

Allied World Assurance Co Holdings, AG
Form 10-Q
April 23, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

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

For the quarterly period ended: March 31, 2014

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

(I.R.S. Employer

Incorporation or Organization)

Identification No.)

Lindenstrasse 8

6340 Baar

Zug, Switzerland

(Address of Principal Executive Offices and Zip Code)

41-41-768-1080

(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

As of April 14, 2014, 32,851,429 common shares were outstanding.

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
 UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
 as of March 31, 2014 and December 31, 2013
 (Expressed in thousands, except share and per share amounts)

	As of March 31, 2014	As of December 31, 2013
ASSETS:		
Fixed maturity investments trading, at fair value (amortized cost: 2014: \$6,010,765; 2013: \$6,065,350)	\$6,068,666	\$6,100,798
Equity securities trading, at fair value (cost: 2014: \$803,954; 2013: \$647,301)	834,893	699,846
Other invested assets	989,791	911,392
Total investments	7,893,350	7,712,036
Cash and cash equivalents	565,802	531,936
Restricted cash	144,570	149,393
Insurance balances receivable	839,630	664,731
Funds held	447,801	632,430
Prepaid reinsurance	331,065	340,992
Reinsurance recoverable	1,280,525	1,234,504
Accrued investment income	29,539	32,236
Net deferred acquisition costs	167,104	126,661
Goodwill	268,376	268,376
Intangible assets	48,198	48,831
Balances receivable on sale of investments	198,640	76,544
Net deferred tax assets	36,948	37,469
Other assets	82,617	89,691
Total assets	\$12,334,165	\$11,945,830
LIABILITIES:		
Reserve for losses and loss expenses	\$5,856,798	\$5,766,529
Unearned premiums	1,627,658	1,396,256
Reinsurance balances payable	160,041	173,023
Balances due on purchases of investments	171,442	104,740
Senior notes	798,573	798,499
Dividends payable	16,495	16,732
Accounts payable and accrued liabilities	86,480	170,225
Total liabilities	\$8,717,487	\$8,426,004
Commitments and contingencies		
SHAREHOLDERS' EQUITY:		
Common shares: 2014: par value CHF 12.30 per share and 2013: par value CHF 12.30 per share (2014: 33,821,752; 2013: 34,492,484 shares issued and 2014: 32,908,821; 2013: 33,417,882 shares outstanding)	410,820	418,988
Treasury shares, at cost (2014: 912,931; 2013: 1,074,602)	(68,756	) (79,992
Retained earnings	3,274,614	3,180,830
Total shareholders' equity	3,616,678	3,519,826
Total liabilities and shareholders' equity	\$12,334,165	\$11,945,830
See accompanying notes to the consolidated financial statements.		

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

for the three months ended March 31, 2014 and 2013

(Expressed in thousands, except share and per share amounts)

	Three Months Ended March 31,	
	2014	2013
REVENUES:		
Gross premiums written	\$901,393	\$837,081
Premiums ceded	(129,779)	(142,029)
Net premiums written	771,614	695,052
Change in unearned premiums	(241,329)	(231,824)
Net premiums earned	530,285	463,228
Net investment income	47,619	33,388
Net realized investment gains	54,205	79,637
	632,109	576,253
EXPENSES:		
Net losses and loss expenses	275,286	255,178
Acquisition costs	67,722	56,685
General and administrative expenses	80,340	82,680
Amortization of intangible assets	633	633
Interest expense	14,534	14,134
Foreign exchange loss	49	2,518
	438,564	411,828
Income before income taxes	193,545	164,425
Income tax expense	16,573	5,433
NET INCOME	176,972	158,992
Other comprehensive income	—	—
COMPREHENSIVE INCOME	\$176,972	\$158,992
PER SHARE DATA		
Basic earnings per share	\$5.33	\$4.59
Diluted earnings per share	\$5.23	\$4.49
Weighted average common shares outstanding	33,181,729	34,613,606
Weighted average common shares and common share equivalents outstanding	33,861,554	35,431,843
Dividends paid per share	\$0.500	\$0.375
See accompanying notes to the consolidated financial statements.		

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
 for the three months ended March 31, 2014 and 2013
 (Expressed in thousands)

	Share Capital	Treasury Shares	Retained Earnings	Total
December 31, 2013	\$418,988	\$(79,992	) \$3,180,830	\$3,519,826
Net income	—	—	176,972	176,972
Dividends	—	—	(16,489	) (16,489
Stock compensation	—	11,236	(6,208	) 5,028
Share repurchases	—	(68,659	) —	(68,659
Shares cancelled	(8,168	) 68,659	(60,491) —
March 31, 2014	\$410,820	\$(68,756	) \$3,274,614	\$3,616,678
December 31, 2012	\$454,980	\$(113,818	) \$2,985,173	\$3,326,335
Net income	—	—	158,992	158,992
Dividends — par value reduction	(12,981	) —	—	(12,981
Stock compensation	—	17,465	(21,603	) (4,138
Share repurchases	—	(36,245	) —	(36,245
Shares cancelled	(5,412	) 36,245	(30,833) —
March 31, 2013	\$436,587	\$(96,353) \$3,091,729	\$3,431,963

See accompanying notes to the consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 for the three months ended March 31, 2014 and 2013
 (Expressed in thousands)

	Three Months Ended March 31,	
	2014	2013
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Net income	\$176,972	\$158,992
Adjustments to reconcile net income to cash provided by operating activities:		
Net realized gains on sales of investments	(49,756	) (38,533
Mark to market adjustments	(13,956	) (46,112
Stock compensation expense	4,240	3,995
Undistributed income of equity method investments	(2,292) —
Changes in:		
Reserve for losses and loss expenses, net of reinsurance recoverables	44,248	5,278
Unearned premiums, net of prepaid reinsurance	241,329	231,824
Insurance balances receivable	(174,899	) (156,967
Funds held	184,629	(34,212
Reinsurance balances payable	(12,982	) (17,803
Net deferred acquisition costs	(40,443	) (34,141
Net deferred tax assets	521	(2,157
Accounts payable and accrued liabilities	(83,745	) (70,780
Other items, net	29,230	14,185
Net cash provided by operating activities	303,096	13,569
CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES:		
Purchases of trading securities	(1,568,993	) (1,330,735
Purchases of other invested assets	(779,934	) (54,026
Sales of trading securities	1,494,648	1,188,307
Sales of other invested assets	663,237	97,989
Purchases of fixed assets	(2,336	) (2,378
Change in restricted cash	4,823	116,785
Net cash (used in) provided by investing activities	(188,555	) 15,942
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Dividends paid - partial par value reduction	—	(12,981
Dividends paid	(16,732) —
Proceeds from the exercise of stock options	3,030	2,472
Share repurchases	(68,659	) (36,245
Net cash used in financing activities	(82,361	) (46,754
Effect of exchange rate changes on foreign currency cash	1,686	(2,055
NET INCREASE IN CASH AND CASH EQUIVALENTS	33,866	(19,298
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	531,936	681,879
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$565,802	\$662,581
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$529	\$6,953
Cash paid for interest expense	\$18,750	\$18,750

See accompanying notes to the consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands, except share, per share, percentage and ratio information)

1. GENERAL

Allied World Assurance Company Holdings, AG, a Swiss holding company (“Allied World Switzerland”), through its wholly-owned subsidiaries (collectively, the “Company”), provides property and casualty insurance and reinsurance on a worldwide basis. References to \$ are to the lawful currency of the United States and to CHF are to the lawful currency of Switzerland.

2. BASIS OF PREPARATION AND CONSOLIDATION

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

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

- The premium estimates for certain reinsurance agreements,
- Recoverability of deferred acquisition costs,
- The reserve for outstanding losses and loss expenses,
- Valuation of ceded reinsurance recoverables,
- Determination of impairment of goodwill and other intangible assets, and
- Valuation of financial instruments.

Intercompany accounts and transactions have been eliminated on consolidation and all entities meeting consolidation requirements have been included in the unaudited condensed consolidated financial statements.

These unaudited condensed consolidated financial statements, including these notes, should be read in conjunction with the Company’s audited consolidated financial statements, and related notes thereto, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

3. NEW ACCOUNTING PRONOUNCEMENTS

There were no recently issued accounting pronouncements that had a material impact on the Company’s financial statements or disclosures.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands, except share, per share, percentage and ratio information)

4. INVESTMENTS

a) Trading Securities

Securities accounted for at fair value with changes in fair value recognized in the unaudited condensed consolidated statements of operations and comprehensive income (“consolidated income statements”) by category are as follows:

	March 31, 2014		December 31, 2013	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
U.S. Government and Government agencies	\$1,476,463	\$1,480,371	\$1,676,788	\$1,684,832
Non-U.S. Government and Government agencies	182,415	187,632	191,776	197,082
States, municipalities and political subdivisions	230,669	228,284	231,555	234,406
Corporate debt:				
Financial institutions	1,097,649	1,083,131	958,794	943,518
Industrials	1,116,004	1,105,613	1,174,047	1,165,448
Utilities	96,807	96,403	69,426	69,658
Mortgage-backed	1,304,130	1,266,663	1,292,502	1,267,863
Asset-backed	564,529	562,668	505,910	502,543
Total fixed maturity investments	\$6,068,666	\$6,010,765	\$6,100,798	\$6,065,350
	March 31, 2014		December 31, 2013	
	Fair Value	Original Cost	Fair Value	Original Cost
Equity securities	\$834,893	\$803,954	\$699,846	\$647,301
Other invested assets	839,987	718,358	764,081	658,683
	\$1,674,880	\$1,522,312	\$1,463,927	\$1,305,984

Other invested assets, included in the table above, include investments in private equity funds, hedge funds and a high yield loan fund that are accounted for at fair value, but excludes other private securities described below in Note 4(b) that are accounted for using the equity method of accounting.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands, except share, per share, percentage and ratio information)

b) Other Invested Assets

Details regarding the carrying value, redemption characteristics and unfunded investment commitments of the other invested assets portfolio as of March 31, 2014 and December 31, 2013 were as follows:

Investment Type	Carrying Value as of March 31, 2014	Investments with Redemption Restrictions	Estimated Remaining Restriction Period	Investments without Redemption Restrictions	Redemption Frequency(1)	Redemption Notice Period(1)	Unfunded Commitments
Private equity	\$144,582	\$144,582	2 - 9 Years	\$—			\$ 262,450
Mezzanine debt	81,474	81,474	8 - 9 Years	—			182,562
Distressed	9,752	9,752	4 Years	—			5,249
Total private equity	235,808	235,808		—			450,261
Distressed	161,033	161,033	1 Year	—			—
Equity long/short	163,964	52,149	1 Year	111,815	Quarterly	30 -60 Days	—
Multi-strategy	122,584	—		122,584	Quarterly	45 -90 Days	—
Event driven	6,407	—		6,407	Annual	60 Days	—
Relative value credit	117,271	—		117,271	Quarterly	60 Days	—
Total hedge funds	571,259	213,182		358,077			—
High yield loan fund	32,920	—		32,920	Monthly	30 days	—
Total other invested assets at fair value	839,987	448,990		390,997			450,261
Other private securities	149,804	—		149,804			—
Total other invested assets	\$989,791	\$448,990		\$540,801			\$ 450,261

Investment Type	Carrying Value as of December 31, 2013	Investments with Redemption Restrictions	Estimated Remaining Restriction Period	Investments without Redemption Restrictions	Redemption Frequency(1)	Redemption Notice Period(1)	Unfunded Commitments
Private equity	\$144,422	\$144,422	2 - 9 Years	\$—			\$ 263,519
Mezzanine debt	64,627	64,627	8 - 9 Years	—			198,756
Distressed	7,776	7,776	4 Years	—			5,249
Total private equity	216,825	216,825		—			467,524
Distressed	151,227	151,227	1 - 2 Years	—			—
Equity long/short	99,365	—		99,365	Quarterly	30 -60 Days	—
Multi-strategy	136,958	—		136,958	Quarterly	45 -90 Days	—
Event driven	14,018	—		14,018	Annual	60 Days	—
Relative value credit	113,730	—		113,730	Quarterly	60 Days	—
Total hedge funds	515,298	151,227		364,071			—
High yield loan fund	31,958	—		31,958	Monthly	30 days	—
Total other invested assets at fair value	764,081	368,052		396,029			467,524
	147,311	—		147,311			—

Other private
securities

Total other invested assets	\$911,392	\$368,052	\$543,340	\$467,524
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(1) The redemption frequency and notice periods only apply to the investments without redemption restrictions. Some or all of these investments may be subject to a gate.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands, except share, per share, percentage and ratio information)

In general, the Company has invested in hedge funds that require at least 30 days' notice of redemption and may be redeemed on a monthly, quarterly, semi-annual, annual or longer basis, depending on the fund. Certain hedge funds have lock-up periods ranging from one to three years from initial investment. A lock-up period refers to the initial amount of time an investor is contractually required to invest before having the ability to redeem. Funds that provide for periodic redemptions may, depending on the funds' governing documents, have the ability to deny or delay a redemption request, called a "gate." The fund may implement this restriction because the aggregate amount of redemption requests as of a particular date exceeds a specified level, generally ranging from 15% to 25% of the fund's net assets. The gate is a method for executing an orderly redemption process to reduce the possibility of adversely affecting investors in the fund. Typically, the imposition of a gate delays a portion of the requested redemption, with the remaining portion settled in cash sometime after the redemption date. Certain funds may impose a redemption fee on early redemptions. Interests in private equity funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the fund.

The following describes each investment type:

Private equity funds: Primary funds may invest in companies and general partnership interests. Secondary funds buy limited partnership interests from existing limited partners of primary private equity funds. As owners of private equity funds seek liquidity, they can sell their existing investments, plus any remaining commitment, to secondary market participants. These funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the fund.

Mezzanine debt funds: Mezzanine debt funds primarily focus on providing capital to upper middle market and middle market companies and private equity sponsors, in connection with leveraged buyouts, mergers and acquisitions, recapitalizations, growth financings and other corporate transactions. The most common position in the capital structure will be between the senior secured debt holder and the equity; however, the funds will utilize a flexible approach when structuring investments, which may include secured debt, subordinated debt, preferred stock and/or private equity. These funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the fund.

Distressed funds: In distressed debt investing, managers take positions in the debt of companies experiencing significant financial difficulties, including bankruptcy, or in certain positions of the capital structure of structured securities. The manager relies on the fundamental analysis of these securities, including the claims on the assets and the likely return to bondholders. Certain funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the fund.

Equity long/short funds: In equity long/short funds, managers take long positions in companies they deem to be undervalued and short positions in companies they deem to be overvalued. Long/short managers may invest in countries, regions or sectors and vary by their use of leverage and by their targeted net long position.

Multi-strategy funds: These funds may utilize many strategies employed by specialized funds including distressed investing, equity long/short, merger arbitrage, convertible arbitrage, fixed income arbitrage and macro trading.

Event driven funds: Event driven strategies seek to deploy capital into specific securities whose returns are affected by a specific event that affects the value of one or more securities of a company. Returns for such securities are linked primarily to the specific outcome of the events and not by the overall direction of the bond or stock markets.

Examples could include mergers and acquisitions (arbitrage), corporate restructurings and spin-offs, and capital structure arbitrage.

Relative value credit funds: These funds seek to take exposure to credit-sensitive securities, long and/or short, based upon credit analysis of issuers and securities and credit market views.

High yield loan fund: A long-only private mutual fund that invests in high yield fixed income securities.

Other private securities: These securities include strategic non-controlling minority investments in private asset management companies and other insurance related investments that are accounted for using the equity method of accounting.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Expressed in thousands, except share, per share, percentage and ratio information)

c) Net Investment Income

	Three Months Ended	
	March 31,	
	2014	2013
Fixed maturity investments	\$36,299	\$32,525
Equity securities	3,253	3,199
Other invested assets	11,408	1,464
Cash and cash equivalents	439	488
Expenses	(3,780	) (4,288
Net investment income	\$47,619	\$33,388

Net investment income from other invested assets included the distributed and undistributed net income from investments accounted for using the equity method of accounting for the three months ended March 31, 2014 and 2013.

d) Components of Realized Gains and Losses

	Three Months Ended	
	March 31,	
	2014	2013
Gross realized gains on sale of invested assets	\$62,292	\$44,249
Gross realized losses on sale of invested assets	(12,247	) (6,965
Net realized and unrealized losses on derivatives	(12,920	) (977
Mark-to-market gains (losses):		
Fixed maturity investments, trading	22,455	(16,475
Equity securities, trading	(21,605	) 32,973
Other invested assets, trading	16,230	26,832
Net realized investment gains	\$54,205	\$79,637

e) Pledged Assets

As of March 31, 2014 and December 31, 2013, \$2,635,901 and \$2,894,401, respectively, of cash and cash equivalents and investments were deposited, pledged or held in trust accounts in favor of ceding companies and other counterparties or government authorities to comply with reinsurance contract provisions, insurance laws and other contract provisions.

In addition, as of March 31, 2014 and December 31, 2013, a further \$1,004,926 and \$1,053,632, respectively, of cash and cash equivalents and investments were pledged as collateral for the Company's letter of credit facilities. See Note 10(d) to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for details on the Company's credit facilities.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Expressed in thousands, except share, per share, percentage and ratio information)

5. DERIVATIVE INSTRUMENTS

As of March 31, 2014 and December 31, 2013, none of the Company's derivatives were designated as hedges for accounting purposes. The following table summarizes information on the location and amounts of derivative fair values on the unaudited condensed consolidated balance sheets ("consolidated balance sheets"):

	March 31, 2014				December 31, 2013			
	Asset Derivative Notional Amount	Asset Derivative Fair Value	Liability Derivative Notional Amount	Liability Derivative Fair Value	Asset Derivative Notional Amount	Asset Derivative Fair Value	Liability Derivative Notional Amount	Liability Derivative Fair Value
Foreign exchange contracts	\$194,081	\$1,408	\$117,757	\$3,145	\$294,788	\$6,254	\$122,439	\$1,176
Interest rate swaps	581,400	860	95,000	15	491,400	6,829	40,000	4,214
Total derivatives	\$775,481	\$2,268	\$212,757	\$3,160	\$786,188	\$13,083	\$162,439	\$5,390

Derivative assets and derivative liabilities are classified within "other assets" or "accounts payable and accrued liabilities" on the consolidated balance sheets.

The following table provides the net realized and unrealized gains (losses) on derivatives not designated as hedges recorded on the consolidated income statements:

	Three Months Ended March 31,	
	2014	2013
Foreign exchange contracts	\$(868)	\$(744)
Total included in foreign exchange loss	(868)	(744)
Put options	—	(3,732)
Foreign exchange contracts	(558)	1,815
Interest rate futures	(12,362)	940
Total included in net realized investment gains	(12,920)	(977)
Total realized and unrealized losses on derivatives	\$(13,788)	\$(1,721)

Derivative Instruments Not Designated as Hedging Instruments

The Company is exposed to foreign currency risk in its investment portfolio. Accordingly, the fair values of the Company's investment portfolio are partially influenced by the change in foreign exchange rates. These foreign currency hedging activities have not been designated as specific hedges for financial reporting purposes.

The Company's insurance and reinsurance subsidiaries and branches operate in various foreign countries and consequently the Company's underwriting portfolio is exposed to foreign currency risk. The Company manages foreign currency risk by seeking to match liabilities under the insurance policies and reinsurance contracts that it writes and that are payable in foreign currencies with cash and investments that are denominated in such currencies. When necessary, the Company may also use derivatives to economically hedge un-matched foreign currency exposures, specifically forward contracts and currency options.

The Company also purchases and sells interest rate future and interest rate swap contracts to actively manage the duration and yield curve positioning of its fixed income portfolio. Interest rate futures and interest rate swaps can efficiently increase or decrease the overall duration of the portfolio. Additionally, interest rate future and interest rate swap contracts can be utilized to obtain the desired position along the yield curve in order to protect against certain future yield curve shapes.

The Company also purchases options to actively manage its equity portfolio.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Expressed in thousands, except share, per share, percentage and ratio information)

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with U.S. GAAP, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon whether the inputs to the valuation of an asset or liability are observable or unobservable in the market at the measurement date, with quoted market prices being the highest level (Level 1) and unobservable inputs being the lowest level (Level 3). A fair value measurement will fall within the level of the hierarchy based on the input that is significant to determining such measurement. The three levels are defined as follows:

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

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

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

The following table shows the fair value of the Company's financial instruments and where in the fair value hierarchy the fair value measurements are included as of the dates indicated below:

March 31, 2014	Carrying Amount	Total Fair Value	Level 1	Level 2	Level 3
Fixed maturity investments:					
U.S. Government and Government agencies	\$1,476,463	\$1,476,463	\$1,135,246	\$341,217	\$—
Non-U.S. Government and Government agencies	182,415	182,415	—	182,415	—
States, municipalities and political subdivisions	230,669	230,669	—	230,669	—
Corporate debt	2,310,460	2,310,460	—	2,310,460	—
Mortgage-backed	1,304,130	1,304,130	—	1,170,069	134,061
Asset-backed	564,529	564,529	—	483,295	81,234
Total fixed maturity investments	6,068,666	6,068,666	1,135,246	4,718,125	215,295
Equity securities	834,893	834,893	800,107	—	34,786
Other invested assets	839,987	839,987	—	—	839,987
Total investments	\$7,743,546	\$7,743,546	\$1,935,353	\$4,718,125	\$1,090,068
Derivative assets:					
Foreign exchange contracts	\$1,408	\$1,408	\$—	\$1,408	\$—
Interest rate swaps	860	860	—	860	—
Derivative liabilities:					
Foreign exchange contracts	\$3,145	\$3,145	\$—	\$3,145	\$—
Interest rate swaps	15	15	—	15	—
Senior notes	\$798,573	\$906,448	\$—	\$906,448	\$—

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December 31, 2013	Carrying Amount	Total Fair Value	Level 1	Level 2	Level 3
Fixed maturity investments:					
U.S. Government and Government agencies	\$1,676,788	\$1,676,788	\$1,370,088	\$306,700	\$—
Non-U.S. Government and Government agencies	191,776	191,776	—	191,776	—
States, municipalities and political subdivisions	231,555	231,555	—	231,555	—
Corporate debt	2,202,267	2,202,267	—	2,202,267	—
Mortgage-backed	1,292,502	1,292,502	—	1,145,164	147,338
Asset-backed	505,910	505,910	—	412,497	93,413
Total fixed maturity investments	6,100,798	6,100,798	1,370,088	4,489,959	240,751
Equity securities	699,846	699,846	625,942	—	73,904
Other invested assets	764,081	764,081	—	—	764,081
Total investments	\$7,564,725	\$7,564,725	\$1,996,030	\$4,489,959	\$1,078,736
Derivative assets:					
Foreign exchange contracts	\$6,254	\$6,254	\$—	\$6,254	\$—
Interest rate swaps	6,829	6,829	—	6,829	—
Derivative liabilities:					
Foreign exchange contracts	\$1,176	\$1,176	\$—	\$1,176	\$—
Interest rate swaps	\$4,214	\$4,214	\$—	\$4,214	\$—
Senior notes	\$798,499	\$897,601	\$—	\$897,601	\$—

“Other invested assets” excluded other private securities that the Company did not measure at fair value, but are accounted for using the equity method of accounting. Derivative assets and derivative liabilities relating to foreign exchange contracts and interest rate swaps are classified within “other assets” or “accounts payable and accrued liabilities” on the consolidated balance sheets.

The following describes the valuation techniques used by the Company to determine the fair value of financial instruments held as of the balance sheet date.

Recurring Fair Value of Financial Instruments

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

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

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

Corporate debt: Comprised of bonds issued by or loan obligations of corporations that are diversified across a wide range of issuers and industries. The fair values of corporate debt that are short-term are priced using spread above the LIBOR yield curve, and the fair values of corporate debt that are long-term are priced using the spread above the risk-free yield curve. The

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spreads are sourced from broker-dealers, trade prices and the new issue market. As the significant inputs used to price corporate bonds are observable market inputs, the fair values of corporate debt are included in the Level 2 fair value hierarchy.

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

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

Equity securities: Comprised of common and preferred stocks and mutual funds. Equities are generally included in the Level 1 fair value hierarchy as prices are obtained from market exchanges in active markets. Non-U.S. mutual funds where the net asset value is not provided on a daily basis are included in the Level 3 fair value hierarchy.

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

Derivative instruments: The fair value of foreign exchange contracts, interest rate futures and interest rate swaps are priced from quoted market prices for similar exchange-traded derivatives and pricing valuation models that utilize independent market data inputs. The fair value of derivatives are included in the Level 2 fair value hierarchy.

Senior notes: The fair value of the senior notes is based on reported trades. The fair value of the senior notes is included in the Level 2 fair value hierarchy.

Non-recurring Fair Value of Financial Instruments

The Company measures the fair value of certain assets on a non-recurring basis, generally quarterly, annually or when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. These assets include investments accounted for using the equity method, goodwill and intangible assets. The Company uses a variety of techniques to measure the fair value of these assets when appropriate, as described below:

Investments accounted for using the equity method: When the Company determines that the carrying value of these assets may not be recoverable, the Company records the assets at fair value with the loss recognized in income. In such cases, the Company measures the fair value of these assets using discounted cash flow models.

Goodwill and intangible assets: The Company tests goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, but at least annually for goodwill and indefinite-lived intangibles. If the Company determines that goodwill and intangible assets may be impaired, the Company uses techniques, including discounted expected future cash flows and market multiple models, to measure fair value.

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Rollforward of Level 3 Financial Instruments

The following is a reconciliation of the beginning and ending balance of financial instruments using significant unobservable inputs (Level 3):

Three Months Ended March 31, 2014	Other invested assets	Mortgage-backed	Asset-backed	Equities
Opening balance	\$ 764,081	\$ 147,338	\$ 93,413	\$ 73,904
Realized and unrealized gains (losses) included in net income	22,626	1,368	(864	) (9,821
Purchases	89,199	14,110	7,493	—
Sales	(35,919	) (17,956	) (3,176	) (29,297
Transfers into Level 3 from Level 2	—	—	606	—
Transfers out of Level 3 into Level 2 (1)	—	(10,799	) (16,238) —
Ending balance	\$ 839,987	\$ 134,061	\$ 81,234	\$ 34,786
Three Months Ended March 31, 2013				
Opening balance	\$ 655,888	\$ 167,825	\$ 62,246	\$ 54,680
Realized and unrealized gains included in net income	32,253	(1,189	) (97	) 3,107
Purchases	73,210	—	2,461	—
Sales	(51,211	) (21,645	) (16,622) —
Transfers into Level 3 from Level 2	—	19,813	—	—
Transfers out of Level 3 into Level 2 (1)	—	(9,384	) (7,085) —
Ending balance	\$ 710,140	\$ 155,420	\$ 40,903	\$ 57,787

(1) Transfers out of Level 3 are primarily attributable to the availability of market observable information.

The Company attempts to verify the significant inputs used by broker-dealers in determining the fair value of the securities priced by them. If the Company could not obtain sufficient information to determine if the broker-dealers were using significant observable inputs, then such securities have been transferred to the Level 3 fair value hierarchy. The Company believes the prices obtained from the broker-dealers are the best estimate of fair value of the securities being priced as the broker-dealers are typically involved in the initial pricing of the security, and the Company has compared the price per the broker-dealer to other pricing sources and noted no material differences. The Company recognizes transfers between levels at the end of the reporting period. There were no transfers between Level 1 and Level 2 during the period.

The Company's external investment accounting service provider receives prices from internationally recognized independent pricing services to measure the fair values of its fixed maturity investments. Pricing sources are evaluated and selected in a manner to ensure that the most reliable sources are used. The Company uses a pricing service ranking to consistently select the most appropriate pricing service in instances where it receives multiple quotes on the same security. The Company obtains multiple quotes for the majority of its securities. The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. Each pricing service has its own proprietary method for determining the fair value of securities that are not actively traded. In general, these methods involve the use of "matrix pricing" in which the independent pricing service uses observable market inputs, including, but not limited to, reported trades, benchmark yields, broker-dealer quotes, interest rates, prepayment speeds, default rates and such other inputs as are available from market sources to determine a reasonable fair value.

All of the Company's securities classified as Level 3, other than investments in other invested assets, are valued based on unadjusted broker-dealer quotes. This includes less liquid securities such as lower quality asset-backed securities, commercial mortgage-backed securities and residential mortgage-backed securities. The primary valuation inputs include monthly payment information, the probability of default, loss severity rates and estimated prepayment rates. Significant changes in these inputs in isolation would result in a significantly lower or higher fair value measurement. In general, a change in the assumption of the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity in an event of default and prepayment rates.

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The Company records the unadjusted price provided and validates this price through a process that includes, but is not limited to, monthly and/or quarterly: (i) comparison of prices between two independent sources, with significant differences requiring additional price sources; (ii) quantitative analysis (e.g., comparing the quarterly return for each managed portfolio to their target benchmark, with significant differences identified and investigated); (iii) evaluation of methodologies used by external parties to calculate fair value, including a review of the inputs used for pricing; (iv) comparing the price to the Company's knowledge of the current investment market; and (v) back-testing, which includes randomly selecting purchased or sold securities and comparing the executed prices to the fair value estimates from the pricing service. In addition to internal controls, management relies on the effectiveness of the valuation controls in place at the Company's external investment accounting service provider (supported by a Statement on Standards for Attestation Engagements No. 16 report) in conjunction with regular discussion and analysis of the investment portfolio's structure and performance.

7. RESERVE FOR LOSSES AND LOSS EXPENSES

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

	March 31, 2014	December 31, 2013
Outstanding loss reserves	\$1,474,376	\$1,520,867
Reserves for losses incurred but not reported	4,382,422	4,245,662
Reserve for losses and loss expenses	\$5,856,798	\$5,766,529

The table below is a reconciliation of the beginning and ending liability for unpaid losses and loss expenses. Losses incurred and paid are reflected net of reinsurance recoverables.

	Three Months Ended	
	March 31, 2014	2013
Gross liability at beginning of period	\$5,766,529	\$5,645,549
Reinsurance recoverable at beginning of period	(1,234,504)	(1,141,110)
Net liability at beginning of period	4,532,025	4,504,439
Net losses incurred related to:		
Current year	324,147	299,248
Prior years	(48,861)	(44,070)
Total incurred	275,286	255,178
Net paid losses related to:		
Current year	3,743	3,581
Prior years	228,594	241,121
Total paid	232,337	244,702
Foreign exchange revaluation	1,299	(5,198)
Net liability at end of period	4,576,273	4,509,717
Reinsurance recoverable at end of period	1,280,525	1,163,503
Gross liability at end of period	\$5,856,798	\$5,673,220

For the three months ended March 31, 2014, the Company recorded net unfavorable reserve development in its U.S. insurance segment and net favorable prior year development in its international insurance and reinsurance segments. The net unfavorable prior year reserve development in the U.S. insurance segment for the 2011 loss year was in the

Company's healthcare line of business and was due to adverse development on several claims above its previous expectations in the managed care errors and omissions class of business and higher than expected loss frequency in the medical malpractice class of business. The international insurance segment had favorable prior year reserve development for the 2007 loss year due to favorable development on an individual professional liability claim, and unfavorable reserve development for the 2013 loss year due to a single claim in the healthcare line of business. The net favorable prior year reserve development in the reinsurance segment for the 2013 loss year was primarily due to benign property loss activity.

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For the three months ended March 31, 2013, the Company had net favorable reserve development in its international and reinsurance segments due to actual loss emergence being lower than initially expected. The U.S. insurance segment had net unfavorable reserve development primarily due to adverse loss emergence trends for the 2011 and 2012 loss years for certain errors and omissions and directors' and officers' classes of business.

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

8. INCOME TAXES

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

Under current Bermuda law, Allied World Assurance Company Holdings, Ltd ("Allied World Bermuda") and its Bermuda subsidiaries are not required to pay taxes in Bermuda on either income or capital gains. Allied World Bermuda and Allied World Assurance Company, Ltd have received an assurance from the Bermuda Minister of Finance under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, that in the event of any such taxes being imposed, Allied World Bermuda and Allied World Assurance Company, Ltd will be exempted until March 2035.

Certain subsidiaries of Allied World Switzerland file U.S. federal income tax returns and various U.S. state income tax returns, as well as income tax returns in Canada, Hong Kong, Ireland, Labuan, the United Kingdom, Singapore and Switzerland. To the best of the Company's knowledge, there are no income tax examinations pending by any tax authority.

Management has deemed all material tax positions to have a greater than 50% likelihood of being sustained based on technical merits if challenged. The Company does not expect any material unrecognized tax benefits within 12 months of March 31, 2014.

9. SHAREHOLDERS' EQUITY

a) Authorized shares

The issued share capital consists of the following:

	March 31, 2014	December 31, 2013
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Common shares issued and fully paid, 2014: CHF 12.30 per share; 2013: CHF 12.30 per share	33,821,752	34,492,484
Share capital at end of period	\$410,820	\$418,988

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	Three Months Ended March 31, 2014
Shares issued at beginning of period	34,492,484
Shares cancelled	(670,732)
Total shares issued at end of period	33,821,752
Treasury shares issued at beginning of period	1,074,602
Shares repurchased	670,732
Shares issued out of treasury	(161,671)
Shares cancelled	(670,732)
Total treasury shares at end of period	912,931
Total shares outstanding at end of period	32,908,821

During the three months ended March 31, 2014, 670,732 shares repurchased and designated for cancellation were constructively retired and cancelled.

b) Dividends

The Company paid the following dividends during the three months ended March 31, 2014:

Dividend Paid	Dividend Per Share	Total Amount Paid
January 2, 2014	\$0.500	\$ 16,732

On May 2, 2013, the shareholders approved the Company's proposal to pay cash dividends in the form of a distribution out of general legal reserve from capital contributions. The distribution amounts were paid to shareholders in quarterly dividends of \$0.50 per share in July 2013, October 2013, January 2014 and April 2014.

c) Share Repurchases

In May 2012, the Company established a share repurchase program in order to repurchase up to \$500,000 of its common shares. Repurchases may be effected from time to time through open market purchases, privately negotiated transactions, tender offers or otherwise. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company's capital position, legal requirements and other factors. Under the terms of this share repurchase program, common shares repurchased shall be designated for cancellation at acquisition and shall be cancelled upon shareholder approval. Shares repurchased and designated for cancellation are constructively retired and recorded as a share cancellation.

The Company's share repurchases were as follows:

	Three Months Ended March 31,	
	2014	2013
Common shares repurchased	670,732	432,117
Total cost of shares repurchased	\$68,659	\$36,245

Average price per share	\$102.36	\$83.88
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10. EMPLOYEE BENEFIT PLANS

a) Restricted stock units and performance-based equity awards

Restricted stock units ("RSUs") vest pro-rata over four years from the date of grant. The compensation expense for the RSUs is based on the fair market value of Allied World Switzerland's common shares at the date of grant. The Company estimates the expected forfeitures of RSUs at the date of grant and recognizes compensation expense only for those awards that the Company expects to vest. The forfeiture assumption is ultimately adjusted to the actual forfeiture rate.

Performance-based equity awards represent the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during an applicable performance period. For the performance-based equity awards granted in 2014, 2013 and 2012, the Company anticipates that the performance goals are likely to be achieved. Based on the performance goals, the performance-based equity awards granted in 2014, 2013 and 2012 are expensed at 100%, 100% and 130%, respectively, of the fair value of Allied World Switzerland's common shares on the date of grant. The expense is recognized over the performance period.

The activity related to the Company's RSUs awards is as follows:

	Three Months Ended March 31, 2014	
	Number of Awards	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	47,899	\$65.07
RSUs granted	151,392	100.68
RSUs forfeited	—	—
RSUs fully vested	(24,876	) (65.06
Outstanding at end of period	174,415	\$95.98

The activity related to the Company's performance-based equity awards is as follows:

	Three Months Ended March 31, 2014	
	Number of Awards	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	268,173	\$69.64
Performance-based equity awards granted	55,434	100.67
Additional awards granted due to achievement of performance criteria	34,965	61.51
Performance-based equity awards forfeited	—	—
Performance-based equity awards fully vested	(151,480	) (61.51
Outstanding at end of period	207,092	\$82.52

b) Cash-equivalent stock awards

As part of the Company's annual year-end compensation awards, the Company granted both awards classified as equity and cash-equivalent stock awards. The cash-equivalent awards were granted to employees who received RSUs and performance-based equity awards in tandem with stock-based awards. The cash-equivalent RSU awards vest pro-rata over four years from the date of grant. The cash-equivalent performance-based equity awards vest after a three-year performance period. The amount payable per unit awarded will be equal to the price per share of Allied World Switzerland's common shares, and as such the Company measures the value of the award each reporting period based on the period-ending share price. The effects of changes in the share price at each period-end during the service period are recognized as changes in compensation expense ratably over the service period. The liability is included in "accounts payable and accrued liabilities" in the consolidated balance sheets and changes in the liability are recorded in "general and administrative expenses" in the consolidated income statements.

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The activity related to the Company's cash-equivalent RSUs and performance-based awards is as follows:

Three Months Ended March 31, 2014	RSU's		Performance-based Awards	
	Number of Awards	Weighted Average Grant Date Fair Value	Number of Awards	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	683,028	\$74.10	343,987	71.02
Granted	146,054	100.67	83,146	100.67
Additional awards granted due to achievement of performance criteria	—	—	34,965	61.51
Forfeited	(960)	(77.72)	—	—
Fully vested	(250,640)	(64.41)	(151,480)	(61.51)
Outstanding at end of period	577,482	\$83.81	310,618	\$82.52

c) Total Stock Related Compensation Expense

The following table shows the total stock-related compensation expense relating to the stock options, RSUs and cash equivalent awards.

	Three Months Ended March 31,	
	2014	2013
Stock options	\$727	\$1,335
RSUs and performance-based equity awards	3,513	2,660
Cash-equivalent stock awards	4,629	12,756
Total	\$8,869	\$16,751

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11. EARNINGS PER SHARE

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

	Three Months Ended March 31,	
	2014	2013
Basic earnings per share:		
Net income	\$ 176,972	\$ 158,992
Weighted average common shares outstanding	33,181,729	34,613,606
Basic earnings per share	\$5.33	\$4.59
	Three Months Ended March 31,	
	2014	2013
Diluted earnings per share:		
Net income	\$ 176,972	\$ 158,992
Weighted average common shares outstanding	33,181,729	34,613,606
Share equivalents:		
Stock options	487,986	482,207
RSUs and performance-based equity awards	188,537	335,575
Employee share purchase plan	3,302	455
Weighted average common shares and common share equivalents outstanding - diluted	33,861,554	35,431,843
Diluted earnings per share	\$5.23	\$4.49

For the three months ended March 31, 2014 and 2013, a weighted average of 25 and 333 RSUs, respectively, were considered anti-dilutive and were therefore excluded from the calculation of the diluted earnings per share.

12. SEGMENT INFORMATION

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

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

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

Management measures results for each segment on the basis of the "loss and loss expense ratio," "acquisition cost ratio," "general and administrative expense ratio" and the "combined ratio." The "loss and loss expense ratio" is derived by dividing

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net losses and loss expenses by net premiums earned. The “acquisition cost ratio” is derived by dividing acquisition costs by net premiums earned. The “general and administrative expense ratio” is derived by dividing general and administrative expenses by net premiums earned. The “combined ratio” is the sum of the “loss and loss expense ratio,” the “acquisition cost ratio” and the “general and administrative expense ratio.”

The following tables provide a summary of the segment results:

Three Months Ended March 31, 2014	U.S. Insurance	International Insurance	Reinsurance	Total	
Gross premiums written	\$269,945	\$134,364	\$497,084	\$901,393	
Net premiums written	202,740	75,459	493,415	771,614	
Net premiums earned	212,123	88,339	229,823	530,285	
Net losses and loss expenses	(141,995)	(23,566)	(109,725)	(275,286))
Acquisition costs	(27,501)	947	(41,168)	(67,722))
General and administrative expenses	(37,436)	(24,761)	(18,143)	(80,340))
Underwriting income	5,191	40,959	60,787	106,937	
Net investment income				47,619	
Net realized investment gains				54,205	
Amortization of intangible assets				(633))
Interest expense				(14,534))
Foreign exchange loss				(49))
Income before income taxes				\$193,545	
Loss and loss expense ratio	66.9	% 26.7	% 47.7	% 51.9	%
Acquisition cost ratio	13.0	% (1.1	)% 17.9	% 12.8	%
General and administrative expense ratio	17.6	% 28.0	% 7.9	% 15.2	%
Combined ratio	97.5	% 53.6	% 73.5	% 79.9	%
Three Months Ended March 31, 2013	U.S. Insurance	International Insurance	Reinsurance	Total	
Gross premiums written	\$256,018	\$128,516	\$452,547	\$837,081	
Net premiums written	192,253	77,745	425,054	695,052	
Net premiums earned	188,439	84,214	190,575	463,228	
Net losses and loss expenses	(133,324)	(28,935)	(92,919)	(255,178))
Acquisition costs	(23,128)	849	(34,406)	(56,685))
General and administrative expenses	(39,596)	(24,789)	(18,295)	(82,680))
Underwriting (loss) income	(7,609)	31,339	44,955	68,685	
Net investment income				33,388	
Net realized investment gains				79,637	
Amortization of intangible assets				(633))
Interest expense				(14,134))
Foreign exchange loss				(2,518))
Income before income taxes				\$164,425	
Loss and loss expense ratio	70.8	% 34.4	% 48.8	% 55.1	%
Acquisition cost ratio	12.3	% (1.0)% 18.1	% 12.2	%
General and administrative expense ratio	21.0	% 29.4	% 9.6	% 17.8	%

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Combined ratio	104.1	% 62.8	% 76.5	% 85.1	%
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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Expressed in thousands, except share, per share, percentage and ratio information)

The following table shows an analysis of the Company's gross premiums written by geographic location of the Company's subsidiaries and branches. All intercompany premiums have been eliminated.

	Three Months Ended	
	March 31,	
	2014	2013
United States	\$520,773	\$478,443
Bermuda	229,631	228,672
Europe	103,336	86,509
Singapore	41,940	38,113
Hong Kong	4,883	5,344
Canada	830	—
Total gross premiums written	\$901,393	\$837,081

Europe includes gross premiums written attributable to Switzerland of \$44,293 and \$40,806 for the three months ended March 31, 2014 and 2013, respectively.

13. COMMITMENTS AND CONTINGENCIES

The Company, in common with the insurance industry in general, is subject to litigation and arbitration in the normal course of its business. These legal proceedings generally relate to claims asserted by or against the Company in the ordinary course of insurance or reinsurance operations. Estimated amounts payable under these proceedings are included in the reserve for losses and loss expenses in the Company's consolidated balance sheets. As of March 31, 2014, the Company was not a party to any material legal proceedings arising outside the ordinary course of business that management believes will have a material adverse effect on the Company's results of operations, financial position or cash flow.

The Company entered into a 20-year mortgage commitment with a Swiss bank for a company-used office building in Zug, Switzerland. The total proceeds to be received under the mortgage are CHF 18,000 with a fixed annual interest rate of 3.2% payable quarterly. The mortgage payments will be CHF 300 per year, plus accrued interest, for the first 19 years with the remaining balance payable at the end of the mortgage. The Company will receive the proceeds from the bank during the fourth quarter of 2014 at which time the Company will recognize the mortgage loan liability in its consolidated balance sheets.

In conjunction with the above mortgage commitment, the Company entered into a three-year credit facility with a Swiss bank that provides up to CHF 5,000 for general corporate purposes; however, the Company will use the proceeds from the credit facility to fund the purchase of the office building in Zug, Switzerland. The interest rate for the credit facility is 2.5%.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands, except share, per share, percentage and ratio information)

14. CONDENSED CONSOLIDATED GUARANTOR FINANCIAL STATEMENTS

The following tables present unaudited condensed consolidating financial information as of March 31, 2014 and December 31, 2013 and for the three months ended March 31, 2014 and 2013 for Allied World Switzerland (the “Parent Guarantor”) and Allied World Bermuda (the “Subsidiary Issuer”). The Subsidiary Issuer is a direct, 100%-owned subsidiary of the Parent Guarantor. Investments in subsidiaries are accounted for by the Parent Guarantor under the equity method for purposes of the supplemental consolidating presentation. Earnings of subsidiaries are reflected in the Parent Guarantor’s investment accounts and earnings. The Parent Guarantor fully and unconditionally guarantees the senior notes issued by the Subsidiary Issuer.

Unaudited Condensed Consolidating Balance Sheet:

As of March 31, 2014	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
ASSETS:					
Investments	\$—	\$—	\$7,893,350	\$—	\$7,893,350
Cash and cash equivalents	22,557	1,047	542,198	—	565,802
Insurance balances receivable	—	—	839,630	—	839,630
Funds held	—	—	447,801	—	447,801
Reinsurance recoverable	—	—	1,280,525	—	1,280,525
Net deferred acquisition costs	—	—	167,104	—	167,104
Goodwill and intangible assets	—	—	316,574	—	316,574
Balances receivable on sale of investments	—	—	198,640	—	198,640
Investments in subsidiaries	3,434,192	4,026,535	—	(7,460,727)	—
Due from subsidiaries	187,571	30,569	20,751	(238,891)	—
Other assets	2,079	4,321	618,339	—	624,739
Total assets	\$3,646,399	\$4,062,472	\$12,324,912	\$(7,699,618)	\$12,334,165
LIABILITIES:					
Reserve for losses and loss expenses	\$—	\$—	\$5,856,798	\$—	\$5,856,798
Unearned premiums	—	—	1,627,658	—	1,627,658
Reinsurance balances payable	—	—	160,041	—	160,041
Balances due on purchases of investments	—	—	171,442	—	171,442
Senior notes	—	798,573	—	—	798,573
Due to subsidiaries	10,565	10,186	218,140	(238,891)	—
Other liabilities	19,156	14,583	69,236	—	102,975
Total liabilities	29,721	823,342	8,103,315	(238,891)	8,717,487
Total shareholders’ equity	3,616,678	3,239,130	4,221,597	(7,460,727)	3,616,678
Total liabilities and shareholders’ equity	\$3,646,399	\$4,062,472	\$12,324,912	\$(7,699,618)	\$12,334,165

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands, except share, per share, percentage and ratio information)

As of December 31, 2013	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
ASSETS:					
Investments	\$—	\$—	\$7,712,036	\$—	\$7,712,036
Cash and cash equivalents	10,790	2,775	518,371	—	531,936
Insurance balances receivable	—	—	664,731	—	664,731
Funds held	—	—	632,430	—	632,430
Reinsurance recoverable	—	—	1,234,504	—	1,234,504
Net deferred acquisition costs	—	—	126,661	—	126,661
Goodwill and intangible assets	—	—	317,207	—	317,207
Balances receivable on sale of investments	—	—	76,544	—	76,544
Investments in subsidiaries	3,413,001	4,018,619	—	(7,431,620)	—
Due from subsidiaries	111,172	122,846	123,479	(357,497)	—
Other assets	1,757	4,671	643,353	—	649,781
Total assets	\$3,536,720	\$4,148,911	\$12,049,316	\$(7,789,117)	\$11,945,830
LIABILITIES:					
Reserve for losses and loss expenses	\$—	\$—	\$5,766,529	\$—	\$5,766,529
Unearned premiums	—	—	1,396,256	—	1,396,256
Reinsurance balances payable	—	—	173,023	—	173,023
Balances due on purchases of investments	—	—	104,740	—	104,740
Senior notes	—	798,499	—	—	798,499
Due to subsidiaries	12,945	110,534	234,018	(357,497)	—
Other liabilities	3,949	17,797	165,211	—	186,957
Total liabilities	16,894	926,830	7,839,777	(357,497)	8,426,004
Total shareholders' equity	3,519,826	3,222,081	4,209,539	(7,431,620)	3,519,826
Total liabilities and shareholders' equity	\$3,536,720	\$4,148,911	\$12,049,316	\$(7,789,117)	\$11,945,830

The investment in subsidiaries and total shareholders' equity balances reported above in the Unaudited Condensed Consolidating Balance Sheet for Allied World Bermuda (Subsidiary Issuer) as of December 31, 2013 were reduced by \$776,000 from the previously reported amounts to properly record intercompany dividends as a reduction in the investment in subsidiaries balance due to a miscalculation. Since the intercompany dividends were eliminated in consolidation there was no impact to consolidated total shareholders' equity.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands, except share, per share, percentage and ratio information)

Unaudited Condensed Consolidating Statement of Operations and Comprehensive Income:

Three Months Ended March 31, 2014	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
Net premiums earned	\$—	\$—	\$530,285	\$—	\$530,285
Net investment income	2	—	47,617	—	47,619
Net realized investment losses	—	—	54,205	—	54,205
Net losses and loss expenses	—	—	(275,286)	—	(275,286)
Acquisition costs	—	—	(67,722)	—	(67,722)
General and administrative expenses	(8,914)	(2,391)	(69,035)	—	(80,340)
Amortization of intangible assets	—	—	(633)	—	(633)
Interest expense	—	(13,848)	(686)	—	(14,534)
Foreign exchange gain (loss)	(2)	33)	(80)	—	(49)
Income tax (expense) benefit	(409)	—	(16,164)	—	(16,573)
Equity in earnings of consolidated subsidiaries	186,295	199,007	—	(385,302)	—
NET INCOME (LOSS)	\$176,972	\$182,801	\$202,501	\$(385,302)	\$176,972
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	\$176,972	\$182,801	\$202,501	\$(385,302)	\$176,972
Three Months Ended March 31, 2013	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
Net premiums earned	\$—	\$—	\$463,228	\$—	\$463,228
Net investment income	7	2	33,379	—	33,388
Net realized investment gains	—	—	79,637	—	79,637
Net losses and loss expenses	—	—	(255,178)	—	(255,178)
Acquisition costs	—	—	(56,685)	—	(56,685)
General and administrative expenses	(10,986)	(457)	(71,237)	—	(82,680)
Amortization of intangible assets	—	—	(633)	—	(633)
Interest expense	—	(13,830)	(304)	—	(14,134)
Foreign exchange gain (loss)	272	(95)	(2,695)	—	(2,518)
Income tax (expense) benefit	—	—	(5,433)	—	(5,433)
Equity in earnings of consolidated subsidiaries	169,699	181,480	—	(351,179)	—
NET INCOME (LOSS)	\$158,992	\$167,100	\$184,079	\$(351,179)	\$158,992
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	\$158,992	\$167,100	\$184,079	\$(351,179)	\$158,992

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands, except share, per share, percentage and ratio information)

Unaudited Condensed Consolidating Statement of Cash Flows:

Three Months Ended March 31, 2014	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES	\$94,128	\$(1,728)	\$212,382	\$—	\$304,782
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:					
Purchases trading securities	—	—	(1,568,993)	—	(1,568,993)
Purchases of other invested assets	—	—	(779,934)	—	(779,934)
Sales of trading securities	—	—	1,494,648	—	1,494,648
Sales of other invested assets	—	—	663,237	—	663,237
Other	—	—	2,487	—	2,487
Net cash provided by (used in) investing activities	—	—	(188,555)	—	(188,555)
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:					
Dividends paid	(16,732)	—	—	—	(16,732)
Proceeds from the exercise of stock options	3,030	—	—	—	3,030
Share repurchases	(68,659)	—	—	—	(68,659)
Net cash provided by (used in) financing activities	(82,361)	—	—	—	(82,361)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	11,767	(1,728)	23,827	—	33,866
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	10,790	2,775	518,371	—	531,936
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$22,557	\$1,047	\$542,198	\$—	\$565,802

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands, except share, per share, percentage and ratio information)

Three Months Ended March 31, 2013	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:	\$59,772	\$5,859	\$(54,117)	\$—	\$11,514
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:					
Purchases of trading securities	—	—	(1,330,735)	—	(1,330,735)
Purchases of other invested assets	—	—	(54,026)	—	(54,026)
Sales of trading securities	—	—	1,188,307	—	1,188,307
Sales of other invested assets	—	—	97,989	—	97,989
Other	—	—	114,407	—	114,407
Net cash provided by (used in) investing activities	—	—	15,942	—	15,942
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:					
Partial par value reduction	(12,981)	—	—	—	(12,981)
Proceeds from the exercise of stock options	2,472	—	—	—	2,472
Share repurchases	(36,245)	—	—	—	(36,245)
Net cash provided by (used in) financing activities	(46,754)	—	—	—	(46,754)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	13,018	5,859	(38,175)	—	(19,298)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	19,997	11,324	650,558	—	681,879
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$33,015	\$17,183	\$612,383	\$—	\$662,581

Notes to Parent Company Condensed Financial Information

a) Dividends

Allied World Switzerland received cash dividends from its subsidiaries of \$94,000 and \$90,000 for the three months ended March 31, 2014 and 2013, respectively. Such dividends are included in “cash flows provided by (used in) operating activities” in the unaudited condensed consolidating cash flows.

15. SUBSEQUENT EVENTS

On April 3, 2014, the Company paid a quarterly dividend of \$0.50 per share to shareholders of record on March 25, 2014.

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

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

Note on Forward-Looking Statement

This Form 10-Q and other publicly available documents may include, and our officers and representatives may from time to time make, projections concerning financial information and statements concerning future economic performance and events, plans and objectives relating to management, operations, products and services, and assumptions underlying these projections and statements. These projections and statements are forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995 and are not historical facts but instead represent only our belief regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These projections and statements may address, among other things, our strategy for growth, product development, financial results and reserves. Actual results and financial condition may differ, possibly materially, from these projections and statements and therefore you should not place undue reliance on them. Factors that could cause our actual results to differ, possibly materially, from those in the specific projections and statements are discussed throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations and in "Risk Factors" in Item 1A. of Part I of our 2013 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission ("SEC") on February 18, 2014 (the "2013 Form 10-K"). We are under no obligation (and expressly disclaim any such obligation) to update or revise any forward-looking statement that may be made from time to time, whether as a result of new information, future developments or otherwise.

Overview

Our Business

We write a diversified portfolio of property and casualty insurance and reinsurance internationally through our subsidiaries and branches based in Bermuda, Canada, Europe, Hong Kong, Singapore, and the United States as well as our Lloyd's Syndicate 2232. We manage our business through three operating segments: U.S. insurance, international insurance and reinsurance. As of March 31, 2014, we had approximately \$12.3 billion of total assets, \$3.6 billion of total shareholders' equity and \$4.4 billion of total capital, which includes shareholders' equity and senior notes.

During the three months ended March 31, 2014, we continued to grow our business, in particular in the United States and Europe, as we entered new lines of business and added scale to our existing lines of business. We experienced positive rate improvements in certain lines of business, such as general casualty, primary casualty and professional liability in our U.S. insurance segment. However, we did experience negative rate changes in our general property line of business in both our U.S. insurance and international insurance segments, as well as negative rate changes in our European casualty lines of business in the international insurance segment. As a result, our consolidated gross premiums written increased by \$64.3 million, or 7.7%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. Overall our combined ratio is lower by 5.2 percentage points, driven by benign

property loss activity during the quarter and lower expenses primarily driven by lower employee stock-based compensation. Each of our operating segments reported higher underwriting income and lower combined ratios during the three months ended March 31, 2014 compared to the three months ended March 31, 2013. Also during the quarter, we received approval from Lloyd's, the Prudential Regulation Authority and the Financial Conduct Authority to establish our own Lloyd's managing agent, Allied World Managing Agency Limited, effective April 1, 2014, to manage Allied World's syndicate 2232.

Our net income increased by \$18.0 million to \$177.0 million compared to the three months ended March 31, 2013. The increase was primarily due to the higher underwriting income reported by each of our operating segments partially offset by lower total investment return and higher income tax expense.

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Financial Highlights

	Three Months Ended			
	2014	2013		
	March 31,			
	(\$ in millions except share, per share and percentage data)			
Gross premiums written	\$901.4	\$837.1		
Net income	177.0	159.0		
Operating income	129.9	84.2		
Basic earnings per share:				
Net income	\$5.33	\$4.59		
Operating income	\$3.91	\$2.43		
Diluted earnings per share:				
Net income	\$5.23	\$4.49		
Operating income	\$3.84	\$2.38		
Weighted average common shares outstanding:				
Basic	33,181,729	34,613,606		
Diluted	33,861,554	35,431,843		
Basic book value per common share	\$109.90	\$99.11		
Diluted book value per common share	\$107.05	\$96.50		
Annualized return on average equity (ROAE), net income	19.8	% 18.8		%
Annualized ROAE, operating income	14.6	% 10.0		%

Non-GAAP Financial Measures

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

Operating income and operating income per share

Operating income is an internal performance measure used in the management of our operations and represents after-tax operational results excluding, as applicable, net realized investment gains or losses, net foreign exchange gain or loss, and other non-recurring items. We exclude net realized investment gains or losses, net foreign exchange gain or loss and any other non-recurring items from our calculation of operating income because these amounts are heavily influenced by and fluctuate in part according to the availability of market opportunities and other factors. In addition to presenting net income determined in accordance with U.S. GAAP, we believe that showing operating income enables investors, analysts, rating agencies and other users of our financial information to more easily analyze our results of operations and our underlying business performance. Operating income should not be viewed as a substitute for U.S. GAAP net income.

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The following is a reconciliation of operating income to its most closely related U.S. GAAP measure, net income.

	Three Months Ended	
	March 31, 2014	2013
	(\$ in millions, except share, per share and percentage data)	
Net income	\$ 177.0	\$ 159.0
Add after tax effect of:		
Net realized investment (gains) losses	(47.2)	(77.3)
Foreign exchange loss (gain)	0.1	2.5
Operating income	\$ 129.9	\$ 84.2
Basic per share data:		
Net income	\$ 5.33	\$ 4.59
Add after tax effect of:		
Net realized investment (gains) losses	(1.42)	(2.23)
Foreign exchange loss (gain)	—	0.07
Operating income	\$ 3.91	\$ 2.43
Diluted per share data:		
Net income	\$ 5.23	\$ 4.49
Add after tax effect of:		
Net realized investment (gains) losses	(1.39)	(2.18)
Foreign exchange loss (gain)	—	0.07
Operating income	\$ 3.84	\$ 2.38

Diluted book value per share

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

	As of March 31,	
	2014	2013
	(\$ in millions, except share and per share data)	
Price per share at period end	\$103.19	\$92.72
Total shareholders' equity	\$3,616.7	\$3,432.0
Basic common shares outstanding	32,908,821	34,626,361
Add:		
Unvested restricted stock units	174,415	91,159
Performance-based equity awards	207,092	272,062
Employee share purchase plan	5,572	5,616
Dilutive stock options outstanding	920,101	1,166,137
Weighted average exercise price per share	\$48.33	\$47.34
Deduct:		
Options bought back via treasury method	(430,938)	(595,451)
Common shares and common share equivalents outstanding	33,785,063	35,565,884
Basic book value per common share	\$109.90	\$99.11
Diluted book value per common share	\$107.05	\$96.50

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Annualized return on average equity

Annualized return on average shareholders' equity ("ROAE") is calculated using average shareholders' equity. We present ROAE as a measure that is commonly recognized as a standard of performance by investors, analysts, rating agencies and other users of our financial information.

Annualized operating return on average shareholders' equity is calculated using operating income and average shareholders' equity.

	Three Months Ended			
	March 31, 2014	2013		
	(\$ in millions except percentage data)			
Opening shareholders' equity	\$3,519.8	\$3,326.3		
Closing shareholders' equity	\$3,616.7	\$3,432.0		
Average shareholders' equity	\$3,568.3	\$3,379.1		
Net income available to shareholders	\$177.0	\$159.0		
Annualized return on average shareholders' equity — net income available to shareholders	19.8	% 18.8		%
Operating income available to shareholders	\$129.9	\$84.2		
Annualized return on average shareholders' equity — operating income available to shareholders	14.6	% 10.0		%

Relevant Factors

Revenues

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

Expenses

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

- losses paid, which are actual cash payments to insureds and reinsureds, net of recoveries from reinsurers;
- outstanding loss or case reserves, which represent management's best estimate of the likely settlement amount for known claims, less the portion that can be recovered from reinsurers; and
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reserves for losses incurred but not reported, or “IBNR”, which are reserves (in addition to case reserves) established by us that we believe are needed for the future settlement of claims. The portion recoverable from reinsurers is deducted from the gross estimated loss.

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

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

Ratios

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

Critical Accounting Policies

It is important to understand our accounting policies in order to understand our financial position and results of operations. Our unaudited condensed consolidated financial statements reflect determinations that are inherently subjective in nature and require management to make assumptions and best estimates to determine the reported values. If events or other factors cause actual results to differ materially from management’s underlying assumptions or estimates, there could be a material adverse effect on our financial condition or results of operations. We believe that some of the more critical judgments in the areas of accounting estimates and assumptions that affect our financial condition and results of operations are related to reserves for losses and loss expenses, reinsurance recoverables, premiums and acquisition costs, valuation of financial instruments and goodwill and other intangible asset impairment valuation. For a detailed discussion of our critical accounting policies, please refer to our 2013 Form 10-K. There were no material changes in the application of our critical accounting estimates subsequent to that report.

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Results of Operations

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

	Three Months Ended			
	March 31,			
	2014	2013		
	(\$ in millions)			
Revenues				
Gross premiums written	\$901.4	\$837.1		
Net premiums written	\$771.6	\$695.1		
Net premiums earned	\$530.3	\$463.2		
Net investment income	47.6	33.4		
Net realized investment gains (losses)	54.2	79.6		
	\$632.1	\$576.2		
Expenses				
Net losses and loss expenses	\$275.3	\$255.1		
Acquisition costs	67.7	56.7		
General and administrative expenses	80.3	82.7		
Amortization of intangible assets	0.6	0.6		
Interest expense	14.6	14.1		
Foreign exchange loss	0.1	2.6		
	\$438.6	\$411.8		
Income before income taxes	193.5	164.4		
Income tax expense	16.5	5.4		
Net income	\$177.0	\$159.0		
Ratios				
Loss and loss expense ratio	51.9	% 55.1	%	
Acquisition cost ratio	12.8	% 12.2	%	
General and administrative expense ratio	15.2	% 17.8	%	
Expense ratio	28.0	% 30.0	%	
Combined ratio	79.9	% 85.1	%	

Comparison of Three Months Ended March 31, 2014 and 2013

Premiums

Gross premiums written increased by \$64.3 million, or 7.7%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The overall increase in gross premiums written was primarily the result of the following:

U.S. insurance: Gross premiums written increased by \$13.9 million, or 5.4%. The increase in gross premiums written was primarily due to \$10.4 million of new business growth from new lines of business and new insureds during the three months ended March 31, 2014 compared to the three months ended March 31, 2013, as well as premium rate increases across most lines of business. This was particularly evident in our general casualty, programs, inland marine and environmental lines of business that had an overall increase in gross premiums written of \$26.2 million. This growth was partially offset by the non-renewal of business, particularly in our healthcare line of business, that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions);

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International insurance: Gross premiums written increased by \$5.9 million, or 4.6%. The increase was primarily due to continued growth from new initiatives and new lines of business. Our new aviation and marine cargo business contributed \$4.4 million of gross premiums written during the current quarter. The professional liability line of business grew by \$4.5 million on new business writings in European errors and omissions ("E&O") and mergers and

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acquisitions classes of business. This growth was partially offset by the general casualty line of business, which decreased by \$3.9 million compared to the prior period, due to \$3.5 million of non-recurring business in 2013; and Reinsurance: Gross premiums written increased by \$44.5 million, or 9.8%. The increase was driven primarily by new business and increased renewals across several major product lines and the timing of renewals that were renewed during the current quarter but were previously bound subsequent to the quarter ended March 31, 2013. In our property reinsurance lines of business, we had increased premiums of approximately \$15.5 million from our collateralized property catastrophe reinsurance program through Aeolus Re, Ltd. ("Aeolus Re"), as well as growth of \$17.7 million from our U.S. property reinsurance operations. In our specialty lines of business, our crop reinsurance line of business increased gross premiums written by \$13.8 million primarily due to increases on renewals, timing of renewals and new business. Partially offsetting these increases in gross premiums written were non-renewals of certain treaties, particularly in our casualty reinsurance line of business, either due to poor terms and conditions or the cedents not renewing their reinsurance or finding other reinsurance alternatives, and net downward premium adjustments on inforce treaties.

The table below illustrates our gross premiums written by underwriter location for each of the periods indicated.

	Three Months Ended		Dollar Change	Percentage Change	
	March 31, 2014	2013			
	(\$ in millions)				
United States	\$520.8	\$478.4	\$42.4	8.9	%
Bermuda	229.6	228.7	0.9	0.4	%
Europe	103.3	86.5	16.8	19.4	%
Asia	46.9	43.5	3.4	7.8	%
Canada	0.8	—	0.8	n/a	
	\$901.4	\$837.1	\$64.3	7.7	%

Net premiums written increased by \$76.5 million, or 11.0%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The increase in net premiums written was due to the increase in gross premiums written and non-renewing our collateralized retrocessional catastrophe cover in our reinsurance segment, which reduced ceded premiums written and therefore increased net premiums written. These increases were partially offset by new reinsurance treaties in support of the aviation, marine cargo, primary construction and small- to medium-sized enterprise lines of business entered into during the three months ended March 31, 2014 that we did not have in place during the three months ended March 31, 2013 and recognizing annual ceded premiums written at the inception of treaties that have contractual minimum premiums. Previously, we recognized ceded premiums written on these agreements based on the actual premiums ceded each quarter. This change resulted in the acceleration of ceded premiums written of \$4.9 million in our international insurance segment to this quarter, but had no impact on net premiums earned. The difference between gross and net premiums written is the cost to us of purchasing reinsurance coverage, including the cost of property catastrophe reinsurance coverage. We ceded 14.4% of gross premiums written for the three months ended March 31, 2014 compared to 17.0% for the same period in 2013. The decrease was primarily due to the non-renewal of the collateralized retrocessional catastrophe cover in our reinsurance segment, which reduced the ratio by 3.1 percentage points.

Net premiums earned increased by \$67.1 million, or 14.5%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013 as a result of higher premiums earned in each of our operating segments.

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

Gross Premiums Written	Net Premiums Earned
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	Three Months Ended		Three Months Ended		
	March 31,		March 31,		
	2014	2013	2014	2013	
U.S. insurance	29.9	% 30.5	% 40.0	% 40.7	%
International insurance	14.9	% 15.4	% 16.7	% 18.2	%
Reinsurance	55.2	% 54.1	% 43.3	% 41.1	%
Total	100.0	% 100.0	% 100.0	% 100.0	%

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Gross premiums written by our reinsurance segment typically accounts for the largest portion of gross premiums written during the first quarter of a calendar year as many reinsurance contracts have January 1st renewal dates.

Net Investment Income

Net investment income increased by \$14.2 million, or 42.5%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The increase was due to higher income across most asset classes such as our fixed maturity investments, our equity method investments owned through Allied World Financial Services, Inc. and our hedge fund and private equity investments. We reported \$7.4 million of earnings from our equity method investments during the three months ended March 31, 2014, whereas we did not report any earnings during the comparative prior period. The earnings from our equity method investments can fluctuate from period to period based on the performance of each equity method investment and the seasonality of their results, and as such the current period earnings may not be indicative of the performance in future periods. The annualized period book yield of the investment portfolio for the three months ended March 31, 2014 and 2013 was 2.3% and 1.6%, respectively.

As of March 31, 2014, we held 11.5% of our total investments and cash equivalents in other invested assets compared to 9.7% as of March 31, 2013.

Investment management expenses of \$3.8 million and \$4.3 million were incurred during the three months ended March 31, 2014 and 2013, respectively. The decrease of \$0.5 million, or 11.8%, was due to better terms with our investment portfolio managers.

As of March 31, 2014, approximately 89.6% of our fixed income investments consisted of investment grade securities. As of March 31, 2014 and December 31, 2013, the average credit rating of our fixed income portfolio was AA- as rated by Standard & Poor's.

Realized Investment Gains (Losses)

Net realized investment gains (losses) were comprised of the following:

	Three Months Ended March 31, 2014		2013
	(\$ in millions)		
Net realized gains (losses) on sale:			
Fixed maturity investments, trading	\$7.5		\$21.9
Equity securities, trading	36.2		9.8
Other invested assets: hedge funds and private equity, trading	6.4		5.6
Total net realized gains on sale	50.1		37.3
Net realized and unrealized losses on derivatives	(12.9	)	(1.0
Mark-to-market gains (losses):			
Fixed maturity investments, trading	22.5		(16.5
Equity securities, trading	(21.6	)	33.0
Other invested assets: hedge funds and private equity, trading	16.2		26.8
Total mark-to-market gains	17.1		43.3
Net realized investment gains	\$54.3		\$79.6

The total return of our investment portfolio was 1.2% and 1.3% for the three months ended March 31, 2014 and 2013, respectively. The slight decrease in total return is primarily due to lower stock price appreciation of our equity

securities during the three months ended March 31, 2014 compared to three months ended March 31, 2013 partially offset by gains in our fixed maturity investments portfolio. The increased realized and unrealized losses on derivatives was a result of entering into contracts to hedge against rising interest rates, however, market interest rates decreased during the quarter, generating a loss on derivatives.

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Net Losses and Loss Expenses

Net losses and loss expenses increased by \$20.2 million, or 7.9%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The following is a breakdown of the loss and loss expense ratio for the three months ended March 31, 2014 and 2013:

	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013		Dollar Change	Change in Percentage Points
	Amount	% of NPE (1)	Amount (\$ in millions)	% of NPE (1)		
Non-catastrophe	\$324.2	61.1	% \$299.2	64.6	% \$25.0	(3.5)
Property catastrophe	—	—	—	—	—	—
Current period	324.2	61.1	299.2	64.6	25.0	(3.5)
Prior period	(48.9)	(9.2)	(44.1)	(9.5)	(4.8)	0.3
Net losses and loss expenses	\$275.3	51.9	% \$255.1	55.1	% \$20.2	(3.2)

(1) "NPE" means net premiums earned.

Current year non-catastrophe losses and loss expenses

The increase in the current year non-catastrophe losses and loss expenses was primarily due to the overall growth of our operations. The reduction in the current year non-catastrophe losses and loss expenses ratio was primarily due to lower reported loss activity in our property lines of business during the three months ended March 31, 2014 compared to the three months March 31, 2013, and an increase to the loss adjustment expense reserve during the three months ended March 31, 2013 that did not occur during the three months ended March 31, 2014, which reduced the current year non-catastrophe loss and loss adjustment expense ratio by 1.7 percentage points.

Current year property catastrophe losses and loss expenses

During the three months ended March 31, 2014 and March 31, 2013, we did not incur any property catastrophe losses.

Prior year losses and loss expenses

We recorded net favorable reserve development related to prior years of \$48.9 million during the three months ended March 31, 2014 compared to net favorable reserve development of \$44.1 million for the three months ended March 31, 2013, as shown in the tables below.

(Favorable) and Unfavorable Loss Reserve Development by Loss Year For the Three Months Ended March 31, 2014											
	2004 and Prior	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
	(\$ in millions)										
U.S. insurance	\$(3.1)	\$—	\$—	\$0.2	\$(0.5)	\$(0.3)	\$(0.1)	\$4.5	\$0.1	\$—	\$0.8
International insurance	3.9	(2.3)	(2.6)	(17.8)	(5.8)	(5.8)	(4.4)	(5.0)	(1.4)	11.8	(29.4)
Reinsurance	(1.4)	0.8	(1.4)	(2.1)	(1.7)	0.2	1.5	0.2	(2.1)	(14.3)	(20.3)
	\$(0.6)	\$(1.5)	\$(4.0)	\$(19.7)	\$(8.0)	\$(5.9)	\$(3.0)	\$(0.3)	\$(3.4)	\$(2.5)	\$(48.9)

The net unfavorable prior year reserve development in the U.S. insurance segment for the 2011 loss year was in our healthcare line of business and was due to adverse development on several claims above our previous expectations in the managed care E&O class of business and higher than expected loss frequency in the medical malpractice class of business. The favorable prior year reserve development in the international insurance segment for the 2007 loss year was due to favorable reserve development on an individual professional liability claim and the unfavorable reserve development for the 2013 loss year was due to a single claim in our healthcare line of business. The net favorable prior year reserve development in our reinsurance segment for the 2013 loss year was primarily due to benign property loss activity, and therefore reported losses were less than our expectations.

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The following table shows the net favorable reserve development by loss year for each of our segments for the three months ended March 31, 2013.

(Favorable) and Unfavorable Loss Reserve Development by Loss Year For the Three Months Ended March 31, 2013											
	2003 and Prior	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
	(\$ in millions)										
U.S. insurance	\$ (0.1)	\$ (1.2)	\$ (2.1)	\$ (1.5)	\$ (6.9)	\$ (3.7)	\$ (2.7)	\$ (0.1)	\$ 4.5	\$ 24.3	\$ 10.5
International insurance	(0.5)	2.7	(7.2)	(6.0)	(2.8)	(7.1)	3.6	(2.5)	(7.6)	(2.3)	(29.7)
Reinsurance	0.5	(0.1)	(2.1)	(0.2)	(2.2)	(3.0)	(1.0)	(2.2)	(5.5)	(9.1)	(24.9)
	\$ (0.1)	\$ 1.4	\$ (11.4)	\$ (7.7)	\$ (11.9)	\$ (13.8)	\$ (0.1)	\$ (4.8)	\$ (8.6)	\$ 12.9	\$ (44.1)

The unfavorable reserve development for the 2011 and 2012 loss years for our U.S. insurance segment was due to higher than expected loss emergence, primarily in our private/not for profit directors' and officers' ("D&O"), healthcare D&O and E&O products. The healthcare D&O emergence was largely driven by two large claims, both in excess of \$3 million. The emergence in the E&O and private/not for profit D&O is due to higher than expected loss frequency.

The following table shows the components of net losses and loss expenses for each of the periods indicated.

	Three Months Ended March 31,		Dollar Change
	2014	2013	
	(\$ in millions)		
Net losses paid	\$232.3	\$244.6	\$ (12.3)
Net change in reported case reserves	(51.1)	9.0	(60.1)
Net change in IBNR	94.1	1.5	92.6
Net losses and loss expenses	\$275.3	\$255.1	\$ 20.2

The table below is a reconciliation of the beginning and ending reserves for losses and loss expenses. Losses incurred and paid are reflected net of reinsurance recoverables.

	Three Months Ended March 31,	
	2014	2013
	(\$ in millions)	
Net reserves for losses and loss expenses, January 1	\$4,532.0	\$4,504.4
Incurred related to:		
Current period non-catastrophe	324.2	299.2
Prior period	(48.9)	(44.1)
Total incurred	275.3	255.1
Paid related to:		
Current period non-catastrophe	3.7	3.5
Prior period	228.6	241.1
Total paid	232.3	244.6
Foreign exchange revaluation	1.3	(5.2)
Net reserve for losses and loss expenses, March 31	4,576.3	4,509.7
Losses and loss expenses recoverable	1,280.5	1,163.5
Reserve for losses and loss expenses, March 31	\$5,856.8	\$5,673.2

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Acquisition Costs

Acquisition costs increased by \$11.0 million, or 19.4%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The increase in acquisition costs was due to the growth in premiums and related acquisition costs. Acquisition costs as a percentage of net premiums earned were 12.8% for the three months ended March 31, 2014 compared to 12.2% for the same period in 2013. The higher acquisition cost ratio is driven from our U.S. insurance segment.

General and Administrative Expenses

General and administrative expenses decreased by \$2.4 million, or 2.9%, for the three months ended March 31, 2014 compared to the same period in 2013. Our general and administrative expense ratio was 15.2% and 17.8% for the three months ended March 31, 2014 and 2013, respectively. The decrease in general and administrative expenses was primarily due to lower stock-based compensation partially offset by higher salary related costs due to higher headcount as our average headcount increased by 15%. We have granted cash equivalent restricted stock units and performance-based equity awards to certain key employees, and we measure the value of each award at the period ending share price. Changes in our share price are recognized as increases or decreases in our compensation expense ratably over the service period. Our share price decreased 9% for the three months ended March 31, 2014, compared to a 18% increase for the same period in 2013.

Amortization of Intangible Assets

The amortization of intangible assets was unchanged for the three months ended March 31, 2014 compared to the three months ended March 31, 2013.

Interest Expense

Interest expense increased by \$0.5 million, or 3.5%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013 reflecting increased letter of credit facility charges.

Net Income

Net income for the three months ended March 31, 2014 was \$177.0 million compared to net income of \$159.0 million for the three months ended March 31, 2013. The \$18.0 million increase was primarily the result of higher underwriting income from each of our operating segments. Income tax expense for the three months ended March 31, 2014 increased by \$11.1 million compared to the three months ended March 31, 2013. The increase in income tax expense was primarily due to higher taxable income in our U.S. operations.

Underwriting Results by Operating Segments

Our company is organized into three operating segments:

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

International Insurance Segment. The international insurance segment includes our direct insurance operations in Bermuda, Europe, Singapore, Labuan and Hong Kong. This segment provides both direct property and casualty

insurance primarily to Fortune 1000 North American domiciled accounts from our Bermuda office and direct property and specialty casualty to our non-North American domiciled accounts from our European, Singapore and Hong Kong offices.

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

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U.S. Insurance Segment

The following table summarizes the underwriting results and associated ratios for the U.S. insurance segment for each of the periods indicated.

	Three Months Ended		
	March 31,		
	2014	2013	
	(\$ in millions)		
Revenues			
Gross premiums written	\$269.9	\$256.0	
Net premiums written	202.7	192.3	
Net premiums earned	212.1	188.4	
Expenses			
Net losses and loss expenses	\$142.0	\$133.3	
Acquisition costs	27.5	23.1	
General and administrative expenses	37.4	39.6	
Underwriting income (loss)	\$5.2	\$(7.6)	
Ratios			
Loss and loss expense ratio	66.9	% 70.8	%
Acquisition cost ratio	13.0	% 12.3	%
General and administrative expense ratio	17.6	% 21.0	%
Expense ratio	30.6	% 33.3	%
Combined ratio	97.5	% 104.1	%

Comparison of Three Months Ended March 31, 2014 and 2013

Premiums. Gross premiums written increased by \$13.9 million, or 5.4%, for the three months ended March 31, 2014 compared to the same period in 2013. The increase in gross premiums written was primarily due to \$10.4 million of new business growth from new lines of business and new insureds during the three months ended March 31, 2014 compared to the three months ended March 31, 2013, as well as premium rate increases across most lines of business. This was particularly evident in our general casualty, programs, inland marine and environmental lines of business that had an overall increase in gross premiums written of \$26.2 million. This growth was partially offset by the non-renewal of business, particularly in our healthcare line of business, that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions).

The table below illustrates our gross premiums written by line of business for each of the periods indicated.

	Three Months Ended		Dollar	Percentage
	March 31,			
	2014	2013	Change	Change
	(\$ in millions)			
General casualty	\$79.2	\$66.9	\$12.3	18.4 %
Professional liability	62.2	63.1	(0.9)	(1.4)%
Programs	39.0	32.9	6.1	18.5 %
Healthcare	34.4	53.5	(19.1)	(35.7)%
General property	19.0	19.7	(0.7)	(3.6)%
Inland marine	12.1	8.0	4.1	51.3 %
Environmental	10.3	6.6	3.7	56.1 %
Other*	13.7	5.4	8.3	153.7 %

\$269.9	\$256.0	\$13.9	5.4	%
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*Includes our primary construction, mergers and acquisitions and surety lines of business.

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Net premiums written increased by \$10.4 million, or 5.4%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013 consistent with the increase in gross premiums written. We ceded 24.9% of gross premiums written for the three months ended March 31, 2014 and March 31, 2013.

Net premiums earned increased by \$23.7 million, or 12.6%, for the three months ended March 31, 2014 compared to the same period in 2013. The increase was due to the continued growth of our U.S. insurance operations during 2013 and into 2014.

Net losses and loss expenses. Net losses and loss expenses increased by \$8.7 million, or 6.5%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The following is a breakdown of the loss and loss expense ratio for the three months ended March 31, 2014 and 2013:

	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013		Dollar Change	Change in Percentage Points
	Amount	% of NPE	Amount (\$ in millions)	% of NPE		
Non-catastrophe	\$ 141.2	66.5	% \$ 122.8	65.2	% \$ 18.4	1.3 Pts
Property catastrophe	—	—	—	—	—	—
Current period	141.2	66.5	122.8	65.2	18.4	1.3
Prior period	0.8	0.4	10.5	5.6	(9.7	) (5.2)
Net losses and loss expenses	\$ 142.0	66.9	% \$ 133.3	70.8	% \$ 8.7	(3.9) Pts

Current year non-catastrophe losses and loss expenses

The increase in the current year non-catastrophe losses and loss expenses was primarily due to growth of the business, while the increase in the current year non-catastrophe losses and loss expense ratio was primarily due to mix of business and increased loss adjustment expenses across several lines of business.

Current year property catastrophe losses and loss expenses

During the three months ended March 31, 2014 and March 31, 2013, we did not incur any property catastrophe losses.

Prior year losses and loss expenses

Overall, our U.S. insurance segment recorded net unfavorable reserve development of \$0.8 million during the three months ended March 31, 2014 compared to net unfavorable reserve development of \$10.5 million for the three months ended March 31, 2013, as shown in the tables below.

	(Favorable) and Unfavorable Loss Reserve Development by Loss Year For the Three Months Ended March 31, 2014										
	2004 and Prior (\$ in millions)	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
General casualty	\$(2.9)	\$—	\$—	\$(0.5)	\$(2.3)	\$0.3	\$(0.1)	\$2.0	\$—	\$—	\$(3.5)
Programs	—	—	—	1.0	1.6	(3.0)	—	(1.0)	(0.2)	—	(1.6)
Healthcare	(0.2)	—	—	(0.3)	0.2	2.0	—	4.3	1.8	—	7.8

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Professional liability	—	—	—	—	—	0.4	—	(0.5)	(1.2)	—	(1.3)
Inland Marine	—	—	—	—	—	—	—	(0.3)	(0.3)	—	(0.6)
	\$(3.1)	\$—	\$—	\$0.2	\$(0.5)	\$(0.3)	\$(0.1)	\$4.5	\$0.1	\$—	\$0.8

The net unfavorable prior year reserve development in the healthcare lines of business is due to adverse development on several claims above our previous expectations in the managed care E&O class of business and higher than expected loss frequency in the medical malpractice class of business.

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(Favorable) and Unfavorable Loss Reserve Development by Loss Year For the Three Months Ended March 31, 2013											
2003 and Prior	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total	
(\$ in millions)											
General casualty Programs	\$—	\$(0.4)	\$(0.3)	\$—	\$(3.3)	\$(1.7)	\$(0.2)	\$—	\$1.2	\$—	\$(4.7)
General property	—	—	—	—	(1.6)	0.1	(0.6)	(0.9)	(0.4)	1.4	(2.0)
Healthcare	(0.1)	(0.3)	(0.9)	(1.0)	(0.8)	(2.6)	0.1	(0.6)	3.0	6.8	3.6
Professional liability	—	(0.5)	(0.9)	(0.5)	(1.2)	0.5	(0.6)	(0.9)	0.8	13.3	10.0
Other	—	—	—	—	—	—	—	—	0.8	0.8	0.8
	\$(0.1)	\$(1.2)	\$(2.1)	\$(1.5)	\$(6.9)	\$(3.7)	\$(2.7)	\$(0.1)	\$4.5	\$24.3	\$10.5

The unfavorable reserve development for the 2011 and 2012 loss years was due to higher than expected loss emergence, primarily in our private/not for profit D&O, healthcare D&O and E&O products. The healthcare D&O emergence was largely driven by two large claims, both in excess of \$3 million. The emergence in the E&O and private/not for profit D&O is due to higher than expected loss frequency.

Acquisition costs. Acquisition costs increased by \$4.4 million, or 19.0%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The increase was driven by the growth in premiums and higher commission and brokerage rates compared to last year due to changes in the mix of business and higher rates charged by brokers. The acquisition cost ratio was 13.0% and 12.3% for the three months ended March 31, 2014 and 2013, respectively, due to the mix of business and higher rates discussed above.

General and administrative expenses. General and administrative expenses decreased by \$2.2 million, or 5.6%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The decrease was primarily due to lower stock-based compensation expense partially offset by higher salary related costs as we continue to grow our U.S. insurance operations. The general and administrative expense ratio decreased to 17.6% for the three months ended March 31, 2014 from 21.0% for the same period in 2013, reflecting lower expenses and higher net premiums earned.

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International Insurance Segment

The following table summarizes the underwriting results and associated ratios for the international insurance segment for each of the periods indicated.

	Three Months Ended March 31,			
	2014	2013		
	(\$ in millions)			
Revenues				
Gross premiums written	\$134.4	\$128.5		
Net premiums written	75.5	77.7		
Net premiums earned	88.4	84.2		
Expenses				
Net losses and loss expenses	\$23.6	\$28.9		
Acquisition costs	(0.9	)	(0.8)
General and administrative expenses	24.8	24.8		
Underwriting income	\$40.9	\$31.3		
Ratios				
Loss and loss expense ratio	26.7	% 34.4		%
Acquisition cost ratio	(1.1	)%	(1.0)%
General and administrative expense ratio	28.0	% 29.4		%
Expense ratio	26.9	% 28.4		%
Combined ratio	53.6	% 62.8		%

Comparison of Three Months Ended March 31, 2014 and 2013

Premiums. Gross premiums written increased by \$5.9 million, or 4.6%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The increase was primarily due to continued growth from new initiatives and new lines of business. Our new aviation and marine cargo business contributed \$4.4 million of gross premiums written during the current quarter. The professional liability line of business grew \$4.5 million on new business writings in European E&O and mergers and acquisitions classes of business. This growth was partially offset by the general casualty line of business, which decreased by \$3.9 million compared to the prior period, due to \$3.5 million of non-recurring business in 2013.

The table below illustrates our gross premiums written by underwriter location for our international insurance operations.

	Three Months Ended March 31,		Dollar Change	Percentage Change
	2014	2013		
	(\$ in millions)			
Bermuda	\$79.9	\$85.2	\$(5.3) (6.2
Europe	49.0	37.6	11.4	30.3
Asia	5.5	5.7	(0.2) (3.5
	\$134.4	\$128.5	\$5.9	4.6

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The table below illustrates our gross premiums written by line of business for each of the periods indicated.

	Three Months Ended March 31,		Dollar Change	Percentage Change	
	2014 (\$ in millions)	2013			
Professional liability	\$37.6	\$33.1	\$4.5	13.6	%
General property	36.6	38.7	(2.1)	(5.4))%
Healthcare	27.2	26.5	0.7	2.6	%
General casualty	20.1	24.0	(3.9)	(16.3))%
Trade credit	8.5	6.2	2.3	37.1	%
Aviation	2.9	—	2.9	n/a	
Other*	1.5	—	1.5	n/a	
	\$134.4	\$128.5	\$5.9	4.6	%

*Includes our marine cargo line of business.

Net premiums written decreased by \$2.2 million, or 2.8%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The decrease in net premiums written was due to higher ceded premiums. We ceded 43.8% of gross premiums written for the three months ended March 31, 2014 compared to 39.5% for the three months ended March 31, 2013. The increase was primarily due to ceded premiums written of \$6.1 million from new reinsurance contracts for our aviation, marine cargo and small-to medium-sized enterprise lines of business that were in place during the three months ended March 31, 2014 but were not in place during the three months ended March 31, 2013. Included in the \$6.1 million of additional ceded premium was \$4.9 million of ceded premiums written due to recognizing annual ceded premiums written at the inception of the treaty rather than ratably over the contract period for those reinsurance contracts where there is a contractual minimum premium.

Net premiums earned increased by \$4.2 million, or 5.0%, primarily due to higher net premiums written during 2013.

Net losses and loss expenses. Net losses and loss expenses decreased by \$5.3 million, or 18.3%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The following is a breakdown of the loss and loss expense ratio for the three months ended March 31, 2014 and 2013:

	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013		Dollar Change	Change in Percentage Points
	Amount	% of NPE	Amount (\$ in millions)	% of NPE		
Non-catastrophe	\$53.0	59.9	% \$58.6	69.7	% \$(5.6)	) (9.8) Pts
Property catastrophe	—	—	—	—	—	—
Current period	53.0	59.9	58.6	69.7	(5.6)	) (9.8)
Prior period	(29.4)	(33.2)	(29.7)	(35.3)	0.3	) 2.1
Net losses and loss expenses	\$23.6	26.7	% \$28.9	34.4	% \$(5.3)	) (7.7) Pts

Current year non-catastrophe losses and loss expenses

The decrease in the current year non-catastrophe losses and loss expenses and related ratio was primarily due to an increase to the loss adjustment expense reserve during the three months ended March 31, 2013 that did not occur during the three months ended March 31, 2014, which reduced the current year non-catastrophe loss and loss adjustment expense reserve by 9.7 percentage points.

Current year property catastrophe losses and loss expenses

During the three months ended March 31, 2014 and March 31, 2013, we did not incur any property catastrophe losses.

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Prior year losses and loss expenses

Overall, our international insurance segment recorded net favorable reserve development of \$29.4 million during the three months ended March 31, 2014 compared to net favorable reserve development of \$29.7 million for the three months ended March 31, 2013, as shown in the tables below.

(Favorable) and Unfavorable Loss Reserve Development by Loss Year For the Three Months Ended March 31, 2014											
	2004 and Prior	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
(\$ in millions)											
General casualty	\$4.4	\$(0.7)	\$(1.3)	\$(2.1)	\$(4.1)	\$(2.7)	\$(4.7)	\$(0.1)	\$—	\$—	\$(11.3)
General property	(0.3)	0.3	(0.1)	(1.0)	(0.3)	(0.5)	0.5	(3.2)	(2.3)	(4.2)	(11.1)
Professional liability	(0.2)	(0.9)	(0.3)	(13.7)	(0.6)	(2.6)	(0.1)	(0.4)	(0.1)	—	(18.9)
Healthcare	—	(1.0)	(0.9)	(1.0)	(0.8)	—	—	(0.3)	—	16.0	12.0
Trade Credit	—	—	—	—	—	—	(0.1)	(1.0)	1.0	—	(0.1)
	\$3.9	\$(2.3)	\$(2.6)	\$(17.8)	\$(5.8)	\$(5.8)	\$(4.4)	\$(5.0)	\$(1.4)	\$11.8	\$(29.4)

The unfavorable prior year reserve development in the healthcare line of business for the 2013 loss year related to a single claim. The favorable prior year reserve development in the professional liability line of business for the 2007 loss year was primarily due to favorable reserve development on an individual claim.

(Favorable) and Unfavorable Loss Reserve Development by Loss Year For the Three Months Ended March 31, 2013											
	2003 and Prior	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
(\$ in millions)											
General casualty	\$(0.3)	\$3.1	\$(5.6)	\$(3.4)	\$(6.3)	\$(2.7)	\$(2.9)	\$(0.2)	\$0.2	\$0.9	\$(17.2)
General property	—	—	—	(0.4)	0.3	(0.6)	0.2	(1.3)	(7.9)	(3.2)	(12.9)
Professional liability	(0.1)	(0.3)	(1.2)	(1.5)	(5.4)	0.3	(0.4)	(0.3)	—	—	(8.9)
Healthcare	(0.1)	(0.1)	(0.4)	(0.7)	8.6	(4.1)	6.7	(0.7)	0.1	—	9.3
	\$(0.5)	\$2.7	\$(7.2)	\$(6.0)	\$(2.8)	\$(7.1)	\$3.6	\$(2.5)	\$(7.6)	\$(2.3)	\$(29.7)

Acquisition costs. Acquisition costs decreased by \$0.1 million, or 12.5%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The acquisition cost ratio was negative 1.1% for the three months ended March 31, 2014 and negative 1.0% for the three months ended March 31, 2013. The negative cost represents ceding commissions received on ceded premiums, that have been earned, in excess of the brokerage fees and commissions paid on gross premiums written, that have been amortized. The ceding commission income also covers costs that are expensed as incurred. The higher negative acquisition cost ratio is primarily due to additional ceding commission income earned on the new aviation reinsurance contracts and increased ceding commission income on certain renewals.

General and administrative expenses. General and administrative expenses were unchanged for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. While the total general and administrative expenses were unchanged, we did have increased salary and related costs as we continue to grow our international operations, however this was offset by lower stock-based compensation expense. The general and administrative expense ratio was 28.0% and 29.4% for the three months ended March 31, 2014 and 2013, respectively. The decrease in the general and administrative expense ratio was due to higher growth in net premiums earned relative to expenses.

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Reinsurance Segment

The following table summarizes the underwriting results and associated ratios for the reinsurance segment for each of the periods indicated.

	Three Months Ended March 31,			
	2014	2013	(\$ in millions)	
Revenues				
Gross premiums written	\$497.1	\$452.6		
Net premiums written	493.4	425.1		
Net premiums earned	229.8	190.6		
Expenses				
Net losses and loss expenses	\$109.7	\$92.9		
Acquisition costs	41.2	34.4		
General and administrative expenses	18.1	18.3		
Underwriting income	\$60.8	\$45.0		
Ratios				
Loss and loss expense ratio	47.7	% 48.8		%
Acquisition cost ratio	17.9	% 18.1		%
General and administrative expense ratio	7.9	% 9.6		%
Expense ratio	25.8	% 27.7		%
Combined ratio	73.5	% 76.5		%

Comparison of Three Months Ended March 31, 2014 and 2013

Premiums. Gross premiums written increased by \$44.5 million, or 9.8%, for the three months ended March 31, 2014 compared to the same period in 2013. The increase was driven primarily by new business and increased renewals across several major product lines and the timing of renewals that were renewed during the current quarter but were previously bound subsequent to the quarter ended March 31, 2013. In our property reinsurance lines of business, we had increased premiums of approximately \$15.5 million from our collateralized property catastrophe reinsurance program through Aeolus Re, as well as growth of \$17.7 million from our U.S. property reinsurance operations. In our specialty lines of business, our crop reinsurance line of business increased gross premiums written by \$13.8 million primarily due to increases on renewals, timing of renewals and new business. Partially offsetting these increases in gross premiums written were non-renewals of certain treaties, particularly in our casualty reinsurance line of business, either due to poor terms and conditions or the cedents not renewing their reinsurance or finding other reinsurance alternatives, and net downward premium adjustments on inforce treaties.

The table below illustrates our gross premiums written by underwriter location for our reinsurance operations.

	Three Months Ended March 31,		Dollar Change	Percentage Change	
	2014	2013			
					(\$ in millions)
United States	\$251.7	\$222.4	\$29.3	13.2	%
Bermuda	149.7	143.5	6.2	4.3	%
Europe	54.4	49.0	5.4	11.0	%
Asia	41.3	37.7	3.6	9.5	%
	\$497.1	\$452.6	\$44.5	9.8	%

The increase in gross premiums written for the U.S. was primarily due to the growth of the property reinsurance and crop reinsurance lines of business.

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The table below illustrates our gross premiums written by line of business for each of the periods indicated.

	Three Months Ended		Dollar Change	Percentage Change	
	March 31, 2014	2013 (\$ in millions)			
Property	\$250.5	\$211.6	\$38.9	18.4	%
Specialty	161.5	143.4	18.1	12.6	%
Casualty	85.1	97.6	(12.5)	(12.8))%
	\$497.1	\$452.6	\$44.5	9.8	%

Net premiums written increased by \$68.3 million, or 16.1%, due the increase in gross premiums written as well as not renewing the collateralized retrocessional catastrophe cover. We decided not to renew the collateralized retrocessional catastrophe cover as we believe our current estimate of probable maximum losses from catastrophes are within acceptable levels.

Net premiums earned increased by \$39.2 million, or 20.6%, as a result of the increase in net premiums written during 2013 and into 2014, as well as the reduction in ceded earned premium related to the non-renewal of the collateralized retrocessional catastrophe cover.

Net losses and loss expenses. Net losses and loss expenses increased by \$16.8 million, or 18.1%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The following is a breakdown of the loss and loss expense ratio for the three months ended March 31, 2014 and 2013:

	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013		Dollar Change	Change in Percentage Points
	Amount	% of NPE	Amount (\$ in millions)	% of NPE		
Non-catastrophe	\$130.0	56.5	% \$117.8	61.9	% \$12.2	(5.4)
Property catastrophe	—	—	—	—	—	—
Current period	130.0	56.5	117.8	61.9	12.2	(5.4)
Prior period	(20.3)	(8.8)	(24.9)	(13.1)	4.6	4.3
Net losses and loss expenses	\$109.7	47.7	% \$92.9	48.8	% \$16.8	(1.1)

Current year non-catastrophe losses and loss expenses

The increase in the current year non-catastrophe losses and loss expenses was primarily due to the growth of the business, while the decrease in the current year non-catastrophe losses and loss expense ratio was primarily due to the mix of business with a greater portion of our business being property reinsurance, which carries a lower losses and loss expense ratio than our other reinsurance lines of business, and lower reported large losses during the three months ended March 31, 2014 compared to the three months ended March 31, 2013.

Current year property catastrophe losses and loss expenses

During the three months ended March 31, 2014 and March 31, 2013, we did not incur any property catastrophe losses.

Prior year losses and loss expenses

Overall, our reinsurance segment recorded net favorable reserve development of \$20.3 million during the three months ended March 31, 2014 compared to net favorable reserve development of \$24.9 million for the three months ended March 31, 2013, as shown in the tables below.

Table of Contents(Favorable) and Unfavorable Loss Reserve Development by Loss Year
For the Three Months Ended March 31, 2014

	2004 and Prior	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
	(\$ in millions)										
Property	\$—	\$—	\$(0.1)	\$(0.2)	\$(0.3)	\$(0.1)	\$0.6	\$(0.7)	\$(1.7)	\$(13.7)	\$(16.2)
Casualty	(1.4)	0.6	(1.3)	(1.9)	(1.4)	0.2	0.8	0.9	0.7	2.2	(0.6)
Specialty	—	0.2	—	—	—	0.1	0.1	—	(1.1)	(2.8)	(3.5)
	\$(1.4)	\$0.8	\$(1.4)	\$(2.1)	\$(1.7)	\$0.2	\$1.5	\$0.2	\$(2.1)	\$(14.3)	\$(20.3)

The net favorable reserve development in the property reinsurance line of business for the 2013 loss year is due to benign reported loss activity.

(Favorable) and Unfavorable Loss Reserve Development by Loss Year
For the Three Months Ended March 31, 2013

	2003 and Prior	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
	(\$ in millions)										
Property	\$—	\$—	\$(1.8)	\$—	\$—	\$(0.1)	\$(0.1)	\$(2.3)	\$(7.0)	\$(12.9)	\$(24.2)
Casualty	0.5	(0.1)	(0.2)	(0.1)	(2.2)	(2.5)	(0.3)	0.2	—	—	(4.7)
Specialty	—	—	(0.1)	(0.1)	—	(0.4)	(0.6)	(0.1)	1.5	3.8	4.0
	\$0.5	\$(0.1)	\$(2.1)	\$(0.2)	\$(2.2)	\$(3.0)	\$(1.0)	\$(2.2)	\$(5.5)	\$(9.1)	\$(24.9)

The net favorable reserve development for loss years 2004 to 2012 is a result of actual loss emergence being lower than anticipated.

Acquisition costs. Acquisition costs increased by \$6.8 million, or 19.8%, for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. The increase was due to the increase in premiums written, as well as increased ceding commission charged by cedents in certain lines of business. The acquisition cost ratio was 17.9% for the three months ended March 31, 2014 compared to 18.1% for the three months ended March 31, 2013. The decrease in the acquisition cost ratio was due to higher earned premium during the current quarter related to the non-renewal of the collateralized retrocessional catastrophe cover partially offset by the increased ceding commission charged by cedents. In the prior period, the collateralized retrocessional catastrophe cover reduced net premiums earned but did not have any offsetting ceding commission income, which caused the acquisition costs ratio to be higher compared to the current quarter.

General and administrative expenses. General and administrative expenses decreased by \$0.2 million, or 1.1%, for the three months ended March 31, 2014 compared to the same period in 2013. The decrease in general and administrative expenses was primarily due to lower stock-based compensation expense partially offset by higher salary related costs. The general and administrative expense ratios for the three months ended March 31, 2014 and 2013 were 7.9% and 9.6%, respectively, due to lower expenses and higher net premiums earned.

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Reserves for Losses and Loss Expenses

Reserves for losses and loss expenses by segment were comprised of the following:

	U.S. Insurance		International Insurance		Reinsurance		Total	
	Mar 31, 2014	Dec 31, 2013	Mar 31, 2014	Dec 31, 2013	Mar 31, 2014	Dec 31, 2013	Mar 31, 2014	Dec 31, 2013
	(\$ in millions)							
Case reserves	\$626.6	\$609.8	\$386.7	\$441.0	\$461.1	\$470.1	\$1,474.4	\$1,520.9
IBNR	1,567.3	1,509.2	1,754.7	1,710.4	1,060.4	1,026.0	4,382.4	4,245.6
Reserve for losses and loss expenses	2,193.9	2,119.0	2,141.4	2,151.4	1,521.5	1,496.1	5,856.8	5,766.5
Reinsurance recoverables	(588.1)	(558.7)	(683.7)	(669.6)	(8.7)	(6.2)	(1,280.5)	(1,234.5)
Net reserve for losses and loss expenses	\$1,605.8	\$1,560.3	\$1,457.7	\$1,481.8	\$1,512.8	\$1,489.9	\$4,576.3	\$4,532.0

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

The following tables provide our ranges of loss and loss expense reserve estimates by business segment as of March 31, 2014:

	Reserve for Losses and Loss Expenses Gross of Reinsurance Recoverable		
	Carried Reserves	Low Estimate	High Estimate
	(\$ in millions)		
U.S. insurance	\$2,193.9	\$1,731.9	\$2,464.8
International insurance	2,141.4	1,648.1	2,369.2
Reinsurance	1,521.5	1,251.8	1,717.2
Consolidated (1)	5,856.8	4,725.8	6,457.2
	Reserve for Losses and Loss Expenses Net of Reinsurance Recoverable		
	Carried Reserves	Low Estimate	High Estimate
	(\$ in millions)		
U.S. insurance	\$1,605.8	\$1,269.2	\$1,838.4
International insurance	1,457.7	1,109.3	1,626.2
Reinsurance	1,512.8	1,242.8	1,705.6
Consolidated (1)	4,576.3	3,703.5	5,088.0

(1) For statistical reasons, it is not appropriate to add together the ranges of each business segment in an effort to determine the low and high range around the consolidated loss reserves.

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

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

Reinsurance Recoverable

The following table illustrates our reinsurance recoverable as of March 31, 2014 and December 31, 2013:

	March 31, 2014	December 31, 2013
	(\$ in millions)	
Ceded case reserves	\$229.2	\$225.8
Ceded IBNR reserves	1,051.3	1,008.7
Reinsurance recoverable	\$1,280.5	\$1,234.5

We remain obligated for amounts ceded in the event our reinsurers do not meet their obligations. Accordingly, we have evaluated the reinsurers that are providing reinsurance protection to us and will continue to monitor their credit ratings and financial stability. We generally have the right to terminate our treaty reinsurance contracts at any time, upon prior written notice to the reinsurer, under specified circumstances, including the assignment to the reinsurer by A.M. Best of a financial strength rating of less than "A-." Approximately 99% of ceded reserves as of March 31, 2014 were recoverable from reinsurers who had an A.M. Best rating of "A-" or higher.

Liquidity and Capital Resources

Liquidity

Liquidity is a measure of our ability to access sufficient cash flows to meet the short-term and long-term cash requirements of our business operations. The company believes that its cash flows from operations and investments will provide sufficient liquidity for the foreseeable future.

Holdings is a holding company and transacts no business of its own. Cash flows to Holdings may comprise dividends, advances and loans from its subsidiary companies. Holdings is therefore reliant on receiving dividends and other permitted distributions from its subsidiaries to make dividend payments on its common shares.

Our operating subsidiaries depend upon cash inflows from premium receipts, net of commissions, investment income and proceeds from sales and redemptions of investments. Cash outflows for our operating subsidiaries are in the form of claims payments, net of reinsurance recoveries, reinsurance premium payments, purchase of investments, operating expenses and income tax payments as well as dividend payments to the holding company.

Historically, our operating subsidiaries have generated sufficient cash flows to meet all of their obligations. Because of the inherent volatility of our business, the seasonality in the timing of payments by insureds and cedents, the irregular timing of loss payments, and the impact of a change in interest rates and credit spreads on the investment income as well as seasonality in coupon payment dates for fixed income securities, cash flows from operating activities may vary between periods. In the unlikely event that paid losses exceed operating cash flows in any given

period, we would use our cash balances available, liquidate a portion of our investment portfolio or borrow under our revolving loan facility (see "Credit Facilities" below) in order to meet our short-term liquidity needs.

Our total investments and cash and cash equivalents totaled \$8.6 billion as of March 31, 2014, the main components of which were investment grade fixed income securities and cash and cash equivalents. As of March 31, 2014, we held \$565.8 million of unrestricted cash and cash equivalents and \$942.0 million of fixed income securities with a maturity of less than one year to meet short-term liquidity needs. Our remaining fixed income securities, equity securities and "other invested assets" are available to meet our long-term liquidity needs.

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As of March 31, 2014, we had \$150 million available under our revolving loan facility.

Dividend Restrictions

The jurisdictions in which our operating subsidiaries are licensed to write business impose regulations requiring companies to maintain or meet various defined statutory ratios, including solvency and liquidity requirements. Some jurisdictions also place restrictions on the declaration and payment of dividends and other distributions. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in the Company's 2013 Form 10-K.

Cash Flows

	Three Months Ended	
	March 31,	
	2014	2013
	(\$ in millions)	
Cash flows provided by operating activities	\$303.1	\$13.6
Cash flows (used in) provided by investing activities	(188.5	) 15.9
Cash flows used in financing activities	(82.4	) (46.8
Effect of exchange rate changes on foreign currency cash	1.7	(2.0
Net increase (decrease) in cash and cash equivalents	33.9	(19.3
Cash and cash equivalents, beginning of period	531.9	681.9
Cash and cash equivalents, end of period	\$565.8	\$662.6

The primary sources of cash inflows from operating activities are premiums received, loss payments from reinsurers and investment income. The primary sources of cash outflows from operating activities are ceded premiums paid to reinsurers, claims paid, commissions paid, operating expenses, interest expense and income taxes. The primary factor in our ability to generate positive operating cash flow is underwriting profitability. We have generated positive operating cash flow for more than 10 consecutive years.

In our casualty lines of business, claims may be reported and settled many years after the coverage period has terminated. As a result, we expect that we will generate significant operating cash flow as we accumulate casualty loss reserves on our balance sheet. In our property lines of business, claims are generally reported and paid within a relatively short period of time and we expect volatility in our operating cash flows as losses are incurred. We expect increases in the amount of expected loss payments in future periods with a resulting decrease in operating cash flow; however, we do not expect loss payments to exceed the premiums generated. Actual premiums written and collected and losses and loss expenses paid in any period could vary materially from our expectations and could have a significant and adverse effect on operating cash flow.

The increase in cash flows from operations was primarily due to the receipt of \$212.3 million of our funds held balance from Aeolus Re, which is included in "funds held" on the unaudited condensed consolidated balance sheets, for the 2013 and prior underwriting years. The return of our funds held balance from Aeolus Re is a function of the performance of each underwriting year. The timing and the amounts received from Aeolus Re can vary significantly, and we could potentially not receive any amounts back.

Cash flows from investing activities consist primarily of proceeds on the sale of investments and payments for investments acquired in addition to changes in restricted cash. The change in cash flows (used in) provided by investing activities reflects the net purchases of securities during the three months ended March 31, 2014 compared to net sales during the same period in 2013.

Cash flows from financing activities consist primarily of capital raising activities, which include the issuance of common shares or debt, the repurchase of our shares, the payment of dividends and the repayment of debt. The increase in cash flows used in financing activities was due to the \$32.4 million increase in share repurchases for the three months ended March 31, 2014 compared to the three months ended March 31, 2013. Dividends paid increased as we increased our quarterly dividend per share amount to \$0.500 in 2014 from \$0.375 in 2013.

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Investments

Our funds are primarily invested in liquid, high-grade fixed income securities. As of March 31, 2014 and December 31, 2013, 89.6% and 89.3%, respectively, of our fixed income portfolio consisted of investment grade securities. The maturity distribution of our fixed-maturity portfolio (on a fair value basis) as of March 31, 2014 and December 31, 2013 was as follows:

	March 31, 2014	December 31, 2013
	(\$ in millions)	
Due in one year or less	\$942.0	\$838.8
Due after one year through five years	2,463.5	2,698.8
Due after five years through ten years	726.0	697.8
Due after ten years	68.6	67.0
Mortgage-backed	1,304.1	1,292.5
Asset-backed	564.5	505.9
Total	\$6,068.7	\$6,100.8

We have investments in "other invested assets", comprising interests in hedge funds, private equity funds, other private securities and high yield loan funds, the carrying value of which was \$989.8 million as of March 31, 2014. Some of these funds have redemption notice requirements. For each of our funds, liquidity is allowed after certain defined periods based on the terms of each fund. See Note 4(b) "Investments — Other Invested Assets" to our unaudited condensed consolidated financial statements for additional details on our other invested assets.

We do not believe that inflation has had a material effect on our consolidated results of operations. The potential exists, after a catastrophe loss, for the development of inflationary pressures in a local economy. The effects of inflation are considered implicitly in pricing. Loss reserves are established to recognize likely loss settlements at the date payment is made. Those reserves inherently recognize the effects of inflation. The actual effects of inflation on our results cannot be accurately known, however, until claims are ultimately resolved.

Credit Facilities

In the normal course of our operations, we enter into agreements with financial institutions to obtain secured and unsecured credit facilities.

Allied World Assurance Company, Ltd currently has access to up to \$1.45 billion in letters of credit under two letter of credit facilities, a \$1.0 billion uncommitted secured facility with Citibank Europe plc and a \$450 million committed secured credit facility with a syndication of lenders (the "Amended Secured Credit Facility"). These credit facilities are primarily for the issuance of standby letters of credit to support obligations in connection with the insurance and reinsurance business.

The letters of credit issued under the credit facility with Citibank Europe plc are deemed to be automatically extended without amendment for twelve months from the expiry date, or any future expiration date unless at least 30 days prior to any expiration date Citibank Europe plc notifies us that they elect not to consider the letters of credit renewed for any such additional period.

A portion of the Amended Secured Credit Facility may also be used for revolving loans for general corporate and working capital purposes, up to a maximum of \$150 million. We may request that existing lenders under the Amended Secured Credit Facility make additional commitments from time to time, up to \$150 million, subject to approval by the lenders. The Amended Secured Credit Facility contains representations, warranties and covenants customary for

similar bank loan facilities, including certain covenants that, among other things, require us to maintain a certain leverage ratio and financial strength rating. We are in compliance with all covenants under the Amended Secured Credit Facility as of March 31, 2014.

As of March 31, 2014, we had a combined unused letters of credit capacity of \$691.3 million from the Amended Secured Credit Facility and Citibank Europe plc. We believe that this remaining capacity is sufficient to meet our future letter of credit needs. During the three months ended March 31, 2014, we did not utilize the revolving loan available under the Amended Secured Credit Facility.

Allied World Assurance Company, AG entered into a 20-year mortgage commitment with a Swiss bank for a company-used office building in Zug, Switzerland. See "Long-Term Debt" below for additional information regarding the 20-year

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mortgage commitment. In conjunction with the mortgage commitment, Allied World Assurance Company, AG entered into a three-year credit facility with a Swiss bank that provides up to CHF 5.0 million for general corporate purposes; however, we will use the proceeds from the credit facility to fund the purchase of the office building in Zug, Switzerland. The interest rate for the credit facility is 2.5%.

Pledged Assets

We use trust accounts primarily to meet security requirements for inter-company and certain reinsurance transactions. We also have cash and cash equivalents and investments on deposit with various state or government insurance departments or pledged in favor of ceding companies in order to comply with reinsurance contract provisions and relevant insurance regulations. In addition, our credit facilities are collateralized, at least to the extent of letters of credit outstanding at any given time.

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

As of March 31, 2014 and December 31, 2013, \$2,635.9 million and \$2,894.4 million, respectively, of cash and cash equivalents and investments were deposited, pledged or held in escrow accounts in favor of ceding companies and other counterparties or government authorities to comply with reinsurance contract provisions, insurance laws and other contract provisions.

In addition, as of March 31, 2014 and December 31, 2013, a further \$1,004.9 million and \$1,053.6 million, respectively, of cash and cash equivalents and investments were pledged as collateral for our credit facilities.

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

Financial Strength Ratings

Financial strength ratings represent the opinions of rating agencies on our capacity to meet our obligations. In the event of a significant downgrade in ratings, our ability to write business and to access the capital markets could be impacted. Our financial strength ratings as of March 31, 2014 have not changed since December 31, 2013. See Item 1. “Business” in our 2013 Form 10-K.

Capital Resources

The table below sets forth the capital structure of the Company as of March 31, 2014 and December 31, 2013:

	March 31, 2014	December 31, 2013
	(\$ in millions)	
Senior notes	\$798.6	\$798.5
Shareholders’ equity	3,616.7	3,519.8

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Total capitalization	\$4,415.3	\$4,318.3	
Debt to total capitalization	18.1	% 18.5	%

On September 10, 2012, we filed a shelf registration statement on Form S-3 with the U.S. Securities and Exchange Commission in which we may offer from time to time common shares of Allied World Switzerland, senior or subordinated debt securities of Allied World Bermuda, guarantees of debt securities of Allied World Bermuda, warrants to purchase common shares of Allied World Switzerland, warrants to purchase debt securities of Allied World Bermuda or units which may consist

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of any combination of the securities listed above. The registration statement is intended to provide us with additional flexibility to access capital markets for general corporate purposes, subject to market conditions and our capital needs.

Share Repurchases

In May 2012, we established a \$500 million share repurchase program. Under the terms of this new share repurchase program, common shares repurchased shall be designated for cancellation and shall be cancelled upon prior shareholder approval. As of March 31, 2014 approximately \$166.9 million remained under this share repurchase authorization.

During the three months ended March 31, 2014, our share repurchases were as follows:

	Three Months Ended March 31, 2014 (\$ in millions)
Common shares repurchased	670,732
Total cost of shares repurchased	\$68.7
Average price per share	\$102.36

Shares repurchased by the Company and not designated for cancellation are classified as “Treasury shares, at cost” on the consolidated balance sheets. The Company will issue shares out of treasury principally related to the Company’s employee benefit plans. Shares repurchased and designated for cancellation are constructively retired and recorded as a share cancellation.

Long-Term Debt

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

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

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

Allied World Assurance Company, AG entered into a 20-year mortgage commitment with a Swiss bank for a company-used office building in Zug, Switzerland. The total proceeds to be received under the mortgage are CHF 18.0 million with a fixed annual interest rate of 3.2% payable quarterly. The mortgage payments will be CHF 0.3 million per year, plus accrued interest, for the first 19 years with the remaining balance payable at the end of the mortgage. We will receive the proceeds from the bank during the fourth quarter of 2014 at which time we will recognize the mortgage loan liability in our consolidated balance sheet.

Off-Balance Sheet Arrangements

As of March 31, 2014, we did not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

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

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

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In the table below changes in fair values as a result of changes in interest rates are determined by calculating hypothetical March 31, 2014 ending prices based on yields adjusted to reflect the hypothetical changes in interest rates, comparing such hypothetical ending prices to actual ending prices, and multiplying the difference by the principal amount of the security. The sensitivity analysis is based on estimates. The estimated changes of our fixed maturity investments and cash and cash equivalents are presented below and actual changes for interest rate shifts could differ significantly.

	Interest Rate Shift in Basis Points						
	-200	-100	-50	—	+50	+100	+200
	(\$ in millions)						
Total fair value	\$7,079.2	\$6,934.2	\$6,857.6	\$6,779.0	\$6,700.5	\$6,623.0	\$6,472.1
Fair value change from base	300.2	155.2	78.6	—	(78.5)	(156.0)	(306.9)
Change in unrealized appreciation/(depreciation)	4.4	% 2.3	% 1.2	% —	% (1.2)	% (2.3)	% (4.5)

In the table below changes in fair values as a result of changes in credit spreads are determined by calculating hypothetical March 31, 2014 ending prices adjusted to reflect the hypothetical changes in credit spreads, comparing such hypothetical ending prices to actual ending prices, and multiplying the difference by the principal amount of the security. The sensitivity analysis is based on estimates. The estimated changes of our non-cash, non-U.S. Treasury fixed maturity investments are presented below and actual changes in credit spreads could differ significantly.

	Credit Spread Shift in Basis Points						
	-200	-100	-50	—	+50	+100	+200
	(\$ in millions)						
Total fair value	\$5,153.3	\$5,043.4	\$4,988.4	\$4,933.4	\$4,878.4	\$4,823.5	\$4,713.5
Fair value change from base	219.9	110.0	55.0	—	(55.0)	(109.9)	(219.9)
Change in unrealized appreciation/(depreciation)	4.5	% 2.2	% 1.1	% —	% (1.1)	% (2.2)	% (4.5)

In addition to credit spread risk, our portfolio is also exposed to the risk of securities being downgraded or of issuers defaulting. In an effort to minimize this risk, our investment guidelines have been defined to ensure that the assets held are well diversified and are primarily high-quality securities.

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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 March 31, 2014.

	Fair Value March 31, 2014 (\$ in millions)	Average Rating	Portfolio Percentage	
Cash and cash equivalents	\$710.4	AAA	8.3	%
U.S. government securities	1,135.2	AA+	13.1	%
U.S. government agencies	341.2	AA+	4.0	%
Non-U.S. government and government agencies	182.4	AA+	2.1	%