Allied World Assurance Co Holdings, AG
Form 10-Q
October 22, 2014

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: September 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 ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

As of October 13, 2014, 96,409,738 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 September 30, 2014 and December 31, 2013
(Expressed in thousands, except share and per share amounts)

	As of September 30, 2014	As of December 31, 2013
ASSETS:		
Fixed maturity investments trading, at fair value (amortized cost: 2014: $6,074,752; 2013: $6,065,350)	$6,128,237	$6,100,798
Equity securities trading, at fair value (cost: 2014: $901,300; 2013: $647,301)	945,076	699,846
Other invested assets	929,201	911,392
Total investments	8,002,514	7,712,036
Cash and cash equivalents	831,270	531,936
Restricted cash	178,958	149,393
Insurance balances receivable	926,183	664,731
Funds held	405,703	632,430
Prepaid reinsurance	376,651	340,992
Reinsurance recoverable	1,349,009	1,234,504
Accrued investment income	30,554	32,236
Net deferred acquisition costs	171,827	126,661
Goodwill	278,085	268,376
Intangible assets	46,931	48,831
Balances receivable on sale of investments	60,122	76,544
Net deferred tax assets	41,312	37,469
Other assets	110,449	89,691
Total assets	$12,809,568	$11,945,830
LIABILITIES:		
Reserve for losses and loss expenses	$6,052,263	$5,766,529
Unearned premiums	1,716,927	1,396,256
Reinsurance balances payable	203,428	173,023
Balances due on purchases of investments	166,026	104,740
Senior notes	798,725	798,499
Dividends payable	21,686	16,732
Accounts payable and accrued liabilities	176,914	170,225
Total liabilities	$9,135,969	$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: 100,775,256; 2013: 103,477,452 shares issued and 2014: 96,382,238; 2013: 100,253,646 shares outstanding)	407,990	418,988
Treasury shares, at cost (2014: 4,393,018; 2013: 3,223,806)	(134,633)	(79,992)
Retained earnings	3,400,242	3,180,830
Total shareholders’ equity	3,673,599	3,519,826
Total liabilities and shareholders’ equity	$12,809,568	$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 nine months ended September 30, 2014 and 2013
(Expressed in thousands, except share and per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
REVENUES:				
Gross premiums written	$707,884	$580,893	$2,369,682	$2,183,174
Premiums ceded	(139,142)	(127,816)	(475,402)	(453,823)
Net premiums written	568,742	453,077	1,894,280	1,729,351
Change in unearned premiums	(27,005)	57,696	(285,011)	(248,079)
Net premiums earned	541,737	510,773	1,609,269	1,481,272
Net investment income	43,412	39,271	127,824	110,294
Net realized investment (losses) gains	(35,136)	27,487	104,286	(8,074)
Other income	1,032	—	1,032	—
	551,045	577,531	1,842,411	1,583,492
EXPENSES:				
Net losses and loss expenses	336,090	276,970	926,231	807,276
Acquisition costs	72,403	65,114	214,404	186,416
General and administrative expenses	88,294	88,553	264,822	251,818
Other expense	6,575	—	6,575	—
Amortization of intangible assets	633	633	1,900	1,900
Interest expense	14,325	14,094	43,451	42,416
Foreign exchange loss	278	4,353	978	7,361
	518,598	449,717	1,458,361	1,297,187
Income before income taxes	32,447	127,814	384,050	286,305
Income tax expense	1,532	4,971	24,300	6,332
NET INCOME	30,915	122,843	359,750	279,973
Other comprehensive income	—	—	—	—
COMPREHENSIVE INCOME	$30,915	$122,843	$359,750	$279,973
PER SHARE DATA				
Basic earnings per share	$0.32	$1.20	$3.67	$2.72
Diluted earnings per share	$0.31	$1.18	$3.60	$2.66
Weighted average common shares outstanding	96,458,231	101,974,077	97,926,378	103,020,681
Weighted average common shares and common share equivalents outstanding	98,444,238	104,184,579	99,965,296	105,393,276
Dividends paid per share	$0.225	$0.167	$0.559	$0.292

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 nine months ended September 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	—	—	359,750	359,750
Dividends	—	—	(60,017)	(60,017)
Stock compensation	—	17,235	1,333	18,568
Share repurchases	—	(164,528)	—	(164,528)
Shares cancelled	(10,998)	92,652	(81,654)	—
September 30, 2014	$407,990	$(134,633)	$3,400,242	$3,673,599
December 31, 2012	$454,980	$(113,818)	$2,985,173	$3,326,335
Net income	—	—	279,973	279,973
Dividends — par value reduction	(12,981)	—	—	(12,981)
Dividends	—	—	(34,069)	(34,069)
Stock compensation	—	26,093	(18,278)	7,815
Share repurchases	—	(123,145)	—	(123,145)
Shares cancelled	(17,162)	125,025	(107,863)	—
September 30, 2013	$424,837	$(85,845)	$3,104,936	$3,443,928

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 nine months ended September 30, 2014 and 2013
(Expressed in thousands)

	Nine Months Ended September 30, 2014	2013
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Net income	$359,750	$279,973
Adjustments to reconcile net income to cash provided by operating activities:		
Net realized gains on sales of investments	(118,640)	(76,104)
Mark to market adjustments	(5,634)	80,136
Stock compensation expense	10,822	9,282
Undistributed loss (income) of equity method investments	10,452	(4,313)
Changes in:		
Reserve for losses and loss expenses, net of reinsurance recoverables	171,229	50,308
Unearned premiums, net of prepaid reinsurance	285,012	248,079
Insurance balances receivable	(260,627)	(229,580)
Funds held	226,727	(38,763)
Reinsurance balances payable	30,405	57,379
Net deferred acquisition costs	(45,166)	(37,941)
Net deferred tax assets	(3,511)	(16,252)
Accounts payable and accrued liabilities	4,473	(18,540)
Other items, net	4,441	34,508
Net cash provided by operating activities	669,733	338,172
CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES:		
Purchases of trading securities	(5,608,594)	(4,955,817)
Purchases of other invested assets	(242,227)	(211,501)
Sales of trading securities	5,500,176	5,137,280
Sales of other invested assets	243,123	189,155
Purchases of fixed assets	(14,490)	(4,171)
Change in restricted cash	(29,565)	(74,032)
Net cash paid for acquisitions	(2,565)	—
Net cash (used in) provided by investing activities	(154,142)	80,914
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Dividends paid - partial par value reduction	—	(12,981)
Dividends paid	(55,064)	(17,117)
Proceeds from the exercise of stock options	7,640	8,465
Share repurchases	(166,207)	(120,163)
Net cash used in financing activities	(213,631)	(141,796)
Effect of exchange rate changes on foreign currency cash	(2,626)	(6,122)
NET INCREASE IN CASH AND CASH EQUIVALENTS	299,334	271,168
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	531,936	681,879
CASH AND CASH EQUIVALENTS, END OF PERIOD	$831,270	$953,047
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$18,052	$17,249
Cash paid for interest expense	$45,750	$45,750

See accompanying notes to the consolidated financial statements.

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

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

The Company has reached definitive agreements to acquire the Hong Kong and Singapore operations of Royal & Sun Alliance Insurance plc for approximately $211,000, at current exchange rates, subject to adjustments at closing. In addition to the purchase price, the Company expects to contribute an additional $90,000 to capitalize the business on an ongoing basis. Subject to regulatory approvals in both Hong Kong and Singapore, as well as court approval in Singapore, the acquisition is expected to be completed in the first half of 2015.

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, include, but are not limited to:

- The premium estimates for certain reinsurance agreements,
- Recoverability of deferred acquisition costs,
- The reserve for outstanding losses and loss expenses,
- Valuation of ceded reinsurance recoverables,
- Determination of impairment of goodwill and other intangible assets, 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 does not believe the adoption of ASU 2014-08 will have a material impact on future financial statements and related disclosures.

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

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 and related disclosures.

In August 2014, the FASB issued Accounting Standards Update 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern" ("ASU 2014-15"). Currently, there is no guidance under U.S. GAAP regarding management's responsibility to assess whether there is substantial doubt about an entity's ability to continue as a going concern. Under ASU 2014-15, the Company will be required to assess its ability to continue as a going concern each interim and annual reporting period and provide certain disclosures if there is substantial doubt about the entity's ability to continue as a going concern, including management's plan to alleviate the substantial doubt. ASU 2014-15 is effective on January 1, 2017 and early adoption is permitted. The Company is currently assessing the impact the adoption of ASU 2014-15 will have on future financial statements and related disclosures.

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:

	September 30, 2014		December 31, 2013	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
U.S. Government and Government agencies	$1,184,115	$ 1,186,185	$1,676,788	$ 1,684,832
Non-U.S. Government and Government agencies	219,287	229,792	191,776	197,082
States, municipalities and political subdivisions	260,690	251,628	231,555	234,406
Corporate debt:				
Financial institutions	1,194,949	1,185,637	958,794	943,518
Industrials	1,202,906	1,201,341	1,174,047	1,165,448
Utilities	125,513	125,202	69,426	69,658
Mortgage-backed	1,240,362	1,196,683	1,292,502	1,267,863
Asset-backed	700,415	698,284	505,910	502,543
Total fixed maturity investments	$6,128,237	$ 6,074,752	$6,100,798	$ 6,065,350

	September 30, 2014		December 31, 2013	
	Fair Value	Original Cost	Fair Value	Original Cost
Equity securities	$945,076	$901,300	$699,846	$647,301
Other invested assets	806,124	701,794	764,081	658,683
	$1,751,200	$1,603,094	$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 September 30, 2014 and December 31, 2013 were as follows:

Investment Type	Carrying Value as of September 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	$179,196	$179,196	2 - 9 Years	$—			$ 223,030
Mezzanine debt	114,399	114,399	5 - 9 Years	—			251,486
Distressed	9,516	9,516	4 Years	—			5,119
Total private equity	303,111	303,111		—			479,635
Distressed	173,111	173,111	1 Year	—			—
Equity long/short	111,627	86,721	1 Year	24,906	Quarterly	30 -60 Days	—
Multi-strategy	81,576	—		81,576	Quarterly	45 -90 Days	—
Relative value credit	105,155	—		105,155	Quarterly	60 Days	—
Total hedge funds	471,469	259,832		211,637			—
High yield loan fund	31,544	—		31,544	Monthly	30 days	—
Total other invested assets at fair value	806,124	562,943		243,181			479,635
Other private securities	123,077	—		123,077			—
Total other invested assets	$929,201	$562,943		$366,258			$ 479,635

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

(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.

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

c) Net Investment Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Fixed maturity investments	$38,762	$31,179	$110,998	$96,366
Equity securities	3,711	6,110	12,876	13,718
Other invested assets: hedge funds and private equity	2,249	3,812	8,767	6,001
Other invested assets: other private securities	3,292	1,997	7,291	5,115
Cash and cash equivalents	552	302	1,562	1,319
Expenses	(5,154)	(4,129)	(13,670)	(12,225)
Net investment income	$43,412	$39,271	$127,824	$110,294

Net investment income from other invested assets: other private securities included the distributed and undistributed net income from investments accounted for using the equity method of accounting. The income reported for other invested assets: other private securities for the nine months ended September 30, 2014 included 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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Gross realized gains on sale of invested assets	$28,773	$51,915	$146,780	$154,387
Gross realized losses on sale of invested assets	(9,955)	(40,770)	(26,228)	(82,812)
Net realized and unrealized gains (losses) on derivatives	2,171	(4,169)	(24,469)	3,392
Mark-to-market (losses) gains:				
Fixed maturity investments, trading	(40,843)	30,383	18,039	(101,205)
Equity securities, trading	(8,479)	(17,198)	(8,768)	(18,555)
Other invested assets, trading	(6,803)	7,326	(1,068)	36,719
Net realized investment (losses) gains	$(35,136)	$27,487	$104,286	$(8,074)

e) Pledged Assets

As of September 30, 2014 and December 31, 2013, $3,082,601 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 September 30, 2014 and December 31, 2013, a further $543,828 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.

5. DERIVATIVE INSTRUMENTS

As of September 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"):

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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)

	September 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	$38,940	$ 814	$ 2,355	$ 22	$294,788	$ 6,254	$122,439	$ 1,176
Interest rate swaps	565,600	414	—	—	491,400	6,829	40,000	4,214
Total derivatives	$604,540	$ 1,228	$ 2,355	$ 22	$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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Foreign exchange contracts	$1,886	$(2,336)	$(580)	$(1,091)
Total included in foreign exchange loss	1,886	(2,336)	(580)	(1,091)
Put options	—	—	—	(3,822)
Foreign exchange contracts	1,701	(4,164)	857	1,925
Interest rate futures and swaps	470	(5)	(25,325)	5,289
Total included in net realized investment gains (losses)	2,171	(4,169)	(24,468)	3,392
Total realized and unrealized gains (losses) on derivatives	$4,057	$(6,505)	$(25,048)	$2,301

The loss related to interest rate future and swap contracts for the nine months ended September 30, 2014 was 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:

September 30, 2014	Carrying Amount	Total Fair Value	Level 1	Level 2	Level 3
Fixed maturity investments:					
U.S. Government and Government agencies	$1,184,115	$1,184,115	$998,487	$185,628	$—
Non-U.S. Government and Government agencies	219,287	219,287	—	219,287	—
States, municipalities and political subdivisions	260,690	260,690	—	260,690	—
Corporate debt	2,523,368	2,523,368	—	2,523,368	—
Mortgage-backed	1,240,362	1,240,362	—	1,120,454	119,908
Asset-backed	700,415	700,415	—	609,045	91,370
Total fixed maturity investments	6,128,237	6,128,237	998,487	4,918,472	211,278
Equity securities	945,076	945,076	907,041	—	38,035
Other invested assets	806,124	806,124	—	—	806,124
Total investments	$7,879,437	$7,879,437	$1,905,528	$4,918,472	$1,055,437
Derivative assets:					
Foreign exchange contracts	$814	$814	$—	$814	$—
Interest rate swaps	414	414	—	414	—
Derivative liabilities:					
Foreign exchange contracts	$22	$22	$—	$22	$—
Interest rate swaps	—	—	—	—	—
Senior notes	$798,725	$888,370	$—	$888,370	$—

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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 ("NAV") of the funds as reported by the fund manager. The fair value of these investments are included in the Level 3 fair value hierarchy as the Company believes NAV is an unobservable input and these securities are not redeemable in the near term.

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 and market multiple 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 September 30, 2014	Other invested assets	Mortgage-backed	Asset-backed	Equities
Opening balance	$ 804,505	$ 146,801	$ 71,232	$ 34,863
Realized and unrealized gains (losses) included in net income	6,797	(882)	(253)	3,172
Purchases	78,629	16,311	18,021	—
Sales	(83,807)	(28,761)	(9,970)	—
Transfers into Level 3 from Level 2	—	1,628	17,863	—
Transfers out of Level 3 into Level 2 (1)	—	(15,189)	(5,523)	—
Ending balance	$ 806,124	$ 119,908	$ 91,370	$ 38,035
Three Months Ended September 30, 2013				
Opening balance	$ 714,391	$ 198,003	$ 61,285	$ 53,499
Realized and unrealized gains (losses) included in net income	9,403	464	(313)	3,972
Purchases	67,554	69,775	16,969	10,000
Sales	(24,277)	(79,001)	(1,302)	—
Transfers into Level 3 from Level 2	—	13	3,394	—
Transfers out of Level 3 into Level 2 (1)	—	—	—	—
Ending balance	$ 767,071	$ 189,254	$ 80,033	$ 67,471

Nine Months Ended September 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	51,921	3,654	(659)	(6,572)
Purchases	267,549	34,187	35,526	—
Sales	(277,427)	(65,038)	(19,871)	(29,297)
Transfers into Level 3 from Level 2	—	1,253	13,923	—
Transfers out of Level 3 into Level 2 (1)	—	(1,486)	(30,962)	—
Ending balance	$ 806,124	$ 119,908	$ 91,370	$ 38,035
Nine Months Ended September 30, 2013				
Opening balance	$ 655,888	$ 167,825	$ 62,246	$ 54,680
Realized and unrealized gains (losses) included in net income	53,365	(5,910)	(791)	2,791
Purchases	237,506	102,369	42,956	10,000
Sales	(179,688)	(69,968)	(26,728)	—
Transfers into Level 3 from Level 2	—	5,073	2,350	—
Transfers out of Level 3 into Level 2 (1)	—	(10,135)	—	—
Ending balance	$ 767,071	$ 189,254	$ 80,033	$ 67,471

(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:

	September 30, 2014	December 31, 2013
Outstanding loss reserves	$1,585,900	$1,520,867
Reserves for losses incurred but not reported	4,466,363	4,245,662
Reserve for losses and loss expenses	$6,052,263	$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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Gross liability at beginning of period	$5,935,678	$5,696,865	$5,766,529	$5,645,549
Reinsurance recoverable at beginning of period	(1,301,742)	(1,179,525)	(1,234,504)	(1,141,110)
Net liability at beginning of period	4,633,936	4,517,340	4,532,025	4,504,439
Net losses incurred related to:				
Current year	382,970	338,420	1,067,111	961,224
Prior years	(46,880)	(61,450)	(140,880)	(153,948)
Total incurred	336,090	276,970	926,231	807,276
Net paid losses related to:				
Current year	53,596	30,399	80,401	54,983
Prior years	202,626	213,252	666,555	696,137
Total paid	256,222	243,651	746,956	751,120
Foreign exchange revaluation	(10,550)	4,088	(8,046)	(5,848)
Net liability at end of period	4,703,254	4,554,747	4,703,254	4,554,747
Reinsurance recoverable at end of period	1,349,009	1,226,034	1,349,009	1,226,034
Gross liability at end of period	$6,052,263	$5,780,781	$6,052,263	$5,780,781

For the three months ended September 30, 2014, the Company recognized unfavorable prior year reserve development in its U.S. insurance segment and net favorable reserve development in its international insurance and reinsurance segments. The net unfavorable prior year reserve development for the U.S. insurance segment primarily related to the 2011 through 2013 loss years was due to a higher level of reported claims in the healthcare line of business and net unfavorable prior year reserve development for the 2005 loss year primarily related to the professional liability line of business. The net favorable reserve development in the international insurance segment was primarily due to lower than expected loss emergence across most lines of business and loss years partially offset by unfavorable prior reserve development for the 2012 loss year related to adverse development on two reported claims in our professional liability line of business. The net favorable reserve development in the reinsurance segment was primarily due to lower than expected loss activity in the property reinsurance line of business for the 2013 loss year.

For the nine months ended September 30, 2014, the Company recognized unfavorable prior year reserve development in its U.S. insurance segment and net favorable reserve development in its international insurance and reinsurance segments. The net unfavorable prior year reserve development in the U.S. insurance segment primarily related to the 2011 through 2013 loss years in our healthcare lines of business and was due to higher than expected loss frequency and severity. The net favorable prior year reserve development in the international insurance segment was primarily due to favorable reserve development for the 2007 loss year in the professional liability line of business, net favorable development for the 2009 and 2010 loss years due to actual loss emergence being lower than anticipated across several lines of business, net unfavorable development for the 2012 loss year in the professional liability line of business and the unfavorable reserve development for the 2013 loss year in the healthcare line of business. The net favorable reserve development in the reinsurance segment was primarily due to lower than expected loss activity in the property reinsurance line of business for the 2013 loss year.

For the three months ended September 30, 2013, the Company had net favorable reserve development in its international insurance and reinsurance 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 2011 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 unfavorable development in the U.S. insurance segment in the 2011 and 2012 loss years primarily due to a higher level of reported claims for certain healthcare, errors and omissions and private/not for profit directors' and officers' lines of business.

For the nine months ended September 30, 2013, the Company had net favorable reserve development in its international insurance and reinsurance segments due to actual loss emergence being lower than initially expected for most loss years. 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 healthcare, errors and omissions and not-for-profit directors' 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.

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 its taxable equity. One of Allied World Switzerland's subsidiaries is a Swiss operating company, which is a 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 September 30, 2014.

9. SHAREHOLDERS' EQUITY

a) Authorized shares

The issued share capital consists of the following:

	September 30, 2014	December 31, 2013
Common shares issued and fully paid, 2014: CHF 4.10 per share; 2013: CHF 4.10 per share	100,775,256	103,477,452
Share capital at end of period	$407,990	$418,988

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	Nine Months Ended September 30, 2014
Shares issued at beginning of period	103,477,452
Shares cancelled	(2,702,196)
Total shares issued at end of period	100,775,256
Treasury shares issued at beginning of period	3,223,806
Shares repurchased	4,616,543
Shares issued out of treasury	(745,135)
Shares cancelled	(2,702,196)
Total treasury shares at end of period	4,393,018
Total shares outstanding at end of period	96,382,238

During the nine months ended September 30, 2014, 2,702,196 shares repurchased and designated for cancellation were constructively retired and cancelled.

b) Dividends

The Company paid the following dividends during the nine months ended September 30, 2014:

Dividend Paid	Dividend Per Share	Total Amount Paid
January 2, 2014	$0.167	$16,732
April 3, 2014	$0.167	$16,495
July 2, 2014	$0.225	$21,870

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 dividends of $0.225 per share. The first dividend was on July 2, 2014 and the second dividend was on October 2, 2014. The Company expects to distribute the remaining dividends in 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.

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The Company's share repurchases were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Common shares repurchased	654,851	1,282,164	4,616,543	4,103,499
Total cost of shares repurchased	$24,996	$40,574	$164,528	$123,145
Average price per share	$38.17	$31.64	$35.64	$30.01

10. EMPLOYEE BENEFIT PLANS

a) Restricted stock units and performance-based equity awards

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

Performance-based equity awards represent the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during an applicable performance period. For the performance-based equity awards granted in 2014, 2013 and 2012, the Company anticipates that the performance goals are likely to be achieved. Based on the performance goals, the performance-based equity awards granted in 2014, 2013 and 2012 are expensed at 100%, 100% and 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:

	Nine Months Ended September 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	(8,061)	(31.71)
RSUs fully vested	(77,700)	(21.68)
Outstanding at end of period	512,112	$32.06

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

	Nine Months Ended September 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

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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.

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

	RSU's		Performance-based Awards	
Nine Months Ended September 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	(50,106)	(26.75)	(2,769)	(25.28)
Fully vested	(752,668)	(22.51)	(454,440)	(20.50)
Outstanding at end of period	1,684,472	$27.98	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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Stock options	$424	$647	$1,564	$2,662
RSUs and performance-based equity awards	2,767	2,070	9,258	6,621
Cash-equivalent stock awards	8,433	13,699	25,930	34,666
Total	$11,624	$16,416	$36,752	$43,949

11. EARNINGS PER SHARE

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Basic earnings per share:				
Net income	$30,915	$122,843	$359,750	$279,973
Weighted average common shares outstanding	96,458,231	101,974,077	97,926,378	103,020,681
Basic earnings per share	$0.32	$1.20	$3.67	$2.72

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Diluted earnings per share:				
Net income	$30,915	$122,843	$359,750	$279,973
Weighted average common shares outstanding	96,458,231	101,974,077	97,926,378	103,020,681
Share equivalents:				
Stock options	1,430,243	1,500,342	1,449,641	1,492,374
RSUs and performance-based equity awards	541,711	708,399	575,675	877,107
Employee share purchase plan	14,053	1,761	13,602	3,114
Weighted average common shares and common share equivalents outstanding - diluted	98,444,238	104,184,579	99,965,296	105,393,276
Diluted earnings per share	$0.31	$1.18	$3.60	$2.66

For the three months ended September 30, 2014, and 2013, there were no common shares considered anti-dilutive and therefore excluded from the calculation of the diluted earnings per share.

For the nine months ended September 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 $9,709 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 primarily provides both direct property and casualty insurance 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.

The Company measures its segment profit or loss as underwriting income or loss plus other insurance-related income and expenses, which may include the net earnings from our claims administration services operations and other income or expense that is not directly related to our underwriting operations. Management measures results for each segment's underwriting income or loss 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

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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."

The following tables provide a summary of the segment results:

Three Months Ended September 30, 2014	U.S. Insurance	International Insurance	Reinsurance	Total
Gross premiums written	$386,681	$144,236	$176,967	$707,884
Net premiums written	321,713	87,820	159,209	568,742
Net premiums earned	224,764	94,013	222,960	541,737
Net losses and loss expenses	(153,010)	(55,814)	(127,266)	(336,090)
Acquisition costs	(31,131)	(1,209)	(40,063)	(72,403)
General and administrative expenses	(41,730)	(27,993)	(18,571)	(88,294)
Underwriting (loss) income	(1,107)	8,997	37,060	44,950
Other insurance-related income	1,032	—	—	1,032
Other insurance-related expenses	(1,270)	(5,305)	—	(6,575)
Segment (loss) income	$(1,345)	$3,692	$37,060	$39,407
Net investment income				43,412
Net realized investment losses				(35,136)
Amortization of intangible assets				(633)
Interest expense				(14,325)
Foreign exchange loss				(278)
Income before income taxes				$32,447
Loss and loss expense ratio	68.1%	59.4%	57.1%	62.0%
Acquisition cost ratio	13.9%	1.3%	18.0%	13.4%
General and administrative expense ratio	18.6%	29.8%	8.3%	16.3%
Expense ratio	32.5%	31.1%	26.3%	29.7%
Combined ratio	100.6%	90.5%	83.4%	91.7%

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Three Months Ended September 30, 2013	U.S. Insurance	International Insurance	Reinsurance	Total
Gross premiums written	$308,709	$132,881	$139,303	$580,893
Net premiums written	238,792	75,632	138,653	453,077
Net premiums earned	207,602	87,554	215,617	510,773
Net losses and loss expenses	(141,222)	(31,094)	(104,654)	(276,970)
Acquisition costs	(28,426)	282	(36,970)	(65,114)
General and administrative expenses	(41,616)	(26,450)	(20,487)	(88,553)
Underwriting (loss) income	(3,662)	30,292	53,506	80,136
Other insurance-related income	—	—	—	—
Other insurance-related expenses	—	—	—	—
Segment (loss) income	$(3,662)	$30,292	$53,506	$80,136
Net investment income				39,271
Net realized investment gains				27,487
Amortization of intangible assets				(633)
Interest expense				(14,094)
Foreign exchange loss				(4,353)
Income before income taxes				$127,814
Loss and loss expense ratio	68.0%	35.5%	48.5%	54.2%
Acquisition cost ratio	13.7%	(0.3)%	17.1%	12.7%
General and administrative expense ratio	20.0%	30.2%	9.5%	17.3%
Expense ratio	33.7%	29.9%	26.6%	30.0%
Combined ratio	101.7%	65.4%	75.1%	84.2%

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Nine Months Ended September 30, 2014	U.S. Insurance	International Insurance	Reinsurance	Total
Gross premiums written	$998,051	$483,079	$888,552	$2,369,682
Net premiums written	746,403	285,450	862,427	1,894,280
Net premiums earned	651,480	271,557	686,232	1,609,269
Net losses and loss expenses	(440,491)	(115,299)	(370,441)	(926,231)
Acquisition costs	(88,311)	(835)	(125,258)	(214,404)
General and administrative expenses	(125,760)	(82,164)	(56,898)	(264,822)
Underwriting (loss) income	(3,082)	73,259	133,635	203,812
Other insurance-related income	1,032	—	—	1,032
Other insurance-related expenses	(1,270)	(5,305)	—	(6,575)
Segment (loss) income	$(3,320)	$67,954	$133,635	$198,269
Net investment income				127,824
Net realized investment gains				104,286
Amortization of intangible assets				(1,900)
Interest expense				(43,451)
Foreign exchange loss				(978)
Income before income taxes				$384,050
Loss and loss expense ratio	67.6%	42.5%	54.0%	57.6%
Acquisition cost ratio	13.6%	0.3%	18.3%	13.3%
General and administrative expense ratio	19.3%	30.3%	8.3%	16.5%
Expense ratio	32.9%	30.6%	26.6%	29.8%
Combined ratio	100.5%	73.1%	80.6%	87.4%

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Nine Months Ended September 30, 2013	U.S. Insurance	International Insurance	Reinsurance	Total
Gross premiums written	$872,024	$453,990	$857,160	$2,183,174
Net premiums written	652,464	259,771	817,116	1,729,351
Net premiums earned	593,477	258,809	628,986	1,481,272
Net losses and loss expenses	(398,910)	(90,997)	(317,369)	(807,276)
Acquisition costs	(78,824)	1,489	(109,081)	(186,416)
General and administrative expenses	(119,514)	(75,374)	(56,930)	(251,818)
Underwriting (loss) income	(3,771)	93,927	145,606	235,762
Other insurance-related income	—	—	—	—
Other insurance-related expenses	—	—	—	—
Segment (loss) income	$(3,771)	$93,927	$145,606	$235,762
Net investment income				110,294
Net realized investment losses				(8,074)
Amortization of intangible assets				(1,900)
Interest expense				(42,416)
Foreign exchange loss				(7,361)
Income before income taxes				$286,305
Loss and loss expense ratio	67.2%	35.2%	50.5%	54.5%
Acquisition cost ratio	13.3%	(0.6)%	17.3%	12.6%
General and administrative expense ratio	20.1%	29.1%	9.1%	17.0%
Expense ratio	33.4%	28.5%	26.4%	29.6%
Combined ratio	100.6%	63.7%	76.9%	84.1%

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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
United States	$483,992	$377,618	$1,447,652	$1,296,212
Bermuda	109,503	111,103	525,005	550,815
Europe	64,947	52,004	245,931	198,747
Asia Pacific	45,070	40,168	142,798	137,400
Canada	4,372	—	8,296	—
Total gross premiums written	$707,884	$580,893	$2,369,682	$2,183,174

Europe includes gross premiums written attributable to Switzerland of $11,130 and $10,509 for the three months ended September 30, 2014 and 2013, respectively and $65,684 and $57,183 for the nine months ended September 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 September 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.

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14. CONDENSED CONSOLIDATED GUARANTOR FINANCIAL STATEMENTS

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

Unaudited Condensed Consolidating Balance Sheet:

As of September 30, 2014	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
ASSETS:					
Investments	$—	$—	$8,002,514	$—	$8,002,514
Cash and cash equivalents	38,196	2,329	790,745	—	831,270
Insurance balances receivable	—	—	926,183	—	926,183
Funds held	—	—	405,703	—	405,703
Reinsurance recoverable	—	—	1,349,009	—	1,349,009
Net deferred acquisition costs	—	—	171,827	—	171,827
Goodwill and intangible assets	—	—	325,016	—	325,016
Balances receivable on sale of investments	—	—	60,122	—	60,122
Investments in subsidiaries	3,644,932	4,255,136	—	(7,900,068)	—
Due from subsidiaries	18,497	407	15,508	(34,412)	—
Other assets	2,009	3,576	732,339	—	737,924
Total assets	$3,703,634	$4,261,448	$12,778,966	$(7,934,480)	$12,809,568
LIABILITIES:					
Reserve for losses and loss expenses	$—	$—	$6,052,263	$—	$6,052,263
Unearned premiums	—	—	1,716,927	—	1,716,927
Reinsurance balances payable	—	—	203,428	—	203,428
Balances due on purchases of investments	—	—	166,026	—	166,026
Senior notes	—	798,725	—	—	798,725
Due to subsidiaries	6,826	8,682	18,904	(34,412)	—
Other liabilities	23,209	12,513	162,878	—	198,600
Total liabilities	30,035	819,920	8,320,426	(34,412)	9,135,969
Total shareholders' equity	3,673,599	3,441,528	4,458,540	(7,900,068)	3,673,599
Total liabilities and shareholders' equity	$3,703,634	$4,261,448	$12,778,966	$(7,934,480)	$12,809,568

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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.

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Unaudited Condensed Consolidating Statement of Operations and Comprehensive Income:

Three Months Ended September 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	$—	$—	$541,737	$—	$541,737
Net investment income	2	—	43,410	—	43,412
Net realized investment gains (losses)	—	—	(35,136)	—	(35,136)
Other income	—	—	1,032	—	1,032
Net losses and loss expenses	—	—	(336,090)	—	(336,090)
Acquisition costs	—	—	(72,403)	—	(72,403)
General and administrative expenses	(8,285)	(182)	(79,827)	—	(88,294)
Other expense	—	—	(6,575)	—	(6,575)
Amortization of intangible assets	—	—	(633)	—	(633)
Interest expense	—	(13,855)	(470)	—	(14,325)
Foreign exchange gain (loss)	16	47	(341)	—	(278)
Income tax (expense) benefit	—	—	(1,532)	—	(1,532)
Equity in earnings of consolidated subsidiaries	39,182	49,491	—	(88,673)	—
NET INCOME (LOSS)	$30,915	$35,501	$53,172	$(88,673)	$30,915
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$30,915	$35,501	$53,172	$(88,673)	$30,915

Three Months Ended September 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	$—	$—	$510,773	$—	$510,773
Net investment income	3	—	39,268	—	39,271
Net realized investment gains (losses)	—	—	27,487	—	27,487
Other income	—	—	—	—	—
Net losses and loss expenses	—	—	(276,970)	—	(276,970)
Acquisition costs	—	—	(65,114)	—	(65,114)
General and administrative expenses	(7,323)	(4,961)	(76,269)	—	(88,553)
Other expense	—	—	—	—	—
Amortization of intangible assets	—	—	(633)	—	(633)
Interest expense	—	(13,838)	(256)	—	(14,094)
Foreign exchange gain (loss)	(13)	(212)	(4,128)	—	(4,353)
Income tax (expense) benefit	—	—	(4,971)	—	(4,971)
Equity in earnings of consolidated subsidiaries	130,176	150,653	—	(280,829)	—
NET INCOME (LOSS)	$122,843	$131,642	$149,187	$(280,829)	$122,843
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$122,843	$131,642	$149,187	$(280,829)	$122,843

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Nine Months Ended September 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	$—	$—	$1,609,269	$—	$1,609,269
Net investment income	6	—	127,818	—	127,824
Net realized investment gains (losses)	—	—	104,286	—	104,286
Other income	—	—	1,032	—	1,032
Net losses and loss expenses	—	—	(926,231)	—	(926,231)
Acquisition costs	—	—	(214,404)	—	(214,404)
General and administrative expenses	(28,012)	(919)	(235,891)	—	(264,822)
Other expense	—	—	(6,575)	—	(6,575)
Amortization of intangible assets	—	—	(1,900)	—	(1,900)
Interest expense	—	(41,556)	(1,895)	—	(43,451)
Foreign exchange gain (loss)	12	68	(1,058)	—	(978)
Income tax (expense) benefit	(86)	—	(24,214)	—	(24,300)
Equity in earnings of consolidated subsidiaries	387,830	419,294	—	(807,124)	—
NET INCOME (LOSS)	$359,750	$376,887	$430,237	$(807,124)	$359,750
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$359,750	$376,887	$430,237	$(807,124)	$359,750

Nine Months Ended September 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	$—	$—	$1,481,272	$—	$1,481,272
Net investment income	11	4	110,279	—	110,294
Net realized investment gains (losses)	—	—	(8,074)	—	(8,074)
Other income	—	—	—	—	—
Net losses and loss expenses	—	—	(807,276)	—	(807,276)
Acquisition costs	—	—	(186,416)	—	(186,416)
General and administrative expenses	(26,875)	(5,873)	(219,070)	—	(251,818)
Other expense	—	—	—	—	—
Amortization of intangible assets	—	—	(1,900)	—	(1,900)
Interest expense	—	(41,503)	(913)	—	(42,416)
Foreign exchange gain (loss)	261	(935)	(6,687)	—	(7,361)
Income tax (expense) benefit	—	—	(6,332)	—	(6,332)
Equity in earnings of consolidated subsidiaries	306,576	353,280	—	(659,856)	—
NET INCOME (LOSS)	$279,973	$304,973	$354,883	$(659,856)	$279,973
Other comprehensive income	—	—	—	—	—
COMPREHENSIVE INCOME (LOSS)	$279,973	$304,973	$354,883	$(659,856)	$279,973

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

Unaudited Condensed Consolidating Statement of Cash Flows:

Nine Months Ended September 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	$241,037	$263,554	$737,516	$(575,000)	$667,107
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:					
Purchases trading securities	—	—	(5,608,594)	—	(5,608,594)
Purchases of other invested assets	—	—	(242,227)	—	(242,227)
Sales of trading securities	—	—	5,500,176	—	5,500,176
Sales of other invested assets	—	—	243,123	—	243,123
Other	—	—	(46,620)	—	(46,620)
Net cash provided by (used in) investing activities	—	—	(154,142)	—	(154,142)
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:					
Dividends paid	(55,064)	—	—	—	(55,064)
Intercompany dividends paid	—	(264,000)	(311,000)	575,000	—
Proceeds from the exercise of stock options	7,640	—	—	—	7,640
Share repurchases	(166,207)	—	—	—	(166,207)
Net cash provided by (used in) financing activities	(213,631)	(264,000)	(311,000)	575,000	(213,631)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	27,406	(446)	272,374	—	299,334
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	10,790	2,775	518,371	—	531,936
CASH AND CASH EQUIVALENTS, END OF PERIOD	$38,196	$2,329	$790,745	$—	$831,270

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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)

Nine Months Ended September 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:	$177,859	$226,564	$431,127	$(503,500)	$332,050
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:					
Purchases of trading securities	—	—	(4,955,817)	—	(4,955,817)
Purchases of other invested assets	—	—	(211,501)	—	(211,501)
Sales of trading securities	—	—	5,137,280	—	5,137,280
Sales of other invested assets	—	—	189,155	—	189,155
Other	—	—	(78,203)	—	(78,203)
Net cash provided by (used in) investing activities	—	—	80,914	—	80,914
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:					
Dividends paid - partial par value reduction	(12,981)	—	—	—	(12,981)
Dividends paid	(17,117)	—	—	—	(17,117)
Intercompany dividends paid	—	(229,500)	(274,000)	503,500	—
Proceeds from the exercise of stock options	8,465	—	—	—	8,465
Share repurchases	(120,163)	—	—	—	(120,163)
Net cash provided by (used in) financing activities	(141,796)	(229,500)	(274,000)	503,500	(141,796)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	36,063	(2,936)	238,041	—	271,168
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	19,997	11,324	650,558	—	681,879
CASH AND CASH EQUIVALENTS, END OF PERIOD	$56,060	$8,388	$888,599	$—	$953,047

Notes to Parent Company Condensed Financial Information

a) Dividends

Allied World Switzerland received cash dividends from its subsidiaries of $264,000 and $229,500 for the nine months ended September 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 October 2, 2014, the Company paid a quarterly dividend of $0.225 per share to shareholders of record on September 23, 2014.

In October 2014, the Company, through its subsidiary Allied World Financial Services, Inc., acquired a minority interest in Blue Vista Capital Management, LLC ("Blue Vista"). Blue Vista invests across real estate asset classes and capital structures through limited partnerships and separate accounts. As part of the acquisition, the Company has agreed to invest $225,000 to various funds managed by Blue Vista over the next several years.

Effective December 31, 2014, the Company will reorganize how it manages its business, and as a result it will realign its executive management team and change its reportable segments to correspond to the reorganization. The Company's Bermuda direct insurance operations, which had previously been included in the international insurance segment, will now be combined with the U.S. insurance segment and renamed North American Insurance. The remaining direct insurance operations of the international insurance segment will be renamed Global Markets Insurance. The reinsurance segment will remain unchanged.

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The newly created segments will be presented in the Company's financial statements beginning with the period ended December 31, 2014 and prior periods will be recast to conform to the new presentation.

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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 II of the Form 10-Q and 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 September 30, 2014, we had approximately $12.8 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 September 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 segment grew its business by selectively writing accounts where pricing, terms and conditions met our underwriting requirements. 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. During the quarter, we also experienced 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, general casualty and aviation lines of business in the international insurance segment. We believe 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 increased by $127.0 million, or 21.9%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 due to growth in each of our operating segments. Overall our combined ratio is higher by 7.5 percentage points, driven by increased property loss activity during the quarter, including $18.5 million related to Hurricane Odile, $8.0 million related to Windstorm Ela and $3.3 million related to Property Claims Services ("PCS") designated storm #45 in the Midwestern U.S. ("PCS storm #45").

Our net income decreased by $91.9 million to $30.9 million compared to the three months ended September 30, 2013. The decrease was primarily due to recording net realized losses on our investments of $35.1 million during the three months ended

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September 30, 2014 compared to recording net realized gains of $27.5 million during the three months ended September 30, 2013 as a result of higher interest rates and widening credit spreads during the current quarter and recording $29.8 million in catastrophe losses.

Recent Developments

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

In August 2014, we reached definitive agreements to acquire the Hong Kong and Singapore operations of Royal & Sun Alliance Insurance plc ("RSA") for approximately $211.0 million, at current exchange rates, subject to adjustments at closing. In addition to the purchase price, we expect to contribute an additional $90.0 million to capitalize the business on an ongoing basis. Subject to regulatory approvals in both Hong Kong and Singapore, as well as court approval in Singapore, the acquisition is expected to be completed in the first half of 2015. We believe the acquisition of the Hong Kong and Singapore branches of RSA complements our global specialist insurance strategy by providing meaningful additional scale in the region.

In October 2014, we acquired, through our subsidiary Allied World Financial Services, Inc., a minority interest in Blue Vista Capital Management, LLC ("Blue Vista"). Blue Vista invests across real estate asset classes and capital structures through limited partnerships and separate accounts. As part of the acquisition, we have agreed to invest $225.0 million to various funds managed by Blue Vista over the next several years.

Effective December 31, 2014, we will reorganize how we manage our business, and as a result we will realign our executive management team and change our reportable segments to correspond to the reorganization. Our Bermuda direct insurance operations, which had previously been included in the international insurance segment, will now be combined with the U.S. insurance segment and renamed North American Insurance. The remaining direct insurance operations of the international insurance segment will be renamed Global Markets Insurance. The reinsurance segment will remain unchanged. The newly created segments will be presented in our financial statements beginning with the period ended December 31, 2014 and prior periods will be recast to conform to the new presentation.

Financial Highlights

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	($ in millions except share, per share and percentage data)			
Gross premiums written	$707.9	$580.9	$2,369.7	$2,183.2
Net income	30.9	122.8	359.8	280.0
Operating income	60.6	101.8	266.5	289.5
Basic earnings per share:				
Net income	$0.32	$1.20	$3.67	$2.72
Operating income	$0.62	$0.99	$2.72	$2.81
Diluted earnings per share:				
Net income	$0.31	$1.18	$3.60	$2.66
Operating income	$0.61	$0.98	$2.67	$2.75
Weighted average common shares outstanding:				
Basic	96,458,231	101,974,077	97,926,378	103,020,681
Diluted	98,444,238	104,184,579	99,965,296	105,393,276
Basic book value per common share	$38.11	$33.95	$38.11	$33.95
Diluted book value per common share	$37.12	$33.05	$37.12	$33.05
Annualized return on average equity (ROAE), net income	3.4 %	14.4 %	13.2 %	11.0 %
Annualized ROAE, operating income	6.6 %	11.9 %	9.7 %	11.4 %

Non-GAAP Financial Measures

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

Operating income and operating income per share

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	($ in millions, except share, per share and percentage data)			
Net income	$30.9	$122.8	$359.8	$280.0
Add after tax effect of:				
Net realized investment losses (gains)	29.4	(25.4)	(94.2)	2.2
Foreign exchange loss	0.3	4.4	1.0	7.3
Operating income	$60.6	$101.8	$266.5	$289.5
Basic per share data:				
Net income	$0.32	$1.20	$3.67	$2.72
Add after tax effect of:				
Net realized investment losses (gains)	0.30	(0.25)	(0.96)	0.02
Foreign exchange loss	0.00	0.04	0.01	0.07
Operating income	$0.62	$0.99	$2.72	$2.81
Diluted per share data:				
Net income	$0.31	$1.18	$3.60	$2.66
Add after tax effect of:				
Net realized investment losses (gains)	0.30	(0.24)	(0.94)	0.02
Foreign exchange loss	0.00	0.04	0.01	0.07
Operating income	$0.61	$0.98	$2.67	$2.75

Diluted book value per share

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

	As of September 30,	
	2014	2013
	($ in millions, except share and per share data)	
Price per share at period end	$36.84	$33.13
Total shareholders' equity	$3,673.6	$3,443.9
Basic common shares outstanding	96,382,238	101,444,760
Add:		
Unvested restricted stock units	512,112	249,720
Performance-based equity awards	619,428	812,559
Employee share purchase plan	28,381	45,960
Dilutive stock options outstanding	2,532,918	3,152,496
Weighted average exercise price per share	$16.30	$15.92
Deduct:		
Options bought back via treasury method	(1,120,699)	(1,515,171)
Common shares and common share equivalents outstanding	98,954,378	104,190,324
Basic book value per common share	$38.11	$33.95
Diluted book value per common share	$37.12	$33.05

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Annualized return on average equity

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	($ in millions except percentage data)			
Opening shareholders' equity	$3,682.8	$3,373.2	$3,616.7	$3,326.3
Closing shareholders' equity	$3,673.6	$3,443.9	$3,673.6	$3,443.9
Average shareholders' equity	$3,678.2	$3,408.6	$3,645.1	$3,385.1
Net income available to shareholders	$30.9	$122.8	$359.8	$280.0
Annualized return on average shareholders' equity — net income available to shareholders	3.4 %	14.4 %	13.2 %	11.0 %
Operating income available to shareholders	$60.6	$101.8	$266.5	$289.5
Annualized return on average shareholders' equity — operating income available to shareholders	6.6 %	11.9 %	9.7 %	11.4 %

Relevant Factors

Revenues

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

Expenses

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

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

Acquisition costs are comprised of commissions, brokerage fees, insurance taxes and other acquisition related costs such as profit commissions. Commissions and brokerage fees are usually calculated as a percentage of premiums and depend on the market and line of business. Acquisition costs are reported after (1) deducting commissions received on ceded reinsurance,

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(2) deducting the part of deferred acquisition costs relating to the successful acquisition of new and renewal insurance and reinsurance contracts and (3) including the amortization of previously deferred acquisition costs.

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

Ratios

The Company measures its segment results as underwriting income or loss plus other insurance-related revenue and expenses, which may include the net earnings from our claims administration services operations and other income or expense that is not directly related to our underwriting operations. Management measures results for each segment's underwriting income or loss on the basis of the “loss and loss expense ratio,” “acquisition cost ratio,” “general and administrative expense ratio,” “expense ratio” and the “combined ratio.” Because we do not manage our assets by segment, investment income, interest expense and total assets are not allocated to individual reportable segments. General and administrative expenses are allocated to segments based on various factors, including staff count and each segment’s proportional share of gross premiums written. The loss and loss expense ratio is derived by dividing net losses and loss expenses by net premiums earned. The acquisition cost ratio is derived by dividing acquisition costs by net premiums earned. The general and administrative expense ratio is derived by dividing general and administrative expenses by net premiums earned. The expense ratio is the sum of the acquisition cost ratio and the general and administrative expense ratio. The combined ratio is the sum of the loss and loss expense ratio, the acquisition cost ratio and the general and administrative expense ratio.

Critical Accounting Policies

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

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Results of Operations

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

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
	($ in millions)			
Revenues				
Gross premiums written	$707.9	$580.9	$2,369.7	$2,183.2
Net premiums written	$568.7	$453.1	$1,894.3	$1,729.4
Net premiums earned	$541.7	$510.8	$1,609.3	$1,481.3
Net investment income	43.4	39.3	127.8	110.3
Net realized investment (losses) gains	(35.1)	27.5	104.3	(8.1)
Other income	1.0	—	1.0	—
	$551.0	$577.6	$1,842.4	$1,583.5
Expenses				
Net losses and loss expenses	$336.1	$277.0	$926.2	$807.3
Acquisition costs	72.4	65.1	214.4	186.4
General and administrative expenses	88.3	88.6	264.8	251.8
Other expense	6.6	—	6.6	—
Amortization of intangible assets	0.6	0.7	1.9	1.9
Interest expense	14.3	14.1	43.5	42.4
Foreign exchange loss	0.3	4.4	1.0	7.4
	$518.6	$449.9	$1,458.4	$1,297.2
Income before income taxes	32.4	127.7	384.0	286.3
Income tax expense	1.5	4.9	24.3	6.3
Net income	$30.9	$122.8	$359.7	$280.0
Ratios				
Loss and loss expense ratio	62.0%	54.2%	57.6%	54.5%
Acquisition cost ratio	13.4%	12.7%	13.3%	12.6%
General and administrative expense ratio	16.3%	17.3%	16.5%	17.0%
Expense ratio	29.7%	30.0%	29.8%	29.6%
Combined ratio	91.7%	84.2%	87.4%	84.1%

Comparison of Three Months Ended September 30, 2014 and 2013

Premiums

Gross premiums written increased by $127.0 million, or 21.9%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013. The overall increase in gross premiums written was primarily the result of the following:

- U.S. insurance: Gross premiums written increased by $78.0 million, or 25.3%. The increase in gross premiums written was primarily due to the growth in our general casualty line of business, in particular our primary casualty class of business which increased due to adding new business on existing accounts. We also continued to see growth in our newer lines of business such as our mergers and acquisitions, environmental and inland marine lines of business. This growth was partially offset by the non-renewal of business, particularly in certain classes within our healthcare line of business, that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions);

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- International insurance: Gross premiums written increased by $11.3 million, or 8.5%. The increase was primarily due to increased premiums on existing lines of business, particularly in our professional liability line of business. This was partially offset by lower premiums written in our aviation line of business. The decrease in our aviation line of business was due to $13.1 million of gross premiums written during the three months ended September 30, 2013 related to the renewal rights agreement we entered into with Markel International that did not occur during the three months ended September 30, 2014 partially offset by new business written during the current quarter; and
- Reinsurance: Gross premiums written increased by $37.7 million, or 27.1%. The increase was from one new treaty in our casualty reinsurance line of business that resulted in $21.9 million of gross premiums written, and the timing of renewals primarily in our property reinsurance line of business. We had a large property treaty that renewed during the three months ended September 30, 2014 that was previously written during the second quarter of last year. This property reinsurance treaty included a fronting component which resulted in our retaining a small portion of the premiums written with the remainder being ceded.

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

	Three Months Ended September 30,		Dollar	Percentage
	2014	2013	Change	Change
	($ in millions)			
United States	$484.0	$377.6	$106.4	28.2 %
Bermuda	109.5	111.1	(1.6)	(1.4)%
Europe	64.9	51.9	13.0	25.0 %
Asia Pacific	45.1	40.3	4.8	11.9 %
Canada	4.4	—	4.4	n/a
	$707.9	$580.9	$127.0	21.9 %

Net premiums written increased by $115.6 million, or 25.5%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013. The increase in net premiums written was primarily due to higher gross premiums written partially offset by higher premiums ceded. The increase in premiums ceded was due to higher ceded premiums related to our collateralized property catastrophe reinsurance protection as the premiums for the current treaty are recognized on a quarterly basis. This increase was partially offset by lower premiums ceded related to treaties that have contractual minimum premiums. The reduction in ceded premiums was due to recognizing annual ceded premiums at the inception of several reinsurance treaties rather than ratably over the contract period. This resulted in higher ceded premiums in previous quarters, as several reinsurance treaties incepted in those quarters, but lower ceded premiums in the current quarter. Previously, we recognized ceded premiums written on these agreements based on the actual premiums ceded each quarter. The difference between gross and net premiums written is the cost to us of purchasing reinsurance coverage, including the cost of property catastrophe reinsurance coverage. We ceded 19.7% of gross premiums written for the three months ended September 30, 2014 compared to 22.0% for the same period in 2013. The reduction was primarily due to the timing of the recognition of premiums ceded that have contractual minimum premiums.

Net premiums earned increased by $30.9 million, or 6.0%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 as a result of higher premiums earned in each of our operating segments.

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

	Gross Premiums Written	Net Premiums Earned

	Three Months Ended September 30,				Three Months Ended September 30,			
	2014		2013		2014		2013	
U.S. insurance	54.6	%	53.1	%	41.4	%	40.7	%
International insurance	20.4	%	22.9	%	17.4	%	17.1	%
Reinsurance	25.0	%	24.0	%	41.2	%	42.2	%
Total	100.0	%	100.0	%	100.0	%	100.0	%

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Net Investment Income

Net investment income increased by $4.1 million, or 10.4%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013. The increase was primarily due to higher income related to our fixed maturity non-core investments, which carry higher yields than government-backed securities. The annualized period book yield of the investment portfolio for the three months ended September 30, 2014 and 2013 was 2.0% and 1.9%, respectively.

As of September 30, 2014, we held 10.3% of our total investments and cash equivalents in "other invested assets" compared to 9.9% as of September 30, 2013.

Investment management expenses of $5.2 million and $4.1 million were incurred during the three months ended September 30, 2014 and 2013, respectively. The increase of $1.1 million, or 26.8%, was primarily due to additional investment portfolio managers utilized in the current period as compared to the prior period.

As of September 30, 2014, approximately 88.0% of our fixed income investments consisted of investment grade securities. As of September 30, 2014 and December 31, 2013, the average Standard & Poor’s credit rating of our fixed income portfolio was A+ and AA-, respectively.

Realized Investment (Losses) Gains

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

	Three Months Ended September 30,	
	2014	2013
	($ in millions)	
Net realized gains on sale:		
Fixed maturity investments, trading	$5.8	$(4.8)
Equity securities, trading	(0.6)	13.9
Other invested assets: hedge funds and private equity, trading	13.6	2.1
Total net realized gains on sale	18.8	11.2
Net realized and unrealized gains (losses) on derivatives	2.2	(4.2)
Mark-to-market (losses) gains:		
Fixed maturity investments, trading	(40.8)	30.4
Equity securities, trading	(8.5)	(17.2)
Other invested assets: hedge funds and private equity, trading	(6.8)	7.3
Total mark-to-market (losses) gains	(56.1)	20.5
Net realized investment (losses) gains	$(35.1)	$27.5

The total return of our investment portfolio was 0.1% and 0.8% for the three months ended September 30, 2014 and 2013, respectively. The decrease in total return was primarily due to higher interest rates and widening credit spreads that caused mark-to-market losses on our fixed maturity investments during the current period compared to lower interest rates and tightening credit spreads during the prior period.

Other Income

Other income represents the revenue of our third-party claims administration services that we acquired in the current year.

Net Losses and Loss Expenses

Net losses and loss expenses increased by $59.1 million, or 21.3%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013. The following is a breakdown of the loss and loss expense ratio for the three months ended September 30, 2014 and 2013:

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	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		Dollar Change	Loss Ratio Percentage Point Change
	Amount	% of NPE (1)	Amount	% of NPE (1)		
			($ in millions)			
Non-catastrophe	$353.2	65.2 %	$338.4	66.2 %	$14.8	(1.0)
Property catastrophe	29.8	5.5	—	—	29.8	5.5
Current period	383.0	70.7	338.4	66.2	44.6	4.5
Prior period	(46.9)	(8.7)	(61.4)	(12.0)	14.5	3.3
Net losses and loss expenses	$336.1	62.0 %	$277.0	54.2 %	$59.1	7.8

(1) "NPE" means net premiums earned.

Current year non-catastrophe losses and loss expenses

The increase in the current year non-catastrophe losses and loss expenses was primarily due to the overall growth of our operations. The decrease in the current year non-catastrophe losses and loss expenses ratio was primarily due to lower reported large property losses during the three months ended September 30, 2014 compared to the three months ended September 30, 2013.

Current year property catastrophe losses and loss expenses

During the three months ended September 30, 2014, we incurred $18.5 million of property catastrophe losses and loss expenses related to Hurricane Odile, of which $15.0 million was recorded by our international insurance segment and $3.5 million by our reinsurance segment, $8.0 million related to Windstorm Ela, and $3.3 million related to PCS storm #45. The losses related to Windstorm Ela and PCS storm #45 were recorded in our reinsurance segment. The losses related to Windstorm Ela and PCS storm #45 were classified as catastrophes in the current period as the additional net losses recorded in this period made the aggregate net losses incurred for these events in excess of $10.0 million, which is our quantitative threshold for classifying property-related losses as catastrophes. We did not incur any property catastrophe losses during the three months ended September 30, 2013.

Prior year losses and loss expenses

We recorded net favorable reserve development related to prior years of $46.9 million during the three months ended September 30, 2014 compared to net favorable reserve development of $61.4 million for the three months ended September 30, 2013, as shown in the tables below.

(Favorable) and Unfavorable Loss Reserve Development by Loss Year
For the Three Months Ended September 30, 2014

	2004 and Prior	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
	($ in millions)										
U.S. insurance	$(0.1)	$10.2	$(16.6)	$8.1	$(3.5)	$(15.4)	$(2.3)	$2.3	$4.0	$13.9	$0.6
International insurance	(0.5)	(1.3)	(3.8)	(8.5)	(5.1)	(7.1)	(8.7)	(7.4)	11.4	1.8	(29.2)
Reinsurance	0.2	5.3	(1.0)	(1.6)	(4.3)	(0.9)	(0.6)	(3.1)	1.9	(14.2)	(18.3)
	$(0.4)	$14.2	$(21.4)	$(2.0)	$(12.9)	$(23.4)	$(11.6)	$(8.2)	$17.3	$1.5	$(46.9)

For the three months ended September 30, 2014, the net unfavorable prior year reserve development for the 2011 through 2013 loss years in our U.S. insurance segment was primarily due to a higher level of reported claims in our healthcare line of business while the net unfavorable prior year reserve development for the 2005 loss year primarily relates to our professional liability line of business. The net favorable reserve development in our international insurance segment for the 2011 and prior loss years was due to lower than expected loss emergence across most lines of business and loss years. The unfavorable prior reserve development for the 2012 loss year related to adverse development on two reported claims in our professional liability line of business. The net favorable reserve development in our reinsurance segment for the 2013 loss year was due to lower than expected reported loss activity in our property reinsurance line of business.

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The following table shows the net favorable reserve development by loss year for each of our segments for the three months ended September 30, 2013.

	(Favorable) and Unfavorable Loss Reserve Development by Loss Year For the Three Months Ended September 30, 2013										
	2003 and Prior	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
	($ in millions)										
U.S. insurance	$(3.0)	$(0.6)	$(1.1)	$(6.1)	$(5.5)	$(2.9)	$(3.5)	$(4.8)	$13.2	$18.1	$3.8
International insurance	0.2	(1.2)	3.2	(4.0)	(8.6)	(4.7)	(5.9)	(4.1)	(2.1)	(2.5)	(29.7)
Reinsurance	(1.6)	(2.4)	1.5	—	0.2	(2.1)	(2.0)	(2.6)	(12.1)	(14.4)	(35.5)
	$(4.4)	$(4.2)	$3.6	$(10.1)	$(13.9)	$(9.7)	$(11.4)	$(11.5)	$(1.0)	$1.2	$(61.4)

For the three months ended September 30, 2013, the unfavorable reserve development for the 2011 loss year for our U.S. insurance segment was primarily due to a higher level of reported claims in our healthcare and errors and omissions ("E&O") lines of business. The unfavorable reserve development for the 2012 loss year for our U.S. insurance segment was primarily due to a higher level of reported claims in our healthcare, private/not for profit directors' and officers' ("D&O") and lawyers E&O lines of business.

The favorable reserve development for the reinsurance segment was primarily related to our property reinsurance line of business, and included favorable reserve development related to recent catastrophic events that occurred in 2010 through 2012.

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

	Three Months Ended September 30,		Dollar
	2014	2013	Change
	($ in millions)		
Net losses paid	$256.2	$243.7	$12.5
Net change in reported case reserves	40.3	(15.7)	56.0
Net change in IBNR	39.6	49.0	(9.4)
Net losses and loss expenses	$336.1	$277.0	$59.1

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

	Three Months Ended September 30,	
	2014	2013
	($ in millions)	
Net reserves for losses and loss expenses, July 1	$4,633.9	$4,517.3
Incurred related to:		
Current period non-catastrophe	353.2	338.4
Current period property catastrophe	29.8	—
Prior period	(46.9)	(61.4)
Total incurred	336.1	277.0
Paid related to:		
Current period	53.6	30.5
Prior period	202.6	213.2
Total paid	256.2	243.7
Foreign exchange revaluation	(10.5)	4.1
Net reserve for losses and loss expenses, September 30	4,703.3	4,554.7
Losses and loss expenses recoverable	1,349.0	1,226.1
Reserve for losses and loss expenses, September 30	$6,052.3	$5,780.8

Acquisition Costs

Acquisition costs increased by $7.3 million, or 11.2%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013. The increase in acquisition costs was primarily due to the growth in premiums earned, higher profit commission accruals in our U.S. insurance segment and higher ceding commissions paid to cedents for certain lines of business in our reinsurance segment. Acquisition costs as a percentage of net premiums earned were 13.4% for the three months ended September 30, 2014 compared to 12.7% for the same period in 2013. The higher acquisition cost ratio was primarily due to the reasons noted above.

General and Administrative Expenses

General and administrative expenses decreased by $0.3 million, or 0.3%, for the three months ended September 30, 2014 compared to the same period in 2013. Our general and administrative expense ratio was 16.3% and 17.3% for the three months ended September 30, 2014 and 2013, respectively. The decrease in general and administrative expenses was primarily due to lower stock-based compensation partially offset by higher salary related costs due to higher headcount. We have granted cash equivalent restricted stock units and performance-based equity awards to certain key employees, and we measure the value of each of those awards at the period ending share price. Changes in our share price are recognized as increases or decreases in our compensation expense ratably over the service period. Our share price decreased 3% for the three months ended September 30, 2014 compared to a 9% increase for the same period in 2013.

Other Expense

Other expense represents the expenses of our third-party claims administration services that we acquired in the current year of $1.3 million and the transaction-related costs incurred for the acquisition of the Hong Kong and Singapore operations of RSA of $5.3 million.

Amortization of Intangible Assets

The amortization of intangible assets was virtually unchanged for the three months ended September 30, 2014 compared to the three months ended September 30, 2013.

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Interest Expense

Interest expense increased by $0.2 million, or 1.4%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013.

Foreign Exchange Loss

The foreign exchange loss decreased by $4.1 million, or 93.2%, for the three months ended September 30, 2014 compared to the three months ended September 30, 2013. The decrease was due to higher gains recorded on our foreign exchange derivative contracts due to the strengthening of the U.S. dollar relative to other major currencies and the timing of the tenor of the derivative contracts.

Net Income

Net income for the three months ended September 30, 2014 was $30.9 million compared to net income of $122.8 million for the three months ended September 30, 2013. The $91.9 million decrease was primarily the result of recording net realized losses on our investments of $35.1 million during the three months ended September 30, 2014 compared to net realized gains of $27.5 million during the three months ended September 30, 2013, and higher net loss and loss expenses, including losses from catastrophes of $29.8 million. Income tax expense for the three months ended September 30, 2014 decreased by $3.4 million compared to the three months ended September 30, 2013. The decrease in income tax expense was primarily due to lower taxable income in our U.S. operations.

Comparison of Nine Months Ended September 30, 2014 and 2013

Premiums

Gross premiums written increased by $186.5 million, or 8.5%, for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. The overall increase in gross premiums written was primarily the result of the following:

- U.S. insurance: Gross premiums written increased by $126.1 million, or 14.5%. The increase in gross premiums written was primarily due to $45.2 million of new business growth during the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013, increased premiums on renewed business as well as premium rate increases across most lines of business. This was particularly evident in our general casualty, mergers and acquisitions, inland marine and environmental lines of business. This growth was partially offset by the non-renewal of business, particularly in certain classes within our healthcare line of business, that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions);
- International insurance: Gross premiums written increased by $29.1 million, or 6.4%. The increase was primarily due to continued growth from new initiatives and new lines of business. The professional liability line of business grew $17.1 million on new business writings in European E&O and mergers and acquisitions classes of business, and our aviation and marine cargo lines of business grew by $11.3 million. This growth was partially offset by the general casualty line of business, which decreased by $3.9 million compared to the prior period, due to non-recurring business written in 2013 and the non-renewal of certain policies during the current period, that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions); and
- Reinsurance: Gross premiums written increased by $31.4 million, or 3.7%. The increase was driven primarily by new business and increased renewals across several major lines of business. In our property reinsurance lines of business, premiums increased by approximately $16.8 million, which included $3.9 million of increased premiums from our collateralized property catastrophe reinsurance program through Aeolus Re, Ltd. ("Aeolus Re"). We also experienced non-renewals of certain treaties, particularly in our casualty reinsurance line of business, either due to poor terms and

conditions or the cedents not renewing their reinsurance.

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

	Nine Months Ended September 30,		Dollar	Percentage
	2014	2013	Change	Change
	($ in millions)			
United States	$1,447.7	$1,296.2	$151.5	11.7%
Bermuda	525.0	550.8	(25.8)	(4.7)%
Europe	245.9	198.7	47.2	23.8%
Asia Pacific	142.8	137.5	5.3	3.9%
Canada	8.3	—	8.3	n/a
	$2,369.7	$2,183.2	$186.5	8.5%

Net premiums written increased by $164.9 million, or 9.5%, for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. The increase in net premiums written was due to the increase in gross premiums written and a decrease in ceded premiums written related to our property catastrophe reinsurance protection. We ceded 20.1% of gross premiums written for the nine months ended September 30, 2014 compared to 20.8% for the same period in 2013.

Net premiums earned increased by $128.0 million, or 8.6%, for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013 as a result of higher premiums earned in each of our operating segments.

The following table illustrates the mix of our business on both a gross premiums written and net premiums earned basis.

	Gross Premiums Written Nine Months Ended September 30,		Net Premiums Earned Nine Months Ended September 30,	
	2014	2013	2014	2013
U.S. insurance	42.1%	39.9%	40.5%	40.0%
International insurance	20.4%	20.8%	16.9%	17.5%
Reinsurance	37.5%	39.3%	42.6%	42.5%
Total	100.0%	100.0%	100.0%	100.0%

Net Investment Income

Net investment income increased by $17.5 million, or 15.9%, for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. The increase was due to higher income across most asset classes. The annualized period book yield of the investment portfolio for the nine months ended September 30, 2014 and 2013 was 2.0% and 1.8%, respectively.

Investment management expenses of $13.7 million and $12.2 million were incurred during the nine months ended September 30, 2014 and 2013, respectively. The increase of $1.5 million, or 12.3%, was primarily due to additional investment portfolio managers utilized in the current period as compared to the prior period.

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Realized Investment Gains (Losses)

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

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
	($ in millions)	
Net realized gains on sale:		
Fixed maturity investments, trading	$23.6	$24.7
Equity securities, trading	43.8	30.1
Other invested assets: hedge funds and private equity, trading	53.2	16.8
Total net realized gains on sale	120.6	71.6
Net realized and unrealized (losses) gains on derivatives	(24.5)	3.4
Mark-to-market gains (losses):		
Fixed maturity investments, trading	18.0	(101.2)
Equity securities, trading	(8.8)	(18.6)
Other invested assets: hedge funds and private equity, trading	(1.1)	36.7
Total mark-to-market gains (losses)	8.1	(83.1)
Net realized investment gains (losses)	$104.2	$(8.1)

The total return of our investment portfolio was 2.7% and 1.2% for the nine months ended September 30, 2014 and 2013, respectively. The increase in total return was primarily due mark-to-market gains on our fixed maturity investments due to lower interest rates and tighter credit spreads during the nine months ended September 30, 2014 compared to mark-to-market losses due to higher rates during the nine months ended September 30, 2013. Equity securities and other invested assets continued to have a positive impact on the total return for the both the nine months ended September 30, 2014 and 2013. The realized and unrealized losses on derivatives for the nine months ended September 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, we recorded a loss related to these interest rate future and swap contracts.

Other Income

Other income represents the revenue of our third-party claims administration services that we acquired in the current year.

Net Losses and Loss Expenses

Net losses and loss expenses increased by $118.9 million, or 14.7%, for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. The following is a breakdown of the loss and loss expense ratio for the nine months ended September 30, 2014 and 2013:

	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		Dollar Change	Loss Ratio Percentage Point Change
	Amount	% of NPE (1)	Amount	% of NPE (1)		
			($ in millions)			
Non-catastrophe	$1,024.1	63.7 %				