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

Form 10-Q
(Mark One)

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

For the quarterly period ended: June 30, 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 Incorporation or Organization)	(I.R.S. Employer Identification No.)

Lindenstrasse 8
6340 Baar
Zug, Switzerland
(Address of Principal Executive Offices and Zip Code)

41-41-768-1080
(Registrant's Telephone Number, Including Area Code)

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
As of July 14, 2014, 96,823,713 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 June 30, 2014 and December 31, 2013
(Expressed in thousands, except share and per share amounts)

	As of June 30, 2014	As of December 31, 2013
ASSETS:		
Fixed maturity investments trading, at fair value (amortized cost: 2014: $6,062,758; 2013: $6,065,350)	$6,157,084	$6,100,798
Equity securities trading, at fair value (cost: 2014: $885,861; 2013: $647,301)	938,117	699,846
Other invested assets	932,639	911,392
Total investments	8,027,840	7,712,036
Cash and cash equivalents	635,138	531,936
Restricted cash	127,755	149,393
Insurance balances receivable	976,441	664,731
Funds held	414,445	632,430
Prepaid reinsurance	390,414	340,992
Reinsurance recoverable	1,301,742	1,234,504
Accrued investment income	30,968	32,236
Net deferred acquisition costs	163,259	126,661
Goodwill	277,761	268,376
Intangible assets	47,564	48,831
Balances receivable on sale of investments	164,713	76,544
Net deferred tax assets	35,867	37,469
Other assets	75,740	89,691
Total assets	$12,669,647	$11,945,830
LIABILITIES:		
Reserve for losses and loss expenses	$5,935,678	$5,766,529
Unearned premiums	1,703,684	1,396,256
Reinsurance balances payable	224,182	173,023
Balances due on purchases of investments	180,378	104,740
Senior notes	798,648	798,499
Dividends payable	21,870	16,732
Accounts payable and accrued liabilities	122,445	170,225
Total liabilities	$8,986,885	$8,426,004
Commitments and contingencies		
SHAREHOLDERS' EQUITY:		
Common shares: 2014: par value CHF 4.10 per share and 2013: par value CHF 4.10 per share (2014: 99,515,760; 2013: 103,477,452 shares issued and 2014: 96,929,091; 2013: 100,253,646 shares outstanding)	402,907	418,988
Treasury shares, at cost (2014: 2,586,669; 2013: 3,223,806)	(65,258)	(79,992)
Retained earnings	3,345,113	3,180,830
Total shareholders' equity	3,682,762	3,519,826
Total liabilities and shareholders' equity	$12,669,647	$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 and six months ended June 30, 2014 and 2013
(Expressed in thousands, except share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
REVENUES:				
Gross premiums written	$760,405	$765,200	$1,661,798	$1,602,281
Premiums ceded	(206,481)	(183,978)	(336,260)	(326,007)
Net premiums written	553,924	581,222	1,325,538	1,276,274
Change in unearned premiums	(16,677)	(73,951)	(258,006)	(305,775)
Net premiums earned	537,247	507,271	1,067,532	970,499
Net investment income	36,793	37,635	84,412	71,023
Net realized investment gains (losses)	85,217	(115,198)	139,422	(35,561)
	659,257	429,708	1,291,366	1,005,961
EXPENSES:				
Net losses and loss expenses	314,855	275,128	590,141	530,306
Acquisition costs	74,279	64,617	142,001	121,302
General and administrative expenses	96,188	80,585	176,528	163,265
Amortization of intangible assets	634	634	1,267	1,267
Interest expense	14,592	14,188	29,126	28,322
Foreign exchange loss	651	490	700	3,008
	501,199	435,642	939,763	847,470
Income (loss) before income taxes	158,058	(5,934)	351,603	158,491
Income tax expense (benefit)	6,195	(4,072)	22,768	1,361
NET INCOME (LOSS)	151,863	(1,862)	328,835	157,130
Other comprehensive income	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$151,863	$(1,862)	$328,835	$157,130
PER SHARE DATA				
Basic earnings (loss) per share	$1.55	$(0.02)	$3.33	$1.52
Diluted earnings (loss) per share	$1.52	$(0.02)	$3.27	$1.48
Weighted average common shares outstanding	97,809,639	103,267,659	98,672,618	103,552,656
Weighted average common shares and common share equivalents outstanding	99,724,802	103,267,659	100,691,568	105,949,785
Dividends paid per share	$0.167	$—	$0.333	$0.125

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 six months ended June 30, 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	—	—	328,835	328,835
Dividends	—	—	(38,345)	(38,345)
Stock compensation	—	14,734	(2,756)	11,978
Share repurchases	—	(139,532)	—	(139,532)
Shares cancelled	(16,081)	139,532	(123,451)	—
June 30, 2014	$402,907	$(65,258)	$3,345,113	$3,682,762
December 31, 2012	$454,980	$(113,818)	$2,985,173	$3,326,335
Net income	—	—	157,130	157,130
Dividends — par value reduction	(12,981)	—	—	(12,981)
Dividends	—	—	(17,127)	(17,127)
Stock compensation	—	22,157	(19,714)	2,443
Share repurchases	—	(82,571)	—	(82,571)
Shares cancelled	(11,602)	82,571	(70,969)	—
June 30, 2013	$430,397	$(91,661)	$3,034,493	$3,373,229

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 six months ended June 30, 2014 and 2013
(Expressed in thousands)

	Six Months Ended June 30, 2014	2013
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Net income	$328,835	$157,130
Adjustments to reconcile net income to cash provided by operating activities:		
Net realized gains on sales of investments	(99,781)	(62,921)
Mark to market adjustments	(59,113)	95,698
Stock compensation expense	7,631	6,566
Undistributed loss (income) of equity method investments	13,744	(2,316)
Changes in:		
Reserve for losses and loss expenses, net of reinsurance recoverables	101,911	12,901
Unearned premiums, net of prepaid reinsurance	258,006	305,776
Insurance balances receivable	(310,885)	(304,088)
Funds held	217,985	(51,231)
Reinsurance balances payable	51,159	69,620
Net deferred acquisition costs	(36,598)	(45,802)
Net deferred tax assets	1,934	(14,970)
Accounts payable and accrued liabilities	(53,397)	(45,601)
Other items, net	27,507	12,880
Net cash provided by operating activities	448,938	133,642
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchases of trading securities	(3,905,650)	(3,186,162)
Purchases of other invested assets	(181,419)	(141,805)
Sales of trading securities	3,705,229	3,171,977
Sales of other invested assets	184,166	126,491
Purchases of fixed assets	(5,601)	(3,363)
Change in restricted cash	21,638	(10,561)
Net cash paid for acquisitions	(2,565)	—
Net cash used in investing activities	(184,202)	(43,423)
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Dividends paid - partial par value reduction	—	(12,981)
Dividends paid	(33,207)	—
Proceeds from the exercise of stock options	6,313	5,293
Share repurchases	(137,810)	(82,571)
Net cash used in financing activities	(164,704)	(90,259)
Effect of exchange rate changes on foreign currency cash	3,170	(7,736)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	103,202	(7,776)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	531,936	681,879
CASH AND CASH EQUIVALENTS, END OF PERIOD	$635,138	$674,103
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$18,061	$12,671
Cash paid for interest expense	$27,000	$27,000

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.

On May 1, 2014, the shareholders approved a 3-for-1 stock split of the Company's common shares. All historical share and per share amounts reflect the effect of the stock split.

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
In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" ("ASU 2014-08"). ASU 2014-08 changes the requirements for reporting discontinued operations, such that a disposal of a component of the Company's operations is required to be reported as discontinued operations if the disposal represents a strategic shift that has, or will have, a major effect on the Company's operations and financial results. Examples of strategic

shifts that could have a major effect on the Company's operations could include a disposal of a major geographical area, a major line of business, a major equity method investment, or other major parts of the Company. ASU 2014-08 is effective for all disposals that occur after January 1, 2015. The Company is currently assessing the impact the adoption of ASU 2014-08 will have on future financial statements.

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In May 2014, the FASB issued Accounting Standards Update 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). ASU 2014-09 provides a framework, through a five-step process, for recognizing revenue from customers, improves comparability and consistency of recognizing revenue across entities, industries, jurisdictions and capital markets, and requires enhanced disclosures. Certain contracts with customers are specifically excluded from the scope of ASU 2014-09, including amongst others, insurance contracts accounted for under Accounting Standard Codification 944, Financial Services - Insurance. ASU 2014-09 is effective on January 1, 2017 with retrospective adoption required for the comparative periods. The Company is currently assessing the impact the adoption of ASU 2014-09 will have on future financial statements.

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:

	June 30, 2014		December 31, 2013	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
U.S. Government and Government agencies	$1,274,331	$1,273,469	$1,676,788	$1,684,832
Non-U.S. Government and Government agencies	185,071	186,142	191,776	197,082
States, municipalities and political subdivisions	261,267	256,698	231,555	234,406
Corporate debt:				
Financial institutions	1,168,937	1,149,005	958,794	943,518
Industrials	1,167,470	1,152,858	1,174,047	1,165,448
Utilities	98,878	97,457	69,426	69,658
Mortgage-backed	1,323,763	1,272,824	1,292,502	1,267,863
Asset-backed	677,367	674,305	505,910	502,543
Total fixed maturity investments	$6,157,084	$6,062,758	$6,100,798	$6,065,350

	June 30, 2014		December 31, 2013	
	Fair Value	Original Cost	Fair Value	Original Cost
Equity securities	$938,117	$885,861	$699,846	$647,301
Other invested assets	804,505	693,370	764,081	658,683
	$1,742,622	$1,579,231	$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 June 30, 2014 and December 31, 2013 were as follows:

Investment Type	Carrying Value as of June 30, 2014	Investments with Redemption Restrictions	Estimated Remaining Restriction Period	Investments without Redemption Restrictions	Redemption Frequency(1)	Redemption Notice Period(1)	Unfunded Commitments
Private equity	$161,667	$161,667	2 - 9 Years	$—			$ 239,697
Mezzanine debt	95,162	95,162	5 - 9 Years	—			206,856
Distressed	10,008	10,008	4 Years	—			4,941
Total private equity	266,837	266,837		—			451,494
Distressed	165,253	165,253	1 Year	—			—
Equity long/short	134,036	58,568	1 Year	75,468	Quarterly	30 -60 Days	—
Multi-strategy	100,263	—		100,263	Quarterly	45 -90 Days	—
Relative value credit	105,624	—		105,624	Quarterly	60 Days	—
Total hedge funds	505,176	223,821		281,355			—
High yield loan fund	32,492	—		32,492	Monthly	30 days	—
Total other invested assets at fair value	804,505	490,658		313,847			451,494
Other private securities	128,134	—		128,134			—
Total other invested assets	$932,639	$490,658		$441,981			$ 451,494

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
Other private securities	147,311	—		147,311			—

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 as described below.

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.

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

c) Net Investment Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Fixed maturity investments	$35,936	$32,662	$72,235	$65,187
Equity securities	5,912	4,409	9,165	7,608
Other invested assets	(890)	3,843	10,518	5,307
Cash and cash equivalents	571	529	1,010	1,017
Expenses	(4,736)	(3,808)	(8,516)	(8,096)
Net investment income	$36,793	$37,635	$84,412	$71,023

Net investment income from other invested assets included the distributed and undistributed net income from investments accounted for using the equity method of accounting. The loss reported for other invested assets for the three months ended June 30, 2014 was due to a loss of $9,348 recorded for an equity method investment due to impairment charges that it recorded.

d) Components of Realized Gains and Losses

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Gross realized gains on sale of invested assets	$55,714	$58,223	$118,006	$102,472
Gross realized losses on sale of invested assets	(4,025)	(35,077)	(16,273)	(42,042)
Net realized and unrealized (losses) gains on derivatives	(13,720)	8,538	(26,640)	7,561
Mark-to-market gains (losses):				
Fixed maturity investments, trading	36,426	(115,113)	58,882	(131,588)
Equity securities, trading	21,316	(34,330)	(289)	(1,357)
Other invested assets, trading	(10,494)	2,561	5,736	29,393
Net realized investment gains (losses)	$85,217	$(115,198)	$139,422	$(35,561)

e) Pledged Assets

As of June 30, 2014 and December 31, 2013, $2,745,352 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 June 30, 2014 and December 31, 2013, a further $886,220 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 June 30, 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”):

	June 30, 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	$57,761	$430	$158,762	$1,996	$294,788	$6,254	$122,439	$1,176
Interest rate swaps	105,000	87	664,500	1,126	491,400	6,829	40,000	4,214
Total derivatives	$162,761	$517	$823,262	$3,122	$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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Foreign exchange contracts	$(1,598)	$1,989	$(2,466)	$1,245
Total included in foreign exchange loss	(1,598)	1,989	(2,466)	1,245
Put options	—	(90)	—	(3,822)
Foreign exchange contracts	(286)	4,274	(844)	6,089
Interest rate futures and swaps	(13,434)	4,354	(25,796)	5,294
Total included in net realized investment gains (losses)	(13,720)	8,538	(26,640)	7,561
Total realized and unrealized (losses) gains on derivatives	$(15,318)	$10,527	$(29,106)	$8,806

The losses related to interest rate future and swap contracts for the three and six months ended June 30, 2014 were the result of selling interest rate future and swap contracts to reduce the duration of the investment portfolio. Given the decrease in interest rates during the year, the Company recorded a loss related to these interest rate future and swap contracts.

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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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:

June 30, 2014	Carrying Amount	Total Fair Value	Level 1	Level 2	Level 3
Fixed maturity investments:					
U.S. Government and Government agencies	$1,274,331	$1,274,331	$1,058,607	$215,724	$—
Non-U.S. Government and Government agencies	185,071	185,071		185,071	—
States, municipalities and political subdivisions	261,267	261,267	—	261,267	—
Corporate debt	2,435,285	2,435,285	—	2,435,285	—
Mortgage-backed	1,323,763	1,323,763	—	1,176,962	146,801
Asset-backed	677,367	677,367	—	606,135	71,232
Total fixed maturity investments	6,157,084	6,157,084	1,058,607	4,880,444	218,033
Equity securities	938,117	938,117	903,254	—	34,863
Other invested assets	804,505	804,505	—	—	804,505
Total investments	$7,899,706	$7,899,706	$1,961,861	$4,880,444	$1,057,401
Derivative assets:					
Foreign exchange contracts	$430	$430	$—	$430	$—
Interest rate swaps	87	87	—	87	—
Derivative liabilities:					
Foreign exchange contracts	$1,996	$1,996	$—	$1,996	$—
Interest rate swaps	1,126	1,126	—	1,126	—
Senior notes	$798,648	$907,005	$—	$907,005	$—

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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 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 June 30, 2014	Other invested assets	Mortgage-backed	Asset-backed	Equities
Opening balance	$839,986	$ 134,061	$81,234	$34,786
Realized and unrealized gains (losses) included in net income	22,498	2,721	450	77
Purchases	99,722	20,928	9,409	—
Sales	(157,701)	(26,734)	(3,743)	—
Transfers into Level 3 from Level 2	—	17,437	—	—
Transfers out of Level 3 into Level 2 (1)	—	(1,612)	(16,118)	—
Ending balance	$804,505	$ 146,801	$71,232	$34,863
Three Months Ended June 30, 2013				
Opening balance	$710,140	$ 155,420	$40,903	$57,787
Realized and unrealized gains (losses) included in net income	11,709	(6,188)	(289)	(4,288)
Purchases	96,742	72,261	23,527	—
Sales	(104,200)	(27,887)	(1,727)	—
Transfers into Level 3 from Level 2	—	11,197	—	—
Transfers out of Level 3 into Level 2 (1)	—	(6,800)	(1,129)	—
Ending balance	$714,391	$ 198,003	$61,285	$53,499

Six Months Ended June 30, 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	45,124	4,479	(355)	(9,744)
Purchases	188,920	50,840	16,938	—
Sales	(193,620)	(54,419)	(8,225)	(29,297)
Transfers into Level 3 from Level 2	—	103	—	—
Transfers out of Level 3 into Level 2 (1)	—	(1,540)	(30,539)	—
Ending balance	$804,505	$ 146,801	$71,232	$34,863
Six Months Ended June 30, 2013				
Opening balance	$655,888	$ 167,825	$62,246	$54,680
Realized and unrealized gains (losses) included in net income	43,962	(7,613)	(382)	(1,181)
Purchases	169,952	71,752	24,782	—
Sales	(155,411)	(29,864)	(18,478)	—
Transfers into Level 3 from Level 2	—	7,109	—	—
Transfers out of Level 3 into Level 2 (1)	—	(11,206)	(6,883)	—
Ending balance	$714,391	$ 198,003	$61,285	$53,499

(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.

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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.

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:

	June 30, 2014	December 31, 2013
Outstanding loss reserves	$1,543,506	$1,520,867
Reserves for losses incurred but not reported	4,392,172	4,245,662
Reserve for losses and loss expenses	$5,935,678	$5,766,529

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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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Gross liability at beginning of period	$5,856,798	$5,673,220	$5,766,529	$5,645,549
Reinsurance recoverable at beginning of period	(1,280,525)	(1,163,503)	(1,234,504)	(1,141,110)
Net liability at beginning of period	4,576,273	4,509,717	4,532,025	4,504,439
Net losses incurred related to:				
Current year	359,994	323,556	684,141	622,804
Prior years	(45,139)	(48,428)	(94,000)	(92,498)
Total incurred	314,855	275,128	590,141	530,306
Net paid losses related to:				
Current year	23,065	21,003	26,808	24,584
Prior years	235,335	241,764	463,929	482,885
Total paid	258,400	262,767	490,737	507,469
Foreign exchange revaluation	1,208	(4,738)	2,507	(9,936)
Net liability at end of period	4,633,936	4,517,340	4,633,936	4,517,340
Reinsurance recoverable at end of period	1,301,742	1,179,525	1,301,742	1,179,525
Gross liability at end of period	$5,935,678	$5,696,865	$5,935,678	$5,696,865

For the three months ended June 30, 2014, the Company had net unfavorable prior year reserve development in the U.S. insurance segment and recorded net favorable prior year reserve development in the international insurance and reinsurance segments. The net unfavorable prior year reserve development in the U.S. insurance segment related primarily to the healthcare line of business, as well as adverse development on reported claims in the lawyers errors and omissions ("E&O") and primary casualty classes of business. The net favorable prior year reserve development in the international insurance and reinsurance segments was due to actual loss emergence being lower than initially expected.

For the six months ended June 30, 2014, the Company had net unfavorable prior year reserve development in the U.S. insurance segment and recorded net favorable prior year reserve development in the international insurance and reinsurance segments. The net unfavorable prior year reserve development in the U.S. insurance segment related to the healthcare line of business due to higher than expected loss frequency and severity in the medical malpractice class of business. The U.S. insurance segment also experienced adverse development on reported claims in the lawyers E&O class of business and the primary casualty class of business in the 2013 loss year. The net favorable prior year reserve development in the international insurance and reinsurance segments was due to actual loss emergence being lower than initially expected.

For the three months ended June 30, 2013, the Company had net favorable reserve development in each of its segments due to actual loss emergence being lower than initially expected. The majority of the net favorable reserve development was recognized in the 2007 through 2010 loss years across most lines of business. In addition, the reinsurance segment recognized net favorable reserve development for the 2012 loss year due to the low level of reported property losses. This was partially offset by adverse development in the U.S. insurance segment in the 2011 and 2012 loss years.

For the six months ended June 30, 2013, the Company had net favorable reserve development in its international and reinsurance segments due to actual loss emergence being lower than initially expected, primarily for loss years 2004 to 2008. The reinsurance segment recognized net favorable reserve development for the 2012 loss year due to the low level of reported property losses. This was partially offset by adverse development in the U.S. insurance segment in the 2011 and 2012 loss years for certain E&O and director's and officers' classes of business.

While the Company at times 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.

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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 June 30, 2014.

9. SHAREHOLDERS' EQUITY

a) Authorized shares

The issued share capital consists of the following:

	June 30, 2014	December 31, 2013
Common shares issued and fully paid, 2014: CHF 4.10 per share; 2013: CHF 4.10 per share	99,515,760	103,477,452
Share capital at end of period	$402,907	$418,988

	Six Months Ended June 30, 2014
Shares issued at beginning of period	103,477,452
Shares cancelled	(3,961,692)

Total shares issued at end of period	99,515,760
Treasury shares issued at beginning of period	3,223,806
Shares repurchased	3,961,692
Shares issued out of treasury	(637,137)
Shares cancelled	(3,961,692)
Total treasury shares at end of period	2,586,669
Total shares outstanding at end of period	96,929,091

During the six months ended June 30, 2014, 3,961,692 shares repurchased and designated for cancellation were constructively retired and cancelled.

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b) Dividends

The Company paid the following dividends during the six months ended June 30, 2014:

Dividend Paid	Dividend Per Share	Total Amount Paid
January 2, 2014	$0.167	$16,732
April 3, 2014	$0.167	$16,495

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 $0.167 per share in July 2013, October 2013, January 2014 and April 2014.

On May 1, 2014, 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 amount will be paid to shareholders in quarterly installments of $0.225 per share. The first installment of the dividend was on July 2, 2014. The Company expects to distribute the remaining installments of the dividend in October 2014, January 2015 and April 2015.

c) Share Repurchases

On May 1, 2014, the shareholders approved a new share repurchase program in order for the Company to repurchase up to $500,000 of its common shares. This new share repurchase program supersedes the 2012 share repurchase program and no further repurchases will be made under the 2012 share repurchase program. 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, the first three million of common shares repurchased will remain in treasury and will be used by the Company to satisfy share delivery obligations under its equity-based compensation plans. Any additional common shares repurchased will be designated for cancellation at acquisition and will be canceled 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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Common shares repurchased	1,949,496	1,524,984	3,961,692	2,821,335
Total cost of shares repurchased	$70,874	$46,326	$139,532	$82,571
Average price per share	$36.36	$30.38	$35.22	$29.27

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%

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and 135%, 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:

	Six Months Ended June 30, 2014	
	Number of Awards	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	143,697	$21.69
RSUs granted	454,176	33.56
RSUs forfeited	(5,097)	(30.64)
RSUs fully vested	(76,230)	(21.75)
Outstanding at end of period	516,546	$32.03

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

	Six Months Ended June 30, 2014	
	Number of Awards	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	804,519	$23.21
Performance-based equity awards granted	166,302	33.56
Additional awards granted due to achievement of performance criteria	104,895	(20.50)
Performance-based equity awards forfeited	(1,848)	(25.28)
Performance-based equity awards fully vested	(454,440)	(20.50)
Outstanding at end of period	619,428	$27.51

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.

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

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

	RSU's		Performance-based Awards	
Six Months Ended June 30, 2014	Number of Awards	Weighted Average Grant Date Fair Value	Number of Awards	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	2,049,084	$24.69	1,031,961	23.67
Granted	438,162	33.56	249,438	33.56
Additional awards granted due to achievement of performance criteria	—	—	104,895	20.50
Forfeited	(38,886)	(26.36)	(2,769)	(25.28)
Fully vested	(751,920)	(22.47)	(454,440)	(20.50)
Outstanding at end of period	1,696,440	$27.93	929,085	$27.51

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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Stock options	$413	$679	$1,140	$2,014
RSUs and performance-based equity awards	2,977	1,891	6,490	4,551
Cash-equivalent stock awards	12,868	8,212	17,497	20,968
Total	$16,258	$10,782	$25,127	$27,533

11. EARNINGS PER SHARE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Basic earnings (loss) per share:				
Net income (loss)	$151,863	$(1,862)	$328,835	$157,130
Weighted average common shares outstanding	97,809,639	103,267,659	98,672,618	103,552,656
Basic earnings (loss) per share	$1.55	$(0.02)	$3.33	$1.52

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Diluted earnings (loss) per share:				
Net income (loss)	$151,863	$(1,862)	$328,835	$157,130
Weighted average common shares outstanding	97,809,639	103,267,659	98,672,618	103,552,656
Share equivalents:				
Stock options	1,448,071	—	1,456,439	1,479,675

RSUs and performance-based equity awards	455,744	—	550,224	913,587
Employee share purchase plan	11,348	—	12,287	3,867
Weighted average common shares and common share equivalents outstanding - diluted	99,724,802	103,267,659	100,691,568	105,949,785
Diluted earnings (loss) per share	$1.52	$(0.02)	$3.27	$1.48

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For the three months ended June 30, 2014, there were no common shares considered anti-dilutive and therefore excluded from the calculation of the diluted earnings per share. For the three months ended June 30, 2013, there were no common share equivalents included in calculating diluted earnings per share as there was a net loss and any additional shares would be anti-dilutive.

For the six months ended June 30, 2014 and 2013, there were no common shares considered anti-dilutive and 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 lines of business fall within these classifications.

The U.S. insurance segment includes the Company’s direct specialty insurance operations in the United States and Canada, as well as the Company's claim administration services operations. The Company acquired the remaining interest in a claims administration services company it did not own in May 2014 and recorded goodwill of $9,385 related to the transaction. The U.S. insurance segment provides both direct property and specialty casualty insurance primarily to non-Fortune 1000 North American domiciled accounts, as well as third-party claims administration services. The international insurance segment includes the Company’s direct insurance operations in Bermuda, Europe, and Asia Pacific, which includes offices in Australia, Hong Kong and Singapore. 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 and Asia Pacific 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”, “expense ratio” and the “combined ratio.” The “loss and loss expense ratio” is derived by dividing net losses and loss expenses by net premiums earned. The “acquisition cost ratio” is derived by dividing acquisition costs by net premiums earned. The “general and administrative expense ratio” is derived by dividing general and administrative expenses by net premiums earned. The 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.”

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The following tables provide a summary of the segment results:

Three Months Ended June 30, 2014	U.S. Insurance	International Insurance	Reinsurance	Total
Gross premiums written	$341,426	$204,478	$214,501	$760,405
Net premiums written	221,950	122,171	209,803	553,924
Net premiums earned	214,593	89,205	233,449	537,247
Net losses and loss expenses	(145,485)	(35,920)	(133,450)	(314,855)
Acquisition costs	(29,677)	(575)	(44,027)	(74,279)
General and administrative expenses	(46,593)	(29,411)	(20,184)	(96,188)
Underwriting (loss) income	(7,162)	23,299	35,788	51,925
Net investment income				36,793
Net realized investment gains				85,217
Amortization of intangible assets				(634)
Interest expense				(14,592)
Foreign exchange loss				(651)
Income before income taxes				$158,058
Loss and loss expense ratio	67.8 %	40.3 %	57.2 %	58.6 %
Acquisition cost ratio	13.8 %	0.6 %	18.9 %	13.8 %
General and administrative expense ratio	21.7 %	33.0 %	8.6 %	17.9 %
Expense ratio	35.5 %	33.6 %	27.5 %	31.7 %
Combined ratio	103.3 %	73.9 %	84.7 %	90.3 %

Three Months Ended June 30, 2013	U.S. Insurance	International Insurance	Reinsurance	Total
Gross premiums written	$307,297	$192,593	$265,310	$765,200
Net premiums written	221,419	106,394	253,409	581,222
Net premiums earned	197,436	87,041	222,794	507,271
Net losses and loss expenses	(124,364)	(30,968)	(119,796)	(275,128)
Acquisition costs	(27,270)	358	(37,705)	(64,617)
General and administrative expenses	(38,302)	(24,135)	(18,148)	(80,585)
Underwriting income	7,500	32,296	47,145	86,941
Net investment income				37,635
Net realized investment losses				(115,198)
Amortization of intangible assets				(634)
Interest expense				(14,188)
Foreign exchange loss				(490)
Loss before income taxes				$(5,934)
Loss and loss expense ratio	63.0 %	35.6 %	53.8 %	54.2 %
Acquisition cost ratio	13.8 %	(0.4)%	16.9 %	12.7 %
General and administrative expense ratio	19.4 %	27.7 %	8.1 %	15.9 %
Expense ratio	33.2 %	27.3 %	25.0 %	28.6 %
Combined ratio	96.2 %	62.9 %	78.8 %	82.8 %

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Six Months Ended June 30, 2014	U.S. Insurance	International Insurance	Reinsurance	Total
Gross premiums written	$611,371	$338,842	$711,585	$1,661,798
Net premiums written	424,690	197,630	703,218	1,325,538
Net premiums earned	426,716	177,544	463,272	1,067,532
Net losses and loss expenses	(287,480)	(59,486)	(243,175)	(590,141)
Acquisition costs	(57,180)	374	(85,195)	(142,001)
General and administrative expenses	(84,030)	(54,171)	(38,327)	(176,528)
Underwriting (loss) income	(1,974)	64,261	96,575	158,862
Net investment income				84,412
Net realized investment gains				139,422
Amortization of intangible assets				(1,267)
Interest expense				(29,126)
Foreign exchange loss				(700)
Income before income taxes				$351,603
Loss and loss expense ratio	67.4%	33.5%	52.5%	55.3%
Acquisition cost ratio	13.4%	(0.2)%	18.4%	13.3%
General and administrative expense ratio	19.7%	30.5%	8.3%	16.5%
Expense ratio	33.1%	30.3%	26.7%	29.8%
Combined ratio	100.5%	63.8%	79.2%	85.1%

Six Months Ended June 30, 2013	U.S. Insurance	International Insurance	Reinsurance	Total
Gross premiums written	$563,315	$321,109	$717,857	$1,602,281
Net premiums written	413,672	184,139	678,463	1,276,274
Net premiums earned	385,875	171,255	413,369	970,499
Net losses and loss expenses	(257,688)	(59,903)	(212,715)	(530,306)
Acquisition costs	(50,398)	1,207	(72,111)	(121,302)
General and administrative expenses	(77,898)	(48,924)	(36,443)	(163,265)
Underwriting (loss) income	(109)	63,635	92,100	155,626
Net investment income				71,023
Net realized investment losses				(35,561)
Amortization of intangible assets				(1,267)
Interest expense				(28,322)
Foreign exchange loss				(3,008)
Income before income taxes				$158,491
Loss and loss expense ratio	66.8%	35.0%	51.5%	54.6%
Acquisition cost ratio	13.1%	(0.7)%	17.4%	12.5%
General and administrative expense ratio	20.2%	28.6%	8.8%	16.8%
Expense ratio	33.3%	27.9%	26.2%	29.3%
Combined ratio	100.1%	62.9%	77.7%	83.9%

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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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
United States	$442,549	$440,151	$963,321	$918,594
Bermuda	185,872	211,040	415,503	439,712
Europe	77,985	60,234	181,321	146,743
Singapore	45,375	48,918	87,316	87,031
Hong Kong	3,756	4,857	8,639	10,201
Canada	3,094	—	3,924	—
Australia	1,774	—	1,774	—
Total gross premiums written	$760,405	$765,200	$1,661,798	$1,602,281

Europe includes gross premiums written attributable to Switzerland of $10,261 and $5,868 for the three months ended June 30, 2014 and 2013, respectively and $54,554 and $46,674 for the six months ended June 30, 2014 and 2013.

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 June 30, 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%.

14. CONDENSED CONSOLIDATED GUARANTOR FINANCIAL STATEMENTS

The following tables present unaudited condensed consolidating financial information as of June 30, 2014 and December 31, 2013 and for the three and six months ended June 30, 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.

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Unaudited Condensed Consolidating Balance Sheet:

As of June 30, 2014	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
ASSETS:					
Investments	$—	$—	$8,027,840	$—	$8,027,840
Cash and cash equivalents	40,976	1,286	592,876	—	635,138
Insurance balances receivable	—	—	976,441	—	976,441
Funds held	—	—	414,445	—	414,445
Reinsurance recoverable	—	—	1,301,742	—	1,301,742
Net deferred acquisition costs	—	—	163,259	—	163,259
Goodwill and intangible assets	—	—	325,325	—	325,325
Balances receivable on sale of investments	—	—	164,713	—	164,713
Investments in subsidiaries	3,600,731	4,201,054	—	(7,801,785)	—
Due from subsidiaries	75,813	18,859	15,536	(110,208)	—
Other assets	1,090	4,026	655,628	—	660,744
Total assets	$3,718,610	$4,225,225	$12,637,805	$(7,911,993)	$12,669,647
LIABILITIES:					
Reserve for losses and loss expenses	$—	$—	$5,935,678	$—	$5,935,678
Unearned premiums	—	—	1,703,684	—	1,703,684
Reinsurance balances payable	—	—	224,182	—	224,182
Balances due on purchases of investments	—	—	180,378	—	180,378
Senior notes	—	798,648	—	—	798,648
Due to subsidiaries	8,373	7,163	94,672	(110,208)	—
Other liabilities	27,475	17,976	98,864	—	144,315
Total liabilities	35,848	823,787	8,237,458	(110,208)	8,986,885
Total shareholders’ equity	3,682,762	3,401,438	4,400,347	(7,801,785)	3,682,762
Total liabilities and shareholders’ equity	$3,718,610	$4,225,225	$12,637,805	$(7,911,993)	$12,669,647

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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.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
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Unaudited Condensed Consolidating Statement of Operations and Comprehensive Income:

Three Months Ended June 30, 2014	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
Net premiums earned	$—	$—	$537,247	$—	$537,247
Net investment income	2	—	36,791	—	36,793
Net realized investment gains (losses)	—	—	85,217	—	85,217
Net losses and loss expenses	—	—	(314,855)	—	(314,855)
Acquisition costs	—	—	(74,279)	—	(74,279)
General and administrative expenses	(10,813)	1,654	(87,029)	—	(96,188)
Amortization of intangible assets	—	—	(634)	—	(634)
Interest expense	—	(13,853)	(739)	—	(14,592)
Foreign exchange gain (loss)	(2)	(12)	(637)	—	(651)
Income tax (expense) benefit	323	—	(6,518)	—	(6,195)
Equity in earnings of consolidated subsidiaries	162,353	170,796	—	(333,149)	—
NET INCOME (LOSS)	$151,863	$158,585	$174,564	$(333,149)	$151,863
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$151,863	$158,585	$174,564	$(333,149)	$151,863

Three Months Ended June 30, 2013	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
Net premiums earned	$—	$—	$507,271	$—	$507,271
Net investment income	1	2	37,632	—	37,635
Net realized investment gains (losses)	—	—	(115,198)	—	(115,198)
Net losses and loss expenses	—	—	(275,128)	—	(275,128)
Acquisition costs	—	—	(64,617)	—	(64,617)
General and administrative expenses	(8,566)	(455)	(71,564)	—	(80,585)
Amortization of intangible assets	—	—	(634)	—	(634)
Interest expense	—	(13,835)	(353)	—	(14,188)
Foreign exchange gain (loss)	2	(628)	136	—	(490)
Income tax (expense) benefit	—	—	4,072	—	4,072
Equity in earnings of consolidated subsidiaries	6,701	21,147	—	(27,848)	—
NET INCOME (LOSS)	$(1,862)	$6,231	$21,617	$(27,848)	$(1,862)
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$(1,862)	$6,231	$21,617	$(27,848)	$(1,862)

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Six Months Ended June 30, 2014	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
Net premiums earned	$—	$—	$1,067,532	$—	$1,067,532
Net investment income	4	—	84,408	—	84,412
Net realized investment gains (losses)	—	—	139,422	—	139,422
Net losses and loss expenses	—	—	(590,141)	—	(590,141)
Acquisition costs	—	—	(142,001)	—	(142,001)
General and administrative expenses	(19,727)	(737)	(156,064)	—	(176,528)
Amortization of intangible assets	—	—	(1,267)	—	(1,267)
Interest expense	—	(27,700)	(1,426)	—	(29,126)
Foreign exchange gain (loss)	(4)	21	(717)	—	(700)
Income tax (expense) benefit	(86)	—	(22,682)	—	(22,768)
Equity in earnings of consolidated subsidiaries	348,648	369,803	—	(718,451)	—
NET INCOME (LOSS)	$328,835	$341,387	$377,064	$(718,451)	$328,835
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$328,835	$341,387	$377,064	$(718,451)	$328,835

Six Months Ended June 30, 2013	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
Net premiums earned	$—	$—	$970,499	$—	$970,499
Net investment income	8	4	71,011	—	71,023
Net realized investment gains (losses)	—	—	(35,561)	—	(35,561)
Net losses and loss expenses	—	—	(530,306)	—	(530,306)
Acquisition costs	—	—	(121,302)	—	(121,302)
General and administrative expenses	(19,552)	(912)	(142,801)	—	(163,265)
Amortization of intangible assets	—	—	(1,267)	—	(1,267)
Interest expense	—	(27,665)	(657)	—	(28,322)
Foreign exchange gain (loss)	274	(723)	(2,559)	—	(3,008)
Income tax (expense) benefit	—	—	(1,361)	—	(1,361)
Equity in earnings of consolidated subsidiaries	176,400	202,627	—	(379,027)	—
NET INCOME (LOSS)	$157,130	$173,331	$205,696	$(379,027)	$157,130
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$157,130	$173,331	$205,696	$(379,027)	$157,130

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Unaudited Condensed Consolidating Statement of Cash Flows:

Six Months Ended June 30, 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	$194,890	$(1,489)	$258,707	$—	$452,108
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:					
Purchases trading securities	—	—	(3,905,650)	—	(3,905,650)
Purchases of other invested assets	—	—	(181,419)	—	(181,419)
Sales of trading securities	—	—	3,705,229	—	3,705,229
Sales of other invested assets	—	—	184,166	—	184,166
Other	—	—	13,472	—	13,472
Net cash provided by (used in) investing activities	—	—	(184,202)	—	(184,202)
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:					
Dividends paid	(33,207)	—	—	—	(33,207)
Proceeds from the exercise of stock options	6,313	—	—	—	6,313
Share repurchases	(137,810)	—	—	—	(137,810)
Net cash provided by (used in) financing activities	(164,704)	—	—	—	(164,704)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	30,186	(1,489)	74,505	—	103,202
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	10,790	2,775	518,371	—	531,936
CASH AND CASH EQUIVALENTS, END OF PERIOD	$40,976	$1,286	$592,876	$—	$635,138

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

Six Months Ended June 30, 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:	$73,938	$(3,025)	$54,993	$—	$125,906
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:					
Purchases of trading securities	—	—	(3,186,162)	—	(3,186,162)
Purchases of other invested assets	—	—	(141,805)	—	(141,805)
Sales of trading securities	—	—	3,171,977	—	3,171,977
Sales of other invested assets	—	—	126,491	—	126,491
Other	—	—	(13,924)	—	(13,924)
Net cash provided by (used in) investing activities	—	—	(43,423)	—	(43,423)
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:					
Partial par value reduction	(12,981)	—	—	—	(12,981)
Proceeds from the exercise of stock options	5,293	—	—	—	5,293
Share repurchases	(82,571)	—	—	—	(82,571)
Net cash provided by (used in) financing activities	(90,259)	—	—	—	(90,259)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(16,321)	(3,025)	11,570	—	(7,776)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	19,997	11,324	650,558	—	681,879
CASH AND CASH EQUIVALENTS, END OF PERIOD	$3,676	$8,299	$662,128	$—	$674,103

Notes to Parent Company Condensed Financial Information

a) Dividends

Allied World Switzerland received cash dividends from its subsidiaries of $205,000 and $155,000 for the six months ended June 30, 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 July 2, 2014, the Company paid a quarterly dividend of $0.225 per share to shareholders of record on June 24, 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 Australia, 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 June 30, 2014, we had approximately $12.7 billion of total assets, $3.7 billion of total shareholders' equity and $4.5 billion of total capital, which includes shareholders' equity and senior notes.

During the three months ended June 30, 2014, we continued to grow our direct insurance 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 while our reinsurance operations had lower premiums mainly due to the timing of certain treaties renewing. During the quarter, we experienced positive rate improvements in certain lines of business, such as general casualty, primary casualty, healthcare and professional liability in our U.S. insurance segment, as well as positive rate changes in our international insurance segment for certain parts of our general casualty and healthcare lines of business. However also during the quarter, 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 professional liability line of business in the international insurance segment. We believe going forward in the near-term, there will be pricing pressure across most lines of business, in particular in our international insurance segment.

Our consolidated gross premiums written decreased by $4.8 million, or 0.6%, for the three months ended June 30, 2014 compared to the three months ended June 30, 2013. Overall our combined ratio is higher by 7.5 percentage points, driven by increased property loss activity during the quarter and higher expenses primarily caused by increased headcount and employee stock-based compensation due primarily to an 11% increase in our stock price. As a result of the above factors, each of our operating segments reported lower underwriting income during the three months ended June 30, 2014 compared to the three months ended June 30, 2013. Also during the quarter, we opened a branch office of Allied World Assurance Company, Ltd in Sydney, Australia to further expand our distribution network in the Asia Pacific region. The branch will initially offer general

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casualty, healthcare, professional liability, mergers and acquisitions and trade credit insurance products. In May 2014, we acquired the remaining interest in a claims administration services company we did not own and recorded goodwill of $9.4 million related to the transaction. The results of the claims administration services company are included in our U.S. insurance segment.

Our net income increased by $153.8 million to $151.9 million compared to the three months ended June 30, 2013. The increase was primarily due to recording net realized gains on our investments of $85.2 million during the three months ended June 30, 2014 compared to recording net realized losses of $115.2 million during the three months ended June 30, 2013 as a result of lower interest rates during the current quarter.

On May 1, 2014, the shareholders of the Company approved the following proposals:

- A cash dividend in the form of a distribution out of general legal reserve from capital contributions. The distribution amount will be paid to shareholders in quarterly installments of $0.225 per share. The first installment of the dividend was paid on July 2, 2014. We expect to distribute the remaining installments of the dividend in October 2014, January 2015 and April 2015.
- A new share repurchase program in order to repurchase up to $500.0 million of our common shares. This supersedes the 2012 share repurchase program and no further repurchases will be made under the 2012 share repurchase program.
- A three-for-one stock split for shareholders of record as of May 12, 2014. All historical share and per share amounts have been recast to reflect the stock split.

Financial Highlights

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	($ in millions except share, per share and percentage data)			
Gross premiums written	$760.4	$765.2	$1,661.8	$1,602.3
Net income (loss)	151.9	(1.9)	328.8	157.1
Operating income	76.1	103.5	205.9	187.7
Basic earnings (loss) per share:				
Net income (loss)	$1.55	$(0.02)	$3.33	$1.52
Operating income	$0.78	$1.00	$2.09	$1.82
Diluted earnings (loss) per share:				
Net income (loss)	$1.52	$(0.02)	$3.27	$1.48
Operating income	$0.76	$0.98	$2.05	$1.77
Weighted average common shares outstanding:				
Basic	97,809,639	103,267,659	98,672,618	103,552,656
Diluted	99,724,802	105,408,888	100,691,568	105,949,785
Basic book value per common share	$37.99	$32.90	$37.99	$32.90
Diluted book value per common share	$36.98	$32.06	$36.98	$32.06
Annualized return on average equity (ROAE), net income (loss)	16.6%	(0.2)%	18.3%	9.4%
Annualized ROAE, operating income	8.3%	12.2%	11.4%	11.2%

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.

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