

ALLEGHANY CORP /DE
Form 10-Q
August 08, 2008

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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 QUARTERLY PERIOD ENDED JUNE 30, 2008

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.

7 TIMES SQUARE TOWER, 17TH FLOOR, NY, NY 10036

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

LARGE ACCELERATED FILER ACCELERATED FILER NON-ACCELERATED FILER SMALLER REPORTING COMPANY

(DO NOT CHECK IF A
SMALLER REPORTING
COMPANY)

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (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.

8,345,911 SHARES AS OF AUGUST 1, 2008

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PART 1. FINANCIAL INFORMATION
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ALLEGHANY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
AND COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED
JUNE 30, 2008 AND 2007

(dollars in thousands, except share and per share amounts)
(unaudited)

| | 2008 | 2007 |
|--|-------------|-------------|
| Revenues | | |
| Net premiums earned | \$ 240,238 | \$ 235,219 |
| Net investment income | 34,768 | 38,694 |
| Realized capital (losses) gains | (21,783) | 5,697 |
| Other income | 122 | 2,350 |
| Total revenues | 253,345 | 281,960 |
| Costs and expenses | | |
| Loss and loss adjustment expenses | 139,455 | 119,709 |
| Commissions, brokerage and other underwriting expenses | 72,542 | 60,506 |
| Other operating expenses | 12,302 | 12,840 |
| Corporate administration | 8,466 | 9,119 |
| Interest expense | 179 | 251 |
| Total costs and expenses | 232,944 | 202,425 |
| Earnings from continuing operations, before income taxes | 20,401 | 79,535 |
| Income taxes | 7,380 | 20,801 |
| Earnings from continuing operations | 13,021 | 58,734 |
| Discontinued operations | | |
| Earnings from discontinued operations | 10,662 | 6,134 |
| Income taxes | 3,248 | 1,928 |
| Earnings from discontinued operations, net | 7,414 | 4,206 |
| Net earnings | \$ 20,435 | \$ 62,940 |

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| | | |
|---|-----------|-----------|
| Changes in other comprehensive income | | |
| Change in unrealized gains, net of deferred taxes | \$ 22,370 | 30,461 |
| Less: reclassification for gains realized in net earnings, net of taxes | 14,159 | (3,714) |
| Other | (3) | 102 |
| Comprehensive income | \$ 56,961 | \$ 89,789 |
| Net earnings | \$ 20,435 | \$ 62,940 |
| Preferred dividends | 4,305 | 4,305 |
| Net earnings available to common stockholders | \$ 16,130 | \$ 58,635 |
| Basic earnings per share of common stock * | | |
| Continuing operations | \$ 1.04 | \$ 6.55 |
| Discontinued operations | 0.89 | 0.50 |
| | \$ 1.93 | \$ 7.05 |
| Diluted earnings per share of common stock * | | |
| Continuing operations | \$ 1.04 | \$ 6.30 |
| Discontinued operations | 0.89 | 0.45 |
| | \$ 1.93 | \$ 6.75 |
| Dividends per share of common stock | * | * |
| Average number of outstanding shares of common stock ** | 8,340,901 | 8,312,967 |

* Adjusted to reflect the common stock dividend declared in February 2008.

** In February 2008 and 2007, Alleghany declared a stock dividend consisting of one share of Alleghany

common stock
for every fifty
shares
outstanding.

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
AND COMPREHENSIVE INCOME
FOR THE SIX MONTHS ENDED
JUNE 30, 2008 AND 2007

(dollars in thousands, except share and per share amounts)
(unaudited)

| | 2008 | 2007 |
|---|-------------------|-------------------|
| Revenues | | |
| Net premiums earned | \$ 485,719 | \$ 466,793 |
| Net investment income | 70,040 | 78,624 |
| Net realized capital gains | 52,929 | 55,838 |
| Other income | 185 | 11,075 |
| Total revenues | 608,873 | 612,330 |
| Costs and expenses | | |
| Loss and loss adjustment expenses | 274,686 | 216,843 |
| Commissions, brokerage and other underwriting expenses | 142,951 | 120,119 |
| Other operating expenses | 24,033 | 25,429 |
| Corporate administration | 18,414 | 17,123 |
| Interest expense | 336 | 974 |
| Total costs and expenses | 460,420 | 380,488 |
| Earnings from continuing operations, before income taxes | 148,453 | 231,842 |
| Income taxes | 44,885 | 69,553 |
| Earnings from continuing operations | 103,568 | 162,289 |
| Discontinued operations | | |
| Earnings from discontinued operations | 22,196 | 10,264 |
| Income taxes | 6,608 | 3,195 |
| Earnings from discontinued operations, net | 15,588 | 7,069 |
| Net earnings | \$ 119,156 | \$ 169,358 |
| Changes in other comprehensive income | | |
| Change in unrealized gains, net of deferred taxes | 23,431 | 57,734 |

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| | | |
|--|------------|------------|
| Less: reclassification for gains realized in net earnings (net of taxes) | (34,404) | (36,306) |
| Other | (8) | 115 |
| Comprehensive income | \$ 108,175 | \$ 190,901 |
| Net earnings | \$ 119,156 | \$ 169,358 |
| Preferred dividends | 8,610 | 8,611 |
| Net earnings available to common stockholders | \$ 110,546 | \$ 160,747 |
| Basic earnings per share of common stock * | | |
| Continuing operations | \$ 11.39 | \$ 18.52 |
| Discontinued operations | 1.87 | 0.85 |
| | \$ 13.26 | \$ 19.37 |
| Diluted earnings per share of common stock * | | |
| Continuing operations | \$ 11.09 | \$ 17.43 |
| Discontinued operations | 1.67 | 0.76 |
| | \$ 12.76 | \$ 18.19 |
| Dividends per share of common stock | * | * |
| Average number of outstanding shares of common stock ** | 8,335,426 | 8,299,807 |

* Adjusted to reflect the common stock dividend declared in February 2008.

** In February 2008 and 2007, Alleghany declared a stock dividend consisting of one share of Alleghany common stock for every fifty shares

outstanding.

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share amounts)

| | June 30, 2008 (unaudited) | December 31, 2007 |
|--|--|------------------------------|
| Assets | | |
| Investments | | |
| Available for sale securities at fair value: | | |
| Equity securities (cost: 2008 \$623,304; 2007 \$691,429) | \$1,130,275 | \$1,176,412 |
| Debt securities (cost: 2008 \$2,609,636; 2007 \$2,541,488) | 2,599,222 | 2,564,717 |
| Short-term investments | 474,032 | 316,897 |
| | 4,203,529 | 4,058,026 |
| Other invested assets | 198,432 | 193,272 |
| Total investments | 4,401,961 | 4,251,298 |
| Cash | 29,724 | 57,646 |
| Premium balances receivable | 200,220 | 170,080 |
| Reinsurance recoverables | 1,034,738 | 1,018,673 |
| Ceded unearned premium reserves | 216,830 | 221,203 |
| Deferred acquisition costs | 77,731 | 75,623 |
| Property and equipment at cost, net of accumulated depreciation and amortization | 19,725 | 19,735 |
| Goodwill and other intangibles, net of amortization | 203,452 | 207,540 |
| Current taxes receivable | 17,519 | 4,116 |
| Assets of discontinued operations | 891,568 | 812,119 |
| Other assets | 115,888 | 104,079 |
| | \$7,209,356 | \$6,942,112 |
| Liabilities and Stockholders Equity | | |
| Losses and loss adjustment expenses | \$2,503,098 | \$2,379,701 |
| Unearned premiums | 688,649 | 699,409 |
| Reinsurance payable | 73,740 | 57,380 |
| Net deferred tax liabilities | 46,998 | 71,594 |
| Liabilities of discontinued operations | 720,228 | 653,869 |
| Other liabilities | 279,454 | 286,284 |
| Total liabilities | 4,312,167 | 4,148,237 |
| | 299,480 | 299,480 |

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| | | |
|---|-------------|-------------|
| Preferred stock (shares authorized: 2008 and 2007 - 1,132,000; issued and outstanding 2008 - 1,131,819; 2007 - 1,131,819) | | |
| Common stock (shares authorized: 2008 and 2007 - 22,000,000; issued and outstanding 2008 - 8,349,108; 2007 - 8,322,348) | 8,349 | 8,159 |
| Contributed capital | 751,118 | 689,435 |
| Accumulated other comprehensive income | 317,651 | 328,632 |
| Treasury stock, at cost (2008 - 5,395 shares; 2007 - none) | (1,839) | |
| Retained earnings | 1,522,430 | 1,468,169 |
| Total stockholders' equity | 2,897,189 | 2,793,875 |
| | \$7,209,356 | \$6,942,112 |
| Shares of Common Stock Outstanding * | 8,343,713 | 8,322,348 |

* Adjusted to reflect the common stock dividend declared in February 2008.

See accompanying Notes to Unaudited Consolidated Financial Statements.

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**ALLEGHANY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED**

JUNE 30, 2008 AND 2007

(dollars in thousands)

(unaudited)

| | 2008 | 2007 |
|--|-------------|-------------|
| Cash flows from operating activities | | |
| Net earnings | \$ 119,156 | \$ 169,358 |
| Earnings from discontinued operations, net | 15,588 | 7,069 |
| Earnings from continuing operations | \$ 103,568 | \$ 162,289 |
| Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities: | | |
| Depreciation and amortization | 11,234 | 6,921 |
| Net realized capital (gains) losses | (52,929) | (55,838) |
| (Increase) decrease in other assets | (13,103) | (11,031) |
| (Increase) decrease in reinsurance receivable, net of reinsurance payable | 295 | 94,420 |
| (Increase) decrease in premium balances receivable | (30,140) | (41,453) |
| (Increase) decrease in ceded unearned premium reserves | 4,373 | 29,264 |
| (Increase) decrease in deferred acquisition costs | (2,108) | (5,792) |
| Increase (decrease) in other liabilities and current taxes | (34,528) | (39,412) |
| Increase (decrease) in unearned premiums | (10,760) | (7,402) |
| Increase (decrease) in losses and loss adjustment expenses | 123,397 | (12,445) |
| Net adjustments | (4,269) | (42,768) |
| Net cash provided by operating activities from continuing operations | 99,299 | 119,521 |
| Net cash provided by operating activities from discontinued operations | 65,182 | 54,654 |
| Net cash provided by operating activities | 164,481 | 174,175 |
| Cash flows from investing activities | | |
| Purchase of investments | (621,148) | (557,754) |
| Sales of investments | 441,822 | 399,117 |
| Maturities of investments | 220,855 | 139,044 |
| Purchases of property and equipment | (2,646) | (1,688) |
| Net change in short-term investments | (158,930) | (121,342) |
| Other, net | (206) | (3,384) |
| Net cash provided by investing activities from continuing operations | (120,253) | (146,007) |
| Net cash provided by investing activities from discontinued operations | (66,211) | (75,650) |
| Net cash (used in) provided by investing activities | (186,464) | (221,657) |
| Cash flows from financing activities | | |

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| | | |
|--|-----------|------------|
| Treasury stock acquisitions | (1,927) | |
| Principal payments on long-term debt | | (80,000) |
| Decrease in notes receivable | | 91,535 |
| Convertible preferred stock dividends paid | (8,741) | (8,755) |
| Tax benefit on stock based compensation | 2,330 | 1,062 |
| Other, net | 1,370 | 2,653 |
| Net cash provided by (used in) financing activities | (6,968) | 6,495 |
| Cash flows of discontinued operations | | |
| Operating activities | (65,182) | (54,654) |
| Investing activities | 66,211 | 75,650 |
| Net cash provided by (used in) discontinued operations | 1,029 | 20,996 |
| Net cash provided by (used in) continuing operations | (27,922) | (19,991) |
| Cash at beginning of period | 57,646 | 41,458 |
| Cash at end of period | \$ 29,724 | \$ 21,467 |
| Supplemental disclosures of cash flow information | | |
| Cash paid during the period for: | | |
| Interest | \$ 72 | \$ 506 |
| Income taxes paid (refunds received) | \$ 93,718 | \$ 132,524 |
| See accompanying Notes to Unaudited Consolidated Financial Statements. | | |

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Notes to Unaudited Consolidated Financial Statements

Alleghany Corporation and Subsidiaries

1. Principles of Financial Statement Presentation

This report should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2007 (the 2007 10-K), and the Quarterly Report on Form 10-Q for the quarter ended March 31, 2008, of Alleghany Corporation (Alleghany).

Alleghany, a Delaware corporation, 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 (collectively CATA) and AIHL s majority-owned subsidiary Employers Direct Corporation (EDC), of which AIHL owns approximately 98 percent. AIHL Re LLC (AIHL Re), a captive reinsurance subsidiary of AIHL, is available to provide reinsurance to Alleghany operating units and affiliates. In addition, Alleghany owns approximately 32.9 percent of the outstanding shares of common stock of Homesite Group Incorporated (Homesite), a national, full-service, mono-line provider of homeowners insurance, and this investment is reflected in Alleghany s financial statements in other invested assets. Alleghany also owns and manages properties in the Sacramento, California region 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.

On June 27, 2008, Darwin Professional Underwriters, Inc. (Darwin), of which AIHL owns approximately 55 percent, entered into a merger agreement with Allied World Assurance Company Holdings, Ltd. (Allied World), whereby Allied World will acquire all of the issued and outstanding shares of Darwin common stock for cash consideration of \$32.00 per share. The transaction is subject to regulatory approvals and the consent of Darwin stockholders. As an inducement to Allied World to enter into the merger agreement, Alleghany entered into a voting agreement with Allied World pursuant to which Alleghany has agreed, subject to certain conditions, to vote a number of shares of its Darwin common stock equal to 40 percent of the issued and outstanding shares of common stock of Darwin in favor of the approval of the transaction. The transaction is expected to close in the fourth quarter of 2008. Upon closing of the transaction, Alleghany expects to receive aggregate proceeds of approximately \$300 million in cash for AIHL s 9,371,096 shares of Darwin common stock. Alleghany anticipates that the transaction will result in an after-tax gain of approximately \$94 million, including approximately \$9 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. See Note 8 for historical financial information of these discontinued operations.

The financial statements contained in this Report on Form 10-Q are unaudited, but reflect all adjustments which, in the opinion of management, are necessary to a fair statement of results of the interim periods covered thereby. All adjustments are of a normal and recurring nature except as described herein.

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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.

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

2. Recent Accounting Pronouncements

(a) 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 to 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 provisions of SFAS 157 as of January 1, 2008, and the implementation did not have a material impact on its results of operations and financial condition. See Note 7.

(b) 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 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.

3. Earnings Per Share of Common Stock

The following is a reconciliation of the income and share data used in the basic and diluted earnings per share computations for the three and six months ended June 30, 2008 and 2007 (in millions, except share amounts):

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| | Three months ended June 30, | | Six months ended June 30, | |
|---|-----------------------------|-----------|---------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Earnings from continuing operations | \$ 13.0 | \$ 58.7 | \$ 103.6 | \$ 162.3 |
| Earnings from discontinued operations | 7.4 | 4.2 | 15.6 | 7.1 |
| Net earnings | \$ 20.4 | \$ 62.9 | \$ 119.2 | \$ 169.4 |
| Preferred dividends | 4.3 | 4.3 | 8.6 | 8.6 |
| Income available to common stockholders for basic earnings per share | 16.1 | 58.6 | \$ 110.6 | 160.8 |
| Preferred dividends | | 4.3 | 8.6 | 8.6 |
| Effect of other dilutive securities | | 0.1 | 0.1 | 0.1 |
| Income available to common stockholders for diluted earnings per share | \$ 16.1 | \$ 63.0 | \$ 119.3 | \$ 169.5 |
| Weighted average shares outstanding applicable to basic earnings per share | 8,340,901 | 8,312,967 | 8,355,426 | 8,299,807 |
| Preferred stock | | 997,998 | 997,969 | 997,998 |
| Effect of other dilutive securities | | 24,825 | 20,302 | 20,328 |
| Adjusted weighted average shares outstanding applicable to diluted earnings per share | 8,340,901 | 9,335,790 | 9,353,697 | 9,318,133 |

Contingently issuable shares of 48,506 and 61,355 were potentially available during 2008 and 2007, respectively, but were not included in the computations of diluted earnings per share because the impact was anti-dilutive to the earnings per share calculation.

Earnings per share by quarter may not equal the amount for the full year due to rounding.

4. Commitments and Contingencies**(a) Leases**

Alleghany leases certain facilities, furniture and equipment under long-term lease agreements.

(b) Litigation

Alleghany's subsidiaries are parties to pending litigation and claims in connection with the ordinary course of their businesses. Each such subsidiary makes provisions for estimated losses to be incurred in such litigation and claims, including legal costs. In the opinion of management, such provisions are adequate.

(c) Asbestos and Environmental Exposure

AIHL's reserve for unpaid losses and loss adjustment expenses includes \$20.7 million of gross reserves and \$20.6 million of net reserves at June 30, 2008 and \$22.9 million of gross reserves and \$22.7 million of net reserves at December 31, 2007, for various liability coverages related to asbestos and environmental impairment claims that arose from reinsurance assumed by a subsidiary of CATA between 1969 and 1976. This subsidiary exited this business in 1976. Although Alleghany is unable at this time to determine whether additional reserves, which could

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have a material impact upon its results of operations, may be necessary in the future, Alleghany believes that CATA's asbestos and environmental reserves are adequate at June 30, 2008. Additional information concerning CATA's asbestos and environmental exposure can be found in Note 13 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2007 10-K.

(d) Indemnification Obligations

On July 14, 2005, Alleghany completed the sale of its world-wide industrial minerals business, World Minerals, Inc. ("World Minerals"), to Imerys USA, Inc. (the "Purchaser"), a wholly-owned subsidiary of Imerys, S.A., pursuant to a Stock Purchase Agreement, dated as of May 19, 2005, by and among the Purchaser, Imerys, S.A. and Alleghany (the "Stock Purchase Agreement"). Pursuant to the Stock Purchase Agreement, Alleghany undertook certain indemnification obligations, including a general indemnification for breaches of representations and warranties set forth in the Stock Purchase Agreement (the "Contract Indemnification") and a special indemnification (the "Products Liability Indemnification") related to products liability claims arising from events that occurred during pre-closing periods, including the period of Alleghany ownership (the "Alleghany Period").

Substantially all of the representations and warranties to which the Contract Indemnification applies survived until July 14, 2007, with the exception of certain representations and warranties such as those related to environmental, real estate and tax matters, which survive for longer periods and generally, except for tax and certain other matters, apply only to aggregate losses in excess of \$2.5 million, up to a maximum of approximately \$123.0 million. The Stock Purchase Agreement provides that Alleghany has no responsibility for products liability claims arising in respect of events occurring after the closing, and that any products liability claims involving both pre-closing and post-closing periods will be apportioned on an equitable basis. Additional information concerning the Contract Indemnification and Products Liability Indemnification can be found in Note 13 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2007 10-K.

Based on Alleghany's experience to date and other analyses, Alleghany established a \$600 thousand reserve in connection with the Products Liability Indemnification for the Alleghany Period. Such reserve was \$400 thousand at June 30, 2008.

(e) Equity Holdings Concentration

At June 30, 2008, Alleghany had a concentration of market risk in its available-for-sale equity securities portfolio of common stock of Burlington Northern Santa Fe Corporation ("Burlington Northern"), a railroad holding company, amounting to \$399.6 million. During the first quarter of 2008, Alleghany sold approximately 1.0 million shares of Burlington Northern common stock, resulting in a pre-tax gain of \$78.1 million.

At June 30, 2008, Alleghany also had a concentration of market risk in its available-for-sale equity securities portfolio with respect to the common stock of certain energy sector businesses amounting to \$417.3 million.

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5. Segment of Business

Information related to Alleghany's reportable segment is shown in the table below. Property and casualty and surety insurance operations are conducted by AIHL through its insurance operating units RSUI, CATA and EDC. Alleghany has classified the operations of Darwin as discontinued operations in its consolidated financial statements for all periods presented. See Notes 1 and 8. In addition, AIHL Re is a wholly-owned subsidiary of AIHL that is available to provide reinsurance to Alleghany's insurance operating units and affiliates.

Alleghany's reportable segment is reported in a manner consistent with the way management evaluates the businesses. As such, insurance underwriting activities are evaluated separately from investment activities. Net realized capital gains or losses are not considered relevant in evaluating investment performance on an annual basis. Segment accounting policies are the same as those described in Note 1 to the Notes to the Consolidated Financial Statements set forth in Item 8 of the 2007 10-K.

The primary components of corporate activities are Alleghany Properties, AIHL's investment in Homesite, and corporate investment and other activities at the parent level, including strategic equity investments. Such strategic equity investments are available to support the internal growth of subsidiaries and for acquisitions of, and substantial investments in, operating companies.

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| (in millions) | Three months ended June | | Six months ended June | |
|--|-------------------------|-------------|-----------------------|-------------|
| | 2008 | 30, 2007 | 2008 | 30, 2007 |
| Revenues: | | | | |
| <i>AIHL insurance group:</i> | | | | |
| Net premiums earned | | | | |
| RSUI | \$ 174.2 | \$ 178.2 | \$ 352.0 | \$ 344.8 |
| CATA | 48.0 | 50.9 | 94.9 | 98.2 |
| EDC | 18.0 | | 38.6 | |
| AIHL Re | | 6.1 | 0.2 | 23.8 |
| | 240.2 | 235.2 | 485.7 | 466.8 |
| Net investment income | 30.6 | 30.7 | 62.2 | 62.6 |
| Net realized capital (losses) gains | (22.8)(1) | 5.7 | (26.2)(1) | |
| Other income | 0.1 | 0.2 | 0.2 | 0.3 |
| Total insurance group | 248.1 | 271.8 | 521.9 | 529.7 |
| <i>Corporate activities:</i> | | | | |
| Net investment income (2) | 4.2 | 8.0 | 7.9 | 16.0 |
| Net realized capital gains | 1.0 | | 79.1(3) | 55.8(3) |
| Other income | | 2.2 | | 10.8 |
| Total | \$ 253.3 | \$ 282.0 | \$ 608.9 | \$ 612.3 |
| Earnings from continuing operations, before income taxes: | | | | |
| <i>AIHL insurance group:</i> | | | | |
| Underwriting profit (loss)(4) | | | | |
| RSUI | \$ 54.7 | \$ 41.5 | \$ 93.3 | \$ 91.7 |
| CATA | 3.5 | 7.4 | 7.7 | 14.4 |
| EDC | (29.9)(5) | | (33.0)(5) | |
| AIHL Re | | 6.1 | 0.1 | 23.7 |
| | 28.3 | 55.0 | 68.1 | 129.8 |
| Net investment income | 30.6 | 30.7 | 62.2 | 62.6 |
| Net realized capital (losses) gains | (22.8)(1) | 5.7 | (26.2)(1) | |
| Other income, less other expenses | (11.5) | (12.0) | (22.5) | (23.4) |
| Total insurance group | 24.6 | 79.4 | 81.6 | 169.0 |
| <i>Corporate activities:</i> | | | | |
| Net investment income (2) | 4.2 | 8.0 | 7.9 | 16.0 |
| Net realized capital gains | 1.0 | | 79.1(3) | 55.8(3) |
| Other income | | 2.2 | | 10.8 |

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| | | | | |
|---|---------|---------|----------|----------|
| Corporate administration and other expenses | 9.2 | 9.8 | 19.8 | 18.8 |
| Interest expense | 0.2 | 0.3 | 0.3 | 1.0 |
| Total | \$ 20.4 | \$ 79.5 | \$ 148.5 | \$ 231.8 |

(1) Primarily reflects impairment charges for unrealized losses related to AIHL s investment portfolio that were deemed to be other than temporary, primarily in the 2008 second quarter.

(2) Includes \$1.2 million and \$3.3 million of Alleghany s equity in earnings of Homesite, net of purchase accounting adjustments, for the three months ended June 30, 2008 and 2007, respectively. The comparable figures for the six months ended June 30, 2008 and 2007 are \$1.0 million and \$6.2 million, respectively (See Note 16 to the Notes to the Consolidated Financial Statements set forth in Item 8

of the 2007
10-K).

- (3) Primarily reflects net realized capital gains from the sale of shares of Burlington Northern common stock in the 2008 first quarter and 2007 first quarter.

- (4) Represents net premiums earned less loss and loss adjustment expenses and underwriting expenses, all as determined in accordance with GAAP, and does not include net investment income and other income or net realized capital gains. Underwriting expenses represent commission and brokerage expenses and that portion of salaries, administration and other operating expenses attributable to underwriting activities, whereas the remainder constitutes other

expenses.

- (5) Reflects a significant increase to loss and loss adjustment expense reserves in the 2008 second quarter.

Table of Contents**6. Reinsurance**

As discussed in the 2007 10-K, RSUI reinsures its property lines of business through a program consisting of surplus share treaties, facultative placements, per risk and catastrophe excess of loss treaties. RSUI's catastrophe reinsurance program (which covers catastrophe risks including, among others, windstorms and earthquakes) and per risk reinsurance program run on an annual basis from May 1 to the following April 30. RSUI has placed all of its catastrophe reinsurance program for the 2008-2009 period. Under the 2008-2009 program, RSUI's catastrophe reinsurance program provides coverage in two layers for \$400.0 million of losses in excess of a \$100.0 million net retention after application of the surplus share treaties, facultative reinsurance and per risk covers. The first layer provides coverage for \$100.0 million of losses, before a 33.15 percent co-participation by RSUI, in excess of the \$100.0 million net retention, and the second layer provides coverage for \$300.0 million of losses, before a 5 percent co-participation by RSUI, in excess of \$200.0 million. In addition, RSUI's property per risk reinsurance program for the 2008-2009 period provides RSUI with coverage for \$90.0 million of losses in excess of \$10.0 million net retention per risk after application of the surplus share treaties and facultative reinsurance.

RSUI reinsures its other lines of business through quota share treaties, except for professional liability and binding authority lines where RSUI retains all of such business. RSUI's quota share reinsurance treaty for umbrella/excess renewed on June 1, 2008 and provides coverage for policies with limits up to \$30.0 million, with RSUI ceding 35 percent of the premium and loss for policies with limits up to \$15.0 million and ceding 67.5 percent of the premium and loss for policies with limits in excess of \$15.0 million up to \$30.0 million. RSUI's directors and officers (D&O) liability line quota share reinsurance treaty renewed on July 1, 2008 and provides coverage for policies with limits up to \$20.0 million, with RSUI ceding 35 percent of the premium and loss for all policies with limits up to \$10.0 million and ceding 60 percent of the premium and loss for policies with limits in excess of \$10.0 million up to \$20.0 million.

7. Investments**(a) Fair Value**

The estimated carrying values and fair values of Alleghany's financial instruments as of June 30, 2008 and December 31, 2007 are as follows (in millions):

| | June 30, 2008 | | December 31, 2007 | |
|--|----------------|------------|-------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Assets | | | | |
| Investments (excluding equity-method investments)* | \$4,222.6 | \$4,222.6 | \$4,069.3 | \$4,069.3 |

* For purposes of this table, investments include available-for-sale securities as well as investments in partnerships carried at fair value that are included in other invested assets. Investments exclude Alleghany's

investment in
Homesite and
partnerships that
are accounted for
under the equity
method which are
included in other
invested assets.

The fair value of
short-term
investments
approximates
amortized cost.

The fair value of
all other
categories of
investments is
discussed below.

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As previously noted, SFAS 157 was issued in September 2006 and adopted by Alleghany as of January 1, 2008. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are not adjusted for transaction costs. In addition, SFAS 157 establishes a three-tiered hierarchy for inputs used in management's determination of fair value of financial instruments that emphasizes the use of observable inputs over the use of unobservable inputs by requiring that the observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing a financial instrument. Unobservable inputs are inputs that reflect management's belief about the assumptions market participants would use in pricing a financial instrument based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

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

Level 2 Management's valuations are based on quoted market prices where such markets are not deemed to be sufficiently active. In such circumstances, additional valuation metrics will be used which involve direct or indirect observable market inputs. For Alleghany, assets utilizing Level 2 inputs generally include debt securities other than debt issued by the U.S. Government and preferred stocks. Third-party dealer quotes typically constitute a significant input in management's determination of the fair value of these types of fixed income securities. In developing such quotes, dealers will use the terms of the security and market-based inputs. Terms of the security include coupon, maturity date, and any special provisions that may, for example, enable the investor, at his election, to redeem the security prior to its scheduled maturity date. Market-based inputs include the level of interest rates applicable to comparable securities in the market place and current credit rating(s) of the security.

Level 3 Management's valuations are based on inputs that are unobservable and significant to the overall fair value measurement. Valuation under Level 3 generally involves a significant degree of judgment on the part of management. For Alleghany, assets utilizing Level 3 inputs are primarily limited to partnership investments. Quotes from the third-party general partner of the entity in which such investment was held, which will often be based on unobservable market inputs, constitute the primary input in management's determination of the fair value.

The estimated fair values of Alleghany's invested assets by balance sheet caption and level as of June 30, 2008 are as follows (in millions):

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| | Level 1 | Level 2 | Level 3 | Total |
|---|------------|------------|---------|------------|
| <i>Assets</i> | | | | |
| Equity securities | \$ 1,084.0 | \$ 46.3 | \$ | \$ 1,130.3 |
| Debt securities | 149.4 | 2,442.1 | 7.7 | 2,599.2 |
| Short-term investments | 328.1 | 145.9 | | 474.0 |
| Other invested assets* | | | 19.1 | 19.1 |
| Investments (excluding equity-method investments) | \$ 1,561.5 | \$ 2,634.3 | \$ 26.8 | \$ 4,222.6 |

* The carrying value of partnership investments of \$19.1 million increased by \$7.7 million from the December 31, 2007 carrying value of \$11.4 million, due principally to additional investments.

(b) Equity Securities

Net realized capital gains of \$52.9 million for the first six months of 2008 included \$62.7 million of impairment charges related to unrealized losses in Alleghany's equity portfolio that were deemed to be other than temporary and, as such, are required to be charged against earnings. The \$62.7 million of impairment charges (of which \$47.6 million was incurred in the second quarter of 2008) relates to equity holdings primarily in the energy (refinery) and financial services sectors. The \$62.7 million charge was primarily due to the severity of the declines in fair value of such securities relative to cost as of June 30, 2008. As of June 30, 2008 and December 31, 2007, no equity security was in a continuous unrealized loss position for twelve months or more.

After adjusting the cost basis of equity securities for the recognition of \$62.7 million of unrealized losses through impairment charges, the following is information regarding unrealized gain (loss), before tax, on Alleghany's equity securities:

| <i>(in millions)</i> | At June 30, 2008 | At December 31, 2007 |
|-------------------------|---------------------|-------------------------|
| Gross unrealized gain | \$ 521.4 | \$ 513.7 |
| Gross unrealized (loss) | (14.4) | (28.7) |
| Net unrealized gain | \$ 507.0 | \$ 485.0 |

8. Discontinued Operations

Alleghany has classified the operations of Darwin as discontinued operations in its consolidated financial statements for all periods presented. Historical balance sheet information related to these discontinued operations, as included in Alleghany's consolidated financial statements, is set forth in the following table (in millions):

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| | June 30, 2008 | December 31, 2007 |
|---|------------------|----------------------|
| Assets | | |
| Available for sale securities at fair value | \$ 572.5 | \$ 449.4 |
| Short term investments | 47.8 | 107.6 |
| Cash | 6.4 | 7.5 |
| Reinsurance recoverables | 148.6 | 136.4 |
| Ceded unearned premium reserves | 44.2 | 43.2 |
| Other | 72.1 | 68.0 |
| | \$ 891.6 | \$ 812.1 |
| Liabilities | | |
| Losses and loss adjustment expenses | 426.1 | 387.9 |
| Unearned premiums | 144.3 | 141.1 |
| Debt | 5.0 | 5.0 |
| Other | 38.2 | 23.9 |
| Minority interest (carried at the AIHL level) | 106.6 | 95.9 |
| | 720.2 | 653.8 |
| Alleghany Equity | | |
| Alleghany's investment in Darwin | 171.4 | 158.3 |
| | \$ 891.6 | \$ 812.1 |

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

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

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| | Six months ended | |
|---|---------------------|------------------|
| | June 30, 2008 | June 30, 2007 |
| <i>Revenues</i> | | |
| Net premiums earned | \$ 106.9 | \$ 86.4 |
| Net investment income | 12.0 | 10.7 |
| Net realized capital gains | (0.6) | |
| Other income | (0.1) | |
| | 118.2 | 97.1 |
| <i>Costs and expenses</i> | | |
| Losses and loss adjustment expenses | 40.6 | 50.7 |
| Commission, brokerage and other underwriting expenses | 30.4 | 24.8 |
| Other operating expenses | 6.9 | 2.8 |
| | 77.9 | 78.3 |
| Earnings before income taxes and minority interest | 40.3 | 18.8 |
| Income taxes | 12.0 | 5.8 |
| Earnings before minority interest | 28.3 | 13.0 |
| Minority interest (carried at the AIHL-level) | 12.7 | 5.9 |
| Net earnings | \$ 15.6 | \$ 7.1 |

Net earnings during the 2008 period include a \$23.2 million release of prior accident year loss reserves (\$15.1 million after tax and before minority interest), reflecting favorable loss emergence.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

References to the Company, Alleghany, we, us, and our in Items 2, 3 and 4 of Part I, as well as in Part II, of this Form 10-Q refer to Alleghany Corporation and its consolidated subsidiaries unless the context otherwise requires.

AIHL refers to our insurance holding company subsidiary Alleghany Insurance Holdings LLC. RSUI refers to our subsidiary RSUI Group, Inc. and its subsidiaries. AIHL Re refers to our subsidiary AIHL Re LLC. CATA refers to our subsidiary Capitol Transamerica Corporation and its subsidiaries and also includes the results and operations of Platte River Insurance Company unless the context otherwise requires. EDC refers to our subsidiary Employers Direct Corporation and its subsidiaries. Unless the context otherwise requires, references to AIHL include the operations of RSUI, CATA, EDC and AIHL Re. Alleghany Properties refers to our subsidiary Alleghany Properties Holdings LLC and its subsidiaries.

Cautionary Statement Regarding Forward-Looking Information

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

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

the cyclical nature of the property and casualty industry;

changes in market prices of our significant equity investments and changes in value of our fixed income portfolio;

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

the cost and availability of reinsurance;

exposure to terrorist acts;

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

changes in the ratings assigned to our insurance operating units;

claims development and the process of estimating reserves;

legal and regulatory changes;

the uncertain nature of damage theories and loss amounts;

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

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

Additional risks and uncertainties include general economic and political conditions, including the effects of a prolonged U.S. or global economic downturn or recession; changes in costs;

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

Critical Accounting Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, or GAAP, requires us 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 covered by the financial statements. Critical accounting estimates are defined as those estimates that are important to the presentation of our financial condition and results of operations and require us to exercise significant judgment.

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

Readers are encouraged to review our Report on Form 10-K for the year ended December 31, 2007, or the 2007 10-K, for a more complete description of our critical accounting estimates.

Business Overview

We are engaged, through AIHL and its subsidiaries, primarily in the property and casualty and surety insurance business. In addition, AIHL Re, a captive reinsurance subsidiary of AIHL, is available to provide reinsurance to our insurance operating units and affiliates. We also own and manage properties in the Sacramento, California region through our subsidiary Alleghany Properties and conduct corporate investment and other activities at the parent level, including the holding of strategic equity investments. Our primary sources of revenues and earnings are our insurance operations and investments.

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

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

Catastrophe losses, or the absence thereof, have also had a significant impact on our results. For example, pre-tax catastrophe losses, net of reinsurance and reinsurance reinstatement premiums, at our insurance operating units were \$48.9 million in 2007, \$18.0 million in 2006 and \$330.8 million in 2005. Pre-tax catastrophe losses, net of reinsurance and reinsurance reinstatement premiums, at our insurance operating units were \$20.0 million for the first six months of 2008, compared with \$33.0 million for the first six months of 2007. The incidence and severity of catastrophes in any short period of time are inherently unpredictable. Catastrophes can cause losses in a variety of our property and casualty lines, and most of our past catastrophe-related claims have resulted from severe storms. Although we experienced minimal catastrophe losses in 2006, 2007 and 2008 to date, it is possible that a catastrophic event or multiple catastrophic events could produce significant losses and have a material adverse effect on our financial condition and results of operations in the future.

The profitability of our insurance operating units is also impacted by price competition. Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical periods of price competition and excess underwriting capacity, followed by periods of high premium rates and shortages of underwriting capacity. Although an individual insurance company's financial performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern. As discussed in more detail below, our insurance operating units experienced increased price competition in certain of their lines of business during 2006. This competitive environment continued and increased during 2007 and continued to increase during the first six months of 2008, resulting in a decrease in pricing over that time. The impact of this price competition cannot be fully quantified in advance, but it is possible that this price competition, to the extent the loss costs of our insurance operating units exceed premiums, could have a material adverse effect on the results of our insurance operating units in the future.

Finally, profitability is also affected by our investment income. Our invested assets, which are derived primarily from our own capital and cash flow from our insurance operating units, are invested principally in fixed income securities, although we also invest in equity securities. The return on fixed income securities is primarily impacted by general interest rates and the credit quality and duration of the securities.

The following discussion and analysis presents a review of our results for the three and six months ended June 30, 2008 and 2007. You should read this review in conjunction with the consolidated financial statements and other data presented in this Form 10-Q as well as Management's Discussion and Analysis of Financial Condition and Results of Operation and Risk Factors contained in our 2007 10-K and our Report on Form 10-Q for the quarter ended March 31, 2008. Our results for the first six months of 2008 are not indicative of operating results in future periods.

Table of Contents**Consolidated Results of Operations**

The following table summarizes our consolidated revenues, costs and expenses and earnings for the three and six months ended June 30, 2008 and 2007.

| (in millions) | Three months ended June | | Six months ended June | |
|---|-------------------------|----------|-----------------------|----------|
| | 30, 2008 | 2007 | 30, 2008 | 2007 |
| Revenues | | | | |
| Net premiums earned | \$ 240.2 | \$ 235.2 | \$ 485.7 | \$ 466.8 |
| Net investment income | 34.8 | 38.7 | 70.1 | 78.6 |
| Net realized capital (losses) gains | (21.8) | 5.7 | 52.9 | 55.8 |
| Other income | 0.1 | 2.4 | 0.2 | 11.1 |
| Total revenues | \$ 253.3 | \$ 282.0 | \$ 608.9 | \$ 612.3 |
| Costs and expenses | | | | |
| Loss and loss adjustment expenses | \$ 139.4 | \$ 119.7 | \$ 274.7 | \$ 216.9 |
| Commissions, brokerage and other underwriting expenses | 72.5 | 60.5 | 143.0 | 120.1 |
| Other operating expenses | 12.3 | 12.9 | 24.0 | 25.4 |
| Corporate administration | 8.5 | 9.1 | 18.4 | 17.1 |
| Interest expense | 0.2 | 0.3 | 0.3 | 1.0 |
| Total costs and expenses | 232.9 | 202.5 | 460.4 | 380.5 |
| Earnings from continuing operations, before income taxes | 20.4 | 79.5 | 148.5 | 231.8 |
| Income taxes | 7.4 | 20.8 | 44.9 | 69.5 |
| Earnings from continuing operations | 13.0 | 58.7 | 103.6 | 162.3 |
| Discontinued operations | | | | |
| Operations | 10.7 | 6.1 | 22.2 | 10.3 |
| Income taxes | 3.3 | 1.9 | 6.6 | 3.2 |
| Earnings from discontinued operations, net of tax | 7.4 | 4.2 | 15.6 | 7.1 |
| Net earnings | \$ 20.4 | \$ 62.9 | \$ 119.2 | \$ 169.4 |
| Revenues: | | | | |
| AIHL | \$ 248.1 | \$ 271.8 | \$ 521.9 | \$ 529.7 |
| Corporate activities* | 5.2 | 10.1 | 87.0 | 82.6 |
| Earnings (loss) from continuing operations, before income taxes: | | | | |
| AIHL | \$ 24.6 | \$ 79.4 | \$ 81.6 | 169.0 |
| Corporate activities* | (4.2) | 0.1 | 66.9 | 62.8 |

*

Corporate
activities consist
of Alleghany
Properties,
Homesite and
corporate
activities at the
parent level.

Our earnings from continuing operations before income taxes in the second quarter and first six months of 2008 decreased from the corresponding 2007 periods, primarily reflecting increases in loss and loss adjustment expenses and commissions, brokerage and other underwriting expenses as well as a decrease in other income and net investment income, partially offset by an increase in net premiums earned. Discontinued operations consist of the operations of Darwin Professional Underwriters, Inc., or Darwin. Additional information regarding the results of discontinued operations can be found in Financial Condition as well as Note 8 to the Consolidated Financial Statements included in this report on Form 10-Q.

The increase in loss and loss adjustment expenses and commissions, brokerage and other underwriting expenses primarily reflects the inclusion of EDC's results in the first six months of 2008, which include a \$24.7 million reserve increase in the second quarter of 2008 for the current and prior accident years. In addition, RSUI's results included a net \$16.7 million release of prior accident year loss reserves in the second quarter of 2008. Additional information regarding these

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reserving actions and other items can be found in the discussion of AIHL's operating unit results from continuing operations on pages 17 through 22 herein. The decrease in other income for the first six months of 2008 from the corresponding 2007 period primarily reflects a pre-tax gain of approximately \$7.2 million realized in the 2007 first quarter on sales of real property by Alleghany Properties, compared with immaterial sales activity during the first six months of 2008. The decrease in net investment income for the second quarter and first six months of 2008 from the corresponding 2007 period was principally due to lower average investment yields on our fixed income portfolio during the second quarter and first six months of 2008. The increase in net premiums earned primarily reflects the inclusion of EDC's results in the first six months of 2008.

Net realized capital gains in the first six months of 2008 and 2007 primarily reflects sales by parent of common stock of Burlington Northern Santa Fe Corporation, or Burlington Northern, during the 2008 first quarter and 2007 first quarter. Net realized capital gains in the first six months of 2008 were partially offset by \$62.7 million of unrealized losses recognized as impairment charges in the 2008 second quarter that are primarily related to energy (refinery) and financial service sector equity holdings of AIHL that were deemed to be other than temporary and, as such, are required to be charged against earnings, partially offset by \$36.5 million of net realized capital gains on the sale of securities by AIHL. Additional information regarding our investments can be found in on pages 28 and 29 herein.

The effective tax rate on earnings from continuing operations before income taxes was 30.2 percent for the first six months of 2008, compared with 30.0 percent for the corresponding 2007 period.

Table of Contents**AIHL Operating Unit Pre-Tax Results from Continuing Operations**

| <i>(in millions, except ratios)</i> | RSUI | AIHL Re | CATA | EDC (1) | AIHL |
|---|----------|------------|---------|------------|----------|
| Three months ended June 30, 2008 | | | | | |
| Gross premiums written | \$ 314.4 | | \$ 56.9 | \$ 19.7 | \$ 391.0 |
| Net premiums written | 192.1 | | 49.2 | 18.9 | 260.2 |
| Net premiums earned (2) | \$ 174.2 | | \$ 48.0 | \$ 18.0 | \$ 240.2 |
| Loss and loss adjustment expenses | 76.1 | | 23.9 | 39.4 | 139.4 |
| Commission, brokerage and other underwriting expenses (3) | 43.4 | | 20.6 | 8.5 | 72.5 |
| Underwriting profit (loss) (4) | \$ 54.7 | | \$ 3.5 | \$ (29.9) | \$ 28.3 |
| Net investment income (2) | | | | | 30.6 |
| Net realized capital losses (2) | | | | | (22.8) |
| Other income (2) | | | | | 0.1 |
| Other expenses (3) | | | | | (11.6) |
| Earnings from continuing operations before income taxes | | | | | \$ 24.6 |
| Loss ratio (5) | 43.7% | | 49.8% | 218.2% | 58.0% |
| Expense ratio (6) | 24.9% | | 43.0% | 47.3% | 30.2% |
| Combined ratio (7) | 68.6% | | 92.8% | 265.5% | 88.2% |
| Three months ended June 30, 2007 | | | | | |
| Gross premiums written | \$ 371.0 | \$ 0.4 | \$ 71.2 | | \$ 442.6 |
| Net premiums written | 224.0 | 1.4 | 56.3 | | 281.7 |
| Net premiums earned (2) | \$ 178.2 | \$ 6.1 | \$ 50.9 | | \$ 235.2 |
| Loss and loss adjustment expenses | 97.3 | | 22.4 | | 119.7 |
| Commission, brokerage and other underwriting expenses (3) | 39.4 | | 21.1 | | 60.5 |
| Underwriting profit (4) | \$ 41.5 | \$ 6.1 | \$ 7.4 | | \$ 55.0 |
| Net investment income (2) | | | | | 30.7 |
| Net realized capital gains (2) | | | | | 5.7 |
| Other income (2) | | | | | 0.2 |
| Other expenses (3) | | | | | (12.2) |
| Earnings from continuing operations before income taxes | | | | | \$ 79.4 |
| Loss ratio (5) | 54.6% | | 44.0% | | 50.9% |
| Expense ratio (6) | 22.1% | 0.8% | 41.4% | | 25.7% |

| | | | | | |
|--------------------|----|-------|------|-------|-------|
| Combined ratio (7) | 22 | 76.7% | 0.8% | 85.4% | 76.6% |
|--------------------|----|-------|------|-------|-------|

Table of Contents**AIHL Operating Unit Pre-Tax Results from Continuing Operations**

| <i>(in millions, except ratios)</i> | RSUI | AIHL Re | CATA | EDC (1) | AIHL |
|---|----------|------------|----------|------------|----------|
| Six months ended June 30, 2008 | | | | | |
| Gross premiums written | \$ 569.5 | \$ 0.2 | \$ 112.1 | \$ 43.0 | \$ 724.8 |
| Net premiums written | 344.5 | 0.2 | 95.2 | 40.0 | 479.9 |
| Net premiums earned (2) | \$ 352.0 | \$ 0.2 | \$ 94.9 | \$ 38.6 | \$ 485.7 |
| Loss and loss adjustment expenses | 170.6 | | 47.4 | 56.6 | 274.6 |
| Commission, brokerage and other underwriting expenses (3) | 88.1 | 0.1 | 39.8 | 15.0 | 143.0 |
| Underwriting profit (loss) (4) | \$ 93.3 | \$ 0.1 | \$ 7.7 | \$ (33.0) | \$ 68.1 |
| Net investment income (2) | | | | | 62.2 |
| Net realized capital losses (2) | | | | | (26.2) |
| Other income (2) | | | | | 0.2 |
| Other expenses (3) | | | | | (22.7) |
| Earnings from continuing operations before income taxes | | | | | \$ 81.6 |
| Loss ratio (5) | 48.5% | | 50.0% | 146.6% | 56.6% |
| Expense ratio (6) | 25.0% | 28.4% | 41.9% | 38.8% | 29.4% |
| Combined ratio (7) | 73.5% | 28.4% | 91.9% | 185.4% | 86.0% |
| Six months ended June 30, 2007 | | | | | |
| Gross premiums written | \$ 659.9 | \$ 0.4 | \$ 135.2 | | \$ 795.5 |
| Net premiums written | 380.4 | 1.4 | 106.8 | | 488.6 |
| Net premiums earned (2) | \$ 344.8 | \$ 23.8 | \$ 98.2 | | \$ 466.8 |
| Loss and loss adjustment expenses | 173.8 | | 43.1 | | 216.9 |
| Commission, brokerage and other underwriting expenses (3) | 79.3 | 0.1 | 40.7 | | 120.1 |
| Underwriting profit (4) | \$ 91.7 | \$ 23.7 | \$ 14.4 | | \$ 129.8 |
| Net investment income (2) | | | | | 62.6 |
| Net realized capital losses (2) | | | | | |
| Other income (2) | | | | | 0.3 |
| Other expenses (3) | | | | | (23.7) |
| Earnings from continuing operations before income taxes | | | | | \$ 169.0 |
| Loss ratio (5) | 50.4% | | 43.9% | | 46.5% |
| Expense ratio (6) | 23.0% | 0.4% | 41.4% | | 25.7% |

| | | | | |
|--|-------|------|-------|-------|
| Combined ratio (7) | 73.4% | 0.4% | 85.3% | 72.2% |
| (1) Includes the results of EDC, net of purchase accounting adjustments, commencing July 18, 2007. See Note 9 to the Notes to the Consolidated Financial Statements set forth in Item 8 of our 2007 10-K. | | | | |
| (2) Represent components of total revenues. | | | | |
| (3) Commission, brokerage and other underwriting expenses represent commission and brokerage expenses and that portion of salaries, administration and other operating expenses attributable to underwriting activities, whereas the remainder constitutes other expenses. | | | | |
| (4) Represents net premiums earned less loss and loss adjustment | | | | |

expenses and underwriting expenses, all as determined in accordance with GAAP, and does not include net investment income and other income or net realized capital gains. Underwriting profit does not replace net income determined in accordance with GAAP as a measure of profitability; rather, we believe that underwriting profit, which does not include net investment income and other income or net realized capital gains, enhances the understanding of AIHL s insurance operating units operating results by highlighting net income attributable to their underwriting performance. With the addition of net investment income and other income and net realized capital gains, reported pre-tax

net income (a GAAP measure) may show a profit despite an underlying underwriting loss. Where underwriting losses persist over extended periods, an insurance company's ability to continue as an ongoing concern may be at risk. Therefore, we view underwriting profit as an important measure in the overall evaluation of performance.

- (5) Loss and loss adjustment expenses divided by net premiums earned, all as determined in accordance with GAAP.
- (6) Underwriting expenses divided by net premiums earned, all as determined in accordance with GAAP.
- (7) The sum of the loss ratio and expense ratio, all as determined in

accordance with
GAAP,
representing the
percentage of
each premium
dollar an
insurance
company has to
spend on losses
(including loss
adjustment
expenses) and
underwriting
expenses.

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Discussion of individual AIHL operating unit results follows, and AIHL investment results are discussed below under Investments.

RSUI

The decrease in gross premiums written by RSUI in the first six months of 2008 from the corresponding 2007 period primarily reflects continuing and increasing price competition, particularly in RSUI's general liability and property lines of business. RSUI's net premiums earned increased slightly in the first six months of 2008 from the corresponding 2007 period in the casualty lines of business, partially offset by the property line of business. The increase in casualty premiums earned primarily reflects the growth of RSUI's binding authority line of business which writes small, specialized coverages pursuant to underwriting authority arrangements with managing general agents, and the non-renewal of a professional liability quota share reinsurance treaty, which expired on April 1, 2007. The decrease in property premiums earned is due to substantially lower premium writings, partially offset by reduced reinsurance limits being purchased and reduced rates paid for catastrophe and per risk reinsurance coverage renewed at May 1, 2007.

The decrease in loss and loss adjustment expenses in the first six months of 2008 from the corresponding 2007 period is due primarily to adjustments to prior accident year reserves, partially offset by higher property losses. Loss and loss adjustment expenses for the first six months of 2008 reflect a net \$16.7 million release of prior accident year loss reserves, compared with a \$17.8 million net reserve increase of prior accident year loss reserves during the corresponding 2007 period. The net \$16.7 million release during the 2008 second quarter consists of a net reserve release of \$21.7 million for the casualty lines of business, partially offset by \$5.0 million increase in estimated losses and loss adjustment expenses related to Hurricane Katrina after reinsurance. The \$21.7 million net casualty reserve release reflects favorable loss emergence in the 2003, 2004 and 2005 accident years for the D&O liability, professional liability and general liability lines of business. Such reduction did not impact the assumptions used in estimating RSUI's loss and loss adjustment expense liabilities for business earned in 2008. The \$17.8 million net reserve increase during the first six months of 2007 reflects an increase in estimated losses and loss adjustment expenses related to Hurricane Katrina in the amount of \$30.9 million after reinsurance, partially offset by an aggregate \$13.1 million decrease in reserves reflecting favorable loss emergence in the 2003 and 2004 accident years for the professional liability and D&O liability lines of business. Loss and loss adjustment expenses in the first six months of 2008 included a single net loss of approximately \$10.0 million arising from a factory explosion in the 2008 first quarter, and higher levels of catastrophe losses related to floods and tornados. The decrease in loss and loss adjustment expenses described above was the primary cause for the increase in RSUI's underwriting profit in the first six months of 2008 from the corresponding 2007 period.

The increase in RSUI's underwriting expenses in the first six months of 2008 from the corresponding 2007 period primarily reflects higher net incurred commission expenses primarily resulting from higher property commission rates in 2008, partially offset by higher ceding commissions on RSUI's property surplus share reinsurance arrangements.

Rates at RSUI in the first six months of 2008, compared with the corresponding 2007 period, reflect overall industry trends of downward pricing as a result of increased competition, with decreased rates in all of RSUI's lines of business. RSUI is also seeing fewer opportunities to

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write business, as a more competitive market causes less business to flow into the wholesale marketplace in which RSUI operates.

As discussed in the 2007 10-K, RSUI reinsures its property lines of business through a program consisting of surplus share treaties, facultative placements, per risk and catastrophe excess of loss treaties. RSUI's catastrophe reinsurance program (which covers catastrophe risks including, among others, windstorms and earthquakes) and per risk reinsurance program run on an annual basis from May 1 to the following April 30. RSUI has placed all of its catastrophe reinsurance program for the 2008-2009 period. Under the 2008-2009 program, RSUI's catastrophe reinsurance program provides coverage in two layers for \$400.0 million of losses in excess of a \$100.0 million net retention after application of the surplus share treaties, facultative reinsurance and per risk covers. The first layer provides coverage for \$100.0 million of losses, before a 33.15 percent co-participation by RSUI, in excess of the \$100.0 million net retention, and the second layer provides coverage for \$300.0 million of losses, before a 5 percent co-participation by RSUI, in excess of \$200.0 million. In addition, RSUI's property per risk reinsurance program for the 2008-2009 period provides RSUI with coverage for \$90.0 million of losses in excess of \$10.0 million net retention per risk after application of the surplus share treaties and facultative reinsurance.

RSUI reinsures its other lines of business through quota share treaties, except for professional liability and binding authority lines where RSUI retains all of such business. RSUI's quota share reinsurance treaty for umbrella/excess renewed on June 1, 2008 and provides coverage for policies with limits up to \$30.0 million, with RSUI ceding 35 percent of the premium and loss for policies with limits up to \$15.0 million and ceding 67.5 percent of the premium and loss for policies with limits in excess of \$15.0 million up to \$30.0 million. RSUI's directors and officers (D&O) liability line quota share reinsurance treaty renewed on July 1, 2008 and provides coverage for policies with limits up to \$20.0 million, with RSUI ceding 35 percent of the premium and loss for all policies with limits up to \$10.0 million and ceding 60 percent of the premium and loss for policies with limits in excess of \$10.0 million up to \$20.0 million.

AIHL Re

AIHL Re was formed in June 2006 as a captive reinsurance subsidiary of AIHL to provide catastrophe reinsurance coverage for AIHL's insurance operating units and affiliates. AIHL Re's results for the first six months of 2008 reflect premiums earned pursuant to a reinsurance agreement with Homesite which expired on March 31, 2008. In connection with the expiration of the agreement, the trust funds established to secure AIHL Re's obligations to make payments to Homesite under such reinsurance agreement were dissolved and the \$20.0 million in such funds was disbursed to AIHL Re in April 2008. AIHL Re's underwriting profit in the first six months of 2007 reflects the absence of catastrophe losses during the period when AIHL Re was participating in the catastrophe reinsurance programs of both Homesite and RSUI. AIHL Re's participation in such RSUI catastrophe reinsurance program expired in April 2007.

CATA

CATA's net premiums earned in the first six months of 2008 decreased from the corresponding 2007 period, primarily reflecting continuing and increasing price competition in CATA's property and casualty (including in excess and surplus markets) and commercial surety lines of business, partially offset by net premiums earned in CATA's recently established

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specialty markets division. The increase in loss and loss adjustment expenses in the first six months of 2008 from the corresponding 2007 period primarily reflects a \$3.9 million release of prior accident year loss reserves during the 2008 period, compared with a \$9.4 million release of prior accident year loss reserves during the corresponding 2007 period. These reserve releases were primarily of casualty and surety prior accident year reserves. The portion of the foregoing reserve releases that was made during the three months ended June 30, 2008 and 2007 was \$2.4 million and \$6.0 million, respectively. CATA's 2008 reserving actions did not impact the assumptions used in estimating CATA's loss and loss adjustment expense liabilities for its casualty and surety lines of business earned in 2008. The increase in loss and loss adjustment expenses described above and lower earned premium were the primary causes for the decrease in CATA's underwriting profit in the first six months of 2008 from the corresponding 2007 period.

Rates at CATA in the first six months of 2008, compared with the corresponding 2007 period, reflect overall industry trends of downward pricing as a result of increased competition, causing a reduction of premium volumes in CATA's lines of business.

EDC

AIHL's results include the results of EDC, net of purchase accounting adjustments, commencing July 18, 2007. See Note 16 to the Notes to the Consolidated Financial Statements set forth in Item 8 of our 2007 10-K. EDC's net premiums earned in the first six months of 2008 reflect increased competition, decreasing rates and declining policy retentions in its California workers' compensation business. Loss and loss adjustment expenses in the first six months of 2008 reflect the exposure of EDC's underlying book of business and the trend of increasing loss costs. In addition, loss and loss adjustment expenses in the second quarter of 2008 reflect a \$24.7 million reserve increase, consisting of \$14.9 million related to prior accident years and \$9.8 million related to the 2008 accident year. The increases for both the prior accident years and the current accident year primarily reflect a significant acceleration in claims emergence, higher than anticipated increases in industry-wide loss severities, and higher loss adjustment expenses. This increase in reserves has also caused EDC to write off its deferred acquisition cost asset of \$2.1 million and establish a modest premium deficiency reserve.

Reserve Review Process

AIHL's insurance operating units periodically analyze, at least quarterly, liabilities for unpaid losses and loss adjustment expenses, or LAE, established in prior years and adjust their expected ultimate cost, where necessary, to reflect positive or negative development in loss experience and new information, including, for certain catastrophic events, revised industry estimates of the magnitude of a catastrophe. Adjustments to previously recorded liabilities for unpaid losses and LAE, both positive and negative, are reflected in our financial results in the periods in which these adjustments are made and are referred to as prior year reserve development. The following table presents the reserves established in connection with the losses and LAE of AIHL's insurance operating units on a gross and net basis by line of business. These reserve amounts represent the accumulation of estimates of ultimate losses (including for claims incurred but not yet reported, or IBNR) and LAE.

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| <i>(in millions)</i> <i>At June 30, 2008</i> | <i>Property</i> | <i>Casualty(1)</i> | <i>CMP(2)</i> | <i>Surety</i> | <i>Workers</i> | | <i>Total</i> |
|---|-----------------|--------------------|---------------|---------------|----------------|-------------------------|--------------|
| | | | | | <i>Comp(3)</i> | <i>All Other(4)</i> | |
| Gross loss and LAE reserves | \$ 327.3 | \$ 1,797.5 | \$ 82.7 | \$ 21.6 | \$ 212.6 | \$ 61.4 | \$ 2,503.1 |
| Reinsurance recoverables on unpaid losses | (130.6) | (836.2) | (1.3) | (0.2) | (9.3) | (40.0) | (1,017.6) |
| Net loss and LAE reserves | \$ 196.7 | \$ 961.3 | \$ 81.4 | \$ 21.4 | \$ 203.3 | \$ 21.4 | \$ 1,485.5 |
| <i>At December 31, 2007</i> | | | | | | | |
| Gross loss and LAE reserves | \$ 332.1 | \$ 1,683.2 | \$ 85.0 | \$ 20.6 | \$ 187.4 | \$ 71.4 | \$ 2,379.7 |
| Reinsurance recoverables on unpaid losses | (126.4) | (799.5) | (1.1) | (0.3) | (8.8) | (46.4) | (982.5) |
| Net loss and LAE reserves | \$ 205.7 | \$ 883.7 | \$ 83.9 | \$ 20.3 | \$ 178.6 | \$ 25.0 | \$ 1,397.2 |

(1) Primarily consists of excess and umbrella, D&O liability, professional liability, and general liability. Excludes loss and LAE reserves from Darwin (Darwin's operations are classified as discontinued operations).

(2)

Commercial
multiple peril.

- (3) Workers compensation amounts include EDC, net of purchase accounting adjustments (See Note 16 to the Notes to the Consolidated Financial Statements set forth in Item 8 of our 2007 10-K). Such adjustments include a minor reduction of gross and net loss and LAE for acquisition-date discounting, as required under purchase accounting.
- (4) Primarily consists of loss and LAE reserves for terminated lines of business and loss reserves acquired in connection with prior acquisitions for which the sellers provided loss reserve guarantees. The loss and LAE reserves are ceded 100 percent to the sellers. Additional

information regarding the loss reserve guarantees can be found in Note 5 to the Notes to the Consolidated Financial Statements set forth in Item 8 of our 2007 10-K Report.

Changes in Loss and LAE Reserves between June 30, 2008 and December 31, 2007

Gross Reserves. The increase in gross loss and LAE reserves at June 30, 2008 from December 31, 2007 primarily reflects increases in casualty, and to a lesser extent, workers' compensation gross loss and LAE reserves, partially offset by modest decreases in other gross loss and LAE reserves. The increase in casualty gross loss and LAE reserves primarily reflects anticipated loss reserves on current accident year gross premiums earned and limited gross paid loss activity for the current and prior accident years at RSUI. The increase in workers' compensation gross loss and LAE reserves primarily relate to increases to both current and prior accident year reserves by EDC. The decrease in other reserves is due primarily to a reduction in loss and LAE reserves acquired in connection with prior acquisitions which are ceded 100 percent to the sellers.

Net Reserves. The increase in net loss and LAE reserves at June 30, 2008 from December 31, 2007 primarily reflects increases in casualty and, to a lesser extent, workers' compensation net loss and LAE reserves, partially offset by modest decreases in property net loss and LAE reserves. The increase in casualty net loss and LAE reserves primarily reflects anticipated loss reserves on current accident year premiums earned and limited net paid loss activity for the current and prior accident years at RSUI. Such increases for RSUI were partially offset by a \$21.7 million net release of prior accident year reserves in the 2008 second quarter. The increase in workers' compensation net loss and LAE reserves is primarily due to increases to both current and prior accident year reserves by EDC. The decrease in net property loss and LAE reserves is mainly due to payments made by RSUI on 2004 and 2005 hurricane related losses, principally Hurricane Katrina, and reduced premium writings.

Table of Contents**Reinsurance Recoverables**

At June 30, 2008, AIHL had total reinsurance recoverables of \$1,034.7 million, consisting of \$1,017.6 million of recoverables on unpaid losses and \$17.1 million of recoverables on paid losses. Approximately 92.2 percent of AIHL's reinsurance recoverables balance at June 30, 2008 was due from reinsurers having an A.M. Best financial strength rating of A (Excellent) or higher.

Corporate Activities Results from Operations

Corporate activities recorded a pre-tax loss of \$4.2 million on revenues of \$5.2 million in the 2008 second quarter, compared with a pre-tax gain of \$0.1 million on revenues of \$10.2 million in the corresponding 2007 period, and a pre-tax gain of \$66.9 million on revenues of \$87.0 million in the first six months of 2008, compared with a pre-tax gain of \$62.8 million on revenues of \$82.6 million in the corresponding 2007 period. The results for the first six months of 2008 and first six months of 2007 primarily reflect net realized capital gains at the parent level of \$78.1 million and \$55.9 million, respectively, resulting from the sale of approximately 1.0 million shares and approximately 0.8 million shares, respectively, of Burlington Northern common stock. In both cases, the sales occurred in the first three months of the year. As of June 30, 2008, we held approximately 4.0 million shares of Burlington Northern common stock with an aggregate market value at that date of approximately \$399.6 million. The results for the first six months of 2007 also benefited from the sale by Alleghany Properties of certain real estate holdings in the 2007 first quarter which generated a pre-tax gain of approximately \$7.2 million, compared with immaterial sales activity during the comparable 2008 period.

Investments

On a consolidated basis, our invested asset portfolio was approximately \$4.40 billion as of June 30, 2008, an increase of 3.5 percent from approximately \$4.25 billion at December 31, 2007. At June 30, 2008, the average duration of our debt securities portfolio was 4.1 years, compared with 4.3 years at December 31, 2007. The following is information relating to Alleghany's investments.

| <i>(in millions)</i> | Six months ended | |
|--|--------------------------|--------------------------|
| | June 30, 2008 | June 30, 2007 |
| Net investment income | | |
| <i>AIHL</i> | \$ 62.2 | \$ 62.6 |
| <i>Corporate activities</i> | 7.9 | 16.0 |
| Total | 70.1 | \$ 78.6 |
| Net realized capital (losses) gains | | |
| <i>AIHL</i> | \$(26.2) | \$ |
| <i>Corporate activities</i> | 79.1 | 55.8 |
| Total | \$ 52.9 | \$ 55.8 |

The slight decrease in AIHL's net investment income in the first six months of 2008 compared with the corresponding 2007 period is due principally to lower average investment yields during the first six months of 2008, largely offset by the net positive effect from the acquisition of EDC and strong underwriting cash flow. Net realized capital losses for AIHL in the first six months of 2008 include \$62.7 million of impairment charges for unrealized losses primarily related to energy (refinery) and financial service sector equity holdings of AIHL that were deemed to be other than temporary and, as such, are required to be charged against earnings,

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partially offset by \$36.5 million of net realized capital gains on the sale of securities by AIHL. The \$62.7 million impairment charge was primarily due to the severity of the declines in fair value of such securities relative to cost as of June 30, 2008. Net realized capital gains in the first six months of 2007 include \$6.6 million of impairment charges for unrealized losses related to AIHL's mortgage- and asset-backed bond holdings, offset by \$6.6 million of net realized capital gains on the sale of securities by AIHL.

The decrease in net investment income for corporate activities in the first six months of 2008 from the corresponding 2007 period reflects: (i) lower earnings from our share of earnings in Homesite, net of purchase accounting adjustments, in the 2008 period; (ii) poor results from parent-level partnership investments in 2008; (iii) lower average investment yields during the first six months of 2008; and (iv) lower average fixed income assets during the 2008 period due to capital contributions made by parent to AIHL in connection with AIHL's acquisition of EDC in July 2007. As previously noted, the net realized capital gains for corporate activities in both the 2008 and 2007 periods are due primarily to the sale of Burlington Northern common stock.

As of June 30, 2008 and December 31, 2007, no equity security was in a continuous unrealized loss position for twelve months or more.

After adjusting the cost basis of our equity securities for the recognition of \$62.7 million of unrealized losses through impairment charges, following is information regarding our unrealized gain (loss), before tax, on our equity securities:

| <i>(in millions)</i> | At June 30, 2008 | At December 31, 2007 |
|-------------------------|-----------------------------|---------------------------------|
| Gross unrealized gain | \$ 521.4 | \$ 513.7 |
| Gross unrealized (loss) | (14.4) | (28.7) |
| Net unrealized gain | \$ 507.0 | \$ 485.0 |

At June 30, 2008, our mortgage- and asset-backed securities portfolio, which constitutes \$779.2 million of our debt securities portfolio, was backed by the following types of underlying collateral (in millions):

| Type of Underlying Collateral | Fair Value | Average Rating |
|--------------------------------------|-------------------|---------------------------|
| Guaranteed by GNMA, FNMA or FHLMC(1) | \$351.4 | Aaa / AAA |
| Prime(2) | 374.4 | Aaa / AAA |
| Alt-A(2) | 43.2 | Aaa / AAA |
| Sub-prime(2) | 10.2 | Aaa / AAA |
| Total | \$779.2 | Aaa / AAA |

- (1) GNMA refers to the Government National Mortgage Association; FNMA refers to the Federal National Mortgage Association; and FHLMC refers to the Federal

Home Loan
Mortgage
Corporation.

- (2) As defined by
Standard &
Poor's.

Financial Condition

Stockholders' equity increased to \$2,897.2 million as of June 30, 2008, compared with \$2,793.9 million as of December 31, 2007, representing an increase of 3.7 percent, due to an increase in net earnings in the first six months of 2008, partially offset by a net decrease in net unrealized appreciation on our investment portfolio during the first six months of 2008.

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On June 27, 2008, Darwin, of which AIHL owns approximately 55 percent, entered into a merger agreement with Allied World Assurance Company Holdings, Ltd. (Allied World), whereby Allied World will acquire all of the issued and outstanding shares of Darwin common stock for cash consideration of \$32.00 per share. The transaction is subject to regulatory approvals and the consent of Darwin stockholders. As an inducement to Allied World to enter into the merger agreement, we entered into a voting agreement with Allied World pursuant to which we have agreed, subject to certain conditions, to vote a number of shares of its Darwin common stock equal to 40% of the issued and outstanding shares of common stock of Darwin in favor of the approval of the transaction. The transaction is expected to close in the fourth quarter of 2008.

Upon closing of the transaction, we expect to receive aggregate proceeds of approximately \$300 million in cash for AIHL's 9,371,096 shares of Darwin common stock. We anticipate that the transaction will result in an after-tax gain of approximately \$94 million, including approximately \$9 million of gain deferred at the time of Darwin's initial public offering in May 2006.

In February 2008, Alleghany announced that its Board of Directors had authorized the purchase of shares of Alleghany common stock, at such times and at prices as management may determine advisable, up to an aggregate of \$300.0 million. During the first six months of 2008, we purchased an aggregate of 5,677 shares of our common stock for approximately \$1.93 million, at an average price per share of \$339.52. As of June 30, 2008 and December 31, 2007, we had 8,343,198 and 8,322,348 shares of our common stock outstanding, respectively, adjusted to reflect the common stock dividend declared in February 2008 and paid in April 2008.

We and our subsidiaries have adequate internally generated funds and unused credit facilities to provide for the currently foreseeable needs of our and their businesses, respectively.

Recent Accounting Pronouncements*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 to 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. We have adopted the provisions of SFAS 157 as of January 1, 2008, and the implementation did not have a material impact on our results of operations and financial condition.

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 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

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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. We will adopt SFAS 141R and SFAS 160 for all business combinations initiated after December 31, 2008.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk is the risk of loss from adverse changes in market prices and rates, such as interest rates, foreign currency exchange rates and commodity prices. The primary market risk related to our non-trading financial instruments is the risk of loss associated with adverse changes in interest rates.

The table below presents a sensitivity analysis of our consolidated debt securities as of June 30, 2008. Sensitivity analysis is defined as the measurement of potential change in future earnings, fair values or cash flows of market sensitive instruments resulting from one or more selected hypothetical changes in interest rates. In this sensitivity analysis model, we use fair values to measure potential change, and a +/- 100, 200 and 300 basis point range of change in interest rates to measure the hypothetical change in fair value of the financial instruments included in the analysis. The change in fair value is determined by calculating hypothetical June 30, 2008 ending prices based on yields adjusted to reflect a +/- 100, 200 and 300 basis point range of change in interest rates, comparing these hypothetical ending prices to actual ending prices, and multiplying the difference by the par outstanding.

At June 30, 2008 (in millions)

| Interest rate shifts | -300 | -200 | -100 | 0 | 100 | 200 | 300 |
|--------------------------------|-----------|-----------|-----------|-----------|------------|------------|------------|
| Debt securities, fair value | \$2,927.0 | \$2,815.2 | \$2,707.1 | \$2,599.2 | \$2,493.4 | \$2,392.3 | \$2,296.9 |
| Estimated change in fair value | \$ 327.8 | \$ 216.0 | \$ 107.9 | | \$ (105.8) | \$ (206.9) | \$ (302.3) |

This sensitivity analysis provides only a limited, point-in-time view of the market risk of the financial instruments discussed above. The actual impact of changes in market conditions on the financial instruments may differ significantly from those shown in the sensitivity analysis. The sensitivity analysis is further limited because it does not consider any actions we could take in response to actual and/or anticipated changes in interest rates.

ITEM 4. CONTROLS AND PROCEDURES.

We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer, or CEO, and our chief financial officer, or CFO, of the effectiveness of design and operation of our disclosure controls and procedures as of the end of the period covered by this report on Form 10-Q pursuant to Rule 13a-15(e) or Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934, or Exchange Act. Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of that date to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and timely reported as specified in the U.S. Securities and Exchange Commission's rules and forms. Additionally, as of the end of the period covered by this report on Form 10-Q, there have been no changes in internal control over financial

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reporting during the period covered by this report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION**ITEM 1A. RISK FACTORS.**

There are no material changes from the risk factors set forth in Part I, Item 1A, Risk Factors, of our 2007 10-K. Please refer to that section for disclosures regarding the risks and uncertainties related to our businesses.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**(c) Issuer Purchases of Equity Securities.**

The following table summarizes our common stock repurchases for the quarter ended June 30, 2008.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|--------------------------------------|---|---|---|---|
| April 1, 2008 through April 30, 2008 | 1,326 | \$ 346.43 | 343 | |
| May 1, 2008 through May 31, 2008 | | | | |
| June 1, 2008 through June 30, 2008 | 704 | 334.35 | | |
| Total | 2,030(1) | \$ 342.24 | 343 | \$298,083,444 |

(1) Of such shares, (i) 343 represent shares purchased pursuant to an authorization of the Board of Directors to purchase shares of our common stock, at such times and at prices as management may determine advisable, up to an aggregate of \$300.0 million and (ii) 1,687 represent the tender to us by certain directors of Alleghany and its subsidiaries of already-owned common stock as payment of the exercise price in connection with option exercises .

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Our 2008 Annual Meeting of Stockholders was held on April 25, 2008. At the Annual Meeting, three directors were elected to serve for three-year terms on our Board of Directors, by the following votes:

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| | FOR | OPPOSED | WITHHELD |
|--------------------|-----------|---------|----------|
| Rex D. Adams | 6,709,210 | 178,398 | 6,772 |
| Weston M. Hicks | 6,689,054 | 198,584 | 6,742 |
| Jefferson W. Kirby | 6,509,268 | 339,674 | 45,438 |

The selection of KPMG LLP, independent registered public accounting firm, as our auditors for the year 2008 was ratified by a vote of 6,838,287 shares in favor and 52,444 shares opposed. A total of 3,649 shares abstained from voting.

ITEM 6. EXHIBITS.

| Exhibit Number | Description |
|----------------|--|
| 10.1 | Agreement and Plan of Merger, dated as of June 27, 2008, by and among Darwin Professional Underwriters, Inc., Allied World Assurance Company Holdings, Ltd. and Allied World Merger Company, filed as Exhibit 2.1 to Alleghany's Current Report on Form 8-K filed on June 30, 2008, is incorporated herein by reference. |
| 10.2 | Voting Agreement, dated as of June 27, 2008, by and between Alleghany Insurance Holdings LLC and Allied World Assurance Company Holdings, Ltd., filed as Exhibit 10.1 to Alleghany's Current Report on Form 8-K filed on June 30, 2008, is incorporated herein by reference. |
| 31.1 | Certification of the Chief Executive Officer of the Company pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of the Chief Financial Officer of the Company pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) of the Securities Exchange Act of 1934, as amended. |
| 32.1 | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This exhibit shall not be deemed filed as a part of this report on Form 10-Q. |
| 32.2 | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This exhibit shall not be deemed filed as a part of this report on Form 10-Q. |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ALLEGHANY CORPORATION

Registrant

Date: August 7, 2008

/s/ Roger B. Gorham

Roger B. Gorham
Senior Vice President
(and chief financial officer)

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