ALLEGHANY CORP /DE
Form 10-Q
November 01, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM __________ TO __________

COMMISSION FILE NUMBER 1-9371

ALLEGHANY CORPORATION

EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER

DELAWARE

STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION

51-0283071

I.R.S. EMPLOYER IDENTIFICATION NO.

1411 BROADWAY, 34TH FLOOR, NY, NY 10018

ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE

212-752-1356

REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE

NOT APPLICABLE

FORMER NAME, FORMER ADDRESS, AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT

INDICATE BY CHECK MARK WHETHER THE REGISTRANT: (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS. YES NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT HAS SUBMITTED ELECTRONICALLY AND POSTED ON ITS CORPORATE WEB SITE, IF ANY, EVERY INTERACTIVE DATA FILE REQUIRED TO BE SUBMITTED AND POSTED PURSUANT TO RULE 405 OF REGULATION S-T (SECTION 232.405 OF THIS CHAPTER) DURING THE PRECEDING 12 MONTHS (OR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO SUBMIT AND POST SUCH FILES). YES NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, A NON-ACCELERATED FILER OR A SMALLER REPORTING COMPANY. SEE THE DEFINITIONS OF LARGE ACCELERATED FILER, ACCELERATED FILER, AND SMALLER REPORTING COMPANY IN RULE 12b-2 OF THE EXCHANGE ACT. (CHECK ONE):

LARGE ACCELERATED FILER		ACCELERATED FILER
NON-ACCELERATED FILER	(DO NOT CHECK IF A SMALLER REPORTING COMPANY)	SMALLER REPORTING COMPANY

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT). YES NO

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER S CLASSES OF COMMON STOCK, AS OF THE LAST PRACTICABLE DATE.

15,419,275 SHARES, PAR VALUE $1.00 PER SHARE, AS OF OCTOBER 26, 2016

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ALLEGHANY CORPORATION

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

	September 30, 2016 (unaudited)	December 31, 2015
	($ in thousands, except share amounts)	
Assets		
Investments:		
Available-for-sale securities at fair value:		
Equity securities (cost: 2016 $2,742,037; 2015 $2,740,984)	$ 2,983,372	$ 3,005,908
Debt securities (amortized cost: 2016 $13,229,154; 2015 $13,529,923)	13,636,512	13,605,963
Short-term investments	752,374	365,810
	17,372,258	16,977,681
Commercial mortgage loans	514,891	177,947
Other invested assets	639,513	676,811
Total investments	18,526,662	17,832,439
Cash	568,907	475,267
Accrued investment income	110,174	115,313
Premium balances receivable	796,444	752,103
Reinsurance recoverables	1,208,250	1,249,948
Ceded unearned premiums	207,956	190,368
Deferred acquisition costs	459,410	419,448
Property and equipment at cost, net of accumulated depreciation and amortization	109,821	101,306
Goodwill	277,057	141,015
Intangible assets, net of amortization	358,233	212,790
Current taxes receivable	6,000	12,129
Net deferred tax assets	251,247	468,440
Funds held under reinsurance agreements	533,921	234,549
Other assets	702,917	633,964
Total assets	$ 24,116,999	$ 22,839,079
Liabilities, Redeemable Noncontrolling Interests and Stockholders Equity		
Loss and loss adjustment expenses	$ 11,058,103	$ 10,799,242
Unearned premiums	2,240,139	2,076,061

Senior Notes	1,383,680	1,383,086
Reinsurance payable	101,380	69,297
Other liabilities	1,151,390	930,967
Total liabilities	15,934,692	15,258,653
Redeemable noncontrolling interests	77,185	25,719
Common stock (shares authorized: 2016 and 2015 22,000,000; shares issued: 2016 and 2015 17,459,961)	17,460	17,460
Contributed capital	3,611,734	3,611,631
Accumulated other comprehensive income	331,593	116,273
Treasury stock, at cost (2016 2,025,332 shares; 2015 1,915,884 shares)	(800,199)	(747,784)
Retained earnings	4,944,534	4,557,127
Total stockholders equity attributable to Alleghany stockholders	8,105,122	7,554,707
Total liabilities, redeemable noncontrolling interest and stockholders equity	$ 24,116,999	$ 22,839,079

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Earnings and Comprehensive Income (Loss)

(unaudited)

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015
	($ in thousands, except per share amounts)	
Revenues		
Net premiums earned	$ 1,253,515	$ 1,049,071
Net investment income	120,603	118,159
Net realized capital gains	27,221	29,202
Other than temporary impairment losses	(11,729)	(52,680)
Other revenue	225,006	45,285
Total revenues	1,614,616	1,189,037
Costs and Expenses		
Net loss and loss adjustment expenses	718,556	594,729
Commissions, brokerage and other underwriting expenses	423,042	360,203
Other operating expenses	228,408	68,453
Corporate administration	10,745	10,922
Amortization of intangible assets	6,008	(1,104)
Interest expense	20,682	22,691
Total costs and expenses	1,407,441	1,055,894
Earnings before income taxes	207,175	133,143
Income taxes	48,328	36,045
Net earnings	158,847	97,098
Net earnings attributable to noncontrolling interest	3,016	568
Net earnings attributable to Alleghany stockholders	$ 155,831	$ 96,530
Net earnings	$ 158,847	$ 97,098
Other comprehensive income:		
Change in unrealized gains (losses), net of deferred taxes of $25,123 and ($81,256) for 2016 and 2015, respectively	46,657	(150,904)
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes of ($5,422) and $8,217 for 2016 and 2015, respectively	(10,070)	15,261

Change in unrealized currency translation adjustment, net of deferred taxes of ($1,637) and ($208) for 2016 and 2015, respectively		(3,041)		(386)
Retirement plans		95		129
Comprehensive income (loss)		192,488		(38,802)
Comprehensive income attributable to noncontrolling interest		3,016		568
Comprehensive income (loss) attributable to Alleghany stockholders	$	189,472	$	(39,370)
Basic earnings per share attributable to Alleghany stockholders	$	10.09	$	6.07
Diluted earnings per share attributable to Alleghany stockholders		10.09		6.07

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Earnings and Comprehensive Income

(unaudited)

	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
	($ in thousands, except per share amounts)	
Revenues		
Net premiums earned	$ 3,736,596	$ 3,140,965
Net investment income	332,326	334,628
Net realized capital gains	117,126	158,513
Other than temporary impairment losses	(38,216)	(112,278)
Other revenue	527,765	125,270
Total revenues	4,675,597	3,647,098
Costs and Expenses		
Net loss and loss adjustment expenses	2,198,512	1,737,100
Commissions, brokerage and other underwriting expenses	1,238,712	1,067,766
Other operating expenses	575,527	199,670
Corporate administration	33,938	33,441
Amortization of intangible assets	14,490	(3,815)
Interest expense	61,384	69,158
Total costs and expenses	4,122,563	3,103,320
Earnings before income taxes	553,034	543,778
Income taxes	162,274	138,113
Net earnings	390,760	405,665
Net earnings attributable to noncontrolling interest	3,353	1,448
Net earnings attributable to Alleghany stockholders	$ 387,407	$ 404,217
Net earnings	$ 390,760	$ 405,665
Other comprehensive income:		
Change in unrealized gains (losses), net of deferred taxes of $128,379 and ($106,986) for 2016 and 2015, respectively	238,418	(198,689)
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes of ($22,999) and ($16,182) for 2016 and 2015, respectively	(42,712)	(30,053)

Change in unrealized currency translation adjustment, net of deferred taxes of $10,318 and ($4,444) for 2016 and 2015, respectively		19,162		(8,253)
Retirement plans		452		(256)
Comprehensive income		606,080		168,414
Comprehensive income attributable to noncontrolling interest		3,353		1,448
Comprehensive income attributable to Alleghany stockholders	$	602,727	$	166,966
Basic earnings per share attributable to Alleghany stockholders	$	25.09	$	25.31
Diluted earnings per share attributable to Alleghany stockholders		25.08		25.30

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(unaudited)

	Nine Months Ended September 30, 2016	2015
	($ in thousands)	
Cash flows from operating activities		
Net earnings	$ 390,760	$ 405,665
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	115,020	124,533
Net realized capital (gains) losses	(117,126)	(158,513)
Other than temporary impairment losses	38,216	112,278
(Increase) decrease in reinsurance recoverables, net of reinsurance payable	73,781	(62,006)
(Increase) decrease in premium balance receivable	(44,341)	(38,766)
(Increase) decrease in ceded unearned premiums	(17,588)	(14,353)
(Increase) decrease in deferred acquisition costs	(39,962)	(24,099)
(Increase) decrease in funds held under reinsurance agreements	(299,372)	59,216
Increase (decrease) in unearned premiums	164,078	102,619
Increase (decrease) in loss and loss adjustment expenses	258,861	(174,724)
Change in unrealized foreign exchange losses (gains)	78,615	132,006
Other, net	(27,283)	97,802
Net adjustments	182,899	155,993
Net cash provided by (used in) operating activities	573,659	561,658
Cash flows from investing activities		
Purchases of debt securities	(4,665,980)	(5,866,914)
Purchases of equity securities	(1,163,687)	(2,793,006)
Sales of debt securities	3,953,367	4,295,126
Maturities and redemptions of debt securities	996,548	1,318,270
Sales of equity securities	1,197,612	2,320,298
Net (purchase) sale in short-term investments	(417,186)	391,904
Purchases of property and equipment	(18,982)	(45,285)
Purchase of subsidiary, net of cash acquired	(145,253)	(47,469)
Other, net	(208,213)	17,177
Net cash provided by (used in) investing activities	(471,774)	(409,899)
Cash flows from financing activities		

Treasury stock acquisitions	(55,678)	(192,522)
Other, net	38,861	14,926
Net cash provided by (used in) financing activities	(16,817)	(177,596)
Effect of exchange rate changes on cash	8,572	(16,235)
Net increase (decrease) in cash	93,640	(42,072)
Cash at beginning of period	475,267	605,259
Cash at end of period	$ 568,907	$ 563,187
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest paid	$ 56,423	$ 67,345
Income taxes paid (refund received)	51,969	22,613

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

1. Summary of Significant Accounting Principles

(a) Principles of Financial Statement Presentation

This Quarterly Report on Form 10-Q (this Form 10-Q) should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2015 (the 2015 Form 10-K) and the Quarterly Reports on Form 10-Q for the quarters ended March 31, 2016 and June 30, 2016 of Alleghany Corporation (Alleghany).

Alleghany, a Delaware corporation, which was initially incorporated in Delaware in 1929, owns and manages certain operating subsidiaries and investments, anchored by a core position in property and casualty reinsurance and insurance. Through its wholly-owned subsidiary Alleghany Insurance Holdings LLC (AIHL) and its subsidiaries, Alleghany is engaged in the property and casualty insurance business. AIHL s insurance operations are principally conducted by its subsidiaries RSUI Group, Inc. (RSUI), CapSpecialty, Inc. (CapSpecialty) and Pacific Compensation Corporation (PacificComp). CapSpecialty has been a subsidiary of AIHL since January 2002, RSUI has been a subsidiary of AIHL since July 2003 and PacificComp has been a subsidiary of AIHL since July 2007. AIHL Re LLC (AIHL Re), a captive reinsurance company which provides reinsurance to Alleghany s insurance operating subsidiaries and affiliates, has been a wholly-owned subsidiary of Alleghany since its formation in May 2006. Alleghany s reinsurance operations commenced on March 6, 2012 when Alleghany consummated a merger with Transatlantic Holdings, Inc. (TransRe) and TransRe became one of Alleghany s wholly-owned subsidiaries. Alleghany s public equity investments, including those held by TransRe s and AIHL s operating subsidiaries, are managed primarily through Alleghany s wholly-owned subsidiary Roundwood Asset Management LLC.

Although Alleghany s primary sources of revenues and earnings are its reinsurance and insurance operations and investments, Alleghany also manages, sources, executes and monitors certain private capital investments primarily through its wholly-owned subsidiary Alleghany Capital Corporation (Alleghany Capital). Alleghany Capital s private capital investments are included in other activities for segment reporting purposes and include: (i) Stranded Oil Resources Corporation (SORC), an exploration and production company focused on enhanced oil recovery, headquartered in Golden, Colorado; (ii) Bourn & Koch, Inc. (Bourn & Koch), a manufacturer and remanufacturer/retrofitter of precision machine tools and supplier of replacement parts, headquartered in Rockford, Illinois; (iii) R.C. Tway Company, LLC (Kentucky Trailer), a manufacturer of custom trailers and truck bodies for the moving and storage industry and other markets, headquartered in Louisville, Kentucky; (iv) IPS-Integrated Project Services, LLC (IPS), a technical service provider focused on the global pharmaceutical and biotechnology industries, headquartered in Blue Bell, Pennsylvania; (v) Jazwares, LLC (together with its affiliates, Jazwares), a toy and consumer electronics company, headquartered in Sunrise, Florida; and (vi) an approximately 15 percent equity interest in ORX Exploration, Inc. (ORX), a regional oil and gas exploration and production company, headquartered in New Orleans, Louisiana. The results of IPS have been included in Alleghany s consolidated results beginning with its acquisition by Alleghany Capital on October 31, 2015. On April 15, 2016, Alleghany Capital acquired an additional 50 percent of Jazwares outstanding equity, bringing its equity ownership interest to 80 percent and, as of that date, the results of Jazwares have been included in Alleghany s consolidated results. Prior to April 15, 2016, Jazwares was accounted for under the equity method of accounting. In the second quarter of 2016, Alleghany Capital s equity interest in ORX was reduced from approximately 40 percent to approximately 15 percent pursuant to an ORX recapitalization. ORX continues to be accounted for under the equity method of accounting. In addition, Alleghany owns and manages properties in the Sacramento, California region through its wholly-owned subsidiary Alleghany Properties Holdings LLC (Alleghany Properties).

Unless the context otherwise requires, references to Alleghany include Alleghany together with its subsidiaries.

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 material inter-company balances and transactions have been eliminated in consolidation.

The portion of stockholders equity, net earnings and accumulated other comprehensive income that is not attributable to Alleghany stockholders is presented on the Consolidated Balance Sheets and the Consolidated Statements of Earnings and Comprehensive Income as noncontrolling interest. Because all noncontrolling interests have the option to sell their ownership interests to Alleghany in the future (generally through 2023), the portion of stockholders equity that is not attributable to Alleghany stockholders is presented on the Consolidated Balance Sheets as redeemable noncontrolling interest for all periods presented. During the first nine months of 2016, Bourn & Koch had approximately 11 percent noncontrolling interests outstanding, Kentucky Trailer had approximately 20 percent noncontrolling interests outstanding, IPS had approximately 16 percent noncontrolling interests outstanding and, beginning April 15, 2016, Jazwares had approximately 20 percent noncontrolling interests outstanding.

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 as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period.

Alleghany relies on historical experience and on various other assumptions that it believes to be reasonable under the circumstances to make judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from those reported results to the extent that those estimates and assumptions prove to be inaccurate. Changes in estimates are reflected in the consolidated statement of earnings and comprehensive income in the period in which the change is made.

(b) Other Significant Accounting Principles

Alleghany s significant accounting principles can be found in Note 1 to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of the 2015 Form 10-K.

(c) Recent Accounting Standards

Recently Adopted

In February 2015, the Financial Accounting Standards Board (the FASB) issued guidance that amended the analysis that must be performed to determine whether an entity should consolidate certain types of legal entities. Under this guidance, the evaluation of whether limited partnerships and similar entities are variable interest entities or voting interest entities is modified, the presumption that general partners should consolidate limited partnerships is eliminated and the process to determine the primary beneficiary of a variable interest entity is modified. This guidance was effective in the first quarter of 2016. Alleghany adopted this guidance in the first quarter of 2016 and the implementation did not have a material impact on its results of operations and financial condition.

In April 2015, the FASB issued guidance that requires debt issuance costs related to debt liabilities be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, which is consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected. This guidance was effective in the first quarter of 2016. Alleghany adopted this guidance on a retrospective basis in the first quarter of 2016 and the implementation resulted in a reduction of other assets and a corresponding decrease in senior notes of approximately $7 million as of March 31, 2016 and December 31, 2015.

Future Application of Accounting Standards

In May 2014, the FASB, together with the International Accounting Standards Board, issued guidance on the recognition of revenue from contracts with customers. Under this guidance, revenue is recognized as the transfer of goods and services to customers takes place, and in amounts that reflect the payment or payments that are expected to be received from the customers for those goods and services. This guidance also requires new disclosures about revenue. Revenues related to insurance and reinsurance are not impacted by this guidance. In July 2015, the FASB decided to delay the effective date of the new revenue standard by a year. This guidance is now effective in the first quarter of 2018 for public entities, with early adoption permitted in 2017. Alleghany will adopt this guidance in the first quarter of 2018 and does not currently believe that the implementation will have a material impact on its results of operations and financial condition.

In May 2015, the FASB issued guidance that requires disclosures related to short-duration insurance contracts. The guidance applies to property and casualty insurance and reinsurance entities, among others, and requires the following annual disclosure related to the liability for loss and loss adjustment expenses (LAE): (i) net incurred and paid claims development information by accident year for up to ten years; (ii) a reconciliation of incurred and paid claims development information to the aggregate carrying amount of the liability for loss and LAE;
(iii) incurred-but-not-reported liabilities by accident year and in total; (iv) a description of reserving methodologies (as

well as any changes to those methodologies); (v) quantitative information about claim frequency by accident year; and (vi) the average annual percentage payout of incurred claims by age by accident year. In addition, the guidance requires insurance entities to disclose for annual and interim reporting periods a roll-forward of the liability for loss and LAE. This guidance is effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016, with early adoption permitted. Alleghany will adopt this guidance as of December 31, 2016 and does not currently believe that the implementation will have an impact on its results of operations and financial condition.

In January 2016, the FASB issued guidance that changes the recognition and measurement of certain financial instruments. This guidance requires investments in equity securities (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. For equity securities that do not have readily determinable fair values, measurement may be at cost, adjusted for any impairment and changes resulting from observable price changes for a similar investment of the same issuer. This guidance also changes the presentation and disclosure of financial instruments by: (i) requiring that financial instrument disclosures of fair value use the exit price notion; (ii) requiring separate presentation of financial assets and financial liabilities by measurement category and form, either on the balance sheet or the accompanying notes to the financial statements; (iii) requiring separate presentation in other comprehensive income for the portion of the change in a liability s fair value resulting from instrument-specific credit risk when an election has been made to measure the liability at fair value; and (iv) eliminating the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet. This guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Except for the change in presentation for instrument-specific credit risk, this guidance does not permit early adoption.

Alleghany will adopt this guidance in the first quarter of 2018. As of January 1, 2018, unrealized gains or losses of equity securities, net of deferred taxes, will be reclassified from accumulated other comprehensive income to retained earnings. Subsequently, all changes in unrealized gains or losses of equity securities, net of deferred taxes, will be presented in the consolidated statement of earnings, rather than the consolidated statement of comprehensive income. Alleghany does not currently believe that the implementation will have a material impact on its financial condition.

In February 2016, the FASB issued guidance on leases. Under this guidance, a lessee is required to recognize assets and liabilities for leases with terms of more than one year, whereas under current guidance, a lessee is only required to recognize assets and liabilities for those leases qualifying as capital leases. This guidance also requires new disclosures about the amount, timing and uncertainty of cash flows arising from leases. The accounting by lessors is to remain largely unchanged. This guidance is effective in the first quarter of 2019 for public entities, with early adoption permitted. Alleghany will adopt this guidance in the first quarter of 2019 and does not currently believe that the implementation will have a material impact on its results of operations and financial condition.

In June 2016, the FASB issued guidance on credit losses. Under this guidance, a company is required to measure all expected credit losses on loans, reinsurance recoverables and other financial assets accounted for at cost or amortized cost, as applicable. Estimates of expected credit losses are to be based on historical experience, current conditions and reasonable and supportable forecasts. Credit losses for securities accounted for on an available-for-sale (AFS) basis are to be measured in a manner similar to GAAP as currently applied and cannot exceed the amount by which fair value is less than the amortized cost. Credit losses for all financial assets are to be recorded through an allowance for credit losses. Subsequent reversals in credit loss estimates are permitted and are to be recognized in earnings. This guidance also requires new disclosures about the significant estimates and judgments used in estimating credit losses, as well as the credit quality of financial assets. This guidance is effective in the first quarter of 2020 for public entities, with early adoption permitted. Alleghany will adopt this guidance in the first quarter of 2020 and does not currently believe that the implementation will have a material impact on its results of operations and financial condition.

2. Fair Value of Financial Instruments

The carrying values and estimated fair values of Alleghany s consolidated financial instruments as of September 30, 2016 and December 31, 2015 were as follows:

	September 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	($ in millions)			
Assets				
Investments (excluding equity method investments and loans)(1)	$ 17,399.0	$ 17,399.0	$ 17,007.6	$ 17,007.6
Liabilities				
Senior Notes(2)	$ 1,383.7	$ 1,567.4	$ 1,383.1	$ 1,488.7

(1) This table includes AFS investments (debt and equity securities, as well as partnership and non-marketable equity investments carried at fair value that are included in other invested assets). This table excludes investments accounted for using the equity method and commercial mortgage loans that are carried at unpaid principal balance. The fair value of short-term investments approximates amortized cost. The fair value of all other categories of

investments is discussed in Note 1(c) to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of the 2015 Form 10-K.

(2) See Note 8 to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of the 2015 Form 10-K for additional information on the senior notes.

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Alleghany s financial instruments measured at fair value and the level of the fair value hierarchy of inputs used as of September 30, 2016 and December 31, 2015 were as follows:

	Level 1	Level 2	Level 3	Total
		($ in millions)		
As of September 30, 2016				
Equity securities:				
Common stock	$ 2,975.0	$ 3.5	$ 4.9	$ 2,983.4
Preferred stock	-	-	-	-
Total equity securities	2,975.0	3.5	4.9	2,983.4
Debt securities:				
U.S. Government obligations	-	1,222.5	-	1,222.5
Municipal bonds	-	4,484.9	-	4,484.9
Foreign government obligations	-	1,111.2	-	1,111.2
U.S. corporate bonds	-	2,024.6	74.3	2,098.9
Foreign corporate bonds	-	1,178.7	1.9	1,180.6
Mortgage and asset-backed securities:				
Residential mortgage-backed securities (RMBS[1])	-	1,163.8	6.0	1,169.8
Commercial mortgage-backed securities (CMBS)	-	825.1	12.2	837.3
Other asset-backed securities[2]	-	623.2	908.1	1,531.3
Total debt securities	-	12,634.0	1,002.5	13,636.5
Short-term investments	-	752.4	-	752.4
Other invested assets[3]	-	-	26.7	26.7
Total investments (excluding equity method investments and loans)	$ 2,975.0	$ 13,389.9	$ 1,034.1	$ 17,399.0
Senior Notes	$ -	$ 1,567.4	$ -	$ 1,567.4

	Level 1	Level 2	Level 3	Total
		($ in millions)		
As of December 31, 2015				
Equity securities:				
Common stock	$ 3,001.2	$ 4.7	$ -	$ 3,005.9
Preferred stock	-	-	-	-
Total equity securities	3,001.2	4.7	-	3,005.9

Debt securities:				
U.S. Government obligations	-	1,074.7	-	1,074.7
Municipal bonds	-	4,339.6	-	4,339.6
Foreign government obligations	-	941.4	-	941.4
U.S. corporate bonds	-	2,126.9	49.8	2,176.7
Foreign corporate bonds	-	1,230.3	-	1,230.3
Mortgage and asset-backed securities:				
RMBS(1)	-	1,238.5	14.9	1,253.4
CMBS	-	1,003.2	20.2	1,023.4
Other asset-backed securities(2)	-	613.5	953.0	1,566.5
Total debt securities	-	12,568.1	1,037.9	13,606.0
Short-term investments	-	365.8	-	365.8
Other invested assets(3)	-	-	29.9	29.9
Total investments (excluding equity method investments and loans)	$ 3,001.2	$ 12,938.6	$ 1,067.8	$ 17,007.6
Senior Notes	$ -	$ 1,488.7	$ -	$ 1,488.7

(1) Primarily includes government agency pass-through securities guaranteed by a government agency or government-sponsored enterprise, among other types of RMBS.

(2) Includes $904.5 million and $946.7 million of collateralized loan obligations as of September 30, 2016 and December 31, 2015, respectively.

(3) Includes partnership and non-marketable equity investments accounted for on an AFS basis, and excludes investments accounted for using the equity method.

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In the three and nine months ended September 30, 2016, there were transfers of $5.1 million and $5.4 million, respectively, of debt securities out of Level 3 that were principally due to an increase in observable inputs related to the valuation of such assets, and specifically, an increase in broker quotes. Of the $5.4 million of transfers, $5.1 million related to U.S. corporate bonds and $0.3 million related to other invested assets.

In the three and nine months ended September 30, 2016, there were transfers of $5.7 million and $8.4 million, respectively, of securities into Level 3 that were principally due to a decrease in observable inputs related to the valuation of such assets, and specifically, a decrease in broker quotes. Of the $8.4 million of transfers, $5.5 million related to U.S. corporate bonds, $1.9 million related to foreign corporate bonds and $1.0 million related to common stock. There were no other material transfers between Levels 1, 2 or 3 in the three and nine months ended September 30, 2016.

In the three and nine months ended September 30, 2015, there were transfers of $3.0 million and $19.3 million, respectively, of debt securities out of Level 3 that were principally due to an increase in observable inputs related to the valuation of such assets. Of the $19.3 million of transfers, $13.8 million related to U.S. corporate bonds and $5.5 million related to foreign corporate bonds.

In the three and nine months ended September 30, 2015, there were transfers of $5.9 million and $15.5 million, respectively, of securities into Level 3 that were principally due to a decrease in observable inputs related to the valuation of such assets. Of the $15.5 million of transfers, $9.8 million related to U.S. corporate bonds, $5.0 million related to other invested assets and $0.7 million related to foreign corporate bonds. There were no other material transfers between Levels 1, 2 or 3 in the three and nine months ended September 30, 2015.

The following tables present reconciliations of the changes during the nine months ended September 30, 2016 and 2015 in Level 3 assets measured at fair value:

		Debt Securities						
				Mortgage and asset-backed				
Nine Months Ended September 30, 2016	Common Stock	U.S. Corporate Bonds	Foreign Corporate Bonds	RMBS	CMBS	Other Asset-backed Securities	Other Invested Assets[1]	Total
				($ in millions)				
Balance as of January 1, 2016	$ -	$ 49.8	$ -	$ 14.9	$ 20.2	$ 953.0	$ 29.9	$ 1,067.8
Net realized/unrealized gains (losses) included in:								
Net earnings[2]	(0.1)	(0.5)	-	0.3	(0.1)	2.2	4.2	6.0
Other comprehensive income	1.8	1.4	-	(0.7)	0.8	25.1	(2.9)	25.5
Purchases	2.2	39.4	-	-	-	32.1	-	73.7
Sales	-	(14.5)	-	(7.0)	(8.2)	(70.7)	(4.2)	(104.6)
Issuances	-	-	-	-	-	-	-	-
Settlements	-	(1.7)	-	(1.5)	(0.5)	(33.6)	-	(37.3)
Transfers into Level 3	1.0	5.5	1.9	-	-	-	-	8.4
Transfers out of Level 3	-	(5.1)	-	-	-	-	(0.3)	(5.4)
Balance as of September 30, 2016	$ 4.9	$ 74.3	$ 1.9	$ 6.0	$ 12.2	$ 908.1	$ 26.7	$ 1,034.1

	Debt Securities						
			Mortgage and asset-backed				
Nine Months Ended September 30, 2015	U.S. Corporate Bonds	Foreign Corporate Bonds	RMBS	CMBS	Other Asset-backed Securities	Other Invested Assets(1)	Total
	($ in millions)						
Balance as of January 1, 2015	$ 36.7	$ 6.0	$ 18.2	$ 23.3	$ 933.1	$ 24.1	$ 1,041.4
Net realized/unrealized gains (losses) included in:							
Net earnings(2)	0.5	-	0.5	(0.3)	2.0	0.2	2.9
Other comprehensive income	(0.8)	0.8	(0.6)	(1.5)	(4.8)	0.8	(6.1)
Purchases	33.9	-	-	-	219.5	1.6	255.0
Sales	(1.8)	(2.0)	-	-	(167.9)	(0.2)	(171.9)
Issuances	-	-	-	-	-	-	-
Settlements	(12.9)	-	(2.2)	(0.6)	(7.9)	-	(23.6)
Transfers into Level 3	9.8	0.7	-	-	-	5.0	15.5
Transfers out of Level 3	(13.8)	(5.5)	-	-	-	-	(19.3)
Balance as of September 30, 2015	$ 51.6	$ -	$ 15.9	$ 20.9	$ 974.0	$ 31.5	$ 1,093.9

(1) Includes partnership and non-marketable equity investments accounted for on an AFS basis.

(2) There were no other than temporary impairment (OTTI) losses recorded in net earnings related to Level 3 investments still held as of September 30, 2016 and 2015.

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Net unrealized losses related to Level 3 investments as of September 30, 2016 and December 31, 2015 were not material.

See Note 1(c) to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of the 2015 Form 10-K for Alleghany s accounting policy on fair value.

3. Investments

(a) Unrealized Gains and Losses

The amortized cost or cost and the fair value of AFS securities as of September 30, 2016 and December 31, 2015 are summarized as follows:

	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	($ in millions)			
As of September 30, 2016				
Equity securities:				
Common stock	$ 2,742.0	$ 319.2	$ (77.8)	$ 2,983.4
Preferred stock	-	-	-	-
Total equity securities	2,742.0	319.2	(77.8)	2,983.4
Debt securities:				
U.S. Government obligations	1,194.6	29.3	(1.4)	1,222.5
Municipal bonds	4,310.0	185.4	(10.5)	4,484.9
Foreign government obligations	1,074.4	37.0	(0.2)	1,111.2
U.S. corporate bonds	2,020.8	80.7	(2.6)	2,098.9
Foreign corporate bonds	1,138.1	43.1	(0.6)	1,180.6
Mortgage and asset-backed securities:				
RMBS	1,144.8	25.3	(0.3)	1,169.8
CMBS	809.6	29.4	(1.7)	837.3
Other asset-backed securities[1]	1,536.9	7.8	(13.4)	1,531.3
Total debt securities	13,229.2	438.0	(30.7)	13,636.5
Short-term investments	752.4	-	-	752.4
Total investments	$ 16,723.6	$ 757.2	$ (108.5)	$ 17,372.3

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	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		($ in millions)		
As of December 31, 2015				
Equity securities:				
Common stock	$ 2,741.0	$ 351.9	$ (87.0)	$ 3,005.9
Preferred stock	-	-	-	-
Total equity securities	2,741.0	351.9	(87.0)	3,005.9
Debt securities:				
U.S. Government obligations	1,086.8	1.9	(14.0)	1,074.7
Municipal bonds	4,213.6	134.8	(8.8)	4,339.6
Foreign government obligations	924.1	18.6	(1.3)	941.4
U.S. corporate bonds	2,201.3	23.4	(48.0)	2,176.7
Foreign corporate bonds	1,219.0	24.0	(12.7)	1,230.3
Mortgage and asset-backed securities:				
RMBS	1,255.1	10.7	(12.4)	1,253.4
CMBS	1,024.8	8.2	(9.6)	1,023.4
Other asset-backed securities[1]	1,605.2	0.3	(39.0)	1,566.5
Total debt securities	13,529.9	221.9	(145.8)	13,606.0
Short-term investments	365.8	-	-	365.8
Total investments	$ 16,636.7	$ 573.8	$ (232.8)	$ 16,977.7

(1) Includes $904.5 million and $946.7 million of collateralized loan obligations as of September 30, 2016 and December 31, 2015, respectively.

(b) Contractual Maturity

The amortized cost and estimated fair value of debt securities by contractual maturity as of September 30, 2016 are shown below. 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 or Cost	Fair Value
	($ in millions)	
Short-term investments due in one year or less	$ 752.4	$ 752.4

Mortgage and asset-backed securities[1]	3,491.3	3,538.4
Debt securities with maturity dates:		
One year or less	364.6	365.8
Over one through five years	3,068.3	3,131.6
Over five through ten years	3,041.7	3,173.6
Over ten years	3,263.3	3,427.1
Total debt securities	13,229.2	13,636.5
Equity securities	2,742.0	2,983.4
Total	$ 16,723.6	$ 17,372.3

(1) Mortgage and asset-backed securities by their nature do not generally have single maturity dates.

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(c) Net Investment Income

Net investment income for the three and nine months ended September 30, 2016 and 2015 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	($ in millions)			
Interest income	$ 99.0	$ 96.1	$ 299.0	$ 283.2
Dividend income	12.2	13.8	35.5	40.1
Investment expenses	(6.2)	(7.1)	(19.8)	(20.4)
Equity in results of Pillar Investments(1)	5.9	7.3	12.9	14.9
Equity in results of Ares(1)	4.6	2.5	5.1	8.2
Equity in results of ORX	-	(1.6)	-	(6.3)
Other investment results	5.1	7.2	(0.4)	14.9
Total	$ 120.6	$ 118.2	$ 332.3	$ 334.6

(1) See Note 3(g) for discussion of the Pillar Investments and the investment in Ares, each as defined therein.
As of September 30, 2016, non-income producing invested assets were insignificant.

(d) Realized Gains and Losses

The proceeds from sales of AFS securities were $0.8 billion and $1.4 billion for the three months ended September 30, 2016 and 2015, respectively, and $5.2 billion and $6.6 billion for the nine months ended September 30, 2016 and 2015, respectively.

Realized capital gains and losses for the three and nine months ended September 30, 2016 and 2015 primarily reflect sales of equity and debt securities. In addition, Alleghany Capital recognized a gain of $13.2 million on April 15, 2016 in connection with its acquisition of an additional 50 percent equity ownership in Jazwares, when its pre-existing 30 percent equity ownership was remeasured at estimated fair value (the Jazwares Remeasurement Gain). Realized capital gains from equity securities for the nine months ended September 30, 2015 include the sales of certain equity securities resulting from a partial restructuring of the equity portfolio, as well as the sales of certain equity securities which had their cost basis reduced in earlier periods for the recognition of OTTI losses.

Gross realized capital gains and gross realized capital losses for the three and nine months ended September 30, 2016 and 2015 were as follows:

	Three Months Ended	Nine Months Ended

	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	($ in millions)			
Gross realized capital gains	$ 32.7	$ 42.4	$ 217.7	$ 258.6
Gross realized capital losses	(5.5)	(13.2)	(100.6)	(100.1)
Net realized capital gains	$ 27.2	$ 29.2	$ 117.1	$ 158.5

Gross realized loss amounts exclude OTTI losses, as discussed below.

(e) OTTI Losses

Alleghany holds its equity and debt securities as AFS, and as such, these securities are recorded at fair value. Alleghany continually monitors the difference between cost and the estimated fair value of its equity and debt investments, which involves uncertainty as to whether declines in value are temporary in nature. The analysis of a security s decline in value is performed in its functional currency. If the decline is deemed temporary, Alleghany records the decline as an unrealized loss in stockholders equity. If the decline is deemed to be other than temporary, Alleghany writes its cost-basis or amortized cost-basis down to the fair value of the security and records an OTTI loss on its statement of earnings. In addition, any portion of such decline related to a debt security that is believed to arise from factors other than credit is recorded as a component of other comprehensive income rather than charged against earnings.

Management s assessment of equity securities initially involves an evaluation of all securities that are in an unrealized loss position, regardless of the duration or severity of the loss, as of the applicable balance sheet date. Such initial review consists primarily of assessing whether: (i) there has been a negative credit or news event with respect to the issuer that could indicate the existence of an OTTI; and (ii) Alleghany has the ability and intent to hold an equity security for a period of time sufficient to allow for an anticipated recovery (generally considered to be 12 months from the balance sheet date).

To the extent that an equity security in an unrealized loss position is not impaired based on the initial review described above, Alleghany then further evaluates such equity security and deems it to be other than temporarily impaired if it has been in an unrealized loss position for 12 months or more or if its unrealized loss position is greater than 50 percent of its cost, absent compelling evidence to the contrary.

Alleghany then evaluates those equity securities where the unrealized loss is at least 20 percent of cost as of the balance sheet date or which have been in an unrealized loss position continuously for six months or more preceding the balance sheet date. This evaluation takes into account quantitative and qualitative factors in determining whether such securities are other than temporarily impaired including: (i) market valuation metrics associated with the equity security (such as dividend yield and price-to-earnings ratio); (ii) current views on the equity security, as expressed by either Alleghany s internal stock analysts and/or by third-party stock analysts or rating agencies; and (iii) credit or news events associated with a specific issuer, such as negative news releases and rating agency downgrades with respect to the issuer of the equity security.

Debt securities in an unrealized loss position are evaluated for OTTI if they meet any of the following criteria: (i) they are trading at a discount of at least 20 percent to amortized cost for an extended period of time (nine consecutive months or more); (ii) there has been a negative credit or news event with respect to the issuer that could indicate the existence of an OTTI; or (iii) Alleghany intends to sell, or it is more likely than not that Alleghany will sell, the debt security before recovery of its amortized cost basis.

If Alleghany intends to sell, or it is more likely than not that Alleghany will sell, a debt security before recovery of its amortized cost basis, the total amount of the unrealized loss position is recognized as an OTTI loss in earnings. To the extent that a debt security that is in an unrealized loss position is not impaired based on the preceding, Alleghany will consider a debt security to be impaired when it believes it to be probable that Alleghany will not be able to collect the entire amortized cost basis. For debt securities in an unrealized loss position as of the end of each quarter, Alleghany develops a best estimate of the present value of expected cash flows. If the results of the cash flow analysis indicate Alleghany will not recover the full amount of its amortized cost basis in the debt security, Alleghany records an OTTI loss in earnings equal to the difference between the present value of expected cash flows and the amortized cost basis of the debt security. If applicable, the difference between the total unrealized loss position on the debt security and the OTTI loss recognized in earnings is the non-credit related portion, which is recorded as a component of other comprehensive income.

In developing the cash flow analyses for debt securities, Alleghany considers various factors for the different categories of debt securities. For municipal bonds, Alleghany takes into account the taxing power of the issuer, source of revenue, credit risk and enhancements and pre-refunding. For mortgage and asset-backed securities, Alleghany discounts its best estimate of future cash flows at an effective rate equal to the original effective yield of the security or, in the case of floating rate securities, at the current coupon. Alleghany s models include assumptions about prepayment speeds, default and delinquency rates and underlying collateral (if any), as well as credit ratings, credit enhancements and other observable market data. For corporate bonds, Alleghany reviews business prospects, credit ratings and available information from asset managers and rating agencies for individual securities.

OTTI losses in the first nine months of 2016 reflect $38.2 million of unrealized losses that were deemed to be other than temporary and, as such, were required to be charged against earnings. Upon the ultimate disposition of the securities for which OTTI losses have been recorded, a portion of the loss may be recoverable depending on market conditions at the time of disposition. Of the $38.2 million of OTTI losses, $16.6 million related to equity securities, primarily in the retail, financial services, technology and chemical sectors, and $21.6 million related to debt securities, primarily in the energy sector. The determination that unrealized losses on equity and debt securities were other than temporary was primarily due to the severity and duration of the decline in the fair value of equity and debt securities relative to their costs. Of the $38.2 million of OTTI losses, $11.7 million was incurred in the third quarter of 2016.

OTTI losses in the first nine months of 2015 reflect $112.3 million of unrealized losses that were deemed to be other than temporary and, as such, were required to be charged against earnings. Of the $112.3 million of OTTI losses, $107.3 million related to equity securities, primarily in the airline, energy, gaming, pharmaceutical and mining sectors, and $5.0 million related to debt securities, primarily in the energy and finance sectors. The determination that unrealized losses on equity and debt securities were other than temporary was primarily due to the fact that Alleghany lacked the intent to hold the securities for a period of time sufficient to allow for an anticipated recovery and, to a lesser extent, based on the duration of the decline in the fair value of equity securities relative to their costs. Of the $112.3 million of OTTI losses, $52.7 million was incurred in the third quarter of 2015.

After adjusting the cost basis of securities for the recognition of OTTI losses, the remaining gross unrealized investment losses for debt and equity securities as of September 30, 2016 were deemed to be temporary, based on, among other factors: (i) the duration of time and the relative magnitude to which the fair value of these investments had been below cost were not indicative of an OTTI loss; (ii) the absence of compelling evidence that would cause Alleghany to call into question the financial condition or

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near-term business prospects of the issuer of the security; and (iii) Alleghany s ability and intent to hold the security for a period of time sufficient to allow for any anticipated recovery.

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

(f) Aging of Gross Unrealized Losses

As of September 30, 2016 and December 31, 2015, gross unrealized losses and related fair values for equity securities and debt securities, grouped by duration of time in a continuous unrealized loss position, were as follows:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
			($ in millions)			
As of September 30, 2016						
Equity securities:						
Common stock	$ 887.2	$ 77.8	$ -	$ -	$ 887.2	$ 77.8
Preferred stock	-	-	-	-	-	-
Total equity securities	887.2	77.8	-	-	887.2	77.8
Debt securities:						
U.S. Government obligations	233.6	1.4	-			