements.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements
(Expressed in thousands of U.S. dollars, except share and per share information)

1. Nature of the business

Validus Holdings, Ltd. (the Company) was incorporated under the laws of Bermuda on October 19, 2005. The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. (Validus Re) and Talbot Holdings Ltd. (Talbot). Validus Re is registered as a Class 4 insurer under The Insurance Act 1978 of Bermuda, amendments thereto and related regulations (The Act). On July 2, 2007, the Company acquired all of the outstanding shares of Talbot from a group of institutional and other investors, and Talbot employees, management, former employees and trusts on behalf of certain employees and their families. Talbot is the Bermuda parent of a specialty insurance group primarily operating within the Lloyd s of London (Lloyd s) insurance market through Syndicate 1183. The Company, through its subsidiaries, provides reinsurance coverage in the Property, Marine and Specialty lines markets, effective January 1, 2006, and insurance coverage in the same markets effective July 2, 2007.

On July 30, 2007, the Company completed its initial public offering (IPO), selling 15,244,888 common shares at a price of $22.00 per share. The net proceeds to the Company from the IPO were approximately $310,731, after deducting the underwriters discount and fees. On August 27, 2007, the Company issued an additional 453,933 common shares at a price of $22.00 per share pursuant to the underwriters option to purchase additional common shares; the net proceeds to the Company were approximately $9,349 and total IPO proceeds inclusive of the underwriters option to purchase additional common shares were $320,080.

On September 4, 2009, pursuant to an Amalgamation Agreement, the Company acquired all of IPC Holdings Ltd s (IPC) outstanding common shares in exchange for 0.9727 Company common shares and $7.50 cash per IPC common share. IPC s operations were focused on short-tail lines of reinsurance. The primary lines in which IPC conducted business were property catastrophe reinsurance and, to a limited extent, property-per-risk excess, aviation (including satellite) and other short-tail reinsurance on a worldwide basis. The acquisition of IPC was undertaken to gain a strategic advantage in the current reinsurance market and increase the Company s capital base.

2. Basis of preparation and consolidation

These consolidated financial statements include the Company and its wholly and majority owned subsidiaries (together, the Company) and have been prepared in accordance with accounting principles generally accepted in the United States of America. Certain amounts in prior periods have been reclassified to conform to current period presentation. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The major estimates reflected in the Company s consolidated financial statements include the reserve for losses and loss expenses, premium estimates for business written on a line slip or proportional basis, the valuation of goodwill and intangible assets, and reinsurance recoverable balances including the provision for unrecoverable reinsurance and investment valuation. The term FASB used in these notes refer to United States Financial Accounting Standards Board. The consolidated financial statements include the results of operations and cash flows of Talbot, since the date of acquisition of July 2, 2007; and IPC, since the date of acquisition of

September 4, 2009 and not any prior periods (including for comparative purposes), except with respect to Supplemental Pro Forma Information included within Note 5.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

3. Significant accounting policies

The following is a summary of significant accounting policies adopted by the Company.

a) Premiums

Insurance premiums written are recorded in accordance with the terms of underlying policies. Reinsurance premiums written are recorded at the inception of the policy and are estimated based on information received from brokers, ceding companies and reinsureds, and any subsequent differences arising on such estimates will be recorded in the periods in which they are determined. Premiums written are earned on a pro-rata basis over the term of the policy. For contracts and policies written on a losses occurring basis, the risk period is generally the same as the contract or policy terms. For contracts written on a policies attaching basis, the risk period is based on the terms of the underlying contracts and policies and is generally assumed to be 24 months. The portion of the premiums written applicable to the unexpired terms of the underlying contracts and policies in force are recorded as unearned premiums. Mandatory reinstatement premiums are recorded at the time a loss event occurs.

b) Policy acquisition costs

Policy acquisition costs are costs that vary with, and are directly related to, the production of new and renewal business, and consist principally of commissions and brokerage expenses. Acquisition costs are shown net of commissions earned on reinsurance ceded. These costs are deferred and amortized over the periods in which the related premiums are earned. Deferred acquisition costs are limited to their estimated realizable value based on the related unearned premiums and anticipated claims expenses. The realizable value of the Company s deferred acquisition costs is determined without consideration of investment income. Policy acquisition costs also include profit commission. Profit commissions are recognized when earned.

c) Reserve for losses and loss expenses

The reserve for losses and loss expenses includes reserves for unpaid reported losses and for losses incurred but not reported (IBNR). The reserve for unpaid reported losses and loss expenses is established by management based on reports from brokers, ceding companies and insureds and represents the estimated ultimate cost of events or conditions that have been reported to, or specifically identified by the Company. The reserve for incurred but not reported losses and loss expenses is established by management based on actuarially determined estimates of ultimate losses and loss expenses. Inherent in the estimate of ultimate losses and loss expenses are expected trends in claim severity and frequency and other factors which may vary significantly as claims are settled. Accordingly, ultimate losses and loss expenses may differ materially from the amounts recorded in the consolidated financial statements. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, will be recorded in earnings in the period in which they become known. Prior period development arises from changes to loss estimates recognized in the current year that relate to loss reserves incurred in previous calendar years.

d) Reinsurance

In the normal course of business, the Company seeks to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk assumed in various areas of exposure with other insurers or reinsurers. The accounting for reinsurance ceded depends on the method of reinsurance. If the policy is on a losses occurring during basis, reinsurance premiums ceded are expensed (and any commissions thereon are earned) on a pro-rata basis over the period the reinsurance coverage is provided. If the policy is a risks attaching during policy, reinsurance premiums ceded are expensed (and any commissions thereon are earned) in line with the gross premiums earned to which the risk attaching policy relates. Prepaid reinsurance premiums represent the portion of premiums ceded applicable to the unexpired term of policies in force. Mandatory reinstatement premiums ceded are

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

recorded and expensed at the time a loss event occurs. Reinsurance recoverables are based on contracts in force. The method for determining the reinsurance recoverable on unpaid loss and loss expenses involves actuarial estimates of unpaid losses and loss expenses as well as a determination of the Company s ability to cede unpaid losses and loss expenses under its reinsurance treaties. The use of different assumptions could have a material effect on the provision for uncollectible reinsurance. To the extent the creditworthiness of the Company s reinsurers was to deteriorate due to adverse event affecting the reinsurance industry, such as a large number of major catastrophes, actual uncollectible amounts could be significantly greater than the Company s provision. Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying liabilities.

e) Investments

During the first quarter of 2007, the Company adopted authoritative guidance on *Fair Value Measurements and Disclosures* and *Financial Instruments.* The guidance defines fair value as the price received to transfer an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting the highest and best use valuation concepts. The guidance provides a framework for measuring fair value by creating a hierarchy of fair value measurements that distinguishes market data between observable independent market inputs and unobservable market assumptions by the reporting entity. The guidance further expands disclosures about such fair value measurements. The guidance applies broadly to most existing accounting pronouncements that require or permit fair value measurements (including both financial and non-financial assets and liabilities) but does not require any new fair value measurements. The Company has adopted all authoritative guidance in effect as of the balance sheet date regarding certain market conditions that allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable.

Short-term investments comprise investments with a remaining maturity of less than one year at time of purchase and money market funds held at the Company s investment managers.

All investment transactions are recorded on a first-in-first-out basis and realized gains and losses on the sale of investments are determined on the basis of amortized cost. Interest on fixed maturity securities is recorded in net investment income when earned and is adjusted for any amortization of premium or discount.

For mortgage-backed securities, and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any adjustments required due to the resultant change in effective yields and maturities are recognized retrospectively. Prepayment fees or call premiums that are only payable to the Company when a security is called prior to its maturity, are earned when received and reflected in net investment income.

The Company participates in a securities lending program whereby certain securities from its portfolio are loaned to third parties for short periods of time through a lending agent. The Company retains all economic interest in the securities it lends and receives a fee from the borrower for the temporary use of the securities. Collateral in the form of cash, government securities and letters of credit is required at a rate of 102% of the market value of the loaned securities and is held by a third party.

Other investments consist of an investment in a fund of hedge funds and a deferred compensation trust. All investment transactions are recorded on a first-in-first-out basis and realized gains and losses on the sale of investments are

determined on the basis of amortized cost. Other investments are carried at fair value with interest and dividend income, income distributions and realized and unrealized gains and losses included in net investment income. The fair value of other investments is generally established on the basis of the net valuation criteria established by the managers of the investments. These net valuations are determined based upon the valuation criteria established by the governing documents of such investments. In addition, due to a lag in reporting, some of the Company s fund managers, fund administrators, or both, are unable to provide final fund valuations as of the

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Company s current reporting date. In these circumstances, the Company estimates the fair value of these funds by starting with the prior month s fund valuation, adjusting these valuations for capital calls, redemptions or distributions and the impact of changes in foreign currency exchange rates, and then estimating the return for the current period. In circumstances in which the Company estimates the return for the current period, it uses all credible information available. This principally includes preliminary estimates reported by its fund managers, obtaining the valuation of underlying portfolio investments where such underlying investments are publicly traded and therefore have a readily observable price, using information that is available to the Company with respect to the underlying investments, reviewing various indices for similar investments or asset classes, as well as estimating returns based on the results of similar types of investments for which the Company has reported results, or other valuation methods, as necessary. Actual final fund valuations may differ, perhaps materially so, from the Company s estimates and these differences are recorded in the period they become known as a change in estimate.

f) Cash and cash equivalents

The Company considers time deposits and money market funds with an original maturity of 30 days or less as equivalent to cash.

g) Foreign exchange

The U.S. Dollar is the functional currency of the Company and the majority of the subsidiaries. For these companies, monetary assets and liabilities denominated in foreign currencies are revalued at the exchange rates in effect at the balance sheet date and revenues and expenses denominated in foreign currencies are translated at the prevailing exchange rate on the transaction date with the resulting foreign exchange gains and losses included in earnings.

Assets and liabilities of subsidiaries whose functional currency is not the U.S. dollar are translated at prevailing year end exchange rates. Revenue and expenses of such foreign operations are translated at average exchange rates during the year. The net effect of translation differences between functional and reporting currencies in foreign operations, net of applicable deferred income taxes, are included in accumulated other comprehensive income (loss).

h) Stock plans

The Company accounts for its share plans in accordance with the U.S. GAAP fair value recognition provisions for *Stock Compensation.* Accordingly, the Company recognizes the compensation expense for stock option grants and restricted share grants based on the fair value of the award on the date of grant over the requisite service period.

i) Warrants

The Company has accounted for certain warrant contracts issued to our sponsoring investors in conjunction with the capitalization of the Company, and which may be settled by the Company using either the physical settlement or net-share settlement methods, in accordance with U.S. GAAP guidance for *Derivatives and Hedging.* Accordingly, the fair value of these warrants has been recorded in equity as an addition to additional paid-in capital.

j) Earnings per share

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding. Diluted earnings per common share are based on the weighted average number of common shares and share equivalents excluding any anti-dilutive effects of warrants and options.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

k) Income taxes and uncertain tax provisions

Deferred tax assets and liabilities are recorded in accordance with U.S. GAAP *Income Taxes* guidance. Consistent with this guidance, the Company records deferred income taxes which reflect the tax effect of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their respective tax bases.

The Company is not subject to any income, withholding or capital gains taxes under current Bermuda law. The Company has operations in subsidiary form in various other jurisdictions around the world, including but not limited to the U.K. and Canada that are subject to relevant taxes in those jurisdictions. One of the Company s subsidiaries is deemed to be engaged in business in the United States and is therefore subject to U.S. corporate tax.

During the first quarter of 2007, the Company adopted authoritative guidance which requires the Company to recognize the tax benefits of uncertain tax positions only where the position is more likely than not to be sustained assuming examination by tax authorities. The Company did not recognize any resulting liabilities for unrecognized tax benefits.

l) Business combinations

On July 2, 2007, the Company acquired all of the outstanding shares of Talbot. The transaction was accounted for as a purchase method business combination in accordance with existing U.S. GAAP guidance for *Business Combinations.* Certain amounts in Talbot s financial statements have been changed to conform to the Company s accounting policies.

On September 4, 2009, the Company acquired all of the outstanding shares of IPC. The transaction was accounted for as an acquisition method business combination. Accordingly, the purchase price was allocated to assets and liabilities based on their estimated fair value at the acquisition date. The consideration for the net assets acquired was concluded upon prior to the assessment of the fair value of the net assets at the acquisition date. Therefore, the excess of the value of the net assets acquired over the purchase price was recorded as gain on bargain purchase and is shown as a separate component of revenues in the Company s Consolidated Statements of Operations and Comprehensive Income for year ended December 31, 2009. IPC s accounting policies have been conformed to those of the Company.

m) Goodwill and other intangible assets

The Company accounts for goodwill and other intangible assets recognized in business combinations in accordance with U.S. GAAP guidance. A purchase price paid that is in excess of net assets (goodwill) arising from a business combination is recorded as an asset, and is not amortized. Goodwill is deemed to have an indefinite life and is not amortized, but tested at least annually for impairment. Where the total fair value of net assets acquired exceeds consideration paid (negative goodwill), the acquirer will record a gain as a result of the bargain purchase, to be recognized through the income statement at the close of the transaction.

Intangible assets with a finite life are amortized over the estimated useful life of the asset. Intangible assets with an indefinite useful life are not amortized. Syndicate capacity is deemed to have an indefinite life. Intangible assets with

definite lives are amortized on a straight line basis over the estimated useful lives. Trademark and Distribution Network are deemed to have definite lives and are therefore amortized. Refer also to Note 5 Business combinations.

Goodwill and intangible assets are tested for impairment on an annual basis or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. Such events or circumstances may include an economic downturn in a geographic market or change in the assessment of future operations. The goodwill impairment test has two steps. The first step identifies potential impairments by comparing the fair value

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

of a reporting unit with its book value, including goodwill. Reporting units are consistent with the segmental basis. If the carrying value exceeds the fair value, the second step calculates the possible impairment loss by comparing the implied fair value of goodwill with the carrying amount. If the implied goodwill is less than the carrying amount, a write-down would be recorded. The measurement of fair values in reporting units is determined on a number of factors and assumptions including ranges of future discounted earnings, forecast revenue and operating expenses and effective tax rates.

If the goodwill or intangible asset is impaired, it is written down to its realizable value with a corresponding expense reflected in the consolidated statements of operations.

4. Recent accounting pronouncements

In December 2007, the FASB issued authoritative guidance on *Business Combinations* and *Consolidation* which are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. In April 2009, the FASB issued further authoritative guidance on business combinations that amended previous guidance on the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets acquired and liabilities assumed in a business combination that arise from contingencies. Significant changes arising from this update, which impact current and future acquisitions include the determination of the purchase price and treatment of transaction expenses, restructuring charges and negative goodwill as follows;

Purchase Price The purchase price is determined as of the acquisition date, which is the date that the acquirer obtains control. Under previous guidance, the date the business combination was announced was used as the effective date in determining the purchase price;

Transaction Expenses All costs associated with purchase transactions must be expensed as incurred. Under previous guidance, all such costs could be capitalized and included as part of transaction purchase price, adding to the amount of goodwill recognized;

Restructuring Costs Expected restructuring costs are not recorded at the closing date, but rather after the transaction. The only costs to be included as a liability at the closing date are those for which an acquirer is obligated at the time of the closing. Under previous guidance, restructuring costs that were planned to occur after the closing of the transaction were recognized and recorded at the closing date as a liability;

Negative Goodwill/Bargain Purchases Where total fair value of net assets acquired exceeds consideration paid (creating negative goodwill), the acquirer will record a gain as a result of the bargain purchase, to be recognized through the income statement at the close of the transaction. Under previous guidance, negative goodwill was recognized as a pro rata reduction of the assets assumed to allow the net assets acquired to equal the consideration paid; and

As a result of the adoption of this update the Company has expensed as incurred the transaction costs related to the definitive Amalgamation Agreement dated July 9, 2009 among IPC, Validus Holdings, Ltd and Validus, Ltd (the Amalgamation Agreement) with IPC, as described in Note 5. The adoption of this update on business combinations

and consolidation materially impacts the consolidated financial statement recognition and measurement of current and future acquisitions.

In June 2008, the FASB issued authoritative guidance on the *Balance Sheet* presentation of instruments granted in Share-based Payment transactions. This update addresses whether instruments granted in share-based payment transactions may be participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing basic earnings per share (EPS) pursuant to the two-class method. This update is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

In January 2009, the FASB issued authoritative guidance on *Investments Other* and the beneficial interests in securitized financial assets that amends certain recognition aspects of other-than-temporary impairments (OTTI). This update is effective prospectively for interim and annual periods ending after December 15, 2008. Retrospective application of this update to a prior interim or annual period is prohibited. As the Company s investment portfolio is classified as trading, the adoption of this guidance has not had a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued authoritative guidance on *Fair Value Measurements and Disclosures* and the recognition and presentation of OTTI. The fair value measurement update includes guidance on; (1) estimating the fair value of an asset or liability (financial and nonfinancial) when the volume and level of activity for the asset or liability have significantly decreased; and (2) identifying transactions that are not orderly. The primary change to the OTTI model for debt securities is the change in focus from an entity s intent and ability to hold a security until recovery. Instead, an OTTI is triggered if; (1) an entity has the intent to sell the security; (2) it is more likely than not that it will be required to sell the security before recovery; or (3) it does not expect to recover the entire amortized cost basis of the security. Both updates are effective for interim and annual periods ending after June 15, 2009. The adoption of these updates has not had a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued authoritative guidance on interim disclosures about fair value of *Financial Instruments.* This update expands the fair value disclosures required for specified financial instruments for interim periods of publicly traded entities. This update also requires entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim basis and to highlight any changes of the methods and significant assumptions from prior periods. This update is effective for interim and annual periods ending after June 15, 2009. As this update only expands certain disclosure requirements it has not had a material impact on the Company s consolidated financial statements.

In May 2009, the FASB issued authoritative guidance on management s assessment of *Subsequent Events* . This update clarifies that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued or are available to be issued. This update is effective prospectively for interim and annual periods ending after June 15, 2009. The adoption of this update has not had a material impact on management s existing processes for assessing subsequent events, and consequently the Company s consolidated financial statements.

In June 2009, the FASB issued authoritative guidance on accounting for *Transfers and Servicing* of financial assets which amends previous derecognition guidance. This update addresses practices that have developed that are not consistent with the original intent and key requirements and concerns that derecognized financial assets and related obligations should continue to be reported in the transferors financial statements. This update is effective for financial asset transfers in the interim and annual periods beginning after November 15, 2009. Early adoption is prohibited. The adoption of this update is not expected to have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued authoritative guidance which amends the *Consolidation* guidance that applies to Variable Interest Entities (VIEs). This update amends the guidance for the identification of VIEs and their primary beneficiaries and the financial statement disclosures required. This update is effective for interim and annual periods beginning after November 15, 2009. On December 4, 2009, the FASB issued a proposed update that would

indefinitely defer the effective date of the above noted authoritative guidance for a reporting enterprise s interest in entities that have certain attributes for which it is industry practice to issue financial statements in accordance with *Financial Services Investment Companies* guidance. The adoption of this update it is not expected to have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued authoritative guidance which prescribes the use of the FASB Accounting Standards Codification (the Codification) as the authoritative source of U.S. *Generally Accepted Accounting*

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Principles (GAAP). All of its content carries the same level of authority, effectively superseding previous guidance to include only two levels of U.S. GAAP: authoritative and nonauthoritative. This update is effective for interim and annual periods ending after September 15, 2009. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

In August 2009, the FASB updated guidance on *Fair Value Measurements and Disclosures* of liabilities. This update clarifies that the quoted price for the identical liability, when traded as an asset in an active market, is also a Level 1 measurement for that liability when no adjustment to the quoted price is required. In the absence of a Level 1 measurement, an entity must use one or more prescribed valuation techniques to estimate fair value. This update is effective for the first interim or annual reporting period beginning after August 28, 2009. The adoption of this update has not had a material impact on the Company s consolidated financial statements and affected disclosures only.

In August 2009, the FASB proposed updated guidance on improving *Fair Value Measurements and Disclosures.* The proposed update would clarify existing requirements regarding disclosures of inputs and valuation techniques and levels of disaggregation. In addition, the proposed updated would require new disclosures on (1) sensitivity disclosures regarding the effect of changing Level 3 inputs if the change in the fair value measurement would change significantly, (2) significant transfers in and out of Levels 1 and 2 and the reasons that such transfers were made, and (3) additional disclosure in the reconciliation of Level 3 activity, including information on a gross basis for purchases, sales, issuances, and settlements. An effective date has not been established. As this update only expands certain disclosure requirements it is not expected to have a material impact on the Company s consolidated financial statements.

In September 2009, the FASB updated guidance on *Fair Value Measurements and Disclosures* of certain alternative investments. This guidance offer investors a practical expedient for measuring the fair value of investments in certain entities that calculate net asset value per share. This guidance is effective for interim and annual reporting periods ending after December 15, 2009. The adoption of this update has not had a material impact on the Company s consolidated financial statements.

In December 2009, the FASB issued a proposed update regarding the recognition of costs associated with acquiring or renewing insurance contracts. The proposed update would limit the costs an entity can include in deferred acquisition costs to those that are directly related to the acquisition of new and renewal insurance contracts. The proposed update would also clarify that direct costs include only those that result in a successful acquisition of a policy and exclude all costs incurred for unsuccessful efforts. In addition, the proposed update also would require that an entity include only actual costs, not costs expected to be incurred, in deferred acquisition costs. The proposed update would be effective for interim and annual reporting periods beginning on or after December 15, 2010, and would be applied prospectively; however, there would be an option for retrospective application. Early adoption would be permitted. The Company will continue to evaluate the potential impact of this proposed guidance.

5. Business combinations

On September 4, 2009, pursuant to an Amalgamation Agreement, the Company acquired all of IPC s outstanding common shares in exchange for 0.9727 Company common shares and $7.50 cash per IPC common share. IPC s operations are focused on short-tail lines of reinsurance. The primary lines in which IPC conducted business were

property catastrophe reinsurance and, to a limited extent, property-per-risk excess, aviation (including satellite) and other short-tail reinsurance on a worldwide basis. The acquisition of IPC was undertaken to gain a strategic advantage in the then current reinsurance market and increase the Company s capital base.

The aggregate purchase price paid by the Company was $1,746,224 for adjusted tangible net assets acquired of $2,076,902. The global financial crisis and related market illiquidity have led to several publicly traded companies

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

trading at substantial discounts. This was the primary factor responsible for a purchase price less than the book value of IPC s net assets, and the recognition of a bargain purchase gain on acquisition.

The estimates of fair values for tangible assets acquired and liabilities assumed are determined by management based on various market and income analyses and recent asset appraisals. Significant judgment is required to arrive at these estimates of fair value and changes to assumptions used could lead to materially different results.

An adjustment of $50,000 was made to IPC s net assets acquired in respect of the termination fee (the Max Termination Fee) paid under the Agreement and Plan of Amalgamation among Max Capital Group Ltd., IPC and IPC Limited. This Max Termination Fee was advanced to IPC by the Company on July 9, 2009, but was repayable in certain circumstances.

In addition, the Company at closing recorded a $21,671 intangible asset for the acquired IPC customer relationships. This intangible asset relates to the acquired broker distribution network and is fair valued using a variation of the income approach. Under this approach, the Company estimated the present value of expected future cash flows to an assumed hypothetical market participant resulting from the existing IPC customer relationships, considering attrition, and discounting at a weighted average cost of capital. The composition of purchase price and fair value of net assets acquired is summarized as follows:

Total allocable purchase price		
IPC shares outstanding at September 4, 2009(a)	56,110,096	
Exchange ratio	0.9727	
Validus common shares issued(a)	54,578,268	
Validus closing share price on September 4, 2009	$ 24.10	
Total value of Validus shares to be issued		$ 1,315,337
Total cash consideration paid at $7.50 per IPC share		420,826
Share compensation awards issued to IPC employees pursuant to the Amalgamation Agreement and earned prior to the Amalgamation		10,061
Total allocable purchase price		1,746,224
Tangible Assets Acquired		
Cash and investments	$ 2,463,374	
Premiums Receivable(b)	202,278	
Tangible Assets Acquired		2,665,652
Liabilities Acquired		
Net loss reserves and paid losses recoverable	$ 304,957	
Unearned premiums, net of expenses	180,370	
Other liabilities	53,423	
Liabilities acquired		538,750

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Net tangible assets acquired, at fair value		2,126,902
Max Termination Fee		(50,000)
Net tangible assets acquired, at fair value, adjusted		2,076,902
Bargain purchase gain before establishment of intangible assets		330,678
Intangible asset customer relationships		21,671
Bargain purchase gain on acquisition of IPC	$	352,349

(a) The number of shares include restricted stock in IPC.

(b) The fair value of receivables approximates the gross contractual amounts receivable and includes other assets.

The Company also incurred transaction and termination expenses related to the IPC acquisition. Transaction expenses are primarily comprised of legal, corporate advisory, and audit related services. Termination expenses are primarily comprised of severance costs and accelerated share compensation costs in connection with certain IPC employment contracts that have been terminated. As of December 31, 2009, the customer relationships intangible asset has been fully amortized as it not expected to significantly contribute to the Company s future cash flows beyond the balance sheet date. The gain on bargain purchase, net of expenses has been presented as a separate line item in the Company s Consolidated Statements of Operations and Comprehensive Income, and is composed of the following:

	December 31, 2009	
Bargain purchase gain on acquisition of IPC	$	352,349
Transaction expenses		(29,448)
Termination expenses		(14,131)
Amortization of intangible asset customer relationships		(21,671)
Gain on bargain purchase, net of expenses	$	287,099

The following selected audited information has been provided to present a summary of the results of IPC since the acquisition date, that have been included within the Validus Re segment in the consolidated financial statements.

From Acquisition Date to December 31, 2009

Net premiums written	$	(4,974)
Total revenue		161,188
Total expenses		33,370
Net income	$	127,818

Supplemental Pro Forma Information

Operating results of IPC have been included in the consolidated financial statements from the September 4, 2009 acquisition date. The following selected unaudited pro forma information has been provided to present a summary of the combined results of the Company and IPC, assuming the transaction had been effected on

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

January 1, 2008. The unaudited pro forma data is for informational purposes only and does not necessarily represent results that would have occurred if the transaction had taken place on the basis assumed above.

	December 31, 2009 (Unaudited)	December 31, 2008 (Unaudited)
Revenues		
Gross premiums written	$ 2,008,578	$ 1,765,628
Reinsurance premiums ceded	(239,412)	(130,031)
Net premiums written	1,769,166	1,635,597
Change in unearned premiums	(57,338)	8,288
Net premiums earned	1,711,828	1,643,885
Net investment income	163,944	213,430
Net realized (losses) on investments	(4,717)	(169,799)
Net unrealized gains (losses) on investments	189,789	(79,707)
Other income	4,603	5,329
Realized gain on repurchase of debentures	4,444	8,752
Foreign exchange gains (losses)	4,294	(51,245)
Total revenues	2,074,185	1,570,645
Expenses		
Losses and loss expenses	556,550	927,786
Policy acquisition costs	289,600	271,380
General and administrative expenses	209,510	144,637
Share compensation expenses	33,751	32,722
Finance expenses	44,513	59,977
Total expenses	1,133,924	1,436,502
Net income before taxes	940,261	134,143
Tax benefit (expense)	3,759	(10,788)
Net income	$ 944,020	123,355
Basic earnings per share	$ 10.01	$ 1.56
Diluted earnings per share	$ 9.72	$ 1.63

6. Goodwill and other intangible assets

Following the acquisition of IPC on September 4, 2009, the Company recorded intangible assets (including certain amortization thereon) and negative goodwill. Intangible assets of $21,671 were recognized as a result of the acquisition of IPC (relating to customer relationships). As of December 31, 2009, the customer relationships intangible asset has been fully amortized.

Following the acquisition of Talbot Holdings Ltd. on July 2, 2007, the Company recorded intangible assets in the name of Syndicate Capacity, Trademark and Distribution Network (including certain amortization thereon) and goodwill. Syndicate capacity represents Talbot s authorized premium income limit to write insurance business in the Lloyd s market. Talbot has owned 100% of Syndicate 1183 s capacity since 2002 and there are no third party tenure rights. The capacity is renewed annually at no cost to Talbot, but may be freely purchased or sold, subject to

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Lloyd s approval. The ability to write insurance business under the syndicate capacity is indefinite with the premium income limit being set yearly by Talbot, subject to Lloyd s approval. Trademark and Distribution Network are estimated to have finite useful lives of 10 years and are amortized on a straight line basis over such periods. Syndicate capacity and goodwill are estimated to have indefinite useful lives. Goodwill includes amounts related to the value of the workforce. The goodwill and intangibles are recorded entirely in the Company s Talbot segment. The following table shows an analysis of goodwill and other intangible assets included in the Talbot segment:

	Goodwill	Intangible Assets With an Indefinite Life	Intangible Assets with a Finite Life	Total
Balance at December 31, 2008	$ 20,393	$ 91,843	$ 35,374	$ 147,610
Accumulated amortization			(4,162)	(4,162)
Balance at December 31, 2009	$ 20,393	$ 91,843	$ 31,212	$ 143,448
Balance at December 31, 2007	$ 20,393	$ 91,843	$ 39,536	$ 151,772
Accumulated amortization			(4,162)	(4,162)
Balance at December 31, 2008	$ 20,393	$ 91,843	$ 35,374	$ 147,610

The estimated remaining amortization expense for the Trademark and Distribution network is as follows:

2010	$ 4,162
2011	4,162
2012	4,162
2013	4,162
2014 and there after	14,564
	$ 31,212

As described in Significant accounting policies, the annual impairment test was performed and neither goodwill nor the intangible assets were deemed to be impaired.

7. Investments

During the first quarter of 2007, the Company adopted authoritative guidance on fair value measurements and disclosures and financial instruments. Beginning on January 1, 2007, the Company s investments in fixed maturities

were classified as trading and carried at fair value, with related net unrealized gains or losses included in earnings. The Company has adopted all authoritative guidance in effect as of the balance sheet date regarding certain market conditions that allow for fair value measurements that incorporate unobservable inputs where active market transaction based measurements are unavailable.

(a) Classification within the fair value hierarchy

Under U.S. GAAP, a company must determine the appropriate level in the fair value hierarchy for each fair value measurement. The fair value hierarchy prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels. It gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. A significant adjustment to a

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement. Level 3 inputs are unobservable inputs for the asset or liability.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices or alternative indices but for which the Company typically obtained independent external valuation information including U.S. and U.K. Treasuries, overnight repos and commercial paper. Level 2 includes financial instruments that are valued through independent external sources using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Sustainably all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. The Company performs internal procedures on the valuations received from independent external sources. Financial instruments in this category include U.S. Treasuries, sovereign debt, corporate debt, catastrophe bonds and U.S. agency and non-agency mortgage and asset-backed securities. Level 3 includes financial instruments that are valued using market approach and income approach valuation techniques. These models incorporate both observable and unobservable inputs. Financial instruments in this category include certain residential mortgage-backed securities.

The Company s external investment advisors have noted illiquidity and dislocation in the non-Agency RMBS market during 2009 and 2008. During the years ended December 31, 2009 and 2008, the Company identified certain non-Agency RMBS securities in its portfolio trading in inactive markets (identified RMBS securities). In order to gauge market activity for the identified RMBS securities, management, with assistance from external investment advisors, reviewed the pricing sources for each security in the portfolio. Pricing services were the primary sources for the prices.

Consistent with U.S. GAAP, market approach fair value measurements for securities trading in inactive markets are not determinative. In weighing the fair value measurements resulting from market approach and income approach valuation techniques, the Company has placed less reliance on the market approach fair value measurements. The income approach valuation technique determines the fair value of each security on the basis of contractual cash flows, discounted using a risk-adjusted discount rate. As the proposed valuation technique incorporates both observable and significant unobservable inputs, these securities are included as Level 3 assets with respect to the fair value hierarchy. The foundation for the income approach is the amount and timing of future cash flows.

Other investments consist of an investment in a fund of hedge funds and a deferred compensation trust. During the fourth quarter of 2009, a majority of the fund of hedge funds was redeemed. The remaining portion is a side pocket of $25,670 at December 31, 2009. While a redemption request has been submitted, the timing of receipt of proceeds on the side pocket is unavailable. The fund investment manager provides monthly reported net asset values (NAV) with a one-month delay in its valuation. As a result, the fund investment manager s November 30, 2009 NAV was used as a partial basis for fair value measurement in the Company s December 31, 2009 balance sheet. The fund investment manager s NAV relies on an estimate of the performance of the fund based on the month end positions from the underlying third-party funds. The Company utilizes the fund investment manager s primary market approach estimated NAV that incorporates relevant valuation sources on a timely basis. As this valuation technique incorporates both observable and significant unobservable inputs, the fund of hedge funds is classified as a Level 3 asset. To determine

the reasonableness of the estimated NAV, the Company assesses the variance between the estimated NAV and the one-month delayed fund investment manager s NAV. These variances are recorded in the following reporting period.

On August 28, 2009, the Company sold short equity index futures contracts with the goal of hedging until the closing of the IPC acquisition and liquidation of IPC s mutual fund equity portfolio exposure. The contracts were

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

closed when the equity positions were fully redeemed on September 9, 2009. The Company experienced a $3,273 realized investment loss as a result of the futures contracts.

At December 31, 2009, the Company s investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. Government and Government Agency	$	$ 1,918,811	$	$ 1,918,811
Non-U.S. Government and Government Agency		673,680		673,680
States, municipalities, political subdivision		19,359		19,359
Agency residential mortgage-backed securities		551,610		551,610
Non-Agency residential mortgage-backed securities		52,233	85,336	137,569
U.S. corporate		1,027,225		1,027,225
Non-U.S. corporate		409,398		409,398
Catastrophe bonds		52,351		52,351
Asset-backed securities		36,712		36,712
Commercial mortgage-backed securities		42,663		42,663
Total fixed maturities		4,784,042	85,336	4,869,378
Total short-term investments	479,552	2,214		481,766
Total other investments		11,945	25,670	37,615
Total	$ 479,552	$ 4,798,201	$ 111,006	$ 5,388,759

At December 31, 2008, the Company s investments were allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
U.S. Government and Government Agency	$	$ 768,344	$	$ 768,344
Non-U.S. Government and Government Agency		96,073		96,073
States, municipalities, political subdivision		15,516		15,516
Agency residential mortgage-backed securities		433,736		433,736
Non-Agency residential mortgage-backed securities		119,813	111,318	231,131
U.S. corporate		443,847		443,847
Non-U.S. corporate		125,700		125,700
Catastrophe bonds		10,872		10,872
Asset-backed securities		137,023		137,023
Commercial mortgage-backed securities		192,259		192,259
Total fixed maturities		2,343,183	111,318	2,454,501

Total short-term investments	365,357	11,679		377,036
Total other investments				
Total	$ 365,357	$ 2,354,862	$ 111,318	$ 2,831,537

F-18

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

At December 31, 2009, Level 3 investments totaled $111,006, representing 2.1% of total investments measured at fair value on a recurring basis. At December 31, 2008, Level 3 investments totaled $111,318, representing 3.9% of total investments measured at fair value on a recurring basis.

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs as at December 31, 2009 and 2008:

	Year Ended December 31, 2009		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments Beginning of period	$ 111,318	$	$ 111,318
Payments and purchases		115,351	115,351
Sales and maturities	(822)	(92,004)	(92,826)
Realized losses	(1,284)	1,609	325
Unrealized losses	(7,329)	714	(6,615)
Amortization	(16,547)		(16,547)
Transfers in			
Level 3 investments End of period	$ 85,336	$ 25,670	$ 111,006

	Year Ended December 31, 2008		
	Fixed Maturity Investments	Other Investments	Total Fair Market Value
Level 3 investments Beginning of period	$	$	$
Payments and purchases			
Sales and maturities	(59)		(59)
Realized losses			
Unrealized losses	(14,603)		(14,603)
Amortization	(4,048)		(4,048)
Transfers in	130,028		130,028
Level 3 investments End of period	$ 111,318	$	$ 111,318

(b) Net investment income

Net investment income was derived from the following sources:

	Years Ended		
	December 31, 2009	**December 31, 2008**	**December 31, 2007**
Fixed maturities and short-term investments	$ 117,631	$ 127,689	$ 98,559
Cash and cash equivalents	3,374	13,416	16,111
Securities lending income	772	1,775	242
Total gross investment income	121,777	142,880	114,912
Investment expenses	(3,004)	(3,352)	(2,588)
Net investment income	$ 118,773	$ 139,528	$ 112,324

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

(c) Fixed maturity and short-term investments

The following represents an analysis of net realized (losses) gains and the change in unrealized gains (losses) on investments:

	Years Ended		
	December 31, 2009	**December 31, 2008**	**December 31, 2007**
Fixed maturities, short-term and other investments and cash equivalents			
Gross realized gains	$ 33,063	$ 24,520	$ 6,055
Gross realized losses	(44,606)	(26,111)	(4,447)
Net realized (losses) gains on investments	(11,543)	(1,591)	1,608
Change in unrealized (losses) of securities lending	(24,186)	(6,734)	
Change in unrealized gains (losses) of investments	108,982	(72,973)	12,364
Total net realized (losses) gains and change in unrealized gains (losses) of investments	$ 73,253	$ (81,298)	$ 13,972

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at December 31, 2009 were as follows:

	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
U.S. Government and Government Agency	$ 1,912,081	$ 12,308	$ (5,578)	$ 1,918,811
Non-U.S. Government and Government Agency	678,555	7,552	(12,427)	673,680
States, municipalities, political subdivision	19,310	105	(56)	19,359
Agency residential mortgage-backed securities	537,876	14,643	(909)	551,610
Non-Agency residential mortgage-backed securities	176,853	481	(39,765)	137,569
U.S. corporate	1,004,464	23,895	(1,134)	1,027,225
Non-U.S. corporate	411,499	4,781	(6,882)	409,398
Catastrophe bonds	51,236	1,244	(129)	52,351

Asset-backed securities		36,828		411		(527)		36,712
Commercial mortgage-backed securities		41,693		971		(1)		42,663
Total fixed maturities		4,870,395		66,391		(67,408)		4,869,378
Total short-term investments		482,632		33		(899)		481,766
Total other investments		35,941		1,674				37,615
Total	$	5,388,968	$	68,098	$	(68,307)	$	5,388,759

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

The amortized cost, gross unrealized gains and losses and estimated fair value of investments at December 31, 2008 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Government and Government Agency	$ 732,155	$ 36,189	$	$ 768,344
Non-U.S. Government and Government Agency	115,389	4,403	(23,719)	96,073
States, municipalities, political subdivision	14,954	562		15,516
Agency residential mortgage-backed securities	425,533	8,358	(155)	433,736
Non-Agency residential mortgage-backed securities	299,346	47,276	(115,491)	231,131
U.S. corporate	454,810	2,126	(13,089)	443,847
Non-U.S. corporate	140,807	1,696	(16,803)	125,700
Catastrophe bonds	11,012	2	(142)	10,872
Asset-backed securities	141,209		(4,186)	137,023
Commercial mortgage-backed securities	217,803		(25,544)	192,259
Total fixed maturities	2,553,018	100,612	(199,129)	2,454,501
Total short-term investments	379,537	55	(2,556)	377,036
Total	$ 2,932,555	$ 100,667	$ (201,685)	$ 2,831,537

The following table sets forth certain information regarding the investment ratings of the Company s fixed maturities portfolio as at December 31, 2009 and 2008. Investment ratings are the lower of Moody s or Standard & Poor s rating for each investment security, presented in Standard & Poor s equivalent rating. For investments where Moody s and Standard & Poor s ratings are not available, Fitch ratings are used and presented in Standard & Poor s equivalent rating.

	December 31, 2009		December 31, 2008	
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total
AAA	$ 3,287,879	67.5%	$ 1,941,349	79.1%
AA	487,364	10.0%	146,923	6.0%
A	925,532	19.0%	338,966	13.8%
BBB	14,416	0.3%	12,427	0.5%

Investment grade	4,715,191	96.8%	2,439,665	99.4%
BB	45,191	0.9%	7,416	0.3%
B	59,116	1.2%	7,420	0.3%
CCC	45,194	1.0%		0.0%
D/NR	4,686	0.1%		0.0%
Non-Investment grade	154,187	3.2%	14,836	0.6%
Total fixed maturities	$ 4,869,378	100.0%	$ 2,454,501	100.0%

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

The amortized cost and estimated fair value amounts for fixed maturity securities held at December 31, 2009 and 2008 are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

	December 31, 2009		December 31, 2008	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 269,889	$ 270,688	$ 277,137	$ 279,727
Due after one year through five years	3,498,792	3,521,167	1,143,494	1,134,275
Due after five years through ten years	306,065	306,502	17,451	17,493
Due after ten years	2,399	2,467	31,045	28,858
	4,077,145	4,100,824	1,469,127	1,460,353
Asset-backed and mortgage-backed securities	793,250	768,554	1,083,891	994,148
Total	$ 4,870,395	$ 4,869,378	$ 2,553,018	$ 2,454,501

The Company has a five year, $500,000 secured letter of credit facility provided by a syndicate of commercial banks. At December 31, 2009, approximately $225,823 (2008: $199,186) of letters of credit were issued and outstanding under this facility for which $314,857 of investments were pledged as collateral (2008: $258,573). In 2007, the Company entered into a $100,000 standby letter of credit facility which provides Funds at Lloyd s. On November 19, 2009, the Company entered into the Second Amendment to the Talbot FAL Facility to reduce the commitment from $100,000 to $25,000. At December 31, 2009, $25,000 (2008: $100,000) of letters of credit were issued and outstanding under this facility for which $128,798 of investments were pledged as collateral (2008: $144,149). In addition, $1,517,249 of investments are held in trust at December 31, 2009, (2008: $1,100,235). Of those, $1,408,084 are held in trust for the benefit of Talbot s cedants and policyholders, and to facilitate the accreditation as an alien insurer/reinsurer by certain regulators (2008: $1,032,267).

The Company assumed two letters of credit facilities as part of the IPC Acquisition. A $250,000 Credit Agreement between IPC Holdings, Ltd., IPCRe Limited, the Lenders party thereto and Wachovia Bank, National Association (the IPC Syndicated Facility) and a $350,000 Letters of Credit Master Agreement between Citibank N.A. and IPCRe Limited (the IPC Bi-Lateral Facility). At December 31, 2009, the IPC Syndicated Facility had $16,537 letters of credit issued and outstanding for which $25,233 investments were pledged as collateral. At December 31, 2009, the IPC Bi-Lateral Facility had $96,047 letters of credit issued and outstanding for which $219,004 of investments were held in an associated collateral account.

(d) Securities lending

The Company participates in a securities lending program whereby certain securities from its portfolio are loaned to third parties for short periods of time through a lending agent. The Company retains all economic interest in the

securities it lends and receives a fee from the borrower for the temporary use of the securities. Collateral in the form of cash, government securities and letters of credit is required at a rate of 102% of the market value of the loaned securities and is held by a third party. As at December 31, 2009, the Company had $88,146 (2008: $103,266) in securities on loan. During the year ended December 31, 2009, the Company recorded a $24,186 unrealized loss on this collateral on its Statements of Operations (2008: unrealized loss $6,734).

Securities lending collateral reinvested is primarily comprised of corporate floating rate securities with an average reset period of 26.1 days (2008: 26.7 days). As at December 31, 2009, the securities lending collateral

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

reinvested by the Company in connection with its securities lending program was allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
Corporate	$	$ 14,123	$	$ 14,123
Agency		9,363		9,363
Asset-backed securities		6,153		6,153
Short-term investments	730	59,981		60,711
Total	$ 730	$ 89,620	$	$ 90,350

As at December 31, 2008, the securities lending collateral reinvested lending by the Company in connection with its securities program was allocated between Levels 1, 2 and 3 as follows:

	Level 1	Level 2	Level 3	Total
Corporate	$	$ 57,574	$	$ 57,574
Asset-backed securities		18,228		18,228
Short-term investments	7,390	15,762		23,152
Total	$ 7,390	$ 91,564	$	$ 98,954

The following table sets forth certain information regarding the investment ratings of the Company s securities lending collateral reinvested as at December 31, 2009 and 2008. Investment ratings are the lower of Moody s or Standard & Poor s rating for each investment security, presented in Standard & Poor s equivalent rating. For investments where Moody s and Standard & Poor s ratings are not available, Fitch ratings are used and presented in Standard & Poor s equivalent rating.

	December 31, 2009		December 31, 2008	
	Estimated Fair Value	% of Total	Estimated Fair Value	% of Total
AAA	$ 33,501	37.1%	$ 45,137	45.7%
AA+	12,011	13.3%	4,784	4.8%
AA	4,998	5.5%	12,789	12.9%
AA-	19,910	22.0%	20,035	20.2%

A+	9,999	11.1%	4,947	5.0%
A	9,006	10.0%	3,782	3.8%
NR	195	0.2%	90	0.1%
	89,620	99.2%	91,564	92.5%
NR Cash(1)	730	0.8%	7,390	7.5%
Total	$ 90,350	100.0%	$ 98,954	100.0%

(1) This amount relates to cash and is therefore not a rated security.

The amortized cost and estimated fair value amounts for securities lending collateral reinvested held at December 31, 2009 and 2008 are shown by contractual maturity below. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

	December 31, 2009		December 31, 2008	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due in one year or less	$ 68,895	$ 70,074	$ 24,390	$ 23,152
Due after one year through five years	21,211	20,276	81,298	75,802
Total	$ 90,106	$ 90,350	$ 105,688	$ 98,954

8. Premiums receivable

Premiums receivable are composed of premiums in course of collection, net of commissions and brokerage, and premiums accrued but unbilled, net of commissions and brokerage. The following is a breakdown of the components of receivables at December 31, 2009 and 2008:

	Premiums in Course of Collection	Premiums Accrued But Unbilled	Total
Balance as at December 31, 2008	$ 160,455	$ 247,804	$ 408,259
Change during 2009	83,475	59,882	143,357
Balance as at December 31, 2009	243,930	307,686	551,616
Balance as at December 31, 2007	147,923	253,318	401,241
Change during 2008	12,532	(5,514)	7,018
Balance as at December 31, 2008	160,455	247,804	408,259

9. Reserve for losses and loss expenses

Reserves for losses and loss expenses are based in part upon the estimation of case losses reported from brokers, insureds and ceding companies. The Company also uses statistical and actuarial methods to estimate ultimate expected losses and loss expenses. The period of time from the occurrence of a loss, the reporting of a loss to the Company and the settlement of the Company s liability may be several months or years. During this period, additional facts and trends may be revealed. As these factors become apparent, case reserves will be adjusted, sometimes requiring an increase or decrease in the overall reserves of the Company, and at other times requiring a reallocation of incurred but not reported reserves to specific case reserves. These estimates are reviewed regularly, and such adjustments, if any,

are reflected in earnings in the period in which they become known. While management believes that it has made a reasonable estimate of ultimate losses, there can be no assurances that ultimate losses and loss expenses will not exceed the total reserves.

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

The following table represents an analysis of paid and unpaid losses and loss expenses incurred and a reconciliation of the beginning and ending unpaid loss expenses for the years ended December 31, 2009, 2008 and 2007:

	Years Ended		
	December 31, 2009	December 31, 2008	December 31, 2007
Reserve for losses and loss expenses, beginning of period	$ 1,305,303	$ 926,117	$ 77,363
Losses and loss expenses recoverable	(208,796)	(134,404)	
Net reserves for losses and loss expenses, beginning of period	1,096,507	791,713	77,363
Net loss reserves acquired in purchase of IPC	304,957		
Net loss reserves acquired in purchase of Talbot			588,068
Increase (decrease) in net losses and loss expenses incurred in respect of losses occurring in:			
Current year	625,810	841,856	351,850
Prior years	(102,053)	(69,702)	(67,857)
Total incurred losses and loss expenses	523,757	772,154	283,993
Less net losses and loss expenses paid in respect of losses occurring in:			
Current year	(122,351)	(184,430)	(68,169)
Prior years	(385,084)	(222,039)	(88,703)
Total net paid losses	(507,435)	(406,469)	(156,872)
Foreign exchange	22,583	(60,891)	(839)
Net reserve for losses and loss expenses, end of period	1,440,369	1,096,507	791,713
Losses and loss expenses recoverable	181,765	208,796	134,404
Reserve for losses and loss expenses, end of period	$ 1,622,134	$ 1,305,303	$ 926,117

Incurred losses and loss adjustment expenses comprise:

	Years Ended		
	December 31, 2009	December 31, 2008	December 31, 2007
Gross losses and loss adjustment expenses	$ 598,877	$ 907,254	$ 276,541
Reinsurance recoverable	(75,120)	(135,100)	7,452

Total incurred losses and loss adjustment expenses	$ 523,757	$ 772,154	$ 283,993

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

The December 31, 2009 and 2008 gross reserves balance comprises reserves for reported claims of $831,325 and $707,717, respectively, and reserves for claims incurred but not reported of $790,809 and $597,586, respectively. The net favorable development on prior years by segment and line of business is as follows:

	Year Ended December 31, 2009			
	Property	**Marine**	**Specialty**	**Total**
Validus Re	$ (65,109)	$ 19,628	$ (7,491)	$ (52,972)
Talbot	(27,630)	(15,306)	(6,145)	(49,081)
Net favorable development	$ (92,739)	$ 4,322	$ (13,636)	$ (102,053)

The amount recorded represents management s best estimate of expected losses and loss expenses on premiums earned. Favorable loss development on prior years totaled $102,053. For Validus Re, the property lines experienced $65,109 of favorable development primarily due to the reclassification of losses from onshore energy exposures during the 2007 California wildfires to the marine line and reduced loss estimates for Hurricane Ike, the June 2008 Midwest flood event and October 2007 Peruvian mining loss, as well as lower than expected claim development elsewhere. The marine lines experienced $19,628 of adverse development primarily due to the reclassification from the property line and increased loss estimates for Hurricanes Ike and Gustav. For Talbot, the property lines experienced $27,630 of favorable loss development primarily due to lower than expected claims development together with a favorable development relating to Hurricane Katrina. The marine lines experienced $15,306 of favorable development due to continued low claims activity and reduced provisions for late reported claims in the more developed underwriting years of the marine liabilities line.

	Year Ended December 31, 2008			
	Property	**Marine**	**Specialty**	**Total**
Validus Re	$ (17,573)	$ 4,119	$ (1,596)	$ (15,050)
Talbot	(5,868)	(16,604)	(32,180)	(54,652)
Net favorable development	$ (23,441)	$ (12,485)	$ (33,776)	$ (69,702)

The amount recorded represents management s best estimate of expected losses and loss expenses on premiums earned. Favorable loss development on prior years totaled $69,702. For Validus Re, the property line experienced favorable development of $17,573 due primarily to favorable development on the 2007 UK floods, Australian storm losses, and several other smaller events. For Talbot, the marine line experienced favorable development of $16,604 due primarily to low claims activity in the cargo and hull classes in the 2006 and prior underwriting years. For the year ended December 31, 2008, the specialty lines experienced favorable development of $32,180, due primarily to a reduction in losses in the political violence, political risk, marine and aviation war, and aviation treaty lines due to

continued low claims activity and reduced provisions for late reported claims in the more developed underwriting years of the financial institutions line.

	Year Ended December 31, 2007			
	Property	**Marine**	**Specialty**	**Total**
Validus Re	$ (13,279)	$ (2,036)	$ (1,942)	$ (17,257)
Talbot	(5,958)	(7,037)	(37,605)	(50,600)
Net favorable development	$ (19,237)	$ (9,073)	$ (39,547)	$ (67,857)

The amount recorded represents management s best estimate of expected losses and loss expenses on premiums earned. Favorable loss development on prior years totaled $67,857 and was experienced in all lines of business. Favorable development at Validus Re was primarily related to better than expected loss experience on the 2006 underwriting year. Favorable development at Talbot resulted from better than expected loss experience in

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

the period post acquisition on the 2005 and prior underwriting years, including the financial institutions, marine liabilities and war accounts.

10. Accounts payable and accrued expenses

The following are components of accounts payable and accrued expenses:

	December 31, 2009	December 31, 2008
Amounts due to third party funds at Lloyd s providers	$ 17,746	$ 32,407
Amounts due to brokers	12,963	14,747
Interest accruals		1,274
Trade and compensation payables	97,100	25,756
Total	$ 127,809	$ 74,184

11. Reinsurance

The Company enters into reinsurance and retrocession agreements in order to mitigate its accumulation of loss, reduce its liability on individual risks, enable it to underwrite policies with higher limits, and increase its aggregate capacity. The cession of insurance and reinsurance does not legally discharge the Company from its primary liability for the full amount of the policies, and the Company is required to pay the loss and bear collection risk if the reinsurer fails to meet its obligations under the reinsurance or retrocession agreement. Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying liabilities.

a) Effects of reinsurance on premiums written and earned

The effects of reinsurance on premiums written and earned for the years ended December 31, 2009, 2008 and 2007 are as follows:

	Year Ended December 31, 2009						
	Validus Re		Talbot			Total	
	Written	Earned	Written	Earned	Elimination	Written	Earned
Direct	$	$	$ 459,771	$ 427,280	$	$ 459,771	$ 427,280
Assumed	768,084	880,434	460,135	382,535	(66,749)	1,161,470	1,262,969
Ceded	(95,446)	(84,884)	(204,186)	(155,788)	66,749	(232,883)	(240,672)
Total	$ 672,638	$ 795,550	$ 715,720	$ 654,027	$	$ 1,388,358	$ 1,449,577

	Year Ended December 31, 2008						
	Validus Re		Talbot			Total	
	Written	Earned	Written	Earned	Elimination	Written	Earned
Direct	$	$	$ 393,003	$ 389,389	$	$ 393,003	$ 389,389
Assumed	687,771	715,253	315,993	299,291	(34,283)	969,481	1,014,544
Ceded	(62,933)	(61,722)	(95,510)	(85,693)	34,283	(124,160)	(147,415)
Total	$ 624,838	$ 653,531	$ 613,486	$ 602,987	$	$ 1,238,324	$ 1,256,518

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Year Ended December 31, 2007						
	Validus Re		Talbot			Total	
	Written	Earned	Written	Earned	Elimination	Written	Earned
Direct	$	$	$ 192,186	$ 195,141	$	$ 192,186	$ 195,141
Assumed	702,098	621,330	94,353	148,509		796,451	769,839
Ceded	(68,842)	(62,301)	(1,368)	(44,600)		(70,210)	(106,901)
Total	$ 633,256	$ 559,029	$ 285,171	$ 299,050	$	$ 918,427	$ 858,079

b) Credit risk

The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- or better rated by Standard & Poor s or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. At December 31, 2009, 99.3% of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) were from reinsurers rated A- or better or from reinsurers posting full collateral and included $99,587 of IBNR recoverable (2008: $71,580). Reinsurance recoverables by reinsurer are as follows:

	December 31, 2009		December 31, 2008	
	Reinsurance Recoverable	% of Total	Reinsurance Recoverable	% of Total
Top 10 reinsurers	$ 170,810	86.9%	198,403	94.4%
Other reinsurers balances > $1 million	19,818	10.1%	8,987	4.3%
Other reinsurers balances < $1 million	5,919	3.0%	2,794	1.3%
Total	$ 196,547	100.0%	210,184	100.0%

		December 31, 2009	
Top 10 Reinsurers	**Rating**	**Reinsurance Recoverable**	**% of Total**
Fully collateralized reinsurers	NR	$ 50,840	29.8%
Lloyd s Syndicates	A+	33,103	19.4%
Munich Re	AA−	19,921	11.7%
Hannover Re	AA−	13,427	7.8%

Aspen	A	11,417	6.7%
Allianz	AA	9,645	5.6%
Swiss Re	A+	8,995	5.3%
Transatlantic Re	A+	8,804	5.1%
Brit Insurance Limited	A	8,159	4.8%
Platinum Underwriters	A	6,499	3.8%
Total		$ 170,810	100.0%

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

		December 31, 2008	
Top 10 Reinsurers	**Rating**	**Reinsurance Recoverable**	**% of Total**
Fully collateralized reinsurers	NR	$ 83,511	41.9%
Hannover Re	AA-	32,855	16.6%
Lloyd s Syndicates	A+	25,533	12.9%
Allianz	AA	14,988	7.6%
Swiss Re	AA-	13,207	6.7%
Munich Re	AA-	12,813	6.5%
Aspen	A	6,040	3.0%
Platinum Underwriters	A	3,270	1.6%
Transatlantic Re	A+	3,096	1.6%
Axa	AA	3,090	1.6%
Total		$ 198,403	100.0%

At December 31, 2009 and 2008, the provision for uncollectible reinsurance relating to losses recoverable was $3,477 and $3,228, respectively. To estimate the provision for uncollectible reinsurance recoverable, the reinsurance recoverable must first be allocated to applicable reinsurers. This determination is based on a process rather than an estimate, although an element of judgment must be applied. As part of this process, ceded IBNR is allocated by reinsurer. Of the $196,547 reinsurance recoverable at December 31, 2009, $50,840 was fully collateralized (2008: $83,511).

The Company uses a default analysis to estimate uncollectible reinsurance. The primary components of the default analysis are reinsurance recoverable balances by reinsurer and default factors used to determine the portion of a reinsurer s balance deemed to be uncollectible. Default factors require considerable judgment and are determined using the current rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions.

(c) Collateralized quota share retrocession treaties

On December 22, 2007, Validus Re entered into a collateralized retrocessional reinsurance agreement with an unaffiliated third party whereby the Company cedes certain business underwritten in the marine offshore energy lines. For the year ended December 31, 2009 and 2008 Validus Re ceded $470 and $19,978 of premiums written through this agreement, respectively. The earned portions of premiums ceded for the year ended December 31, 2009 and 2008 were $650 and $19,798, respectively.

12. Share capital

a) Authorized and issued

The Company s authorized share capital is 571,428,571 voting and non-voting shares with a par value of $0.175 each. The holders of common voting shares are entitled to receive dividends and are allocated one vote per share, provided that, if the controlled shares of any shareholder or group of related shareholders constitute more than 9.09 percent of the outstanding common shares of the Company, their voting power will be reduced to 9.09 percent.

On September 4, 2009, the Company acquired all of the outstanding shares of IPC from a group of institutional and other investors. Pursuant to the Amalgamation Agreement, the Company acquired all of IPC s outstanding common shares in exchange for the Company s common shares and cash. The Company issued 54,556,762

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

common shares (and 21,506 restricted share awards) valued at $24.10 per share as partial consideration for the acquisition.

The Company may from time to time repurchase its securities, including common shares and Junior Subordinated Deferrable Debentures. In November 2009, the Board of Directors of the Company authorized an initial $400.0 million share repurchase program. On February 17, 2010, the Board of Directors of the Company authorized the Company to return up to $750.0 million to shareholders. To this end, the Board of Directors expanded the Company s share repurchase program authorizing the Company to repurchase up to $750.0 million of common shares. This amount is in addition to, and in excess of, the $135.5 million of common shares purchased by the Company through February 17, 2010 under its previously authorized $400.0 million share repurchase program announced in November 2009. The Company expects the purchases to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company s capital position relative to internal and rating agency targets, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of Directors at any time.

The following table is a summary of the common shares issued and outstanding:

	Common Shares
Common shares outstanding, December 31, 2008	75,624,697
IPC acquisition issuance	54,556,762
Restricted share awards vested	423,746
Restricted share units vested	360,383
Employee seller shares vested	248,085
Options exercised	164,834
Warrants exercised	237,842
Treasury Stock	(3,156,871)
Common shares outstanding, December 31, 2009	128,459,478

	Common Shares
Common shares outstanding, December 31, 2007	74,199,836
Restricted share awards vested	777,953
Employee seller shares vested	515,103
Options exercised	112,825
Warrants exercised	18,980
Common shares outstanding, December 31, 2008	75,624,697

b) Warrants

In consideration for the founder s and sponsoring investors commitments, the Company had issued as at December 31, 2009 warrants to the founding shareholder and sponsoring investors to purchase, in the aggregate, up to 7,952,138 (December 31, 2008: 8,680,148) common shares. Of those issued, 2,090,815 (December 31, 2008: 2,090,815) of the warrants are to purchase non-voting common shares. No further warrants are anticipated to be issued.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

In July 2007, in connection with the acquisition of Talbot, additional warrants of 256,409 were issued to the founding shareholder and sponsoring investors to maintain the allocation at 12.0% of the fully diluted shares of the Company pursuant to the anti-dilution provision of the warrants.

The warrants may be settled using either the physical settlement or net-share settlement methods. The warrants have been classified as equity instruments, in accordance with U.S. GAAP guidance for *Derivatives and Hedging, Contracts in Entity s own Equity*. The warrants were initially measured at fair value and recorded in additional paid-in capital. The additional warrants issued for the period ended December 31, 2007 increased the fair value to $78,060 with the increase of $2,893 expensed.

The fair value of each warrant issued was estimated on the date of grant using the Black-Scholes option-pricing model. The volatility assumption used, of approximately 30.0%, was derived from the historical volatility of the share price of a range of publicly-traded Bermuda reinsurance companies of a similar business nature to the Company. No allowance was made for any potential illiquidity associated with the private trading of the Company s shares. The other assumptions in the warrant-pricing model were as follows:

	July 24, 2007 Issuance	February 3, 2006 Issuance	December 15, 2005 Issuance
Warrants issued	256,409	8,593	8,446,727
Average strike price	$ 20.00	$ 17.50	$ 17.50
Volatility	30.0%	30.0%	30.0%
Risk-free rate	4.5%	4.5%	4.5%
Expected dividend yield	0.0%	0.0%	0.0%
Expected term (years)	8	10	10
Calculated fair-value per warrant	$ 11.28	$ 8.89	$ 8.89

During the year ended December 31, 2009, 728,010 (2008: 31,581) warrants were exercised which resulted in the net share issuance of 237,842 (2008: 18,980) common shares.

c) Deferred share units

Under the terms of the Company s Director Stock Compensation Plan, non-management directors may elect to receive their director fees in deferred share units rather than cash. The number of share units distributed in case of election under the plan is equal to the amount of the annual retainer fee otherwise payable to the director on such payment date divided by 100% of the fair market value of a share on such payment date. Additional deferred share units are issued in lieu of dividends that accrue on these deferred share units. The total outstanding deferred share units at December 31, 2009 were 4,577 (December 31, 2008: 4,430).

d) Dividends

On February 12, 2009, the Company announced a quarterly cash dividend of $0.20 (2008: $0.20) per common share and $0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on March 31, 2009 to holders of record on March 16, 2009.

On May 4, 2009, the Company announced a quarterly cash dividend of $0.20 (2008: $0.20) per common share and $0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on June 30, 2009 to holders of record on June 15, 2009.

On July 28, 2009, the Company announced a quarterly cash dividend of $0.20 (2008: $0.20) per common share and $0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on September 30, 2009 to holders of record on August 20, 2009.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

On November 4, 2009, the Company announced a quarterly cash dividend of $0.20 (2008: $0.20) per common share and $0.20 per common share equivalent for which each outstanding warrant is then exercisable, payable on December 31, 2009 to holders of record on December 15, 2009.

13. Retirement plans

The Company s provides pension benefits to eligible employees through various plans which are managed externally and sponsored by the Company. All pension plans are structured as defined contribution retirement plans. The Company s contributions are expensed as incurred. The Company s expenses for its defined contribution retirement plans for the years ended December 31, 2009, 2008 and 2007 were $5,606, $4,732 and $2,442, respectively.

14. Stock plans

a) Long-term incentive plans

The Company s Long Term Incentive Plan (LTIP) provides for grants to employees of any option, stock appreciation right (SAR), restricted share, restricted share unit, performance share, performance unit, dividend equivalent or other share-based awards. The total number of shares reserved for issuance under the LTIP is 13,126,896 shares. The LTIP is administered by the Compensation Committee of the Board of Directors. No SARs or performance shares have been granted to date. Grant prices are established at the estimated fair market value of the Company s common shares at the date of grant.

In accordance with the terms of the Amalgamation Agreement, the IPC 2007 Stock Incentive Plan (the IPC Plan) was assumed by Validus on the acquisition date and this resulted in shares underlying the following awards to be converted into the Company s awards: 21,603 restricted share awards, 218,804 restricted share units, 199,315 performance share units and 650,557 fully exercisable non-qualified options.

i. Options

Options may be exercised for voting common shares upon vesting. Options have a life of 10 years and vest either ratably or at the end of the required service period from the date of grant. All options granted in 2009 were as a result of the Amalgamation Agreement. Grant prices are established at the estimated fair value of the Company s common shares at the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used for all grants to date:

Year	Weighted Average Risk Free Interest Rate	Weighted Average Dividend Yield	Expected Life (Years)	Expected Volatility

2007 and prior years	4.5%	0.0%	7	30.0%
2008	3.5%	3.2%	7	30.0%
2009	3.9%	3.7%	2	34.6%

Expected volatility is based on stock price volatility of comparable publicly-traded companies. The Company uses the simplified method consistent with U.S. GAAP authoritative guidance on stock compensation expenses to estimate expected lives for options granted during the period as historical exercise data is not available and the options met the requirement as set out in the bulletin.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Share compensation expenses of $4,158 were recorded for the year ended December 31, 2009 (2008: $4,251, 2007: $3,944). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to the options for the year ended December 31, 2009 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2008	2,799,938	$ 7.57	$ 18.23
Options granted	650,557	3.42	27.27
Options exercised	(164,834)	5.80	21.01
Options forfeited	(7,646)	10.30	20.39
Options outstanding, December 31, 2009	3,278,015	$ 6.83	$ 19.88
Options exercisable at December 31, 2009	2,468,944	$ 5.83	$ 20.10

Activity with respect to options for the year ended December 31, 2008 was as follows:

	Options	Weighted Average Grant Date Fair Value	Weighted Average Grant Date Exercise Price
Options outstanding, December 31, 2007	2,761,176	$ 7.61	$ 17.82
Options granted	164,166	6.73	24.73
Options exercised	(112,825)	7.36	17.57
Options forfeited	(12,579)	8.56	18.69
Options outstanding, December 31, 2008	2,799,938	$ 7.57	$ 18.23
Options exercisable at December 31, 2008	1,396,353	$ 7.46	$ 17.63

Activity with respect to options for the year ended December 31, 2007 was as follows:

Weighted Average	Weighted Average

	Options	Grant Date Fair Value	Grant Date Exercise Price
Options outstanding, December 31, 2006	2,568,894	$ 7.35	$ 17.50
Options granted	206,464	10.88	21.44
Options exercised			
Options forfeited	(14,182)	10.30	20.39
Options outstanding, December 31, 2007	2,761,176	$ 7.61	$ 17.82
Options exercisable at December 31, 2007	908,361	$ 7.36	$ 17.52

At December 31, 2009, there were $4,713 (2008: $9,139, 2007: $12,340) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.3 years (2008: 2.2 years; 2007: 3.1 years).

ii. Restricted share awards

Restricted share awards vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $16,775 were recorded for the year ended

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

December 31, 2009 (2008: $15,060; 2007: $7,083). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested restricted share awards for the year ended December 31, 2009 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2008	2,307,402	$ 22.73
Restricted share awards granted	772,672	24.68
Restricted share awards vested	(512,847)	22.11
Restricted share awards forfeited	(41,269)	24.05
Restricted share awards outstanding, December 31, 2009	2,525,958	$ 23.43

Activity with respect to unvested restricted share awards for the period ended December 31, 2008 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2007	2,158,220	$ 20.44
Restricted share awards granted	1,007,083	24.09
Restricted share awards vested	(822,370)	18.55
Restricted share awards forfeited	(35,531)	21.87
Restricted share awards outstanding, December 31, 2008	2,307,402	$ 22.73

Activity with respect to unvested restricted share awards for the period ended December 31, 2007 was as follows:

	Restricted Share Awards	Weighted Average Grant Date Fair Value
Restricted share awards outstanding, December 31, 2006	733,964	$ 17.52

Restricted share awards granted	1,428,306		21.94
Restricted share awards vested			
Restricted share awards forfeited	(4,050)		20.39
Restricted share awards outstanding, December 31, 2007	2,158,220	$	20.44

At December 31, 2009, there were $38,395 (2008: $35,915; 2007: $25,116) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.8 years (2008: 3.2 years; 2007: 3.4 years).

iii. Restricted share units

Restricted share units under the LTIP vest either ratably or at the end of the required service period and contain certain restrictions for the vesting period, relating to, among other things, forfeiture in the event of termination of employment and transferability. Share compensation expenses of $5,513 were recorded for the year ended December 31, 2009 (2008: $43; 2007: $nil) related to restricted share units. The expenses represent

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested restricted share units for the year ended December 31, 2009 was as follows:

	Restricted Share Units		Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2008	11,853	$	25.28
Restricted share units granted	427,451		24.76
Restricted share units vested	(360,713)		24.76
Restricted share units forfeited			
Restricted share units outstanding, December 31, 2009	78,591	$	24.84

Activity with respect to unvested restricted share units for the year ended December 31, 2008 was as follows:

	Restricted Share Units		Weighted Average Grant Date Fair Value
Restricted share units outstanding, December 31, 2007		$	
Restricted share units granted	11,853		25.28
Restricted share units vested			
Restricted share units forfeited			
Restricted share units outstanding, December 31, 2008	11,853	$	25.28

At December 31, 2009, there were $578 (2008: $227; 2007: $nil) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 2.5 years (2008: 4.3 years; 2007: nil). Additional restricted share units are issued in lieu of accrued dividends from unvested restricted share units. As at December 31, 2009, unvested restricted share units issued in lieu of dividends were 858 (December 31, 2008: 410).

iv. Performance share units

The Performance Share Units (PSUs) contained both a market and performance based component. On November 4, 2009, it was resolved by the Board of Directors that as the performance factor of the award had been removed, the

performance share units would be converted into restricted share units. The vesting terms, rights and restrictions of the awards remain unchanged. During the year ended December 31, 2009, 199,315 PSUs were granted, of these, 173,591 vested during the year ended December 31, 2009.

b) Employee seller shares

Pursuant to the Share Sale Agreement for the purchase of Talbot, the Company issued 1,209,741 restricted shares to Talbot employees (the employee seller shares). Upon consummation of the acquisition, the employee seller shares were validly issued, fully-paid and non-assessable and entitled to vote and participate in distributions and dividends in accordance with the Company s Bye-laws. However, the employee seller shares are subject to a restricted period during which they are subject to forfeiture (as implemented by repurchase by the Company for a nominal amount). Forfeiture of employee seller shares will generally occur in the event that any such Talbot employee s employment terminates, with certain exceptions, prior to the end of the restricted period. The restricted period will end for 25% of the employee seller shares on each anniversary of the closing date of July 2, 2007 for all Talbot employees other than Talbot s Chairman, such that after four years forfeiture will be completely extinguished.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Share compensation expenses of $6,022 were recorded for the year ended December 31, 2009 (2008: $7,743; 2007: $5,162). The expenses represent the proportionate accrual of the fair value of each grant based on the remaining vesting period. Activity with respect to unvested employee seller shares for the year ended December 31, 2009 was as follows:

	Employee Seller Shares	Weighted Average Grant Date Fair Value
Employee seller shares outstanding, December 31, 2008	663,375	$ 22.01
Employee seller shares granted		
Employee seller shares vested	(248,085)	22.01
Employee seller shares forfeited	(4,623)	22.01
Employee seller shares outstanding, December 31, 2009	410,667	$ 22.01

Activity with respect to unvested employee seller shares for the year ended December 31, 2008 was as follows:

	Employee Seller Shares	Weighted Average Grant Date Fair Value
Employee seller shares outstanding, December 31, 2007	1,209,741	$ 22.01
Employee seller shares granted		
Employee seller shares vested	(515,103)	22.01
Employee seller shares forfeited	(31,263)	22.01
Employee seller shares outstanding, December 31, 2008	663,375	$ 22.01

Activity with respect to unvested employee seller shares for the year ended December 31, 2007 was as follows:

	Employee Seller Shares	Weighted Average Grant Date Fair Value

Employee seller shares outstanding, December 31, 2006		$	
Employee seller shares granted	1,209,741		22.01
Employee seller shares vested			
Employee seller shares forfeited			
Employee seller shares outstanding, December 31, 2007	1,209,741	$	22.01

At December 31, 2009, there were $6,135 (2008: $12,157; 2007: $18,852) of total unrecognized share compensation expenses that are expected to be recognized over a weighted-average period of 1.5 years (2008: 2.5 years; 2007: 3.1 years).

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

c) Total share compensation expense

Total share compensation expense includes $5,431 of IPC-related termination expenses which have been included as part of the gain on bargain purchase, net of expenses in the Statements of Operations. The breakdown of share compensation expense is as follows:

		Years Ended	
	December 31, 2009	December 31, 2008	December 31, 2007
Options	$ 4,158	$ 4,251	$ 3,944
Restricted share awards	16,775	15,060	7,083
Restricted share units	5,513	43	
Employee seller shares	6,022	7,743	5,162
Total	$ 32,468	$ 27,097	$ 16,189

15. Debt and financing arrangements

a) Financing structure and finance expenses

The financing structure at December 31, 2009 was:

	Commitment	Outstanding(1)	Drawn
9.069% Junior Subordinated Deferrable Debentures	$ 150,000	$ 150,000	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	200,000	139,800	139,800
$200,000 unsecured letter of credit facility	200,000		
$500,000 secured letter of credit facility	500,000	225,823	
Talbot FAL facility(2)	25,000	25,000	
$250,000 IPC Syndicated Facility	16,537	16,537	
$350,000 IPC Bi-Lateral Facility	350,000	96,047	
Total	$ 1,441,537	$ 653,207	$ 289,800

The financing structure at December 31, 2008 was:

	Commitment	Outstanding(1)	Drawn

9.069% Junior Subordinated Deferrable Debentures	$ 150,000	$ 150,000	$ 150,000
8.480% Junior Subordinated Deferrable Debentures	200,000	154,300	154,300
$200,000 unsecured letter of credit facility	200,000		
$500,000 secured letter of credit facility	500,000	199,186	
Talbot FAL facility(2)	100,000	100,000	
Talbot third party FAL facility(2)	144,015	144,015	
Total	$ 1,294,015	$ 747,501	$ 304,300

(1) Indicates utilization of commitment amount, not drawn borrowings.

(2) Talbot operates in Lloyd s through a corporate member, Talbot 2002 Underwriting Capital Ltd (T02), which is the sole participant in Syndicate 1183. Lloyd s sets T02 s required capital annually based on syndicate 1183 s business plan, rating environment, reserving environment together with input arising from Lloyd s discussions

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

with, inter alia, regulatory and rating agencies. Such capital, called Funds at Lloyd s (FAL), comprises: cash, investments and undrawn letters of credit provided by various banks.

Finance expenses consist of interest on our junior subordinated deferrable debentures, the amortization of debt offering costs, fees relating to our credit facilities and the costs of FAL as follows:

	Years Ended		
	December 31, 2009	December 31, 2008	December 31, 2007
9.069% Junior Subordinated Deferrable Debentures	$ 14,354	$ 14,354	$ 14,398
8.480% Junior Subordinated Deferrable Debentures	12,732	14,704	8,938
Credit facilities	2,319	910	2,332
Talbot letter of credit facilities	542	255	658
Talbot other interest		(186)	620
Talbot third party FAL facility	14,183	27,281	24,808
Total	$ 44,130	$ 57,318	$ 51,754

(b) Junior subordinated deferrable debentures

On June 15, 2006, the Company participated in a private placement of $150,000 of junior subordinated deferrable interest debentures due 2036 (the 9.069% Junior Subordinated Deferrable Debentures). The 9.069% Junior Subordinated Deferrable Debentures mature on June 15, 2036, are redeemable at the Company s option at par beginning June 15, 2011, and require quarterly interest payments by the Company to the holders of the 9.069% Junior Subordinated Deferrable Debentures. Interest will be payable at 9.069% per annum through June 15, 2011, and thereafter at a floating rate of three-month LIBOR plus 355 basis points, reset quarterly. The proceeds of $150,000 from the sale of the 9.069% Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, are being used by the Company to fund Validus Re segment operations and for general working capital purposes. Debt issuance costs of $3,750 were deferred as an asset and are amortized to income over the five year optional redemption period.

On June 21, 2007, the Company participated in a private placement of $200,000 of junior subordinated deferrable interest debentures due 2037 (the 8.480% Junior Subordinated Deferrable Debentures). The 8.480% Junior Subordinated Deferrable Debentures mature on June 15, 2037, are redeemable at the Company s option at par beginning June 15, 2012, and require quarterly interest payments by the Company to the holders of the 8.480% Junior Subordinated Deferrable Debentures. Interest will be payable at 8.480% per annum through June 15, 2012, and thereafter at a floating rate of three-month LIBOR plus 295 basis points, reset quarterly. The proceeds of $200,000 from the sale of the 8.480% Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, were used by the Company to fund the purchase of Talbot Holdings Ltd. Debt issuance costs of $2,000 were deferred as an asset and are amortized to income over the five year

optional redemption period.

On April 29, 2008, the Company repurchased from an unaffiliated financial institution $45,700 principal amount of its 8.480% Junior Subordinated Deferrable Debentures due 2037 at an aggregate price of $36,560, plus accrued and unpaid interest of $474. The repurchase resulted in the recognition of a realized gain of $8,752 for the year ended December 31, 2008.

On December 1, 2009, the Company repurchased from an unaffiliated financial institution $14,500 principal amount of its 8.480% Junior Subordinated Deferrable Debentures due 2037 at an aggregated price of $9,933, plus accrued and unpaid interest of $246. The repurchase resulted in the recognition of a realized gain of $4,444 for the year ended December 31, 2009.

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Future expected payments of interest and principal on the Junior Subordinated Deferrable Debentures assuming that the Company exercises its call option at the earliest opportunity are as follows:

2010	$ 25,459
2011	168,657
2012	145,727
2013 and thereafter	
Total minimum future payments	$ 339,843

(c) Credit facilities

(i) $200,000 unsecured letter of credit facility and $500,000 letter of credit facility

On March 12, 2007, the Company entered into a $200,000 three-year unsecured facility, as subsequently amended on October 25, 2007 and September 4, 2009, which provides for letter of credit availability for Validus Re and our other subsidiaries and revolving credit availability for the Company (the Three Year Facility) (the full $200,000 of which is available for letters of credit and/or revolving loans), and a $500,000 five-year secured letter of credit facility, as subsequently amended on October 25, 2007 and September 4, 2009, which provides for letter of credit availability for Validus Re and our other subsidiaries (the Five Year Facility and together with the Three Year Facility, the Credit Facilities). The Credit Facilities were provided by a syndicate of commercial banks arranged by J.P. Morgan Securities Inc. and Deutsche Bank Securities Inc.

As amended, the Credit Facilities contain covenants that include, among other things, (i) the requirement that the Company initially maintain a minimum level of consolidated net worth of at least 70% of consolidated net worth as calculated using the pro forma balance sheet included in the definitive proxy statement relating to the IPC Acquisition and, commencing with the end of the fiscal quarter ending September 30, 2009 to be increased quarterly by an amount equal to 50% of our consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, (ii) the requirement that the Company maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00, and (iii) the requirement that Validus Re and any other material insurance subsidiaries maintain a financial strength rating by A.M. Best of not less than B++ (Fair). For purposes of covenant compliance (i) net worth is calculated with investments carried at amortized cost and (ii) consolidated total debt does not include the Company s junior subordinated deferrable debentures. The credit facilities also contain restrictions on our ability to pay dividends and other payments in respect of equity interests at any time that we are otherwise in default with respect to certain provisions under the credit facilities, make investments, incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others.

As of December 31, 2009, there was $225,823 in outstanding letters of credit under the Five Year Facility (December 31, 2008: $199,186) and $nil outstanding under the Three Year Facility (December 31, 2008: $nil).

On October 25, 2007, the Company entered into the First Amendment to the Credit Facilities to provide for, among other things, additional capacity to incur up to $100,000 under a new Funds at Lloyd s Letter of Credit Facility (as described below) to support underwriting capacity provided to Talbot 2002 Underwriting Ltd through Syndicate 1183 at Lloyd s of London for the 2008 and 2009 underwriting years of account. The amendment also modified certain provisions in the Credit Facilities in order to permit dividend payments on existing and future preferred and hybrid securities notwithstanding certain events of default.

On September 4, 2009, the Company entered into the Second Amendment to the Credit Facilities to provide for, among other things, the IPC Acquisition.

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

As of December 31, 2009 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Credit Facilities.

(ii) Talbot FAL facility

On November 28, 2007, Talbot entered into a $100,000 standby Letter of Credit facility (the Talbot FAL Facility) to provide Funds at Lloyd s for the 2008 and 2009 underwriting years of account; this facility is guaranteed by the Company and is secured against the assets of Validus Re. The Talbot FAL Facility was provided by a syndicate of commercial banks arranged by Lloyds TSB Bank plc and ING Bank N.V., London Branch.

On November 19, 2009, the Company entered into an Amendment and Restatement of the Talbot FAL Facility to reduce the commitment from $100,000 to $25,000, and to extend the support to the 2010 and 2011 underwriting years of account.

As amended, the Talbot FAL Facility contains affirmative covenants that include, among other things, (i) the requirement that we initially maintain a minimum level of consolidated net worth of at least 70% of consolidated net worth as calculated using the pro forma balance sheet included in the definitive proxy statement relating to the IPC Acquisition, and commencing with the end of the fiscal quarter ending September 30, 2009 to be increased quarterly by an amount equal to 50% of our consolidated net income (if positive) for such quarter plus 50% of any net proceeds received from any issuance of common shares during such quarter, and (ii) the requirement that we maintain at all times a consolidated total debt to consolidated total capitalization ratio not greater than 0.35:1.00.

The Talbot FAL Facility also contains restrictions on our ability to incur debt at our subsidiaries, incur liens, sell assets and merge or consolidate with others. Other than in respect of existing and future preferred and hybrid securities, the payment of dividends and other payments in respect of equity interests are not permitted at any time that we are in default with respect to certain provisions under the Credit Facilities. As of December 31, 2009 the Company had $25,000 in outstanding letters of credit under this facility.

As of December 31, 2009 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the Talbot FAL Facility.

(iii) IPC Syndicated Facility and IPC Bi-Lateral Facility

IPC obtained letters of credit through the IPC Syndicated Facility and the IPC Bi-Lateral Facility (the IPC Facilities). In July, 2009, certain terms of these facilities were amended including suspending IPCRe s ability to increase existing letters of credit or to issue new letters of credit. With respect to the IPC Syndicated Facility, IPCRe provides the banks security by depositing cash in the amount of 103% of the aggregate letters of credit outstanding. Effective December 31, 2009, there were outstanding letters of credit of $112,584 of which $16,537 were issued from the IPC Syndicated Facility with $96,047 issued from the IPC Bi-Lateral Facility.

As of December 31, 2009 and throughout the reporting periods presented, the Company was in compliance with all covenants and restrictions under the IPC Facilities.

(d) Funds at Lloyd s

Talbot s underwriting at Lloyd s is supported by Funds at Lloyd s (FAL) comprising: cash, investments and undrawn letters of credit provided by various banks on behalf of various companies and persons under reinsurance and other agreements. The FAL are provided in exchange for payment calculated principally by reference to the syndicate s results, as appropriate, when they are declared. The amounts of cash, investments and letters of credit at December 31, 2009 supporting the 2010 underwriting year amount to $452,000 all of which is provided by the Company.

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

16. Income taxes

The Company provides for income taxes based upon amounts reported in the financial statements and the provisions of currently enacted tax laws. The Company is registered in Bermuda and is subject to Bermuda law with respect to taxation. Under current Bermuda law, the Company is not taxed on any Bermuda income or capital gains taxes and has received an undertaking from the Bermuda Minister of Finance that, in the event of any Bermuda income or capital gains taxes being imposed, the Company will be exempt from those taxes until March 28, 2016.

The Company has subsidiaries based in the United Kingdom, United States and Canada that are subject to the tax laws of those countries. Under current law, these subsidiaries are taxed at the applicable corporate tax rates. Corporate income tax losses incurred in the United Kingdom can be carried forward, for application against future income, indefinitely.

		Years Ended		
		December 31, 2009	**December 31, 2008**	**December 31, 2007**
Income (loss) before tax	Bermuda	$ 892,425	$ 39,302	$ 396,467
Income (loss) before tax	United Kingdom	814	24,358	7,957
Income (loss) before tax	Canada	409	239	77
Income (loss) before tax	Total	$ 893,648	$ 63,899	$ 404,501

Income tax (benefit) expense is comprised of current and deferred tax. Income tax (benefit) expense is as follows:

	Years Ended		
	December 31, 2009	**December 31, 2008**	**December 31, 2007**
Current	$ (9)	$ (73)	$ 34
Deferred	(3,750)	10,861	1,471
Income tax (benefit) expense	$ (3,759)	$ 10,788	$ 1,505

The table below details the tax charge by jurisdiction:

	Years Ended		
	December 31, 2009	December 31, 2008	December 31, 2007
Expected tax provision at Bermuda Statutory Rate of 0%	$	$	$
Effect of taxable income generated in:			
United Kingdom	4,158	8,277	865
Canada	160	101	32
Other jurisdictions on deemed income arising from Lloyds operations	638	673	383
	4,956	9,051	1,280
Adjustments to prior period tax	(8,715)	1,737	225
Income tax (benefit) expense	$ (3,759)	$ 10,788	$ 1,505

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Ears Ended	
	December 31, 2009	December 31, 2008
Deferred tax asset		
UK tax losses carried forward	$ (8,627)	$ (32,251)
Timing differences	(2,689)	(3,136)
Deferred tax asset, gross of valuation allowance	(11,316)	(35,387)
Valuation allowance		
Deferred tax asset, net of valuation allowance	(11,316)	(35,387)
Deferred tax liability		
Underwriting profit taxable in future periods	34,731	55,819
Revenue to be taxed in future periods	1,093	1,347
Deferred tax liability	35,824	57,166
Net deferred tax liability	$ 24,508	$ 21,779

Net deferred tax assets and liabilities represent the tax effect of temporary differences between the value of assets and liabilities for financial statement purposes and such values as measured by UK tax laws and regulations.

In assessing whether deferred tax assets can be realized, management considers whether it is more likely than not that part, or all, of the deferred tax asset will not be realized. The realization of deferred tax assets is dependent upon the generation of future taxable income in the period during which those temporary differences and operating losses become deductible. Management considers the reversal of the deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. The amount of the deferred tax asset considered realizable could be reduced in the future if estimates of future taxable income are reduced.

As of December 31, 2009, net operating loss carry forwards in the U.K. were approximately $30,812 (inclusive of cumulative currency translation adjustments) and have no expiration.

17. Commitments and contingencies

a) Concentrations of credit risk

The Company s investments are managed following prudent standards of diversification. The Company attempts to limit its credit exposure by purchasing high quality fixed income investments to maintain an average portfolio credit quality of AA- or higher with mortgage and commercial mortgage-backed issues having an aggregate weighted

average credit quality of triple-A. In addition, the Company limits its exposure to any single issuer to 3% or less, excluding treasury and agency securities. The minimum credit rating of any security purchased is A-/A3 and where investments are downgraded, the Company permits a holding of up to 2% in aggregate market value, or 10% with written pre-authorization. At December 31, 2009, 3.2% of the portfolio had a split rating below A-/A3 and the Company did not have an aggregate exposure to any single issuer of more than 1.5% of its investment portfolio, other than with respect to government and agency securities.

The Company underwrites a significant amount through brokers and credit risk exists should any of these brokers be unable to fulfill their contractual obligations with respect to the payments of insurance and reinsurance balances to the Company. These companies are large, well established, and there are no indications that any of them are financially troubled. No other broker and no one insured or reinsured accounted for more than 10% of gross premiums written for the periods mentioned.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

The following table shows the percentage of gross premiums written by broker for the years ended December 31, 2009, 2008 and 2007:

	Years Ended		
	December 31, 2009	December 31, 2008	December 31, 2007
Marsh & McLennan	23.3%	21.9%	32.1%
Willis Group Holdings Ltd.	14.0%	13.8%	17.4%
Aon Benfield Group Ltd.	25.7%	25.5%	26.1%

b) Employment agreements

The Company has entered into employment agreements with certain individuals that provide for option awards, executive benefits and severance payments under certain circumstances.

c) Operating leases

The Company leases office space and office equipment under operating leases. Total rent expense with respect to these operating leases for the year ended December 31, 2009 was approximately $4,308 (2008: $2,314, 2007: $1,541). Future minimum lease commitments are as follows:

2010	$ 2,787
2011	2,516
2012	2,497
2013	4,382
2014 and there after	31,579
	$ 43,761

d) Funds at Lloyd s

Talbot operates in Lloyd s through a corporate member, Talbot 2002 Underwriting Capital Ltd (T02), which is the sole participant in Syndicate 1183. Lloyd s sets T02 s required capital annually based on syndicate 1183 s business plan, rating environment, reserving environment together with input arising from Lloyd s discussions with, inter alia, regulatory and rating agencies. Such capital, called Funds at Lloyd s (FAL), comprises: cash, investments and undrawn letters of credit provided by various banks. The amounts of cash, investments and letters of credit at December 31, 2009 amount to $452,000 (December 31, 2008: $351,394) of which $25,000 is provided under the Talbot FAL Facility (December 31, 2008: $100,000).

The Talbot third party FAL Facility support each year of account as follows:

	2009 Underwriting Year	2008 Underwriting Year	2007 Underwriting Year
2007 only	$	$	$ 121,515
Total	$	$	$ 121,515

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

The FAL are provided for each year of account as follows:

	2010 Underwriting Year	2009 Underwriting Year	2008 Underwriting Year
Talbot third party FAL Facility	$	$	$
Talbot FAL Facility	25,000	25,000	25,000
Group funds	427,000	326,394	291,483
Total	$ 452,000	$ 351,394	$ 316,483

The amounts which the Company provides as FAL are not available for distribution to the Company for the payment of dividends. Talbot s corporate member may also be required to maintain funds under the control of Lloyd s in excess of its capital requirement and such funds also may not be available for distribution to the Company for the payment of dividends.

The amounts provided under the Talbot FAL facility would become a liability of the group in the event of the syndicate declaring a loss at a level which would call on this arrangement.

e) National Indemnity Corporation (NIC) capital agreement

The Talbot group had entered into an agreement with NIC whereby NIC, in the past, provided letters of credit to support the group s underwriting. Part of that agreement stipulated that part of the reinsurance to close premium in respect of the 2006 year of account be made available to NIC at NIC s option as a limited quota share agreement. The portion that shall be offered is the amount of support provided by NIC for the 2006 year of account divided by the overall support provided for that year. During the year, NIC exercised their option and an amount of $2.183 million was accrued at December 31, 2001.

f) Lloyd s central fund

Whenever a member of Lloyd s is unable to pay its debts to policyholders, such debts may be payable by the Lloyd s central fund. If Lloyd s determines that the central fund needs to be increased, it has the power to assess premium levies on current Lloyd s members up to 3% of a member s underwriting capacity in any one year. The Company does not believe that any assessment is likely in the foreseeable future and has not provided any allowance for such an assessment. However, based on the Company s 2009 estimated premium income at Lloyd s of £410,000, the December 31, 2009 exchange rate of £1 equals $1.5928 and assuming the maximum 3% assessment the Company would be assessed approximately $19,591.

18. Related party transactions

The transactions listed below are classified as related party transactions as each counterparty has either a direct or indirect shareholding in the Company.

a) The Company entered into an agreement on December 8, 2005 with BlackRock Financial Management, Inc. (BlackRock) under which BlackRock was appointed as an investment manager of part of Company s investment portfolio. Merrill Lynch is a shareholder of Blackrock. Merrill Lynch entities, which are now wholly-owned subsidiaries of Bank of America Corp, own 5,714,285 non-voting shares and 658,614 voting shares in the Company, hold warrants to purchase 1,067,187 shares and have an employee on the Company s Board of Directors who does not receive compensation from the Company. 486,405 of Merrill Lynch s warrants are convertible to non-voting shares. Under the terms of the investment manager agreement with Blackrock, the Company incurred expenses of $2,036 during the year ended December 31, 2009 (2008: $2,243; 2007: $1,781), of which $1,229 was included in accounts payable and accrued expenses at December 31, 2009 (2008: $584).

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

b) The Company entered into an agreement on December 8, 2005 with Goldman Sachs Asset Management and its affiliates (GSAM) under which GSAM was appointed as an investment manager of part of the Company s investment portfolio. Goldman Sachs entities, own 14,057,137 non-voting shares in the Company, hold warrants to purchase 1,604,410 non-voting shares, and have an employee on the Company s Board of Directors who does not receive compensation from the Company. The Company incurred expenses of $1,280 during the year ended December 31, 2009 (2008: $1,404; 2007: $858), of which $371 was included in accounts payable and accrued expenses at December 31, 2009 (2008: $641).

c) Vestar Capital entities, which own 8,571,427 shares in the Company, hold warrants to purchase 972,810 shares, and have an employee on the Company s Board of Directors who does not receive compensation from the Company were during 2009, shareholders of PARIS RE Holdings Limited (Paris Re). Pursuant to reinsurance agreements with Paris Re, the Company recognized gross premiums written of $5,176 during the year ended December 31, 2009 (2008: $6,807; 2007: $1,900), of which $3,950 was included in premiums receivable at December 31, 2009 (2008: $4,412). The earned premium adjustments of $5,918 was recorded for the year ended December 31, 2009 (2008: $4,457; 2007: $950).

d) Aquiline Capital Partners, LLC and its related companies (Aquiline), which own 6,886,342 shares in the Company, hold warrants to purchase 3,193,865 shares, and have three employees on the Board of Directors who do not receive compensation from the Company, are shareholders of Group Ark Insurance Holdings Ltd. (Group Ark). Pursuant to reinsurance agreements with Group Ark, the Company recognized $953 (2008: $1,348; 2007: $181) of reinsurance premiums ceded during the year ended December 31, 2009, of which $nil was included in reinsurance balances payable at December 31, 2009 (2008: $60).

Aquiline are also shareholders of Tiger Risk. Pursuant to reinsurance agreements with Tiger Risk, the Company recognized gross premiums written of $12,314 during the year ended December 31, 2009 (2008: $nil; 2007: $nil), of which $6,433 was included in premiums receivable at December 31, 2009 (2008: $nil). Brokerage expenses of $1,231 were recorded for the year ended December 31, 2009 (2008: $nil; 2007: $nil).

The Company entered into an Investment Management Agreement on November 24, 2009 with Conning, Inc. (Conning) to manage a portion of the Company s investment portfolio. On June 16, 2009, Aquiline acquired Conning. John J. Hendrickson, a director of the Company, serves as a director of Conning Holdings Corp. The accrued management fees payable to Conning were $13 during the year ended December 31, 2009 (2008: $nil; 2007: $nil).

e) Certain members of the Company s management and staff have provided guarantees to 1384 Capital Ltd, a company formed to indirectly facilitate the provision of Funds at Lloyd s (FAL). The Company paid $416 of finance expenses to such management and staff in respect of such provision of FAL for the year ended December 31, 2009 (2008: $803; 2007: $889), all of which was included in accounts payable and accrued expenses at December 31, 2009 (2008: $803). An amount of $29 was included in general and administrative expenses in respect of the reimbursement of expenses relating to such FAL provision for the year ended December 31, 2009 (2008: $66; 2007: $154).

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

19. Earnings per share

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2009, 2008 and 2007:

	Years Ended		
	December 31, 2009	**December 31, 2008**	**December 31, 2007**
Basic earnings per share			
Income	$ 897,407	$ 53,111	$ 402,996
less: Dividends and distributions declared on outstanding warrants	(6,507)	(6,947)	
Income available to common shareholders	$ 890,900	$ 46,164	$ 402,996
Weighted average number of common shares outstanding	93,697,194	74,677,903	65,068,093
Basic earnings per share	**$ 9.51**	**$ 0.62**	**$ 6.19**
Diluted earnings per share			
Income	$ 897,407	$ 53,111	$ 402,996
less: Dividends and distributions declared on outstanding warrants		(6,947)	
Income available to common shareholders	$ 897,407	$ 46,164	$ 402,996
Weighted average number of common shares outstanding	93,697,194	74,677,903	65,068,093
Share equivalents:			
Warrants	2,220,096		1,973,983
Stock options	478,472	136,701	97,039
Unvested restricted shares	772,647	1,004,809	647,558
Weighted average number of diluted common shares outstanding	97,168,409	75,819,413	67,786,673
Diluted earnings per share	**$ 9.24**	**$ 0.61**	**$ 5.95**

Share equivalents that would result in the issuance of common shares of 172,425, 220,512 and 137,350 were outstanding for the years ended December 31, 2009, 2008 and 2007, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

20. Segment information

The Company conducts its operations worldwide through two wholly-owned subsidiaries, Validus Reinsurance, Ltd. and Talbot Holdings Ltd. from which two operating segments have been determined under U.S. GAAP segment reporting. The Company s operating segments are strategic business units that offer different products and services. They are managed and have capital allocated separately because each business requires different strategies.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Validus Re

The Validus Re segment is focused on short-tail lines of reinsurance. The primary lines in which the segment conducts business are property, marine and specialty which includes agriculture, aerospace, nuclear, terrorism, life and accident & health and workers compensation catastrophe.

On September 4, 2009, the Company acquired all of the outstanding shares of IPC from a group of institutional and other investors. The primary lines in which IPC conducted business were property catastrophe reinsurance and, to a limited extent, property-per-risk excess, aviation (including satellite) and other short-tail reinsurance on a worldwide basis. For segmental reporting purposes, the results of IPC s operations since the acquisition date have been included within the Validus Re segment in the consolidated financial statements.

Talbot

The Talbot segment focuses on a wide range of marine and energy, war, political violence, commercial property, financial institutions, contingency, bloodstock & livestock, accident & health classes of business on an insurance or facultative reinsurance basis. Additionally, the Talbot segment writes property, aerospace and marine classes of business on a treaty reinsurance basis.

Corporate and other reconciling items

The Company has a Corporate function, which includes the activities of the parent company, and which carries out functions for the group. Corporate also denotes the activities of certain key executives such as the Chief Executive Officer and Chief Financial Officer. The only revenue earned by Corporate is a minor amount of interest income that is incidental to the activities of the enterprise. For internal reporting purposes, Corporate is reflected separately as a business unit; however Corporate is not considered an operating segment under these circumstances and U.S. GAAP segment reporting. Other reconciling items include, but are not limited to, the elimination of intersegment revenues and expenses and unusual items that are not allocated to segments.

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

The following tables summarize the underwriting results of our operating segments and corporate segment:

Year Ended December 31, 2009	Validus Re	Talbot	Corporate & Eliminations	Total
Gross premiums written	$ 768,084	$ 919,906	$ (66,749)	$ 1,621,241
Reinsurance premiums ceded	(95,446)	(204,186)	66,749	(232,883)
Net premiums written	672,638	715,720		1,388,358
Change in unearned premiums	122,912	(61,693)		61,219
Net premiums earned	795,550	654,027		1,449,577
Losses and loss expenses	186,704	337,053		523,757
Policy acquisition costs	127,433	139,932	(4,399)	262,966
General and administrative expenses	65,710	96,352	23,506	185,568
Share compensation expenses	7,576	7,171	12,290	27,037
Underwriting income (loss)	**$ 408,127**	**$ 73,519**	**$ (31,397)**	**$ 450,249**
Net investment income	94,973	30,114	(6,314)	118,773
Realized gain on repurchase of debentures			4,444	4,444
Net realized (losses) on investments	(5,428)	(6,115)		(11,543)
Net unrealized gains on investments	75,209	9,587		84,796
Other income	5,149	5,225	(5,740)	4,634
Finance expenses	(1,774)	(14,725)	(27,631)	(44,130)
Foreign exchange (losses) gains	(1,406)	676	56	(674)
Gain on bargain purchase			287,099	287,099
Net income before taxes	**574,850**	**98,281**	**220,517**	**893,648**
Tax (expense) benefit	(163)	3,922		3,759
Net income	**$ 574,687**	**$ 102,203**	**$ 220,517**	**$ 897,407**
Selected ratios(1)				
Losses and loss expenses	23.5%	51.5%		36.1%
Policy acquisition costs	16.0%	21.4%		18.1%
General and administrative expenses	9.2%	15.8%		14.7%
Expense ratio	25.2%	37.2%		32.8%
Combined ratio	48.7%	88.7%		68.9%

Total assets	**$ 4,865,771**	**$ 2,137,393**	**$ 15,976**	**$ 7,019,140**

(1) Ratios are based on net premiums earned. The general and administrative expense ratio includes share compensation expenses.

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Year Ended December 31, 2008	Validus Re	Talbot	Corporate & Eliminations	Total
Gross premiums written	$ 687,771	$ 708,996	$ (34,283)	$ 1,362,484
Reinsurance premiums ceded	(62,933)	(95,510)	34,283	(124,160)
Net premiums written	624,838	613,486		1,238,324
Change in unearned premiums	28,693	(10,499)		18,194
Net premiums earned	653,531	602,987		1,256,518
Losses and loss expenses	420,645	351,509		772,154
Policy acquisition costs	100,243	135,017	(309)	234,951
General and administrative expenses	34,607	71,443	17,898	123,948
Share compensation expenses	6,829	4,702	15,566	27,097
Underwriting income (loss)	**$ 91,207**	**$ 40,316**	**$ (33,155)**	**$ 98,368**
Net investment income	101,994	41,520	(3,986)	139,528
Realized gain on repurchase of debentures			8,752	8,752
Net realized (losses) gains on investments	(9,718)	8,127		(1,591)
Net unrealized (losses) gains on investments	(84,714)	5,007		(79,707)
Other income	309	5,264	(309)	5,264
Finance expenses	(879)	(27,351)	(29,088)	(57,318)
Foreign exchange (losses)	(16,701)	(32,696)		(49,397)
Net income (loss) before taxes	**81,498**	**40,187**	**(57,786)**	**63,899**
Tax (expense)	(88)	(10,700)		(10,788)
Net income (loss)	**$ 81,410**	**$ 29,487**	**$ (57,786)**	**$ 53,111**
Selected ratios(1)				
Losses and loss expenses	64.4%	58.3%		61.5%
Policy acquisition costs	15.3%	22.4%		18.7%
General and administrative expenses	6.3%	12.6%		12.0%
Expense ratio	21.6%	35.0%		30.7%
Combined ratio	86.0%	93.3%		92.2%
Total assets	**$ 2,583,290**	**$ 1,732,832**	**$ 6,358**	**$ 4,322,480**

(1) Ratios are based on net premiums earned. The general and administrative expense ratio includes share compensation expenses.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Year Ended December 31, 2007	Validus Re	Talbot	Corporate & Eliminations	Total
Gross premiums written	$ 702,098	$ 286,539	$	$ 988,637
Reinsurance premiums ceded	(68,842)	(1,368)		(70,210)
Net premiums written	633,256	285,171		918,427
Change in unearned premiums	(74,227)	13,879		(60,348)
Net premiums earned	559,029	299,050		858,079
Losses and loss expenses	175,538	108,455		283,993
Policy acquisition costs	70,323	63,954		134,277
General and administrative expenses	31,412	48,886	17,467	97,765
Share compensation expenses	4,013	1,709	10,467	16,189
Underwriting income	**$ 277,743**	**$ 76,046**	**$ (27,934)**	**$ 325,855**
Net investment income	85,981	25,805	538	112,324
Net realized (losses) gains on investments	443	1,165		1,608
Net unrealized (losses) gains on investments	8,556	3,808		12,364
Other income		3,301		3,301
Fair value of warrants issued			(2,893)	(2,893)
Aquiline termination fee			(3,000)	(3,000)
Finance expenses	(1,378)	(26,086)	(24,290)	(51,754)
Foreign exchange gains (losses)	7,495	(799)		6,696
Net income (loss) before taxes	**378,840**	**83,240**	**(57,579)**	**404,501**
Income tax benefit (expense)	(61)	(1,444)		(1,505)
Net income (loss)	**$ 378,779**	**$ 81,796**	**$ (57,579)**	**$ 402,996**
Selected ratios(1)				
Losses and loss expenses	31.4%	36.3%		33.1%
Policy acquisition costs	12.6%	21.4%		15.6%
General and administrative expenses	6.3%	16.9%		13.3%
Expense ratio	18.9%	38.3%		28.9%
Combined ratio	50.3%	74.6%		62.0%
Total assets	**$ 2,464,176**	**$ 1,674,987**	**$ 5,061**	**$ 4,144,224**

(1) Ratios are based on net premiums earned. The general and administrative expense ratio includes share compensation expenses.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

The Company s exposures are generally diversified across geographic zones. The following tables set forth the gross premiums written allocated to the territory of coverage exposure for the periods indicated:

	Year Ended December 31, 2009 Gross Premiums Written				
	Validus Re	Talbot	Eliminations	Total	%
United States	$ 335,331	$ 77,528	$ (7,031)	$ 405,828	25.0%
Worldwide excluding United States(1)	47,258	264,057	(13,385)	297,930	18.4%
Europe	59,197	65,013	(3,287)	120,923	7.4%
Latin America and Caribbean	41,828	83,909	(36,592)	89,145	5.5%
Japan	22,095	4,986	(470)	26,611	1.6%
Canada	470	9,303	(470)	9,303	0.6%
Sub-total, non United States	170,848	427,268	(54,204)	543,912	33.5%
Worldwide including United States(1)	78,872	50,118	(3,053)	125,937	7.8%
Marine and Aerospace(2)	183,033	364,992	(2,461)	545,564	33.7%
Total	$ 768,084	$ 919,906	$ (66,749)	$ 1,621,241	100.0%

	Year Ended December 31, 2008 Gross Premiums Written				
	Validus Re	Talbot	Eliminations	Total	%
United States	$ 356,902	$ 62,098	$	$ 419,000	30.8%
Worldwide excluding United States(1)	27,512	221,260	(20,870)	227,902	16.7%
Europe	44,079	57,132		101,211	7.4%
Latin America and Caribbean	18,404	46,721	(13,413)	51,712	3.8%
Japan	9,416	3,955		13,371	1.0%
Canada		9,630		9,630	0.7%
Sub-total, non United States	99,411	338,698	(34,283)	403,826	29.6%
Worldwide including United States(1)	74,391	58,079		132,470	9.7%
Marine and Aerospace(2)	157,067	250,121		407,188	29.9%
Total	$ 687,771	$ 708,996	$ (34,283)	$ 1,362,484	100.0%

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Year Ended December 31, 2007 Gross Premiums Written				
	Validus Re	Talbot	Eliminations	Total	%
United States	$ 342,502	$ 26,262	$	$ 368,764	37.3%
Worldwide excluding United States(1)	22,794	94,434		117,228	11.9%
Europe	44,266	29,007		73,273	7.4%
Latin America and Caribbean	7,218	13,497		20,715	2.1%
Japan	8,252	1,028		9,280	0.9%
Canada		4,649		4,649	0.5%
Sub-total, non United States	82,530	142,615		225,145	22.8%
Worldwide including United States(1)	103,997	24,847		128,844	13.0%
Marine and Aerospace(2)	173,069	92,815		265,884	26.9%
Total	$ 702,098	$ 286,539	$	$ 988,637	100.0%

(1) Represents risks in two or more geographic zones.

(2) Not classified as geographic area as marine and aerospace risks can span multiple geographic areas and are not fixed locations in some instances.

21. Statutory and regulatory requirements

As disclosed in Note 17 (d), Syndicate 1183 and Talbot 2002 Underwriting Capital Ltd (T02) are subject to regulation by the Council of Lloyd s. Syndicate 1183 and T02 are also subject to regulation by the U.K. Financial Services Authority (FSA) under the Financial Services and Markets Act 2000.

T02 is a corporate member of Lloyd s. As a corporate member of Lloyd s, T02 is bound by the rules of the Society of Lloyd s, which are prescribed by Bye-laws and Requirements made by the Council of Lloyd s under powers conferred by the Lloyd s Act 1982. These rules (among other matters) prescribe T02 s membership subscription, the level of its contribution to the Lloyd s central fund and the assets it must deposit with Lloyd s in support of its underwriting. The Council of Lloyd s has broad powers to sanction breaches of its rules, including the power to restrict or prohibit a member s participation on Lloyd s syndicates.

The Company has three Bermuda-based subsidiaries, Validus Re, AlphaCat Reinsurance Ltd and Talbot Insurance (Bermuda) Ltd. (TIBL) registered under The Insurance Act 1978 (Bermuda), Amendments Thereto and Related Regulations (The Act). Under the Insurance Act, these subsidiaries are required to prepare Statutory Financial Statements and to file Statutory Financial Returns. These subsidiaries have to meet certain requirements for minimum

solvency and liquidity ratios. Effective for statutory filings for the year ended December 31, 2008, the BMA introduced a risk-based capital model, or Bermuda Solvency Capital Requirement (BSCR), as a tool to assist the BMA in measuring risk and determining appropriate capitalization. As at December 31, 2009 and 2008, these requirements were met.

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

Statutory requirements based on draft unaudited filings for Validus Re, AlphaCat Reinsurance, Ltd and TIBL are set out below:

	Validus Re		TIBL		AlphaCat Reinsurance, Ltd	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
Minimum statutory capital and surplus	$ 335,802	$ 312,419	$ 13,315	$ 4,309	$ 120	$
Actual statutory capital and surplus	3,576,958	1,731,928	341,316	250,751	120	
Minimum share capital	1,000	1,000	120	120	120	
Actual share capital	2,659,942	1,310,593	62,731	62,731	120	
Minimum relevant assets	582,002	783,787	161,902	66,684	35,019	
Actual relevant assets	2,283,968	2,672,585	556,816	339,571	46,812	

The Bermuda Companies Act 1981 (the Companies Act) limits the Company s ability to pay dividends and distributions to shareholders.

22. Subsequent events

On January 21, 2010, the Company offered and sold $250.0 million of Senior Notes due 2040 (the 8.875% Senior Notes) in a registered public offering. The 8.875% Senior Notes mature on January 26, 2040, and are redeemable at the Company s option in whole any time or in part from time to time at a make-whole redemption price. Interest on the 8.875% Senior Notes is payable at 8.875% per annum through January 26, 2040. Interest on the Notes is payable semi-annually in arrears on January 26 and July 26 of each year, commencing on July 26, 2010. The net proceeds of $244.3 million from the sale of the 8.875% Senior Notes, after the deduction of commissions paid to the underwriters in the transaction and other expenses, will be used by the Company for general corporate purposes, which may include the repurchase of our outstanding capital stock, dividends to our shareholders and/or potential acquisitions.

On February 17, 2010, the Board of Directors of the Company authorized the Company to return up to $750.0 million to shareholders. To this end, the Board of the Company expanded the Company s current share repurchase program authorizing the Company to repurchase up to $750.0 million of common shares. This amount is in addition to, and in excess of, the $135.5 million of common shares repurchased by the Company through February 17, 2010 under its previously authorized $400.0 million share repurchase program announced in November 2009. The Company expects the repurchases to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company s capital position relative to internal and rating agency targets, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of the Company at any time. For the period November 4, 2009 through February 26, 2010, the Company repurchased 5,715,071 shares at a cost of

$152.4 million under the share repurchase program.

On Saturday February 27, 2010, an earthquake of magnitude 8.8 occurred in the Offshore Maule region approximately 70 miles North North East of Concepcion, Chile. At this time there is a lack of credible information upon which to base an estimate of losses arising from this event. The earthquake is a significant event and the Company is continuing to review its in-force contracts and preliminary loss information from clients. The losses arising from this event may have a material impact on the Company s shareholders equity.

Between February 27 and February 28, 2010, Windstorm Xynthia caused damage in western and northern France and northern Germany. Preliminary reports suggest property damage, flooding and widespead power

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

outages across Western Europe. At this time there is a lack of credible information upon which to base an estimate of losses arising from this event. The Company is reviewing its in-force contracts and preliminary loss information from clients but does not expect that any losses will have a material impact on its shareholders equity.

23. Condensed unaudited quarterly financial data

	Quarters Ended(a)			
	December 31, 2009 (Unaudited)	September 30, 2009 (Unaudited)	June 30, 2009 (Unaudited)	March 31, 2009 (Unaudited)
Revenues				
Gross premiums written	$ 255,289	$ 331,028	$ 425,032	$ 609,892
Reinsurance premiums ceded	(30,393)	(67,687)	(62,291)	(72,512)
Net premiums written	224,896	263,341	362,741	537,380
Change in unearned premiums	203,005	111,376	(34,541)	(218,621)
Net premiums earned	427,901	374,717	328,200	318,759
Gain on bargain purchase, net of expenses		302,950	(15,851)	
Net investment income	35,506	29,532	26,963	26,772
Realized gain on repurchase of debentures	4,444			
Net realized gains (losses) on investments	9,099	5,429	(2,650)	(23,421)
Net unrealized (losses) gains on investments	(25,043)	50,437	37,249	22,153
Other income	1,759	1,101	1,017	757
Foreign exchange gains (losses)	338	(5,244)	8,432	(4,200)
Total revenues	454,004	758,922	383,360	340,820
Expenses				
Losses and loss expenses	133,020	134,152	124,751	131,834
Policy acquisition costs	72,843	64,236	64,438	61,449
General and administrative expenses	60,253	46,036	41,200	38,079
Share compensation expenses	8,189	5,862	5,632	7,354
Finance expenses	14,398	11,257	10,752	7,723
Total expenses	288,703	261,543	246,773	246,439

Net income before taxes	165,301	497,379	136,587	94,381
Tax benefit (expense)	458	1,799	976	526
Net income	$ 165,759	499,178	137,563	94,907
Earnings per share				
Weighted average number of common shares and common share equivalents outstanding				
Basic	130,413,790	92,492,373	76,138,038	75,744,577
Diluted	134,794,120	95,834,809	78,942,065	79,102,643
Basic earnings per share	$ 1.26	$ 5.38	$ 1.79	$ 1.23
Diluted earnings per share	$ 1.23	$ 5.21	$ 1.74	$ 1.20
Selected ratios:				
Losses and loss expenses	31.1%	35.8%	38.0%	41.4%
Expense ratio	33.0%	30.9%	33.9%	33.6%
Combined ratio	64.1%	66.7%	71.9%	75.0%

(a) Operating results of IPC Holdings, Ltd. have been included from September 4, 2009, the date of acquisition.

Table of Contents

Validus Holdings, Ltd.

Notes to Consolidated Financial Statements (Continued)
(Expressed in thousands of U.S. dollars, except share and per share information)

	Quarters Ended			
	December 31, 2008 (Unaudited)	**September 30, 2008 (Unaudited)**	**June 30, 2008 (Unaudited)**	**March 31, 2008 (Unaudited)**
Revenues				
Gross premiums written	$ 191,736	$ 269,236	$ 379,919	$ 521,594
Reinsurance premiums ceded	(2,722)	(35,139)	(1,399)	(84,900)
Net premiums written	189,014	234,097	378,520	436,694
Change in unearned premiums	127,017	105,229	(69,222)	(144,830)
Net premiums earned	316,031	339,326	309,298	291,864
Net investment income	30,671	36,379	36,435	36,043
Realized gain on repurchase of debentures			8,752	
Net realized gains (losses) on investments	6,757	(13,667)	(2,425)	7,744
Net unrealized (losses) on investments	(7,099)	(14,649)	(42,982)	(14,977)
Other income	1,598	1,269	1,462	935
Foreign exchange (losses) gains	(13,554)	(44,933)	911	8,179
Total revenues	334,404	303,725	311,451	329,788
Expenses				
Losses and loss expenses	191,576	318,464	122,089	140,024
Policy acquisition costs	61,407	60,425	56,419	56,701
General and administrative expenses	22,809	30,120	33,912	37,107
Share compensation expenses	7,279	6,012	7,271	6,535
Finance expenses	8,522	14,517	12,762	21,517
Total expenses	291,593	429,538	232,453	261,884
Net income (loss) before taxes	42,811	(125,813)	78,998	67,904
Tax (expense)	(5,796)	(487)	(3,077)	(1,429)
Net income (loss)	$ 37,015	(126,300)	75,921	66,475

Earnings per share

Weighted average number of common shares and common share equivalents outstanding								
Basic		75,404,091		74,864,724		74,233,425		74,209,371
Diluted		75,740,546		74,864,724		77,257,545		78,329,727
Basic earnings (loss) per share	$	0.47	$	(1.71)	$	1.00	$	0.87
Diluted earnings (loss) per share	$	0.47	$	(1.71)	$	0.98	$	0.85
Selected Ratios:								
Losses and loss expenses		60.6%		93.9%		39.5%		48.0%
Expense ratio		28.9%		28.4%		31.5%		34.4%
Combined ratio		89.5%		122.3%		71.0%		82.4%

Table of Contents

SCHEDULE I

VALIDUS HOLDINGS, LTD.
SUMMARY OF INVESTMENTS OTHER THAN INVESTMENTS IN RELATED PARTIES
At December 31, 2009
(Expressed in thousands of U.S. dollars)

	Amortized Cost	Market Value	Amount at Which Shown on the Balance Sheet
U.S. Government and Government Agency	$ 1,912,081	$ 1,918,811	$ 1,918,811
Non-U.S. Government and Government Agency	678,555	673,680	673,680
States, municipalities, political subdivision	19,310	19,359	19,359
Agency residential mortgage-backed securities	537,876	551,610	551,610
Non-Agency residential mortgage-backed securities	176,853	137,569	137,569
U.S. corporate	1,004,464	1,027,225	1,027,225
Non-U.S. corporate	411,499	409,398	409,398
Catastrophe bonds	51,236	52,351	52,351
Asset-backed securities	36,828	36,712	36,712
Commercial mortgage-backed securities	41,693	42,663	42,663
Total fixed maturities	4,870,395	4,869,378	4,869,378
Total short-term investments	482,632	481,766	481,766
Total other investments	35,941	37,615	37,615
Total	$ 5,388,968	$ 5,388,759	$ 5,388,759

Table of Contents

Schedule II

VALIDUS HOLDINGS, LTD. (parent company only)

BALANCE SHEETS

As at December 31, 2009 and 2008
(Expressed in thousands of U.S. dollars)

	December 31, 2009	December 31, 2008
ASSETS		
Cash and cash equivalents	$ 6,646	$ 3,031
Investment in subsidiaries on an equity basis	4,381,882	2,285,714
Receivable from subsidiaries	5,336	
Other assets	3,602	3,654
Total assets	4,397,466	2,292,399
LIABILITIES		
Payable to subsidiaries		679
Accounts payable and accrued expenses	16,346	2,986
Debentures payable	350,000	350,000
Total liabilities	366,346	353,665
Commitments and contingent liabilities		
SHAREHOLDERS EQUITY		
Ordinary shares, 571,428,571 authorized, par value $0.175 Issued and outstanding (2009: 128,459,478; 2008: 75,624,697)	23,033	13,235
Treasury shares	(553)	
Additional paid-in capital	2,675,680	1,412,635
Accumulated other comprehensive (loss)	(4,851)	(7,858)
Retained earnings	1,337,811	520,722
Total shareholders equity	4,031,120	1,938,734
Total liabilities and shareholders equity	$ 4,397,466	$ 2,292,399

Table of Contents

VALIDUS HOLDINGS, LTD. (parent company only)

STATEMENTS OF OPERATIONS

For the Years Ended December 31, 2009, 2008 and 2007
(Expressed in thousands of U.S. dollars)

	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007
Revenues			
Equity in net earnings of subsidiaries	$ 954,457	$ 88,966	$ 436,169
Net investment income	14	71	537
Foreign exchange gain	56		
Total revenues	954,527	89,037	436,706
Expenses			
General and administrative expenses	25,404	4,181	6,527
Finance expenses	31,716	31,745	24,290
Fair value of warrants issued			2,893
Total expenses	57,120	35,926	33,710
Net income	$ 897,407	$ 53,111	$ 402,996

Table of Contents

VALIDUS HOLDINGS, LTD. (parent company only)

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2009, 2008 and 2007
(Expressed in thousands of U.S. dollars)

	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007
Cash flows provided by (used in) operating activities			
Net income for the year	$ 897,407	$ 53,111	$ 402,996
Adjustments to reconcile net income to net cash provided by operating activities:			
Fair value of warrants expensed			2,893
Equity in net earnings of subsidiary	(954,457)	(88,966)	(396,169)
Other assets	52	1,326	409
Receivable from subsidiaries	(5,336)		
Payable to subsidiaries	(679)	(888)	(7,591)
Dividends received from subsidiaries	223,959	105,100	40,000
Accounts payable and accrued expenses	13,360	1,732	707
Net cash provided by operating activities	174,306	71,415	43,245
Cash flows provided by (used in) investing activities			
Investment in subsidiaries	(7,459)		(561,448)
Net cash (used in) investing activities	(7,459)		(561,448)
Cash flows provided by (used in) financing activities			
Net proceeds on issuance of debentures			198,000
Purchase of common shares under repurchase program	(84,164)		
Dividends	(80,318)	(69,649)	
Issue of common shares, net	1,250	1,184	320,248
Net cash (used in) provided by financing activities	(163,232)	(68,465)	518,248
Net increase in cash	3,615	2,950	45
Cash and cash equivalents Beginning of year	3,031	81	36
Cash and cash equivalents End of year	$ 6,646	$ 3,031	$ 81

SCHEDULE III

VALIDUS HOLDINGS, LTD.
SUPPLEMENTARY INSURANCE INFORMATION
As at and for the years ended December 31, 2009, 2008, and 2007
(Expressed in thousands of U.S. dollars)

As at and for the year ended December 31, 2009

	Deferred Acquisition Costs	Reserve for Losses and Loss Expenses	Unearned Premiums	Net Premiums Earned	Net Investment Income	Losses and Loss Expenses	Amortization of Deferred Acquisition Costs	Other Operating Expenses	Net Premiu Writte
us Re	$ 54,325	$ 742,510	$ 325,260	$ 795,550	$ 94,973	$ 186,704	$ 127,433	$ 73,286	$ 672
t	68,341	903,986	427,284	654,027	30,114	337,053	139,932	103,523	715
orate & nations	(10,337)	(24,362)	(28,440)		(6,314)		(4,399)	35,796	
	$ 112,329	$ 1,622,134	$ 724,104	$ 1,449,577	$ 118,773	$ 523,757	$ 262,966	$ 212,605	$ 1,388

As at and for the year ended December 31, 2008

	Deferred Acquisition Costs	Reserve for Losses and Loss Expenses	Unearned Premiums	Net Premiums Earned	Net Investment Income	Losses and Loss Expenses	Amortization of Deferred Acquisition Costs	Other Operating Expenses	Net Premiums Written
Re	$ 46,415	$ 535,888	$ 232,522	$ 653,531	$ 101,994	$ 420,645	$ 100,243	$ 41,436	$ 624,83
	62,153	790,199	317,207	602,987	41,520	351,509	135,017	76,145	613,48
te & ions	(412)	(20,784)	(10,279)		(3,986)		(309)	33,464	
	$ 108,156	$ 1,305,303	$ 539,450	$ 1,256,518	$ 139,528	$ 772,154	$ 234,951	$ 151,045	$ 1,238,32

As at and for the year ended December 31, 2007

	Deferred	Reserve for Losses		Net	Net	Losses	Amortization of Deferred	Other	Net

	Acquisition Costs	and Loss Expenses	Unearned Premiums	Premiums Earned	Investment Income	and Loss Expenses	Acquisition Costs	Operating Expenses	Premiums Written
alidus Re	$ 45,860	$ 196,813	$ 259,592	$ 559,029	$ 85,981	$ 175,538	$ 70,323	$ 35,425	$ 633,256
albot	59,702	729,304	297,752	299,050	25,805	108,455	63,954	50,595	285,171
orporate & iminations					538			30,934	
otal	$ 105,562	$ 926,117	$ 557,344	$ 858,079	$ 112,324	$ 283,993	$ 134,277	$ 116,954	$ 918,427

Table of Contents

SCHEDULE IV

VALIDUS HOLDINGS, LTD.
SUPPLEMENTARY REINSURANCE INFORMATION
As at and for the years ended December 31, 2009, 2008, and 2007
(Expressed in thousands of U.S. dollars)

	Gross	Ceded to Other Companies	Assumed From Other Companies	Net Amount	Percentage of Amount Assumed to Net
Year ended December 31, 2009	$ 459,771	$ 232,883	$ 1,161,470	$ 1,388,358	84%
Year ended December 31, 2008	$ 393,003	$ 124,160	$ 969,481	$ 1,238,324	78%
Year ended December 31, 2007	$ 192,186	$ 70,210	$ 796,451	$ 918,427	87%

SCHEDULE VI

VALIDUS HOLDINGS, LTD.
SUPPLEMENTARY INFORMATION CONCERNING PROPERTY/CASUALTY (RE)INSURANCE INFORMATION
As at and for the years ended December 31, 2009, 2008, and 2007
(Expressed in thousands of U.S. dollars)

					Losses and Loss Expenses incurred related to				
Deferred cquisition Costs	Reserves For Losses and Loss Expenses	Reserves for Unearned Premiums	Net Earned Premiums	Net Investment Income	Current Year	Prior Year	Net Paid Losses and Loss Expenses	Amortization of Deferred Acquisition Costs	N Pren Wr
112,329	$ 1,622,134	$ 724,104	$ 1,449,577	$ 118,773	$ 625,810	$ (102,053)	$ 507,435	$ 262,966	$ 1,3
108,156	$ 1,305,303	$ 539,450	$ 1,256,518	$ 139,528	$ 841,856	$ (69,702)	$ 406,469	$ 234,951	$ 1,2
105,562	$ 926,117	$ 557,344	$ 858,079	$ 112,324	$ 351,850	$ (67,857)	$ 156,872	$ 134,277	$ 9