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Allied World Assurance Co Holdings, AG

Form 10-Q

May 10, 2011

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-Q

(Mark One)

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

For the quarterly period ended: March 31, 2011

OR

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

For the transition period from _____ to _____

Commission file number: 001-32938

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

(Exact Name of Registrant as Specified in Its Charter)

Switzerland

*(State or Other Jurisdiction of
Incorporation or Organization)*

98-0681223

*(I.R.S. Employer
Identification No.)*

Lindenstrasse 8, 6340 Baar, Zug, Switzerland

(Address of Principal Executive Offices and Zip Code)

41-41-768-1080

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark 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

As of May 2, 2011, 37,919,865 common shares were outstanding.

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

PART II

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 3. Defaults Upon Senior Securities

Item 4. [Removed and Reserved.]

Item 5. Other Information

Item 6. Exhibits

SIGNATURES

EXHIBIT INDEX

EX-31.1

EX-31.2

EX-32.1

EX-32.2

EX-101 INSTANCE DOCUMENT

EX-101 SCHEMA DOCUMENT

EX-101 CALCULATION LINKBASE DOCUMENT

EX-101 LABELS LINKBASE DOCUMENT

EX-101 PRESENTATION LINKBASE DOCUMENT

EX-101 DEFINITION LINKBASE DOCUMENT

Table of Contents

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

as of March 31, 2011 and December 31, 2010

(Expressed in thousands of United States dollars, except share and per share amounts)

| | As of March 31, 2011 | As of December 31, 2010 |
|---|-------------------------------------|--|
| ASSETS | | |
| Fixed maturity investments available for sale, at fair value (amortized cost: 2011: \$505,638; 2010: \$828,544) | \$ 543,808 | \$ 891,849 |
| Fixed maturity investments trading, at fair value | 5,960,830 | 5,769,097 |
| Equity securities trading, at fair value | 271,057 | 174,976 |
| Other invested assets trading, at fair value | 469,999 | 347,632 |
| | | |
| Total investments | 7,245,694 | 7,183,554 |
| Cash and cash equivalents | 693,980 | 756,995 |
| Restricted cash | 52,022 | 96,373 |
| Insurance balances receivable | 569,836 | 529,927 |
| Prepaid reinsurance | 175,348 | 187,287 |
| Reinsurance recoverable | 975,523 | 927,588 |
| Accrued investment income | 41,328 | 40,520 |
| Net deferred acquisition costs | 113,097 | 96,803 |
| Goodwill | 268,376 | 268,376 |
| Intangible assets | 56,109 | 56,876 |
| Balances receivable on sale of investments | 363,151 | 188,408 |
| Net deferred tax assets | 20,618 | 19,740 |
| Other assets | 93,697 | 75,184 |
| | | |
| Total assets | \$ 10,668,779 | \$ 10,427,631 |
| | | |
| LIABILITIES: | | |
| Reserve for losses and loss expenses | \$ 5,100,643 | \$ 4,879,188 |
| Unearned premiums | 1,096,260 | 962,203 |
| Reinsurance balances payable | 91,852 | 99,732 |
| Balances due on purchases of investments | 567,918 | 506,978 |
| Senior notes | 797,761 | 797,700 |
| Accounts payable and accrued liabilities | 63,392 | 106,010 |
| | | |
| Total liabilities | \$ 7,717,826 | \$ 7,351,811 |
| | | |
| SHAREHOLDERS EQUITY: | | |
| Common shares: par value CHF 15.00 per share (2011: 40,003,642; 2010: 40,003,642 shares issued and 2011: 37,899,699; 2010: 38,089,226 shares outstanding) | 600,055 | 600,055 |
| Additional paid-in capital | 75,166 | 170,239 |

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| | | |
|---|---------------|---------------|
| Treasury shares, at cost (2011: 2,103,943; 2010: 1,914,416) | (127,053) | (112,811) |
| Retained earnings | 2,369,822 | 2,361,202 |
| Accumulated other comprehensive income: net unrealized gains on investments, net of tax | 32,963 | 57,135 |
| Total shareholders' equity | 2,950,953 | 3,075,820 |
| Total liabilities and shareholders' equity | \$ 10,668,779 | \$ 10,427,631 |

See accompanying notes to the consolidated financial statements.

-1-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE (LOSS) INCOME

for the three months ended March 31, 2011 and 2010

(Expressed in thousands of United States dollars, except share and per share amounts)

| | Three Months Ended | |
|--|---------------------------|----------------|
| | March 31, | |
| | 2011 | 2010 |
| REVENUES: | | |
| Gross premiums written | \$ 560,688 | \$ 504,163 |
| Premiums ceded | (79,817) | (70,871) |
| Net premiums written | 480,871 | 433,292 |
| Change in unearned premiums | (145,995) | (94,968) |
| Net premiums earned | 334,876 | 338,324 |
| Net investment income | 50,208 | 68,902 |
| Net realized investment gains | 50,376 | 77,487 |
| Net impairment charges recognized in earnings: | | |
| Total other-than-temporary impairment charges | | (168) |
| Portion of loss recognized in other comprehensive income, before taxes | | |
| Net impairment charges recognized in earnings | | (168) |
| Other income | | 297 |
| | 435,460 | 484,842 |
| EXPENSES: | | |
| Net losses and loss expenses | 304,452 | 232,154 |
| Acquisition costs | 38,082 | 40,784 |
| General and administrative expenses | 67,956 | 63,463 |
| Amortization and impairment of intangible assets | 767 | 892 |
| Interest expense | 13,742 | 9,528 |
| Foreign exchange (gain) loss | (442) | 1,076 |
| | 424,557 | 347,897 |
| Income before income taxes | 10,903 | 136,945 |
| Income tax expense | 2,283 | 3,205 |
| NET INCOME | 8,620 | 133,740 |
| Other comprehensive income: | | |
| Unrealized (losses) gains on investments arising during the period net of applicable deferred income tax (expense) benefit for the three months ended March 31, 2011: \$(964); 2010: \$219 | (8,044) | 37,470 |
| Reclassification adjustment for net realized investment gains included in net income, net of applicable income tax | (16,128) | (45,035) |

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| | | |
|-----------------------------|-------------|------------|
| Other comprehensive loss | (24,172) | (7,565) |
| COMPREHENSIVE (LOSS) INCOME | \$ (15,552) | \$ 126,175 |

PER SHARE DATA

| | | |
|---|------------|------------|
| Basic earnings per share | \$ 0.23 | \$ 2.67 |
| Diluted earnings per share | \$ 0.21 | \$ 2.52 |
| Weighted average common shares outstanding | 38,199,867 | 50,023,816 |
| Weighted average common shares and common share equivalents outstanding | 40,383,523 | 53,115,756 |
| Dividends declared per share | \$ | \$ 0.20 |

See accompanying notes to the consolidated financial statements.

-2-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

for the three months ended March 31, 2011 and 2010

(Expressed in thousands of United States dollars)

| | Share Capital USD | Share Capital CHF | Additional Paid-in Capital | Treasury Shares | Accumulated Other Comprehensive Income | Retained Earnings | Total |
|-----------------------------------|-------------------------|-------------------------|----------------------------------|--------------------|---|----------------------|--------------|
| December 31, 2010 | \$ | 600,055 | \$ 170,239 | \$ (112,811) | \$ 57,135 | \$ 2,361,202 | \$ 3,075,820 |
| Net income | | | | | | 8,620 | 8,620 |
| Dividends | | | | | | | |
| Other comprehensive loss | | | | | (24,172) | | (24,172) |
| Stock compensation | | | (41,453) | 45,758 | | | 4,305 |
| Share repurchases | | | | (60,000) | | | (60,000) |
| Repurchase of founder warrants | | | (53,620) | | | | (53,620) |
| March 31, 2011 | \$ | 600,055 | \$ 75,166 | \$ (127,053) | \$ 32,963 | \$ 2,369,822 | \$ 2,950,953 |
| | | | | | | | |
| | Share Capital USD | Share Capital CHF | Additional Paid-in Capital | Treasury Shares | Accumulated Other Comprehensive Income | Retained Earnings | Total |
| December 31, 2009 | \$ 1,492 | | \$ 1,359,934 | \$ | \$ 149,849 | \$ 1,702,020 | \$ 3,213,295 |
| Net income | | | | | | 133,740 | 133,740 |
| Dividends | | | | | | (10,092) | (10,092) |
| Other comprehensive loss | | | | | (7,565) | | (7,565) |
| Stock compensation | 22 | | 9,407 | | | | 9,429 |
| March 31, 2010 | \$ 1,514 | | \$ 1,369,341 | \$ | \$ 142,284 | \$ 1,825,668 | \$ 3,338,807 |

See accompanying notes to the consolidated financial statements.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

for the three months ended March 31, 2011 and 2010

(Expressed in thousands of United States dollars)

| | Three Months Ended | |
|---|---------------------------|-------------|
| | March 31, | |
| | 2011 | 2010 |
| CASH FLOWS PROVIDED BY OPERATING ACTIVITIES: | | |
| Net income | \$ 8,620 | \$ 133,740 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Net realized gains on sales of investments | (21,624) | (45,261) |
| Mark to market adjustments | (34,248) | (32,226) |
| Net impairment charges recognized in earnings | | 168 |
| Stock compensation expense | 5,850 | 9,527 |
| Insurance balances receivable | (39,909) | (98,154) |
| Prepaid reinsurance | 11,939 | 15,662 |
| Reinsurance recoverable | (47,935) | (489) |
| Accrued investment income | (808) | (1,486) |
| Net deferred acquisition costs | (16,294) | (9,608) |
| Net deferred tax assets | 86 | 4,779 |
| Other assets | (978) | (6,073) |
| Reserve for losses and loss expenses | 221,455 | 91,587 |
| Unearned premiums | 134,057 | 79,307 |
| Reinsurance balances payable | (7,880) | (20,296) |
| Accounts payable and accrued liabilities | (42,618) | (33,695) |
| Other items, net | 5,202 | (2,182) |
| Net cash provided by operating activities | 174,915 | 85,300 |
| CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES: | | |
| Purchases of fixed maturity investments available for sale | (352) | (85,767) |
| Purchases of fixed maturity investments trading | (2,332,315) | (2,075,196) |
| Purchases of equity securities | (97,893) | (19,517) |
| Purchases of other invested assets | (171,048) | (52,285) |
| Sales of fixed maturity investments available for sale | 340,418 | 1,304,598 |
| Sales of fixed maturity investments trading | 2,036,961 | 960,823 |
| Sales of equity securities | 12,509 | |
| Sales of other invested assets | 40,135 | 884 |
| Purchases of fixed assets | (1,639) | (3,168) |
| Change in restricted cash | 44,351 | 42,123 |
| Net cash (used in) provided by investing activities | (128,873) | 72,495 |
| CASH FLOWS (USED IN) PROVIDED BY FINANCING ACTIVITIES: | | |
| Proceeds from the exercise of stock options | 3,224 | 2,735 |
| Share repurchase | (60,000) | |
| Repurchase of founder warrants | (53,620) | |

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| | | |
|--|------------|------------|
| Net cash (used in) provided by financing activities | (110,396) | 2,735 |
| Effect of exchange rate changes on foreign currency cash | 1,339 | (584) |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (63,015) | 159,946 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 756,995 | 292,188 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 693,980 | \$ 452,134 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | \$ | \$ 3,627 |
| Cash paid for interest expense | 18,750 | 18,750 |

See accompanying notes to the consolidated financial statements.

-4-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

1. GENERAL

Allied World Assurance Company Holdings, AG, a Swiss holding company (Allied World Switzerland), through its wholly-owned subsidiaries (collectively, the Company), provides property and casualty insurance and reinsurance on a worldwide basis through operations in Bermuda, the United States, Europe, Hong Kong and Singapore.

On November 26, 2010, the Company received approval from the Supreme Court of Bermuda to change the place of incorporation of the ultimate parent company from Bermuda to Switzerland (the Redomestication), which was completed on December 1, 2010. The ultimate parent company is now Allied World Switzerland which wholly owns Allied World Assurance Company Holdings, Ltd (Allied World Bermuda). After the Redomestication, the Company continues to report under accounting principles generally accepted in the United States of America (U.S. GAAP) and the Company s common shares continue to trade on the New York Stock Exchange under the symbol AWH, the same symbol under which the common shares were listed prior to the Redomestication. In addition, the Company remains subject to U.S. Securities and Exchange Commission (SEC) reporting requirements and continues to report consolidated financial results in U.S. dollars. The Company believes the Redomestication provides the ability to maintain a competitive worldwide effective corporate tax rate. See Note 11(b) for further details of the Redomestication.

2. BASIS OF PREPARATION AND CONSOLIDATION

These unaudited condensed consolidated financial statements include the accounts of the Company and have been prepared in accordance with U.S. GAAP for interim financial information and with Article 10 of Regulation S-X as promulgated by the SEC. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, these unaudited condensed consolidated financial statements reflect all adjustments that are normal and recurring in nature and necessary for a fair presentation of financial position and results of operations as of the end of and for the periods presented. The results of operations for any interim period are not necessarily indicative of the results for a full year.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant estimates reflected in the Company s financial statements include, but are not limited to:

The premium estimates for certain reinsurance agreements,

Recoverability of deferred acquisition costs,

The reserve for outstanding losses and loss expenses,

Valuation of ceded reinsurance recoverables,

Determination of impairment of goodwill and other intangible assets,

Valuation of financial instruments, and

Determination of other-than-temporary impairment of investments.

Inter-company accounts and transactions have been eliminated on consolidation and all entities meeting consolidation requirements have been included in the consolidation.

These unaudited condensed consolidated financial statements, including these notes, should be read in conjunction with the Company s audited consolidated financial statements, and related notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

3. NEW ACCOUNTING PRONOUNCEMENTS

In July 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-20 Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (ASU 2010-20). ASU 2010-20 enhances disclosures about credit quality of financing receivables and the allowance of credit losses by requiring additional information regarding the Company s credit risk exposures and evaluating the adequacy of its allowance for credit losses. The balance sheet related disclosures for ASU 2010-20 are effective for the year ended December 31, 2010 and the income statement related disclosures are effective for quarter ended March 31, 2011. Refer to Note 15 for the Company s related disclosures.

In October 2010, the FASB issued ASU 2010-26 Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (ASU 2010-26). ASU 2010-26 clarifies what costs associated with acquiring or renewing insurance contracts can be deferred and amortized over the coverage period. Under the revised guidance of ASU 2010-26, incremental direct costs that result directly from and are essential to the insurance contract and would not have been incurred had the insurance contract not been written are costs that may be capitalized, including costs relating to activities specifically performed by the Company such as underwriting, policy issuance and processing. ASU 2010-26 will be effective January 1, 2012 and early adoption is permitted. The Company has not elected early adoption and is currently evaluating the provisions of ASU 2010-26 and its potential impact on future financial statements.

In January 2011, the FASB issued ASU 2011-01 Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 (ASU 2011-01). In April 2011, the FASB issued ASU 2011-02 A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring (ASU 2011-02). ASU 2011-02 provides further guidance on what constitutes a troubled debt restructuring. The guidance is effective for interim and annual periods beginning on or after June 15, 2011 and applies retrospectively to restructurings within the fiscal year of adoption. The Company is currently assessing the provisions of ASU 2011-02 and its potential impact on future financial statements.

4. INVESTMENTS*a) Available for Sale Securities*

The amortized cost, gross unrealized gains, gross unrealized losses and fair value of the Company s available for sale investments by category as of March 31, 2011 and December 31, 2010 are as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|-------------------|------------------------------|-------------------------------|-----------------|
| March 31, 2011 | | | | |
| U.S. Government and Government agencies | \$ 37,745 | \$ 985 | \$ (2) | \$ 38,728 |
| Non-U.S. Government and Government agencies States, municipalities and political subdivisions | 5,503 85,029 | 27 9,068 | | 5,530 94,097 |
| Corporate debt: | | | | |
| Financial institutions | 44,055 | 2,123 | (33) | 46,145 |
| Industrials | 222,470 | 15,460 | | 237,930 |
| Utilities | 110,836 | 10,542 | | 121,378 |
| Total fixed maturity investments, available for sale | \$ 505,638 | \$ 38,205 | \$ (35) | \$ 543,808 |

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December 31, 2010

| | | | | |
|--|------------|-----------|------------|------------|
| U.S. Government and Government agencies | \$ 85,030 | \$ 6,923 | \$ | \$ 91,953 |
| Non-U.S. Government and Government agencies | 138,386 | 9,539 | (2,541) | 145,384 |
| States, municipalities and political subdivisions | 107,289 | 10,901 | (13) | 118,177 |
| Corporate debt: | | | | |
| Financial institutions | 66,660 | 6,776 | (38) | 73,398 |
| Industrials | 310,664 | 20,548 | (2) | 331,210 |
| Utilities | 120,515 | 11,212 | | 131,727 |
| Total fixed maturity investments, available for sale | \$ 828,544 | \$ 65,899 | \$ (2,594) | \$ 891,849 |

-6-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

b) Trading Securities

Securities accounted for at fair value with changes in fair value recognized in the consolidated income statements by category as of March 31, 2011 and December 31, 2010 are as follows:

| | March 31, 2011 | December 31, 2010 |
|---|---------------------------|------------------------------|
| U.S. Government and Government agencies | \$ 1,107,059 | \$ 1,229,720 |
| Non-U.S. Government and Government agencies | 170,663 | 120,793 |
| States, municipalities and political subdivisions | 105,778 | 127,436 |
| Corporate debt | | |
| Financial institutions | 1,461,364 | 1,261,219 |
| Industrials | 670,142 | 627,524 |
| Utilities | 117,440 | 101,472 |
| Residential mortgage-backed | | |
| Non-agency residential | 369,757 | 371,935 |
| Agency residential | 1,089,883 | 1,195,905 |
| Commercial mortgage-backed | 242,979 | 184,043 |
| Asset-backed | 625,765 | 549,050 |
| | | |
| Total fixed maturity investments, trading | 5,960,830 | 5,769,097 |
| Equity securities | 271,057 | 174,976 |
| Hedge funds | 469,999 | 347,632 |
| | | |
| Total | \$ 6,701,886 | \$ 6,291,705 |

c) Contractual Maturity Dates

The contractual maturity dates of available for sale fixed maturity investments as of March 31, 2011 are as follows:

| | Amortized Cost | Fair Value |
|--|---------------------------|-------------------|
| Due within one year | \$ 31,931 | \$ 32,270 |
| Due after one year through five years | 387,914 | 416,428 |
| Due after five years through ten years | 70,001 | 77,535 |
| Due after ten years | 15,792 | 17,575 |
| | \$ 505,638 | \$ 543,808 |

Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

d) Other Invested Assets

Included in other invested assets are the Company's hedge fund investments. As of March 31, 2011, the Company held 19 hedge fund investments with a total fair value of \$469,999, which comprised 5.9% of the total fair value of its investments and cash and cash equivalents and are summarized as follows by type of investment strategy:

| Hedge Fund Type | Fair Value as of March 31, 2011 | Unfunded Commitments | Long | Short | Gross Exposure ⁽³⁾ | Net Exposure ⁽⁴⁾ |
|----------------------|--|-------------------------|---|---|----------------------------------|--------------------------------|
| | | | Exposure ⁽¹⁾ (% of funded) | Exposure ⁽²⁾ (% of funded) | | |
| Private equity funds | \$ 32,964 | \$ 81,519 | 100% | 0% | 100% | 100% |
| Mezzanine debt | 1,978 | 33,022 | 100% | 0% | 100% | 100% |
| Distressed | 68,094 | 37,288 | 70% | 7% | 77% | 63% |
| Equity long/short | 128,589 | | 108% | 65% | 173% | 43% |
| Multi-strategy | 154,930 | | 113% | 61% | 174% | 52% |
| Event driven | 83,444 | | 109% | 59% | 168% | 50% |
| Total | \$ 469,999 | \$ 151,829 | | | | |

(1) Long exposure represents the ratio of the fund's long investments in securities to the fund's equity capital (over 100% may denote explicit borrowing).

(2) Short exposure represents the ratio of the securities sold short to the fund's equity capital.

(3) Gross exposure is the addition of the long and short exposures (over 100% may denote explicit borrowing).

(4) Net exposure is the subtraction of the short exposure from the long exposure.

Private equity funds: These funds buy limited partnership interests from existing limited partners of primary private equity funds. As owners of private equity funds seek liquidity, they can sell their existing investments, plus any remaining commitment, to secondary market participants. The Company has invested in three private equity funds to purchase those primary limited partnership interests. The fair values of the investments in this class have been estimated using the net asset value per share of the investments. These funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the fund. The remaining restriction period for these funds ranges from seven to ten years.

Mezzanine debt funds: Mezzanine debt funds invest primarily in privately negotiated mezzanine investments. The funds' strategies will focus primarily on providing capital to upper middle market and middle market companies, and private equity sponsors, in connection with leveraged buyouts, mergers and acquisitions, recapitalizations, growth financings and other corporate transactions. The most common position in the capital structure will be between the senior secured debt holder and the equity, however the funds will utilize a flexible approach when structuring investments, which may include secured debt, subordinated debt, preferred stock and/or private equity. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in one mezzanine debt fund which cannot be redeemed at this time because the investments include restrictions that do not allow for redemption until termination of the fund. The remaining restriction period for this fund is approximately ten years.

Distressed funds: In distressed debt investing, managers take positions in the debt of companies experiencing significant financial difficulties, including bankruptcy, or in certain positions of the capital structure of structured securities. The manager relies on the fundamental analysis of these securities, including the claims on the assets and the likely return to bondholders. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in five distressed funds, three of which (representing approximately 35% of the value of the funds in this class) are not currently eligible for redemption due to imposed lock-up periods with remaining periods ranging from three months to seven years. Funds representing approximately 39% of the value of the funds in this class are currently eligible for quarterly redemption with a 65-day notification period, subject to redemption limitations. Funds representing approximately 26% of the value of the funds in this class are currently eligible for quarterly redemption with a 45-day notification period and redemption fee if redeemed prior to January 2012.

-8-

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

Equity long/short funds: In equity long/short funds, managers take long positions in companies they deem to be undervalued and short positions in companies they deem to be overvalued.

Long/short managers may invest in countries, regions or sectors and vary by their use of leverage and target net long position. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in four equity long/short funds, one of which (representing approximately 21% of the value of the funds in this class) is not currently eligible for redemption due to an imposed lock-up period with a remaining period of twelve months, at which time the funds will be eligible for quarterly redemption with a 45-day notification period. The remaining three funds, representing approximately 79% of the value of the funds in this class, are currently eligible for quarterly redemption, one with a 30-day notification period or monthly redemption with a 30-day notification period and redemption fee, one with a 45 day notification period and redemption fee if redeemed prior to July 2012 and one with a 60-day notification period.

Multi-strategy funds: These funds may utilize many strategies employed by specialized funds including distressed investing, equity long/short, merger arbitrage, convertible arbitrage, fixed income arbitrage and macro trading. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in four equity long/short funds, three of which (representing approximately 72% of the value of the funds in this class) are currently eligible for quarterly redemption one with a 60-day notification period and the others with a 90-day notification period. The remaining fund, representing approximately 28% of the value of the funds in this class, is currently eligible for redemption of one third of the net asset value with a 65-day notification period.

Event driven funds: Event driven strategies seek to deploy capital into specific securities whose returns are affected by a specific event that affects the value of one or more securities of a company. Returns for such securities are linked primarily to the specific outcome of the events and not by the overall direction of the bond or stock markets. Examples could include mergers and acquisitions (arbitrage), corporate restructurings and spin-offs and capital structure arbitrage. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in two event driven funds. Approximately 51% of the value of the funds is not currently eligible for redemption due to an imposed two year lock-up period from initial investment. The remaining 49% of the value of the funds in this class is currently eligible for quarterly redemption, but is subject to redemption fees and limitations.

Six of the Company's hedge funds, three equity long/short funds, two multi-strategy funds and one event driven fund, had long exposure greater than 100% of the funds' net asset value (indicating explicit leverage) of 120%, 110%, 107%, 166%, 105% and 130%, respectively, as of March 31, 2011.

e) Net Investment Income

| | For the Three Months Ended March 31, | |
|---|---|-------------|
| | 2011 | 2010 |
| Fixed maturity investments | \$ 50,946 | \$ 71,098 |
| Equity securities and other invested assets | 2,196 | 306 |
| Cash and cash equivalents | 318 | 52 |

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| | | |
|-----------------------|-----------|-----------|
| Expenses | (3,252) | (2,554) |
| Net investment income | \$ 50,208 | \$ 68,902 |

-9-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

f) Components of Realized Gains and Losses

Components of realized gains for the three months ended March 31, 2011 and 2010 are summarized in the following table:

| | For the Three Months Ended March 31, | |
|---|---|------------------|
| | 2011 | 2010 |
| Gross realized gains on sale of securities | \$ 43,557 | \$ 51,667 |
| Gross realized losses on sale of securities | (21,932) | (6,406) |
| Futures not designated as hedges | (5,496) | |
| Mark-to-market changes: debt securities trading | 13,464 | 27,731 |
| Mark-to-market changes: hedge funds and equity securities | 20,783 | 4,495 |
| Net realized investment gains | \$ 50,376 | \$ 77,487 |
| Proceeds from sale of available for sale securities | \$ 343,520 | \$ 1,306,625 |
| Proceeds from sale of trading securities | \$ 2,209,598 | \$ 1,215,553 |

g) Pledged Assets

As of March 31, 2011 and December 31, 2010, \$272,880 and \$280,175, respectively, of cash and cash equivalents and investments were on deposit with various state or government insurance departments or pledged in favor of ceding companies in order to comply with relevant insurance regulations. In addition, the Company has set up trust accounts to meet security requirements for inter-company reinsurance transactions. These trusts contained assets of \$1,206,251 and \$1,377,266 as of March 31, 2011 and December 31, 2010, respectively, and are included in fixed maturity investments.

The Company also has facilities available for the issuance of letters of credit collateralized against the Company's investment portfolio. The collateralized portion of these facilities is up to \$1,300,000 as of March 31, 2011 and December 31, 2010. See Note 8 Debt and Financing Arrangements for details on the facilities.

The following table shows the Company's trust accounts on deposit, as well as outstanding and remaining letter of credit facilities, and the collateral committed to support the letter of credit facilities as of March 31, 2011 and December 31, 2010:

| | As of March 31, 2011 | As of December 31, 2010 |
|--|-------------------------------------|--|
| Total trust accounts on deposit | \$ 1,479,131 | \$ 1,657,441 |
| Total letter of credit facilities: | | |
| Citibank Europe plc | 900,000 | 900,000 |
| Credit Facility | 800,000 | 800,000 |
| Total letter of credit facilities | 1,700,000 | 1,700,000 |
| Total letter of credit facilities outstanding: | | |
| Citibank Europe plc | 690,371 | 689,851 |
| Credit Facility | 158,983 | 158,983 |

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| | | |
|---|--------------|--------------|
| Total letter of credit facilities outstanding | 849,354 | 848,834 |
| Total letter of credit facilities remaining: | | |
| Citibank Europe plc | 209,629 | 210,149 |
| Credit Facility (1) | 641,017 | 641,017 |
| Total letter of credit facilities remaining | 850,646 | 851,166 |
| Collateral committed to support the letter of credit facilities | \$ 1,064,449 | \$ 1,121,345 |

(1) Net of any borrowing or repayments under the Unsecured Facility (as defined in Note 8). See Note 8 for further details on the Unsecured Facility.

Total trust accounts on deposit includes available for sale securities, trading securities and cash and cash equivalents. The fair values of the combined total cash and cash equivalents and investments held under trust were \$2,543,580 and \$2,778,786 as of March 31, 2011 and December 31, 2010, respectively. Of the total letters of credit facilities outstanding as of March 31, 2011 and December 31, 2010, \$7,295 was used to meet security requirements for inter-company transactions and the remaining letters of credit facilities outstanding of \$842,059 and \$841,539 was used for third-party beneficiaries, respectively.

-10-

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

h) Analysis of Unrealized Losses

The following table summarizes the market value of those investments in an unrealized loss position for periods less than and greater than 12 months as of March 31, 2011 and December 31, 2010:

| | March 31, 2011 | | December 31, 2010 | |
|---|------------------|-----------------|-------------------|-----------------|
| | Gross Fair Value | Unrealized Loss | Gross Fair Value | Unrealized Loss |
| Less than 12 months | | | | |
| U.S. Government and Government agencies | \$ 1,090 | \$ (2) | \$ | \$ |
| Non-U.S. Government and Government agencies | | | 34,204 | (1,116) |
| States, municipalities and political subdivisions | | | 472 | (13) |
| Corporate debt | | | | |
| Financial institutions | 2,784 | (33) | 2,796 | (38) |
| Industrials | | | 2,150 | (2) |
| | \$ 3,874 | \$ (35) | \$ 39,622 | \$ (1,169) |
| More than 12 months | | | | |
| Non-U.S. Government and Government agencies | \$ | \$ | \$ 10,998 | \$ (1,425) |
| | \$ | \$ | \$ 10,998 | \$ (1,425) |
| | \$ 3,874 | \$ (35) | \$ 50,620 | \$ (2,594) |

As of March 31, 2011 and December 31, 2010, there were approximately 2 and 9 securities, respectively, in an unrealized loss position. The decrease in the gross unrealized loss from December 31, 2010 to March 31, 2011 is primarily due to selling available for sale debt securities and reinvesting proceeds in trading debt securities thereby reducing unrealized gains/losses recognized in accumulated other comprehensive income.

i) Other-than-temporary impairment charges

Following the Company's review of the securities in the investment portfolio during the three months ended March 31, 2011 and 2010, no securities and one mortgage-backed security, respectively, were considered to be other-than-temporarily impaired due to the present value of the expected cash flows being lower than the amortized cost. The \$168 of other than temporary impairment (OTTI) during the three months ended March 31, 2010 was recognized through earnings due to credit related losses.

For the mortgage-backed security for which OTTI was recognized due to credit loss during the three months ended March 31, 2010, the significant inputs utilized to determine a credit loss were the estimated frequency and severity of losses of the underlying mortgages that comprise the mortgage-backed security. The frequency of losses was measured as the credit default rate, which includes such factors such as loan-to-value ratios and credit scores of borrowers. The severity of losses includes such factors as trends in overall housing prices and house prices that are obtained at foreclosure. The frequency and severity inputs were used in projecting the future cash flows of the mortgage backed security. For the security in which the Company recognized an OTTI due to credit loss, the credit default rate was 10.3% and the severity rate was 49.0%.

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

The following table summarizes the amounts related to credit losses on debt securities for which a portion of the OTTI was recognized in other comprehensive income in the consolidated income statements for the three months ended March 31, 2011 and 2010:

| | For the Three Months ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| Beginning balance of credit losses | \$ | \$ 1,096 |
| Additions for credit loss for which OTTI was not previously recognized | | 168 |
| Reductions for securities sold during the period (realized) | | |
| Reductions for OTTI previously recognized due to intent to sell | | |
| Additions resulting from the increase in credit losses | | |
| Reductions resulting from the improvement in expected cash flows | | |
| Ending balance of credit losses | \$ | \$ 1,264 |

5. DERIVATIVE INSTRUMENTS

The Company uses currency forward contracts and swaps to manage currency exposure. The U.S. dollar is the Company's reporting currency and the functional currency of its operating subsidiaries. The Company enters into insurance and reinsurance contracts where the premiums receivable and losses payable are denominated in currencies other than the U.S. dollar. In addition, the Company maintains a portion of its investments and liabilities in currencies other than the U.S. dollar, primarily the Canadian dollar, Euro and British Sterling. For liabilities incurred in currencies other than U.S. dollars, U.S. dollars are converted to the currency of the loss at the time of claim payment. As a result, the Company has an exposure to foreign currency risk resulting from fluctuations in exchange rates. The Company has developed a hedging strategy using currency forward contracts and swaps to minimize the potential loss of value caused by currency fluctuations. These currency forward contracts and swaps are not designated as hedges and accordingly are carried at fair value on the consolidated balance sheets as a part of other assets or accounts payable and accrued liabilities, with the corresponding realized and unrealized gains and losses included in foreign exchange (gain) loss in the unaudited condensed consolidated statements of operations and comprehensive (loss) income. The fair value of the currency forward contracts and swaps as of March 31, 2011 was a net receivable of \$1,088 and was included in other assets on the consolidated balance sheets. The fair value of the currency forward contracts as of December 31, 2010 was a net payable of \$632 and was included in accounts payable and accrued expenses in the consolidated balance sheet.

The Company also purchases and sells interest rate future contracts to actively manage the duration and yield curve positioning of its fixed income portfolio. Interest rate futures can efficiently increase or decrease the overall duration of the portfolio. Additionally, interest rate future contracts can be utilized to obtain the desired position along the yield curve in order to protect against certain future yield curve shapes (steeper, flatter). These interest rate futures are not designated as hedges and are marked to market daily with the corresponding realized gains and losses included in net realized investment gains in the unaudited condensed consolidated statements of operations and comprehensive (loss) income (consolidated income statements). For future contracts that were pending settlement at the period end (there were no future contracts traded during 2010), any associated gain or loss is reflected in the consolidated balance sheets as part of balances receivable on sale of investments for gains and balances due on purchases of investments for losses.

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with U.S. GAAP, fair value is defined 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. There is a three-level

valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon whether the inputs to the valuation of an asset or liability are observable or unobservable in the market at the measurement date, with quoted market prices being the highest level (Level 1) and unobservable inputs being the lowest level (Level 3). A fair value measurement will fall within the level of the hierarchy based on the input that is significant to determining such measurement. The three levels are defined as follows:

Level 1: Observable inputs to the valuation methodology that are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Observable inputs to the valuation methodology other than quoted market prices (unadjusted) for identical assets or liabilities in active markets. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical assets in markets that are not active and inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

-12-

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

Level 3: Inputs to the valuation methodology that are unobservable for the asset or liability.

The following table shows the fair value of the Company's financial instruments and where in the fair value hierarchy the fair value measurements are included as of March 31, 2011:

| | Carrying amount | Total fair value | Fair value measurement using: | | |
|--|--------------------|---------------------|---|---|--|
| | | | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Available for sale securities: | | | | | |
| U.S. Government and Government agencies | \$ 38,728 | \$ 38,728 | \$ 38,728 | \$ | \$ |
| Non-U.S. Government and Government agencies States, municipalities and political subdivisions | 5,530 | 5,530 | | 5,530 | |
| Corporate debt | 94,097 | 94,097 | | 94,097 | |
| | 405,453 | 405,453 | | 405,453 | |
| Total available for sale fixed maturity investments | 543,808 | 543,808 | | | |
| Trading securities: | | | | | |
| U.S. Government and Government agencies | \$ 1,107,059 | \$ 1,107,059 | \$ 969,815 | \$ 137,244 | \$ |
| Non-U.S. Government and Government agencies States, municipalities and political subdivisions | 170,663 | 170,663 | | 170,663 | |
| Corporate debt | 105,778 | 105,778 | | 105,778 | |
| Mortgage-backed | 2,248,946 | 2,248,946 | | 2,248,946 | |
| Asset-backed | 1,702,619 | 1,702,619 | | 1,468,532 | 234,087 |
| | 625,765 | 625,765 | | 481,936 | 143,829 |
| Total trading fixed maturity investments | 5,960,830 | 5,960,830 | | | |
| Total fixed maturity investments | 6,504,638 | 6,504,638 | | | |
| Hedge funds | 469,999 | 469,999 | | | 469,999 |
| Equity securities | 271,057 | 271,057 | 271,057 | | |

| | | | | | |
|-------------------|--------------|--------------|--------------|--------------|------------|
| Total investments | \$ 7,245,694 | \$ 7,245,694 | \$ 1,279,600 | \$ 5,118,179 | \$ 847,915 |
| Senior notes | \$ 797,761 | \$ 856,207 | \$ | \$ 856,207 | \$ |

The following describes the valuation techniques used by the Company to determine the fair value of financial instruments held as of March 31, 2011.

U.S. government and U.S. government agencies: Comprised primarily of bonds issued by the U.S. treasury, the Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. The fair values of the Company's U.S. government securities are based on quoted market prices in active markets and are included in the Level 1 fair value hierarchy. The Company believes the market for U.S. treasury securities is an actively traded market given the high level of daily trading volume. The fair values of U.S. government agency securities are priced using the spread above the risk-free yield curve. As the yields for the risk-free yield curve and the spreads for these securities are observable market inputs, the fair values of U.S. government agency securities are included in the Level 2 fair value hierarchy.

Non-U.S. government and government agencies: Comprised of fixed income obligations of non-U.S. governmental entities. The fair values of these securities are based on prices obtained from international indices and are included in the Level 2 fair value hierarchy.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

States, municipalities and political subdivisions: Comprised of fixed income obligations of U.S. domiciled state and municipality entities. The fair values of these securities are based on prices obtained from the new issue market, and are included in the Level 2 fair value hierarchy.

Corporate debt: Comprised of bonds issued by corporations that are diversified across a wide range of issuers and industries. The fair values of corporate bonds that are short-term are priced using spread above the London Interbank Offered Rate yield curve, and the fair value of corporate bonds that are long-term are priced using the spread above the risk-free yield curve. The spreads are sourced from broker-dealers, trade prices and the new issue market. As the significant inputs used to price corporate bonds are observable market inputs, the fair values of corporate bonds are included in the Level 2 fair value hierarchy.

Mortgage-backed: Primarily comprised of residential and commercial mortgages originated by both U.S. government agencies (such as the Federal National Mortgage Association) and non-U.S. government agencies originators. The fair values of mortgage-backed securities originated by U.S. government agencies and non-U.S. government agencies are based on a pricing model that incorporates prepayment speeds and spreads to determine appropriate average life of mortgage-backed securities. The spreads are sourced from broker-dealers, trade prices and the new issue market. As the significant inputs used to price the mortgage-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy, unless the significant inputs used to price the mortgage-backed securities are broker-dealer quotes and the Company is not able to determine if those quotes are based on observable market inputs, in which case the fair value is included in the Level 3 hierarchy.

Asset-backed: Principally comprised of bonds backed by pools of automobile loan receivables, home equity loans, credit card receivables and collateralized loan obligations originated by a variety of financial institutions. The fair values of asset-backed securities are priced using prepayment speed and spread inputs that are sourced from the new issue market or broker-dealer quotes. As the significant inputs used to price the asset-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy, unless the significant inputs used to price the asset-backed securities are broker-dealer quotes and the Company is not able to determine if those quotes are based on observable market inputs, in which case the fair value is included in the Level 3 hierarchy.

Hedge funds: Comprised of hedge funds invested in a range of diversified strategies. In accordance with U.S. GAAP, the fair values of the hedge funds are based on the net asset value of the funds as reported by the fund manager which the Company believes is an unobservable input, and as such, the fair values of those hedge funds are included in the Level 3 fair value hierarchy.

Equity securities: The fair value of the equity securities are priced from market exchanges and therefore included in the Level 1 fair value hierarchy.

Senior notes: The fair value of the senior notes is based on trades as reported in Bloomberg. As of March 31, 2011, the 7.50% Senior Notes and 5.50% Senior Notes (each as defined in Note 8) were traded at 111.7% and 99.2% of their principal amount, providing an effective yield of 5.0% and 5.6%, respectively. The fair value of the senior notes is included in the Level 2 fair value hierarchy.

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

The following is a reconciliation of the beginning and ending balance of financial instruments using significant unobservable inputs (Level 3) for the three months ended March 31, 2011:

| | Fair value measurement using significant unobservable inputs (Level 3): | | |
|---|--|------------------------|---------------------|
| | Hedge funds | Mortgage-backed | Asset-backed |
| Three Months Ended March 31, 2011 | | | |
| Opening balance | \$ 347,632 | \$ 172,558 | \$ 48,707 |
| Total realized and unrealized gains included in net income | 16,449 | 2,374 | 118 |
| Total realized and unrealized losses included in net income | (4,769) | (827) | (25) |
| Purchases | 151,048 | 32,777 | 83,009 |
| Sales | (40,361) | (8,957) | (426) |
| Transfers into Level 3 | | 61,695 | 12,555 |
| Transfers out of Level 3 | | (25,533) | (109) |
| Ending balance | \$ 469,999 | \$ 234,087 | \$ 143,829 |
| Three Months Ended March 31, 2010 | | | |
| Opening balance | \$ 184,725 | \$ 253,979 | \$ 104,871 |
| Total gains or losses included in earnings: | | | |
| Realized losses | | (1,358) | |
| Change in fair value of investments | 4,362 | 4,646 | 142 |
| Total unrealized gains included in OCI | | 3,696 | 23 |
| Purchases or sales | 53,048 | (69,687) | 1,044 |
| Transfers in and/or out of Level 3 | | 42,391 | (69,548) |
| Ending balance | \$ 242,135 | \$ 233,667 | \$ 36,532 |

The Company attempts to verify the significant inputs used by broker-dealers in determining the fair value of the securities priced by them. If the Company could not obtain sufficient information to determine if the broker-dealers were using significant observable inputs, such securities have been transferred to Level 3 fair value hierarchy. The Company believes the prices obtained from the broker-dealers are the best estimate of fair value of the securities being priced as the broker-dealers are typically involved in the initial pricing of the security, and the Company has compared the price per the broker-dealer to other pricing sources and noted no material differences.

During the three months ended March 31, 2011, the Company transferred \$25,533 of mortgage-backed securities and \$109 of asset-backed securities, respectively, from Level 3 to Level 2 in the fair value hierarchy. The Company transferred those securities as they no longer utilized broker-dealer quotes and instead used other pricing sources that have significant observable inputs. The Company recognizes transfers between levels at the end of the reporting period.

7. RESERVE FOR LOSSES AND LOSS EXPENSES

The reserve for losses and loss expenses consists of the following:

| March 31, 2011 | December 31, 2010 |
|---------------------------|------------------------------|
|---------------------------|------------------------------|

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| | | |
|---|--------------|--------------|
| Outstanding loss reserves | \$ 1,285,803 | \$ 1,166,516 |
| Reserves for losses incurred but not reported | 3,814,840 | 3,712,672 |
| Reserve for losses and loss expenses | \$ 5,100,643 | \$ 4,879,188 |

-15-

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

The table below is a reconciliation of the beginning and ending liability for unpaid losses and loss expenses as of March 31, 2011 and March 31, 2010. Losses incurred and paid are reflected net of reinsurance recoveries.

| | For the Three Months Ended March 31, | |
|---|---|--------------|
| | 2011 | 2010 |
| Gross liability at beginning of period | \$ 4,879,188 | \$ 4,761,772 |
| Reinsurance recoverable at beginning of period | (927,588) | (919,991) |
| Net liability at beginning of period | 3,951,600 | 3,841,781 |
| Net losses incurred related to: | | |
| Commutation of variable-rated reinsurance contracts | | 8,864 |
| Current year | 348,802 | 297,246 |
| Prior years | (44,350) | (73,956) |
| Total incurred | 304,452 | 232,154 |
| Net paid losses related to: | | |
| Current year | 1,699 | 6,706 |
| Prior years | 134,358 | 129,300 |
| Total paid | 136,057 | 136,006 |
| Foreign exchange revaluation | 5,125 | (5,050) |
| Net liability at end of period | 4,125,120 | 3,932,879 |
| Reinsurance recoverable at end of period | 975,523 | 920,480 |
| Gross liability at end of period | \$ 5,100,643 | \$ 4,853,359 |

For the three months ended March 31, 2011, the Company had net favorable reserve development in its international and reinsurance segments due to actual loss emergence being lower than the initial expected loss emergence. The majority of the net favorable reserve development was recognized in the international insurance and reinsurance segment in the 2005 through 2007 loss years related to the healthcare line of business as well as the general casualty and professional liability insurance and reinsurance lines of business. The Company had net unfavorable reserve development in its U.S. insurance segment due to actual loss emergence being higher than the initial expected loss emergence. The majority of the net unfavorable reserve development was recognized in the 2006 loss year related to the professional liability line of business.

For the year ended December 31, 2010, the Company had net favorable reserve development in each of its segments due to actual loss emergence being lower than the initial expected loss emergence. The majority of the net favorable reserve development was recognized in the international insurance segment in the 2004 through 2006 loss years related to the general casualty, healthcare and professional liability lines of business.

While the Company has experienced favorable development in its insurance and reinsurance lines, there is no assurance that conditions and trends that have affected the development of liabilities in the past will continue. It is not appropriate to extrapolate future redundancies based on prior years' development. The methodology of estimating loss

reserves is periodically reviewed to ensure that the key assumptions used in the actuarial models continue to be appropriate.

8. DEBT AND FINANCING ARRANGEMENTS

In November 2010, Allied World Bermuda issued \$300,000 aggregate principal amount of 5.50% Senior Notes due November 10, 2020 (5.50% Senior Notes), with interest on the notes payable on May 15 and November 15 of each year commencing on May 15, 2011. The 5.50% Senior Notes were offered by the underwriters at a price of 98.89% of their principal amount, providing an effective yield to investors of 5.56%. The net proceeds from the offering of the 5.50% Senior Notes were used for general corporate purposes, including the repurchase of the Company's outstanding common shares. The 5.50% Senior Notes are Allied World Bermuda's unsecured and unsubordinated obligations and rank equally in right of payment with all existing and future unsecured and unsubordinated indebtedness. Allied World Bermuda may redeem the 5.50% Senior Notes at any time or from time to time in whole or in part at a redemption price equal to the greater of the principal amount of the 5.50% Senior Notes to be redeemed or a make-whole price, plus accrued and unpaid interest. Allied World Bermuda has no current expectations of redeeming the notes prior to maturity. The 5.50% Senior Notes include covenants and events of default that are usual and customary, but do not contain any financial covenants.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

In 2006, Allied World Bermuda issued \$500,000 aggregate principal amount of 7.50% Senior Notes due August 1, 2016 (7.50% Senior Notes), with interest on the notes payable on August 1 and February 1 of each year, commencing on February 1, 2007. The 7.50% Senior Notes were offered by the underwriters at a price of 99.71% of their principal amount, providing an effective yield to investors of 7.54%. The 7.50% Senior Notes can be redeemed by Allied World Bermuda prior to maturity subject to payment of a make-whole premium. Allied World Bermuda has no current expectations of redeeming the notes prior to maturity. The 7.50% Senior Notes include covenants and events of default that are usual and customary, but do not contain any financial covenants.

The 5.50% Senior Notes and the 7.50% Senior Notes have been unconditionally and irrevocably guaranteed for the payment of the principal and interest by Allied World Switzerland.

Allied World Assurance Company, Ltd has a collateralized amended letter of credit facility of \$900,000 with Citibank Europe plc. that has been, and will continue to be, used to issue standby letters of credit.

In addition, Allied World Bermuda entered into an \$800,000 five-year senior credit facility (the Credit Facility) with a syndication of lenders. The Credit Facility consists of a \$400,000 secured letter of credit facility for the issuance of standby letters of credit (the Secured Facility) and a \$400,000 unsecured facility for the making of revolving loans and for the issuance of standby letters of credit (the Unsecured Facility). Both the Secured Facility and the Unsecured Facility have options to increase the aggregate commitments by up to \$200,000, subject to approval of the lenders. The Credit Facility will be used for general corporate purposes and to issue standby letters of credit. The Credit Facility contains representations, warranties and covenants customary for similar bank loan facilities, including a covenant to maintain a ratio of consolidated indebtedness to total capitalization as of the last day of each fiscal quarter or fiscal year of not greater than 0.35 to 1.0 and a covenant under the Unsecured Facility to maintain a certain consolidated net worth. In addition, each material insurance subsidiary must maintain a financial strength rating from A.M Best Company of at least A- under the Unsecured Facility and of at least B++ under the Secured Facility. Allied World Bermuda is in compliance with all covenants under the Credit Facility as of March 31, 2011 and December 31, 2010.

There are a total of 13 lenders that make up the Credit Facility syndication and that have varying commitments ranging from \$20,000 to \$87,500. Of the 13 lenders, four have commitments of \$87,500 each, four have commitments of \$62,500 each, four have commitments of \$45,000 each and one has a commitment of \$20,000.

In May 2010, Allied World Capital (Europe) Limited established an irrevocable standby letter of credit in order to satisfy funding requirements of the Company s Lloyd s Syndicate 2232. As of March 31, 2011 and December 31, 2010, the amount of the letter of credit was £53,700 (\$86,307) and £53,700 (\$82,838), respectively.

9. GOODWILL AND INTANGIBLE ASSETS

The following table shows an analysis of goodwill and intangible assets for the three months ended March 31, 2011 and the year ended December 31, 2010:

| | Goodwill | Intangible assets with indefinite lives | Intangible assets with finite lives | Total |
|----------------------------------|-----------------|--|--|--------------|
| Net balance at December 31, 2009 | \$ 268,376 | \$ 23,920 | \$ 36,439 | \$ 328,735 |
| Additions | | | | |
| Amortization | | | (3,483) | (3,483) |
| Net balance at December 31, 2010 | 268,376 | 23,920 | 32,956 | 325,252 |
| Additions | | | | |

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| | | | | |
|-------------------------------|------------|-----------|-----------|------------|
| Amortization | | | (767) | (767) |
| Net balance at March 31, 2011 | 268,376 | 23,920 | 32,189 | 324,485 |
| Gross balance | 268,532 | 23,920 | 48,200 | 340,652 |
| Accumulated amortization | | | (9,145) | (9,145) |
| Impairments | (156) | | (6,866) | (7,022) |
| Net balance | \$ 268,376 | \$ 23,920 | \$ 32,189 | \$ 324,485 |

The amortization of the intangible assets with definite lives for the remainder of 2011 and for the years ended December 31, 2012, 2013, 2014, 2015 and thereafter will be \$2,211, \$2,533, \$2,533, \$2,533, \$2,533 and \$19,846, respectively. The intangible assets will be amortized over a weighted average useful life of 12.5 years.

-17-

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

10. INCOME TAXES

Under Swiss law, a resident company is subject to income tax at the federal, cantonal and communal levels that is levied on net income. Income attributable to permanent establishments or real estate located abroad is excluded from the Swiss tax base. Allied World Switzerland is a holding company and, therefore, is exempt from cantonal and communal income tax. As a result, Allied World Switzerland is subject to Swiss income tax only at the federal level. Allied World Switzerland is a resident of the Canton of Zug and, as such, is subject to an annual cantonal and communal capital tax on the taxable equity of Allied World Switzerland in Switzerland. Allied World Switzerland has a Swiss operating company resident in the Canton of Zug. The operating company is subject to federal, cantonal and communal income tax and to annual cantonal and communal capital tax.

Under current Bermuda law, Allied World Bermuda and its Bermuda subsidiaries are not required to pay taxes in Bermuda on either income or capital gains. Allied World Bermuda and Allied World Assurance Company, Ltd have received an assurance from the Bermuda Minister of Finance under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, that in the event of any such taxes being imposed, Allied World Bermuda and Allied World Assurance Company, Ltd will be exempted until March 28, 2016.

Certain subsidiaries of Allied World Switzerland file U.S. federal income tax returns and various U.S. state income tax returns, as well as income tax returns in the United Kingdom, Ireland, Switzerland, Hong Kong and Singapore. The following tax years by jurisdiction are open to examination:

| | Fiscal Years | |
|---|---------------------|------|
| U.S. Internal Revenue Service (IRS) for the U.S. subsidiaries | 2007 | 2010 |
| Inland Revenue for the U.K. branches | 2009 | 2010 |
| Irish Revenue Commissioners for the Irish subsidiaries | 2006 | 2010 |
| Swiss Federal Tax Administration for the Swiss branch | 2008 | 2010 |
| Inland Revenue Department for the Hong Kong branch | 2009 | 2010 |
| Inland Revenue Department for the Singapore branch | | 2010 |

To the best of the Company's knowledge, there are no examinations pending by any tax authority except for the IRS. The IRS is currently completing an examination of Darwin's 2006 tax returns. The examination covers the tax return filed for the period subsequent to Darwin's initial public offering on May 16, 2006 to December 31, 2006.

Management has deemed all material tax positions to have a greater than 50% likelihood of being sustained based on technical merits if challenged. The Company does not expect any material unrecognized tax benefits within 12 months of January 2011.

11. SHAREHOLDERS' EQUITY**a) Authorized shares**

The articles of association authorize the Board of Directors to increase the share capital by a maximum amount of 20% of the share capital registered in the commercial register up to CHF 119,404 or 7,690,260 voting shares, and create conditional capital of 7,200,000 voting shares. The issued share capital consists of the following:

| | March 31, 2011 | December 31, 2010 |
|--|---------------------------|------------------------------|
| Common shares issued and fully paid, CHF 15.00 per share | 40,003,642 | 40,003,642 |
| Share capital at end of period | 600,055 | 600,055 |

**Three Months
Ended**

| | March 31, 2011 |
|--|-----------------------|
| Total shares issued at beginning and end of period | 40,003,642 |
| Treasury shares issued, balance at beginning of period | 1,914,416 |
| Shares repurchased | 969,163 |
| Shares issued out of treasury | (779,636) |
| Total treasury shares at end of period | 2,103,943 |
| Total shares outstanding at end of period | 37,899,699 |

As of March 31, 2011, there were outstanding 37,855,839 voting common shares and 43,860 non-voting common shares.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

b) Redomestication

As of December 31, 2010 in conjunction with the Redomestication, Allied World Switzerland had total share capital of CHF of 597,020 comprised of 39,801,302 voting shares, with a par value of CHF 15.00 (\$15.00) per share. In addition as of December 31, 2010, Allied World Switzerland had participation capital of CHF 3,035 comprised of 202,340 non-voting participation certificates, with a par value of CHF 15.00 (\$15.00) per certificate. To affect the Redomestication on December 1, 2010, Allied World Switzerland and Allied World Bermuda entered into a contribution-in-kind agreement. Under the terms of the contribution-in-kind agreement all issued and outstanding voting and non-voting shares of Allied World Bermuda were cancelled and issued to Allied World Switzerland as a contribution-in-kind in exchange for which the holders of such voting and non-voting shares immediately prior to the completion of the Redomestication received the same number of voting and non-voting shares of Allied World Switzerland. As a result of the contribution-in-kind and the resulting par value changing from \$0.03 to CHF 15.00, the share capital balance was increased to CHF 600,055 with an equal reduction in additional paid-in capital. At the time of contribution-in-kind, the exchange rate between the U.S. Dollar and Swiss Franc was one-for-one.

As required under Swiss law, the Company cannot hold more than 10% of its registered capital in treasury shares, unless it receives shareholder approval to do so. As a result, immediately prior to the Redomestication, the Company cancelled 10,879,106 shares held in treasury with a related reduction to additional paid in capital of \$561,851.

c) Share Warrants

In conjunction with the private placement offering at the formation of the Allied World Bermuda, Allied World Bermuda granted warrant agreements to certain founding shareholders to acquire up to 5,500,000 common shares at an exercise price of \$34.20 per share. These warrants are exercisable in certain limited conditions, including a public offering of common shares, and expire November 21, 2011. Any cash dividends paid to shareholders do not impact the exercise price of \$34.20 per share for these founder warrants. There are various restrictions on the ability of warrant holders to dispose of their shares.

In August 2010, Allied World Bermuda repurchased a warrant owned by The Chubb Corporation (Chubb) in a privately negotiated transaction. The warrant entitled Chubb to purchase 2,000,000 of Allied World Bermuda s common shares for \$34.20 per share. Allied World Bermuda repurchased the warrant for an aggregate purchase price of \$32,819. After this repurchase, Chubb has no warrants remaining and no other disclosed equity interest in the Company. In November 2010, Allied World Bermuda repurchased a warrant owned by GS Capital Partners and other investment funds, which are affiliates of The Goldman Sachs Group, Inc (Goldman Sachs) and founding shareholders in a privately negotiated transaction. The warrant entitled Goldman Sachs to purchase 1,500,000 of Allied World Bermuda s common shares for \$34.20 per share. Allied World Bermuda repurchased the warrant for an aggregate purchase price of \$37,197. The repurchase of the warrants was recognized as a reduction in additional paid-in capital in the consolidated balance sheets. The repurchase was executed separately from the share repurchase program discussed in Note 11(e) below.

In February 2011, the Company repurchased a warrant owned by American International Group, Inc. (AIG) in a privately negotiated transaction. The warrant entitled AIG to purchase 2,000,000 of the Company s common shares for \$34.20 per share. The Company repurchased the warrant for an aggregate purchase price of \$53,620. The repurchase of the warrant was recognized as a reduction in additional paid-in capital on the consolidated balance sheets. The repurchase was executed separately from the share repurchase program discussed in Note 11(e) below. After this repurchase, AIG has no warrants remaining and no other disclosed equity interest in the Company.

d) Dividends

The Company paid a special dividend of \$0.25 per common share related to the Redomestication on November 26, 2010 to shareholders of record on November 15, 2010. Under Swiss law, the Company can only pay a dividend with prior shareholder approval. The next distribution was approved during the annual shareholders meeting. This special dividend provided a dividend to shareholders for the interim period. Under Swiss law, distributions to shareholders may be paid out only if the Company has sufficient distributable profits from previous fiscal years, or if the Company

has freely distributable reserves, each as presented on the audited stand-alone statutory balance sheet. Distributions to shareholders out of the share and participation capital may be made by way of a capital reduction in the form of a reduction to par value to achieve a similar result as the payment of a dividend.

In February 2010, the Company declared a dividend of \$0.20 per common share payable on April 1, 2010 to shareholders of record on March 16, 2010. The total dividend payable amounted to \$10,092.

-19-

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

e) Share repurchase

In May 2010, the Company established a share repurchase program in order to repurchase its common shares. Repurchases may be effected from time to time through open market purchases, privately negotiated transactions, tender offers or otherwise. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company's capital position, legal requirements and other factors. As part of the share repurchase program, the Company entered into a rule 10b5-1 repurchase plan that enables the Company to complete share repurchases during trading blackout periods. During the three months ended March 31, 2011, the Company repurchased through open market purchases 969,163 shares at a total cost of \$60,000 for an average price of \$61.91 per share. These repurchased shares have been classified as Treasury shares, at cost on the consolidated balance sheets. The Company will issue shares out of treasury principally related to the Company's employee benefit plans.

In August 2010, the Company repurchased 5,000,000 of its common shares for \$250,000, or \$50.00 per share, in a privately negotiated transaction from Goldman Sachs. The shares repurchased were classified as Treasury shares, at cost on the consolidated balance sheets. In November 2010, the Company repurchased the remaining 3,159,793 common shares from Goldman Sachs for \$185,448, or \$58.69 per share. The repurchase price per common share is based on and reflects 0.5% discount from the volume-weighted average trading price of the Company's common shares on November 5, 2010. These repurchases were executed separately from the Company's share repurchase program discussed above. After these repurchases, including the warrant repurchased, Goldman Sachs has no other disclosed equity interest in the Company.

12. EMPLOYEE BENEFIT PLANS**a) Employee option plan**

In 2001, the Company implemented the Allied World Assurance Holdings, Ltd 2001 Employee Warrant Plan, which was subsequently amended, restated and renamed the Allied World Assurance Company Holdings, Ltd Second Amended and Restated 2001 Employee Stock Option Plan (the ESOP). Under the ESOP, up to 4,000,000 common shares may be issued.

As part of the Redomestication, Allied World Switzerland adopted and assumed the ESOP from Allied World Bermuda which was subsequently amended, restated and renamed the Allied World Assurance Company Holdings, AG Third Amended and Restated 2001 Employee Stock Option Plan (the Plan). Allied World Switzerland has filed a registration statement on Form S-8 under the Securities Act of 1933, as amended, to register common shares issued or reserved for issuance under the Plan. These options are exercisable in certain limited conditions, expire after 10 years, and generally vest pro-rata over four years from the date of grant. The exercise price of options issued are recommended by the Compensation Committee to the Board of Directors for approval but shall not be less than 100% of the fair market value of the common shares of Allied World Switzerland on the date the option award is granted.

| | Three Months Ended March 31, 2011 | |
|------------------------------------|--|--|
| | Options | Weighted Average Exercise Price |
| Outstanding at beginning of period | 1,272,739 | \$ 38.77 |
| Granted | 494,885 | 61.51 |
| Exercised | (84,305) | 38.49 |
| Forfeited | (8,326) | 44.37 |
| Expired | | |
| Outstanding at end of period | 1,674,993 | \$ 45.47 |

Assumptions used in the option-pricing model for the options granted during the three months ended March 31, 2011 are as follows:

| | Options Granted During the Three Months Ended March 31, 2011 |
|---|---|
| Expected term of option | 5.48 years |
| Weighted average risk-free interest rate | 2.33% |
| Weighted average expected volatility | 31.51% |
| Dividend yield | 1.00% |
| Weighted average fair value on grant date | \$ 18.27 |

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

The Company has assumed a weighted average annual forfeiture rate of 6.72% in determining the compensation expense over the service period.

Compensation expense of \$1,179 and \$792 relating to the options has been included in general and administrative expenses in the Company's consolidated income statements for the three months ended March 31, 2011 and 2010, respectively. As of March 31, 2011 and December 31, 2010, the Company has recorded in additional paid-in capital on the consolidated balance sheets an amount of \$40,934 and \$41,505, respectively, in connection with all options granted.

b) Stock incentive plan

In 2004, the Company implemented the Allied World Assurance Holdings, Ltd 2004 Stock Incentive Plan. As part of the Redomestication, Allied World Switzerland adopted and assumed this plan from Allied World Bermuda, which was subsequently amended, restated and renamed the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan (the Stock Incentive Plan). The Stock Incentive Plan provides for grants of restricted stock, restricted stock units (RSUs), dividend equivalent rights and other equity-based awards. A total of 2,000,000 common shares may be issued under the Stock Incentive Plan. To date, only RSUs have been granted. These RSUs generally vest pro-rata over four years from the date of grant or vest in the fourth or fifth year from the date of grant.

| | Three Months Ended March 31, 2011 | |
|---|--|---|
| | RSUs | Weighted Average Grant Date Fair Value |
| Outstanding RSUs at beginning of period | 851,078 | \$ 39.88 |
| RSUs granted | 45,239 | 61.51 |
| Performance-based RSUs granted | 139,210 | 61.51 |
| RSUs fully vested | (129,377) | 42.61 |
| RSUs forfeited | (11,361) | 37.01 |
| Outstanding RSUs at end of period | 894,789 | \$ 43.98 |

The Company granted performance-based RSUs in lieu of utilizing the LTIP (as defined in Note 12(c)). The performance-based RSUs are structured in exactly the same form as shares issued under the LTIP in terms of vesting restrictions and achievement of established performance criteria. For the performance-based RSUs granted in 2010 and 2011, the Company anticipates that the performance goals are likely to be achieved. Based on the performance goals, the performance-based RSUs granted in 2010 and 2011 are expensed at 100% of the fair market value of Allied World Switzerland's common shares on the date of grant. The expense is recognized over the performance period.

Compensation expense of \$3,822 and \$3,714 relating to the issuance of the RSUs, including the performance-based RSUs, has been recognized in general and administrative expenses in the Company's consolidated income statements for the three months ended March 31, 2011 and 2010, respectively. The compensation expense for the RSUs is based on the fair market value of Allied World Switzerland's common shares at the time of grant. The Company believes it is unlikely that performance-based RSUs will be forfeited as these awards are issued to senior management. Thus, no forfeiture rate is applied to the performance-based RSUs. The Company has assumed a weighted average annual forfeiture rate of 2.80%, excluding performance-based RSUs, in determining the compensation expense over the service period.

As of March 31, 2011 and December 31, 2010, the Company has recorded \$30,784 and \$37,991, respectively, in additional paid-in capital on the consolidated balance sheets in connection with the RSUs awarded.

c) Long-term incentive plan

In May 2006, the Company implemented the Long-Term Incentive Plan (LTIP), which it amended and restated in November 2007. The LTIP provides for performance-based equity awards to key employees in order to promote the long-term growth and profitability of the Company. As part of the Redomestication, Allied World Switzerland adopted and assumed the LTIP from Allied World Bermuda. Each award represents the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during the applicable three-year performance period. A total of 2,000,000 common shares may be issued under the LTIP. The awards granted in 2009 will vest after the fiscal year ending December 31, 2011, subject to the achievement of the performance conditions and terms of the LTIP. The awards granted in 2008 generally vested after the fiscal year ended December 31, 2010, however, a portion of this award will vest after the fourth or fifth year from the original grant date, subject to the achievement of the performance conditions and terms of the LTIP.

-21-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

| | Three Months Ended March 31, 2011 | |
|---|--|---|
| | LTIP | Weighted Average Grant Date Fair Value |
| Outstanding LTIP awards at beginning of period | 773,411 | \$ 41.74 |
| Additional LTIP awards granted due to the achievement of 2008 – 2010 performance criteria | 212,938 | 43.27 |
| LTIP forfeited | (13,500) | 42.48 |
| LTIP awards vested | (638,813) | 43.27 |
| Outstanding LTIP awards at end of period | 334,036 | \$ 39.76 |

Compensation expense of \$849 and \$5,021 relating to the LTIP has been recognized in general and administrative expenses in the Company's consolidated income statements for the three months ended March 31, 2011 and 2010, respectively. The decrease in compensation expense relating to LTIP is primarily the result of the Company issuing performance-based RSUs in lieu of LTIP as discussed in Note 12(b). The compensation expense for the LTIP is based on the fair market value of Allied World Switzerland's common shares at the time of grant. The LTIP is deemed to be an equity plan and as such, \$43,545 and \$77,728 have been included in additional paid-in capital on the consolidated balance sheets as of March 31, 2011 and December 31, 2010, respectively.

In calculating the compensation expense and in the determination of share equivalents for the purpose of calculating diluted earnings per share, it is estimated for the unvested LTIP awards granted in 2008 and 2009 that the maximum performance goals as set by the LTIP are likely to be achieved over the performance period. Based on the performance goals, the unvested LTIP awards granted in 2008 and 2009 are expensed at 150% of the fair market value of Allied World Switzerland's common shares on the date of grant. The expense is recognized over the performance period.

d) Cash-equivalent stock awards

Since 2009, as part of the Company's annual year-end compensation awards, the Company granted both stock-based awards and cash-equivalent stock awards. The cash-equivalent awards were granted to employees who received RSU, LTIP and performance-based RSU awards and were granted in lieu of granting the full award as a stock-based award. The cash-equivalent RSU awards vest pro-rata over four years from the date of grant. The cash-equivalent LTIP and performance-based RSU awards vest after a three-year performance period. As the cash-equivalent awards are settled in cash, we establish a liability equal to the product of the fair market value of Allied World Switzerland's common shares as of the end of the reporting period and the total awards outstanding. The liability is included in accounts payable and accrued expenses in the balance sheets and changes in the liability are recorded in general and administrative expenses in the consolidated income statements. For the three months ended March 31, 2011 and 2010, the expense recognized for the cash-equivalent stock awards was \$5,169 and \$2,309, respectively.

The following table shows the stock related compensation expense relating to the stock options, RSUs, LTIP and cash equivalent awards for the three months ended March 31, 2011 and 2010.

| For the Three Months Ended March 31, | |
|---|-------------|
| 2011 | 2010 |

| | | |
|------------------------------|-----------|-----------|
| Stock Options | \$ 1,179 | \$ 792 |
| RSUs | 3,822 | 3,714 |
| LTIP | 849 | 5,021 |
| Cash-equivalent stock awards | 5,169 | 2,309 |
| Total | \$ 11,019 | \$ 11,836 |

13. EARNINGS PER SHARE

The following table sets forth the comparison of basic and diluted earnings per share:

| | Three Months Ended | |
|--|---------------------------|-------------|
| | March 31, | |
| | 2011 | 2010 |
| Basic earnings per share | | |
| Net income | \$ 8,620 | \$ 133,740 |
| Weighted average common shares outstanding | 38,199,867 | 50,023,816 |
| Basic earnings per share | \$ 0.23 | \$ 2.67 |

-22-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

| | Three Months Ended March 31, | |
|---|---|-------------|
| | 2011 | 2010 |
| Diluted earnings per share | | |
| Net income | \$ 8,620 | \$ 133,740 |
| Weighted average common shares outstanding | 38,199,867 | 50,023,816 |
| Share equivalents: | | |
| Warrants and options | 679,820 | 1,583,024 |
| Restricted stock units | 575,436 | 482,390 |
| LTIP awards | 928,400 | 1,026,526 |
| Weighted average common shares and common share equivalents outstanding diluted | 40,383,523 | 53,115,756 |
| Diluted earnings per share | \$ 0.21 | \$ 2.52 |

For the three months ended March 31, 2011 and 2010, a weighted average of 429,241 and 516,385 employee stock options, respectively, were considered anti-dilutive and were therefore excluded from the calculation of the diluted earnings per share. For the three months ended March 31, 2011 and 2010 a weighted average of 11,307 and 9,471 RSUs, respectively, were considered anti-dilutive and were therefore excluded from the calculation of the diluted earnings per share.

14. SEGMENT INFORMATION

The determination of reportable segments is based on how senior management monitors the Company's underwriting operations. Management monitors the performance of its direct underwriting operations based on the geographic location of the Company's offices, the markets and customers served and the type of accounts written. The Company is currently organized into three operating segments: U.S. insurance, international insurance and reinsurance. All product lines fall within these classifications.

The U.S. insurance segment includes the Company's direct specialty insurance operations in the United States. This segment provides both direct property and specialty casualty insurance primarily to non-Fortune 1000 North American domiciled accounts. The international insurance segment includes the Company's direct insurance operations in Bermuda, Europe, Singapore and Hong Kong. This segment provides both direct property and casualty insurance primarily to Fortune 1000 North American domiciled accounts and mid-sized to large non-North American domiciled accounts. The reinsurance segment includes the reinsurance of property, general casualty, professional liability, specialty lines and property catastrophe coverages written by insurance companies. The Company presently writes reinsurance on both a treaty and a facultative basis, targeting several niche reinsurance markets.

Responsibility and accountability for the results of underwriting operations are assigned by major line of business within each segment. Because the Company does not manage its assets by segment, investment income, interest expense and total assets are not allocated to individual reportable segments. General and administrative expenses are allocated to segments based on various factors, including staff count and each segment's proportional share of gross premiums written.

Management measures results for each segment on the basis of the loss and loss expense ratio, acquisition cost ratio, general and administrative expense ratio and the combined ratio. The loss and loss expense ratio is derived by dividing net losses and loss expenses by net premiums earned. The acquisition cost ratio is derived by dividing acquisition costs by net premiums earned. The general and administrative expense ratio is derived by dividing general and administrative expenses by net premiums earned. The combined ratio is the sum of the loss and loss expense ratio,

the acquisition cost ratio and the general and administrative expense ratio.

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

The following table provides a summary of the segment results for the three months ended March 31, 2011 and 2010.

| | International | | Total | |
|--|------------------|------------------|--------------------|------------|
| | U.S. | | | |
| Three months ended March 31, 2011 | Insurance | Insurance | Reinsurance | |
| Gross premiums written | \$ 183,302 | \$ 111,325 | \$ 266,061 | \$ 560,688 |
| Net premiums written | 139,902 | 74,910 | 266,059 | 480,871 |
| Net premiums earned | 135,481 | 76,290 | 123,105 | 334,876 |
| Net losses and loss expenses | (115,831) | (71,184) | (117,437) | (304,452) |
| Acquisition costs | (18,102) | 1,856 | (21,836) | (38,082) |
| General and administrative expenses | (30,799) | (20,728) | (16,429) | (67,956) |
| Underwriting loss | (29,251) | (13,766) | (32,597) | (75,614) |
| Net investment income | | | | 50,208 |
| Net realized investment gains | | | | 50,376 |
| Net impairment charges recognized in earnings | | | | |
| Amortization and impairment of intangible assets | | | | (767) |
| Interest expense | | | | (13,742) |
| Foreign exchange gain | | | | 442 |
| Income before income taxes | | | | \$ 10,903 |
| Loss and loss expense ratio | 85.5% | 93.3% | 95.4% | 90.9% |
| Acquisition cost ratio | 13.4% | (2.4%) | 17.7% | 11.4% |
| General and administrative expense ratio | 22.7% | 27.2% | 13.3% | 20.3% |
| Combined ratio | 121.6% | 118.1% | 126.4% | 122.6% |

| | International | | Total | |
|--|------------------|------------------|--------------------|------------|
| | U.S. | | | |
| Three months ended March 31, 2010 | Insurance | Insurance | Reinsurance | |
| Gross premiums written | \$ 162,085 | \$ 121,422 | \$ 220,656 | \$ 504,163 |
| Net premiums written | 131,555 | 81,081 | 220,656 | 433,292 |
| Net premiums earned | 129,205 | 87,043 | 122,076 | 338,324 |
| Other income | 297 | | | 297 |
| Net losses and loss expenses | (98,425) | (57,449) | (76,280) | (232,154) |
| Acquisition costs | (16,960) | (66) | (23,758) | (40,784) |
| General and administrative expenses | (27,114) | (21,845) | (14,504) | (63,463) |
| Underwriting (loss) income | (12,997) | 7,683 | 7,534 | 2,220 |
| Net investment income | | | | 68,902 |
| Net realized investment gains | | | | 77,487 |

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| | |
|--|------------|
| Net impairment charges recognized in earnings | (168) |
| Amortization and impairment of intangible assets | (892) |
| Interest expense | (9,528) |
| Foreign exchange loss | (1,076) |
| Income before income taxes | \$ 136,945 |

| | | | | |
|--|--------|-------|-------|-------|
| Loss and loss expense ratio | 76.2% | 66.0% | 62.5% | 68.6% |
| Acquisition cost ratio | 13.1% | 0.1% | 19.5% | 12.1% |
| General and administrative expense ratio | 21.0% | 25.1% | 11.9% | 18.8% |
| Combined ratio | 110.3% | 91.2% | 93.9% | 99.5% |

-24-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

The following table shows an analysis of the Company's net premiums written by geographic location of the Company's subsidiaries for the three months ended March 31, 2011 and 2010. All inter-company premiums have been eliminated.

| | Three Months Ended | |
|--------------------------------|---------------------------|----------------|
| | March 31, | |
| | 2011 | 2010 |
| United States | \$ 263,231 | \$ 245,280 |
| Bermuda | 146,331 | 127,782 |
| Europe | 51,876 | 52,160 |
| Singapore | 15,236 | 3,691 |
| Hong Kong | 4,197 | 4,379 |
| Total net premiums written | \$ 480,871 | \$ 433,292 |

15. COMMITMENTS AND CONTINGENCIES

Insurance balances receivable primarily consist of net premiums due from insureds and reinsureds. The Company believes that the counterparties to these receivables are able to meet, and will meet, all of their obligations. Consequently, the Company has not included any allowance for doubtful accounts against the receivable balance. Of the \$569,836 in insurance balances receivable as of March 31, 2011, \$4,140 was past due over 90 days, which represented 0.7% of the total balance. Of the \$529,927 in insurance balances receivable as of December 31, 2010, \$2,658 was past due over 90 days, which represented 0.5% of the total balance.

16. CONDENSED CONSOLIDATED GUARANTOR FINANCIAL STATEMENTS

The following tables present unaudited condensed consolidating financial information as of March 31, 2011, and December 31, 2010, and for the three months ended March 31, 2011 and 2010, for Allied World Switzerland (the Parent Guarantor) and Allied World Bermuda (the Subsidiary Issuer). The Subsidiary Issuer is a direct 100 percent-owned subsidiary of the Parent Guarantor. Investments in subsidiaries are accounted for by the Parent Guarantor under the equity method for purposes of the supplemental consolidating presentation. Earnings of subsidiaries are reflected in the Parent Guarantor's investment accounts and earnings. The Parent Guarantor fully and unconditionally guarantees the 5.50% Senior Notes and the 7.50% Senior Notes issued by Subsidiary Issuer.

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

Unaudited Condensed Consolidating Balance Sheet:

| As of March 31, 2011 | Allied World | Allied World | Other Allied World | Consolidating Adjustments | Allied World Switzerland Consolidated |
|--|---|--|-----------------------------------|--------------------------------------|--|
| ASSETS: | Switzerland (Parent Guarantor) | Bermuda (Subsidiary Issuer) | World Subsidiaries | | |
| Investments | \$ | \$ | \$ 7,245,694 | \$ | \$ 7,245,694 |
| Cash and cash equivalents | 78,400 | 54,360 | 561,220 | | 693,980 |
| Insurance balances receivable | | | 569,836 | | 569,836 |
| Prepaid reinsurance | | | 175,348 | | 175,348 |
| Reinsurance recoverable | | | 975,523 | | 975,523 |
| Net deferred acquisition costs | | | 113,097 | | 113,097 |
| Goodwill | | | 268,376 | | 268,376 |
| Intangible assets | | | 56,109 | | 56,109 |
| Balances receivable on sale of investments | | | 363,151 | | 363,151 |
| Investments in subsidiaries | 2,878,300 | 1,984,690 | | (4,862,990) | |
| Due (to) from subsidiaries | (5,010) | (14,406) | 19,416 | | |
| Other assets | 77 | 62,328 | 198,880 | (53,620) | 207,665 |
| Total assets | \$ 2,951,767 | \$ 2,086,972 | \$ 10,546,650 | \$ (4,916,610) | \$ 10,668,779 |
| LIABILITIES: | | | | | |
| Reserve for losses and loss expenses | \$ | \$ | \$ 5,100,643 | \$ | \$ 5,100,643 |
| Unearned premiums | | | 1,096,260 | | 1,096,260 |
| Reinsurance balances payable | | | 91,852 | | 91,852 |
| Balances due on purchases of investments | | | 567,918 | | 567,918 |
| Senior notes | | 797,761 | | | 797,761 |
| Accounts payable and accrued liabilities | 814 | 13,004 | 49,574 | | 63,392 |
| Total liabilities | 814 | 810,765 | 6,906,247 | | 7,717,826 |
| Total shareholders equity | 2,950,953 | 1,276,207 | 3,640,403 | (4,916,610) | 2,950,953 |
| Total liabilities and shareholders equity | \$ 2,951,767 | \$ 2,086,972 | \$ 10,546,650 | \$ (4,916,610) | \$ 10,668,779 |

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

| | Allied World | Allied World | Other Allied World | Consolidating adjustments | Allied World Switzerland Consolidated |
|--|---|--|-----------------------------------|--------------------------------------|--|
| As of December 31, 2010 | Switzerland (Parent Guarantor) | Bermuda (Subsidiary Issuer) | World Subsidiaries | | |
| ASSETS: | | | | | |
| Investments | \$ | \$ | \$ 7,183,554 | \$ | \$ 7,183,554 |
| Cash and cash equivalents | 138,488 | 125,663 | 492,844 | | 756,995 |
| Insurance balances receivable | | | 529,927 | | 529,927 |
| Prepaid reinsurance | | | 187,287 | | 187,287 |
| Reinsurance recoverable | | | 927,588 | | 927,588 |
| Net deferred acquisition costs | | | 96,803 | | 96,803 |
| Goodwill | | | 268,376 | | 268,376 |
| Intangible assets | | | 56,876 | | 56,876 |
| Balances receivable on sale of investments | | | 188,408 | | 188,408 |
| Investments in subsidiaries | 2,944,975 | 1,981,158 | | (4,926,133) | |
| Due (to) from subsidiaries | (7,143) | (9,419) | 16,562 | | |
| Other assets | | 8,801 | 223,016 | | 231,817 |
| Total assets | \$ 3,076,320 | \$ 2,106,203 | \$ 10,171,241 | \$ (4,926,133) | \$ 10,427,631 |
| LIABILITIES: | | | | | |
| Reserve for losses and loss expenses | \$ | \$ | \$ 4,879,188 | \$ | \$ 4,879,188 |
| Unearned premiums | | | 962,203 | | 962,203 |
| Reinsurance balances payable | | | 99,732 | | 99,732 |
| Balances due on purchases of investments | | | 506,978 | | 506,978 |
| Senior notes | | 797,700 | | | 797,700 |
| Accounts payable and accrued liabilities | 500 | 18,111 | 87,399 | | 106,010 |
| Total liabilities | 500 | 815,811 | 6,535,500 | | 7,351,811 |
| Total shareholders equity | 3,075,820 | 1,290,392 | 3,635,741 | (4,926,133) | 3,075,820 |
| Total liabilities and shareholders equity | \$ 3,076,320 | \$ 2,106,203 | \$ 10,171,241 | \$ (4,926,133) | \$ 10,427,631 |

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

Unaudited Condensed Consolidating Income Statement:

| | Allied World | Allied World | Other Allied World | Consolidating Adjustments | Allied World Switzerland Consolidated |
|--|---|--|-----------------------------------|--------------------------------------|--|
| For the three months ended March 31, 2011 | Switzerland (Parent Guarantor) | Bermuda (Subsidiary Issuer) | World Subsidiaries | | |
| REVENUES: | | | | | |
| Gross premiums written | \$ | \$ | \$ 560,688 | \$ | \$ 560,688 |
| Premiums ceded | | | (79,817) | | (79,817) |
| Net premiums written | | | 480,871 | | 480,871 |
| Change in unearned premiums | | | (145,995) | | (145,995) |
| Net premiums earned | | | 334,876 | | 334,876 |
| Net investment income | 30 | 14 | 50,164 | | 50,208 |
| Net realized investment gains | | | 50,376 | | 50,376 |
| | 30 | 14 | 435,416 | | 435,460 |
| EXPENSES: | | | | | |
| Net losses and loss expenses | | | 304,452 | | 304,452 |
| Acquisition costs | | | 38,082 | | 38,082 |
| General and administrative expenses | 1,064 | 2,744 | 64,148 | | 67,956 |
| Amortization and impairment of intangible assets | | | 767 | | 767 |
| Interest expense | | 13,742 | | | 13,742 |
| Foreign exchange (gain) loss | (4) | 241 | (679) | | (442) |
| Income tax expense | | | 2,283 | | 2,283 |
| | 1,060 | 16,727 | 409,053 | | 426,840 |
| (Loss) income before equity in earnings of consolidated subsidiaries | (1,030) | (16,713) | 26,363 | | 8,620 |
| Equity in earnings of consolidated subsidiaries | 9,650 | | | (9,650) | |
| NET INCOME (LOSS) | \$ 8,620 | \$ (16,713) | \$ 26,363 | \$ (9,650) | \$ 8,620 |

-28-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

| | Allied World | Allied World | Other Allied World | Consolidating Adjustments | Allied World Switzerland Consolidated |
|--|--------------------------------------|-----------------------------------|--------------------------|------------------------------|--|
| For the three months ended March 31, 2010 | Switzerland (Parent Guarantor) | Bermuda (Subsidiary Issuer) | World Subsidiaries | Consolidating Adjustments | Allied World Switzerland Consolidated |
| REVENUES: | | | | | |
| Gross premiums written | \$ | \$ | \$ 504,163 | \$ | \$ 504,163 |
| Premiums ceded | | | (70,871) | | (70,871) |
| Net premiums written | | | 433,292 | | 433,292 |
| Change in unearned premiums | | | (94,968) | | (94,968) |
| Net premiums earned | | | 338,324 | | 338,324 |
| Net investment income | | | 68,902 | | 68,902 |
| Net realized investment gains | | | 77,487 | | 77,487 |
| Net impairment charges recognized in earnings | | | (168) | | (168) |
| Other income | | | 297 | | 297 |
| | | | 484,842 | | 484,842 |
| EXPENSES: | | | | | |
| Net losses and loss expenses | | | 232,154 | | 232,154 |
| Acquisition costs | | | 40,784 | | 40,784 |
| General and administrative expenses | | 3,482 | 59,981 | | 63,463 |
| Amortization and impairment of intangible assets | | | 892 | | 892 |
| Interest expense | | 9,528 | | | 9,528 |
| Foreign exchange loss | | | 1,076 | | 1,076 |
| Income tax expense | | | 3,205 | | 3,205 |
| | | 13,010 | 338,092 | | 351,102 |
| (Loss) income before equity in earnings of consolidated subsidiaries | | (13,010) | 146,750 | | 133,740 |
| Equity in earnings of consolidated subsidiaries | | 146,750 | | (146,750) | |
| NET INCOME (LOSS) | \$ | \$ | \$ 133,740 | \$ | \$ 133,740 |

Table of Contents**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

Unaudited Condensed Consolidating Cash Flows:

| | Allied World | Allied World | Other Allied World | Consolidating Adjustments | Allied World Switzerland Consolidated |
|---|---|--|-----------------------------------|--------------------------------------|--|
| For the three months ended March 31, 2011 | Switzerland (Parent Guarantor) | Bermuda (Subsidiary Issuer) | World Subsidiaries | World Subsidiaries | World Subsidiaries |
| CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES: | | | | | |
| Net income | \$ 8,620 | \$ (16,713) | \$ 26,363 | \$ (9,650) | \$ 8,620 |
| Adjustments to reconcile net income to cash provided by operating activities: | | | | | |
| Equity in earnings of consolidated subsidiaries | (9,650) | | | 9,650 | |
| Stock compensation expenses | 121 | | 5,729 | | 5,850 |
| Amortization of discount on senior notes | | 61 | | | 61 |
| Other assets | (77) | 5,019 | (148,233) | | (143,291) |
| Accounts payable and accrued liabilities | (1,819) | 143 | 311,940 | | 310,264 |
| Interest payable | | (5,250) | | | (5,250) |
| Net cash provided by (used in) operating activities | (2,805) | (16,740) | 195,799 | | 176,254 |
| CASH FLOWS USED IN INVESTING ACTIVITIES: | | | | | |
| Purchase of fixed maturity investments available for sale | | | (352) | | (352) |
| Purchase of fixed maturity investments trading | | | (2,332,315) | | (2,332,315) |
| Purchases of equity securities and other invested assets | | | (268,941) | | (268,941) |
| Sales of fixed maturity investments available for sale | | | 340,418 | | 340,418 |
| Sales of fixed maturity investments trading | | | 2,036,961 | | 2,036,961 |
| Sale of equity securities and other invested assets | | | 52,644 | | 52,644 |
| Other | | | 42,712 | | 42,712 |
| Net cash used in investing activities | | | (128,873) | | (128,873) |
| CASH FLOWS (USED IN) PROVIDED BY FINANCING ACTIVITIES: | | | | | |
| Proceeds from the exercise of stock options | 3,224 | | | | 3,224 |
| Share repurchase | (60,000) | | | | (60,000) |

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| | | | | |
|---|-----------|-----------|------------|------------|
| Repurchase of founder warrants | | (53,620) | | (53,620) |
| Other | (507) | (943) | 1,450 | |
| Net cash (used in) provided by financing activities | (57,283) | (54,563) | 1,450 | (110,396) |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (60,088) | (71,303) | 68,376 | (63,015) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 138,488 | 125,663 | 492,844 | 756,995 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 78,400 | \$ 54,360 | \$ 561,220 | \$ 693,980 |

-30-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

| | Allied World | Allied World | | | |
|---|--------------------------------------|-----------------------------------|--|------------------------------|--|
| | Switzerland (Parent Guarantor) | Bermuda (Subsidiary Issuer) | Other Allied World Subsidiaries | Consolidating Adjustments | Allied World Switzerland Consolidated |
| For the three months ended March 31, 2010 | | | | | |
| CASH FLOWS PROVIDED BY (USED IN) | | | | | |
| OPERATING ACTIVITIES: | | | | | |
| Net income | \$ | \$ 133,740 | \$ 146,750 | \$ (146,750) | \$ 133,740 |
| Adjustments to reconcile net income to cash provided by operating activities: | | | | | |
| Equity in earnings of consolidated subsidiaries | | (146,750) | | 146,750 | |
| Dividends received from subsidiaries | | 80,000 | | (80,000) | |
| Stock compensation expenses | | 104 | 9,423 | | 9,527 |
| Amortization of discount on senior notes | | 32 | | | 32 |
| Other assets | | (725) | (174,760) | | (175,485) |
| Accounts payable and accrued liabilities | | 2,667 | 123,610 | | 126,277 |
| Interest payable | | (9,375) | | | (9,375) |
| Net cash provided by (used in) operating activities | | 59,693 | 105,023 | (80,000) | 84,716 |
| CASH FLOWS PROVIDED BY (USED IN) | | | | | |
| INVESTING ACTIVITIES: | | | | | |
| Purchase of fixed maturity investments available for sale | | | (85,767) | | (85,767) |
| Purchase of fixed maturity investments trading | | | (2,075,196) | | (2,075,196) |
| Purchases of equity securities and other invested assets | | | (71,802) | | (71,802) |
| Sales of fixed maturity investments available for sale | | | 1,304,598 | | 1,304,598 |
| Sales of fixed maturity investments trading | | | 960,823 | | 960,823 |
| Sale of other invested assets | | | 884 | | 884 |
| Other | | (1,854) | 40,809 | | 38,955 |
| Net cash provided by (used in) investing activities | | (1,854) | 74,349 | | 72,495 |
| CASH FLOWS PROVIDED BY (USED IN) | | | | | |
| FINANCING ACTIVITIES: | | | | | |
| Dividends paid | | | (80,000) | 80,000 | |
| Proceeds from the exercise of stock options | | 2,735 | | | 2,735 |

| | | | | |
|---|--------|------------|------------|------------|
| Net cash provided by (used in) financing activities | 2,735 | (80,000) | 80,000 | 2,735 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 60,574 | 99,372 | | 159,946 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 53,849 | 238,339 | | 292,188 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ | \$ 114,423 | \$ 337,711 | \$ 452,134 |

17. SUBSEQUENT EVENTS

The Company's proposal to pay dividends in the form of a distribution by way of par value reductions was approved by its shareholders on May 5, 2011. The aggregate reduction amount will be paid to shareholders in quarterly installments of \$0.375 per share and the Company expects to distribute such dividends in August 2011, October 2011, January 2012 and April 2012. Dividend payments will be subject to Swiss law and other related factors described in the Company's 2011 Proxy Statement.

-31-

Table of Contents

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included elsewhere in this Form 10-Q. References in this Form 10-Q to the terms we, us, our, the company or other similar terms mean the consolidated operations of Allied World Assurance Company Holdings, AG, a Swiss holding company, and our consolidated subsidiaries, unless the context requires otherwise. References in this Form 10-Q to the term Allied World Switzerland or Holdings means only Allied World Assurance Company Holdings, AG. References to Allied World Bermuda means only Allied World Assurance Company Holdings, Ltd, a Bermuda holding company. References to our insurance subsidiaries may include our reinsurance subsidiaries. References in this Form 10-Q to \$ are to the lawful currency of the United States and to CHF are to the lawful currency of Switzerland. References in this Form 10-Q to Holdings common shares means its registered voting shares and non-voting participation certificates.

Note on Forward-Looking Statement

This Form 10-Q and other publicly available documents may include, and our officers and representatives may from time to time make, projections concerning financial information and statements concerning future economic performance and events, plans and objectives relating to management, operations, products and services, and assumptions underlying these projections and statements. These projections and statements are forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995 and are not historical facts but instead represent only our belief regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These projections and statements may address, among other things, our strategy for growth, product development, financial results and reserves. Actual results and financial condition may differ, possibly materially, from these projections and statements and therefore you should not place undue reliance on them. Factors that could cause our actual results to differ, possibly materially, from those in the specific projections and statements are discussed throughout this Management’s Discussion and Analysis of Financial Condition and Results of Operations and in Risk Factors in Item 1A of Part I of our 2010 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) on March 1, 2011 (the 2010 Form 10-K). We are under no obligation (and expressly disclaim any such obligation) to update or revise any forward-looking statement that may be made from time to time, whether as a result of new information, future developments or otherwise.

Overview

Our Business

We write a diversified portfolio of property and casualty insurance and reinsurance internationally through our subsidiaries and branches based in Bermuda, Europe, Hong Kong, Singapore and the United States as well as our Lloyd’s Syndicate 2232. We manage our business through three operating segments: U.S. insurance, international insurance and reinsurance. As of March 31, 2011, we had approximately \$10.7 billion of total assets, \$3.0 billion of total shareholders’ equity and \$3.7 billion of total capital, which includes shareholders’ equity and senior notes.

During the three months ended March 31, 2011, we experienced premium rate declines across all of our operating segments and most lines of business. We believe the premium rate decreases are due to increased competition, increased capacity and a favorable loss environment. We expect this trend to continue through 2011. Despite the challenging pricing environment, we believe that there are opportunities where certain products have adequate premium rates and that the expanded breadth of our operations allows us to target those classes of business. Given these trends, we continue to be selective in the insurance policies and reinsurance contracts we underwrite. Our consolidated gross premiums written increased by \$56.5 million, or 11.2%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Our net income for the three months ended March 31, 2011 decreased by \$125.1 million, or 93.6%, to \$8.6 million compared to \$133.7 million for the three months ended March 31, 2010. The decrease was primarily due to higher net losses and loss expenses from property catastrophe losses of \$132.2 million in the Asia-Pacific region.

Table of Contents**Financial Highlights**

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions except share, per share and percentage data) | |
| Gross premiums written | \$ 560.7 | \$ 504.2 |
| Net income | 8.6 | 133.7 |
| Operating (loss) income | (41.3) | 61.3 |
| Basic earnings per share: | | |
| Net income | \$ 0.23 | \$ 2.67 |
| Operating (loss) income | \$ (1.08) | \$ 1.23 |
| Diluted earnings per share: | | |
| Net income | \$ 0.21 | \$ 2.52 |
| Operating (loss) income | \$ (1.02) | \$ 1.16 |
| Weighted average common shares outstanding: | | |
| Basic | 38,199,867 | 50,023,816 |
| Diluted | 40,383,523 | 53,115,756 |
| Basic book value per common share | \$ 77.86 | \$ 66.17 |
| Diluted book value per common share | \$ 74.23 | \$ 61.59 |
| Annualized return on average equity (ROAE), net income | 1.2% | 17.1% |
| Annualized ROAE, operating (loss) income | (5.6%) | 7.8% |

Non-GAAP Financial Measures

In presenting the company's results, management has included and discussed certain non-GAAP financial measures, as such term is defined in Item 10(e) of Regulation S-K promulgated by the SEC. Management believes that these non-GAAP measures, which may be defined differently by other companies, better explain the company's results of operations in a manner that allows for a more complete understanding of the underlying trends in the company's business. However, these measures should not be viewed as a substitute for those determined in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

Operating (loss) income & operating (loss) income per share

Operating income is an internal performance measure used in the management of our operations and represents after tax operational results excluding, as applicable, net realized investment gains or losses, net impairment charges recognized in earnings, impairment of intangible assets and foreign exchange gain or loss. We exclude net realized investment gains or losses, net impairment charges recognized in earnings and net foreign exchange gain or loss from our calculation of operating income because the amount of

Table of Contents

these gains or losses is heavily influenced by and fluctuates in part according to the availability of market opportunities and other factors. We exclude impairment of intangible assets as these are non-recurring charges. In addition to presenting net income determined in accordance with U.S. GAAP, we believe that showing operating income enables investors, analysts, rating agencies and other users of our financial information to more easily analyze our results of operations and our underlying business performance. Operating income should not be viewed as a substitute for U.S. GAAP net income. The following is a reconciliation of operating income to its most closely related U.S. GAAP measure, net income.

| | Three Months Ended March 31, | |
|---|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions except per share data) | |
| Net income | \$ 8.6 | \$ 133.7 |
| Add after tax affect of: | | |
| Net realized investment gains | (49.5) | (73.6) |
| Net impairment charges recognized in earnings | | 0.1 |
| Foreign exchange (gain) loss | (0.4) | 1.1 |
| Operating (loss) income | \$ (41.3) | \$ 61.3 |
| Basic per share data: | | |
| Net income | \$ 0.23 | \$ 2.67 |
| Add after tax affect of: | | |
| Net realized investment gains | (1.30) | (1.47) |
| Net impairment charges recognized in earnings | | 0.03 |
| Foreign exchange (gain) loss | (0.01) | 0.03 |
| Operating (loss) income | \$ (1.08) | \$ 1.23 |
| Diluted per share data: | | |
| Net income | \$ 0.21 | \$ 2.52 |
| Add after tax affect of: | | |
| Net realized investment gains | (1.22) | (1.38) |
| Net impairment charges recognized in earnings | | 0.02 |
| Foreign exchange (gain) loss | (0.01) | 0.02 |
| Operating (loss) income | \$ (1.02) | \$ 1.16 |

Diluted book value per share

We have included diluted book value per share because it takes into account the effect of dilutive securities; therefore, we believe it is an important measure of calculating shareholder returns.

Table of Contents

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions except share and per share data) | |
| Price per share at period end | \$ 62.69 | \$ 44.85 |
| Total shareholders' equity | \$ 2,951.0 | \$ 3,338.8 |
| Basic common shares outstanding | 37,899,699 | 50,459,000 |
| Add: | | |
| Unvested restricted share units | 475,679 | 801,540 |
| Performance based equity awards | 920,164 | 1,409,984 |
| Dilutive options/warrants outstanding | 1,674,993 | 6,702,546 |
| Weighted average exercise price per share | \$ 45.47 | \$ 34.53 |
| Deduct: | | |
| Options bought back via treasury method | (1,215,020) | (5,159,746) |
| Common shares and common share equivalents outstanding | 39,755,515 | 54,213,324 |
| Basic book value per common share | \$ 77.86 | \$ 66.17 |
| Diluted book value per common share | \$ 74.23 | \$ 61.59 |

Annualized return on average equity

Annualized return on average shareholders' equity (ROAE) is calculated using average equity, excluding the average after tax unrealized gains or losses on investments. We present ROAE as a measure that is commonly recognized as a standard of performance by investors, analysts, rating agencies and other users of our financial information.

Annualized operating return on average shareholders' equity is calculated using operating income and average shareholders' equity, excluding the average after tax unrealized gains or losses on investments.

| | Three Months Ended March 31, | |
|--|--|-------------|
| | 2011 | 2010 |
| | (\$ in millions except percentage data) | |
| Opening shareholders' equity | \$ 3,075.8 | \$ 3,213.3 |
| Deduct: accumulated other comprehensive income | (57.1) | (149.8) |
| Adjusted opening shareholders' equity | \$ 3,018.7 | \$ 3,063.5 |
| Closing shareholders' equity | \$ 2,951.0 | \$ 3,338.8 |
| Deduct: accumulated other comprehensive income | (33.0) | (142.3) |
| Adjusted closing shareholders' equity | \$ 2,918.0 | \$ 3,196.5 |
| Average shareholders' equity | \$ 2,968.3 | \$ 3,130.0 |
| Net income available to shareholders | \$ 8.6 | \$ 133.7 |

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| | | | | |
|--|----|--------|----|-------|
| Annualized return on average shareholders equity net income available to shareholders | | 1.2% | | 17.1% |
| Operating (loss) income available to shareholders | \$ | (41.3) | \$ | 61.3 |
| Annualized return on average shareholders equity operating (loss) income available to shareholders | | (5.6%) | | 7.8% |

-35-

Table of Contents**Relevant Factors****Revenues**

We derive our revenues primarily from premiums on our insurance policies and reinsurance contracts, net of any reinsurance or retrocessional coverage purchased. Insurance and reinsurance premiums are a function of the amounts and types of policies and contracts we write, as well as prevailing market prices. Our prices are determined before our ultimate costs, which may extend far into the future, are known. In addition, our revenues include income generated from our investment portfolio, consisting of net investment income and net realized investment gains or losses. Investment income is principally derived from interest and dividends earned on investments, partially offset by investment management expenses and fees paid to our custodian bank. Net realized investment gains or losses include gains or losses from the sale of investments, as well as the change in the fair value of investments that we mark-to-market through net income.

Expenses

Our expenses consist largely of net losses and loss expenses, acquisition costs, and general and administrative expenses. Net losses and loss expenses incurred are comprised of three main components:

losses paid, which are actual cash payments to insureds and reinsureds, net of recoveries from reinsurers;

outstanding loss or case reserves, which represent management's best estimate of the likely settlement amount for known claims, less the portion that can be recovered from reinsurers; and

reserves for losses incurred but not reported, or IBNR, which are reserves (in addition to case reserves) established by us that we believe are needed for the future settlement of claims. The portion recoverable from reinsurers is deducted from the gross estimated loss.

Acquisition costs are comprised of commissions, brokerage fees and insurance taxes. Commissions and brokerage fees are usually calculated as a percentage of premiums and depend on the market and line of business. Acquisition costs are reported after (1) deducting commissions received on ceded reinsurance, (2) deducting the part of acquisition costs relating to unearned premiums and (3) including the amortization of previously deferred acquisition costs.

General and administrative expenses include personnel expenses including stock-based compensation expense, rent expense, professional fees, information technology costs and other general operating expenses.

Ratios

Management measures results for each segment on the basis of the loss and loss expense ratio, acquisition cost ratio, general and administrative expense ratio, expense ratio and the combined ratio. Because we do not manage our assets by segment, investment income, interest expense and total assets are not allocated to individual reportable segments. General and administrative expenses are allocated to segments based on various factors, including staff count and each segment's proportional share of gross premiums written. The loss and loss expense ratio is derived by dividing net losses and loss expenses by net premiums earned. The acquisition cost ratio is derived by dividing acquisition costs by net premiums earned. The general and administrative expense ratio is derived by dividing general and administrative expenses by net premiums earned. The expense ratio is the sum of the acquisition cost ratio and the general and administrative expense ratio. The combined ratio is the sum of the loss and loss expense ratio, the acquisition cost ratio and the general and administrative expense ratio.

Critical Accounting Policies

It is important to understand our accounting policies in order to understand our financial position and results of operations. Our unaudited condensed consolidated financial statements reflect determinations that are inherently subjective in nature and require management to make assumptions and best estimates to determine the reported values. If events or other factors cause actual results to differ materially from management's underlying assumptions or estimates, there could be a material adverse effect on our financial condition or results of operations. We believe that some of the more critical judgments in the areas of accounting estimates and assumptions that affect our financial condition and results of operations are related to reserves for losses and loss expenses, reinsurance recoverables, premiums and acquisition costs, valuation of financial instruments, other than temporary impairment (OTTI) of

investments and goodwill and other intangible asset impairment valuation. For a detailed discussion of our critical

Table of Contents

accounting policies please refer to our 2010 Form 10-K. There were no material changes in the application of our critical accounting estimates subsequent to that report.

Results of Operations

The following table sets forth our selected consolidated statement of operations data for each of the periods indicated.

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions) | |
| Gross premiums written | \$ 560.7 | \$ 504.2 |
| Net premiums written | \$ 480.9 | \$ 433.3 |
| Net premiums earned | 334.9 | 338.3 |
| Net investment income | 50.2 | 68.9 |
| Net realized investment gains | 50.4 | 77.5 |
| Net impairment charges recognized in earnings | | (0.2) |
| Other income | | 0.3 |
| | \$ 435.5 | \$ 484.8 |
| Net losses and loss expenses | \$ 304.4 | \$ 232.1 |
| Acquisition costs | 38.1 | 40.9 |
| General and administrative expenses | 68.0 | 63.4 |
| Amortization and impairment of intangible assets | 0.8 | 0.9 |
| Interest expense | 13.7 | 9.5 |
| Foreign exchange (gain) loss | (0.4) | 1.1 |
| | \$ 424.6 | \$ 347.9 |
| Income before income taxes | \$ 10.9 | \$ 136.9 |
| Income tax expense | 2.3 | 3.2 |
| Net income | \$ 8.6 | \$ 133.7 |
| Ratios | | |
| Loss and loss expense ratio | 90.9% | 68.6% |
| Acquisition cost ratio | 11.4% | 12.1% |
| General and administrative expense ratio | 20.3% | 18.8% |
| Expense ratio | 31.7% | 30.9% |
| Combined ratio | 122.6% | 99.5% |

Comparison of Three Months Ended March 31, 2011 and 2010**Premiums**

Gross premiums written increased by \$56.5 million, or 11.2%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The overall increase in gross premiums written was primarily the result of the following:

Gross premiums written in our U.S. insurance segment increased by \$21.2 million, or 13.1%. The increase in gross premiums written was primarily due to increased new business, including from new products, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. This increase was partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition.

Gross premiums written in our international insurance segment decreased by \$10.1 million, or 8.3%, due to the continued trend of the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition.

-37-

Table of Contents

Gross premiums written in our reinsurance segment increased by \$45.5 million, or 20.6%. The increase in gross premiums written was primarily due to increased new business, including gross premiums written by our new global marine and specialty division and the build-out of our international platform.

The table below illustrates our gross premiums written by geographic location for the three months ended March 31, 2011 and 2010.

| | Three Months Ended | | Dollar Change | Percentage Change |
|---------------|---------------------------|-----------------------|-------------------------|--------------------------|
| | March 31, 2011 | March 31, 2010 | | |
| | | | (\$ in millions) | |
| United States | \$ 306.6 | \$ 275.8 | \$ 30.8 | 11.2% |
| Bermuda | 170.5 | 154.2 | 16.3 | 10.6 |
| Europe | 64.1 | 66.1 | (2.0) | (3.0) |
| Singapore | 15.2 | 3.7 | 11.5 | 310.8 |
| Hong Kong | 4.3 | 4.4 | (0.1) | (2.3) |
| | \$ 560.7 | \$ 504.2 | \$ 56.5 | 11.2% |

Net premiums written increased by \$47.6 million, or 11.0%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase in net premiums written was due to the increase in gross premiums written. The difference between gross and net premiums written is the cost to us of purchasing reinsurance coverage, including the cost of property catastrophe reinsurance coverage. We ceded 14.2% of gross premiums written for the three months ended March 31, 2011 compared to 14.1% for the same period in 2010.

Net premiums earned decreased by \$3.4 million, or 1.0%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. This was as a result of the impact of the commutation of swing-rated reinsurance contracts during the three months ended March 31, 2010, which added \$9.3 million to net premiums earned. There was no commutation during the three months ended March 31, 2011. Additionally, downward adjustments on estimated premiums, the majority of which was fully earned, were higher by \$3.7 million during the three months ended March 31, 2011 compared to the same period in 2010. There also was a decrease in net premiums earned in our international insurance segment during the three months ended March 31, 2011 as a result of lower net premiums written in 2010. This was partially offset by higher net premiums earned for the U.S. insurance segment, driven by premium growth of our U.S. operations.

We evaluate our business by segment, distinguishing between U.S. insurance, international insurance and reinsurance. The following chart illustrates the mix of our business on both a gross premiums written and net premiums earned basis.

| | Gross Premiums Written | | Net Premiums Earned | |
|-------------------------|-------------------------------------|-------------|----------------------------|-------------|
| | Three Months Ended March 31, | | | |
| | 2011 | 2010 | 2011 | 2010 |
| U.S. insurance | 32.7% | 32.1% | 40.4% | 38.2% |
| International insurance | 19.8% | 24.1% | 22.8% | 25.7% |
| Reinsurance | 47.5% | 43.8% | 36.8% | 36.1% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |

Net Investment Income

Net investment income decreased by \$18.7 million, or 27.1%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The decrease was due to lower yields on our fixed maturity investments as well as an increased allocation to equity securities and hedge funds, which contribute to our total return but carry little or no current yield. We increased our equity and hedge fund investments by \$479.1 million between March 31, 2010 and March 31, 2011. The annualized period book yield of the investment portfolio for the three months ended March 31, 2011 and 2010 was 2.6% and 3.7%, respectively, and the financial statement total return of our investment portfolio was 1.0% for the three months ended March 31, 2011. Investment management expenses of \$3.3 million and \$2.6 million were incurred during the three months ended March 31, 2011 and 2010, respectively. The increase in investment management expenses was primarily due to the increase in the size of our investment portfolio, as well as expenses from higher expense asset classes (equities).

As of March 31, 2011, approximately 95.8% of our fixed income investments consisted of investment grade securities. As of March 31, 2011, the average credit rating of our fixed income portfolio was AA as rated by Standard & Poor's and Aa3 as rated by Moody's. As of December 31, 2010, the average credit rating of our fixed income portfolio was AA as rated by Standard & Poor's

Table of Contents

and Aa2 as rated by Moody's. The average duration of fixed maturity investments and cash and cash equivalents was approximately 2.8 years as of March 31, 2011 and 3.5 years as of March 31, 2010.

Realized Investment Gains/Losses and Net Impairment Charges Recognized in Earnings

During the three months ended March 31, 2011, we recognized \$50.4 million in net realized investment gains compared to net realized investment gains of \$77.5 million during the three months ended March 31, 2010. During the three months ended March 31, 2011, we did not recognize any net impairment charges compared to \$0.2 million during the three months ended March 31, 2010. Net realized investment gains of \$50.4 million for the three months ended March 31, 2011 were comprised of the following:

Net realized investment gains of \$16.1 million primarily from the sale of fixed maturity securities due to the rebalancing of our portfolio from U.S. treasury and agency securities into equity securities, hedge fund investments and future contracts.

Net realized investment gains of \$34.3 million related to mark-to-market adjustments.

| | | Mark-to-Market Adjustments for the Three Months Ended March 31, 2011 (\$ in millions) |
|--|----|--|
| Fixed maturity investments accounted for as trading securities | \$ | 13.5 |
| Hedge funds and equity securities | | 20.8 |
| Total | \$ | 34.3 |

Net realized investment gains of \$77.5 million for the three months ended March 31, 2010 were comprised of the following:

Net realized investment gains of \$45.3 million from the sale of securities.

Net realized investment gains of \$32.2 million primarily related to the mark-to-market adjustments for our hedge fund investments and fixed maturity investments that are accounted for as trading securities.

Other Income

The other income of \$0.3 million for the three months ended March 31, 2010 represented fee income from our program administrator and wholesale brokerage operations, which we sold during the third quarter of 2010.

Net Losses and Loss Expenses

Net losses and loss expenses increased by \$72.3 million, or 31.2%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase in net losses and loss expenses was due to higher catastrophe loss activity in the current period, which included estimated net losses and loss expenses incurred of \$19.0 million for the Australian storms, \$38.2 million for the New Zealand earthquake and \$75.0 million for the Tohoku earthquake and tsunami. During the three months ended March 31, 2010, we incurred \$86.5 million of net losses and loss expenses related to the earthquakes in Haiti and Chile, a Connecticut power plant explosion and European windstorms. We also recognized lower net favorable prior year reserve development for the three months ended March 31, 2011 compared to March 31, 2010.

We recorded net favorable reserve development related to prior years of \$44.3 million and \$73.9 million during the three months ended March 31, 2011 and 2010, respectively. The following table shows the net favorable reserve development of \$44.3 million by loss year for each of our segments for the three months ended March 31, 2011. In the table, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

Table of Contents

**Loss Reserve Development by Loss Year
For the Three Months Ended March 31, 2011**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | Total |
|-------------------------|------------------|----------|----------|-----------|---------|-----------|----------|-----------|--------|-----------|
| | (\$ in millions) | | | | | | | | | |
| U.S. insurance | \$ (0.1) | \$ (0.8) | \$ (1.7) | \$ (5.9) | \$ 25.0 | \$ 0.1 | \$ (1.7) | \$ (1.1) | \$ 8.4 | \$ 22.2 |
| International insurance | 1.5 | (2.7) | 1.9 | (17.2) | (4.3) | (7.8) | 3.6 | (1.4) | (2.2) | (28.6) |
| Reinsurance | | (2.1) | (2.6) | (11.8) | (5.9) | (3.3) | (2.4) | (8.8) | (1.0) | (37.9) |
| | \$ 1.4 | \$ (5.6) | \$ (2.4) | \$ (34.9) | \$ 14.8 | \$ (11.0) | \$ (0.5) | \$ (11.3) | \$ 5.2 | \$ (44.3) |

The net favorable reserve development is a result of actual loss emergence being lower than anticipated. The unfavorable reserve development of \$25.0 million in our U.S. insurance segment for the 2006 loss year was primarily due to directors and officers claims within our professional liability line of business related to a class action suit filed against a number of private equity firms alleging collusion.

The following table shows the favorable reserve development of \$73.9 million by loss year for each of our segments for the three months ended March 31, 2010.

**Loss Reserve Development by Loss Year
For the Three Months Ended March 31, 2010**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
|-------------------------|------------------|----------|-----------|-----------|-----------|----------|--------|----------|-----------|
| | (\$ in millions) | | | | | | | | |
| U.S. insurance | \$ (0.4) | \$ (1.0) | \$ (7.6) | \$ (2.5) | \$ 0.3 | \$ 2.1 | \$ 4.8 | \$ 0.7 | \$ (3.6) |
| International insurance | | (2.2) | (20.0) | (28.9) | (10.0) | (4.5) | 7.4 | 0.6 | (57.6) |
| Reinsurance | (0.8) | 0.3 | (3.0) | (3.9) | (0.4) | (0.9) | (2.5) | (1.5) | (12.7) |
| | \$ (1.2) | \$ (2.9) | \$ (30.6) | \$ (35.3) | \$ (10.1) | \$ (3.3) | \$ 9.7 | \$ (0.2) | \$ (73.9) |

The loss and loss expense ratio for the three months ended March 31, 2011 was 90.9% compared to 68.6% for the three months ended March 31, 2010. Net favorable reserve development recognized during the three months ended March 31, 2011 reduced the loss and loss expense ratio by 13.2 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 104.1%. Net favorable reserve development recognized and the impact of the commutation during the three months ended March 31, 2010 reduced the loss and loss expense ratio by 21.8 percentage points. Thus, the loss and loss expense ratio related to that loss year was 90.4%. The increase in the loss and loss expense ratio for the current loss year was primarily due to the \$132.2 million of losses from global catastrophes during the three months ended March 31, 2011, as previously discussed, which contributed 39.5 percentage points to the current year's loss and loss expense ratio.

The following table shows the components of the increase in net losses and loss expenses of \$72.3 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010.

| | Three Months Ended March 31, | | Dollar Change |
|--------------------------------------|---|-------------|--------------------------|
| | 2011 | 2010 | |
| | (\$ in millions) | | |
| Net losses paid | \$ 136.0 | \$ 136.0 | \$ |
| Net change in reported case reserves | 112.3 | 6.2 | 106.1 |

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| | | | |
|------------------------------|----------|----------|---------|
| Net change in IBNR | 56.1 | 89.9 | (33.8) |
| Net losses and loss expenses | \$ 304.4 | \$ 232.1 | \$ 72.3 |

-40-

Table of Contents

The table below is a reconciliation of the beginning and ending reserves for losses and loss expenses for the three months ended March 31, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoverables.

| | Three Months Ended March 31, | |
|---|---|-------------------|
| | 2011 | 2010 |
| | (\$ in millions) | |
| Net reserves for losses and loss expenses, January 1 | \$ 3,951.6 | \$ 3,841.8 |
| Included related to: | | |
| Commutation of variable-rated reinsurance contracts | | 8.9 |
| Current period non-catastrophe | 216.5 | 232.1 |
| Current period property catastrophe | 132.2 | 65.0 |
| Prior period non-catastrophe | (35.3) | (72.9) |
| Prior period property catastrophe | (9.0) | (1.0) |
| Total incurred | \$ 304.4 | \$ 232.1 |
| Paid related to: | | |
| Current period non-catastrophe | 1.6 | 6.3 |
| Current period property catastrophe | | 0.4 |
| Prior period non-catastrophe | 128.3 | 123.4 |
| Prior period property catastrophe | 6.1 | 5.9 |
| Total paid | \$ 136.0 | \$ 136.0 |
| Foreign exchange revaluation | 5.1 | (5.0) |
| Net reserve for losses and loss expenses, March 31 | 4,125.1 | 3,932.9 |
| Losses and loss expenses recoverable | 975.5 | 920.5 |
| Reserve for losses and loss expenses, March 31 | \$ 5,100.6 | \$ 4,853.4 |

Acquisition Costs

Acquisition costs decreased by \$2.8 million, or 6.8%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The decrease in acquisition costs was primarily due to a change in the business mix for our reinsurance segment where we wrote a larger percentage of excess-of-loss contracts that carry lower acquisition costs than quota share contracts. Acquisition costs as a percentage of net premiums earned were 11.4% for the three months ended March 31, 2011 compared to 12.1% for the same period in 2010.

General and Administrative Expenses

General and administrative expenses increased by \$4.6 million, or 7.3%, for the three months ended March 31, 2011 compared to the same period in 2010. The increase in general and administrative expenses was primarily due to an increase in global headcount from 664 at March 31, 2010 to 686 at March 31, 2011 resulting in an overall increase in salary and related costs of \$1.9 million offset by a decrease in stock compensation expense. We also incurred approximately \$1.8 million in costs during the quarter related to the operations of Syndicate 2232, and we incurred an increase of approximately \$1.5 million in building related expenses as a result of the expansion of several of our offices.

Our general and administrative expense ratio was 20.3% for the three months ended March 31, 2011, which was higher than the 18.8% for the three months ended March 31, 2010. The increase was primarily due to the factors discussed above.

Our expense ratio was 31.7% for the three months ended March 31, 2011 compared to 30.9% for the three months ended March 31, 2010 primarily due to an increase in the general and administrative expense ratio.

Amortization and Impairment of Intangible Assets

The amortization and impairment of intangible assets decreased \$0.1 million, or 11.1%, for the three months ended March 31, 2011 compared the three months ended March 31, 2010. The decrease was due to the non-compete covenants related to the acquisition

-41-

Table of Contents

of Darwin being fully amortized during 2010. No impairment of intangible assets was recognized during the three months ended March 31, 2011 and March 31, 2010, respectively.

Interest Expense

Interest expense increased \$4.2 million, or 44.2%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 primarily as a result of additional interest expense on our 5.50% senior notes that were issued by Allied World Bermuda in November 2010.

Net Income

Net income for the three months ended March 31, 2011 was \$8.6 million compared to \$133.7 million for the three months ended March 31, 2010. The decrease was primarily the result of higher net loss and loss expenses. Net income for the three months ended March 31, 2011 included a net foreign exchange gain of \$0.4 million and an income tax expense of \$2.3 million. Net income for the three months ended March 31, 2010 included a net foreign exchange loss of \$1.1 million and an income tax expense of \$3.2 million.

Underwriting Results by Operating Segments

Our company is organized into three operating segments:

U.S. Insurance Segment. The U.S. insurance segment includes our direct specialty insurance operations in the United States. This segment provides both direct property and specialty casualty insurance primarily to non-Fortune 1000 North American domiciled accounts.

International Insurance Segment. The international insurance segment includes our direct insurance operations in Bermuda, Europe, Singapore and Hong Kong. This segment provides both direct property and casualty insurance primarily to Fortune 1000 North American domiciled accounts and mid-sized to large non-North American domiciled accounts.

Reinsurance Segment. Our reinsurance segment has operations in Bermuda, Europe, Singapore and the United States. This segment includes the reinsurance of property, general casualty, professional liability, specialty lines and property catastrophe coverages written by insurance companies. We presently write reinsurance on both a treaty and a facultative basis, targeting several niche reinsurance markets.

-42-

Table of Contents**U.S. Insurance Segment**

The following table summarizes the underwriting results and associated ratios for the U.S. insurance segment for the three months ended March 31, 2011 and 2010.

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions) | |
| Revenues | | |
| Gross premiums written | \$183.3 | \$162.1 |
| Net premiums written | 139.9 | 131.6 |
| Net premiums earned | 135.5 | 129.2 |
| Other income | | 0.3 |
| Expenses | | |
| Net losses and loss expenses | \$115.8 | \$ 98.4 |
| Acquisition costs | 18.1 | 17.0 |
| General and administrative expenses | 30.8 | 27.1 |
| Underwriting loss | (29.2) | (13.0) |
| Ratios | | |
| Loss and loss expense ratio | 85.5% | 76.2% |
| Acquisition cost ratio | 13.4% | 13.1% |
| General and administrative expense ratio | 22.7% | 21.0% |
| Expense ratio | 36.1% | 34.1% |
| Combined ratio | 121.6% | 110.3% |

Comparison of Three Months Ended March 31, 2011 and 2010

Premiums. Gross premiums written increased by \$21.2 million, or 13.1%, for the three months ended March 31, 2011 compared to the same period in 2010. The increase in gross premiums written was primarily due to higher volume from new products, specifically in our general casualty and environmental lines of business, where we believe profitable underwriting opportunities exist. The increase was partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition, particularly in our healthcare and general property lines of business.

The table below illustrates our gross premiums written by line of business for the three months ended March 31, 2011 and 2010.

| | Three Months Ended March 31, | | Dollar Change | Percentage Change |
|------------------------------|---|-------------|--------------------------|------------------------------|
| | 2011 | 2010 | | |
| | (\$ in millions) | | | |
| Professional liability(1) | \$ 55.0 | \$ 45.3 | \$ 9.7 | 21.4% |
| Healthcare | 45.3 | 47.5 | (2.2) | (4.6) |
| General casualty Programs | 41.0 | 28.0 | 13.0 | 46.4 |
| General property | 19.9 | 24.8 | (4.9) | (19.8) |
| Other | 13.6 | 16.5 | (2.9) | (17.6) |
| | 8.5 | | 8.5 | n/a* |
| | \$ 183.3 | \$ 162.1 | \$ 21.2 | 13.1% |

* n/a: not applicable

(1) Includes our *i-bind* line of business

Net premiums written increased by \$8.3 million, or 6.3%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase in net premiums written was due to higher gross premiums written. We ceded 23.7% of gross premiums written for the three months ended March 31, 2011 compared to 18.8% for the same period in 2010. The increase in the ceded premium ratio was primarily due to the commutation of certain variable-rated reinsurance contracts with swing-rated provisions of \$9.3 million during the three months ended March 31, 2010.

-43-

Table of Contents

Net premiums earned increased \$6.3 million, or 4.9%, for the three months ended March 31, 2011 compared to the same period in 2010 primarily due to the growth of our U.S. insurance operations during 2010, partially offset by the \$9.3 million commutation during the three months ended March 31, 2010, which was fully earned.

Net losses and loss expenses. Net losses and loss expenses increased by \$17.4 million, or 17.7%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase in net losses and loss expenses was primarily due to unfavorable prior year reserve development in the 2006 loss year related to directors and officers claims within our professional liability line of business related to a class action suit filed against a number of private equity firms alleging collusion. In addition, there were increased property losses of \$3.6 million as a result of winter storms in the U.S. Midwest and Northeast.

Overall, our U.S. insurance segment recorded net unfavorable reserve development of \$22.2 million during the three months ended March 31, 2011 compared to net favorable reserve development of \$3.6 million for the three months ended March 31, 2010, as shown in the tables below. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

| | Loss Reserve Development by Loss Year For the Three Months Ended March 31, 2011 | | | | | | | | | |
|---------------------------|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | Total |
| | (\$ in millions) | | | | | | | | | |
| Professional liability | \$ | \$ | \$ (0.1) | \$ (0.7) | \$ 24.3 | \$ (0.2) | \$ 0.4 | \$ (1.6) | \$ 6.3 | \$ 28.4 |
| Healthcare | (0.1) | (0.5) | (0.5) | 1.0 | 0.6 | 0.3 | (1.1) | 0.5 | 0.1 | 0.3 |
| General casualty | | (0.3) | (0.8) | (5.6) | | | | | | (6.7) |
| General property Programs | | | (0.3) | (0.6) | 0.1 | | (1.1) | (0.3) | 1.2 | (1.0) |
| | | | | | | | 0.1 | 0.3 | 0.8 | 1.2 |
| | \$ (0.1) | \$ (0.8) | \$ (1.7) | \$ (5.9) | \$ 25.0 | \$ 0.1 | \$ (1.7) | \$ (1.1) | \$ 8.4 | \$ 22.2 |

| | Loss Reserve Development by Loss Year For the Three Months Ended March 31, 2010 | | | | | | | | |
|---------------------------|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
| | (\$ in millions) | | | | | | | | |
| Professional liability | \$ | \$ | \$ (0.5) | \$ (0.2) | \$ (0.1) | \$ 0.4 | \$ 0.9 | \$ | \$ 0.5 |
| Healthcare | (0.4) | (0.4) | (0.7) | (1.7) | 0.4 | | 1.0 | | (1.8) |
| General casualty | | (0.6) | (6.4) | | | (1.0) | 3.6 | | (4.4) |
| General property Programs | | | | (0.6) | | 1.7 | (1.0) | | 0.1 |
| | | | | | | 1.0 | 0.3 | 0.7 | 2.0 |
| | \$ (0.4) | \$ (1.0) | \$ (7.6) | \$ (2.5) | \$ 0.3 | \$ 2.1 | \$ 4.8 | \$ 0.7 | \$ (3.6) |

The loss and loss expense ratio for the three months ended March 31, 2011 was 85.5% compared to 76.2% for the three months ended March 31, 2010. Net unfavorable reserve development recognized during the three months ended March 31, 2011 increased the loss and loss expense ratio by 16.4 percentage points. Thus, the loss and loss expense ratio for the current loss year was 69.1%. In comparison, net favorable reserve development and the impact of the commutation adjustment to ceded IBNR recognized in the three months ended March 31, 2010 decreased the loss and loss expense ratio by 1.5 percentage points. Thus, the loss and loss expense ratio for that loss year was 77.7%. The decrease in the loss and loss expense ratio was primarily due to a \$12.0 million net loss on a Connecticut power plant explosion during the three months ended March 31, 2010.

Table of Contents

The table below is a reconciliation of the beginning and ending reserves for losses and loss expenses for the three months ended March 31, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoverables.

| | Three Months Ended March 31, | |
|---|---|-------------------|
| | 2011 | 2010 |
| | (\$ in millions) | |
| Net reserves for losses and loss expenses, January 1 | \$ 1,035.1 | \$ 901.9 |
| Included related to: | | |
| Commutation of variable-rated reinsurance contracts | | 8.9 |
| Current period non-catastrophe | 93.6 | 93.1 |
| Current period property catastrophe | | |
| Prior period non-catastrophe | 23.8 | (3.4) |
| Prior period property catastrophe | (1.6) | (0.2) |
| Total incurred | \$ 115.8 | \$ 98.4 |
| Paid related to: | | |
| Current period non-catastrophe | 0.5 | 0.7 |
| Current period property catastrophe | | |
| Prior period non-catastrophe | 40.5 | 28.0 |
| Prior period property catastrophe | | (0.3) |
| Total paid | \$ 41.0 | \$ 28.4 |
| Net reserve for losses and loss expenses, March 31 | 1,109.9 | 971.9 |
| Losses and loss expenses recoverable | 425.8 | 365.9 |
| Reserve for losses and loss expenses, March 31 | \$ 1,535.7 | \$ 1,337.8 |

Acquisition costs. Acquisition costs increased by \$1.1 million, or 6.5%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase was primarily caused by increased net premiums earned. The acquisition cost ratio increased to 13.4% for the three months ended March 31, 2011 from 13.1% for the same period in 2010.

General and administrative expenses. General and administrative expenses increased by \$3.7 million, or 13.7%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase in the general and administrative expense ratio from 21.0% for the three months ended March 31, 2010 to 22.7% for the same period in 2011 was primarily due to the impact of the commutation on net premiums earned during the three months ended March 31, 2010. Excluding the impact of the commutation adjustment, the prior period ratio would have been 22.6%.

Table of Contents**International Insurance Segment**

The following table summarizes the underwriting results and associated ratios for the international insurance segment for the three months ended March 31, 2011 and 2010.

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions) | |
| Revenues | | |
| Gross premiums written | \$ 111.3 | \$ 121.4 |
| Net premiums written | 74.9 | 81.1 |
| Net premiums earned | 76.3 | 87.0 |
| Expenses | | |
| Net losses and loss expenses | \$ 71.2 | \$ 57.4 |
| Acquisition costs | (1.8) | 0.1 |
| General and administrative expenses | 20.7 | 21.8 |
| Underwriting (loss) income | (13.8) | 7.7 |
| Ratios | | |
| Loss and loss expense ratio | 93.3% | 66.0% |
| Acquisition cost ratio | (2.4%) | 0.1% |
| General and administrative expense ratio | 27.2% | 25.1% |
| Expense ratio | 24.8% | 25.2% |
| Combined ratio | 118.1% | 91.2% |

Comparison of Three Months Ended March 31, 2011 and 2010

Premiums. Gross premiums written decreased by \$10.1 million, or 8.3%, for the three months ended March 31, 2011 compared to the same period in 2010. The decrease in gross premiums written was due to the continued trend of the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition in our international insurance segment. The decrease includes the non-renewal of one general property policy which was previously written during the three months ended March 31, 2010 for \$5.1 million in addition to the non-renewal of several policies totaling \$5.0 million in our general casualty line of business.

The table below illustrates our gross premiums written by line of business for the three months ended March 31, 2011 and 2010.

| | Three Months Ended March 31, | | Dollar Change | Percentage Change |
|------------------------|---|-------------|--------------------------|------------------------------|
| | 2011 | 2010 | | |
| | (\$ in millions) | | | |
| General property | \$ 37.2 | \$ 39.7 | \$ (2.5) | (6.3)% |
| Professional liability | 28.9 | 27.2 | 1.7 | 6.3 |
| General casualty | 23.4 | 31.7 | (8.3) | (26.2) |
| Healthcare | 20.6 | 22.8 | (2.2) | (9.6) |
| Other | 1.2 | | 1.2 | n/a |
| | \$ 111.3 | \$ 121.4 | \$ (10.1) | (8.3)% |

Net premiums written decreased \$6.2 million, or 7.6%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The decrease in net premiums written was due to the decrease in gross

premiums written. We ceded to reinsurers 32.7% of gross premiums written for the three months ended March 31, 2011 compared to 33.2% for the three months ended March 31, 2010. Net premiums earned decreased \$10.7 million, or 12.3%, primarily due to lower net premiums written during 2010.

Net losses and loss expenses. Net losses and loss expenses increased by \$13.8 million, or 24.0%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase in net losses and loss expenses was due to higher loss activity in the current year, which included net losses and loss expenses incurred from the Australian storms and New Zealand earthquake of \$4.0 million and \$9.7 million, respectively, \$29.5 million related to the Tohoku earthquake and tsunami and lower net favorable prior year reserve development.

-46-

Table of Contents

Overall, our international insurance segment recorded net favorable reserve development of \$28.6 million during the three months ended March 31, 2011 compared to net favorable reserve development of \$57.6 million for the three months ended March 31, 2010, as shown in the tables below. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

| | Loss Reserve Development by Loss Year | | | | | | | | | |
|------------------------|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| | For the Three Months Ended March 31, 2011 | | | | | | | | | |
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | Total |
| | (\$ in millions) | | | | | | | | | |
| General property | \$ | \$ (0.1) | \$ (0.4) | \$ (2.0) | \$ 0.8 | \$ (0.1) | \$ (5.4) | \$ (8.6) | \$ (2.2) | \$ (18.0) |
| Professional liability | 2.0 | (1.0) | (2.5) | (4.3) | (8.1) | | 9.0 | | | (4.9) |
| General casualty | (0.5) | (1.3) | 5.2 | (10.4) | 11.3 | (7.7) | | 7.2 | | 3.8 |
| Healthcare | | (0.3) | (0.4) | (0.5) | (8.3) | | | | | (9.5) |
| | \$ 1.5 | \$ (2.7) | \$ 1.9 | \$ (17.2) | \$ (4.3) | \$ (7.8) | \$ 3.6 | \$ (1.4) | \$ (2.2) | \$ (28.6) |

| | Loss Reserve Development by Loss Year | | | | | | | | |
|------------------------|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| | For the Three Months Ended March 31, 2010 | | | | | | | | |
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total |
| | (\$ in millions) | | | | | | | | |
| General property | \$ | \$ (0.1) | \$ (0.3) | \$ (0.7) | \$ (5.3) | \$ (4.5) | \$ (3.9) | \$ 0.6 | \$ (14.2) |
| Professional liability | | (0.2) | (3.3) | (17.9) | | | | | (21.4) |
| General casualty | | (1.6) | (16.0) | (2.4) | (4.7) | | 11.3 | | (13.4) |
| Healthcare | | (0.3) | (0.4) | (7.9) | | | | | (8.6) |
| | \$ | \$ (2.2) | \$ (20.0) | \$ (28.9) | \$ (10.0) | \$ (4.5) | \$ 7.4 | \$ 0.6 | \$ (57.6) |

The loss and loss expense ratio for the three months ended March 31, 2011 was 93.3%, compared to 66.0% for the three months ended March 31, 2010. The net favorable reserve development recognized during the three months ended March 31, 2011 decreased the loss and loss expense ratio by 37.5 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 130.8%. Comparatively, the net favorable reserve development recognized during the three months ended March 31, 2010 decreased the loss and loss expense ratio by 66.2 percentage points. Thus, the loss and loss expense ratio related to that period's business was 132.2%. The decrease in the loss and loss expense ratio for the current loss year was primarily due to a decrease in catastrophe losses compared to the three months ended March 31, 2010, which included \$57.5 million related to the earthquakes in Haiti and Chile and contributed 66.1 percentage points to that year's loss and loss expense ratio. The \$43.2 million of losses from the Australian storms, New Zealand earthquake and Tohoku earthquake and tsunami during the three months ended March 31, 2011 contributed 56.6 percentage points to the current year's loss and loss expense ratio.

Table of Contents

The table below is a reconciliation of the beginning and ending reserves for losses and loss expenses for the three months ended March 31, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoverables.

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions) | |
| Net reserves for losses and loss expenses, January 1 | \$ 1,695.7 | \$ 1,790.1 |
| Incurring related to: | | |
| Current period non-catastrophe | 56.6 | 65.0 |
| Current period property catastrophe | 43.2 | 50.0 |
| Prior period non-catastrophe | (24.5) | (58.2) |
| Prior period property catastrophe | (4.1) | 0.6 |
| Total incurred | \$ 71.2 | \$ 57.4 |
| Paid related to: | | |
| Current period non-catastrophe | 0.6 | 5.6 |
| Current period property catastrophe | | |
| Prior period non-catastrophe | 46.9 | 56.0 |
| Prior period property catastrophe | 2.7 | 4.9 |
| Total paid | \$ 50.2 | \$ 66.5 |
| Foreign exchange revaluation | 5.1 | (5.0) |
| Net reserve for losses and loss expenses, March 31 | 1,721.8 | 1,776.0 |
| Losses and loss expenses recoverable | 549.1 | 553.3 |
| Reserve for losses and loss expenses, March 31 | \$ 2,270.9 | \$ 2,329.3 |

Acquisition costs. Acquisition costs decreased by \$1.9 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The negative cost represents ceding commissions received on ceded premiums in excess of the brokerage fees and commissions paid on gross premiums written. The acquisition cost ratio decreased from 0.1% for the three months ended March 31, 2010 to negative 2.4% for the three months ended March 31, 2011.

General and administrative expenses. General and administrative expenses decreased \$1.1 million, or 5.0%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The decrease in general and administrative expenses was primarily due to a decrease in stock-based compensation expense. The general and administrative expense ratios for the three months ended March 31, 2011 and 2010 were 27.2% and 25.1%, respectively. The increase was due to a lower decrease in general and administrative expenses compared to the decrease in net premiums earned.

Table of Contents**Reinsurance Segment**

The following table summarizes the underwriting results and associated ratios for the reinsurance segment for the three months ended March 31, 2011 and 2010.

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions) | |
| Revenues | | |
| Gross premiums written | \$266.1 | \$220.6 |
| Net premiums written | 266.0 | 220.6 |
| Net premiums earned | 123.1 | 122.1 |
| Expenses | | |
| Net losses and loss expenses | \$117.4 | \$ 76.3 |
| Acquisition costs | 21.8 | 23.8 |
| General and administrative expenses | 16.4 | 14.5 |
| Underwriting (loss) income | (32.5) | 7.5 |
| Ratios | | |
| Loss and loss expense ratio | 95.4% | 62.5% |
| Acquisition cost ratio | 17.7% | 19.5% |
| General and administrative expense ratio | 13.3% | 11.9% |
| Expense ratio | 31.0% | 31.4% |
| Combined ratio | 126.4% | 93.9% |

Comparison of Three Months Ended March 31, 2011 and 2010

Premiums. Gross premiums written increased by \$45.5 million, or 20.6%, for the three months ended March 31, 2011 compared to the same period in 2010. The increase in gross premiums written was primarily due to \$18.0 million of new business related to our new global marine and specialty division in our specialty reinsurance line of business, in addition to increased writings in our international reinsurance lines of business with the build out of our London and Singapore offices, including business written through Lloyd's Syndicate 2232. These increases were partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and higher net downward adjustments. Downward adjustments on estimated premiums were higher by \$3.7 million during the three months ended March 31, 2011 compared to same period in 2010.

During the three months ended March 31, 2011, our Bermuda, U.S., European and Singapore reinsurance operations had gross premiums written of \$97.4 million, \$123.4 million, \$30.4 million and \$14.9 million, respectively. During the three months ended March 31, 2010, our Bermuda, U.S., European and Singapore reinsurance operations had gross premiums written of \$80.3 million, \$113.7 million, 23.0, and \$3.6 million, respectively.

The table below illustrates our gross premiums written by line of business for the three months ended March 31, 2011 and 2010.

| | Three Months Ended March 31, | | Dollar Change | Percentage Change |
|-------------------------------|---|-------------|--------------------------|------------------------------|
| | 2011 | 2010 | | |
| | (\$ in millions) | | | |
| Property reinsurance | \$ 76.0 | \$ 60.6 | \$ 15.4 | 25.4% |
| International reinsurance | 58.2 | 41.1 | 17.1 | 41.6 |
| General casualty reinsurance* | 55.7 | 66.9 | (11.2) | (16.7) |
| Specialty reinsurance | 40.6 | 15.7 | 24.9 | 158.6 |

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| | | | | |
|------------------------------------|----------|----------|---------|-------|
| Professional liability reinsurance | 35.6 | 36.3 | (0.7) | (1.9) |
| | \$ 266.1 | \$ 220.6 | \$ 45.5 | 20.6% |

* Includes our facultative reinsurance line of business

Net premiums written increased by \$45.4 million, or 20.6%, which is consistent with the increase in gross premiums written. Net premiums earned increased \$1.0 million, or 0.8%, due to the increase in net premiums written. Premiums related to our reinsurance

-49-

Table of Contents

business earn at a slower rate than those related to our direct insurance business. Direct insurance premiums typically earn ratably over the term of a policy. Reinsurance premiums under a quota share reinsurance contract are typically earned over the same period as the underlying policies, or risks, covered by the contract. As a result, the earning pattern of a quota share reinsurance contract may extend up to 24 months, reflecting the inception dates of the underlying policies. Property catastrophe premiums and premiums for other treaties written on a losses occurring basis earn ratably over the term of the reinsurance contract.

Net losses and loss expenses. Net losses and loss expenses increased by \$41.1 million, or 53.9%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase in net losses and loss expenses was due to higher loss activity in the current year, which included net losses and loss expenses incurred from the Australian storms and New Zealand earthquake of \$15.0 million and \$28.5 million, respectively, \$45.5 million related to the Tohoku earthquake and tsunami, partially offset by higher net favorable prior year reserve development. The current year's losses were partially offset by higher net favorable prior year reserve development recognized during the three months ended March 31, 2011 compared to the same period in 2010.

Overall, our reinsurance segment recorded net favorable prior year reserve development of \$37.9 million and \$12.7 million during the three months ended March 31, 2011 and 2010, respectively, as shown in the tables below. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

| | Loss Reserve Development by Loss Year | | | | | | | | | |
|------------------------------------|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| | For the Three Months Ended March 31, 2011 | | | | | | | | | |
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | Total |
| | (\$ in millions) | | | | | | | | | |
| Property reinsurance | \$ | \$ (0.4) | \$ (0.1) | \$ (1.3) | \$ (1.0) | \$ (2.2) | \$ (1.6) | \$ (0.9) | \$ | \$ (7.5) |
| International reinsurance | | | (0.5) | (1.5) | (0.1) | (0.2) | (0.2) | (2.1) | (1.8) | (6.4) |
| General casualty reinsurance | (0.1) | (2.0) | (1.9) | (5.1) | (0.7) | (0.5) | (0.1) | | 2.8 | (7.6) |
| Professional liability reinsurance | 0.1 | 0.3 | (0.1) | (3.9) | (4.1) | (0.4) | (0.3) | | | (8.4) |
| Specialty reinsurance | | | | | | | (0.2) | (5.8) | (2.0) | (8.0) |
| | \$ | \$ (2.1) | \$ (2.6) | \$ (11.8) | \$ (5.9) | \$ (3.3) | \$ (2.4) | \$ (8.8) | \$ (1.0) | \$ (37.9) |

| | Loss Reserve Development by Loss Year | | | | | | | | | |
|------------------------------------|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|--|
| | For the Three Months Ended March 31, 2010 | | | | | | | | | |
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | Total | |
| | (\$ in millions) | | | | | | | | | |
| Property reinsurance | \$ | \$ | \$ (0.1) | \$ (1.3) | \$ | \$ | \$ 0.6 | \$ (1.5) | \$ (2.3) | |
| International reinsurance | (0.1) | (0.1) | (0.1) | (0.2) | | | | | (0.5) | |
| General casualty reinsurance | | 0.8 | (0.1) | (2.9) | (0.4) | | | | (2.6) | |
| Professional liability reinsurance | (0.7) | (0.4) | (2.7) | | | | | | (3.8) | |
| Specialty reinsurance | | | | 0.5 | | (0.9) | (3.1) | | (3.5) | |

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\$ (0.8) \$ 0.3 \$ (3.0) \$ (3.9) \$ (0.4) \$ (0.9) \$ (2.5) \$ (1.5) \$ (12.7)

The loss and loss expense ratio for the three months ended March 31, 2011 was 95.4%, compared to 62.5% for the three months ended March 31, 2010. Net favorable reserve development recognized during the three months ended March 31, 2011 reduced the loss and loss expense ratio by 30.8 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 126.2%. In comparison, net favorable reserve development recognized in the three months ended March 31, 2010 reduced the loss and loss expense ratio by 10.4 percentage points. Thus, the loss and loss expense ratio related to that loss year was 72.9%. The increase in the loss and loss expense ratio for the current loss year was primarily due to the \$89.0 million of losses from the Australian storms, New Zealand earthquake and Tohoku earthquake and tsunami during the three months ended March 31, 2011, discussed above, which contributed 72.3 percentage points to the loss and loss expense ratio for the three months ended March 31, 2011.

-50-

Table of Contents

The table below is a reconciliation of the beginning and ending reserves for losses and loss expenses for the three months ended March 31, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoverables.

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2011 | 2010 |
| | (\$ in millions) | |
| Net reserves for losses and loss expenses, January 1 | \$ 1,220.8 | \$ 1,149.8 |
| Incurred related to: | | |
| Current period non-catastrophe | 66.3 | 74.0 |
| Current period property catastrophe | 89.0 | 15.0 |
| Prior period non-catastrophe | (34.6) | (11.3) |
| Prior period property catastrophe | (3.3) | (1.4) |
| Total incurred | \$ 117.4 | \$ 76.3 |
| Paid related to: | | |
| Current period non-catastrophe | 0.5 | |
| Current period property catastrophe | | 0.4 |
| Prior period non-catastrophe | 40.9 | 39.4 |
| Prior period property catastrophe | 3.4 | 1.3 |
| Total paid | \$ 44.8 | \$ 41.1 |
| Net reserve for losses and loss expenses, March 31 | 1,293.4 | 1,185.0 |
| Losses and loss expenses recoverable | 0.6 | 1.3 |
| Reserve for losses and loss expenses, March 31 | \$ 1,294.0 | \$ 1,186.3 |

Acquisition costs. Acquisition costs decreased by \$2.0 million, or 8.4%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 primarily as a result of an increase in our excess-of-loss contracts that carry lower acquisition costs than quota share contracts. The acquisition cost ratio was 17.7% for the three months ended March 31, 2011, compared to 19.5% for the three months ended March 31, 2010.

General and administrative expenses. General and administrative expenses increased \$1.9 million, or 13.1%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase in general and administrative expenses was primarily due to an increase in salary and related costs in addition to professional fees related to the operation of Lloyd's Syndicate 2232. The general and administrative expense ratios for the three months ended March 31, 2011 and 2010 were 13.3% and 11.9%, respectively.

Reserves for Losses and Loss Expenses

Reserves for losses and loss expenses by segment as of March 31, 2011 and December 31, 2010 were comprised of the following:

| | U.S. Insurance | | International Insurance | | Reinsurance | | Total | |
|---------------|-------------------------|--------------------------|------------------------------------|--------------------------|-------------------------|--------------------------|-------------------------|--------------------------|
| | Mar 31, 2011 | Dec. 31, 2010 | Mar 31, 2011 | Dec. 31, 2010 | Mar 31, 2011 | Dec. 31, 2010 | Mar 31, 2011 | Dec. 31, 2010 |
| | (\$ in millions) | | | | | | | |
| Case reserves | \$ 356.2 | \$ 295.3 | \$ 502.7 | \$ 498.3 | \$ 426.9 | \$ 373.0 | \$ 1,285.8 | \$ 1,166.5 |
| IBNR | 1,179.5 | 1,136.4 | 1,768.2 | 1,728.4 | 867.1 | 847.8 | 3,814.8 | 3,712.7 |
| | 1,535.7 | 1,431.7 | 2,270.9 | 2,226.7 | 1,294.0 | 1,220.8 | 5,100.6 | 4,879.2 |

| | | | | | | | | |
|--|------------|------------|------------|------------|------------|------------|------------|------------|
| Reserve for losses and loss expenses | | | | | | | | |
| Reinsurance recoverables | (425.8) | (396.6) | (549.1) | (531.0) | (0.6) | | (975.5) | (927.6) |
| Net reserve for losses and loss expenses | \$ 1,109.9 | \$ 1,035.1 | \$ 1,721.8 | \$ 1,695.7 | \$ 1,293.4 | \$ 1,220.8 | \$ 4,125.1 | \$ 3,951.6 |

We participate in certain lines of business where claims may not be reported for many years. Accordingly, management does not solely rely upon reported claims on these lines for estimating ultimate liabilities. We also use statistical and actuarial methods to estimate expected ultimate losses and loss expenses. Loss reserves do not represent an exact calculation of liability. Rather, loss reserves are estimates of what we expect the ultimate resolution and administration of claims will cost. These estimates are based on various factors including underwriters' expectations about loss experience, actuarial analysis, comparisons with the results of industry benchmarks and loss experience to date. Loss reserve estimates are refined as experience develops and as claims are reported and resolved. Establishing an appropriate level of loss reserves is an inherently uncertain process. Ultimate losses and loss expenses may differ from our reserves, possibly by material amounts.

-51-

Table of Contents

The following tables provide our ranges of loss and loss expense reserve estimates by business segment as of March 31, 2011:

| | Reserve for Losses and Loss Expenses Gross of Reinsurance Recoverable(1) | | |
|-------------------------|---|-------------------------|--------------------------|
| | Carried Reserves | Low Estimate | High Estimate |
| | (\$ in millions) | | |
| U.S. insurance | \$ 1,535.7 | \$ 1,241.8 | \$ 1,665.6 |
| International insurance | 2,270.9 | 1,716.1 | 2,552.6 |
| Reinsurance | 1,294.0 | 1,007.1 | 1,534.0 |

| | Reserve for Losses and Loss Expenses Net of Reinsurance Recoverable(2) | | |
|-------------------------|---|-------------------------|--------------------------|
| | Carried Reserves | Low Estimate | High Estimate |
| | (\$ in millions) | | |
| U.S. insurance | \$ 1,109.9 | \$ 891.1 | \$ 1,202.8 |
| International insurance | 1,721.8 | 1,303.0 | 1,942.7 |
| Reinsurance | 1,293.4 | 1,006.6 | 1,532.7 |

(1) For statistical reasons, it is not appropriate to add together the ranges of each business segment in an effort to determine the low and high range around the consolidated loss reserves. On a gross basis, the consolidated low estimate is \$4,226.8 million and the consolidated high estimate is \$5,490.4 million.

(2) For statistical reasons, it is not appropriate to add together the ranges of each business segment in an effort to determine the low and high range around the consolidated loss reserves. On a net basis, the consolidated low estimate is \$3,417.1 million and the consolidated high estimate is \$4,461.7 million.

Our range for each business segment was determined by utilizing multiple actuarial loss reserving methods along with various assumptions of reporting patterns and expected loss ratios by loss year. The various outcomes of these techniques were combined to determine a reasonable range of required loss and loss expense reserves. While we believe our approach to determine the range of loss and loss expense is reasonable, there are no assurances that actual loss experience will be within the ranges of loss and loss expense noted above.

Our selection of the actual carried reserves is generally above the midpoint of the range. We believe that we should be prudent in our reserving practices due to the lengthy reporting patterns and relatively large limits of net liability for any one risk of our direct excess casualty business and of our casualty reinsurance business. Thus, due to this uncertainty regarding estimates for reserve for losses and loss expenses, we have carried our consolidated reserve for losses and loss expenses, net of reinsurance recoverable, above the midpoint of the low and high estimates for the consolidated net losses and loss expenses. We believe that relying on the more prudent actuarial indications is appropriate for these lines of business.

Reinsurance Recoverable

The following table illustrates our reinsurance recoverable as of March 31, 2011 and December 31, 2010:

| Reinsurance Recoverable | |
|---|--|
| As of March 31, 2011 | As of December 31, 2010 |
| (\$ in millions) | |

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| | | |
|-------------------------|----------|----------|
| Ceded case reserves | \$ 208.0 | \$ 206.2 |
| Ceded IBNR reserves | 767.5 | 721.4 |
| Reinsurance recoverable | \$ 975.5 | \$ 927.6 |

We remain obligated for amounts ceded in the event our reinsurers do not meet their obligations. Accordingly, we have evaluated the reinsurers that are providing reinsurance protection to us and will continue to monitor their credit ratings and financial stability. We generally have the right to terminate our treaty reinsurance contracts at any time, upon prior written notice to the reinsurer, under specified circumstances, including the assignment to the reinsurer by A.M. Best of a financial strength rating of less than A-. Approximately 95% of ceded reserves as of March 31, 2011 were recoverable from reinsurers who had an A.M. Best rating of A- or higher.

-52-

Table of Contents

Liquidity and Capital Resources

General

As of March 31, 2011, our shareholders' equity was \$3.0 billion, a 4.1% decrease compared to \$3.1 billion as of December 31, 2010. The decrease was primarily the result of our share and warrant repurchase activities of \$113.6 million during the three months ended March 31, 2011.

On November 26, 2010, we received approval from the Supreme Court of Bermuda to change the place of incorporation of our ultimate parent company from Bermuda to Switzerland (the "Redomestication"), and on December 1, 2010 we completed the Redomestication. Our ultimate parent company is now Holdings and Allied World Bermuda is a wholly-owned subsidiary of Holdings.

Holdings is a holding company and transacts no business of its own. Cash flows to Holdings may comprise dividends, advances and loans from its subsidiary companies. Holdings is therefore reliant on receiving dividends and other permitted distributions from its subsidiaries to make dividend payments on its common shares. Under Swiss law, distributions to shareholders may be paid out only if the company has sufficient distributable profits from previous fiscal years, or if the company has freely distributable reserves, each as presented on the audited annual stand-alone statutory balance sheet. Distributions to shareholders out of the share and participation capital may be made by way of a capital reduction in the form of a reduction in the par value of the common shares to achieve a similar result as the payment of a dividend.

Allied World Bermuda is a holding company and transacts no business of its own. Cash flows to Allied World Bermuda may comprise dividends, advances and loans from its subsidiary companies. Allied World Bermuda is therefore reliant on receiving dividends and other permitted distributions from its subsidiaries to make principal and interest payments on its senior notes.

Capital Activities

In May 2010, the company established a share repurchase program in order to repurchase Holdings' common shares. Repurchases under the authorization may be effected from time to time through open market purchases, privately negotiated transactions, and tender offers or otherwise. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the company's capital position, legal requirements and other factors. The terms of any privately negotiated repurchase under the share repurchase program will be at a price equal to or at a discount to the fair market value of the Company's common shares at the time of such repurchase. Fair market value will be based on the closing price of the common shares on a specific date (or series of dates) or based on a volume weighted average share price over a certain period. As part of the share repurchase program, we may enter into a rule 10b5-1 repurchase plan that will enable us to complete share repurchases during trading blackout periods. During the three months ended March 31, 2011, we repurchased through open-market purchases 969,163 shares at a total cost of \$60.0 million, for an average price of \$61.91 per share. We have classified these repurchased shares as treasury shares, at cost on the consolidated balance sheets.

In November 2010, Allied World Bermuda issued \$300 million senior notes due in 2020. The senior notes bear interest at an annual rate of 5.50% per year and were priced to yield 5.56%. Interest on the senior notes is payable semi-annually on May 15 and November 15 of each year commencing on May 15, 2011. The net proceeds from the offering of the senior notes were used for general corporate purposes, including the repurchase of the company's outstanding common shares. The senior notes are the company's unsecured and unsubordinated obligations and rank equally in right of payment with all existing and future unsecured and unsubordinated indebtedness. We may redeem the senior notes at any time or from time to time in whole or in part at a redemption price equal to the greater of the principal amount of the senior notes to be redeemed or a make-whole price, plus accrued and unpaid interest. The senior notes includes covenants and events of default that are usual and customary, but do not contain any financial covenants. In addition, these senior notes as well as the senior notes issued in 2006 have been unconditionally and irrevocably guaranteed for the payment of the principal and interest by Holdings.

In February 2011, we repurchased a warrant owned by American International Group, Inc. ("AIG") in a privately negotiated transaction. The warrant entitled AIG to purchase 2,000,000 of our common shares for \$34.20 per share. We repurchased the warrant for an aggregate purchase price of \$53.6 million. The repurchase of the warrant was recognized as a reduction in additional paid-in capital in the consolidated balance sheets. The repurchase was executed

separately from the company's share repurchase program.

Table of Contents

We believe our company's capital position continues to remain well within the range needed for our business requirements and we have sufficient liquidity to fund our ongoing operations.

Restrictions and Specific Requirements

The jurisdictions in which our operating subsidiaries are licensed to write business impose regulations requiring companies to maintain or meet various defined statutory ratios, including solvency and liquidity requirements. Some jurisdictions also place restrictions on the declaration and payment of dividends and other distributions.

The payment of dividends from Holdings' Bermuda domiciled operating subsidiary is, under certain circumstances, limited under Bermuda law, which requires our Bermuda operating subsidiary to maintain certain measures of solvency and liquidity. Holdings' U.S. domiciled operating subsidiaries are subject to significant regulatory restrictions limiting their ability to declare and pay dividends. In particular, payments of dividends by Allied World Assurance Company (U.S.) Inc., Allied World National Assurance Company, Allied World Reinsurance Company, Darwin National Assurance Company, Darwin Select Insurance Company and Vantapro Specialty Insurance Company are subject to restrictions on statutory surplus pursuant to the respective states in which these insurance companies are domiciled. Each state requires prior regulatory approval of any payment of extraordinary dividends. In addition, Allied World Assurance Company, AG is subject to Swiss financial and regulatory restrictions limiting its ability to declare and pay dividends and Allied World Assurance Company (Europe) Limited and Allied World Assurance Company (Reinsurance) Limited are subject to regulatory restrictions limiting their ability to declare and pay any dividends without the consent of the Central Bank of Ireland. We also have branch operations in Canada, Hong Kong and Singapore, which have regulatory restrictions limiting their ability to declare and pay dividends. We also have insurance subsidiaries that are the parent company for other insurance subsidiaries, which means that dividends and other distributions will be subject to multiple layers of regulations in order to dividend funds to Holdings. The inability of the subsidiaries of Holdings to pay dividends and other permitted distributions could have a material adverse effect on Holdings' cash requirements and our ability to make principal, interest and dividend payments on the senior notes and common shares.

Holdings' operating subsidiary in Bermuda, Allied World Assurance Company, Ltd, is neither licensed nor admitted as an insurer, nor is it accredited as a reinsurer, in any jurisdiction in the United States. As a result, it is generally required to post collateral security with respect to any reinsurance liabilities it assumes from ceding insurers domiciled in the United States in order for U.S. ceding companies to obtain credit on their U.S. statutory financial statements with respect to insurance liabilities ceded to them. Under applicable statutory provisions, the security arrangements may be in the form of letters of credit, reinsurance trusts maintained by trustees or funds-withheld arrangements where assets are held by the ceding company.

Allied World Assurance Company, Ltd uses trust accounts primarily to meet security requirements for inter-company and certain reinsurance transactions. We also have cash and cash equivalents and investments on deposit with various state or government insurance departments or pledged in favor of ceding companies in order to comply with relevant insurance regulations. In addition, Allied World Assurance Company, Ltd currently has access to up to \$1.7 billion in letters of credit under two letter of credit facilities, \$900 million with Citibank Europe plc and \$800 million with a syndication of lenders described below. These facilities are used to provide security to reinsureds and are collateralized by us, at least to the extent of letters of credit outstanding at any given time. The letters of credit issued under the credit facility with Citibank Europe plc are deemed to be automatically extended without amendment for twelve months from the expiry date, or any future expiration date unless at least 30 days prior to any expiration date Citibank Europe plc notifies us that they elect not to consider the letters of credit renewed for any such additional period. If Citibank Europe plc no longer provides capacity under the credit facility it may limit our ability to meet our security requirements and would require us to obtain other sources of security at terms that may not be favorable to us.

In November 2007, we entered into an \$800 million five-year senior credit facility (the "Credit Facility") with a syndication of lenders. The Credit Facility consists of a \$400 million secured letter of credit facility for the issuance of standby letters of credit (the "Secured Facility") and a \$400 million unsecured facility for the making of revolving loans and for the issuance of standby letters of credit (the "Unsecured Facility"). Both the Secured Facility and the Unsecured Facility have options to increase the aggregate commitments by up to \$200 million, subject to approval of the lenders. The Credit Facility will be used for general corporate purposes and to issue standby letters of credit. The Credit

Facility contains representations, warranties and covenants customary for similar bank loan facilities, including a covenant to maintain a ratio of consolidated indebtedness to total capitalization as of the last day of each fiscal quarter or fiscal year of not greater than 0.35 to 1.0 and a covenant under the Unsecured Facility to maintain a certain consolidated net worth. In addition, each material insurance subsidiary must maintain a financial strength rating from A.M. Best Company of at least A- under the Unsecured Facility and of at least B++ under the Secured Facility. As of March 31, 2011 we had a consolidated indebtedness to total capitalization of 0.22 to 1.0 and all of our subsidiaries had a financial strength rating from A.M. Best of A. The Unsecured Facility required a minimum net worth as of March 31, 2011 of \$1.4 billion and our net worth as calculated according to the Unsecured Facility was \$2.9 billion as of March 31, 2011. Based on the results of these financial calculations, we were in compliance with all covenants under the Credit Facility as of March 31, 2011.

-54-

Table of Contents

There are a total of 13 lenders that make up the Credit Facility syndication and they have varying commitments ranging from \$20.0 million to \$87.5 million. Of the 13 lenders, four have commitments of \$87.5 million each, four have commitments of \$62.5 million each, four have commitments of \$45.0 million each and one has a commitment of \$20.0 million.

In May 2010, Allied World Capital (Europe) Limited established an irrevocable standby letter of credit in order to satisfy funding requirements of our Lloyd's Syndicate 2232. As of March 31, 2011, the amount of the letter of credit was £53.7 million (\$86.3 million).

Security arrangements with ceding insurers may subject our assets to security interests or require that a portion of our assets be pledged to, or otherwise held by, third parties. Both of our letter of credit facilities are fully collateralized by assets held in custodial accounts at the Bank of New York Mellon held for the benefit of the banks. Although the investment income derived from our assets while held in trust accrues to our benefit, the investment of these assets is governed by the terms of the letter of credit facilities or the investment regulations of the state or territory of domicile of the ceding insurer, which may be more restrictive than the investment regulations applicable to us under Bermuda law. The restrictions may result in lower investment yields on these assets, which may adversely affect our profitability.

The following shows our trust accounts on deposit, as well as outstanding and remaining letter of credit facilities and the collateral committed to support the letter of credit facilities as of March 31, 2011 and December 31, 2010:

| | As of March 31, 2011 | As of December 31, 2010 |
|---|---|--|
| | (\$ in millions) | |
| Total trust accounts on deposit | \$ 1,479.1 | \$ 1,657.4 |
| Total letter of credit facilities: | | |
| Citibank Europe plc | 900.0 | 900.0 |
| Credit Facility | 800.0 | 800.0 |
| Total letter of credit facilities | 1,700.0 | 1,700.0 |
| Total letter of credit facilities outstanding: | | |
| Citibank Europe plc | 690.4 | 689.8 |
| Credit Facility | 159.0 | 159.0 |
| Total letter of credit facilities outstanding | 849.4 | 848.8 |
| Total letter of credit facilities remaining: | | |
| Citibank Europe plc | 209.6 | 210.2 |
| Credit Facility(1) | 641.0 | 641.0 |
| Total letter of credit facilities remaining | 850.6 | 851.2 |
| Collateral committed to support the letter of credit facilities | \$1,064.4 | \$ 1,121.3 |

(1) Net of any borrowing or repayments under the Unsecured Facility.

As of March 31, 2011, we had a combined unused letter of credit capacity of \$850.6 million from the Credit Facility and Citibank Europe plc. We believe that this remaining capacity is sufficient to meet our future letter of credit needs.

We do not currently anticipate that the restrictions on liquidity resulting from restrictions on the payment of dividends by our subsidiary companies or from assets committed in trust accounts or to collateralize the letter of credit facilities will have a material impact on our ability to carry out our normal business activities, including interest and dividend payments, respectively, on our senior notes and common shares.

Sources and Uses of Funds

Our sources of funds primarily consist of premium receipts net of commissions, investment income, net proceeds from capital raising activities that may include the issuance of common shares, senior notes and other debt or equity issuances, and proceeds from sales and redemption of investments. Cash is used primarily to pay losses and loss expenses, purchase reinsurance, pay general and administrative expenses and taxes, and pay dividends and interest, with the remainder made available to our investment portfolio managers for investment in accordance with our investment policy.

Cash flows from operating activities for the three months ended March 31, 2011 were \$174.9 million compared to \$85.3 million for the three months ended March 31, 2010. The increase in cash flows from operations for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 was primarily due to \$69.3 million of cash received on funds withheld balances.

Table of Contents

The funds held balance can be used by the cedent to pay claims, if any. Any balance remaining after the expiry of the reinsurance treaty is returned to us.

Cash flows from investing activities consist primarily of proceeds on the sale of investments and payments for investments acquired in addition to an increase in restricted cash. We had net cash used in investing activities of \$128.9 million for the three months ended March 31, 2011 compared to net cash flows from investing activities of \$72.5 million for the three months ended March 31, 2010. The increase in cash flows used in investing activities reflects additional investment of the Company's operating cash flow.

Cash flows used in financing activities consist primarily of capital raising activities, which include the issuance of common shares or debt and the payment of dividends or the repayment of debt. Cash flows used in financing activities were \$110.4 million for three months ended March 31, 2011 compared to cash flows from financing activities of \$2.7 million for the three months ended March 31, 2010. The increase in cash flows used in financing activities was due to the repurchase of the founder warrant and common shares of \$113.6 million.

In November 2010, the Board of Directors declared a special dividend of \$0.25 per common share related to the Redomestication. This special dividend was paid on November 26, 2010 to shareholders of record on November 15, 2010. The Company's proposal to pay dividends in the form of a distribution by way of par value reductions was approved by its shareholders on May 5, 2011. The aggregate reduction amount will be paid to shareholders in quarterly installments of \$0.375 per share and the Company expects to distribute such dividends in August 2011, October 2011, January 2012 and April 2012. Dividend payments will be subject to Swiss law and other related factors described in the Company's 2011 Proxy Statement.

Our funds are primarily invested in liquid, high-grade fixed income securities. As of March 31, 2011 and December 31, 2010, 95.8% and 96.2%, respectively, of our fixed income portfolio consisted of investment grade securities. As of March 31, 2011 and December 31, 2010, net accumulated unrealized gains on our available for sale fixed maturity investments were \$33.0 million and \$57.1 million, respectively. The decrease in net unrealized gains was due to selling certain available for sale securities during the three months ended March 31, 2011 and reinvesting the proceeds in fixed maturity investments where mark-to-market changes are reflected in the consolidated statements of operations and comprehensive (loss) income. We expect this trend to continue for the remainder of 2011. The maturity distribution of our fixed income portfolio (on a fair value basis) as of March 31, 2011 and December 31, 2010 was as follows:

| | As of March 31, 2011 | As of December 31, 2010 |
|--|---|--|
| | (\$ in millions) | |
| Due in one year or less | \$ 280.1 | \$ 249.3 |
| Due after one year through five years | 3,012.6 | 3,119.9 |
| Due after five years through ten years | 793.3 | 867.9 |
| Due after ten years | 90.2 | 122.9 |
| Mortgage-backed | 1,702.6 | 1,751.9 |
| Asset-backed | 625.8 | 549.0 |
| Total | \$ 6,504.6 | \$ 6,660.9 |

We have investments in various hedge funds, the market value of which was \$470.0 million as of March 31, 2011. Each of the hedge funds has redemption notice requirements. For each of our hedge funds, liquidity is allowed after certain defined periods based on the terms of each hedge fund. See Note 4(d) Investments - Other Invested Assets to our unaudited condensed consolidated financial statements for additional details on our hedge fund investments.

We do not believe that inflation has had a material effect on our consolidated results of operations. The potential exists, after a catastrophe loss, for the development of inflationary pressures in a local economy. The effects of

inflation are considered implicitly in pricing. Loss reserves are established to recognize likely loss settlements at the date payment is made. Those reserves inherently recognize the effects of inflation. The actual effects of inflation on our results cannot be accurately known, however, until claims are ultimately resolved.

Financial Strength Ratings

Financial strength ratings represent the opinions of rating agencies on our capacity to meet our obligations. The rating agencies consider a number of quantitative and qualitative factors in determining an insurance company's financial strength ratings. Quantitative considerations of an insurance company include the evaluation of financial statements, historical operating results and, through the use of proprietary capital models, the measure of investment and insurance risks relative to capital. Among the qualitative considerations are management strength, business profile, market conditions and established risk management practices used, among other things, to manage risk exposures and limit capital volatility. Some of our reinsurance treaties contain special funding and

Table of Contents

termination clauses that are triggered in the event that we or one of our subsidiaries is downgraded by one of the major rating agencies to levels specified in the treaties, or our capital is significantly reduced. If such an event were to happen, we would be required, in certain instances, to post collateral in the form of letters of credit and/or trust accounts against existing outstanding losses, if any, related to the treaty. In a limited number of instances, the subject treaties could be cancelled retroactively or commuted by the cedent and might affect our ability to write business.

The following were the financial strength ratings of all of our operating insurance and reinsurance subsidiaries as of May 2, 2011, except as noted below:

| | |
|---------------------|-------------|
| A.M. Best | A/stable |
| Moody's* | A2/stable |
| Standard & Poor's** | A-/positive |

* Moody's financial strength ratings are for Allied World Assurance Company, Ltd, Allied World Assurance Company (U.S.) Inc., Allied World National Assurance Company and Allied World Reinsurance Company only.

** Standard & Poor's financial strength ratings are for Allied World Assurance Company, Ltd, Allied World Assurance Company (U.S.) Inc., Allied World National Assurance Company, Allied World Reinsurance Company, Allied World Assurance Company (Europe) Limited and Allied World Assurance Company (Reinsurance) Limited only. Standard & Poor's revised its outlook from stable to positive on June 24, 2010.

We believe that the quantitative and qualitative factors that influence our ratings are supportive of our ratings.

Long-Term Debt

In July 2006, Allied World Bermuda issued \$500.0 million aggregate principal amount of 7.50% senior notes due August 1, 2016, with interest payable August 1 and February 1 each year, commencing February 1, 2007. Allied World Bermuda can redeem the senior notes prior to maturity, subject to payment of a make-whole premium; however, Allied World Bermuda currently has no intention of redeeming the notes.

In November 2010, Allied World Bermuda issued \$300.0 million aggregate principal amount of 5.50% senior notes due November 1, 2020, with interest payable May 15 and November 15 each year, commencing May 15, 2011. Allied World Bermuda can redeem the senior notes prior to maturity, subject to payment of a make-whole premium; however, Allied World Bermuda currently has no intention of redeeming the notes.

The senior notes issued in 2006 and 2010 have been unconditionally and irrevocably guaranteed for the payment of the principal and interest by Holdings.

Off-Balance Sheet Arrangements

As of March 31, 2011, we did not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We believe that we are principally exposed to three types of market risk: interest rate risk, credit risk and currency risk.

The fixed income securities in our investment portfolio are subject to interest rate risk and credit risk. Any changes in interest rates and credit spreads have a direct effect on the market values of fixed income securities. As interest rates rise, the market values fall, and vice versa. As credit spreads widen, the market values fall, and vice versa.

The changes in market values as a result of changes in interest rates is determined by calculating hypothetical March 31, 2011 ending prices based on yields adjusted to reflect the hypothetical changes in interest rates, comparing such hypothetical ending prices to actual ending prices, and multiplying the difference by the principal amount of the security. The sensitivity analysis is based on estimates. The estimated changes of our fixed maturity investments and cash and cash equivalents are presented below and actual changes for interest rate shifts could differ significantly.

Table of Contents

| | Interest Rate Shift in Basis Points | | | | | | |
|--|--|-------------|------------|-----------|------------|-------------|-------------|
| | -200 | -100 | -50 | 0 | +50 | +100 | +200 |
| | (\$ in millions) | | | | | | |
| Total market value | \$7,542.3 | \$7,429.8 | \$7,348.1 | \$7,250.6 | \$7,149.7 | \$7,047.8 | \$6,845.0 |
| Market value change from base | 291.7 | 179.2 | 97.5 | 0.0 | (100.9) | (202.8) | (405.6) |
| Change in unrealized appreciation/(depreciation) | 4.0% | 2.5% | 1.3% | 0.0% | (1.4)% | (2.8)% | (5.6)% |

The changes in market values as a result of changes in credit spreads are determined by calculating hypothetical March 31, 2011 ending prices adjusted to reflect the hypothetical changes in credit spreads, comparing such hypothetical ending prices to actual ending prices, and multiplying the difference by the principal amount of the security. The sensitivity analysis is based on estimates. The estimated changes of our non-cash, non-U.S. treasury fixed maturity investments are presented below and actual changes in credit spreads could differ significantly.

| | Credit Spread Shift in Basis Points | | | | | | |
|--|--|-------------|------------|-----------|------------|-------------|-------------|
| | -200 | -100 | -50 | 0 | +50 | +100 | +200 |
| | (\$ in millions) | | | | | | |
| Total market value | \$5,797.6 | \$5,646.8 | \$5,571.5 | \$5,496.1 | \$5,420.7 | \$5,345.4 | \$5,194.6 |
| Market value change from base | 301.5 | 150.7 | 75.4 | 0.0 | (75.4) | (150.7) | (301.5) |
| Change in unrealized appreciation/(depreciation) | 5.5% | 2.7% | 1.4% | 0.0% | (1.4)% | (2.7)% | (5.5)% |

As a holder of fixed income securities, we also have exposure to credit risk. In an effort to minimize this risk, our investment guidelines have been defined to ensure that the assets held are well diversified and are primarily high-quality securities. As of March 31, 2011 we held assets totaling \$6.5 billion of fixed income securities. Of those assets, approximately 4.2% were rated below investment grade (Ba1/BB+ or lower) with the remaining 95.8% rated in the investment grade category. The average credit quality of the investment grade portfolios was AA by Standard & Poor s.

As of March 31, 2011, we held \$2,654.4 million, or 33.3%, of our total investments and cash and cash equivalents in corporate bonds, \$1,507.5 million of which were issued by entities within the financial services industry. These corporate bonds had an average credit rating of AA- by Standards & Poor s.

As of March 31, 2011, we held \$1,702.6 million, or 21.3%, of our total investments and cash and cash equivalents in mortgage-backed securities, which included agency pass-through mortgage-backed securities, non-agency mortgage-backed securities and commercial mortgage-backed securities. The agency pass-through mortgage-backed securities, non-agency mortgage-backed securities and commercial mortgage-backed securities represented 13.6%, 4.7% and 3.0%, respectively, of our total investments and cash and cash equivalents. In addition, 98.9% of our commercial mortgage-backed securities and 61.6% of our core non-agency residential mortgage-backed securities, were rated AAA by Standard & Poor s and Fitch as of March 31, 2011. These agency pass-through mortgage-backed securities are exposed to prepayment risk, which occurs when holders of individual mortgages increase the frequency with which they prepay the outstanding principal before the maturity date to refinance at a lower interest rate cost. Given the proportion that these securities comprise of the overall portfolio, and the current interest rate environment and condition of the credit market, prepayment risk is not considered significant at this time.

Additionally as of March 31, 2011, we held \$212.9 million of high yield (below investment grade) non-agency residential mortgage-backed securities, which is included in the \$1,702.6 million referenced in the preceding paragraph. As of March 31, 2011, 87.9% of those assets were rated below investment grade, and the average credit rating of this below investment grade portfolio was CCC+ by Standard & Poor s.

As of March 31, 2011, we held investments in hedge funds with a fair value of \$470.0 million. Investments in hedge funds involve certain risks related to, among other things, the illiquid nature of the fund shares, the limited

operating history of the fund, as well as risks associated with the strategies employed by the managers of the funds. The funds' objectives are generally to seek attractive long-term returns with lower volatility by investing in a range of diversified investment strategies. As our reserves and capital continue to build, we may consider additional investments in these or other alternative investments.

The U.S. dollar is our reporting currency and the functional currency of all of our operating subsidiaries. We enter into insurance policies and reinsurance contracts where the premiums receivable and losses payable are denominated in currencies other than the U.S. dollar. In addition, we maintain a portion of our investments and liabilities in currencies other than the U.S. dollar, primarily Euro, British Sterling, Swiss Franc and the Canadian dollar. Receivables in non-U.S. currencies are generally converted into U.S. dollars at the time of receipt. When we incur a liability in a non-U.S. currency, we carry such liability on our books in the original currency. These liabilities are converted from the non-U.S. currency to U.S. dollars at the time of payment. As a result, we have an exposure to foreign currency risk resulting from fluctuations in exchange rates. We utilize a hedging strategy whose objective

-58-

Table of Contents

is to minimize the potential loss of value caused by currency fluctuations by using foreign currency forward contract derivatives that expire in 90 days from purchase.

As of March 31, 2011 and 2010, approximately 1.7% and 2.2%, respectively, of our aggregate invested assets were denominated in currencies other than the U.S. dollar. Of our business written during the three months ended March 31, 2011 and 2010, approximately 14% and 13%, respectively, was written in currencies other than the U.S. dollar.

Our foreign exchange loss/gain for the three months ended March 31, 2011 and 2010 and the year ended December 31, 2010 are set forth in the chart below.

| | Three Months Ended | | Year Ended |
|-------------------------------|---------------------------|-----------------------|--------------------------|
| | March 31, 2011 | March 31, 2010 | December 31, 2010 |
| | (\$ in millions) | | |
| Realized exchange gain (loss) | \$ 0.3 | \$ (2.2) | \$ (2.0) |
| Unrealized exchange gain | 0.1 | 1.1 | 1.6 |
| Foreign exchange gain (loss) | \$ 0.4 | \$ (1.1) | \$ (0.4) |

Item 4. Controls and Procedures.

In connection with the preparation of this quarterly report, our management has performed an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of March 31, 2011. Disclosure controls and procedures are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by SEC rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow for timely decisions regarding required disclosures. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2011, our company's disclosure controls and procedures were effective to ensure that information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by SEC rules and forms and accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosures.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide an absolute assurance that all control issues and instances of fraud, if any, within our company have been detected.

No changes were made in our internal controls over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f), during the quarter ended March 31, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings.

We are and in the future may become involved in various claims and legal proceedings that arise in the normal course of our business. While any claim or legal proceeding contains an element of uncertainty, we do not currently

believe that any claim or legal proceeding to which we are presently a party to is likely to have a material adverse effect on our results of operations.

Item 1A. Risk Factors.

Our business is subject to a number of risks, including those identified in Item 1A. of Part I of our 2010 Form 10-K, that could have a material effect on our business, results of operations, financial condition and/or liquidity and that could cause our operating results to vary significantly from period to period. There have been no material changes to the risk factors described in our 2010 Form 10-K. The risks described in our 2010 Form 10-K are not the only risks we face. Additional risks and uncertainties not currently

-59-

Table of Contents

known to us or that we currently deem to be immaterial also could have a material effect on our business, results of operations, financial condition and/or liquidity.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

- (c) The following table summarizes our repurchases of our common shares during the three months ended March 31, 2011:

| | | | | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Value (or Approximate Dollar Value) of Shares that May Yet be Purchased Under the Plans or Programs |
|---------------------|---|---|--|---|---|
| Period | Total Number of Shares Purchased | Average Price Paid per Share | | | |
| January 1 31, 2011 | | \$ | | | \$ 260,872,492 |
| February 1 28, 2011 | 282,609 | 61.67 | | 282,609 | 243,444,462 |
| March 1 31, 2011 | 686,554 | 62.01 | | 686,554 | 200,872,527 |
| Total | 969,163 | \$ 61.91 | | 969,163 | \$ 200,872,527(1) |

- (1) In May 2010, the company established a share repurchase program in order to repurchase Holdings' common shares. Repurchases may be effected from time to time through open market purchases, privately negotiated transactions and tender offers or otherwise.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. [Removed and Reserved.]**Item 5. Other Information.**

None.

Item 6. Exhibits.**Exhibit****Number****Description**

| | |
|---------|---|
| 10.1(1) | Warrant Purchase Agreement, dated as of February 3, 2011, by and between Allied World Assurance Company Holdings, Ltd and American International Group, Inc. |
| 31.1 | Certification by Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification by Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification by Chief Executive Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification by Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.1** | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010, (ii) the Consolidated Statements of Operations and Comprehensive Income for the three months ended March 31, 2011 and 2010, (iii) the Consolidated Statements of Shareholders' Equity for the three months ended March 31, 2011 and 2010, (iv) the |

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Consolidated Statements of Cash Flows for the three months ended March 31, 2011 and 2010 and (v) the
Notes to the Consolidated Financial Statements, tagged as blocks of text.

-60-

Table of Contents

- (1) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on February 3, 2011.
- * These certifications are being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, chapter 63 of title 18 United States Code) and are not being filed as part of this report.
- ** In accordance with Rule 406T of Regulation S-T, the information in Exhibit 101.1 to this Quarterly Report on Form 10-Q is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, is deemed not filed for purposes of Section 18 of the Exchange Act and otherwise is not subject to liability under these sections.

-61-

Table of Contents

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.

ALLIED WORLD ASSURANCE COMPANY
HOLDINGS, AG

Dated: May 10, 2011

By: /s/ Scott A. Carmilani
Name:
Scott A. Carmilani
Title: President and Chief Executive Officer

Dated: May 10, 2011

By: /s/ Joan H. Dillard
Name:
Joan H. Dillard
Title: Executive Vice President and Chief Financial
Officer

-62-

Table of Contents

EXHIBIT INDEX

| Exhibit Number | Description |
|---------------------------|---|
| 10.1(1) | Warrant Purchase Agreement, dated as of February 3, 2011, by and between Allied World Assurance Company Holdings, Ltd and American International Group, Inc. |
| 31.1 | Certification by Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification by Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification by Chief Executive Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification by Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.1** | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010, (ii) the Consolidated Statements of Operations and Comprehensive Income for the three months ended March 31, 2011 and 2010, (iii) the Consolidated Statements of Shareholders Equity for the three months ended March 31, 2011 and 2010, (iv) the Consolidated Statements of Cash Flows for the three months ended March 31, 2011 and 2010 and (v) the Notes to the Consolidated Financial Statements, tagged as blocks of text. |
| (1) | Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on February 3, 2011. |
| * | These certifications are being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, chapter 63 of title 18 United States Code) and are not being filed as part of this report. |
| ** | In accordance with Rule 406T of Regulation S-T, the information in Exhibit 101.1 to this Quarterly Report on Form 10-Q is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, is deemed not filed for purposes of Section 18 of the Exchange Act and otherwise is not subject to liability under these sections. |