Allied World Assurance Co Holdings, AG
Form 10-K
February 26, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2012

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	**98-0681223**
(State or Other Jurisdiction of Incorporation or Organization)	*(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)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Shares, par value CHF 12.64 per share	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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 þ No ¨

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ

The aggregate market value of voting and non-voting common shares held by non-affiliates of the registrant as of June 29, 2012 (the last business day of the registrant s most recently completed second fiscal quarter) was approximately $2.8 billion based on the closing sale price of the registrant s common shares on the New York Stock Exchange on that date.

As of February 18, 2013, 34,541,409 common shares were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A with respect to the annual general meeting of the shareholders of the registrant scheduled to be held on May 2, 2013 is incorporated in Part III of this Form 10-K.

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PART I

References in this Annual Report on Form 10-K 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-K to the terms Allied World Switzerland or Holdings means only Allied World Assurance Company Holdings, AG. References to our insurance subsidiaries may include our reinsurance subsidiaries. References in this Form 10-K 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-K to Holdings common shares means its registered voting shares. For your convenience, we have included a glossary beginning on page 51 of selected insurance and reinsurance terms.

Item 1. Business.

Overview

We are a Swiss-based insurance and reinsurance company that underwrites a diverse portfolio of property and casualty lines of business through offices located in Bermuda, Hong Kong, Ireland, Singapore, Switzerland, the United Kingdom and the United States. For the year ended December 31, 2012, our U.S. insurance, international insurance and reinsurance segments accounted for 42.7%, 24.7% and 32.6%, respectively, of our total gross premiums written of $2,329.3 million. As of December 31, 2012, we had $12.0 billion of total assets and $3.3 billion of shareholders equity.

We were formed in Bermuda in 2001, and we redomesticated to Switzerland in December 2010, at which time Holdings became the ultimate parent company of Allied World Assurance Company Holdings, Ltd, the former publicly-traded Bermuda holding company (Allied World Bermuda) and its subsidiaries. Since our formation, we have focused primarily on the direct insurance markets. We offer our clients and producers significant capacity in both the direct property and casualty insurance markets as well as in the reinsurance market. We have expanded since our formation and now have 17 offices located in seven different countries.

Internationally, we first established a presence in Europe when Allied World Assurance Company (Europe) Limited was approved to carry on business in the European Union (E.U.) from its office in Dublin, Ireland in October 2002 and from a branch office in London, England in May 2003. Allied World Assurance Company (Reinsurance) Limited was approved to write reinsurance in the E.U. from its office in Ireland in July 2003 and from a branch office in London, England in August 2004. In recent years, we have further expanded our European presence, first in October 2008 when Allied World Assurance Company (Reinsurance) Limited opened a branch office in Zug, Switzerland to further penetrate the European market, and later in March 2011 when we received an insurance and reinsurance license for Allied World Assurance Company, AG, a Swiss-domiciled company located in Zug, Switzerland.

In July 2002, we established a presence in the United States when we acquired two insurance companies, Allied World Assurance Company (U.S.) Inc. and Allied World National Assurance Company. We have made substantial investments to expand our North American business, which has grown significantly since 2009 and which we expect will continue to grow in size and importance in the coming years. In February 2008, we acquired a U.S. reinsurance company which we operated under the name Allied World Reinsurance Company until December 2012, when it was renamed Allied World Insurance Company. We write our U.S. reinsurance business through this company. In October 2008, we acquired Darwin Professional Underwriters, Inc. and its subsidiaries (collectively, Darwin) to further expand our U.S. insurance platform. We currently have eleven offices in the United States and are licensed in Canada.

Our corporate expansion continued into Asia when Allied World Assurance Company, Ltd opened branch offices in Hong Kong in March 2009 and in Singapore in December 2009. In July 2011, we received a license to write reinsurance business in Labuan, a financial center in Malaysia.

In early 2010, we received approval from Lloyd s to establish a syndicate. Our Lloyd s syndicate, Syndicate 2232, commenced underwriting in June 2010. Syndicate 2232 is managed by Capita Managing Agency Limited, a subsidiary of The Capita Group PLC, which is authorized by the Financial Services Authority in the United

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Kingdom (the FSA). In July 2010, we received approval from the Monetary Authority of Singapore and Lloyd s Asia to register and operate a service company, Capita 2232 Services Pte Ltd. As part of the Lloyd s Asia platform, the service company underwrites exclusively on behalf of Syndicate 2232. Syndicate 2232, via the service company, offers a broad range of insurance and reinsurance treaty products from Singapore, including property, casualty and specialty lines, to clients in the Asia Pacific, Middle East and Africa regions. In September 2012, Allied World Reinsurance Management Company received approval to act as a Lloyd s coverholder to underwrite Latin American and Caribbean treaty business from our Miami office on behalf of Syndicate 2232.

Available Information

We maintain a website at www.awac.com. The information on our website is not incorporated by reference in this Annual Report on Form 10-K.

We make available, free of charge through our website, our financial information, including the information contained in our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the U.S. Securities and Exchange Commission (the SEC). We also make available, free of charge through our website, our Audit Committee Charter, Compensation Committee Charter, Investment Committee Charter, Nominating & Corporate Governance Committee Charter, Enterprise Risk Committee Charter, Corporate Governance Guidelines, Code of Ethics for CEO and Senior Financial Officers and Code of Business Conduct and Ethics. Such information is also available in print for any shareholder who sends a request to Allied World Assurance Company Holdings, AG, Lindenstrasse 8, 6340 Baar, Zug, Switzerland, attention: Wayne H. Datz, Corporate Secretary, or via e-mail to secretary@awac.com. Reports and other information we file with the SEC may also be viewed at the SEC s website at www.sec.gov or viewed or obtained at the SEC Public Reference Room at 100 F Street, N.E., Washington, DC 20549. Information on the operation of the SEC Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

Our Strategy

Our business objective is to generate attractive returns on equity and book value per share growth for our shareholders. We seek to achieve this objective by executing the following strategies:

Capitalize on profitable underwriting opportunities. Our experienced management and underwriting teams are positioned to locate and identify business with attractive risk/reward characteristics. We pursue a strategy that emphasizes profitability, not market share. Key elements of this strategy are prudent risk selection, appropriate pricing and adjusting our business mix to remain flexible and opportunistic. We seek ways to take advantage of underwriting opportunities that we believe will be profitable.

Exercise underwriting and risk management discipline. We believe we exercise underwriting and risk management discipline by: (i) maintaining a diverse spread of risk across product lines and geographic zones, (ii) managing our aggregate property catastrophe exposure through the application of sophisticated modeling tools, (iii) monitoring our exposures on non-property catastrophe coverages, (iv) adhering to underwriting guidelines across our business lines and (v) fostering a culture that focuses on enterprise risk management and strong internal controls.

Maintain a conservative investment strategy. We believe that we follow a conservative investment strategy designed to emphasize the preservation of our capital and provide adequate liquidity for the prompt payment of claims. Our investment portfolio consists primarily of investment-grade, fixed-maturity securities of short-to medium-term duration.

Our premium revenues are generated by operations conducted from our corporate headquarters in Switzerland and our other offices in Bermuda, Europe, Hong Kong, Singapore and the United States. For information concerning our gross premiums written by geographic location of underwriting office, see Item 7.

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Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Comparison of Years Ended December 31, 2012 and 2011 and Comparison of Years Ended December 31, 2011 and 2010.

Our Operating Segments

We have three business segments: U.S. insurance, international insurance and reinsurance. These segments and their respective lines of business and products may, at times, be subject to different underwriting cycles. We modify our product strategy as market conditions change and new opportunities emerge by developing new products, targeting new industry classes or de-emphasizing existing lines. Our diverse underwriting skills and flexibility allow us to concentrate on the business lines where we expect to generate the greatest returns. Financial data relating to our three segments is included in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and in our consolidated financial statements included in this report.

The gross premiums written in each segment for the years ended December 31, 2012. 2011 and 2010 were as follows:

	Year Ended December 31, 2012		Year Ended December 31, 2011		Year Ended December 31, 2010	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
			($ in millions)			
U.S. insurance	$ 993.9	42.7%	$ 838.6	43.3%	$ 729.3	41.5%
International insurance	575.1	24.7%	530.4	27.3%	504.9	28.7%
Reinsurance	760.3	32.6%	570.5	29.4%	524.2	29.8%
Total	$ 2,329.3	100.0%	$ 1,939.5	100.0%	$ 1,758.4	100.0%

U.S. Insurance Segment

General

The U.S. insurance segment includes our direct insurance operations in the United States. Within this segment we provide an increasingly diverse range of specialty liability products, with a particular emphasis on coverages for healthcare and professional liability risks. Additionally, we offer a selection of direct general casualty insurance and general property insurance products. We generally target small- and middle-market, non-Fortune 1000 accounts domiciled in North America, including public entities, private companies and non-profit organizations. In recent years we have enhanced our U.S. insurance operating platform, principally through hiring underwriting talent, through an expanded network of branch offices located in strategically important locations across the country and through upgrades to our information technology platform to accommodate our increasing business demands. Our underwriters are spread among our locations in the United States because we believe it is important to be physically present in the major insurance markets where we compete for business. We believe improvements to our operating platform have allowed us to assume and maintain a significant role as a writer of primary professional liability and other specialty liability coverage for small firms. We will continue to seek attractive opportunities in the U.S. market.

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The table below illustrates the breakdown of the company s U.S. direct insurance gross premiums written by line of business for the year ended December 31, 2012.

	Year Ended December 31, 2012	
	Amount	% of Total
	($ in millions)	
General casualty	$ 269.6	27.1%
Professional liability	260.8	26.2%
Healthcare	207.3	20.9%
Programs	105.3	10.6%
General property	94.3	9.5%
Other(1)	56.6	5.7%
	$ 993.9	100.0%

(1) Includes our inland marine, environmental and mergers and acquisitions lines of business.

Products and Customer Base

Our casualty operations in the United States focus on insurance products providing coverage for specialty type risks, such as professional liability, environmental liability, product liability, and healthcare liability risks, and we offer commercial general liability products as well. Professional liability products include policies covering directors and officers, employment practices and fiduciary liability insurance. We also offer a diverse mix of errors and omissions liability coverages for a variety of service providers, including law firms, technology companies, insurance companies, insurance agents and brokers, and municipalities. We also provide both primary and excess liability and other casualty coverages to the healthcare industry, including hospitals and hospital systems, managed care organizations, accountable care organizations and medical facilities such as home care providers, specialized surgery and rehabilitation centers, and outpatient clinics. We regularly assess our product mix, and we evaluate new products and markets where we believe our underwriting and service will allow us to differentiate our offerings.

In late 2009, we commenced writing environmental liability business by offering a line of environmental casualty products covering the pollution and related liability exposures of general contractors, tank installers, remediation contractors and others. During 2012, we introduced new coverages for mergers and acquisitions liability, privacy and technology liability.

With respect to general casualty products, we provide both primary and excess liability coverage, and our focus is on complex risks in a variety of industries including construction, real estate, public entities, retailers, manufacturing, transportation, and finance and insurance services. We also offer comprehensive insurance to contractors and their employees working outside of the United States on contracts for agencies of the U.S. government or foreign operations of U.S. companies.

Our U.S. property insurance operations provide direct coverage of physical property and business interruption coverage for commercial property risks. During 2011, we also commenced writing inland marine business. We write solely commercial coverages and concentrate our efforts on primary risk layers of insurance (as opposed to excess layers), offering meaningful but limited capacity in these layers. This means that we are typically part of the first group of insurers that cover a loss up to a specified limit. We offer general property products from our underwriting platforms in the United States, and cover risks for retail chains, real estate, manufacturers, hotels and casinos, and municipalities.

We currently have a total of 12 insurance programs in the United States, offering a variety of products including professional liability, excess casualty and primary general liability. We generally retain responsibility for administration of claims, although we may opt to outsource claims in selected situations. In selecting program administrators, we consider the integrity, experience and reputation of the program administrator, the availability of reinsurance and the potential profitability of the business. In order to assure the continuing integrity of the underwriting and related business operations in our program business, we conduct additional reviews and audits of the program administrator. To help align our interests with those of our program administrators, we seek to set up incentive-based compensation to encourage better long-term underwriting results as a component of their fees.

For more information concerning our gross premiums written by line of business in our U.S. insurance segment, see Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations U.S. Insurance Segment Comparison of Years Ended December 31, 2012 and 2011 and Comparison of Years Ended December 31, 2011 and 2010.

Distribution

Within our U.S. insurance segment, insurance policies are placed through a network of over 200 insurance intermediaries, including excess and surplus lines wholesalers and regional and national retail brokerage firms. A subset of these intermediaries also access certain of our U.S. casualty products via our proprietary *i-bind* platform that allows for accelerated quote and bind capabilities through the internet. Marsh & McLennan Companies, Inc. (Marsh) accounted for approximately 10% of gross premiums written in the U. S. insurance segment during 2012.

International Insurance Segment

General

The international insurance segment includes our direct insurance operations outside of the United States. It includes our operations in Bermuda, Europe and Asia. Our Bermuda operations underwrite primarily larger, Fortune 1000 casualty and property risks for accounts domiciled in North America. Our insurance operations in Europe, with offices in Dublin, London and Switzerland, have focused on mid-sized to large European and multi-national companies domiciled outside of North America, and we are also diversifying into insurance products for smaller commercial clients. In addition, Syndicate 2232 offers select product lines including international property, general casualty and professional liability, targeted at key territories such as countries in Latin America and the Asia Pacific region. The international insurance segment also encompasses our offices in Asia that underwrite a variety of primary and excess professional liability lines and general casualty and healthcare insurance products. Our staff in the international insurance segment is spread among our locations in Bermuda, Europe and Asia because we believe it is important that our underwriters be physically present in the major insurance markets around the world where we compete for business.

The table below illustrates the breakdown of the company s international insurance gross premiums written by line of business for the year ended December 31, 2012.

	Year Ended December 31, 2012	
	Amount	% of Total
	($ in millions)	
Professional liability	$ 182.0	31.7%
General property	157.2	27.3%
General casualty	131.6	22.9%
Healthcare	73.2	12.7%
Other	31.1	5.4%
	$ 575.1	100.0%

Products and Customer Base

Our casualty operations within our international insurance provide general casualty products; professional liability products such as directors and officers, employment practices, fiduciary and errors and omissions liability insurance; and healthcare liability products. Our focus with respect to general casualty products is on complex risks in a variety of industries, including manufacturing, energy, chemicals, transportation, real estate, consumer products, medical and healthcare services and construction. We also offer a diverse mix of coverages for a number of industries including law firms, technology companies, financial institutions, insurance companies and brokers, manufacturing and energy, and engineering and construction firms. Our healthcare underwriters provide risk transfer products to numerous healthcare institutions, such as hospitals, managed care organizations and healthcare systems. We offer both primary and excess coverage, with the latter focused primarily on insuring excess layers, with a median attachment point of $80 million. Our international insurance segment utilizes significant gross limit capacity.

We offer general property products from our underwriting platforms in Bermuda and Europe. Our international property insurance operations provide direct coverage of physical property and business interruption coverage for commercial property risks and mining risks. We write solely commercial coverages and focus on the insurance of the primary risk layer. The types of commercial property risks we cover include retail chains, real estate, manufacturers, hotels and casinos.

In 2010, we commenced writing trade credit insurance by offering short- and medium-term credit insurance for clients that export primarily to and from Latin America and the Caribbean.

For more information on our gross premiums written by line of business in our international insurance segment, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations International Insurance Segment Comparison of Years Ended December 31, 2012 and 2011 and Comparison of Years Ended December 31, 2011 and 2010.

Distribution

With regard to our international insurance segment, we utilize our relationships with insurance intermediaries as our principal method for obtaining business. Our international insurance segment maintains significant relationships with Marsh, Aon Corporation (Aon) and Willis Group Holdings (Willis), which accounted for 29%, 25% and 11%, respectively, of our gross premiums written in this segment during 2012.

Reinsurance Segment

General

Our reinsurance segment includes the reinsurance of property, general casualty, professional liability, specialty lines and property catastrophe coverages written by other insurance companies. In order to diversify our portfolio and complement our direct insurance business, we target the overall contribution from reinsurance to be approximately 30% of our total annual gross premiums written.

We presently write reinsurance on both a treaty and a facultative basis, targeting several niche markets including professional liability lines, specialty casualty, property for U.S. regional insurers, accident and health, marine, aerospace and crop risks. Overall, we strive to diversify our reinsurance portfolio through the appropriate combination of business lines, ceding source, geography and contract configuration. Our primary customer focus is on highly-rated carriers with proven underwriting skills and dependable operating models.

We determine appropriate pricing either by using pricing models built or approved by our actuarial staff or by relying on established pricing set by one of our pricing actuaries for a specific treaty. Pricing models are generally used for facultative reinsurance, property catastrophe reinsurance, property per risk reinsurance and workers compensation and personal accident catastrophe reinsurance. Other types of reinsurance rely on actuarially-established pricing. On a written basis, our business mix is more heavily weighted to reinsurance during the first three months of the year. Our reinsurance segment operates from our offices in Bermuda, London, Miami, New York, Singapore and Switzerland.

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The table below illustrates the breakdown of the company s reinsurance gross premiums written by line of business for the year ended December 31, 2012.

	Year Ended December 31, 2012	
	Amount	% of Total
	($ in millions)	
Property	$ 354.6	46.7%
Casualty	254.3	33.4%
Specialty	151.4	19.9%
	$ 760.3	100.0%

Product Lines and Customer Base

Property, casualty and specialty reinsurance is the principal source of revenue for this segment. The insurers we reinsure range from single state to nationwide insurers located in the United States as well as specialty carriers or the specialty divisions of standard lines carriers. For our international treaty unit, our clients include multi-national insurers, single territory insurers, niche carriers and Lloyd s syndicates. We focus on niche programs and coverages, frequently sourced from excess and surplus lines insurers. In October 2008, we expanded our international reach by opening a branch office in Switzerland that offers property, general casualty and professional liability products throughout Europe. This business is now being written by Allied World Assurance Company, AG, our Swiss licensed insurance and reinsurance company. Syndicate 2232 also offers international treaty reinsurance. During 2009, we expanded our reinsurance operations both in Asia, where we opened a branch office in Singapore that serves as the company s hub for all classes of treaty reinsurance business for the region, and in the United States, where we added a property underwriting team to our reinsurance platform. In December 2010, we expanded our specialty reinsurance offerings by launching a marine and specialty division. In 2011, we added crop reinsurance offerings. In September 2012, our Miami operations received approval to act as a Lloyd s coverholder to underwrite treaty business in Latin America and the Caribbean on behalf of Syndicate 2232. We target a portfolio of well-rated companies that are highly knowledgeable in their product lines, have the financial resources to execute their business plans and are committed to underwriting discipline throughout the underwriting cycle.

Our property reinsurance underwrites treaties which protect insurers who write residential, commercial and industrial accounts in North America, Europe, Asia and Latin America. Our predominant exposure to loss is in North America. We also write Euro-centric business, including Lloyd s syndicates and Continental European companies, and are expanding our capabilities in Asia and Latin America. We emphasize monoline, per risk accounts, which are structured as either quota share or excess-of-loss reinsurance. Monoline reinsurance applies to one kind of coverage, and per risk reinsurance coverage applies to a particular risk (for example a building and its contents), rather than on a per accident, event or aggregate basis. Where possible, coverage is provided on a losses occurring basis, which limits coverage to property losses occurring within the treaty year. We selectively write industry loss warranties where we believe market opportunities justify the risks.

Our casualty reinsurance business consists of general casualty and professional liability lines and writes both treaty and facultative business. Our general casualty treaties cover working layer, intermediate layer and catastrophe exposures. We sell both quota share and excess-of-loss reinsurance. We principally underwrite general liability, auto liability and commercial excess and umbrella liability for both admitted and non-admitted companies. Our general casualty facultative business is principally comprised of lower-attachment, individual-risk reinsurance covering automobile liability, general liability and workers compensation risks for many of the largest U.S. property-casualty and surplus lines insurers. Our professional liability treaties cover several products, primarily directors and officers liability, but also attorneys malpractice, medical malpractice, miscellaneous professional classes and transactional risk liability. The complex exposures undertaken by this unit demand highly technical underwriting and pricing analysis.

For our specialty reinsurance business, we underwrite on a global basis crop, marine and aviation, and other specialty lines of business, including accident and health business with an emphasis on catastrophe personal accident programs and workers compensation catastrophe business.

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For more information on our gross premiums written by line of business in our reinsurance segment, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Reinsurance Segment Comparison of Years Ended December 31, 2012 and 2011 and Comparison of Years Ended December 31, 2011 and 2010.

Distribution

Due to a number of factors, including transactional size and complexity, the distribution infrastructure of the reinsurance marketplace is characterized by relatively few intermediary firms. As a result, we have close business relationships with a small number of reinsurance intermediaries, and our business during 2012 was primarily with affiliates of Marsh, Aon and Willis accounting for 41%, 27% and 14%, respectively, of total gross premiums written in this segment during 2012. Due to the substantial percentage of premiums produced in our reinsurance segment by the top three intermediaries, the loss of business from any one of them could have a material adverse effect on our business.

Security Arrangements

Allied World Assurance Company, Ltd, our Bermuda insurance and reinsurance company, is not admitted as an insurer nor is it accredited as a reinsurer in any jurisdiction in the United States, although it is qualified as an eligible reinsurer in several U.S. states. Except in states where it has qualified as an eligible reinsurer, Allied World Assurance Company, Ltd 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 these cedents to obtain credit on their U.S. statutory financial statements with respect to insurance liabilities ceded by 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. For a description of the security arrangements used by us, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Pledged Assets.

Enterprise Risk Management

General

While the assumption of risk is inherent in our business, we believe we have developed a strong risk management culture that is fostered and maintained by our senior management. Our enterprise risk management (ERM) consists of numerous processes and controls that have been designed by our senior management, with oversight by our Board of Directors, including through its Enterprise Risk Committee, and implemented by employees across our organization. One key element of our ERM is our economic capital model. Utilizing this modeling framework, we review the relative interaction between risks impacting us from underwriting through investment risks. Our ERM supports our firm-wide decision making process by aiming to provide reliable and timely risk information. Our primary ERM objectives are to:

- protect our capital position,
- ensure that our assumed risks (individually and in the aggregate) are within our firm-wide risk appetite,
- maximize our risk-adjusted returns on capital, and
- manage our earnings volatility.

We have identified the following six major categories of risk within our business:

Underwriting risk: Encompasses risks associated with entering into insurance and reinsurance transactions and includes frequency and severity assessments, pricing adequacy issues and exposures posed by new products. For more information concerning our management of underwriting risk, see Underwriting Risk Management below.

Catastrophe and Aggregate Accumulation risk: Addresses the organization s exposure to natural catastrophes, such as windstorms, earthquakes or floods, particularly with regard to managing the concentration of exposed insurance limits within coastal or other areas that are more prone to severe catastrophic events. For more information concerning our management of catastrophe risk, see Underwriting Risk Management below.

Reserving risk: The risks associated with overestimating or underestimating required reserves is a significant risk for any company that writes long-tailed casualty business.

Investment risk: Addresses risks of market volatility and losses associated with individual investments and investment classes, as well as overall portfolio risk associated with decisions as to asset mix, geographic risk, duration and liquidity.

Reinsurance risk: The ceding of policies we write to other reinsurers is a principal risk management activity, and it requires careful monitoring of the concentration of our reinsured exposures and the creditworthiness of the reinsurers to which we cede business.

Operational risk: Encompasses a wide range of risks related to our operations, including: corporate governance, claims settlement processes, regulatory compliance, employment practices and IT exposures (including disaster recovery and business continuity planning).

Our risk governance structure includes committees comprised of senior underwriting, actuarial, finance, legal, investment and operations staff that identify, monitor and help manage each of these risks. Our management-based Risk Management Committee, chaired by our Chief Risk Officer, focuses primarily on identifying correlations among our primary categories of risk, developing metrics to assess our overall risk position, performing an annual risk assessment and reviewing continually factors that may impact our organizational risk. This risk governance structure is complemented by our internal audit department, which assesses the adequacy and effectiveness of our internal control systems and coordinates risk-based audits and compliance reviews and other specific initiatives to evaluate and address risk within targeted areas of our business. Our ERM is a dynamic process, with periodic updates being made to reflect organizational processes and the recalibration of our models, as well as staying current with changes within our industry and the global economic environment.

Our management s internal ERM efforts are overseen by our Board of Directors, primarily through its Enterprise Risk Committee. This committee, comprised of independent directors, is charged with reviewing and recommending to the Board of Directors our overall firm-wide risk appetite as well as overseeing management s compliance therewith. Our Enterprise Risk Committee reviews our risk management methodologies, standards, tolerances and risk strategies, and assesses whether management is addressing risk issues in a timely and appropriate manner. Our Audit Committee, Investment Committee and Compensation Committee also oversee aspects of our financial, investment and compensation risks, respectively. Internal controls and ERM can provide a reasonable but not absolute assurance that our control objectives will be met. The possibility of material financial loss remains in spite of our ERM efforts.

Underwriting Risk Management

Underwriting insurance and reinsurance coverage, which is our primary business activity, entails the assumption of risk. Therefore, protecting corporate assets from an unexpected level of loss related to underwriting activities is a major area of focus. We emphasize careful risk selection by evaluating a potential insured s risk management practices, loss history and adequacy of retention. Other factors that go into the effective management of underwriting risk may differ depending on the line of business involved and the type of account being insured or reinsured.

In our direct insurance casualty products, we strive to write diverse business across a variety of product lines and industry classes, and we review business concentrations on a regular basis with the objective of creating balanced portfolios. By maintaining a balanced casualty portfolio, we believe we are less vulnerable to adverse market changes in any one product or industry. In addition, because of the large limits we often deploy for casualty business written in the U.S. insurance segment and the international insurance segment, we utilize both facultative and treaty reinsurance to reduce our net exposure. For more information on the reinsurance we purchase for the casualty business written in the U.S. insurance and international insurance segments, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Ceded Reinsurance.

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In our direct insurance property products, we have historically managed our property catastrophe exposure by closely monitoring our policy limits in addition to utilizing complex risk models that analyze the locations covered by each insurance policy enabling us to obtain a more accurate assessment of our property catastrophe exposure. In addition to our continued focus on aggregate limits and modeled probable maximum loss, we have implemented a gross exposed policy limits approach that focuses on exposures in catastrophe-prone geographic zones and takes into consideration flood severity, demand surge and business interruption exposures for each critical area. We closely monitor our gross accumulations in each zone and restrict our gross exposed policy limits in each critical property catastrophe zone to an amount consistent with our probable maximum loss. Subsequent to a catastrophic event, we reassess our risk appetite and risk tolerances to ensure they are aligned with our capital preservation targets. Additionally, for our direct property, workers compensation, accident and health catastrophe and property reinsurance business, we seek to manage our risk exposure so that our probable maximum losses for a single catastrophe event, after all applicable reinsurance, in any one-in-250-year event does not exceed approximately 20% of our total capital.

Before we review the specifics of any proposal in our reinsurance segment, we consider the attributes of the client, including the experience and reputation of its management and its risk management strategy. We also examine the level of shareholders equity, industry ratings, length of incorporation, duration of business model, portfolio profitability, types of exposures and the extent of its liabilities. To identify, manage and monitor accumulations of exposures from potential property catastrophes, we employ industry-recognized software. Our underwriters, actuaries and claims personnel collaborate throughout the reinsurance underwriting process. For property proposals, we also obtain information on the nature of the perils to be included and the policy information on locations to be covered under the reinsurance contract. If a program meets our underwriting criteria, we then assess the adequacy of its proposed pricing, terms and conditions, and its potential impact on our profit targets and risk objectives.

Competition

The insurance and reinsurance industry is highly competitive. Insurance and reinsurance companies compete on the basis of many factors, including premium rates, general reputation and perceived financial strength, the terms and conditions of the products offered, ratings assigned by independent rating agencies, speed of claims payments and reputation and experience in risks underwritten.

We compete with major U.S. and non-U.S. insurers and reinsurers, many of which have greater financial, marketing and management resources than we do. Some of these companies have more capital than our company. In our direct insurance business, we compete with insurers that provide property and casualty-based lines of insurance such as: ACE Limited, Arch Capital Group Ltd., Axis Capital Holdings Limited, American International Group, Inc., The Chubb Corporation, Endurance Specialty Holdings Ltd., Factory Mutual Insurance Company, HCC Insurance Holdings, Inc., Ironshore Inc., Liberty Mutual Insurance Company, Lloyd s, Markel Insurance Company, Munich Re Group, The Navigators Group, Inc., OneBeacon Insurance Group, Ltd, Swiss Reinsurance Company, W.R. Berkeley Corporation, XL Capital Ltd and Zurich Financial Services. In our reinsurance business, we compete with reinsurers that provide property and casualty-based lines of reinsurance such as: ACE Limited, Alterra Capital Holdings, Ltd, Arch Capital Group Ltd., Berkshire Hathaway, Inc., Everest Re Group, Ltd., Lloyd s, Montpelier Re Holdings Ltd., Munich Re Group, PartnerRe Ltd., Platinum Underwriters Holdings, Ltd., RenaissanceRe Holdings Ltd., Swiss Reinsurance Company, Transatlantic Holdings, Inc. and XL Capital Ltd.

In addition, risk-linked securities, derivatives and other non-traditional risk transfer vehicles are being developed and offered by other parties, including entities other than insurance and reinsurance companies. The availability of these non-traditional products could reduce the demand for traditional insurance and reinsurance.

Our Financial Strength Ratings

Ratings are an important factor in establishing the competitive position of insurance and reinsurance companies. A.M. Best, Moody s, Standard & Poor s and Fitch Ratings have each developed a rating system to provide an opinion of an insurer s or reinsurer s financial strength and ability to meet ongoing obligations to its policyholders. Each rating reflects the rating agency s opinion of the capitalization, management and sponsorship

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of the entity to which it relates, and is neither an evaluation directed to investors in our common shares nor a recommendation to buy, sell or hold our common shares. A.M. Best ratings currently range from A++ (Superior) to F (In Liquidation) and include 15 separate ratings categories. Moody s maintains a letter scale rating system ranging from Aaa (Exceptional) to C (Lowest-rated) and includes 21 separate ratings categories. Standard & Poor s maintains a letter scale rating system ranging from AAA (Extremely Strong) to R (under regulatory supervision) and includes 21 separate ratings categories. Fitch Ratings maintains a letter scale rating system ranging from AAA (Extremely Strong) to C (Distressed) and includes 19 separate ratings categories. Our principal operating subsidiaries and their respective ratings from each rating agency are provided in the table below.

Subsidiary	Rated A (Excellent) from A.M. Best(1)	Rated A2 (Good) from Moody s(2)	Rated A (Strong) from Standard & Poor s(3)	Rated A (Strong) from Fitch Ratings(4)
Allied World Assurance Company, Ltd	X	X	X	X
Allied World Assurance Company (U.S.) Inc.	X	X	X	X
Allied World National Assurance Company	X	X	X	X
Allied World Insurance Company	X	X	X	X
Darwin National Assurance Company	X			
Darwin Select Insurance Company	X			
Allied World Assurance Company, AG			X	
Allied World Assurance Company (Europe) Limited	X		X	
Allied World Assurance Company (Reinsurance) Limited	X		X	

(1) Third highest of 15 available ratings from A.M. Best.

(2) Sixth highest of 21 available ratings from Moody s.

(3) Sixth highest of 21 available ratings from Standard & Poor s.

(4) Fifth highest of 19 available ratings from Fitch Ratings.

In addition to the above-named subsidiaries, we underwrite through our Lloyd s Syndicate 2232. All Lloyd s syndicates benefit from Lloyd s central resources, including Lloyd s brand, its network of global licenses and the central fund. As all of Lloyd s policies are ultimately backed by this common security, a single market rating can be applied. A.M. Best has assigned Lloyd s a financial strength rating of A (Excellent) and Standard & Poor s and Fitch Ratings have assigned Lloyd s a financial strength rating of A+ (Strong). These ratings are subject to periodic review, and may be revised upward, downward or revoked, at the sole discretion of the rating agencies.

Reserve for Losses and Loss Expenses

We are required by applicable insurance laws and regulations in the countries in which we operate and accounting principles generally accepted in the United States (U.S. GAAP) to establish loss reserves to cover our estimated liability for the payment of all losses and loss expenses incurred with respect to premiums earned on the policies and treaties that we write. These reserves are balance sheet liabilities representing estimates of losses and loss expenses we are required to pay for insured or reinsured claims that have occurred as of or before the balance sheet date. It is our policy to establish these losses and loss expense reserves using prudent actuarial methods after reviewing all information known to us as of the date they are recorded. For more specific information concerning the statistical and actuarial methods we use to estimate ultimate expected losses and loss expenses, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Reserve for Losses and Loss Expenses.

The following tables show the development of gross and net reserves for losses and loss expenses, respectively. The tables do not present accident or policy year development data. Each table begins by showing

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the original year-end reserves recorded at the balance sheet date for each of the years presented (as originally estimated). This represents the estimated amounts of losses and loss expenses arising in all prior years that are unpaid at the balance sheet date, including reserves for losses incurred but not reported (IBNR). The re-estimated liabilities reflect additional information regarding claims incurred prior to the end of the preceding financial year. A (redundancy) or deficiency arises when the re-estimation of reserves recorded at the end of each prior year is (less than) or greater than its estimation at the preceding year-end. The cumulative (redundancies) or deficiencies represent cumulative differences between the original reserves and the currently re-estimated liabilities over all prior years. Annual changes in the estimates are reflected in the consolidated statement of operations and comprehensive income for each year, as the liabilities are re-estimated.

The lower sections of the tables show the portions of the original reserves that were paid (claims paid) as of the end of subsequent years. This section of each table provides an indication of the portion of the re-estimated liability that is settled and is unlikely to develop in the future. For our quota share treaty reinsurance business, we have estimated the allocation of claims paid to applicable years based on a review of large losses and earned premium percentages.

Development of Reserve for Losses and Loss Expenses Cumulative Deficiency (Redundancy)

Gross Losses

	Year Ended December 31, ($ in thousands)										
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008(1)**	**2009**	**2010**	**2011**	**2012**
As Originally Estimated:	$ 310,508	$ 1,062,138	$ 2,084,331	$ 3,543,811	$ 3,900,546	$ 4,307,637	$ 4,576,828	$ 4,761,772	$ 4,879,188	$ 5,225,143	$ 5,645,549
Liability Re-estimated as of:											
One Year Later	253,691	981,713	1,961,172	3,403,274	3,622,721	3,484,894	4,290,335	4,329,254	4,557,847	4,991,161	
Two Years Later	226,943	899,176	1,873,599	3,249,263	3,247,858	3,149,303	3,877,832	3,975,195	4,246,518		
Three Years Later	217,712	845,162	1,733,707	2,894,460	2,911,300	2,791,110	3,576,846	3,670,311			
Four Years Later	199,860	810,183	1,513,697	2,558,600	2,605,761	2,533,557	3,295,723				
Five Years Later	205,432	704,666	1,306,220	2,315,913	2,432,597	2,300,062					
Six Years Later	196,495	626,818	1,235,604	2,190,495	2,314,204						
Seven Years Later	179,752	619,903	1,207,675	2,168,471							
Eight Years Later	184,107	618,248	1,199,686								
Nine Years Later	184,104	618,607									
Ten Years Later	188,482										
Cumulative (Redundancy)	(122,026)	(443,531)	(884,645)	(1,375,340)	(1,586,342)	(2,007,575)	(1,281,105)	(1,091,461)	(632,670)	(233,982)	
Cumulative Claims Paid as of:											
One Year Later	54,288	138,843	374,605	718,263	560,163	583,447	574,823	634,463	656,568	852,091	
Two Years Later	83,465	237,949	574,399	1,154,901	1,002,503	943,879	1,089,540	1,036,171	1,242,079		
Three Years Later	100,978	301,264	725,955	1,521,586	1,252,921	1,311,398	1,391,252	1,408,003			
Four Years Later	124,109	372,187	842,931	1,662,811	1,531,899	1,469,345	1,680,698				
Five Years Later	163,516	425,394	910,393	1,828,977	1,622,539	1,634,536					
Six Years Later	184,691	456,652	971,953	1,864,908	1,705,920						
Seven Years Later	195,688	478,055	994,769	1,916,912							

Eight Years Later	201,516	499,459	1,031,853
Nine Years Later	149,044	514,810	
Ten Years Later	156,529		

(1) Reserve for losses and loss expenses includes the reserves for losses and loss expenses of Finial Insurance Company (now renamed Allied World Insurance Company), which we acquired in February 2008, and Darwin, which we acquired in October 2008.

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Development of Reserve for Losses and Loss Expenses Cumulative Deficiency (Redundancy)

Gross Losses

	Year Ended December 31,									
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Liability Re-estimated as of:										
One Year Later	82%	92%	94%	96%	93%	81%	94%	91%	93%	96%
Two Years Later	73%	85%	90%	92%	83%	73%	85%	83%	87%	
Three Years Later	70%	80%	83%	82%	75%	65%	78%	77%		
Four Years Later	64%	76%	73%	72%	67%	59%	72%			
Five Years Later	66%	66%	63%	65%	62%	53%				
Six Years Later	63%	59%	59%	62%	59%					
Seven Years Later	58%	58%	58%	61%						
Eight Years Later	59%	58%	58%							
Nine Years Later	59%	58%								
Ten Years Later	61%									
Cumulative (Redundancy)	(39%)	(42%)	(42%)	(39%)	(41%)	(47%)	(28%)	(23%)	(13%)	(4%)

Gross Loss and Loss Expense Cumulative Paid as a Percentage of Originally Estimated Liability

Cumulative Claims Paid as of:										
One Year Later	17%	13%	18%	20%	14%	14%	13%	13%	13%	16%
Two Years Later	27%	22%	28%	33%	26%	22%	24%	22%	25%	
Three Years Later	33%	28%	35%	43%	32%	30%	30%	30%		
Four Years Later	40%	35%	40%	47%	39%	34%	37%			
Five Years Later	53%	40%	44%	52%	42%	38%				
Six Years Later	59%	43%	47%	53%	44%					
Seven Years Later	63%	45%	48%	54%						
Eight Years Later	65%	47%	50%							
Nine Years Later	48%	48%								
Ten Years Later	50%									

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Development of Reserve for Losses and Loss Expenses Cumulative Deficiency (Redundancy)

Losses Net of Reinsurance

	Year Ended December 31, ($ in thousands)										
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008(1)**	**2009**	**2010**	**2011**	**2012**
As Originally Estimated:	$ 299,946	$ 967,305	$ 1,809,588	$ 2,826,930	$ 3,211,441	$ 3,624,872	$ 3,688,514	$ 3,841,781	$ 3,951,600	$ 4,222,224	$ 4,504,439
Liability Re-estimated as of:											
One Year Later	243,129	887,870	1,760,469	2,662,723	2,978,320	3,312,248	3,440,522	3,528,426	3,698,072	4,051,875	
Two Years Later	216,381	833,496	1,655,675	2,551,946	2,699,585	3,032,063	3,128,342	3,255,966	3,474,313		
Three Years Later	207,945	773,967	1,551,115	2,281,007	2,416,966	2,742,484	2,882,645	3,020,003			
Four Years Later	191,471	746,355	1,353,988	1,986,782	2,152,221	2,518,524	2,655,736				
Five Years Later	197,656	648,469	1,162,263	1,776,483	1,997,008	2,326,535					
Six Years Later	188,733	574,803	1,098,702	1,663,577	1,895,963						
Seven Years Later	172,219	568,273	1,075,318	1,644,204							
Eight Years Later	176,582	566,975	1,067,080								
Nine Years Later	176,579	567,803									
Ten Years Later	180,956										
Cumulative (Redundancy)	(118,990)	(399,502)	(742,508)	(1,182,726)	(1,315,478)	(1,298,337)	(1,032,778)	(821,778)	(477,287)	(170,349)	
Cumulative Claims Paid as of:											
One Year Later	52,077	133,336	306,865	461,310	377,250	415,214	415,902	498,084	542,649	743,844	
Two Years Later	76,843	214,939	482,038	759,276	698,959	681,332	811,697	843,697	1,050,845		
Three Years Later	93,037	272,028	624,894	990,514	884,077	964,790	1,069,303	1,171,454			
Four Years Later	116,494	342,898	733,286	1,090,679	1,094,011	1,099,963	1,318,773				
Five Years Later	155,904	407,712	783,091	1,219,997	1,167,580	1,244,936					
Six Years Later	172,974	426,354	833,918	1,248,296	1,241,493						
Seven Years Later	176,390	440,812	851,312	1,293,137							
Eight Years Later	177,880	455,271	883,239								
Nine Years Later	141,507	467,305									
Ten Years Later	145,698										

(1) Reserve for losses and loss expenses net includes the reserves for losses and loss expenses of Finial Insurance Company (now renamed Allied World Insurance Company), which we acquired in February 2008, and Darwin, which we acquired in October 2008.

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Development of Reserve for Losses and Loss Expenses Cumulative Deficiency (Redundancy)

Losses Net of Reinsurance

	Year Ended December 31,									
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Liability Re-estimated as of:										
One Year Later	81%	92%	97%	94%	93%	91%	93%	92%	94%	96%
Two Years Later	72%	86%	91%	90%	84%	84%	85%	85%	88%	
Three Years Later	69%	80%	86%	81%	75%	76%	78%	79%		
Four Years Later	64%	77%	75%	70%	67%	69%	72%			
Five Years Later	66%	67%	64%	63%	62%	64%				
Six Years Later	63%	59%	61%	59%	59%					
Seven Years Later	57%	59%	59%	58%						
Eight Years Later	59%	59%	59%							
Nine Years Later	59%	59%								
Ten Years Later	60%									
Cumulative (Redundancy)	(40%)	(41%)	(41%)	(42%)	(41%)	(36%)	(28%)	(21%)	(12%)	(4%)

Net Loss and Loss Expense Cumulative Paid as a Percentage of Originally Estimated Liability

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Cumulative Claims Paid as of:										
One Year Later	17%	14%	17%	16%	12%	11%	11%	13%	14%	18%
Two Years Later	27%	22%	27%	27%	22%	19%	22%	22%	27%	
Three Years Later	33%	28%	35%	35%	28%	27%	29%	30%		
Four Years Later	40%	35%	41%	39%	34%	30%	36%			
Five Years Later	53%	42%	43%	43%	36%	34%				
Six Years Later	59%	44%	46%	44%	39%					
Seven Years Later	63%	46%	47%	46%						
Eight Years Later	65%	47%	49%							
Nine Years Later	48%	48%								
Ten Years Later	49%									

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Losses Net of Reinsurance

The table below is a reconciliation of the beginning and ending liability for unpaid losses and loss expenses for the years ended December 31, 2012, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoveries.

	Year Ended December 31,		
	2012	2011	2010
		($ in millions)	
Net reserves for losses and loss expenses, January 1	$ 4,222.2	$ 3,951.6	$ 3,841.8
Incurred related to:			
Commutation of variable rated reinsurance contracts		11.5	8.9
Current year non-catastrophe	1,130.0	909.0	913.9
Current year property catastrophe	179.6	292.2	98.4
Prior year	(170.3)	(253.5)	(313.3)
Total incurred	1,139.3	959.2	707.9
Paid related to:			
Current year non-catastrophe	99.1	72.1	61.0
Current year property catastrophe	18.1	70.1	37.6
Prior year	743.8	542.6	498.1
Total paid	861.0	684.8	596.7
Foreign exchange revaluation	3.9	(3.8)	(1.4)
Net reserve for losses and loss expenses, December 31	4,504.4	4,222.2	3,951.6
Losses and loss expenses recoverable	1,141.1	1,002.9	927.6
Reserve for losses and loss expenses, December 31	$ 5,645.5	$ 5,225.1	$ 4,879.2

Investments

Investment Strategy and Guidelines

We believe that we follow a conservative investment strategy designed to emphasize the preservation of our invested assets and provide adequate liquidity for the prompt payment of claims. To help ensure adequate liquidity for payment of claims, we take into account the maturity and duration of our investment portfolio and our general liability profile. In making investment decisions, we consider the impact of various catastrophic events to which we may be exposed. As of December 31, 2012, investment grade, fixed-maturity securities and cash and cash equivalents, represented 77% of our total investments and cash and cash equivalents, with the remainder invested in non-investment grade securities and loans, equities, hedge funds and other alternative investments. Our current Investment Policy Statement contains restrictions on the maximum amount of our investment portfolio that may be invested in alternative investments (such as hedge funds and private equity vehicles) as well as a minimum amount that must be maintained in investment grade fixed income securities and cash. Beginning in 2012, two new subsidiaries (Allied World Financial Services, Ltd and Allied World Financial Services, Inc., collectively, AWFS) invest in nonpublic entities that we believe will complement our core insurance and reinsurance operations and diversify our revenues. These investments do not and are not expected to represent a material part of the company s total investment portfolio.

In an effort to meet business needs and mitigate risks, our investment guidelines provide restrictions on our portfolio s composition, including limits on the type of issuer, sector limits, credit quality limits, portfolio duration, limits on the amount of investments in approved countries and permissible security types. We may direct our investment managers to invest some of the investment portfolio in currencies other than the U.S. dollar based on the business we have written, the currency in which our loss reserves are denominated on our books or regulatory requirements.

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Our investment performance is subject to a variety of risks, including risks related to general economic conditions, market volatility, interest rate fluctuations, liquidity risk and credit and default risk. Investment guideline restrictions have been established in an effort to minimize the effect of these risks but may not always be effective due to factors beyond our control. Interest rates are highly sensitive to many factors, including governmental monetary and fiscal policies, domestic and international economic and political conditions and other factors beyond our control. A significant increase in interest rates could result in significant losses, realized or unrealized, in the value of our investment portfolio. Similarly, given our portfolio s exposure to credit assets, a significant increase in credit spreads could result in significant losses to our investment portfolio. Additionally, with respect to some of our investments, we are subject to prepayment and therefore reinvestment risk. Alternative investments, such as our hedge fund and private equity investments, subject us to restrictions on sale, transfer and redemption, which may limit our ability to withdraw funds or realize gains on such investments for some period of time after our initial investment. The values of, and returns on, such investments may also be more volatile.

Investment Committee and Investment Managers

The Investment Committee of our Board of Directors has approved an Investment Policy Statement that contains investment guidelines and supervises our investment activity. The Investment Committee regularly monitors our overall investment results and compliance with investment objectives and guidelines, and ultimately reports our overall investment results to the Board of Directors.

For our fixed income assets and loans we have engaged six outside investment managers to provide us with certain discretionary investment management services. We have agreed to pay investment management fees based on the market values of the investments in the portfolio. The fees, which vary depending on the amount of assets under management, are included as a deduction to net investment income. These investment management agreements may generally be terminated by either party upon 30 days prior written notice.

Our Portfolio

Composition as of December 31, 2012

As of December 31, 2012, we had total investments and cash and cash equivalents of $8.8 billion, including restricted cash, fixed-maturity securities, equity securities, hedge fund, private equity investments and other securities. The average credit quality of our investments is rated AA by Standard & Poor s and Aa3 by Moody s. Short-term instruments must be rated a minimum of A-1, F-1 or P-1 by Standard & Poor s, Moody s or Fitch. The target duration range is 1.00 to 4.25 years. The portfolio has a total return rather than income orientation. The average duration of our investment portfolio was 2.1 years as of December 31, 2012.

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The following table shows the types of securities in our portfolio, their fair market values, average rating and portfolio percentage as of December 31, 2012.

	Fair Value	Average Rating ($ in millions)	Portfolio Percentage
Type of Investment			
Cash and cash equivalents	$ 865.4	AAA	9.8%
U.S. government securities	1,529.2	AA+	17.3%
U.S. government agencies	336.8	AA+	3.8%
Non-U.S. government and government agencies	261.6	AA+	3.0%
State, municipalities and political subdivisions	40.4	AA-	0.5%
Mortgage-backed securities:			
Agency mortgage-backed securities	1,400.9	AA+	15.9%
Non-agency residential mortgage-backed securities	90.3	BBB+	1.0%
Non-agency mortgage-backed securities (non-investment grade strategy)	176.8	CCC	2.0%
Commercial mortgage-backed securities	290.4	AA+	3.4%
Total mortgage-backed securities	1,958.4		22.3%
Corporate securities:			
Financial institutions	866.1	A+	9.8%
Industrials	1,153.9	BBB-	13.1%
Utilities	69.2	BBB-	0.8%
Total corporate securities	2,089.2		23.7%
Asset-backed securities:			
Credit card receivables	24.9	AAA	0.3%
Automobile loan receivables	31.3	AAA	0.4%
Student loan receivables	133.0	AA+	1.5%
Collateralized loan obligations	190.2	AA+	2.2%
Other	31.5	AAA	0.3%
Total asset-backed securities	410.9		4.7%
Other invested assets:			
Hedge funds	151.0	N/A	1.7%
Private equity funds	504.9	N/A	5.7%
Other private securities	127.6	N/A	1.5%
Total other invested assets	783.5		8.9%
Equity securities	523.9	N/A	6.0%
Total investment portfolio	$ 8,799.3		100.0%

For more information on the securities in our investment portfolio, please see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Fair Value of Financial Instruments .

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Ratings as of December 31, 2012

The investment ratings (provided by Standard & Poor s and Moody s) for fixed-maturity securities held as of December 31, 2012 and the percentage of our total fixed-maturity securities they represented on that date were as follows:

	Fair Value	Percentage of Total Fair Value
	($ in millions)	
Ratings		
U.S. government and government agencies	$ 1,865.9	28.2%
AAA/Aaa	866.7	13.1%
AA/Aa	1,905.3	28.8%
A/A	876.1	13.2%
BBB/Bbb	393.9	5.9%
BB/Bb	245.9	3.7%
B/B	262.3	4.0%
CCC+ and below	210.4	3.1%
Total	$ 6,626.5	100.0%

Maturity Distribution as of December 31, 2012

The maturity distribution for our fixed-maturity securities held as of December 31, 2012 was as follows:

	Fair Value	Percentage of Total Fair Value
	($ in millions)	
Maturity		
Due within one year	$ 573.9	8.6%
Due after one year through five years	2,835.9	42.8%
Due after five years through ten years	774.4	11.7%
Due after ten years	73.0	1.1%
Mortgage-backed	1,958.4	29.6%
Asset-backed	410.9	6.2%
Total	$ 6,626.5	100.0%

Investment Returns for the Year Ended December 31, 2012

Our investment returns for year ended December 31, 2012 ($ in millions):

Net investment income	$ 167.1
Net realized investment gains	306.4
Net change in unrealized gains	(17.6)
Total net investment return	$ 455.9

Total financial statement portfolio return(1)	5.5%
Effective annualized yield(2)	2.1%

(1) Total financial statement portfolio return for our investment portfolio is calculated using beginning and ending market values adjusted for external cash flows and includes the net change in unrealized gains and losses.

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(2) Effective annualized yield is calculated by dividing net investment income by the average balance of aggregate invested assets, on an amortized cost basis.

Our Principal Operating Subsidiaries

Allied World Assurance Company, Ltd is a registered Class 4 Bermuda insurance and reinsurance company that began operations in November 2001. It carries on business from its offices in Bermuda and from branch offices licensed in Hong Kong and Singapore, as well as under its license from Labuan. Allied World Assurance Company (Europe) Limited was incorporated as a wholly-owned subsidiary of Allied World Assurance Holdings (Ireland) Ltd and has been approved to carry on business in the E.U. from its office in Dublin, Ireland since October 2002 and from a branch office in London, England since May 2003. Since its formation, Allied World Assurance Company (Europe) Limited has written business primarily originating from Dublin, Ireland, the United Kingdom and Continental Europe. Allied World Assurance Company (Reinsurance) Limited was incorporated as a wholly-owned subsidiary of Allied World Assurance Holdings (Ireland) Ltd and has been approved to carry on business in the E.U. from its office in Ireland since July 2003, from a branch office in London, England since August 2004 and from a branch office in Zug, Switzerland since October 2008. We include the business produced by Allied World Assurance Company (Reinsurance) Limited in our international insurance segment (other than reinsurance business written through its Swiss branch office) even though the majority of coverages are structured as facultative reinsurance. Allied World Assurance Company, AG is a direct subsidiary of Holdings which was formed in Switzerland in May 2010 and licensed by the Swiss Financial Market Supervisory Authority (FINMA) to write insurance and reinsurance from our office in Zug, Switzerland and approved to operate a branch from our office in Bermuda.

We write direct insurance in the United States primarily through four subsidiaries, Allied World Assurance Company (U.S.) Inc. and Allied World National Assurance Company, which we acquired in July 2002, and Darwin National Assurance Company and Darwin Select Insurance Company, which we acquired in October 2008. These companies are authorized or eligible to write insurance on both a surplus lines and admitted basis throughout the United States. In February 2008, we also acquired a fully licensed subsidiary which we operated as Allied World Reinsurance Company until late 2012, when it was renamed Allied World Insurance Company. It offers primarily reinsurance, although it also writes direct insurance. Lastly, Allied World Reinsurance Management Company was formed in Delaware in February 2012. It is licensed to write as a managing general underwriter for our U.S. reinsurance business.

The activities of AWAC Services Company (Bermuda), Ltd, AWAC Services Company (Ireland) Limited and AWAC Services Company are limited to providing certain administrative services to various subsidiaries of Holdings. During 2010, we formed a new subsidiary, 2232 Services Limited, in the United Kingdom in order to administratively support the operations of Syndicate 2232 at Lloyd s. Allied World Financial Services, Ltd and Allied World Financial Services, Inc. were incorporated in Bermuda and Delaware, respectively, during 2012 to engage in investment transactions intended to complement the Company s core property and casualty business.

Our Employees

As of February 11, 2013, we had a total of 818 full-time employees. We believe that our employee relations are good. No employees are subject to collective bargaining agreements.

Regulatory Matters

General

The business of insurance and reinsurance is regulated in most countries, and our operating subsidiaries are required to comply with a wide variety of laws and regulations both in the jurisdictions in which they are organized and where they sell their products. The insurance regulatory environment has become subject to increased scrutiny in many jurisdictions globally.

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Allied World Assurance Company, AG obtained its license from FINMA in March 2011 and is approved to carry on insurance and reinsurance business in specific lines of non-life business. Allied World Assurance Company, AG is required to comply with the Federal Insurance Supervision Act (the ISA), the Federal Insurance Supervision Ordinance and regulations and guidance issued by FINMA. The following are some significant aspects of the Swiss regulatory framework:

Capital and Solvency Requirements. Allied World Assurance Company, AG is required to satisfy minimum capital and solvency requirements. Solvency is determined based on two independent methodologies:

Solvency I: This involves calculating a solvency margin by applying defined percentages to a base of the higher of gross annual premium or gross claims over a prescribed period of time and comparing coverage in terms of the company s admissible funds against the required solvency margin determined in accordance with the ISA.

Swiss Solvency Test (the SST): The SST is similar in nature to the methodology that will be applied under the E.U. s Solvency II regime. Under this approach, capital adequacy is achieved if risk bearing capital exceeds the required solvency capital.

The SST model involves a more sophisticated analysis by providing for a market-consistent valuation of all assets and liabilities of the firm with a methodological approach to risk categories (insurance risk, credit risk etc.) subjecting them to scenario stress tests at a basic level in the context of the use of a standard regulatory model or internal model validated by FINMA.

Allied World Assurance Company, AG is also required to satisfy technical provisions with regard to its assets, which include restrictions concerning the investment of tied assets, which are assets that are secured to ensure the claims of the company s insurance clients.

Corporate Governance, Risk Management and Internal Controls. In addition to quantitative risk measures, FINMA requires full qualitative governance and control of risk in the firm. This includes requirements as to the ongoing fitness, propriety and competence of the directors and senior management, observance of ethical standards, objective and appropriate remuneration procedures, management of conflicts of interests, the institution of a compliance function, independence and adequate resourcing of control functions (including the responsible actuary, the risk management function and the internal audit function). Insurance companies are required to implement documented procedures for risk management and internal control.

In addition, Allied World Assurance Company, AG is subject to annual reporting requirements enacted by FINMA.

Allied World Assurance Company (Reinsurance) Limited also operates a branch office in Zug, Switzerland. As this subsidiary is domiciled outside of Switzerland, conducts only reinsurance business in Switzerland and is regulated by the Central Bank of Ireland (CBI) as a reinsurance undertaking, it is not required to be licensed by FINMA.

Bermuda

The Insurance Act 1978 of Bermuda (the Insurance Act) regulates the insurance and reinsurance business of Allied World Assurance Company, Ltd and provides that no person may carry on any insurance business in or from Bermuda unless registered as an insurer by the Bermuda Monetary Authority (the BMA). Allied World Assurance Company, Ltd has been registered as a Class 4 insurer by the BMA and approved to carry on general insurance and reinsurance business. The Insurance Act also imposes solvency and liquidity standards and auditing and reporting requirements on Bermuda insurance and reinsurance companies and grants the Bermuda Monetary Authority powers to supervise and investigate the affairs of these companies.

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The following are some significant aspects of the Bermuda insurance and reinsurance regulatory framework:

Solvency and Capital Standards. As a Class 4 insurer, Allied World Assurance Company, Ltd is required to maintain a minimum solvency margin and to hold available statutory capital and surplus equal to or exceeding its enhanced capital requirement and target capital level as determined by the BMA under the Bermuda Solvency Capital Requirement model (BSCR model). The BSCR model is a risk-based capital model that provides a method for determining an insurer s enhanced capital requirement and total capital level taking into account the risk characteristics of different aspects of an insurer s business. Allied World Assurance Company, Ltd is required to maintain a minimum solvency margin that is equal to the greatest of (1) $100,000,000; (2) 50% of net premiums written (being gross premiums written less any premiums ceded, but the company may not deduct more than 25% of gross premiums written when computing net premiums written); and (3) 15% of net losses and loss expense reserves.

Eligible Capital. Allied World Assurance Company, Ltd is now required to disclose the makeup of its capital in accordance with the recently introduced three-tiered capital system . Under this system, all of the insurer s capital instruments will be classified as either basic or ancillary capital, which in turn will be classified into one of three tiers based on their loss absorbency characteristics. Highest quality capital will be classified tier 1 capital, lesser quality capital will be classified as either tier 2 capital or tier 3 capital. The maximum of tier 1, 2 and 3 capital that may be used to support the company s minimum solvency margin, enhanced capital requirement and target capital level will be determined in accordance with the BMA s rules.

Liquidity. Allied World Assurance Company, Ltd must maintain a minimum liquidity ratio at least equal to the value of its relevant assets at not less than 75% of the amount of its relevant liabilities.

Dividends. Allied World Assurance Company, Ltd is prohibited from declaring or paying any dividends during any financial year if it is, or would be after such dividend, in breach of its minimum solvency margin, minimum liquidity ratio or enhanced capital requirements. Allied World Assurance Company, Ltd is also prohibited, without prior BMA approval, from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus or from reducing by 15% or more its total statutory capital. Under the Companies Act, Allied World Assurance Company Holdings, Ltd and each of its Bermuda subsidiaries may not declare or pay a dividend if such company has reasonable grounds for believing that it is, or would after the payment be, unable to pay its liabilities as they become due, or that the realizable value of its assets would thereby be less than its liabilities.

Principal office and representatives. Allied World Assurance Company, Ltd must maintain a principal office and appoint a principal representative, loss reserve specialist and independent auditor approved by the BMA.

Filings. Allied World Assurance Company, Ltd must file with the BMA annual and quarterly statutory financial returns, annual GAAP financial statements and an annual capital and solvency return.

Group Supervision. In 2011, the BMA notified Allied World Assurance Company, Ltd that it intended to act as group supervisor of our insurance and reinsurance companies and that Allied World Assurance Company, Ltd had been designated as the designated insurer in respect thereof. In accordance with the current group supervision and solvency rules, Allied World Assurance Company, Ltd is now required to prepare and submit annual audited group U.S. GAAP financial statements, annual group statutory financial statements, an annual group statutory financial return, an annual group capital and solvency return and quarterly group unaudited financial returns. Enhanced group capital requirements will come into effect in 2014.

Currency matters. As the BMA has classified each of our Bermuda subsidiaries as non-residents of Bermuda, these subsidiaries may engage in transactions in currencies other than Bermuda dollars and there are no restrictions on our ability to transfer funds (other than funds denominated in Bermuda dollars) in and out of Bermuda.

Code of Conduct. Allied World Assurance Company, Ltd must comply with the Insurance Code of Conduct which prescribes the duties, standards, procedures and sound business principles with which all companies registered under the Insurance Act must comply. Failure to comply with the requirements of the Insurance Code of Conduct will be taken into account by the BMA in determining whether an insurer is conducting its business in a sound and prudent manner as prescribed by the Insurance Act and may result in the BMA exercising its powers of intervention and investigation and will be a factor in calculating the operational risk charge under the insurer s BSCR model.

Shareholder notification requirements. The BMA also requires written notification from any person who, directly or indirectly, becomes a holder of at least 10%, 20%, 33% or 50% of the voting shares of Allied World Assurance Company, Ltd or its parent within 45 days of becoming such a holder. The BMA may object to such a person if it appears to the BMA that the person is not fit and proper to be such a holder and/or require the shareholder to reduce its holdings or voting rights. A person that does not give the required notification or comply with such a notice or direction from the BMA will be guilty of an offense.

If it appears to the BMA that there is a risk of Allied World Assurance Company, Ltd becoming insolvent, or that Allied World Assurance Company, Ltd is in breach of the Insurance Act or any conditions imposed upon its registration, the BMA may take numerous restrictive actions to protect the public interest, including cancelling our registration under the Insurance Act.

Ireland

Allied World Assurance Company (Europe) Limited is authorized as a non-life insurance undertaking and is regulated by the CBI pursuant to the Insurance Acts 1909 to 2011, the Central Bank Acts 1942 to 2010, and all statutory instruments relating to insurance made or adopted under the European Communities Acts 1972 to 2009 (the Irish Insurance Acts and Regulations). The Third Non-Life Directive of the European Union (the Non-Life Directive) established a common framework for the authorization and regulation of non-life insurance undertakings within the E.U. The Non-Life Directive permits non-life insurance undertakings authorized in a member state of the E.U. to operate in other member states of the E.U. either directly from the home member state (on a freedom to provide services basis) or through local branches (by way of permanent establishment). Allied World Assurance Company (Europe) Limited operates a branch office in the United Kingdom and operates on a freedom to provide services basis in other European Union member states.

Allied World Assurance Company (Reinsurance) Limited is authorized and regulated by the CBI pursuant to the Central Bank Acts 1942 to 2010, all statutory instruments relating to reinsurance made or adopted under the European Communities Acts 1972 to 2009 and the provisions of the European Communities (Reinsurance) Regulations 2006 (which transposed the E.U. Reinsurance Directive into Irish law) and operates branches in London, England and Zug, Switzerland. Pursuant to the provisions of these regulations, reinsurance undertakings may, subject to the satisfaction of certain formalities, carry on reinsurance business in other E.U. member states either directly from the home member state (on a freedom to provide services basis) or through local branches (by way of permanent establishment).

United States

Our U.S. insurance and reinsurance subsidiaries are admitted or surplus line eligible in all 50 states and the District of Columbia. Allied World Assurance Company (U.S.) Inc. is admitted in three states, including Delaware, its state of domicile, surplus lines eligible in 49 jurisdictions, including the District of Columbia and Puerto Rico, and an accredited reinsurer in 38 jurisdictions, including the District of Columbia. Allied World National Assurance Company is admitted in 44 jurisdictions, including New Hampshire, its state of domicile, surplus lines eligible in three states and an accredited reinsurer in one state. Allied World Insurance Company (f/k/a Allied World Reinsurance Company) is admitted to write insurance and reinsurance in all 50 states, including New Hampshire, its state of domicile, and the District of Columbia. Darwin National Assurance Company is domiciled in Delaware and admitted to write in all other U.S. jurisdictions except Arkansas. Darwin Select

Insurance Company, which is an Arkansas company, is admitted in that state and is an eligible surplus lines writer in all other states and the District of Columbia, and Vantapro Specialty Insurance Company, which is an inactive Arkansas company, is currently admitted only in Arkansas and Illinois.

Our U.S. admitted and authorized insurers and reinsurers are subject to considerable regulation and supervision by state insurance regulators. The extent of regulation varies but generally has its source in statutes that delegate regulatory, supervisory and administrative authority to a department of insurance in each state. Among other things, state insurance commissioners regulate inter-affiliate transactions and dividend payments, insurer solvency standards, insurer and agent licensing, authorized investments, premium rates, restrictions on the size of risks that may be insured under a single policy, loss and expense reserves and provisions for unearned premiums, and deposits of securities for the benefit of policyholders. The states regulatory schemes also extend to policy form approval and market conduct regulation. In addition, some states have enacted variations of competitive rate making laws, which allow insurers to set premium rates for certain classes of insurance without obtaining the prior approval of the state insurance department. State insurance departments also conduct periodic examinations of the affairs of authorized insurance companies and require the filing of annual and other reports relating to the financial condition of companies and other matters.

Holding Company Regulation. Insurance holding company laws vary by state but generally require admitted insurers that are subsidiaries of insurance holding companies to register and file with state regulatory authorities certain reports including information concerning their capital structure, ownership, financial condition and general business operations. Generally, all transactions involving the insurers in a holding company system and their affiliates must be fair and, if material, require prior notice and approval or non-disapproval by the state insurance department. In addition, insurance holding company laws limit the amount of inter-company dividend payments which may be paid without regulator approval, as well as restricting any change of control transactions involving more than 10% of an insurance company s voting securities.

Guaranty Fund Assessments and Involuntary Pools. Virtually all states require admitted insurers to participate in various forms of guaranty associations in order to bear a portion of the loss suffered by certain insureds caused by the insolvency of other insurers. Depending upon state law, insurers can be assessed an amount that is generally equal to between 1% and 2% of the annual premiums written for the relevant lines of insurance in that state to pay the claims of insolvent insurers. Most of these assessments are recoverable through premium rates, premium tax credits or policy surcharges. Many states also require participation in assigned risk pools involving workers compensation and automobile insurance.

Risk-Based Capital. U.S. insurers are also subject to risk-based capital (or RBC) guidelines that provide a method to measure the total adjusted capital (statutory capital and surplus plus other adjustments) of insurance companies taking into account the risk characteristics of the company s investments and products. The RBC formulas establish capital requirements for four categories of risk: asset risk, insurance risk, interest rate risk and business risk. As of December 31, 2012, we believe all of our U.S. insurance and reinsurance subsidiaries had adjusted capital in excess of amounts requiring company or regulatory action.

NAIC Ratios. The National Association of Insurance Commissioners (NAIC) Insurance Regulatory Information System, or IRIS, was developed to help state regulators identify companies that may require special attention. IRIS is comprised of statistical and analytical phases consisting of key financial ratios whereby financial examiners review annual statutory basis statements and financial ratios. As of December 31, 2012, we do not believe that any of our U.S. insurance and reinsurance subsidiaries had an IRIS ratio range warranting any regulatory action.

Surplus Lines Regulation. The regulation of our U.S. subsidiaries excess and surplus lines insurance business differs significantly from their regulation as admitted or authorized insurers. These companies are subject to the surplus lines regulation and reporting requirements of the jurisdictions in which they are eligible to write surplus lines insurance. Allied World Assurance Company (U.S.) Inc. and Darwin Select Insurance Company, which conduct business on a surplus lines basis in a particular state, are generally exempt from that state s guaranty fund laws and from participation in its involuntary pools.

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Lloyd s

General. Syndicate 2232 was licensed to start underwriting certain lines of insurance and reinsurance business effective June 2010. Allied World Capital (Europe) Limited is the sole corporate member of Syndicate 2232. Syndicate 2232 is managed by Capita Managing Agency Limited, an unaffiliated entity (Capita).

Lloyd s intervention powers. As a member of Lloyd s, Allied World Capital (Europe) Limited is obliged to comply with Lloyd s bye laws and applicable provisions of the Financial and Services and Markets Act 2000. The Council of Lloyd s has wide discretionary powers to regulate members underwriting at Lloyd s and its exercise of these powers might affect the return on an investment of the corporate member in a given underwriting year.

Capital requirements. The capital required to support a syndicate s underwriting capacity, referred to as funds at Lloyd s , is assessed annually and is determined by Lloyd s in accordance with the capital adequacy rules established by the FSA. If a member of Lloyd s is unable to pay its debts to policyholders, such debts may be payable from the Lloyd s Central Fund, which in many respects acts as an equivalent to a state guaranty fund in the United States. The Council of Lloyd s has discretion to call or assess up to 3% of a member s underwriting capacity in any one year as a Central Fund contribution.

Our business plan, including the maximum underwriting capacity, for Syndicate 2232 requires annual approval by Lloyd s. The Lloyd s Franchise Board may require changes to any business plan and may also require the provision of additional capital to support an approved business plan. If material changes in the business plan for Syndicate 2232 were required by Lloyd s or if charges and assessments payable by Allied World Capital (Europe) Limited to Lloyd s were to increase significantly, these events could have an adverse effect on the operations and financial results of Allied World Capital (Europe) Limited.

The Company has provided capital to support the underwriting of Syndicate 2232 in the form of a letter of credit. An underwriting year of account is closed by way of reinsurance to close on the third anniversary of the inception of the relevant underwriting year. Upon the closing of an underwriting year, a profit or loss will be declared for the closed year of account. Prior to the closure of an underwriting year, funds at Lloyd s cannot typically be reduced unless the consent of Lloyd s is obtained and such consent will only be considered where a member has surplus funds at Lloyd s . Lloyd s approval is also required before any person can acquire control of a Lloyd s managing agent or Lloyd s corporate member.

FSA regulation. Lloyd s is authorized by the FSA and required to implement certain rules prescribed by the FSA under the Lloyd s Act of 1982 regarding the operation of the Lloyd s market. With respect to managing agents and corporate members, Lloyd s prescribes certain minimum standards relating to management and control, solvency and other requirements and monitors managing agents compliance with such standards. Future regulatory changes or rulings by the FSA could impact the business strategy or financial assumptions made by Capita and/or Allied World Capital (Europe) Limited and such impact could adversely affect the Syndicate 2232 s financial conditions and results.

Other applicable laws. Lloyd s worldwide insurance and reinsurance business is subject to various laws, regulations, treaties and policies of the E.U. as well as each jurisdiction in which it operates. Material changes in governmental requirements or laws could have an adverse effect on Lloyd s and its member companies, including Allied World Capital (Europe) Limited.

Asia

Allied World Assurance Company, Ltd received regulatory approval to operate branch offices in Hong Kong, Singapore and Labuan, the Malaysian financial district, in March 2009, December 2009 and July 2011, respectively.

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Latin America

In connection with the opening in 2012 of a Miami office to service primarily markets in Latin America and the Caribbean, Allied World Insurance Company has become registered as a foreign reinsurer in a number of Latin American countries.

Item 1A. Risk Factors.

Factors that could cause our actual results to differ materially from those in the forward-looking statements contained in this Annual Report on Form 10-K and other documents we file with the SEC include the following:

Risks Related to Our Company

Downgrades or the revocation of our financial strength ratings would affect our standing among brokers and customers and may cause our premiums and earnings to decrease significantly.

Ratings have become an increasingly important factor in establishing the competitive position of insurance and reinsurance companies. Each rating is subject to periodic review by, and may be revised downward or revoked at the sole discretion of, the rating agency. The ratings are neither an evaluation directed to our investors nor a recommendation to buy, sell or hold our securities. For the financial strength rating of each of our principal operating subsidiaries, please see Item 1. Business Our Financial Strength Ratings .

If the rating of any of our subsidiaries is revised downward or revoked, our competitive position in the insurance and reinsurance industry may suffer, and it may be more difficult for us to market our products. Specifically, any revision or revocation of this kind could result in a significant reduction in the number of insurance and reinsurance contracts we write and in a substantial loss of business as customers and brokers that place this business move to competitors with higher financial strength ratings.

Additionally, it is common for our reinsurance contracts to contain terms that would allow the ceding companies to cancel the contract for the portion of our obligations if our insurance subsidiaries are downgraded below an A by either A.M. Best or Standard & Poor s. Whether a ceding company would exercise the cancellation right (and, in the case of our U.S. reinsurance business, as described in the paragraph below, the right to require the posting of security) would depend, among other factors, on the reason for such downgrade, the extent of the downgrade, the prevailing market conditions and the pricing and availability of replacement reinsurance coverage. Therefore, we cannot predict in advance the extent to which these rights would be exercised, if at all, or what effect any such cancellations or security postings would have on our financial condition or future operations, but such effect could be material.

For example, if all ceding companies for which we have in force business as of December 31, 2012 were to exercise their cancellation rights or require the posting of security, the estimated impact could result in the return of premium, the commutation of loss reserves, the posting of collateral or a combination thereof. The unearned premium and reserve for losses and loss expenses associated with our reinsurance segment was $323.1 million and $1,480.6 million at December 31, 2012, respectively.

Our U.S. reinsurance subsidiary does not typically post security for the reinsurance contracts it writes. In addition to the cancellation right discussed above, should the company s A.M. Best rating or Standard & Poor s rating be downgraded below A-, some ceding companies would have the right to require the subsidiary to post security for its portion of the obligations under such contracts. If this were to occur, our U.S. reinsurance subsidiary may not have the liquidity to post security as stipulated in such reinsurance contracts.

All Lloyd s syndicates benefit from Lloyd s central resources, including the Lloyd s brand, its network of global licenses and the central fund. The central fund is available at the discretion of the Council of Lloyd s to meet any valid claim that cannot be met by the resources of any member. Because all Lloyd s policies are ultimately backed by the central fund, a single market rating can be applied. The ability of Lloyd s syndicates to trade in certain classes of business at current levels is dependent on the maintenance of a satisfactory credit rating issued by an accredited rating agency. A. M. Best has assigned Lloyd s a financial strength rating of A (Excellent) and Standard & Poor s and Fitch Ratings have assigned Lloyd s a financial strength rating of A+ (Strong). Syndicate 2232 benefits from Lloyd s current ratings and would be adversely affected if the current ratings were downgraded from their present levels.

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We also cannot assure you that A.M. Best, Standard & Poor s, Moody s or Fitch Ratings will not downgrade our insurance subsidiaries.

Actual claims may exceed our reserves for losses and loss expenses.

Our success depends on our ability to accurately assess the risks associated with the businesses that we insure and reinsure. We establish loss reserves to cover our estimated liability for the payment of all losses and loss expenses incurred with respect to the policies we write. 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 actuarial and statistical projections and on our assessment of currently available data, as well as estimates of future trends in claims severity and frequency, judicial theories of liability and other factors. Loss reserve estimates are refined as experience develops and claims are reported and resolved. Establishing an appropriate level of loss reserves is an inherently uncertain process. It is therefore possible that our reserves at any given time will prove to be inadequate.

To the extent we determine that actual losses or loss expenses exceed our expectations and reserves reflected in our financial statements, we will be required to increase our reserves to reflect our changed expectations. This could cause a material increase in our liabilities and a reduction in our profitability, including operating losses and a reduction of capital. Our results for the year ended December 31, 2012 included $298.6 million and $128.3 million of favorable (*i.e*., a loss reserve decrease) and adverse development (*i.e*., a loss reserve increase), respectively, of reserves relating to losses incurred for prior loss years. In comparison, our results for the year-ended December 31, 2011 included $362.2 million and $108.7 million of favorable and adverse development, respectively, of reserves relating to losses incurred for prior loss years. Our results for the year ended December 31, 2010 included $358.8 million and $45.5 million of favorable and adverse development, respectively, of reserves relating to losses incurred for prior loss years.

We have estimated our net losses from catastrophes based on actuarial analyses of claims information received to date, industry modeling and discussions with individual insureds and reinsureds. Accordingly, actual losses may vary from those estimated and will be adjusted in the period in which further information becomes available.

We may experience significant losses and volatility in our financial results from catastrophic events.

As a casualty and property insurer and reinsurer, we may experience significant losses from claims arising out of catastrophic events. Catastrophes can be caused by various unpredictable events, including earthquakes, volcanic eruptions, hurricanes, windstorms, hailstorms, drought, severe winter weather, floods, fires, tornadoes, explosions and other natural or man-made disasters, including oil spills and other environmental contamination. The international geographic distribution of our business subjects us to catastrophe exposure from natural events occurring in a number of areas throughout the world, examples of which include floods and windstorms in Europe, hurricanes and windstorms in Mexico, Florida, the Gulf Coast and the Atlantic Coast regions of the United States, typhoons and earthquakes in Japan and Taiwan, and earthquakes in California and parts of the Midwestern United States known as the New Madrid zone. Our largest exposure to wind events is concentrated in the Southeast and Gulf Coast of the United States. Our largest exposure to earthquake events is concentrated in California. The loss experience of catastrophe insurers and reinsurers has historically been characterized as low frequency but high severity in nature. In recent years, the frequency of major catastrophes appears to have increased and may continue to increase as a result of global climate change and other factors. Increases in the values and concentrations of insured property and the effects of inflation have resulted in increased severity of losses to the industry in recent years, and we expect this trend to continue.

The loss limitation methods we employ, such as establishing maximum aggregate exposed limits on policies written in key coastal and other defined geographical zones, restrictive underwriting guidelines and purchasing reinsurance, may not be sufficient protection against losses from catastrophes. In the event we do not accurately estimate losses from catastrophes that have already occurred, there is a possibility that loss reserves for such catastrophes will be inadequate to cover the losses. Because U.S. GAAP does not permit insurers and reinsurers to reserve for catastrophes until they occur, claims from these events could cause substantial volatility in our

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financial results for any fiscal quarter or year and could have a material adverse effect on our financial condition and results of operations. In addition, losses from catastrophic events could result in downward revisions to our financial strength ratings from the various rating agencies that cover us.

The risk models we use to quantify catastrophe exposures and risk accumulations may prove inadequate in predicting all outcomes from potential catastrophe events.

We use widely accepted and industry-recognized catastrophe risk modeling programs to help us quantify our aggregate exposure to any one event. As with any model of physical systems, particularly those with low frequencies of occurrence and potentially high severity of outcomes, the accuracy of the model s predictions is largely dependent on the accuracy and quality of the data provided in the underwriting process and the judgments of our employees and other industry professionals. These models do not anticipate all potential perils or events that could result in a catastrophic loss to us. Furthermore, it is often difficult for models to anticipate and incorporate events that have not been experienced during or as a result of prior catastrophes. Accordingly, it is possible for us to be subject to events or contingencies that have not been anticipated by our catastrophe risk models and which could have a material adverse effect on our reserves and results of operations.

We may be adversely impacted by inflation.

Our operations, like those of other property and casualty insurers and reinsurers, are susceptible to the effects of inflation because premiums are established before the ultimate amounts of loss and loss adjustment expense are known. Although we consider the potential effects of inflation when setting premium rates, our premiums may not fully offset the effects of inflation and essentially result in our under pricing the risks we insure and reinsure. Our reserve for losses and loss adjustment expenses includes assumptions about future payments for settlement of claims and claims-handling expenses, such as the value of replacing property and associated labor costs for the property business we write, the value of medical treatments and litigation costs. To the extent inflation causes theses costs to increase above reserves established for these claims, we will be required to increase our loss reserves with a corresponding reduction in our net income in the period in which the deficiency is identified, which may have a material adverse effect on our financial condition and results of operations.

We could face losses from terrorism and political unrest.

We have exposure to losses resulting from acts of terrorism and political instability. Although we generally exclude acts of terrorism from our property insurance policies and property reinsurance treaties where practicable, we provide coverage in circumstances where we believe we are adequately compensated for assuming those risks.

Our trade credit and political risk insurance program protects insureds with interests in foreign jurisdictions in the event governmental action prevents them from exercising their contractual rights and may also protect their assets against physical damage perils. This may include risks arising from expropriation, forced abandonment, license cancellation, trade embargo, contract frustration, non-payment, war on land or political violence, including terrorism, revolution, insurrection and civil unrest. Political risk insurance is typically provided to financial institutions, equity investors, exporters, importers, export credit agencies and multilateral agencies in an array of industries, in connection with investments and contracts in both emerging markets and developed countries.

Our trade credit and political risk insurance program also protects insureds in foreign jurisdictions against non-payment coverage on specific loan obligations as a result of commercial as well as political risk events. We attempt to manage our exposure, by among other things, setting credit limits by country, region, industry and individual counterparty and regularly reviewing our aggregate exposures. The occurrence of one or more large losses in our credit and political risk insurance portfolio could have a material adverse effect on our results of operations or financial condition.

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We could face losses from pandemic diseases.

A pandemic disease could also cause us to suffer significantly increased insurance losses on a variety of coverages we offer. Our reinsurance protections may only partially offset these losses. Moreover, even in cases where we seek to exclude coverage, we may not be able to completely eliminate our exposure to these events. It is impossible to predict the timing or severity of these events with statistical certainty or to estimate the amount of loss that any given occurrence will generate. We could also suffer losses from a disruption of our business operations and our investments may suffer a decrease in value due to the occurrence of any of these events. To the extent we suffer losses from these risks, such losses could be significant.

Our business and our financial results may be adversely affected by unexpected levels of loss due to climate change.

A substantial portion of our revenues are derived from the underwriting of property insurance and reinsurance around the world. Therefore, large scale climate change (often referred to as global warming) as well as changing ocean temperatures could increase the frequency and severity of our loss costs related to property damage and/or business interruption due to hurricanes, windstorms, flooding, blizzards, tornadoes or other severe weather events particularly with respect to properties located in coastal areas. Additionally, if changes in climatic patterns and ocean temperature conditions continue, it is likely that such changes will further impair the ability to predict the frequency and severity of future weather-related disasters in many parts of the world. Over the longer term, such decreased predictability will create additional uncertainty as to future trends and exposures. In addition to unexpected increases in covered losses and decreased predictability, global climate change may also give rise to new environmental liability claims against policyholders that compete in the energy, automobile manufacturing and other industries that we serve. There could be an increase in claims against policyholders of directors and officers liability or related management liability policies alleging a failure to supervise, manage or properly disclose climate change exposures. We may also incur greater-than-expected expense levels due to the costs involved in responding to regulators, rating agencies and other interested constituencies with respect to climate change and other environmental disclosures.

The perceived effects of climate change on debt obligations can impact our investment mix in any one issuer, industry or region. The largest per-issuer exposure, outside of government and government-related issuers, represented less than 1% of our investment portfolio and the largest ten exposures represented less than 4% of the portfolio as of December 31, 2012.

The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or results of operations.

We seek to limit our loss exposure by adhering to maximum limitations on policies written in defined geographical zones (which limits our exposure to losses in any one geographic area), limiting program size for each client (which limits our exposure to losses with respect to any one client), adjusting retention levels and establishing per risk and per occurrence limitations for each event and establishing prudent underwriting guidelines for each insurance program written (all of which limit our liability on any one policy). Many of our direct liability insurance policies include maximum aggregate limitations. We cannot assure you that any of these loss limitation methods will be effective. In particular, geographic zone limitations involve significant underwriting judgments, including the determination of the areas of the zones and whether a policy falls within particular zone limits. Disputes relating to coverage and choice of legal forum may also arise. As a result, various provisions of our policies that are designed to limit our risks, such as limitations or exclusions from coverage (which limit the range and amount of liability to which we are exposed on a policy) or choice of forum (which provides us with a predictable set of laws to govern our policies and the ability to lower costs by retaining legal counsel in fewer jurisdictions), may not be enforceable in the manner we intend and some or all of our other loss limitation methods may prove to be ineffective. One or more catastrophic or other events could result in claims and expenses that substantially exceed our expectations and could have a material adverse effect on our results of operations.

Turmoil in the U.S. and international financial markets could harm our business, liquidity and financial condition, and our share price.

Recent U.S. debt ceiling and budget deficit concerns, together with adverse sovereign debt conditions in Europe, have increased the possibility of further economic slowdowns. These conditions, including the possibility of a prolonged recession, may potentially affect various aspects of our business, including the demand for and claims made under our products, our counterparty credit risk and the ability of our customers, counterparties and others to establish or maintain their relationships with us, our ability to access and efficiently use internal and external capital resources and our investment performance. Continued volatility in the U.S. and other securities markets may also adversely affect our share price.

We may be adversely impacted by the European sovereign debt crisis.

Developments in Europe have created uncertainty with respect to the ability of certain European countries to continue to service their sovereign debt obligations. The debt crisis and related European financial restructuring efforts may cause the value of the Euro to deteriorate. These factors could lead to an exit by a member country from the European Union. A country s exit from the European Union could lead to a devaluation of any currency that such country introduces to replace the Euro. Our customers or brokers located in the impacted country may be unable to pay the monies due to us or may seek to renegotiate their insurance policies or reinsurance contracts in the new currency at terms that are less favorable or unfavorable to us. The resulting financial climate from such an event could also lead to greater-than-expected losses on some of the in-force insurance policies or reinsurance contracts. For example, directors and officers policies issued to financial institutions may experience higher losses as a result. We may also experience increased loss activity in our trade credit and political risk portfolio. To the extent we suffer losses from the crisis in Europe, such losses could be significant.

For our reinsurance business, we depend on the policies, procedures and expertise of ceding companies; these companies may fail to accurately assess the risks they underwrite which may lead us to inaccurately assess the risks we assume.

Because we participate in reinsurance markets, the success of our reinsurance underwriting efforts depends in part on the policies, procedures and expertise of the ceding companies making the original underwriting decisions (when an insurer transfers some or all of its risk to a reinsurer, the insurer is sometimes referred to as a ceding company). Underwriting is a matter of judgment, involving important assumptions about matters that are inherently unpredictable and beyond the ceding companies control and for which historical experience and statistical analysis may not provide sufficient guidance. We face the risk that the ceding companies may fail to accurately assess the risks they underwrite, which, in turn, may lead us to inaccurately assess the risks we assume as reinsurance; if this occurs, the premiums that are ceded to us may not adequately compensate us and we could face significant losses on these reinsurance contracts.

The availability and cost of security arrangements for reinsurance transactions may materially impact our ability to provide reinsurance from Bermuda to insurers domiciled in the United States.

Allied World Assurance Company, Ltd, our Bermuda insurance and reinsurance company, is not admitted as an insurer, nor is it accredited as a reinsurer, in any jurisdiction in the United States. As a result, it is required to post collateral security with respect to most 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 the 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 and has access to up to $1.45 billion in letters of credit under two letter of credit facilities. The letter of credit facilities impose restrictive covenants, including restrictions on asset sales, limitations on the incurrence of certain liens and required collateral and financial strength levels. Violations of these or other covenants could result in the suspension of access to letters of credit or such letters of credit becoming due and payable. Our access to our existing letter of credit facilities is dependent on the ability of the banks that are parties to these facilities to meet their commitments. Our $1 billion letter of credit facility with Citibank Europe plc is on an uncommitted basis, which means Citibank Europe has agreed to offer us up to $1 billion in letters of credit, but they are not contractually obligated for that full amount. Our $450 million syndicated letter of credit facility expires in June 2016. The lenders under our letter of credit facilities may not be able to meet their commitments if they become insolvent, file for bankruptcy protection or if they otherwise experience shortages of capital and liquidity. If these letter of credit facilities are not sufficient or drawable or if Allied World Assurance Company, Ltd is unable to renew either or both of these facilities or to arrange for trust accounts or other types of security on commercially acceptable terms, its ability to provide reinsurance to U.S.-domiciled insurers may be severely limited and adversely affected.

In addition, security arrangements with ceding insurers may subject our assets to security interests or may require that a portion of our assets be pledged to, or otherwise held by, third parties. Although the investment income derived from our assets while held in trust typically accrues to our benefit, the investment of these assets is governed by the terms of the letter of credit facilities and the investment regulations of the state of domicile of the ceding insurer, which generally regulate the amount and quality of investments permitted and which may be more restrictive than the investment regulations applicable to us under Bermuda law. These restrictions may result in lower investment yields on these assets, which could adversely affect our profitability.

We depend on a small number of brokers for a large portion of our revenues. The loss of business provided by any one of them could adversely affect us.

We market our insurance and reinsurance products worldwide through insurance and reinsurance brokers. For the year ended December 31, 2012, our top three brokers represented approximately 55% of our total gross premiums written. Marsh, Aon (including Benfield Group Ltd.) and Willis were responsible for the distribution of approximately 25%, 19% and 11%, respectively, of our total gross premiums written for the year ended December 31, 2012. Loss of all or a substantial portion of the business produced by any one of those brokers could have a material adverse effect on our financial condition, results of operations and business.

Our reliance on brokers subjects us to their credit risk.

In accordance with industry practice, we frequently pay amounts owed on claims under our insurance and reinsurance contracts to brokers, and these brokers, in turn, pay these amounts to the customers that have purchased insurance or reinsurance from us. If a broker fails to make such a payment, it is likely that, in most cases, we will be liable to the client for the deficiency because of local laws or contractual obligations. Likewise, when a customer pays premiums for policies written by us to a broker for further payment to us, these premiums are generally considered to have been paid and, in most cases, the client will no longer be liable to us for those amounts, whether or not we actually receive the premiums. Consequently, we assume a degree of credit risk associated with the brokers we use with respect to our insurance and reinsurance business.

We may be unable to purchase reinsurance for our own account on commercially acceptable terms or to collect under any reinsurance we have purchased.

We acquire reinsurance purchased for our own account to mitigate the effects of large or multiple losses on our financial condition. From time to time, market conditions have limited, and in some cases prevented, insurers and reinsurers from obtaining the types and amounts of reinsurance they consider adequate for their business needs. For example, following the events of September 11, 2001, terms and conditions in the reinsurance markets generally became less attractive to buyers of such coverage. Similar conditions may occur at any time in the future and we may not be able to purchase reinsurance in the areas and for the amounts required or desired. Even if reinsurance is generally available, we may not be able to negotiate terms that we deem appropriate or acceptable or to obtain coverage from entities with satisfactory financial resources.

In addition, the recent financial market turmoil may significantly adversely affect the ability of our reinsurers and retrocessionaires to meet their obligations to us. A reinsurer s insolvency, or inability or refusal to make payments under a reinsurance or retrocessional reinsurance agreement with us, could have a material adverse effect on our financial condition and results of operations because we remain liable to the insured under the corresponding coverages written by us.

Our investment performance may adversely affect our financial performance and ability to conduct business.

We derive a significant portion of our income from our invested assets. As a result, our operating results depend in part on the performance of our investment portfolio. Ongoing conditions in the U.S. and international financial markets have and could continue to adversely affect our investment portfolio. Depending on market conditions, we could incur additional losses in future periods, which could have a material adverse effect on our financial condition, results of operations and business.

Our investment portfolio is overseen by our Chief Investment Officer and managed by professional investment management firms in accordance with the Investment Policy Statement approved by the Investment Committee of the Board of Directors. Our investment performance is subject to a variety of risks, including risks related to general economic conditions, market volatility and interest rate fluctuations, liquidity risk, and credit and default risk. Additionally, with respect to some of our investments, we are subject to pre-payment or reinvestment risk. Our current Investment Policy Statement constrains the amount of our investment portfolio that may be invested in alternatives (such as hedge funds and private equity). As a result, we may be subject to restrictions on redemption, which may limit our ability to withdraw funds or realize on such investments for some period of time after our initial investment. The values of, and returns on, such investments may also be more volatile. In addition, investments in hedge funds may involve certain other risks, including the limited operating history of a fund as well as risks associated with the strategies employed by the managers of the fund.

Because of the unpredictable nature of losses that may arise under insurance or reinsurance policies written by us, our liquidity needs could be substantial and may arise at any time. To the extent we are unsuccessful in managing our investment portfolio within the context of our expected liabilities, we may be forced to liquidate our investments at times and prices that are not optimal, or we may have difficulty in liquidating some of our alternative investments due to restrictions on sales, transfers and redemptions noted above. This could have a material adverse effect on the performance of our investment portfolio. If our liquidity needs or general liability profile unexpectedly change, we may not be successful in continuing to structure our investment portfolio in its current manner. In addition, investment losses could significantly decrease our book value, thereby affecting our ability to conduct business.

While we maintain an investment portfolio with instruments rated highly by the recognized rating agencies, there are no assurances that these high ratings will be maintained. Over the past several years companies with highly-rated debt have filed for bankruptcy. The assignment of a high credit rating does not preclude the potential for the risk of default on any investment instrument.

Any increase in interest rates and/or credit spread levels could result in significant losses in the fair value of our investment portfolio.

Our investment portfolio contains interest-rate-sensitive instruments that may be adversely affected by changes in interest rates. Fluctuations in interest rates affect our returns on fixed income investments. Generally, investment income will be reduced during sustained periods of lower interest rates as higher-yielding fixed income securities are called, mature or are sold and the proceeds reinvested at lower rates. During periods of rising interest rates, prices of fixed income securities tend to fall and realized gains upon their sale are reduced. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. We may not be able to effectively mitigate interest rate sensitivity. In particular, a significant increase in interest rates could result in significant losses, realized or unrealized, in the fair value of our investment portfolio and, consequently, could have a material adverse effect on our financial condition and results of operations. Additionally, changes in the credit spread (the difference in the percentage yield) between U.S. Treasury securities and non-U.S. Treasury securities may negatively impact our investment portfolio as we may not be able to effectively mitigate credit spread sensitivity. In particular, a significant increase in credit spreads could result in significant losses, realized or unrealized, in the fair value of our investment portfolio and, consequently, could have a material adverse effect on our financial condition and results of operations.

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In addition, our investment portfolio includes U.S. government agency and non-agency commercial and residential mortgage-backed securities. As of December 31, 2012, mortgage-backed securities constituted approximately 22% of the fair value of our total investments and cash and cash equivalents, of which 16% of the fair value was invested in U.S. government agency mortgage-backed securities. Changes in interest rates can expose us to prepayment risks on these investments. In periods of declining interest rates, mortgage prepayments generally increase and mortgage-backed securities are generally prepaid more quickly, requiring us to reinvest the proceeds at the then current market rates. In periods of rising interest rates, mortgage-backed securities may have declining levels of prepayments, extending their maturity and duration, thereby negatively impacting the security s price.

Our non-agency commercial and residential mortgage-backed securities are subject to delinquencies, defaults and losses on the underlying mortgage loans. While many of the factors that led to such delinquencies, defaults and losses have moderated over the last 12 months, further deterioration is possible. Delinquencies, defaults and losses with regard to non-agency residential mortgage-backed securities are driven in part by residential property values. A decline or an extended flattening in property values may result in increased delinquencies, defaults and losses on residential mortgage loans generally, especially with respect to second homes and investor properties, and with respect to any residential mortgage loans where the aggregate loan amounts (including any subordinate loans) are close to or greater than the related property values. This would negatively impact the value of our securities.

Our investment portfolio includes below investment-grade securities that have a higher degree of credit or default risk, which could result in significant losses in the fair value of our investment portfolio.

Our investment portfolio consists primarily of investment grade, fixed-maturity securities. We invest a smaller portion of the portfolio in below investment-grade securities. As of December 31, 2012, below investment-grade securities comprised approximately 11% of our fixed-maturity portfolio. These securities, which pay a higher rate of interest, also have a higher degree of credit or default risk. These securities may also be less liquid and/or may experience default losses in times of economic weakness or market disruptions (such as a recession), which could have a material adverse effect on our financial condition and results of operations.

The valuation of our investments may include methodologies, estimations and assumptions that are subject to differing interpretations and could result in changes to investment valuations that may materially adversely affect our financial condition or results of operations.

During periods of market disruptions, it may be difficult to value certain of our securities if trading becomes less frequent or market data becomes less observable. In addition, there may be certain asset classes that were in active markets with significant observable data that become illiquid due to the recent financial environment. In such cases, the valuation of a greater number of securities in our investment portfolio may require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation as well as valuation methods that are more sophisticated or require greater estimation thereby resulting in values which may be less than the value at which the investments may be ultimately sold. Further, rapidly changing and unpredictable credit and equity market conditions could materially affect the valuation of securities as reported within our consolidated financial statements and the period-to-period changes in value could vary significantly. Decreases in value could have a material adverse effect on our financial condition and results of operations.

We may be adversely affected by fluctuations in currency exchange rates.

The U.S. dollar is our reporting currency and the functional currency of all of our operating subsidiaries. We enter into insurance 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. Assets 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. We may incur foreign currency exchange gains or losses as we ultimately receive premiums and settle claims required to be paid in foreign currencies.

We have currency hedges in place that seek to alleviate our potential exposure to volatility in foreign exchange rates and intend to consider the use of additional hedges when we are advised of known or probable significant losses that will be paid in currencies other than the U.S. dollar. To the extent that we do not seek to hedge our foreign currency risk or our hedges prove ineffective, the impact of a movement in foreign currency exchange rates could adversely affect our financial condition or results of operations. The sovereign debt crisis in Europe and the related restructuring efforts may, among other factors, magnify the risk of exchange rate volatility.

We may require additional capital in the future that may not be available to us on commercially favorable terms.

Our future capital requirements depend on many factors, including our ability to write new business and to establish premium rates and reserves at levels sufficient to cover losses. To the extent that the funds generated by insurance premiums received and sale proceeds and income from our investment portfolio are insufficient to fund future operating requirements and cover losses and loss expenses, we may need to raise additional funds through financings or reduce our assets. Financial market volatility since 2008 has created uncertainty in the equity and credit markets and may have affected our ability, and the ability of others within our industry, to raise additional capital in the public or private markets. Any future financing, if available at all, may be on terms that are not favorable to us. In the case of equity financing, dilution to our shareholders could result, and the securities issued may have rights, preferences and privileges that are senior or otherwise superior to those of our common shares.

Our business could be adversely affected if we lose any member of our management team or are unable to attract and retain our personnel.

Our success depends in substantial part on our ability to attract and retain our employees who generate and service our business. We rely substantially on the services of our executive management team. If we lose the services of any member of our executive management team, our business could be adversely affected. If we are unable to attract and retain other talented personnel, the further implementation of our business strategy could be impeded. This, in turn, could have a material adverse effect on our business. We currently have written employment agreements with our Chief Executive Officer, General Counsel, Chief Actuary and certain other members of our executive management team. We do not maintain key man life insurance policies for any of our employees.

Employee error and misconduct may be difficult to detect and prevent and could adversely affect our business, results of operations and financial condition.

We may experience losses from, among other things, fraud, errors, the failure to document transactions properly or to obtain proper internal authorization or the failure to comply with regulatory or legal requirements. It is not always possible to deter or prevent employee misconduct and the precautions we take to prevent and detect this activity may not be effective in all cases. Losses related to employee error or misconduct could adversely affect our financial condition, results of operations and business.

If a program administrator were to exceed its underwriting authority or otherwise breach obligations owed to us, we could be adversely affected.

We write a portion of our insurance business through relationships with program administrators, under contracts pursuant to which we authorize such program administrators to underwrite and bind business on our behalf, within guidelines we prescribe. In this structure, we rely on controls incorporated in the provisions of the program administration agreement, as well as on the administrator s internal controls, to limit the risks insured to those which are within the prescribed parameters. Although we monitor program administrators on an ongoing basis, our monitoring efforts may not be adequate or our program administrators could exceed their underwriting authorities or otherwise breach obligations owed to us. We are liable to policyholders under the terms of policies underwritten by program administrators, and to the extent such administrators exceed their authorities or otherwise breach their obligations to us, our financial condition or results of operations could be material adversely affected.

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If we experience difficulties with our information technology and telecommunications systems and/or data security, our ability to conduct our business might be adversely affected.

We rely heavily on the successful, uninterrupted functioning of our information technology (IT) and telecommunications systems. Our business and continued expansion is highly dependent upon our ability to perform, in an efficient and uninterrupted fashion, necessary business functions, such as pricing, quoting and processing policies, paying claims, performing actuarial and other modeling functions. A failure of our IT and telecommunication systems or the termination of third-party software licenses we rely on in order to maintain such systems could materially impact our ability to write and process business, provide customer service, pay claims in a timely manner or perform other necessary actuarial, legal, financial and other business functions. Computer viruses, hackers and other external hazards, as well as internal exposures such as potentially dishonest employees, could expose our IT and data systems to security breaches that may result in liability to us, cause our data to be corrupted and cause us to commit resources, management time and money to prevent or correct security breaches. Some of our key business partners rely on our systems for critical underwriting and administration functions and interruption and/or failure of these systems could cause significant liability to them. If we do not maintain adequate IT and telecommunications systems, we could experience adverse consequences, including inadequate information on which to base critical decisions, the loss of existing customers, difficulty in attracting new customers, litigation exposures and increased administrative expenses. As a result, our ability to conduct our business might be adversely affected.

The integration of acquired companies, the growth of our operations through new lines of insurance or reinsurance business, the expansion into new geographic regions and/or the entering into joint ventures or partnerships may expose us to operational risks.

Acquisitions involve numerous risks, including operational, strategic and financial risks such as potential liabilities associated with the acquired business. We may experience difficulties in integrating an acquired company, which could adversely affect the acquired company s performance or prevent us from realizing anticipated synergies, cost savings and operational efficiencies. Our existing businesses could also be negatively impacted by acquisitions. Expanding our lines of business, expanding our geographic reach and entering into joint ventures or partnerships also involve operational, strategic and financial risks, including retaining qualified management and implementing satisfactory budgetary, financial and operational controls. Our failure to manage successfully these risks may adversely affect our financial condition, results of operations or business, or we may not realize any of the intended benefits.

As a result of the higher par value of our common shares and increased shareholder approval power under Swiss law, we have less flexibility with respect to certain aspects of capital management.

The par value of our common shares is CHF 12.64 per share (as may be adjusted in connection with the payment of dividends by virtue of a par value reduction, as approved by our shareholders). Under Swiss law, we may not issue shares below par value. In the event we need to raise common equity capital at a time when the trading price of our shares is below the par value of such shares, we will be unable to do so. As a consequence we would have to consider reducing the par value of our common shares, which in turn would reduce our ability to make tax-free distributions by par value reductions to our shareholders. We would also need to obtain approval of our shareholders to decrease the par value of our common shares, which would require us to file a proxy statement with the SEC and convene a meeting of shareholders. This would delay any capital raising plans and there is no assurance that we would be able to obtain such shareholder approval. See Risks Related to Taxation We may not be able to make distributions or repurchase shares without subjecting you to Swiss withholding tax.

Swiss law affords shareholders more powers and allows our shareholders to authorize share capital that can be issued by the Board of Directors without shareholder approval. Under Swiss law, this authorization is limited to 50% of a company s existing registered share capital and must be renewed by the shareholders every two years. Under our Articles of Association, this authorization is further limited to 20% of our existing registered share capital. Additionally, subject to specified exceptions described in our Articles of Association, Swiss law grants preemptive rights to existing shareholders to subscribe for new issuances of shares and other securities.

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Swiss law also does not provide as much flexibility in the various terms that can attach to different classes of shares. For example, we will not be able to issue preferred stock without the approval of a majority of the votes cast at a shareholder meeting. Swiss law also reserves for approval by shareholders many corporate actions, such as that dividends must be approved by shareholders. There may be situations where the restrictions on capital management flexibility under Swiss law could have a material adverse effect on us and our shareholders.

We may become subject to additional Swiss regulation.

Under so-called group supervision, FINMA has the right to supervise us on a group-wide basis. On December 11, 2009, we received non-binding written confirmation from FINMA that it will not subject us to group supervision based primarily on the fact that most of our senior management will not reside in Switzerland. Factors which can cause FINMA to subject us to group supervision include the location of our top management and corresponding requests by foreign regulators. We cannot assure you that our future business needs may not require us to have a greater management presence in Switzerland or that FINMA will not otherwise determine to exercise group supervision over us. If subjected to group supervision, we may incur additional costs and administrative obligations. These additional costs and administrative obligations may have a substantial impact on our organizational and operational flexibility.

Risks Related to the Insurance and Reinsurance Business

The insurance and reinsurance business is historically cyclical and we expect to experience periods with excess underwriting capacity and unfavorable premium rates and policy terms and conditions.

Historically, insurers and reinsurers have experienced significant fluctuations in operating results due to competition, frequency of occurrence or severity of catastrophic events, levels of underwriting capacity, general economic conditions and other factors. The supply of insurance and reinsurance is related to prevailing prices, the level of insured losses and the level of industry surplus which, in turn, may fluctuate in response to changes in rates of return on investments being earned in the insurance and reinsurance industry. The occurrence, or non-occurrence, of catastrophic events, the frequency and severity of which are unpredictable, affects both industry results and consequently prevailing market prices for certain of our products. As a result of these factors, the insurance and reinsurance business historically has been a cyclical industry characterized by periods of intense competition on price and policy terms due to excessive underwriting capacity as well as periods when shortages of capacity permit favorable premium rates and policy terms and conditions. Increases in the supply of insurance and reinsurance may have adverse consequences for us, including fewer policies and contracts written, lower premium rates, increased expenses for customer acquisition and retention and less favorable policy terms and conditions.

Increased competition in the insurance and reinsurance markets in which we operate could adversely impact our operating margins.

The insurance and reinsurance industry are highly competitive. We compete with major U.S. and international insurers and reinsurers. Many of our competitors have greater financial, marketing and management resources. We also compete with new companies that continue to be formed to enter the insurance and reinsurance markets.

In addition, risk-linked securities and derivative and other non-traditional risk transfer mechanisms and vehicles are being developed and offered by other parties, including entities other than insurance and reinsurance companies. The availability of these non-traditional products could reduce the demand for traditional insurance and reinsurance. A number of new, proposed or potential industry or legislative developments could further increase competition in our industry.

New competition from these developments could result in fewer contracts written, lower premium rates, increased expenses for customer acquisition and retention and less favorable policy terms and conditions, which could have a material adverse effect on our growth, financial condition or results of operations.

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The effects of emerging claims and coverage issues on our business are uncertain.

As industry practices and legal, judicial, social and other conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have issued insurance or reinsurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance and reinsurance contracts may not be known for many years after a contract is issued. Examples of emerging claims and coverage issues include:

- larger defense costs, settlements and jury awards in cases involving professionals and corporate directors and officers covered by professional liability and directors and officers liability insurance; and

- a trend of plaintiffs targeting property and casualty insurers in class action litigation related to claims handling, insurance sales practices and other practices related to the conduct of our business.

Risks Related to Laws and Regulations Applicable to Us

Compliance by our insurance subsidiaries with the legal and regulatory requirements to which they are subject is expensive. Any failure to comply could have a material adverse effect on our business.

Our insurance subsidiaries are required to comply with a wide variety of laws and regulations applicable to insurance or reinsurance companies, both in the jurisdictions in which they are organized and where they sell their insurance and reinsurance products. The insurance and regulatory environment, in particular for offshore insurance and reinsurance companies, has become subject to increased scrutiny in many jurisdictions, including the United States, various states within the United States and the United Kingdom. In the past, there have been Congressional and other initiatives in the United States regarding increased supervision and regulation of the insurance industry. It is not possible to predict the future impact of changes in laws and regulations on our operations. The cost of complying with any new legal requirements affecting our subsidiaries could have a material adverse effect on our business.

In addition, our subsidiaries may not always be able to obtain or maintain necessary licenses, permits, authorizations or accreditations. They also may not be able to fully comply with, or to obtain appropriate exemptions from, the laws and regulations applicable to them. Any failure to comply with applicable law or to obtain appropriate exemptions could result in restrictions on either the ability of the company in question, as well as potentially its affiliates, to do business in one or more of the jurisdictions in which they operate or on brokers on which we rely to produce business for us. In addition, any such failure to comply with applicable laws or to obtain appropriate exemptions could result in the imposition of fines or other sanctions. Any of these sanctions could have a material adverse effect on our business.

Our Bermuda insurance subsidiary, Allied World Assurance Company, Ltd, is registered as a Class 4 Bermuda insurance and reinsurance company and is subject to regulation and supervision in Bermuda. The applicable Bermudian statutes and regulations generally are designed to protect insureds and ceding insurance companies rather than shareholders or noteholders. Among other things, those statutes and regulations:

- require Allied World Assurance Company, Ltd to maintain minimum levels of capital and surplus,

- impose liquidity requirements which restrict the amount and type of investments it may hold,

- prescribe solvency standards that it must meet, and

- restrict payments of dividends and reductions of capital and provide for the performance of periodic examinations of Allied World Assurance Company, Ltd and its financial condition.

These statutes and regulations may, in effect, restrict the ability of Allied World Assurance Company, Ltd to write new business or distribute funds. Although it conducts its operations from Bermuda, Allied World Assurance Company, Ltd is not authorized to directly underwrite local risks in Bermuda.

Allied World Assurance Company, Ltd also operates branch offices in Hong Kong, Singapore and Labuan, which offices are regulated by the Office of the Insurance Commissioner in Hong Kong, the Monetary Authority of Singapore and the Labuan Financial Services Authority, respectively.

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Our U.S. insurance and reinsurance subsidiaries, Allied World Assurance Company (U.S.) Inc. and Darwin National Assurance Company, each a Delaware domiciled subsidiary, Allied World National Assurance Company and Allied World Insurance Company, each a New Hampshire domiciled subsidiary, and Darwin Select Insurance Company and Vantapro Specialty Insurance Company, each an Arkansas domiciled subsidiary, are subject to the statutes and regulations of their relevant state of domicile as well as any other state in the United States where they conduct business. In the states where the companies are admitted, the companies must comply with all insurance laws and regulations, including insurance rate and form requirements. Insurance laws and regulations may vary significantly from state to state. In those states where the companies act as surplus lines carriers, the states regulation focuses mainly on the company s solvency.

Allied World Assurance Company (Europe) Limited, an Irish domiciled insurer, operates within the E.U. non-life insurance legal and regulatory framework as established under the Non-Life Directive, and operates a branch in London, England. Allied World Assurance Company (Europe) Limited is required to operate in accordance with the provisions of the Irish Insurance Acts and Regulations and the requirements of the CBI.

Allied World Assurance Company (Reinsurance) Limited, an Irish domiciled reinsurer, is regulated by the CBI pursuant to the Central Bank Acts 1942 to 2010, all statutory instruments relating to reinsurance made or adopted under the European Communities Acts 1972 to 2009, and the provisions of the European Communities (Reinsurance) Regulations 2006 (which transposed the E.U. Reinsurance Directive into Irish law) and operates branches in London, England and Zug, Switzerland. Pursuant to the provisions of these regulations, reinsurance undertakings may, subject to the satisfaction of certain formalities, carry on reinsurance business in other E.U. member states either directly from the home member state (on a freedom to provide services basis) or through local branches (by way of permanent establishment).

Capita, as the managing agent for our Lloyd s Syndicate 2232, is regulated by the FSA and must adhere to certain minimum standards relating to management, underwriting, control and solvency as established by Lloyd s. Capita must also ensure that the underwriting activities of Lloyd s Syndicate 2232 are in accordance with the business plan approved by Lloyd s annually.

Allied World Assurance Company, AG, a Swiss domiciled insurer and reinsurer located in Zug, is regulated by FINMA.

Our Bermuda operating company could become subject to regulation in the United States.

Allied World Assurance Company, Ltd, our Bermuda operating company is not admitted as an insurer, nor accredited as a reinsurer, in any jurisdiction in the United States. For the year ended December 31, 2012, more than 70% of the gross premiums written by Allied World Assurance Company, Ltd, however, are derived from insurance or reinsurance contracts entered into with entities domiciled in the United States. The insurance laws of each state in the United States regulate the sale of insurance and reinsurance within the state s jurisdiction by foreign insurers. Allied World Assurance Company, Ltd conducts its business through its Bermuda office and does not maintain an office, and its personnel do not solicit insurance business, resolve claims or conduct other insurance business, in the United States. While Allied World Assurance Company, Ltd does not believe it is in violation of insurance laws of any jurisdiction in the United States, we cannot be certain that inquiries or challenges to our insurance and reinsurance activities will not be raised in the future. It is possible that, if Allied World Assurance Company, Ltd were to become subject to any laws of this type at any time in the future, we would not be in compliance with the requirements of those laws.

Our holding company structure and regulatory and other constraints affect our ability to pay dividends and make other payments.

Allied World Assurance Company Holdings, AG is a holding company, and as such has no substantial operations of its own. It does not have any significant assets other than its ownership of the shares of its direct and indirect subsidiaries. Dividends and other permitted distributions from subsidiaries are expected to be the sole source of funds for Allied World Assurance Company Holdings, AG to meet any ongoing cash requirements and to pay any dividends to shareholders.

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Swiss Law

Under Swiss law, dividends may be paid out only if we have sufficient distributable profits from previous fiscal years or if we have legal reserves, each as will be presented on Holdings audited statutory financial statements prepared in accordance with Swiss law. Payments out of the share capital (in other words, the aggregate par value of our share capital) in the form of dividends are not allowed; however, payments out of share capital may be made by way of a capital reduction to achieve a similar result as the payment of dividends. The affirmative vote of shareholders holding a majority of the votes cast at a shareholder meeting must approve reserve reclassifications and distributions of dividends. Our Board of Directors may propose to shareholders that a dividend be paid but cannot itself authorize the dividend. In addition, our shareholders may propose dividends without any dividend proposal by the Board of Directors. Under Swiss law, upon satisfaction of all legal requirements, we will be required to submit an application to the Swiss Commercial Register to register each applicable par value reduction. Without effective registration of the appropriate documentation with the Swiss Commercial Register, we will not be able to proceed with the payment of any installment of any dividend made by par value reduction. We cannot assure you that the Swiss Commercial Register will approve the registration of any applicable par value reduction.

Under Swiss law, if our general capital reserves amount to less than 20% of the share capital recorded in the Swiss Commercial Register (i.e., 20% of the aggregate par value of our capital), then at least 5% of our annual profit must be retained as general reserves. Swiss law permits us to accrue additional general reserves. In addition, we are required to create a special reserve on Holdings audited statutory financial statements in the amount of the purchase price of common shares we or any of our subsidiaries repurchases, which amount may not be used for dividends.

Swiss companies generally must maintain separate audited statutory financial statements for the purpose of, among other things, determining the amounts available for the return of capital to shareholders, including by way of a distribution of dividends. Amounts available for the return of capital as indicated on Holdings audited statutory financial statements may be materially different from amounts reflected in our consolidated U.S. GAAP financial statements. Our auditor must confirm that a dividend proposal made to shareholders complies with Swiss law and our Articles of Association.

We are required under Swiss law to declare any dividends and other capital distributions in Swiss francs. We have made and intend to continue to make any dividend payments to holders of our common shares in U.S. dollars. Continental Stock Transfer & Trust Company, our transfer agent, will be responsible for paying the U.S. dollars to registered holders of our common shares, less amounts subject to withholding for taxes. As a result, shareholders may be exposed to fluctuations in the U.S. dollar Swiss franc exchange rate between the date used for purposes of calculating the Swiss franc amount of any proposed dividend or par value reduction and the relevant payment date.

Bermuda Law

Bermuda law, including Bermuda insurance regulations and the Companies Act, restricts the declaration and payment of dividends and the making of distributions by our Bermuda entities, unless specified requirements are met. Allied World Assurance Company, Ltd is prohibited from paying dividends of more than 25% of its total statutory capital and surplus (as shown in its previous financial year s statutory balance sheet) without prior BMA approval. Allied World Assurance Company, Ltd is also prohibited from declaring or paying dividends without the approval of the BMA if Allied World Assurance Company, Ltd failed to meet its minimum solvency margin and minimum liquidity ratio on the