ALLEGHANY CORP /DE
Form 10-K/A
March 11, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K/A
Amendment No. 1

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

For the fiscal year ended December 31, 2008

or

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

For the transition period from to

Commission file number 1-9371

ALLEGHANY CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**51-0283071**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
7 Times Square Tower, New York, New York (Address of principal executive offices)	10036 (Zip Code)

Registrant s telephone number, including area code:
(212) 752-1356
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1.00 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
Not applicable

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No þ

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

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

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

Yes o No þ

As of June 30, 2008, the aggregate market value (based upon the closing price of these shares on the New York Stock Exchange) of the shares of Common Stock of Alleghany Corporation held by non-affiliates was $2,161,992,492.

As of February 20, 2009, 8,273,891 shares of Common Stock were outstanding.

EXPLANATORY NOTE

Alleghany Corporation (the Company) is filing this Amendment No.1 (this Amendment) to its Annual Report on Form 10-K for the year ended December 31, 2008, as originally filed with the Securities and Exchange Commission on February 27, 2009 (the Form 10-K Report), for the sole purpose of (i) adding to Part II, Item 8, Financial Statements and Supplementary Data, the report of KPMG LLP dated February 25, 2009 with respect to the effectiveness of the Company s internal control over financial reporting as of December 31, 2008, which appears on page 46 below (the Attestation Report), and the reference to the Attestation Report in the audit report of KPMG LLP dated February 25, 2009, which appears on page 45 below, and (ii) adding to Part II, Item 9A, Controls and Procedures, under the subheading, Management s Annual Report on Internal Control over Financial Reporting, a statement that KPMG LLP has issued the Attestation Report, which appears on page 47 below.

As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, new certifications of our principal executive officer and principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, are filed as exhibits to this Amendment.

Other than as set forth above, this Amendment does not modify or update any of the other disclosure contained in the Form 10-K Report and does not reflect events occurring after the filing of the Form 10-K Report on February 27, 2009.

Item 8. Financial Statements and Supplementary Data.

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Alleghany Corporation and Subsidiaries

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ALLEGHANY CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31, **2008**	December 31, 2007
	(in thousands, except share amounts)	
Assets		
Investments		
Available-for-sale securities at fair value:		
Equity securities (cost: 2008 $463,207; 2007 $691,429)	**$ 629,518**	$ 1,176,412
Debt securities (amortized cost: 2008 $2,781,829; 2007 $2,541,488)	**2,760,019**	2,564,717
Short-term investments	**636,197**	316,897
	4,025,734	4,058,026
Other invested assets	**250,407**	193,272
Total investments	**4,276,141**	4,251,298
Cash	**18,125**	57,646
Premium balances receivable	**154,022**	170,080
Reinsurance recoverables	**1,056,438**	1,018,673
Ceded unearned premium reserves	**185,402**	221,203
Deferred acquisition costs	**71,753**	75,623
Property and equipment at cost, net of accumulated depreciation and amortization	**23,310**	19,735
Goodwill and other intangibles, net of amortization	**151,223**	207,540
Current taxes receivable	**14,338**	4,116
Net deferred tax assets	**130,293**	
Assets of discontinued operations		812,119
Other assets	**100,783**	104,079
	$ 6,181,828	$ 6,942,112
Liabilities and Stockholders Equity		
Losses and loss adjustment expenses	**$ 2,578,590**	$ 2,379,701
Unearned premiums	**614,067**	699,409
Reinsurance payable	**53,541**	57,380
Net deferred tax liabilities		71,594
Liabilities of discontinued operations		663,417
Other liabilities	**288,941**	286,284
Total liabilities	**3,535,139**	4,157,785
Preferred stock		
	299,429	299,480

(shares authorized: 2008 and 2007 1,132,000; shares issued and outstanding: 2008 1,131,619; 2007 1,131,819)		
Common stock (shares authorized: 2008 and 2007 22,000,000; issued and outstanding 2008 8,349,284; 2007 8,322,348)	**8,349**	8,159
Contributed capital	**742,863**	689,435
Accumulated other comprehensive income	**87,249**	328,632
Treasury stock, at cost (2008 76,513 shares; 2007 none)	**(24,290)**	
Retained earnings	**1,533,089**	1,458,621
Total stockholders equity	**2,646,689**	2,784,327
	$ 6,181,828	$ 6,942,112

See accompanying Notes to Consolidated Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES
Consolidated Statements of Earnings and Comprehensive Income

	Years Ended December 31,		
	2008	2007	2006
	(in thousands, except per share amounts)		
Revenues			
Net premiums earned	**$ 948,652**	$ 974,321	$ 877,750
Net investment income	**130,184**	146,082	127,935
Net realized capital (losses) gains	**(92,168)**	92,766	28,212
Other income	**2,432**	15,427	26,435
Total revenues	**989,100**	1,228,596	1,060,332
Costs and expenses			
Loss and loss adjustment expenses	**570,019**	449,052	410,335
Commissions, brokerage and other underwriting expenses	**286,573**	257,198	215,533
Other operating expenses	**34,861**	55,604	47,361
Corporate administration	**35,895**	32,987	41,667
Interest expense	**700**	1,476	5,626
Total costs and expenses	**928,048**	796,317	720,522
Earnings from continuing operations, before income taxes	**61,052**	432,279	339,810
Income taxes	**20,485**	144,737	98,863
Earnings from continuing operations	**40,567**	287,542	240,947
Discontinued operations			
Operations (including a gain on disposal of $141,688 in 2008)	**164,193**	24,976	14,998
Income taxes (including tax on the gain on disposal of $49,591 in 2008)	**56,789**	13,448	8,042
Earnings from discontinued operations, net of tax	**107,404**	11,528	6,956
Net earnings	**$ 147,971**	$ 299,070	$ 247,903
Changes in other comprehensive income			
Change in unrealized (losses) gains, net of deferred taxes of $(145,368), $60,778 and $23,227 for 2008, 2007 and 2006, respectively	**$ (269,969)**	$ 112,874	$ 43,136
Less: reclassification for (losses) gains realized in net earnings, net of taxes of $(15,198), $32,458 and $9,878 for 2008, 2007 and 2006, respectively	**28,225**	(60,280)	(18,346)
Other	**361**	167	(106)
Comprehensive income	**$ (93,412)**	$ 351,831	$ 272,587

Net earnings	**$ 147,971**	$ 299,070	$ 247,903
Preferred dividends	**17,218**	17,223	8,994
Net earnings available to common stockholders	**$ 130,753**	$ 281,847	$ 238,909
Basic earnings per share of common stock: *			
Continuing operations	**$ 2.81**	$ 32.53	$ 27.95
Discontinued operations	**12.92**	1.39	0.84
Basic earnings per share	**$ 15.73**	$ 33.92	$ 28.79
Diluted earnings per share of common stock: *			
Continuing operations	**$ 2.81**	$ 30.85	$ 27.23
Discontinued operations	**12.92**	1.23	0.78
Diluted earnings per share	**$ 15.73**	$ 32.08	$ 28.01

* Amounts reflect subsequent common stock dividends.

See accompanying Notes to Consolidated Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders Equity

	Three Years Ended December 31, 2008						
	Preferred Stock	Common Stock	Contributed Capital	Accumulated Other Comprehensive Income	Treasury Stock	Retained Earnings	Total Stockholders Equity
	(in thousands, except share amounts)						
Balance at December 31, 2005 (8,388,721 shares of common stock issued; none in treasury)*	$	$ 7,905	$ 591,164	$ 254,397	$	$ 1,040,920	$ 1,894,386
Add (deduct):							
Net earnings						247,903	247,903
Other comprehensive loss, net of tax:							
Retirement plans				(3,316)			(3,316)
Change in unrealized appreciation of investments, net				24,790			24,790
Comprehensive income				21,474		247,903	269,377
Dividends paid		22	6,759		37,542	(53,431)	(9,108)
Stock based compensation			19,302				19,302
Treasury stock purchase					(39,185)		(39,185)
Gain on sale of subsidiary stock			9,473				9,473
Issuance of preferred stock	299,527		(9,105)				290,422
Other, net		32	9,622		1,643		11,297
Balance at December 31, 2006 (8,280 848 shares of common stock issued; none in treasury)*	299,527	7,959	627,215	275,871		1,235,392	2,445,964
Add (deduct):							
Net earnings						299,070	299,070
Other comprehensive loss, net of tax:							
Retirement plans				167			167
Change in unrealized appreciation of				52,594			52,594

investments, net							
Comprehensive income				52,761		299,070	351,831
Dividends paid		159	58,315			(75,840)	(17,366)
Stock based compensation			1,144				1,144
Other, net	(47)	41	2,761			(1)	2,754
Balance at December 31, 2007 (8,322,348 shares of common stock issued; none in treasury)*	299,480	8,159	689,435	328,632		1,458,621	2,784,327
Add (deduct):							
Net earnings						147,971	147,971
Other comprehensive loss, net of tax:							
Retirement plans				361			361
Change in unrealized appreciation of investments, net				(241,744)			(241,744)
Comprehensive income				(241,383)		147,971	(93,412)
Dividends paid		163	55,988			(73,501)	(17,350)
Stock based compensation			2,941				2,941
Treasury stock purchase					(24,290)		(24,290)
Adjust gain on sale of subsidiary stock			(9,473)				(9,473)
Other, net	(51)	27	3,972			(2)	3,946
Balance at December 31, 2008 (8,349,284 shares of common stock issued; 76,513 in treasury)	**$ 299,429**	**$ 8,349**	**$ 742,863**	**$ 87,249**	**$ (24,290)**	**$ 1,533,089**	**$ 2,646,689**

* Amounts reflect subsequent common stock dividends.

See accompanying Notes to Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Cash flows from operating activities			
Net earnings	**$ 147,971**	$ 299,070	$ 247,903
Earnings from discontinued operations, net	**107,404**	11,528	6,956
Earnings from continuing operations	**40,567**	287,542	240,947
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	**25,674**	16,275	11,674
Net realized capital (gains) losses	**92,168**	(92,766)	(28,212)
(Increase) decrease in other assets	**(37,117)**	(2,515)	(29,191)
(Increase) decrease in reinsurance receivable, net of reinsurance payable	**(41,604)**	116,257	482,467
(Increase) decrease in premium balances receivable	**17,671**	27,318	9,424
(Increase) decrease in ceded unearned premium reserves	**35,801**	90,098	43,294
(Increase) decrease in deferred acquisition costs	**3,870**	(8,286)	(12,736)
Increase (decrease) in other liabilities and current taxes	**(24,928)**	46,224	80,115
Increase (decrease) in unearned premiums	**(86,955)**	(102,873)	(4,880)
Increase (decrease) in losses and loss adjustment expenses	**198,889**	(25,469)	(342,936)
Net adjustments	**183,469**	64,263	209,019
Net cash provided by operating activities from continuing operations	**224,036**	351,805	449,966
Net cash provided by operating activities from discontinued operations	**106,510**	127,355	103,769
Net cash provided by operating activities	**330,546**	479,160	553,735
Cash flows from investing activities			
Purchase of investments	**(1,564,024)**	(1,336,433)	(1,436,265)
Sales of investments	**1,149,434**	824,305	298,408
Maturities of investments	**325,970**	284,666	283,095
Purchases of property and equipment	**(9,760)**	(4,884)	(4,251)
Net change in short-term investments	**(320,111)**	79,974	196,628
Other, net	**3,700**	4,640	9,270
Acquisition of majority- and minority-owned companies, net of cash acquired	**(50,816)**	(186,743)	(120,670)
Net cash provided by investing activities from continuing operations	**(465,607)**	(334,475)	(773,785)

Net cash provided by investing activities from discontinued operations	**151,607**	(152,076)	(91,998)
Net cash (used in) provided by investing activities	**(314,000)**	(486,551)	(865,783)
Cash flows from financing activities			
Proceeds from issuance of convertible preferred stock, net of issuance costs			290,422
Proceeds from issuance of subsidiary common stock, net of issuance costs			86,288
Treasury stock acquisitions	**(25,068)**		(39,186)
Principal payments on long-term debt		(80,000)	
Proceeds from repayment of note receivable		91,536	
Convertible preferred stock dividends paid	**(17,350)**	(17,367)	(8,342)
Tax benefit on stock based compensation	**2,330**	1,063	1,034
Other, net	**2,133**	3,626	2,406
Net cash provided by (used in) financing activities from continuing operations	**(37,955)**	(1,142)	332,622
Net cash provided by (used in) financing activities from discontinued operations	**(5,000)**	5,316	301
Net cash provided by (used in) financing activities	**(42,955)**	4,174	332,923
Cash flows of discontinued operations			
Operating activities	**(106,510)**	(127,355)	(103,769)
Investing activities	**88,398**	152,076	91,998
Financing activities	**5,000**	(5,316)	(301)
Net cash provided by (used in) discontinued operations	**(13,112)**	19,405	(12,072)
Net cash provided by (used in) continuing operations	**(39,521)**	16,188	8,803
Cash at beginning of period	**57,646**	41,458	32,655
Cash at end of period	**$ 18,125**	$ 57,646	$ 41,458
Supplemental disclosures of cash flow information			
Cash paid during the period for:			
Interest	**$ 200**	$ 505	$ 4,350
Income taxes paid (refunds received)	**$ 179,984**	$ 191,680	$ 105,282

See accompanying Notes to Consolidated Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Principles

a. Principles of Financial Statement Presentation

Alleghany Corporation, a Delaware corporation, which together with its subsidiaries is referred to as Alleghany unless the context otherwise requires, is engaged in the property and casualty and surety insurance business through its wholly-owned subsidiary Alleghany Insurance Holdings LLC (AIHL). AIHL s insurance business is conducted through its wholly-owned subsidiaries RSUI Group, Inc. (RSUI), Capitol Transamerica Corporation and Platte River Insurance Company (Platte River) (collectively, CATA unless the context otherwise requires) and AIHL s majority-owned subsidiary, Employers Direct Corporation (EDC), of which AIHL owns approximately 98.5 percent. AIHL Re LLC (AIHL Re), a captive reinsurance subsidiary of AIHL, has, in the past, been available to provide reinsurance to Alleghany operating units and affiliates. In addition, Alleghany owns approximately 33 percent of the outstanding shares of common stock of Homesite Group Incorporated (Homesite), a national, full-service, mono-line provider of homeowners insurance, and approximately 40 percent of ORX Exploration, Inc. (ORX), a regional oil and gas exploration and production company. These investments are reflected in Alleghany s financial statements in other invested assets. Alleghany also owns and manages properties in Sacramento, California through its subsidiary Alleghany Properties Holdings LLC (Alleghany Properties), and conducts corporate investment and other activities at the parent level, including the holding of strategic equity investments. These strategic equity investments are available to support the internal growth of subsidiaries and for acquisitions of, and substantial investments in, operating companies. Alleghany also owned approximately 55 percent of Darwin Professional Underwriters, Inc. (Darwin) until its disposition on October 20, 2008. Accordingly, the operations of Darwin have been reclassified as discontinued operations for all periods presented. See Note 2.

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

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

During the third quarter of 2008, Alleghany identified an error in the amount of $15.0 million with respect to additional deferred tax liability that relates to prior periods. The $15.0 million specifically relates to the capital gains taxes incurred by Alleghany at the date of Darwin s disposition. GAAP requires that capital gains taxes be accrued for over time as income is reported, from the date of Darwin s initial public offering in May 2006 until the date of Darwin s disposition. As a result, for the year ended December 31, 2007, earnings from discontinued operations (as well as net earnings) were reduced by $6.2 million related to the portion of the $15.0 million attributable to 2007. Similarly, for the year ended December 31, 2006, earnings from discontinued operations and net earnings were reduced by $3.3 million. Similar corrections to earnings from discontinued operations and net earnings will be made in future reports for the three-month period ended March 31, 2008 and for the six-month period ended June 30, 2008 in the amounts of $2.9 million and $5.5 million, respectively. These corrections are not material to Alleghany s consolidated financial statements.

b. Investments

Investments consist of equity securities, debt securities, short-term investments and other invested assets. Alleghany classifies its equity securities, debt securities and short-term investments as available for sale. Debt securities consist of securities with an initial fixed maturity of more than one year. Short-term investments include

Notes to Consolidated Financial Statements, continued

1. Summary of Significant Accounting Principles, continued

commercial paper, certificates of deposit, money market instruments and any fixed maturity with an initial maturity of one year or less.

At December 31, 2008 and 2007, available-for-sale securities are recorded at fair value.

Unrealized gains and losses during the year, net of the related tax effect applicable to available-for-sale securities, are excluded from earnings and reflected in comprehensive income and the cumulative effect is reported as a separate component of stockholders equity until realized. A decline in the fair value of an available-for-sale security below its cost that is deemed other-than-temporary is charged to earnings.

Realized gains and losses on investments are determined in accordance with the specific identification method.

Other invested assets include strategic equity investments in operating companies which are accounted for under the equity method, and partnership investments which are accounted for as either available-for-sale or equity-method investments.

Premiums and discounts arising from the purchase of certain debt securities are treated as a yield adjustment over the estimated useful life of the securities, adjusted for anticipated prepayments using the retrospective interest method. Under this method, the effective yield on a security is estimated. Such estimates are based on the prepayment terms of the security, past actual cash flows and assumptions as to future expected cash flow. The future cash flow assumptions consider various prepayment assumptions based on historical experience, as well as current market conditions. Periodically, the effective yield is re-estimated to reflect actual prepayments and updated future cash flow assumptions. Upon a re-estimation, the security s book value is restated at the most recently calculated effective yield, assuming that yield had been in effect since the security was purchased. This treatment results in an increase or decrease to net investment income (amortization of premium or discount) at the new measurement date.

c. Derivative Financial Instruments

Alleghany entered into an interest rate swap for purposes of matching interest expense with interest income. The interest rate swap was accounted for as a hedge of the obligation. Interest expense was recorded using the revised interest rate. The interest rate swap matured in January 2007, at no gain or loss to Alleghany.

d. Cash

For purposes of the consolidated statements of cash flows and consolidated balance sheets, cash includes all deposit balances with a bank that are available for immediate withdrawal, whether interest-bearing or non-interest bearing.

e. Premiums and Unearned Premiums

Premiums are recognized as revenue on a pro-rata basis over the term of an insurance policy. This recognition method is based on the short term (twelve months or less) nature of the lines of business written by AIHL s insurance operating units, which consist of property and casualty and surety lines. Unearned premiums represent the portion of premiums written which are applicable to the unexpired terms of insurance policies in force.

Premium balances receivable are reported net of an allowance for estimated uncollectible premium amounts. Ceded premiums are charged to income over the applicable terms of the various reinsurance contracts with third-party reinsurers.

Notes to Consolidated Financial Statements, continued

1. Summary of Significant Accounting Principles, continued

f. Reinsurance Recoverables

AIHL s insurance operating units reinsure a significant portion of the risks they underwrite in order to mitigate their exposure to losses, manage capacity and protect capital resources. Reinsuring loss exposures does not relieve AIHL s insurance operating units from their obligations to policyholders. AIHL s insurance operating units remain liable to their policyholders for the portion reinsured to the extent that any reinsurer does not meet the obligations assumed under the reinsurance agreements. To minimize their exposure to losses from a reinsurer s inability to pay, AIHL s insurance operating units evaluate the financial condition of their reinsurers upon placement of the reinsurance and periodically thereafter.

Reinsurance recoverables (including amounts related to IBNR and prepaid reinsurance premiums) are reported as assets. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business. Ceded premiums are charged to income over the applicable terms of the various reinsurance contracts with third-party reinsurers.

Reinsurance contracts that do not result in a reasonable possibility that the reinsurer may realize a significant loss from the insurance risk assumed and that do not provide for the transfer of significant insurance risk generally do not meet the conditions for reinsurance accounting and are accounted for as deposits. Alleghany currently does not have any reinsurance contracts that qualify for deposit accounting.

g. Deferred Acquisition Costs

Acquisition costs related to unearned premiums that vary with, and are directly related to, the production of such premiums (principally commissions, premium taxes, compensation and certain other underwriting expenses) are deferred. Deferred acquisition costs are amortized to expense as the related premiums are earned. Deferred acquisition costs amortized to expense in 2008 and 2007 were $155.2 million and $146.1 million, respectively.

Deferred acquisition costs are periodically reviewed to determine their recoverability from future income, including investment income, and if any such costs are determined to be not recoverable they are charged to expense. In the second quarter of 2008, EDC wrote-off its deferred acquisition cost asset of $2.1 million, primarily reflecting a significant acceleration in claims emergence and higher than anticipated increases in industry-wide severity.

h. Property and Equipment

Property and equipment is recorded at cost, net of accumulated depreciation and amortization. Depreciation of buildings and equipment is principally calculated using the straight-line method over the estimated useful life of the respective assets. Estimated useful lives for such assets range from 3 to 20 years. Amortization of leasehold improvements is principally calculated using the straight-line method over the estimated useful life of the leasehold improvement or the life of the lease, whichever is less. Rental expense on operating leases is recorded on a straight-line basis over the term of the lease, regardless of the timing of actual lease payments.

i. Goodwill and Other Intangible Assets

Goodwill and other intangible assets, net of amortization, is recorded as a result of business acquisitions. Other intangible assets that are not deemed to have an indefinite useful life are amortized over their estimated useful lives. Goodwill and other intangible assets deemed to have an indefinite useful life are tested annually in the fourth quarter of every year for impairment. Goodwill and other intangible assets are also tested whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. A significant amount of judgment is required in performing goodwill and other intangible assets impairment tests. These tests include estimating the fair value of Alleghany s operating units and other intangible assets. With respect to goodwill, as required by Financial Accounting Standards Board Statement No. 142 (SFAS 142) a comparison is made between the estimated fair values of Alleghany s operating units with their respective carrying amounts

Notes to Consolidated Financial Statements, continued

1. Summary of Significant Accounting Principles, continued

including goodwill. Under SFAS 142, fair value refers to the amount for which the entire operating unit may be bought or sold. The methods for estimating operating unit values include asset and liability fair values and other valuation techniques, such as discounted cash flows and multiples of earnings or revenues. All of these methods involve significant estimates and assumptions. If the carrying value exceeds estimated fair value, there is an indication of potential impairment, and a second step is performed to measure the amount of impairment. The second step involves calculating an implied fair value of goodwill by measuring the excess of the estimated fair value of Alleghany s operating units over the aggregate estimated fair values of the individual assets less liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill, an impairment charge is recorded for the excess. Subsequent reversal of any goodwill impairment charge is not permitted.

In connection with impairment testing of goodwill and other intangible assets during the fourth quarter of 2008, Alleghany determined that the $48.7 million of goodwill associated with Alleghany s acquisition of EDC was impaired. As a result, as of December 31, 2008, Alleghany recorded a non-cash charge of $48.7 million, which is classified as a net realized capital loss in Alleghany s consolidated statement of earnings and represents the entire EDC goodwill balance at such date. See Note 4 for further information on this impairment as well as information on goodwill and other intangible assets.

j. Income Taxes

Alleghany files a consolidated federal income tax return with its subsidiaries. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

k. Loss Reserves

The reserves for losses and loss adjustment expenses represent management s best estimate of the ultimate cost of all reported and unreported losses incurred through the balance sheet date and include, but are not limited to: (i) the accumulation of individual estimates for claims reported on direct business prior to the close of an accounting period; (ii) estimates received from reinsurers with respect to reported claims which have been reinsured; (iii) estimates for claims incurred but not reported (IBNR) based on past experience modified for current trends and industry data; and (iv) estimates of expenses for investigating and settling claims based on past experience. The reserves recorded are based on estimates resulting from the review process, and differences between estimates and ultimate payments are reflected as an expense in the statement of earnings in the period in which the estimates are revised.

l. Revenue Recognition for Land Sales

Revenue and profits from land sales are recognized using the full accrual method when title has passed to the buyer, the collectibility of the sales price is reasonably assured, the required minimum cash down payment has been received and Alleghany has no continuing involvement with the property. Alleghany records land sales under the full accrual method as all requirements have been met.

m. Earnings Per Share of Common Stock

Basic earnings per share of common stock are based on the average number of shares of common stock, par value $1.00 per share, of Alleghany (Common Stock) outstanding during the years ended December 31, 2008, 2007 and 2006, respectively, retroactively adjusted for stock dividends. Diluted earnings per share of Common Stock are based on those shares used to calculate basic earnings per common share. Diluted earnings per share of

Notes to Consolidated Financial Statements, continued

1. Summary of Significant Accounting Principles, continued

Common Stock also include the dilutive effect of stock-based compensation awards, retroactively adjusted for stock dividends.

n. Share-Based Compensation Plans

Alleghany follows Statement of Financial Accounting Standards No. 123 (revised), Share Based Payment (SFAS 123R). SFAS 123R requires that the cost resulting from all share-based compensation transactions be recognized in the financial statements, establishes fair value as the measurement objective in accounting for share-based compensation arrangements, and requires the application of the fair value based measurement method in accounting for share-based compensation transactions with employees. SFAS 123R was adopted by Alleghany for awards made or modified on or after January 1, 2006. Prior to SFAS 123R, Alleghany followed Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123). SFAS 123 established accounting and reporting standards for share-based employee compensation plans and allowed companies to choose between the fair value based method of accounting as defined in SFAS 123 and the intrinsic value based method of accounting as prescribed by Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB25). Alleghany had elected to continue to follow the intrinsic value based method of accounting for awards granted prior to 2003, and accordingly, no expense was recognized with respect to stock option grants. Effective January 1, 2003, Alleghany adopted the fair value based method of accounting of SFAS 123, using the prospective transition method for awards granted after January 1, 2003. The fair value based method under SFAS 123 is similar to that employed under SFAS 123R. The impact of the adoption of SFAS 123R on Alleghany s consolidated financial results and financial condition was immaterial. Both SFAS 123 and SFAS 123R treat non-employee directors as employees for accounting purposes.

With respect to stock option grants, the fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Common Stock. Alleghany uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

	2008	2007	2006
Expected volatility	19%	18%	18%-19%
Expected dividends			
Expected term (in years)	10	8-10	7-8
Risk-free rate	3.8%	5.2%	3.2%-5.2%

See Note 10 for further information on stock option grants as well as information on all other types of share-based compensation awards.

o. Reclassification

Certain prior year amounts have been reclassified to conform to the 2008 presentation.

p. Recent Accounting Standards

Recently Adopted

In September 2006, FASB Statement No. 157, Fair Value Measurements, (SFAS 157) was issued. SFAS 157 provides guidance for using fair value to measure assets and liabilities. SFAS 157 does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Alleghany has adopted the

Notes to Consolidated Financial Statements, continued

1. Summary of Significant Accounting Principles, continued

provisions of SFAS 157 as of January 1, 2008, and the implementation did not have any material impact on Alleghany s results of operations and financial condition. See Note 14.

In October 2008, Financial Accounting Standards Board Staff Position No. 157-3 (FSP FAS 157-3) was issued. FSP FAS 157-3 clarifies the application of SFAS 157 in an inactive market. If a market becomes inactive, then the fair value determination for securities in that market may be based on inputs that are unobservable in the market, rather than being based on either unadjusted quoted prices or observable market inputs. FSP FAS 157-3 is effective upon issuance, including periods for which financial statements have not been issued. Alleghany has adopted the provisions of FSP FAS 157-3 as of September 30, 2008, and the implementation did not have a material impact on its results of operations and financial condition. See Note 14.

Future Application of Accounting Standards

In December 2007, FASB Statements No. 141 (revised 2007), Business Combinations (SFAS 141R), and No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160) were issued. SFAS 141R replaces FASB Statement No. 141, Business Combinations (SFAS 141). SFAS 141R: requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose additional information regarding the nature and financial effect of the business combination. SFAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries in the same way as equity in the consolidated financial statements. SFAS 160 also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. Alleghany will adopt SFAS 141R and SFAS 160 for all business combinations initiated after December 31, 2008.

q. Statutory Accounting Practices

Alleghany s insurance operating units, domiciled principally in the States of California, New Hampshire, Delaware, Wisconsin and Nebraska, prepare statutory financial statements in accordance with the accounting practices prescribed or permitted by the insurance departments of the states of domicile. Prescribed statutory accounting practices are those practices that are incorporated directly or by reference in state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled in a particular state. Permitted statutory accounting practices include practices not prescribed by the domiciliary state, but allowed by the domiciliary state regulatory authority. The impact of any permitted accounting practices on statutory surplus of Alleghany is not material.

2. Discontinued Operations

On October 20, 2008, Darwin, of which AIHL owned approximately 55 percent, merged with Allied World Assurance Company Holdings, Ltd. (AWAC) whereby AWAC acquired all of the issued and outstanding shares of Darwin common stock for cash consideration of $32.00 per share (the Transaction). At that time, Alleghany received aggregate proceeds of approximately $300 million in cash for AIHL s 9,371,096 shares of Darwin common stock. Alleghany recorded an after-tax gain from the Transaction of approximately $92.1 million in the 2008 fourth quarter, including approximately $9.5 million of gain deferred at the time of Darwin s initial public offering in May 2006.

Alleghany has classified the operations of Darwin as discontinued operations in its consolidated financial statements for all periods presented.

Notes to Consolidated Financial Statements, continued

2. Discontinued Operations, continued

Historical balance sheet information related to the discontinued operations of Darwin, as included in Alleghany s consolidated financial statements, is set forth in the following table (in millions):

	December 31, 2007
Assets	
Available-for-sale securities at fair value	$ 449.4
Short-term investments	107.6
Cash	7.5
Reinsurance recoverables	136.4
Ceded unearned premium reserves	43.2
Other	68.0
	$ 812.1
Liabilities	
Losses and loss adjustment expenses	$ 387.9
Unearned premiums	141.1
Debt	5.0
Other	23.9
Minority interest (carried at the AIHL level)	105.4
	663.3
Alleghany Equity	
Alleghany s investment in Darwin	148.8
	$ 812.1

Alleghany s investment in Darwin excludes the portion of Darwin s stockholders equity that is attributable to common stockholders other than Alleghany.

Notes to Consolidated Financial Statements, continued

2. Discontinued Operations, continued

Historical information related to the results of operations of the discontinued operations of Darwin, as included in Alleghany s consolidated financial statements, is set forth in the following table (in millions):

	January 1, 2008 Through October 19, 2008	Years Ended December 31, 2007	2006
Revenues			
Net premiums earned	$ 170.9	$ 180.9	$ 132.4
Net investment income	19.4	22.6	16.4
Net realized capital (losses)	(3.4)		
Other income	4.7		
	191.6	203.5	148.8
Costs and expenses			
Losses and loss adjustment expenses	67.6	101.3	88.6
Commission, brokerage and other underwriting expenses	65.2	50.9	36.4
Other operating expenses	17.9	5.9	0.7
	150.7	158.1	125.7
Earnings before income taxes and minority interest	40.9	45.4	23.1
Income taxes	11.0	13.2	7.2
Earnings before minority interest	29.9	32.2	15.9
Minority interest*	14.6	20.7	8.9
Net earnings	$ 15.3	$ 11.5	$ 7.0

* Represents the portion of Darwin s earnings that is attributable to common stockholders other than Alleghany, as well as parent capital gains taxes incurred (see Note 1a). These expense accruals were made at the AIHL level.

Earnings before income taxes and minority interest during the 2008 period include a $32.5 million release of prior accident year loss reserves ($21.1 million after tax and before minority interest), reflecting favorable loss emergence. Net earnings during the 2008 period excludes the gain recorded associated with the Transaction of approximately $92.1 million in the 2008 fourth quarter, including approximately $9.5 million of gain deferred at the time of Darwin s initial public offering in May 2006.

Notes to Consolidated Financial Statements, continued

3. Investments

Available-for-sale securities at December 31, 2008 and 2007 are summarized as follows (in millions):

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2008				
Consolidated				
Equity securities:				
Common stock	$ 453.5	$ 215.0	$ (48.7)	$ 619.8
Preferred stock	9.7			9.7
Debt securities:				
U.S. Government obligations	274.7	11.9		286.6
Mortgage and asset-backed securities	707.7	10.1	(63.3)	654.5
States, municipalities, political subdivisions	1,421.8	23.4	(11.1)	1,434.1
Foreign	172.5	6.6	(1.8)	177.3
Corporate bonds and other	205.1	4.1	(1.7)	207.5
	2,781.8	56.1	(77.9)	2,760.0
Short-term investments	636.2			636.2
	$ 3,881.2	$ 271.1	$ (126.6)	$ 4,025.7
Industry Segment				
AIHL insurance group	$ 3,624.0	$ 79.2	$ (125.9)	$ 3,577.3
Corporate activities	257.2	191.9	(0.7)	448.4
	$ 3,881.2	$ 271.1	$ (126.6)	$ 4,025.7

Notes to Consolidated Financial Statements, continued

3. Investments, continued

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2007				
Consolidated				
Equity securities:				
Common stock	$ 656.6	$ 504.0	$ (27.6)	$ 1,133.0
Preferred stock	34.8	9.7	(1.1)	43.4
Debt securities:				
U.S. Government obligations	282.8	6.6	(0.1)	289.3
Mortgage and asset-backed securities	693.1	5.3	(5.4)	693.0
States, municipalities, political subdivisions	1,149.1	11.2	(2.2)	1,158.1
Foreign	176.0	6.2	(0.1)	182.1
Corporate bonds and other	240.5	2.6	(0.9)	242.2
	2,541.5	31.9	(8.7)	2,564.7
Short-term investments	316.9			316.9
	$ 3,549.8	$ 545.6	$ (37.4)	$ 4,058.0
Industry Segment				
AIHL insurance group	$ 3,345.6	$ 186.1	$ (36.8)	$ 3,494.9
Corporate activities	204.2	359.5	(0.6)	563.1
	$ 3,549.8	$ 545.6	$ (37.4)	$ 4,058.0

The amortized cost and estimated fair value of debt securities at December 31, 2008 by contractual maturity are shown below (in millions). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Short-term investments due in one year or less	$ 636.2	$ 636.2
Mortgage and asset-backed securities	707.7	654.5
Debt securities		
One year or less	165.0	166.7

Over one through five years	978.5	1,002.4
Over five through ten years	337.1	344.2
Over ten years	593.5	592.2
Equity securities	463.2	629.5
	$ 3,881.2	$ 4,025.7

The proceeds from sales of available-for-sale securities were $1,149.4 million, $824.3 million and $298.4 million, in 2008, 2007 and 2006, respectively. The amounts of gross realized gains and gross realized losses of available-for-sale securities were, respectively, $259.9 million and $303.3 million in 2008, $103.1 million and $10.3 million in 2007 and $38.6 million and $10.4 million in 2006. The gross loss amounts include impairment charges, as discussed below.

Notes to Consolidated Financial Statements, continued

3. Investments, continued

Alleghany continually monitors the difference between cost and the estimated fair value of its investments, which involves uncertainty as to whether declines in value are temporary in nature. If a decline in the value of a particular investment is deemed temporary, Alleghany records the decline as an unrealized loss in common stockholders equity. If a decline is deemed to be other than temporary, it is written down to the carrying value of the investment and a realized loss is recorded on Alleghany s statement of earnings. Management s assessment of a decline in value includes, among other things, (i) the duration of time and the relative magnitude to which fair value of the investment has been below cost; (ii) the financial condition and near-term prospects of the issuer of the investment; (iii) extraordinary events, including negative news releases and rating agency downgrades, with respect to the issuer of the investment; and (iv) Alleghany s ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. If that judgment changes in the future, Alleghany may ultimately record a realized loss after having originally concluded that the decline in value was temporary. If the review indicates that the declines were other-than-temporary, Alleghany would record a realized capital loss. A debt security is impaired if it is probable that Alleghany will not be able to collect all amounts due under the security s contractual terms. An equity investment is deemed impaired if, among other things, its decline in estimated fair value has existed for more than twelve months or more or if its decline in estimated fair value from its cost is greater than 50 percent, absent compelling evidence to the contrary. Further, for securities expected to be sold, an other-than-temporary impairment charge is recognized if Alleghany does not expect the fair value of a security to recover its cost prior to the expected date of sale.

Net realized capital gains in 2008 include $244.0 million of impairment charges related to unrealized losses that were deemed to be other than temporary and, as such, are required to be charged against earnings. Of the $244.0 million of impairment charges, $144.8 million related to energy sector (including refinery) equity holdings, $34.4 million related to financial sector equity holdings, $30.4 million related to construction sector equity holdings, $13.6 million related to mining sector equity holdings, $17.6 million related to equity holdings in other sectors and $3.2 million related to fixed income security holdings. The determination that unrealized losses on such securities were other than temporary was primarily based on the severity of the declines in fair value of such securities relative to cost as of the balance sheet date. Such severe declines are primarily related to a significant deterioration of U.S. equity market conditions during 2008. Net realized capital gains in 2007 and 2006 include $7.7 million and $4.7 million, respectively, of impairment charges related to unrealized losses that were deemed to be other than temporary and, as such, are required to be charged against earnings.

Notes to Consolidated Financial Statements, continued

3. Investments, continued

After adjusting the cost basis of securities for the recognition of unrealized losses through impairment charges, the gross unrealized investment losses and related fair value for debt securities and equity securities at December 31, 2008 and December 31, 2007, were as follows (in millions):

	Fair Value	Gross Unrealized Losses
2008		
Debt securities		
U.S. Government obligations		
Less than 12 months	$	$
More than 12 months		
Mortgage & asset-backed securities		
Less than 12 months	311.9	46.1
More than 12 months	57.0	17.2
States, municipalities & political subdivisions		
Less than 12 months	380.1	8.6
More than 12 months	20.9	2.5
Foreign		
Less than 12 months	54.9	1.8
More than 12 months		
Corporate bonds and other		
Less than 12 months	39.8	1.1
More than 12 months	11.4	0.6
Total debt securities		
Less than 12 months	786.7	57.6
More than 12 months	89.3	20.3
Equity securities		
Less than 12 months	151.5	48.7
More than 12 months		