

Allied World Assurance Co Holdings, AG  
Form 10-K  
February 29, 2012  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**Form 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-32938

**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**

*(Exact Name of Registrant as Specified in Its Charter)*

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

**Lindenstrasse 8 6340 Baar Zug, Switzerland**

**98-0681223**  
*(I.R.S. Employer  
Identification No.)*

# Edgar Filing: Allied World Assurance Co Holdings, AG - Form 10-K

(Address of Principal Executive Offices and Zip Code)

**41-41-768-1080**

(Registrant's Telephone Number, Including Area Code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Shares, par value CHF 14.03 per share	New York Stock Exchange, Inc.

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

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

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

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

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

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

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

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

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

The aggregate market value of voting and non-voting common shares held by non-affiliates of the registrant as of June 30, 2011 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$2.1 billion based on the closing sale price of the registrant's common shares on the New York Stock Exchange on that date.

As of February 21, 2012, 36,835,178 common shares were outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

The registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A with respect to the annual general meeting of the shareholders of the registrant scheduled to be held on May 3, 2012 is incorporated in Part III of this Form 10-K.

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**PART I**

*References in this Annual Report on Form 10-K to the terms we, us, our, the company or other similar terms mean the consolidated operations of Allied World Assurance Company Holdings, AG, a Swiss holding company, and our consolidated subsidiaries, unless the context requires otherwise. References in this Form 10-K to the terms Allied World Switzerland or Holdings means only Allied World Assurance Company Holdings, AG. References to our insurance subsidiaries may include our reinsurance subsidiaries. References in this Form 10-K to \$ are to the lawful currency of the United States and to CHF are to the lawful currency of Switzerland. References in this Form 10-K to Holdings common shares means its registered voting shares and non-voting participation certificates. For your convenience, we have included a glossary beginning on page 53 of selected insurance and reinsurance terms.*

**Item 1. Business.**

**Overview**

We are a Swiss-based specialty insurance and reinsurance company that underwrites a diversified portfolio of property and casualty lines of business through offices located in Bermuda, Hong Kong, Ireland, Singapore, Switzerland, the United Kingdom and the United States. For the year ended December 31, 2011, our U.S. insurance, international insurance and reinsurance segments accounted for 43.2%, 27.4% and 29.4%, respectively, of our total gross premiums written of \$1,939.5 million. As of December 31, 2011, we had \$11,122.2 million of total assets and \$3,149.0 million of shareholders' equity.

We were formed in Bermuda in 2001, and we redomesticated to Switzerland in December 2010, at which time Holdings became the ultimate parent company of Allied World Assurance Company Holdings, Ltd, the former publicly-traded Bermuda holding company (Allied World Bermuda) and its subsidiaries. Since our formation, we have focused primarily on the direct insurance markets. We offer our clients and producers significant capacity in both the direct property and casualty insurance markets as well as in the reinsurance market. We have expanded since our formation and now have 16 offices located in seven different countries.

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

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

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

In early 2010, we received approval from Lloyd's of London (Lloyd's) to establish a syndicate at Lloyd's. Our new Lloyd's syndicate, Syndicate 2232, commenced underwriting in June 2010. Syndicate 2232 is managed by Capita Managing Agency Limited, a subsidiary of The Capita Group PLC, which is authorized by the

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Financial Services Authority in the United Kingdom (the FSA ). In July 2010, we received approval from the Monetary Authority of Singapore and Lloyd's Asia to register and operate a service company, Capita 2232 Services Pte. Ltd. As part of the Lloyd's Asia platform, the service company underwrites exclusively on behalf of Syndicate 2232. Syndicate 2232, via the service company, offers a broad range of insurance and reinsurance treaty products from Singapore, including property, casualty and specialty lines, to clients in the Asia Pacific, Middle East and Africa regions.

### ***Available Information***

We maintain a website at [www.awac.com](http://www.awac.com). The information on our website is not incorporated by reference in this Annual Report on Form 10-K.

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

### ***Our Strategy***

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

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

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

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

Our premium revenues are generated by operations conducted from our corporate headquarters in Switzerland and our other offices in Bermuda, Europe, Hong Kong, Singapore and the United States. For information concerning our gross premiums written by geographic location of underwriting office, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Comparison of Years Ended December 31, 2011 and 2010 and Comparison of Years Ended December 31, 2010 and 2009.

**Table of Contents****Our Operating Segments**

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

The gross premiums written in each segment for the years ended December 31, 2011, 2010 and 2009 were as follows:

Operating Segments	Year Ended December 31, 2011		Year Ended December 31, 2010		Year Ended December 31, 2009	
	Gross Premiums Written		Gross Premiums Written		Gross Premiums Written	
	\$(In millions)	% of Total	\$(In millions)	% of Total	\$(In millions)	% of Total
U.S. insurance	\$ 838.6	43.2	\$ 729.3	41.5	\$ 674.8	39.8
International insurance	530.4	27.4	504.9	28.7	555.9	32.8
Reinsurance	570.5	29.4	524.2	29.8	465.6	27.4
Total	\$ 1,939.5	100.0%	\$ 1,758.4	100.0%	\$ 1,696.3	100.0%

**U.S. Insurance Segment****General**

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

The chart below illustrates the breakdown of the company's U.S. direct insurance gross premiums written by line of business for the year ended December 31, 2011.

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### ***Products and Customer Base***

Our casualty operations in the United States focus on insurance products providing coverage for specialty type risks, such as professional liability, environmental liability, product liability, inland marine liability and healthcare liability risks, and we offer commercial general liability products as well. Professional liability products include policies covering directors and officers, employment practices and fiduciary liability insurance. We also offer a diverse mix of errors and omissions liability coverages for a variety of service providers, including law firms, technology companies, insurance companies, insurance agents and brokers, and municipalities. We regularly assess our product mix, and we evaluate new products and markets where we believe our underwriting and service will allow us to differentiate our offerings. During the year ended December 31, 2011, our professional liability business accounted for 28.1%, or \$235.4 million, of our total gross premiums written in the U.S. insurance segment.

We also provide both primary and excess liability and other casualty coverages to the healthcare industry, including hospitals and hospital systems, managed care organizations and medical facilities such as home care providers, specialized surgery and rehabilitation centers, and outpatient clinics. Our healthcare operations in the U.S. target small- and middle-market accounts. During the year ended December 31, 2011, our healthcare business accounted for 24.0%, or \$201.7 million, of our total gross premiums written in the U.S. insurance segment.

In late 2009, we commenced writing environmental liability business by offering a line of environmental casualty products covering the pollution and related liability exposures of general contractors, tank installers, remediation contractors and others. During 2011, we commenced writing inland marine business. During the year ended December 31, 2011, these lines of business accounted for approximately 3.6%, or \$30.6 million, of our total gross premiums written in the U.S. insurance segment.

With respect to general casualty products, we provide both primary and excess liability coverage, and our focus is on complex risks in a variety of industries including construction, real estate, public entities, retailers, manufacturing, transportation, and finance and insurance services. We also offer comprehensive insurance to contractors and their employees working outside of the United States on contracts for agencies of the U.S. government or foreign operations of U.S. companies. During the year ended December 31, 2011, our general casualty business accounted for 24.5%, or \$205.3 million, of our total gross premiums written in the U.S. insurance segment.

Our U.S. property insurance operations provide direct coverage of physical property and business interruption coverage for commercial property risks. We write solely commercial coverages and concentrate our efforts on primary risk layers of insurance (as opposed to excess layers), offering meaningful but limited capacity in these layers. This means that we are typically part of the first group of insurers that cover a loss up to a specified limit. Our underwriters are spread among our locations in the United States because we believe it is important to be physically present in the major insurance markets where we compete for business.

We offer general property products from our underwriting platforms in the United States, and cover risks for retail chains, real estate, manufacturers, hotels and casinos, and municipalities. During the year ended December 31, 2011, our general property business accounted for 9.4%, or \$78.5 million, of our total gross premiums written in the U.S. insurance segment.

We currently have a total of six insurance programs in the United States, offering a variety of products including professional liability, excess casualty and primary general liability. We retain responsibility for administration of claims, although we may opt to outsource claims in selected situations. Before we enter into a program administration relationship, we analyze historic loss data associated with the program business and perform a diligence review of the administrator's underwriting, financial condition and information technology. In selecting program administrators, we consider the integrity, experience and reputation of the program administrator, the availability of reinsurance and the potential profitability of the business. In order to assure the continuing integrity of the underwriting and related business operations in our program business, we conduct additional reviews and audits of the program administrator on an ongoing basis. To help align our interests with those of our program administrators, we seek to set up incentive-based compensation to encourage better long-

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term underwriting results as a component of their fees. During the year ended December 31, 2011, our program business accounted for 10.4%, or \$87.1 million, of our total gross premiums written in the U.S. insurance segment.

For more information concerning our gross premiums written by line of business in our U.S. insurance segment, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations U.S. Insurance Segment Comparison of Years Ended December 31, 2011 and 2010 and Comparison of Years Ended December 31, 2010 and 2009.

### ***Distribution***

Within our U.S. insurance segment, insurance policies are placed through a network of over 200 insurance intermediaries, including excess and surplus lines wholesalers and regional and national retail brokerage firms. A subset of these intermediaries also access certain of our U.S. casualty products via our proprietary *i-bind* platform that allows for accelerated quote and bind capabilities through the Internet. Marsh & McLennan Companies, Inc. ( Marsh ) accounted for approximately 10% of gross premiums written in this segment during 2011.

### **International Insurance Segment**

#### ***General***

The international insurance segment includes our direct insurance operations outside of the United States. It includes our operations in Bermuda, Europe and Asia. Our Bermuda operations underwrite primarily larger, Fortune 1000 casualty and property risks for accounts domiciled in North America. Our Bermuda and European operations have entered into a relationship with Latin American Underwriters to offer trade credit and political risk coverages primarily for clients doing business in Latin America and the Caribbean. Our insurance operations in Europe, with offices in Dublin, London and Switzerland, have focused on mid-sized to large European and multi-national companies domiciled outside of North America, and we are also diversifying into insurance products for smaller commercial clients. In addition, Syndicate 2232 offers select product lines including international property, general casualty, healthcare and professional liability, targeted at key territories such as countries in Latin America and the Asia Pacific region. The international insurance segment also encompasses our offices in Asia that were opened in 2009, including our Hong Kong and Singapore offices and Lloyd's Asia, which underwrite a variety of primary and excess professional liability lines and general casualty and healthcare insurance products. Our staff in the international insurance segment is spread among our locations in Bermuda, Europe and Asia because we believe it is important that our underwriters be physically present in the major insurance markets around the world where we compete for business.

The chart below illustrates the breakdown of the company's international insurance gross premiums written by line of business for the year ended December 31, 2011.



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### ***Products and Customer Base***

The casualty business within our international insurance segment offers both primary and excess coverage, with the latter focused primarily on insuring excess layers, with a median attachment point of \$80 million for large and Fortune 1000 accounts that constitute our core casualty accounts in this segment. Our international insurance segment utilizes significant gross limit capacity. Our focus with respect to general casualty products is on complex risks in a variety of industries, including manufacturing, energy, chemicals, transportation, real estate, consumer products, medical and healthcare services and construction. During the year ended December 31, 2011, our general casualty business accounted for 24.0%, or \$127.2 million, of our total gross premiums written in the international insurance segment.

We provide professional liability products such as directors and officers, employment practices, fiduciary and errors and omissions liability insurance. We offer a diverse mix of coverages for a number of industries including law firms, technology companies, financial institutions, insurance companies and brokers, manufacturing and energy, and engineering and construction firms. During the year ended December 31, 2011, our professional liability business accounted for 31.0%, or \$164.4 million, of our total gross premiums written in the international insurance segment.

Our healthcare underwriters provide risk transfer products to numerous healthcare institutions, such as hospitals, managed care organizations and healthcare systems. During the year ended December 31, 2011, our healthcare business accounted for 12.8%, or \$68.1 million, of our total gross premiums written in the international insurance segment.

We offer general property products from our underwriting platforms in Bermuda and Europe. Our international property insurance operations provide direct coverage of physical property and business interruption coverage for commercial property risks. We write solely commercial coverages and focus on the insurance of the primary risk layer. The types of commercial property risks we cover include retail chains, real estate, manufacturers, hotels and casinos. During the year ended December 31, 2011, our general property business (including energy lines) accounted for 30.1%, or \$159.4 million, of our total gross premiums written in the international insurance segment.

In 2010, we commenced writing trade credit insurance by offering short- and medium-term credit insurance for clients that export to and from Latin America and the Caribbean. During the year ended December 31, 2011, our trade credit business accounted for 2.1%, or \$11.3 million, of our total gross premiums written in the international insurance segment.

Because of the large limits we often deploy for casualty and property business written in the international insurance segment, we utilize both facultative and treaty reinsurance to reduce our net exposure. For more information on the reinsurance we purchase for the property and casualty business written in international insurance segment, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Ceded Reinsurance. For more information on our gross premiums written by line of business in our international insurance segment, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations International Insurance Segment Comparison of Years Ended December 31, 2011 and 2010 and Comparison of Years Ended December 31, 2010 and 2009.

### ***Distribution***

With regard to our international insurance segment, we utilize our relationships with insurance intermediaries as our principal method for obtaining business. Our international insurance segment maintains significant relationships with Marsh, Aon Corporation (Aon) and Willis Group Holdings (Willis), which accounted for 30%, 26% and 12%, respectively, of our gross premiums written in this segment during 2011.

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### **Reinsurance Segment**

#### ***General***

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

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

We determine appropriate pricing either by using pricing models built or approved by our actuarial staff or by relying on established pricing set by one of our pricing actuaries for a specific treaty. Pricing models are generally used for facultative reinsurance, property catastrophe reinsurance, property per risk reinsurance and workers compensation and personal accident catastrophe reinsurance. Other types of reinsurance rely on actuarially-established pricing. During the year ended December 31, 2011, our reinsurance segment generated gross premiums written of \$570.5 million. On a written basis, our business mix is more heavily weighted to reinsurance during the first three months of the year. Our reinsurance segment operates from our offices in Bermuda, London, New York, Singapore and Switzerland.

The chart below illustrates the breakdown of the company's reinsurance gross premiums written by line of business for the year ended December 31, 2011.

#### ***Product Lines and Customer Base***

Property, general casualty, professional liability and international treaty reinsurance is the principal source of revenue for this segment. The insurers we reinsure range from single state to nationwide insurers located in the United States as well as specialty carriers or the specialty divisions of standard lines carriers. For our international treaty unit, our clients include multi-national insurers, single territory insurers, niche carriers and Lloyd's syndicates. We focus on niche programs and coverages, frequently sourced from excess and surplus lines insurers. In October 2008, we expanded our international reach by opening a branch office in Switzerland that offers property, general casualty and professional liability products throughout Europe. A large portion of this business is now being written by Allied World Assurance Company, AG, our Swiss licensed insurance and reinsurance company. Syndicate 2232 also offers international treaty reinsurance. During 2009, we expanded our reinsurance operations both in Asia, where we opened a branch office in Singapore that serves as the company's hub for all classes of treaty reinsurance business for the region, and in the United States, where we added a property underwriting team to our reinsurance platform. In December 2010, we expanded our specialty reinsurance offerings by launching a marine and specialty division. We target a portfolio of well-rated companies

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that are highly knowledgeable in their product lines, have the financial resources to execute their business plans and are committed to underwriting discipline throughout the underwriting cycle.

Our North American property reinsurance treaties protect insurers who write residential, commercial and industrial accounts where the exposure to loss is chiefly North American. We emphasize monoline, per risk accounts, which are structured as either quota share or excess-of-loss reinsurance. Monoline reinsurance applies to one kind of coverage, and per risk reinsurance coverage applies to a particular risk (for example a building and its contents), rather than on a per accident, event or aggregate basis. Where possible, coverage is provided on a losses occurring basis, which limits coverage to property losses occurring within the treaty year. We selectively write industry loss warranties where we believe market opportunities justify the risks. During the year ended December 31, 2011, our property treaty business accounted for 26.8%, or \$153.1 million, of our total gross premiums written in the reinsurance segment.

Our North American general casualty business writes both treaty and facultative business. Our North American general casualty treaties cover working layer, intermediate layer and catastrophe exposures. We sell both quota share and excess-of-loss reinsurance. We principally underwrite general liability, auto liability and commercial excess and umbrella liability for both admitted and non-admitted companies. Our general casualty facultative business is principally comprised of lower-attachment, individual-risk reinsurance covering automobile liability, general liability and workers compensation risks for many of the largest U.S. property-casualty and surplus lines insurers. During the year ended December 31, 2011, our North American general casualty business accounted for 25.0%, or \$142.8 million, of our total gross premiums written in the reinsurance segment.

Our North American professional liability treaties cover several products, primarily directors and officers liability, but also attorneys malpractice, medical malpractice, miscellaneous professional classes and transactional risk liability. The complex exposures undertaken by this unit demand highly technical underwriting and pricing modeling analysis. During the year ended December 31, 2011, our professional liability treaty business accounted for 10.0%, or \$57.2 million, of our total gross premiums written in the reinsurance segment.

Our international treaty unit's portfolio protects U.K. insurers, including Lloyd's of London syndicates and Continental European companies. While we continue to concentrate on Euro-centric business, we are now writing and will increasingly expand our capabilities outside of Europe, including in Asia and Latin America. During the year ended December 31, 2011, the international treaty unit accounted for 26.9%, or \$153.2 million, of our total gross premiums written in the reinsurance segment.

For our specialty reinsurance business, we underwrite accident and health business, emphasizing catastrophe personal accident programs and workers compensation catastrophe business. Our marine and specialty division offers reinsurance for marine, aerospace and crop risks on a global basis. During the year ended December 31, 2011, our specialty reinsurance business accounted for 11.3%, or \$64.2 million, of our total gross premiums written in the reinsurance segment.

For more information on our gross premiums written by line of business in our reinsurance segment, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Reinsurance Segment Comparison of Years Ended December 31, 2011 and 2010 and Comparison of Years Ended December 31, 2010 and 2009.

***Distribution***

Due to a number of factors, including transactional size and complexity, the distribution infrastructure of the reinsurance marketplace is characterized by relatively few intermediary firms. As a result, we have close business relationships with a small number of reinsurance intermediaries, and our reinsurance segment business during 2011 was primarily with affiliates of Marsh, Aon and Willis accounting for 36%, 32% and 15%, respectively, of total gross premiums written in this segment during 2011. Due to the substantial percentages of premiums produced in our U.S. insurance, international insurance and reinsurance segments by the top three intermediaries, the loss of business from any one of them could have a material adverse effect on our business.

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### ***Security Arrangements***

Allied World Assurance Company, Ltd, our Bermuda insurance and reinsurance company, is not admitted as an insurer nor is it accredited as a reinsurer in any jurisdiction in the United States. As a result, it is generally required to post collateral security with respect to any reinsurance liabilities it assumes from ceding insurers domiciled in the United States in order for U.S. ceding companies to obtain credit on their U.S. statutory financial statements with respect to insurance liabilities ceded by them. Under applicable statutory provisions, the security arrangements may be in the form of letters of credit, reinsurance trusts maintained by trustees or funds-withheld arrangements where assets are held by the ceding company. For a description of the security arrangements used by us, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Restrictions and Specific Requirements.

### **Enterprise Risk Management**

#### ***General***

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

protect our capital position,

ensure that our assumed risks (individually and in the aggregate) are within our firm-wide risk appetite,

maximize our risk-adjusted returns on capital, and

manage our earnings volatility.

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

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

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

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

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

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

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



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

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

### ***Underwriting Risk Management***

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

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

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

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

## **Competition**

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

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

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

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### Our Financial Strength Ratings

Ratings are an important factor in establishing the competitive position of insurance and reinsurance companies. A.M. Best, Moody's and Standard & Poor's have each developed a rating system to provide an opinion of an insurer's or reinsurer's financial strength and ability to meet ongoing obligations to its policyholders. Each rating reflects the rating agency's opinion of the capitalization, management and sponsorship of the entity to which it relates, and is neither an evaluation directed to investors in our common shares nor a recommendation to buy, sell or hold our common shares. A.M. Best ratings currently range from A++ (Superior) to F (In Liquidation) and include 16 separate ratings categories. Moody's maintains a letter scale rating from Aaa (Exceptional) to C (Lowest-rated) and includes 21 separate ratings categories. Standard & Poor's maintains a letter scale rating system ranging from AAA (Extremely Strong) to R (under regulatory supervision) and includes 21 separate ratings categories. Our principal operating subsidiaries and their respective ratings from A.M. Best, Moody's and Standard & Poor's are provided in the table below.

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

(1) Third highest of 16 available ratings from A.M. Best.

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

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

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

### Reserve for Losses and Loss Expenses

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





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

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

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

	2001	2002	2003	2004	2005	Year Ended December 31, 2006 2007		2008(1)	2009	2010	2011
	(\$ in thousands)										
<b>As Originally Estimated:</b>	\$ 213	\$ 310,508	\$ 1,062,138	\$ 2,084,331	\$ 3,543,811	\$ 3,900,546	\$ 4,307,637	\$ 4,576,828	\$ 4,761,772	\$ 4,879,188	\$ 5,225,143
<b>Liability Re-estimated as of</b>											
One Year Later	213	253,691	981,713	1,961,172	3,403,274	3,622,721	3,484,894	4,290,335	4,329,254	4,557,847	
Two Years Later	213	226,943	899,176	1,873,599	3,249,263	3,247,858	3,149,303	3,877,832	3,975,195		
Three Years Later	213	217,712	845,162	1,733,707	2,894,460	2,911,300	2,791,110	3,576,846			
Four Years Later	213	199,860	810,183	1,513,697	2,558,600	2,605,761	2,533,557				
Five Years Later	213	205,432	704,666	1,306,220	2,315,913	2,432,597					
Six Years Later	213	196,495	626,818	1,235,604	2,190,495						
Seven Years Later	213	179,752	619,903	1,207,675							
Eight Years Later	213	184,107	618,248								
Nine Years Later	213	184,104									
Ten Years Later	213										
<b>Cumulative (Redundancy)</b>		(126,404)	(443,890)	(876,656)	(1,353,316)	(1,467,949)	(1,774,080)	(999,982)	(786,577)	(321,341)	
<b>Cumulative Claims Paid as of:</b>											
One Year Later		54,288	138,843	374,605	718,263	560,163	583,447	574,823	634,463	656,568	
Two Years Later		83,465	237,949	574,399	1,154,901	1,002,503	943,879	1,089,540	1,036,171		
Three Years Later		100,978	301,264	725,955	1,521,586	1,252,921	1,311,398	1,391,252			
Four Years Later	18	124,109	372,187	842,931	1,662,811	1,531,899	1,469,345				
Five Years Later	18	163,516	425,394	910,393	1,828,977	1,622,539					

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Six Years Later	18	184,691	456,652	971,953	1,864,908
Seven Years Later	18	195,688	478,055	994,769	
Eight Years Later	18	201,516	499,459		
Nine Years Later	18	149,044			
Ten Years Later	18				

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

**Table of Contents****Development of Reserve for Losses and Loss Expenses****Cumulative Deficiency (Redundancy)****Gross Losses**

	Year Ended December 31,									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Liability Re-estimated as of:</b>										
One Year Later	100%	82%	92%	94%	96%	93%	81%	94%	91%	93%
Two Years Later	100%	73%	85%	90%	92%	83%	73%	85%	83%	
Three Years Later	100%	70%	80%	83%	82%	75%	65%	78%		
Four Years Later	100%	64%	76%	73%	72%	67%	59%			
Five Years Later	100%	66%	66%	63%	65%	62%				
Six Years Later	100%	63%	59%	59%	62%					
Seven Years Later	100%	58%	58%	58%						
Eight Years Later	100%	59%	58%							
Nine Years Later	100%	59%								
Ten Years Later	100%									
<b>Cumulative (Redundancy)</b>		(41)%	(42)%	(42)%	(38)%	(38)%	(41)%	(22)%	(17)%	(7)%
<b>Gross Loss and Loss Expense</b>										
<b>Cumulative Paid as a Percentage of</b>										
<b>Originally Estimated Liability</b>										
<b>Cumulative Claims Paid as of:</b>										
One Year Later	0%	17%	13%	18%	20%	14%	14%	13%	13%	13%
Two Years Later	0%	27%	22%	28%	33%	26%	22%	24%	22%	
Three Years Later	0%	33%	28%	35%	43%	32%	30%	30%		
Four Years Later	8%	40%	35%	40%	47%	39%	34%			
Five Years Later	8%	53%	40%	44%	52%	42%				
Six Years Later	8%	59%	43%	47%	53%					
Seven Years Later	8%	63%	45%	48%						
Eight Years Later	8%	65%	47%							
Nine Years Later	8%	48%								
Ten Years Later	8%									

**Table of Contents****Losses Net of Reinsurance**

	2001	2002	2003	2004	2005	2006	2007	2008(1)	2009	2010	2011
<b>As Originally Estimated:</b>	\$ 213	\$ 299,946	\$ 967,305	\$ 1,809,588	\$ 2,826,930	\$ 3,211,441	\$ 3,624,872	\$ 3,688,514	\$ 3,841,781	\$ 3,951,600	\$ 4,222,224
<b>Liability Re-estimated as of:</b>											
One Year Later	213	243,129	887,870	1,760,469	2,662,723	2,978,320	3,312,248	3,440,522	3,528,426	3,698,072	
Two Years Later	213	216,381	833,496	1,655,675	2,551,946	2,699,585	3,032,063	3,128,342	3,255,966		
Three Years Later	213	207,945	773,967	1,551,115	2,281,007	2,416,966	2,742,484	2,882,645			
Four Years Later	213	191,471	746,355	1,353,988	1,986,782	2,152,221	2,518,524				
Five Years Later	213	197,656	648,469	1,162,263	1,776,483	1,997,008					
Six Years Later	213	188,733	574,803	1,098,702	1,663,577						
Seven Years Later	213	172,219	568,273	1,075,318							
Eight Years Later	213	176,582	566,975								
Nine Years Later	213	176,579									
Ten Years Later	213										
<b>Cumulative (Redundancy)</b>		(123,367)	(400,330)	(734,270)	(1,163,353)	(1,214,433)	(1,106,348)	(805,869)	(585,815)	(253,528)	
<b>Cumulative Claims Paid as of:</b>											
One Year Later		52,077	133,336	306,865	461,310	377,250	415,214	415,902	498,084	542,649	
Two Years Later		76,843	214,939	482,038	759,276	698,959	681,332	811,697	843,697		
Three Years Later		93,037	272,028	624,894	990,514	884,077	964,790	1,069,303			
Four Years Later	18	116,494	342,898	733,286	1,090,679	1,094,011	1,099,963				
Five Years Later	18	155,904	407,712	783,091	1,219,997	1,167,580					
Six Years Later	18	172,974	426,354	833,918	1,248,296						
Seven Years Later	18	176,390	440,812	851,312							
Eight Years Later	18	177,880	455,271								
Nine Years Later	18	141,507									
Ten Years Later	18										

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

**Table of Contents****Losses Net of Reinsurance**

	Year Ended December 31,									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Liability Re-estimated as of:</b>										
One Year Later	100%	81%	92%	97%	94%	93%	91%	93%	92%	94%
Two Years Later	100%	72%	86%	91%	90%	84%	84%	85%	85%	
Three Years Later	100%	69%	80%	86%	81%	75%	76%	78%		
Four Years Later	100%	64%	77%	75%	70%	67%	69%			
Five Years Later	100%	66%	67%	64%	63%	62%				
Six Years Later	100%	63%	59%	61%	59%					
Seven Years Later	100%	57%	59%	59%						
Eight Years Later	100%	59%	59%							
Nine Years Later	100%	59%								
Ten Years Later										
<b>Cumulative (Redundancy)</b>		(41)%	(41)%	(41)%	(41)%	(38)%	(31)%	(22)%	(15)%	(6)%
<b>Net Loss and Loss Expense</b>										
<b>Cumulative</b>										
<b>Paid as a Percentage of Originally</b>										
<b>Estimated Liability</b>										
<b>Cumulative Claims Paid as of:</b>										
One Year Later	0%	17%	14%	17%	16%	12%	11%	11%	13%	14%
Two Years Later	0%	26%	22%	27%	27%	22%	19%	22%	22%	
Three Years Later	0%	31%	28%	35%	35%	28%	27%	29%		
Four Years Later	8%	39%	35%	41%	39%	34%	30%			
Five Years Later	8%	52%	42%	43%	43%	36%				
Six Years Later	8%	58%	44%	46%	44%					
Seven Years Later	8%	59%	46%	47%						
Eight Years Later	8%	59%	47%							
Nine Years Later	8%	47%								
Ten Years Later	8%									

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The table below is a reconciliation of the beginning and ending liability for unpaid losses and loss expenses for the years ended December 31, 2011, 2010 and 2009. Losses incurred and paid are reflected net of reinsurance recoveries.

	Year Ended December 31,		
	2011	2010	2009
	(\$ in thousands)		
Gross liability at beginning of year	4,879,188	\$ 4,761,772	\$ 4,576,828
Reinsurance recoverable at beginning of year	(927,588)	(919,991)	(888,314)
Net liability at beginning of year	3,951,600	3,841,781	3,688,514
Net losses incurred related to:			
Commutation of variable-rated reinsurance contracts	11,529	8,864	
Current year	1,201,155	1,012,374	852,052
Prior years	(253,528)	(313,355)	(247,992)
Total incurred	959,156	707,883	604,060
Net paid losses related to:			
Current year	142,162	98,646	42,320
Prior years	542,649	498,084	415,901
Total paid	684,811	596,730	458,221
Foreign exchange revaluation	(3,721)	(1,334)	7,428
Net liability at end of year	4,222,224	3,951,600	3,841,781
Reinsurance recoverable at end of year	1,002,919	927,588	919,991
Gross liability at end of year	\$ 5,225,143	\$ 4,879,188	\$ 4,761,772

**Investments*****Investment Strategy and Guidelines***

We believe that we follow a conservative investment strategy designed to emphasize the preservation of our invested assets and provide adequate liquidity for the prompt payment of claims. To help ensure adequate liquidity for payment of claims, we take into account the maturity and duration of our investment portfolio and our general liability profile. In making investment decisions, we consider the impact of various catastrophic events to which we may be exposed. Our portfolio therefore consists primarily of investment grade, fixed-maturity securities of short-to-medium term duration. As of December 31, 2011, these securities, along with cash and cash equivalents, represented 83% of our total investments and cash and cash equivalents, with the remainder invested in non-investment grade securities and loans, equities, hedge funds and other alternative investments. Our current Investment Policy Statement contains restrictions on the maximum amount of our investment portfolio that may be invested in alternative investments (such as hedge funds and private equity vehicles) as well as a minimum amount that must be maintained in investment grade fixed income securities and cash.

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

Our investment performance is subject to a variety of risks, including risks related to general economic conditions, market volatility, interest rate fluctuations, liquidity risk and credit and default risk. Investment guideline restrictions have been established in an effort to minimize the effect of these risks but may not always be effective due to factors beyond our control. Interest rates are highly sensitive to many factors, including





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governmental monetary and fiscal policies, domestic and international economic and political conditions and other factors beyond our control. A significant increase in interest rates could result in significant losses, realized or unrealized, in the value of our investment portfolio. Similarly, given our portfolio's exposure to credit assets, a significant increase in credit spreads could result in significant losses to our investment portfolio. Additionally, with respect to some of our investments, we are subject to prepayment and therefore reinvestment risk. Alternative investments, such as our hedge fund and private equity investments, subject us to restrictions on sale, transfer and redemption, which may limit our ability to withdraw funds or realize gains on such investments for some period of time after our initial investment. The values of, and returns on, such investments may also be more volatile.

## **Investment Committee and Investment Managers**

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

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

## **Our Portfolio**

### ***Composition as of December 31, 2011***

As of December 31, 2011, we had total investments and cash and cash equivalents of \$8.1 billion, including restricted cash, fixed-maturity securities and hedge fund and private equity investments. The average credit quality of our investments is rated AA- by Standard & Poor's and Aa3 by Moody's. Short-term instruments must be rated a minimum of A-1, F-1 or P-1 by Standard & Poor's, Moody's or Fitch. The target duration range was 1.75 to 4.25 years. The portfolio has a total return rather than income orientation. As of December 31, 2011, the average duration of our investment portfolio was 1.9 years and there were approximately \$14.5 million of net unrealized gains in the portfolio, net of applicable tax.

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The following table shows the types of securities in our portfolio, their fair market values, average rating and portfolio percentage as of December 31, 2011.

Type of Investment	As of December 31, 2011		
	Fair Value	Average Rating (\$ in thousands)	Portfolio Percentage
Cash and cash equivalents	\$ 716,604	AAA	8.8%
U.S. government securities	1,087,633	AA+	13.4%
U.S. government agencies	224,262	AA+	2.7%
Non-U.S. government securities	256,756	AAA	3.2%
Mortgage-backed securities:			
Agency mortgage-backed securities	1,183,893	AA+	14.6%
Non-agency residential mortgage-backed securities	120,345	A+	1.5%
Non-agency residential mortgage-backed securities-non-investment grade strategy	182,482	CCC	2.3%
Commercial mortgage-backed securities	331,371	AAA	4.1%
Total mortgage-backed securities	1,818,091		22.5%
Corporate securities:			
Financial Institutions	1,179,391	A+	14.5%
Industrials	1,064,813	BBB	13.1%
Utilities	187,177	BBB+	2.3%
Total corporate securities	2,431,381		29.9%
Asset-backed securities:			
Credit card receivables	44,424	AAA	0.5%
Automobile loan receivables	73,226	AAA	0.9%
Student loan receivables	178,898	AA+	2.2%
Collateralized loan obligations	139,678	AA+	1.7%
Other	76,972	AAA	0.9%
Total asset-backed securities	513,198		6.2%
State, municipalities and political subdivisions	167,381	AA-	2.1%
Hedge funds	431,544	N/A	5.3%
Private equity	108,865	N/A	1.4%
Equity securities	367,483	N/A	4.5%
Total investment portfolio	\$ 8,123,198		100.0%

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

**Table of Contents****Ratings as of December 31, 2011**

The investment ratings (provided by Standard & Poor's and Moody's) for fixed maturity securities held as of December 31, 2011 and the percentage of our total fixed maturity securities they represented on that date were as follows:

	Fair Value (\$ in millions)	Percentage of Total Fair Value
<b>Ratings</b>		
U.S. government and government agencies	\$ 1,311.9	20.2%
AAA/Aaa	1,336.2	20.6%
AA/Aa	1,656.9	25.4%
A/A	1,148.1	17.7%
BBB/Baa	565.1	8.7%
BB	168.1	2.6%
B/B	103.3	1.6%
CCC+ and below	209.1	3.2%
Total	\$ 6,498.7	100.0%

**Maturity Distribution as of December 31, 2011**

The maturity distribution for our fixed maturity securities held as of December 31, 2011 was as follows:

	Fair Value (\$ in millions)	Percentage of Total Fair Value
<b>Maturity</b>		
Due within one year	\$ 661.6	10.2%
Due after one year through five years	2,686.1	41.3%
Due after five years through ten years	725.5	11.2%
Due after ten years	94.2	1.4%
Mortgage-backed	1,818.1	28.0%
Asset backed	513.2	7.9%
Total	\$ 6,498.7	100.0%

**Investment Returns for the Year Ended December 31, 2011**

Our investment returns for year ended December 31, 2011:

Net investment income	\$ 195.9
Net realized investment gains	10.1
Net change in unrealized gains	(45.7)

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Total net investment return	\$ 160.3
Total financial statement portfolio return(1)	2.0%
Effective annualized yield(2)	2.5%

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

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

### **Our Principal Operating Subsidiaries**

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

We write insurance in the United States primarily through four subsidiaries, Allied World Assurance Company (U.S.) Inc. and Allied World National Assurance Company, which we acquired in July 2002, and Darwin National Assurance Company and Darwin Select Insurance Company, which we acquired in October 2008. These companies are authorized or eligible to write insurance on both a surplus lines and admitted basis throughout the United States. In February 2008, we also acquired Allied World Reinsurance Company, through which we write our U.S. reinsurance business.

The activities of AWAC Services Company (Bermuda), Ltd, AWAC Services Company (Ireland) Limited and AWAC Services Company are limited to providing certain administrative services to various subsidiaries of Holdings. During 2010, we formed a new subsidiary, 2232 Services Limited, in the United Kingdom in order to administratively support the operations of Syndicate 2232 at Lloyd s.

### **Our Employees**

As of February 21, 2012, we had a total of 702 full-time employees, of which 128 worked in Bermuda, 467 in the United States, 82 in Europe, and 25 in Hong Kong and Singapore. We believe that our employee relations are good. No employees are subject to collective bargaining agreements.

### **Regulatory Matters**

#### ***General***

The business of insurance and reinsurance is regulated in most countries, although the degree and type of regulation varies significantly from one jurisdiction to another. Our insurance and reinsurance subsidiaries are required to comply with a wide variety of laws and regulations applicable to insurance and reinsurance companies, both in the jurisdictions in which they are organized and where they sell their insurance and reinsurance products. The insurance regulatory environment has become subject to increased scrutiny in many jurisdictions globally.

#### ***Switzerland***

Allied World Assurance Company, AG obtained its license from FINMA in March 2011 and is approved to carry on insurance and reinsurance business in specific lines of non-life business. Allied World Assurance

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Company, AG is required to comply with the Federal Insurance Supervision Act (the ISA), the Federal Insurance Supervision Ordinance and regulations and guidance issued by FINMA. The following are some significant aspects of the Swiss regulatory framework:

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

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

*Swiss Solvency Test (the SST):* The SST is similar in nature to the methodology that will be applied under the E.U.'s Solvency II regime. Under this approach, capital adequacy is achieved if risk bearing capital exceeds the required solvency capital. The SST model involves a more sophisticated analysis by providing for a market-consistent valuation of all assets and liabilities of the firm with a methodological approach to risk categories (insurance risk, credit risk etc.) subjecting them to scenario stress tests at a basic level in the context of the use of a standard regulatory model or internal model validated by FINMA.

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

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

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

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

### ***Bermuda***

The Insurance Act 1978 of Bermuda and related regulations, as amended (the Insurance Act), regulates the insurance and reinsurance business of Allied World Assurance Company, Ltd. The Insurance Act provides that no person may carry on any insurance business in or from within Bermuda unless registered as an insurer by the Bermuda Monetary Authority (the BMA). Allied World Assurance Company, Ltd has been registered as a Class 4 insurer by the BMA and approved to carry on general insurance and reinsurance business. Allied World Assurance Company Holdings, Ltd and Allied World Assurance Holdings (Ireland) Ltd are holding companies and AWAC Services (Bermuda), Ltd is a services company that do not carry on any insurance or reinsurance business, and as such each is not subject to Bermuda insurance regulations; however, like all Bermuda companies, they are subject to the provisions and regulations of the Companies Act 1981 of Bermuda, as amended (the Companies Act). The Insurance Act imposes solvency and liquidity standards and auditing and reporting requirements on Bermuda insurance and reinsurance companies and grants the BMA powers to supervise, investigate, require information and the production of documents and intervene in the affairs of these companies.

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

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

*Eligible Capital.* Allied World Assurance Company, Ltd is now required to disclose the makeup of its capital in accordance with the recently introduced three-tiered capital system. Under this system, all of the insurer's capital instruments will be classified as either basic or ancillary capital, which in turn will be classified into one of three tiers based on their loss absorbency characteristics. Highest quality capital will be classified tier 1 capital, lesser quality capital will be classified as either tier 2 capital or tier 3 capital. Under this regime, not less than 80% of tier 1 capital and up to 20% of tier 2 capital may be used to support the company's minimum solvency margin. Thereafter, a minimum of 60% of tier 1 capital and a maximum of 15% of tier 3 capital may be used to satisfy the company's enhanced capital requirement. Any combination of tier 1, 2 or 3 capital may be used to meet the total capital level.

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

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

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

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

*Group Supervision.* In 2011, the BMA notified Allied World Assurance Company, Ltd that it intended to act as group supervisor of our insurance and reinsurance companies and that Allied World Assurance Company, Ltd had been designated as the designated insurer in respect thereof. In accordance with the Group Supervision and Insurance Group Solvency Rules that came into effect on January 16, 2012, Allied World Assurance Company, Ltd is now required to prepare and submit annual audited group U.S. GAAP financial statements, annual group statutory financial statements, an annual group statutory financial return, an annual group capital and solvency return and quarterly group unaudited financial returns. Enhanced group capital requirements will come into effect in 2013.

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

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

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

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

***Ireland***

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

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

***United States***

Our U.S. insurance and reinsurance subsidiaries are admitted or surplus line eligible in all 50 states and the District of Columbia. Allied World Assurance Company (U.S.) Inc. is admitted in three states, including Delaware, its state of domicile, surplus lines eligible in 49 jurisdictions, including the District of Columbia and Puerto Rico, and an accredited reinsurer in 38 jurisdictions, including the District of Columbia. Allied World National Assurance Company is admitted in 43 jurisdictions, including New Hampshire, its state of domicile, surplus lines eligible in three states and an accredited reinsurer in one state. Allied World Reinsurance Company is admitted to write insurance and reinsurance in all 50 states, including New Hampshire, its state of domicile, and the District of Columbia. Darwin National Assurance Company is domiciled in Delaware and admitted to write in all other U.S. jurisdictions except Arkansas. Darwin Select Insurance Company, which is an Arkansas company, is admitted in that state and is an eligible surplus lines writer in all other states and the District of Columbia, and Vantapro Specialty Insurance Company, which is an inactive Arkansas company, is currently admitted only in Arkansas and Illinois.



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

*Holding Company Regulation.*  Our U.S. insurance subsidiaries are subject to regulation under the insurance holding company laws of certain states. The insurance holding company laws and regulations vary by state, but generally require admitted insurers that are subsidiaries of insurance holding companies to register and file with state regulatory authorities certain reports including information concerning their capital structure, ownership, financial condition and general business operations. Generally, all transactions involving the insurers in a holding company system and their affiliates must be fair and, if material, require prior notice and approval or non-disapproval by the state insurance department.

State insurance holding company laws typically place limitations on the amounts of dividends or other distributions payable by insurers. These limitations vary by state, but generally are based on statutory surplus, statutory net income and investment income. Delaware allows us to pay ordinary dividends without the prior approval of its insurance commissioner so long as the dividend is paid out of earned surplus (as defined under Delaware law). New Hampshire requires 15 days notice to its insurance commissioner prior to paying an ordinary dividend, provided that our surplus with regard to policyholders following such dividend payment would be adequate and could not lead to a hazardous financial condition. Arkansas allows us to pay ordinary dividends upon ten business days prior notice to its insurance commissioner. For extraordinary dividends, each state requires 30 days prior notice to and non-disapproval of its insurance commissioner before being declared. An extraordinary dividend generally includes any dividend whose fair market value together with that of other dividends or distributions made within the preceding 12 months exceeds the greater of: (1) 10% of the insurer's surplus as regards policyholders as of December 31 of the prior year, or (2) the net income of the insurer, not including realized capital gains, for the 12-month period ending December 31 of the prior year, but does not include pro rata distributions of any class of the insurer's own securities.

State insurance holding company laws also require prior notice and state insurance department approval of changes in control of an insurer or its holding company. Under the insurance laws of Delaware, New Hampshire and Arkansas, any beneficial owner of 10% or more of the outstanding voting securities of an insurance company or its holding company is presumed to have acquired control, unless this presumption is rebutted.

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

*Involuntary Pools.*  In the states where they are admitted, our insurance subsidiaries are also required to participate in various involuntary assigned risk pools, principally involving workers compensation and automobile insurance, which provide various insurance coverages to individuals or other entities that otherwise are unable to purchase such coverage in the voluntary market. Participation in these pools in most states is generally in proportion to voluntary writings of related lines of business in that state.

*Risk-Based Capital.*  U.S. insurers are also subject to risk-based capital (or RBC) guidelines that provide a method to measure the total adjusted capital (statutory capital and surplus plus other adjustments) of insurance

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companies taking into account the risk characteristics of the company's investments and products. The RBC formulas establish capital requirements for four categories of risk: asset risk, insurance risk, interest rate risk and business risk. As of December 31, 2011, we believe all of our U.S. insurance and reinsurance subsidiaries had adjusted capital in excess of amounts requiring company or regulatory action.

*NAIC Ratios.* The National Association of Insurance Commissioners (NAIC) Insurance Regulatory Information System, or IRIS, was developed to help state regulators identify companies that may require special attention. IRIS is comprised of statistical and analytical phases consisting of key financial ratios whereby financial examiners review annual statutory basis statements and financial ratios. Each ratio has an established usual range of results and assists state insurance departments in executing their statutory mandate to oversee the financial condition of insurance companies. As of December 31, 2011, we do not believe that any of our U.S. insurance and reinsurance subsidiaries had an IRIS ratio range warranting any regulatory action.

*Surplus Lines Regulation.* The regulation of our U.S. subsidiaries' excess and surplus lines insurance business differs significantly from their regulation as admitted or authorized insurers. These companies are subject to the surplus lines regulation and reporting requirements of the jurisdictions in which they are eligible to write surplus lines insurance. Allied World Assurance Company (U.S.) Inc. and Darwin Select Insurance Company, which conduct business on a surplus lines basis in a particular state, are generally exempt from that state's guaranty fund laws and from participation in its involuntary pools. Although surplus lines business is generally less regulated than the admitted market, strict regulations apply to surplus lines placements under the laws of every state, and the regulation of surplus lines insurance may undergo changes in the future. Federal and/or state measures may be introduced and promulgated that would result in increased oversight and regulation of surplus lines insurance.

***Lloyd's of London***

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

*Lloyd's intervention powers.* As a member of Lloyd's, Allied World Capital (Europe) Limited is obliged to comply with Lloyd's bye laws and regulations (made pursuant to the Lloyd's Acts 1871 to 1982) and applicable provisions of the Financial and Services and Markets Act 2000 (the FSMA). The Council of Lloyd's has wide discretionary powers to regulate members' underwriting at Lloyd's and its exercise of these powers might affect the return on an investment of the corporate member in a given underwriting year.

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

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

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

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member has surplus funds at Lloyd's. Lloyd's approval is also required before any person can acquire control of a Lloyd's managing agent or Lloyd's corporate member.

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

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

### ***Asia***

In March 2009, Allied World Assurance Company, Ltd received regulatory approval from the Office of the Insurance Commissioner in Hong Kong to operate as a branch office from which it conducts general insurance business in certain specified classes under Section 8 of the Insurance Companies Ordinance.

In December 2009, Allied World Assurance Company, Ltd received regulatory approval from the Monetary Authority of Singapore to operate a branch office from which it conducts general insurance and reinsurance business under Section 8 of the Insurance Act.

In July 2011, Allied World Assurance Company, Ltd received regulatory approval from the Labuan Financial Services Authority to operate a branch office from which it underwrites treaty reinsurance and long-tail facultative business from within Labuan, the Malaysian financial district.

### **Item 1A. Risk Factors.**

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

#### **Risks Related to Our Company**

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

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

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

Additionally, it is common for our reinsurance contracts to contain terms that would allow the ceding companies to cancel the contract for the portion of our obligations if our insurance subsidiaries are downgraded below an A- by either A.M. Best or Standard & Poor's. Whether a ceding company would exercise the cancellation right (and, in the case of Allied World Reinsurance Company, as described in the paragraph below, the right to require the posting of security) would depend, among other factors, on the reason for such

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downgrade, the extent of the downgrade, the prevailing market conditions and the pricing and availability of replacement reinsurance coverage. Therefore, we cannot predict in advance the extent to which these rights would be exercised, if at all, or what effect any such cancellations or security postings would have on our financial condition or future operations, but such effect could be material.

For example, if all ceding companies for which we have in force business as of December 31, 2011 were to exercise their cancellation rights or require the posting of security, the estimated impact could result in the return of premium, the commutation of loss reserves, the posting of collateral or a combination thereof. The unearned premium and reserve for losses and loss expenses associated with our reinsurance segment was \$306.5 million and \$1,313.7 million at December 31, 2011, respectively.

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

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

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

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

Our success depends on our ability to accurately assess the risks associated with the businesses that we insure and reinsure. We establish loss reserves to cover our estimated liability for the payment of all losses and loss expenses incurred with respect to the policies we write. Loss reserves do not represent an exact calculation of liability. Rather, loss reserves are estimates of what we expect the ultimate resolution and administration of claims will cost. These estimates are based on actuarial and statistical projections and on our assessment of currently available data, as well as estimates of future trends in claims severity and frequency, judicial theories of liability and other factors. Loss reserve estimates are refined as experience develops and claims are reported and resolved. Establishing an appropriate level of loss reserves is an inherently uncertain process. It is therefore possible that our reserves at any given time will prove to be inadequate.

To the extent we determine that actual losses or loss expenses exceed our expectations and reserves reflected in our financial statements, we will be required to increase our reserves to reflect our changed expectations. This could cause a material increase in our liabilities and a reduction in our profitability, including operating losses and a reduction of capital. Our results for the year ended December 31, 2011 included \$157.9 million and \$95.6 million of favorable (i.e., a loss reserve decrease) and adverse development (i.e., a loss reserve increase), respectively, of reserves relating to losses incurred for prior loss years. In comparison, our results for the year-ended December 31, 2010 included \$369.8 million and \$56.4 million of favorable and adverse development, respectively, of reserves relating to losses incurred for prior loss years. Our results for the year ended December 31, 2009 included \$376.9 million and \$128.9 million of favorable and adverse development, respectively, of reserves relating to losses incurred for prior loss years.

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

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

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

The loss limitation methods we employ, such as establishing maximum aggregate exposed limits on policies written in key coastal and other defined geographical zones, restrictive underwriting guidelines and purchasing reinsurance, may not be sufficient protection against losses from catastrophes. In the event we do not accurately estimate losses from catastrophes that have already occurred, there is a possibility that loss reserves for such catastrophes will be inadequate to cover the losses. Because U.S. GAAP does not permit insurers and reinsurers to reserve for catastrophes until they occur, claims from these events could cause substantial volatility in our financial results for any fiscal quarter or year and could have a material adverse effect on our financial condition and results of operations. In addition, losses from catastrophic events could result in downward revisions to our financial strength ratings from the various rating agencies that cover us.

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

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

### ***We may be adversely impacted by inflation.***

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

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### ***We could face losses from terrorism and political unrest.***

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

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

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

### ***We could face losses from pandemic diseases.***

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

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

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

The perceived effects of climate change on debt obligations can impact our investment mix in any one issuer, industry or region. The largest per-issuer exposure, outside of government and government-related issuers, represented less than 1% of our investment portfolio and the largest ten exposures represented less than 6% of the portfolio.

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

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

***A prolonged recession and other adverse consequences as a result of the turmoil in the U.S. and international financial markets could harm our business, liquidity and financial condition, and our share price.***

The U.S. and international financial markets have been severely disrupted. Recent U.S. debt ceiling and budget deficit concerns, together with signs of deteriorating sovereign debt conditions in Europe have increased the possibility of economic slowdowns. Although U.S. lawmakers passed legislation to raise the federal debt ceiling, Standard & Poor's lowered its long-term sovereign credit rating on the United States from AAA to AA+ in August 2011. These conditions, including the possibility of a prolonged recession, may potentially affect various aspects of our business, including the demand for and claims made under our products, our counterparty credit risk and the ability of our customers, counterparties and others to establish or maintain their relationships with us, our ability to access and efficiently use internal and external capital resources and our investment performance. Continued volatility in the U.S. and other securities markets may also adversely affect our share price.

***We may be impacted from claims relating to the financial market turmoil, including subprime and other credit and insurance exposures, beyond our current estimates.***

We write corporate directors and officers, errors and omissions and other insurance coverages for financial institutions and financial services companies. We also write liability coverages for fiduciaries of pension funds. In addition, we also reinsure other insurance companies that write these types of coverages. The financial institutions and financial services segment has been particularly impacted by the financial market turmoil. As a result, this industry segment has been the subject of heightened scrutiny and in some cases investigations by regulators with respect to the industry's actions as they relate to subprime mortgages, collateralized debt obligations, structured investment vehicles, swap and derivative transactions and executive compensation. During this time, a number of U.S. and international financial institutions, insurance companies and other companies have failed, been acquired under distressed circumstances, become reliant upon the central governments of their jurisdictions for financial assistance to remain solvent and/or suffered significant declines in their stock price. Fraud or other claims may be made against financial institutions and members of other industries, including the insurance industry. These events may give rise to increased bankruptcies and increased litigation, including class action suits, which may involve our insureds. To the extent we have claims relating to these events, it could cause substantial volatility in our financial results and could have a material adverse effect on our financial condition and results of operations.

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

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

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

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

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

Allied World Assurance Company, Ltd, our Bermuda insurance and reinsurance company, is not admitted as an insurer, nor is it accredited as a reinsurer, in any jurisdiction in the United States. As a result, it is required to post collateral security with respect to any reinsurance liabilities it assumes from ceding insurers domiciled in the United States in order for U.S. ceding companies to obtain credit on their U.S. statutory financial statements with respect to the insurance liabilities ceded to them. Under applicable statutory provisions, the security arrangements may be in the form of letters of credit, reinsurance trusts maintained by trustees or funds-withheld arrangements where assets are held by the ceding company. Allied World Assurance Company, Ltd uses trust accounts and has access to up to \$1.7 billion in letters of credit under two letter of credit facilities. The letter of credit facilities impose restrictive covenants, including restrictions on asset sales, limitations on the incurrence of certain liens and required collateral and financial strength levels. Violations of these or other covenants could result in the suspension of access to letters of credit or such letters of credit becoming due and payable. Our access to our existing letter of credit facilities is dependent on the ability of the banks that are parties to these facilities to meet their commitments. Our \$900 million letter of credit facility with Citibank Europe plc is on an uncommitted basis, which means Citibank Europe has agreed to offer us up to \$900 million in letters of credit, but they are not contractually obligated for that full amount. Our \$800 million syndicated letter of credit facility expires in November 2012. The lenders under our letter of credit facilities may not be able to meet their commitments if they become insolvent, file for bankruptcy protection or if they otherwise experience shortages of capital and liquidity. If these letter of credit facilities are not sufficient or drawable or if Allied World Assurance Company, Ltd is unable to renew either or both of these facilities or to arrange for trust accounts or other types of security on commercially acceptable terms, its ability to provide reinsurance to U.S.-domiciled insurers may be severely limited and adversely affected.

In addition, security arrangements with ceding insurers may subject our assets to security interests or may require that a portion of our assets be pledged to, or otherwise held by, third parties. Although the investment



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income derived from our assets while held in trust typically accrues to our benefit, the investment of these assets is governed by the terms of the letter of credit facilities and the investment regulations of the state of domicile of the ceding insurer, which generally regulate the amount and quality of investments permitted and which may be more restrictive than the investment regulations applicable to us under Bermuda law. These restrictions may result in lower investment yields on these assets, which could adversely affect our profitability.

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

We market our insurance and reinsurance products worldwide through insurance and reinsurance brokers. For the year ended December 31, 2011, our top three brokers represented approximately 55% of our total gross premiums written. Marsh, Aon (including Benfield Group Ltd.) and Willis were responsible for the distribution of approximately 23%, 21% and 11%, respectively, of our total gross premiums written for the year ended December 31, 2011. Loss of all or a substantial portion of the business produced by any one of those brokers could have a material adverse effect on our financial condition, results of operations and business.

***Our reliance on brokers subjects us to their credit risk.***

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

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

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

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

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

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

Our investment portfolio is overseen by our Chief Investment Officer and managed by professional investment management firms in accordance with the Investment Policy Statement approved by the Investment

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

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

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

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

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

In addition, our investment portfolio includes U.S. government agency and non-agency commercial and residential mortgage-backed securities. As of December 31, 2011, mortgage-backed securities constituted approximately 23% of the fair value of our total investments and cash and cash equivalents, of which 15% of the fair value was invested in U.S. government agency mortgage-backed securities. Changes in interest rates can expose us to prepayment risks on these investments. In periods of declining interest rates, mortgage prepayments generally increase and mortgage-backed securities are generally prepaid more quickly, requiring us to reinvest the proceeds at the then current market rates. In periods of rising interest rates, mortgage-backed securities may have declining levels of prepayments, extending their maturity and duration, thereby negatively impacting the security's price.

Our non-agency commercial and residential mortgage-backed securities are subject to delinquencies, defaults and losses on the underlying mortgage loans. While many of the factors that led to such delinquencies,

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defaults and losses have moderated over the last 12 months, further deterioration is possible. Delinquencies, defaults and losses with regard to non-agency residential mortgage-backed securities are driven in part by residential property values. A decline or an extended flattening in property values may result in increased delinquencies, defaults and losses on residential mortgage loans generally, especially with respect to second homes and investor properties, and with respect to any residential mortgage loans where the aggregate loan amounts (including any subordinate loans) are close to or greater than the related property values. This would negatively impact the value of our securities. Additionally, as of December 31, 2011 commercial mortgage-backed securities constituted 4% of the fair value of our total investments and cash and cash equivalents. While delinquencies, defaults and losses have been slower to materialize in the commercial sector than in the residential sector, this market remains susceptible to price declines on the underlying properties based on local supply/demand factors as well as overall levels of economic activity. We continue to believe the risk is most acute in the commercial mortgage-backed securities offerings issued in 2007 and 2008. As of December 31, 2011, we had approximately \$37 million of exposure to commercial mortgage-backed securities transactions of the 2007 and 2008 vintage.

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

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

***The determination of the impairments taken on our investments is highly subjective and could materially impact our financial position or results of operations.***

The determination of the impairments taken on our investments varies by investment type and is based upon our periodic evaluations and assessments of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions change and new information becomes available. Management updates its evaluations quarterly and reflects impairments in operations as such evaluations are revised. There can be no assurance that our management has accurately assessed the level of impairments taken in our financial statements. Furthermore, additional impairments may need to be taken in the future, which could have a material adverse effect on our financial condition or results of operations. Historical trends may not be indicative of future impairments.

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

The U.S. dollar is our reporting currency and the functional currency of all of our operating subsidiaries. We enter into insurance and reinsurance contracts where the premiums receivable and losses payable are denominated in currencies other than the U.S. dollar. In addition, we maintain a portion of our investments and liabilities in currencies other than the U.S. dollar. Assets in non-U.S. currencies are generally converted into U.S. dollars at the time of receipt. When we incur a liability in a non-U.S. currency, we carry such liability on our books in the original currency. These liabilities are converted from the non-U.S. currency to U.S. dollars at the time of payment. We may incur foreign currency exchange gains or losses as we ultimately receive premiums and settle claims required to be paid in foreign currencies.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The par value of our common shares is CHF 14.03 per share (as may be adjusted in connection with the payment of dividends by virtue of a par value reduction, as approved by our shareholders). Under Swiss law, we may not issue shares below par value. In the event we need to raise common equity capital at a time when the trading price of our shares is below the par value of such shares, we will be unable to do so. As a consequence we would have to consider reducing the par value of our common shares, which in turn would reduce our ability to make tax-free distributions by par value reductions to our shareholders. We would also need to obtain approval of our shareholders to decrease the par value of our common shares, which would require us to file a proxy statement with the SEC and convene a meeting of shareholders. This would delay any capital raising plans and there is no assurance that we would be able to obtain such shareholder approval. See **Risks Related to Taxation**. We may not be able to make distributions or repurchase shares without subjecting you to Swiss withholding tax.

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

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

### ***We may become subject to additional Swiss regulation.***

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

## **Risks Related to the Insurance and Reinsurance Business**

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

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

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

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

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

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

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

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

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

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

### **Risks Related to Laws and Regulations Applicable to Us**

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

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

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

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

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

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

prescribe solvency standards that it must meet, and

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

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

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



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

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

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

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

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

Allied World Assurance Company, Ltd, our Bermuda operating company is not admitted as an insurer, nor accredited as a reinsurer, in any jurisdiction in the United States. For the year ended December 31, 2011, more than 72% of the gross premiums written by Allied World Assurance Company, Ltd, however, are derived from insurance or reinsurance contracts entered into with entities domiciled in the United States. The insurance laws of each state in the United States regulate the sale of insurance and reinsurance within the state's jurisdiction by foreign insurers. Allied World Assurance Company, Ltd conducts its business through its Bermuda office and does not maintain an office, and its personnel do not solicit insurance business, resolve claims or conduct other insurance business, in the United States. While Allied World Assurance Company, Ltd does not believe it is in violation of insurance laws of any jurisdiction in the United States, we cannot be certain that inquiries or challenges to our insurance and reinsurance activities will not be raised in the future. It is possible that, if Allied World Assurance Company, Ltd were to become subject to any laws of this type at any time in the future, we would not be in compliance with the requirements of those laws.

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

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

*Swiss Law*

Under Swiss law, dividends may be paid out only if we have sufficient distributable profits from previous fiscal years or if we have legal reserves, each as will be presented on Holdings' audited statutory financial statements prepared in accordance with Swiss law. Payments out of the share and participation capital (in other

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words, the aggregate par value of our share and participation capital) in the form of dividends are not allowed; however, payments out of share and participation capital may be made by way of a capital reduction to achieve a similar result as the payment of dividends. The affirmative vote of shareholders holding a majority of the votes cast at a shareholder meeting must approve reserve reclassifications and distributions of dividends. Our Board of Directors may propose to shareholders that a dividend be paid but cannot itself authorize the dividend. In addition, our shareholders may propose dividends without any dividend proposal by the Board of Directors. Under Swiss law, upon satisfaction of all legal requirements (including shareholder approval of a par value reduction as described in this proposal), we will be required to submit an application to the Swiss Commercial Register to register each applicable par value reduction. Without effective registration of the applicable par value reduction with the Swiss Commercial Register, we will not be able to proceed with the payment of any installment of any dividend. We cannot assure you that the Swiss Commercial Register will approve the registration of any applicable par value reduction.

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

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

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

*Bermuda Law*

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

Furthermore, in order to reduce its total statutory capital by 15% or more, Allied World Assurance Company, Ltd would require the prior approval of the BMA. In addition, Bermuda corporate law prohibits a company from declaring or paying a dividend if there are reasonable grounds for believing that (i) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (ii) the realizable value of the company's assets would thereby be less than the aggregate of its liabilities, its issued share capital and its share premium accounts.

*U.S. and Irish Law*

In addition, our U.S. and Irish insurance subsidiaries are subject to significant regulatory restrictions limiting their ability to declare and pay any dividends.

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In general, a U.S. insurance company subsidiary may not pay an extraordinary dividend or distribution until 30 days after the applicable insurance regulator has received notice of the intended payment and has not objected to, or has approved, the payment within the 30-day period. In general, an extraordinary dividend or distribution is defined by these laws and regulations as a dividend or distribution that, together with other dividends and distributions made within the preceding 12 months, exceeds the greater (or, in some jurisdictions, the lesser) of: (a) 10% of the insurer's statutory surplus as of the immediately prior year end; or (b) the statutory net income during the prior calendar year. The laws and regulations of some of these U.S. jurisdictions also prohibit an insurer from declaring or paying a dividend except out of its earned surplus. For example, payments of dividends by U.S. insurance companies are subject to restrictions on statutory surplus pursuant to state law. In addition, insurance regulators may prohibit the payment of ordinary dividends or other payments by our U.S. insurance subsidiaries (such as a payment under a tax sharing agreement or for employee or other services) if they determine that such payment could be adverse to such subsidiaries policyholders.

Without the consent of the CBI, Allied World Assurance Company (Europe) Limited and Allied World Assurance Company (Reinsurance) Limited are not permitted to reduce the level of their capital, may not make any dividend payments, may not make inter-company loans and must maintain a minimum solvency margin. These rules and regulations may have the effect of restricting the ability of these companies to declare and pay dividends.

In addition, we have insurance subsidiaries that are the parent company for other insurance subsidiaries, and dividends and other distributions are subject to multiple layers of the regulations discussed above as funds are pushed up to our ultimate parent company. The inability of any of our insurance subsidiaries to pay dividends in an amount sufficient to enable Allied World Assurance Company Holdings, AG to meet its cash requirements at the holding company level could have a material adverse effect on our business, our ability to transfer capital from one subsidiary to another and our ability to declare and pay dividends to our shareholders. Furthermore, Allied World Bermuda has senior notes outstanding. The inability of any of our insurance subsidiaries to pay dividends in an amount sufficient to enable Allied World Bermuda to make payments on the outstanding senior notes could have a material adverse effect on our business.

### ***In 2010, the U.S. Congress enacted healthcare reform legislation that could have a material impact on our business.***

Our U.S. insurance segment and our international insurance segment derive substantial revenues from healthcare liability underwriting in the United States, that is, providing insurance to individuals and institutions that participate in the U.S. healthcare delivery infrastructure. U.S. healthcare legislation in 2010 will effect far-reaching changes in the healthcare delivery system and the healthcare cost reimbursement structure in the United States and could negatively impact our healthcare liability business. Additionally, future healthcare proposals could include tort reform provisions under which plaintiffs would be restricted in their ability to bring suit against healthcare providers, which could negatively impact the demand for our healthcare liability products. While the impact of this healthcare legislation or future healthcare proposals on our business is difficult to predict, any material changes in how healthcare providers insure their malpractice liability risks could have a material adverse effect on our results of operations.

### ***In 2010, the U.S. Congress enacted the Dodd Frank Wall Street Reform and Consumer Protection Act ( Dodd-Frank Act ), which could have an impact on our business.***

The Dodd-Frank Act, which effects sweeping changes to financial services regulation in the United States, was enacted in July 2010. The Dodd-Frank Act establishes the Financial Services Oversight Council ( FSOC ) and the Federal Insurance Office ( FIO ) and in limited instances authorizes the federal preemption of certain state insurance laws. The FSOC and FIO are authorized to study, monitor and report to Congress on the U.S. insurance industry and the significance of global reinsurance to the U.S. insurance market. The potential impact of the Dodd-Frank Act on the U.S. insurance business is not clear; however, our business could be affected by changes to the U.S. system of insurance regulation or the designation of insurers or reinsurers with which we do business as systemically significant non-bank financial companies.

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*Other legislative, regulatory and industry initiatives could adversely affect our business.*

The insurance and reinsurance regulatory framework is subject to heavy scrutiny by U.S. federal and individual state governments as well as an increasing number of international authorities. Government regulators are generally concerned with the protection of policyholders to the exclusion of other constituencies, including shareholders. Governmental authorities in the United States and worldwide seem increasingly interested in the potential risks posed by the insurance industry as a whole, and to commercial and financial systems in general. While we do not believe these inquiries have identified meaningful, new risks posed by the insurance and reinsurance industry, and while we cannot predict the exact nature, timing or scope of possible governmental initiatives, there may be increased regulatory intervention in our industry in the future. For example, the U.S. federal government has increased its scrutiny of the insurance regulatory framework in recent years, and some state legislators have considered or enacted laws that will alter and likely increase state regulation of insurance and reinsurance companies and holding companies. Moreover, the NAIC, which is an association of the insurance commissioners of all 50 states and the District of Columbia and state insurance regulators, regularly reexamine existing laws and regulations.

For example, we could be adversely affected by proposals to:

provide insurance and reinsurance capacity in markets and to consumers that we target;

require our participation in industry pools and guaranty associations;

expand the scope of coverage under existing policies;

increasingly mandate the terms of insurance and reinsurance policies;

establish a new federal insurance regulator or financial industry systemic risk regulator;

revise laws and regulations under which we operate, including a potential change to U.S. tax laws to disallow or limit the current tax deduction for reinsurance premiums paid by our U.S. subsidiaries to our Bermuda insurance subsidiary for reinsurance protections it provides to our U.S. subsidiaries; or

disproportionately benefit the companies of one country over those of another.

With respect to international measures, an E.U. directive concerning the capital adequacy, risk management and regulatory reporting for insurers and reinsurers ( Solvency II ) which was adopted by the European Parliament in April 2009, may affect our insurance businesses. Implementation of Solvency II by E.U. member states is anticipated at the beginning of 2014. Implementing those measures necessary for compliance with the requirements of Solvency II may require us to utilize a significant amount of resources to ensure compliance. In addition, the capital and solvency margin requirements of Solvency II may lead to either an increase or decrease of the capital required by our E.U. domiciled insurers in order that they comply with Solvency II. Solvency II provides for the supervision of insurers and reinsurers on both a solo (entity level) and group basis. In respect of our non-E.U. subsidiaries engaging in E.U. insurance or reinsurance business, should the regulatory regime in which they are operating not be deemed equivalent to that established within the E.U. pursuant to Solvency II, additional capital requirements may be imposed in order that such companies may continue to insure or reinsure E.U. domiciled risk/cedents.

We are unable to predict the future impact on our operations of changes in the laws and regulations to which we are or may become subject. Moreover, our exposure to potential regulatory initiatives could be heightened by the fact that our principal insurance subsidiary is domiciled in, and operates exclusively from, Bermuda. For example, Bermuda, a small jurisdiction, may be disadvantaged in participating in global or cross-border regulatory matters as compared with larger jurisdictions such as the United States or the leading E.U. countries. In addition, Bermuda, which is currently an overseas territory of the United Kingdom, may consider changes to its relationship with the United Kingdom in the future. These changes could adversely affect Bermuda's position with respect to its regulatory initiatives, which could adversely impact us

commercially.

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***Changes in current accounting practices and future pronouncements may materially impact our reported financial results.***

Developments in accounting practices, for example a convergence of U.S. GAAP with International Financial Reporting Standards, or IFRS, may require considerable additional expense to comply with, particularly if we are required to prepare information relating to prior periods for comparison purposes or to apply the new requirements retroactively. The impact of changes in current accounting practices and future pronouncements cannot be predicted, but may affect the results of our operations, including among other things, the calculation of net income.

**Risks Related to Ownership of Our Common Shares**

***Future sales of our common shares may adversely affect the market price.***

As of February 21, 2012, we had 36,835,178 common shares outstanding. Up to an additional 2,607,942 common shares may be issuable upon the vesting and exercise of outstanding stock options, restricted stock units ( RSUs ) and performance-based equity awards. We have filed a registration statement on Form S-8 under the Securities Act of 1933, as amended (the Securities Act ) to register common shares issued or reserved for issuance under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2001 Employee Stock Option Plan, the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan, the Allied World Assurance Company Holdings, AG Third Amended and Restated Long-Term Incentive Plan (the LTIP ) and the Allied World Assurance Company Holdings, AG Amended and Restated 2008 Employee Share Purchase Plan. Subject to the exercise of issued and outstanding stock options, shares registered under the registration statement on Form S-8 will be available for sale to the public. We cannot predict what effect, if any, future sales of our common shares, or the availability of common shares for future sale, will have on the market price of our common shares. Sales of substantial amounts of our common shares in the public market, or the perception that sales of this type could occur, could depress the market price of our common shares and may make it more difficult for you to sell your common shares at a time and price that you deem appropriate.

***Our Articles of Association contain restrictions on voting, ownership and transfers of our common shares.***

Our Articles of Association generally provide that shareholders have one vote for each common share held by them and are entitled to vote at all meetings of shareholders. However, the voting rights exercisable by a shareholder may be limited so that certain persons or groups are not deemed to hold 10% or more of the voting power conferred by our common shares. Moreover, these provisions could have the effect of reducing the voting power of some shareholders who would not otherwise be subject to the limitation by virtue of their direct share ownership. Our Board of Directors may refuse to register holders of shares as shareholders with voting rights based on certain grounds, including if the holder would, directly or indirectly, formally, constructively or beneficially own (as described in Articles 8 and 14 of our Articles of Association) or otherwise control voting rights with respect to 10% or more of our registered share capital recorded in the Swiss Commercial Register. In addition, our Board of Directors shall reject entry of holders of voting shares as shareholders with voting rights in the share register or shall decide on their deregistration when the acquirer or shareholder upon request does not expressly state that it has acquired or holds the voting shares for its own account and benefit. Furthermore, our Board of Directors may cancel, with retroactive application, the registration of a shareholder with voting rights if the initial registration was on the basis of false information in the shareholder s application. Shareholders registered without voting rights may not participate in or vote at our shareholders meetings, but will be entitled to dividends, preemptive rights and liquidation proceeds. Only shareholders that are registered as shareholders with voting rights on the relevant record date are permitted to participate in and vote at a shareholders meeting.

***Anti-takeover provisions in our Articles of Association could impede an attempt to replace or remove our directors, which could diminish the value of our common shares.***

Our Articles of Association contain provisions that may entrench directors and make it more difficult for shareholders to replace directors even if the shareholders consider it beneficial to do so. In addition, these provisions could delay or prevent a change of control that a shareholder might consider favorable. For example,

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these provisions may prevent a shareholder from receiving the benefit from any premium over the market price of our shares offered by a bidder in a potential takeover. Even in the absence of an attempt to effect a change in management or a takeover attempt, these provisions may adversely affect the prevailing market price of our common shares if they are viewed as discouraging changes in management and takeover attempts in the future.

For example, the following provisions in our Articles of Association could have such an effect:

the election of our directors is staggered, meaning that members of only one of three classes of our directors are elected each year, thus limiting a shareholder's ability to replace directors;

shareholders whose shares represent 10% or more of our total voting shares will be reduced to less than 10% of the total voting power. Conversely, shareholders owning less than 10% of the total voting power may gain increased voting power as a result of these cutbacks;

our directors may decline the registration of a shareholder as a shareholder with voting rights in the share register if and to the extent such shareholder owns or otherwise controls alone or together with others 10% of our total voting rights or if such shareholder refuses to confirm to us that it has acquired the voting shares for its own account and benefit; and

at any time until November 30, 2012, our Board of Directors has the power to issue a number of voting shares up to 20% of our share capital registered in the Swiss Commercial Register and to limit or withdraw the preemptive rights of the existing shareholders in various circumstances.

***As a shareholder of our company, you may have greater difficulties in protecting your interests than as a shareholder of a U.S. corporation.***

Swiss law differs in material respects from laws generally applicable to U.S. corporations and their shareholders. Taken together with the provisions of our Articles of Association, some of these differences may result in your having greater difficulties in protecting your interests as a shareholder of our company than you would have as a shareholder of a U.S. corporation. This affects, among other things, the circumstances under which transactions involving an interested director are voidable, whether an interested director can be held accountable for any benefit realized in a transaction with our company, what approvals are required for business combinations by our company with a large shareholder or a wholly-owned subsidiary, what rights you may have as a shareholder to enforce specified provisions of Swiss corporate law or our Articles of Association, the rights of shareholders to bring class action and derivative lawsuits and the circumstances under which we may indemnify our directors and officers.

***It may be difficult to enforce service of process and enforcement of judgments against us and our officers and directors.***

Holdings is incorporated pursuant to the laws of Switzerland. In addition, certain of our directors and officers reside outside the United States, and all or a substantial portion of our assets and the assets of such persons are located in jurisdictions outside the United States. As such, it may be difficult or impossible to effect service of process within the United States upon us or those persons or to recover against us or them on judgments of U.S. courts, including judgments predicated upon civil liability provisions of the U.S. federal securities laws.

We have been advised by Swiss counsel, that there is doubt as to whether the courts in Switzerland would enforce judgments of U.S. courts obtained in actions against us or our directors and officers, predicated upon the civil liability provisions of the U.S. federal securities laws or original actions brought in Switzerland against us or such persons predicated solely upon U.S. federal securities laws. Further, we have been advised by Swiss counsel that there is no treaty in effect between the United States and Switzerland providing for the enforcement of judgments of U.S. courts. Some remedies available under the laws of U.S. jurisdictions, including some remedies available under the U.S. federal securities laws, may not be allowed in Swiss courts as contrary to that jurisdiction's public policy. Because judgments of U.S. courts are not automatically enforceable in Switzerland, it may be difficult for investors to recover against us based upon such judgments.

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### ***There are regulatory limitations on the ownership and transfer of our common shares.***

The BMA must approve all issuances and transfers of securities of our Bermuda exempted companies. Before any shareholder acquires 10% or more of the voting shares, either directly or indirectly, of any of our U.S. insurance subsidiaries, that shareholder must file an acquisition statement with and obtain prior approval from the domiciliary insurance commissioner of the respective company. Similar provisions apply to our Lloyd's corporate member. Any company or individual that, together with its or his associates, directly or indirectly acquires 10% or more of the shares in a Lloyd's corporate member or its parent company, or is entitled to exercise or control the exercise of 10% or more of the voting power in such Lloyd's corporate member or its parent company, would be considered to have acquired control for the purposes of the relevant legislation, as would a person who had significant influence over the management of such Lloyd's corporate member or its parent company by virtue of his shareholding or voting power in either. In such a case, the controlling entity would be required to provide notice to Lloyd's.

### **Risks Related to Taxation**

#### ***U.S. taxation of our non-U.S. companies could materially adversely affect our financial condition and results of operations.***

We believe that our non-U.S. companies, including our Swiss, Bermuda and Irish companies, have operated and will operate their respective businesses in a manner that will not cause them to be subject to U.S. tax (other than U.S. federal excise tax on insurance and reinsurance premiums and withholding tax on specified investment income from U.S. sources) on the basis that none of them are engaged in a U.S. trade or business. However, there are no definitive standards under current law as to those activities that constitute a U.S. trade or business and the determination of whether a non-U.S. company is engaged in a U.S. trade or business is inherently factual. Therefore, we cannot assure you that the U.S. Internal Revenue Service (the "IRS") will not contend that a non-U.S. company is engaged in a U.S. trade or business. If any of the non-U.S. companies are engaged in a U.S. trade or business and does not qualify for benefits under the applicable income tax treaty, such company may be subject to U.S. federal income taxation at regular corporate rates on its premium income from U.S. sources and investment income that is effectively connected with its U.S. trade or business. In addition, a U.S. federal branch profits tax at the rate of 30% may be imposed on the earnings and profits attributable to such income. All of the premium income from U.S. sources and a significant portion of investment income of such company, as computed under Section 842 of the Code, requiring that a foreign company carrying on a U.S. insurance or reinsurance business have a certain minimum amount of effectively connected net investment income, determined in accordance with a formula that depends, in part, on the amount of U.S. risks insured or reinsured by such company, may be subject to U.S. federal income and branch profits taxes.

If Allied World Assurance Company, Ltd, our Bermuda insurance subsidiary, or any Bermuda insurance subsidiary we form or acquire in the future is engaged in a U.S. trade or business and qualifies for benefits under the United States-Bermuda tax treaty, U.S. federal income taxation of such subsidiary will depend on whether (i) it maintains a U.S. permanent establishment and (ii) the relief from taxation under the treaty generally applies to non-premium income. We believe that our Bermuda insurance subsidiary has operated and will continue to operate its business in a manner that will not cause it to maintain a U.S. permanent establishment. However, the determination of whether an insurance company maintains a U.S. permanent establishment is inherently factual. Therefore, we cannot assure you that the IRS will not successfully assert that our Bermuda insurance subsidiary maintains a U.S. permanent establishment. In such case, our Bermuda insurance subsidiary will be subject to U.S. federal income tax at regular corporate rates and branch profit tax at the rate of 30% with respect to its income attributable to the permanent establishment. Furthermore, although the provisions of the treaty clearly apply to premium income, it is uncertain whether they generally apply to other income of a Bermuda insurance company. Therefore, if a Bermuda insurance subsidiary of our company qualifies for benefits under the treaty and does not maintain a U.S. permanent establishment but is engaged in a U.S. trade or business, and the treaty is interpreted not to apply to income other than premium income, such subsidiary will be subject to U.S. federal income and branch profits taxes on its investment and other non-premium income as described in the preceding paragraph. In addition, a Bermuda subsidiary will qualify for benefits under the treaty only if more than 50% of



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its shares are beneficially owned, directly or indirectly, by individuals who are Bermuda residents or U.S. citizens or residents. Our Bermuda subsidiaries may not be able to continually satisfy such beneficial ownership test or be able to establish it to the satisfaction of the IRS.

If any of our Swiss or Irish companies are engaged in a U.S. trade or business and qualify for benefits under the relevant income tax treaty with the United States, U.S. federal income taxation of such company will depend on whether it maintains a U.S. permanent establishment. We believe that each such company has operated and will continue to operate its business in a manner that will not cause it to maintain a U.S. permanent establishment. However, the determination of whether a non-U.S. company maintains a U.S. permanent establishment is inherently factual. Therefore, we cannot assure you that the IRS will not successfully assert that any of such companies maintains a U.S. permanent establishment. In such case, the company will be subject to U.S. federal income tax at regular corporate rates and branch profits tax at the rate of 5% with respect to its income attributable to the permanent establishment.

U.S. federal income tax, if imposed, will be based on effectively connected or attributable income of a non-U.S. company computed in a manner generally analogous to that applied to the income of a U.S. corporation, except that all deductions and credits claimed by a non-U.S. company in a taxable year can be disallowed if the company does not file a U.S. federal income tax return for such year. Penalties may be assessed for failure to file such return. None of our non-U.S. companies filed U.S. federal income tax returns for the 2002 and 2001 taxable years. However, we have filed protective U.S. federal income tax returns on a timely basis for each non-U.S. company for subsequent years in order to preserve our right to claim tax deductions and credits in such years if any of such companies is determined to be subject to U.S. federal income tax.

If any of our non-U.S. companies is subject to such U.S. federal taxation, our financial condition and results of operations could be materially adversely affected.

### ***Our U.S. subsidiaries may be subject to additional U.S. taxes in connection with our interaffiliate arrangements.***

Our U.S. subsidiaries reinsure a significant portion of their insurance policies with Allied World Assurance Company, Ltd. While we believe that the terms of these reinsurance arrangements are arm's length, we cannot assure you that the IRS will not successfully assert that the payments made by the U.S. subsidiaries with respect to such arrangements exceed arm's length amounts. In such case, our U.S. subsidiaries will be treated as realizing additional income that may be subject to additional U.S. income tax, possibly with interest and penalties. Such excess amount may also be deemed to have been distributed as dividends to the indirect parent of the U.S. subsidiaries, Allied World Assurance Holdings (Ireland) Ltd, in which case this deemed dividend will also be subject to a U.S. federal withholding tax of 5%, assuming that the parent is eligible for benefits under the United States-Ireland income tax treaty (or a withholding tax of 30% if the parent is not so eligible). If any of these U.S. taxes are imposed, our financial condition and results of operations could be materially adversely affected. In addition, if legislation is enacted in the U.S. that limits or eliminates our ability to enter into interaffiliate arrangements, our financial condition or results of operations could be materially adversely affected.

### ***We may not be able to make distributions or repurchase shares without subjecting you to Swiss withholding tax.***

If we are not successful in our efforts to make distributions, if any, through a reduction of par value or pay dividends out of qualifying additional paid-in-capital, then any dividends paid by us will generally be subject to a Swiss federal withholding tax at a rate of 35%. The withholding tax must be withheld from the gross distribution and paid to the Swiss Federal Tax Administration. A U.S. holder that qualifies for benefits under the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income may apply for a refund of the tax withheld in excess of the 15% treaty rate (or in excess of the 5% reduced treaty rate for qualifying corporate shareholders with at least 10% participation in our voting shares, or for a full refund in case of qualified pension funds). Payment of a capital distribution in the form of a par value reduction is not subject to Swiss withholding tax. However, there can be no assurance that our shareholders will approve a reduction in par value, that we will be able to meet the other legal requirements

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for a reduction in par value, or that Swiss withholding rules will not be changed in the future. In addition, over the long term, the amount of par value available for us to use for par value reductions will be limited. If we are unable to make a distribution through a reduction in par value or, pay a dividend out of qualifying additional paid-in-capital, we may not be able to make distributions without subjecting you to Swiss withholding taxes.

**The repurchase of our shares to be held in treasury will generally not be subject to Swiss withholding tax. However, under Swiss law, we are generally prohibited from holding in treasury an aggregate amount of voting shares and non-voting shares in excess of 10% of our aggregate share capital, which could limit our ability to repurchase our shares in the future.**

*You may be subject to U.S. income taxation with respect to income of our non-U.S. companies and ordinary income characterization of gains on disposition of our shares under the controlled foreign corporation ( CFC ) rules.*

Generally, each United States shareholder of a CFC will be subject to (i) U.S. federal income taxation on its ratable share of the CFC's subpart F income, even if the earnings attributable to such income are not distributed, provided that such United States shareholder holds directly or through non-U.S. entities shares of the CFC; and (ii) potential ordinary income characterization of gains from the sale or exchange of the directly owned shares of the non-U.S. corporation. For these purposes, any U.S. person who owns directly, through non-U.S. entities, or under applicable constructive ownership rules, 10% or more of the total combined voting power of all classes of stock of any non-U.S. company will be considered to be a United States shareholder. An insurance company is classified as a CFC only if its United States shareholders own 25% or more of the vote or value of its stock. Although our non-U.S. companies may be or become CFCs, for the following reasons we believe it is unlikely that any U.S. person holding our shares directly, or through non-U.S. entities, would be subject to tax as a United States shareholder.

First, although certain of our principal U.S. shareholders previously owned 10% or more of our common shares, no such shareholder currently owns more than 10%. We will be classified as a CFC only if United States shareholders own 25% or more of our stock; one United States shareholder alone will not be subject to tax on subpart F income unless that shareholder owns 25% or more of our stock or there is at least one other United States shareholder that in combination with the first United States shareholder owns 25% or more of our common stock. Second, our Articles of Association provide that no individual or legal entity may, directly or through Constructive Ownership (as defined in Article 14 of our Articles of Association) or otherwise control voting rights with respect to 10% or more of our registered share capital recorded in the Swiss Commercial Register and authorize our Board of Directors to refuse to register holders of shares as shareholders with voting rights under certain circumstances. We cannot assure you, however, that the provisions of the Articles of Association referenced in this paragraph will operate as intended or that we will be otherwise successful in preventing a U.S. person from exceeding, or being deemed to exceed, these voting limitations. Accordingly, U.S. persons who hold our shares directly or through non-U.S. entities should consider the possible application of the CFC rules.

*You may be subject to U.S. income taxation under the related person insurance income ( RPII ) rules.*

Our non-U.S. insurance and reinsurance subsidiaries may currently insure and reinsure and may continue to insure and reinsure directly or indirectly certain of our U.S. shareholders and persons related to such shareholders. We believe that U.S. persons that hold our shares directly or through non-U.S. entities will not be subject to U.S. federal income taxation with respect to the income realized in connection with such insurance and reinsurance prior to distribution of earnings attributable to such income either on the basis (i) that RPII, determined on a gross basis, realized by each non-U.S. insurance and reinsurance subsidiary will be less than 20% of its gross insurance income in each taxable year; or (ii) that at all times during the year U.S. insureds hold less than 20% of the combined voting power of all classes of our shares entitled to vote and hold less than 20% of the total value of our shares. However, the identity of all of our shareholders, as well as some of the factors that determine the extent of RPII in any period, may be beyond our knowledge or control. For example, we may be considered to insure indirectly the risk of our shareholder if an unrelated company that insured such risk in the first instance reinsures such risk with us. Therefore, we cannot assure you that we will be successful in keeping

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the RPII realized by the non-U.S. insurance and reinsurance subsidiaries or the ownership of us by U.S. insureds below the 20% limit in each taxable year. Furthermore, even if we are successful in keeping the RPII or the ownership of us by U.S. insureds below the 20% limit, we cannot assure you that we will be able to establish that fact to the satisfaction of the U.S. tax authorities. If we are unable to establish that the RPII of any non-U.S. insurance or reinsurance subsidiary is less than 20% of that subsidiary's gross insurance income in any taxable year, and no other exception from the RPII rules applies, each U.S. person who owns our shares, directly or through non-U.S. entities, on the last day of the taxable year will be generally required to include in its income for U.S. federal income tax purposes that person's ratable share of that subsidiary's RPII for the taxable year, determined as if that RPII were distributed proportionately to U.S. holders at that date, regardless of whether that income was actually distributed.

The RPII rules provide that if a holder who is a U.S. person disposes of shares in a foreign insurance corporation that has RPII (even if the amount of RPII is less than 20% of the corporation's gross insurance income and the ownership of us by U.S. insureds is below 20%) and in which U.S. persons own 25% or more of the shares, any gain from the disposition will generally be treated as a dividend to the extent of the holder's share of the corporation's undistributed earnings and profits that were accumulated during the period that the holder owned the shares (whether or not those earnings and profits are attributable to RPII). In addition, such a shareholder will be required to comply with specified reporting requirements, regardless of the amount of shares owned. These rules should not apply to dispositions of our shares because Allied World Assurance Company Holdings, AG is not itself directly engaged in the insurance business and these rules appear to apply only in the case of shares of corporations that are directly engaged in the insurance business. We cannot assure you, however, that the IRS will interpret these rules in this manner or that the proposed regulations addressing the RPII rules will not be promulgated in final form in a manner that would cause these rules to apply to dispositions of our shares.

***U.S. tax-exempt entities may recognize unrelated business taxable income ( UBTI ).***

A U.S. tax-exempt entity holding our shares generally will not be subject to U.S. federal income tax with respect to dividends and gains on our shares, provided that such entity does not purchase our shares with borrowed funds. However, if a U.S. tax-exempt entity realizes income with respect to our shares under the CFC or RPII rules, as discussed above, such entity will be generally subject to U.S. federal income tax with respect to such income as UBTI. Accordingly, U.S. tax-exempt entities that are potential investors in our shares should consider the possible application of the CFC and RPII rules.

***You may be subject to additional U.S. federal income taxation with respect to distributions on and gains on dispositions of our shares under the passive foreign investment company ( PFIC ) rules.***

We believe that U.S. persons holding our shares should not be subject to additional U.S. federal income taxation with respect to distributions on and gains on dispositions of shares under the PFIC rules. We expect that our insurance subsidiaries will be predominantly engaged in, and derive their income from the active conduct of, an insurance business and will not hold reserves in excess of reasonable needs of their business, and therefore qualify for the insurance exception from the PFIC rules. However, the determination of the nature of such business and the reasonableness of such reserves is inherently factual. Furthermore, we cannot assure you, as to what positions the IRS or a court might take in the future regarding the application of the PFIC rules to us. Therefore, we cannot assure you that we will not be considered to be a PFIC. If we are considered to be a PFIC, U.S. persons holding our shares could be subject to additional U.S. federal income taxation on distributions on and gains on dispositions of shares. Accordingly, each U.S. person who is considering an investment in our shares should consult his or her tax advisor as to the effects of the PFIC rules.

***Application of a published IRS Revenue Ruling with respect to our insurance or reinsurance arrangements can materially adversely affect us.***

The IRS published Revenue Ruling 2005-40 (the Ruling ) addressing the requirement of adequate risk distribution among insureds in order for a primary insurance arrangement to constitute insurance for U.S. federal income tax purposes. If the IRS successfully contends that our insurance or reinsurance arrangements, including

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such arrangements with affiliates of our principal shareholders, and with our U.S. subsidiaries, do not provide for adequate risk distribution under the principles set forth in the Ruling, we could be subject to material adverse U.S. federal income tax consequences.

*Our non-U.K. companies may be subject to U.K. tax, which may have a material adverse effect on our results of operations.*

Two of our subsidiaries, Allied World Capital (Europe) Limited and 2232 Services Limited, are incorporated in the United Kingdom and, are therefore, subject to tax in the United Kingdom. None of our other companies are incorporated in the United Kingdom. Accordingly, none of our other companies should be treated as being resident in the United Kingdom for corporation tax purposes unless the central management and control of any such company is exercised in the United Kingdom. The concept of central management and control is indicative of the highest level of control of a company, which is wholly a question of fact. Each of our companies currently intend to manage our affairs so that none of our other companies are resident in the United Kingdom for tax purposes.

The rules governing the taxation of foreign companies operating in the United Kingdom through a branch or agency were amended by the Finance Act 2003. The current rules apply to the accounting periods of non-U.K. resident companies which start on or after January 1, 2003. Accordingly, a non-U.K. resident company will only be subject to U.K. corporation tax if it carries on a trade in the United Kingdom through a permanent establishment in the United Kingdom. In that case, the company is, in broad terms, taxable on the profits and gains attributable to the permanent establishment in the United Kingdom. Broadly a company will have a permanent establishment if it has a fixed place of business in the United Kingdom through which the business of the company is wholly or partly carried on or if an agent acting on behalf of the company has and habitually exercises authority in the United Kingdom to do business on behalf of the company. Each of our companies, other than Allied World Assurance Company (Reinsurance) Limited and Allied World Assurance Company (Europe) Limited (which have established branches in the United Kingdom), currently intend to operate in such a manner so that none of our companies, other than Allied World Assurance Company (Reinsurance) Limited and Allied World Assurance Company (Europe) Limited, carry on a trade through a permanent establishment in the United Kingdom.

If any of our U.S. subsidiaries were trading in the United Kingdom through a branch or agency and the U.S. subsidiaries were to qualify for benefits under the applicable income tax treaty between the United Kingdom and the United States, only those profits which were attributable to a permanent establishment in the United Kingdom would be subject to U.K. corporation tax.

If Allied World Assurance Holdings (Ireland) Ltd was trading in the United Kingdom through a branch or agency and it was entitled to the benefits of the tax treaty between Ireland and the United Kingdom, it would only be subject to U.K. taxation on its profits which were attributable to a permanent establishment in the United Kingdom. The branches established in the United Kingdom by Allied World Assurance Company (Reinsurance) Limited and Allied World Assurance Company (Europe) Limited constitute a permanent establishment of those companies and the profits attributable to those permanent establishments are subject to U.K. corporation tax.

The United Kingdom has no income tax treaty with Bermuda.

There are circumstances in which companies that are neither resident in the United Kingdom nor entitled to the protection afforded by a double tax treaty between the United Kingdom and the jurisdiction in which they are resident may be exposed to income tax in the United Kingdom (other than by deduction or withholding) on income arising in the United Kingdom (including the profits of a trade carried on there even if that trade is not carried on through a branch agency or permanent establishment), but each of our companies currently operates in such a manner that none of our companies will fall within the charge to income tax in the United Kingdom (other than by deduction or withholding) in this respect.

If any of our non-U.K. companies were treated as being resident in the United Kingdom for U.K. corporation tax purposes, or if any of our companies, other than Allied World Assurance Company (Reinsurance) Limited and Allied World Assurance Company (Europe) Limited, were to be treated as carrying on a trade in the

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United Kingdom through a branch agency or of having a permanent establishment in the United Kingdom, our results of operations and your investment could be materially adversely affected.

*We may be subject to Irish tax, which may have a material adverse effect on our results of operations.*

Companies resident in Ireland are generally subject to Irish corporation tax on their worldwide income and capital gains. None of our companies, other than our Irish companies and Allied World Assurance Holdings (Ireland) Ltd, which resides in Ireland, should be treated as being resident in Ireland unless the central management and control of any such company is exercised in Ireland. The concept of central management and control is indicative of the highest level of control of a company, and is wholly a question of fact. Each of our companies, other than Allied World Assurance Holdings (Ireland) Ltd and our Irish companies, currently intend to operate in such a manner so that the central management and control of each of our companies, other than Allied World Assurance Holdings (Ireland) Ltd and our Irish companies, is exercised outside of Ireland. Nevertheless, because central management and control is a question of fact to be determined based on a number of different factors, the Irish Revenue Commissioners might contend successfully that the central management and control of any of our companies, other than Allied World Assurance Holdings (Ireland) Ltd or our Irish companies, is exercised in Ireland. Should this occur, such company will be subject to Irish corporation tax on their worldwide income and capital gains.

The trading income of a company not resident in Ireland for Irish tax purposes can also be subject to Irish corporation tax if it carries on a trade through a branch or agency in Ireland. Each of our companies currently intend to operate in such a manner so that none of our companies carry on a trade through a branch or agency in Ireland. Nevertheless, because neither case law nor Irish legislation definitively defines the activities that constitute trading in Ireland through a branch or agency, the Irish Revenue Commissioners might contend successfully that any of our companies, other than Allied World Assurance Holdings (Ireland) Ltd and our Irish companies, is trading through a branch or agency in Ireland. Should this occur, such companies will be subject to Irish corporation tax on profits attributable to that branch or agency.

If any of our companies, other than Allied World Assurance Holdings (Ireland) Ltd and our Irish companies, were treated as resident in Ireland for Irish corporation tax purposes, or as carrying on a trade in Ireland through a branch or agency, our results of operations and your investment could be materially adversely affected.

*If corporate tax rates in Ireland increase, our business and financial results could be adversely affected.*

Trading income derived from the insurance and reinsurance businesses carried on in Ireland by our Irish companies is generally taxed in Ireland at a rate of 12.5%. Over the past number of years, various E.U. Member States have, from time to time, called for harmonization of corporate tax rates within the E.U. Ireland, along with other member states, has consistently resisted any movement towards standardized corporate tax rates in the E.U. The Government of Ireland has also made clear its commitment to retain the 12.5% rate of corporation tax until at least the year 2025. Should, however, tax laws in Ireland change so as to increase the general corporation tax rate in Ireland, our results of operations could be materially adversely affected.

*If investments held by our Irish companies are determined not to be integral to the insurance and reinsurance businesses carried on by those companies, additional Irish tax could be imposed and our business and financial results could be adversely affected.*

Based on administrative practice, taxable income derived from investments made by our Irish companies is generally taxed in Ireland at the rate of 12.5% on the grounds that such investments either form part of the permanent capital required by regulatory authorities, or are otherwise integral to the insurance and reinsurance businesses carried on by those companies. Our Irish companies intend to operate in such a manner so that the level of investments held by such companies does not exceed the amount that is integral to the insurance and reinsurance businesses carried on by our Irish companies. If, however, investment income earned by our Irish companies exceeds these thresholds, or if the administrative practice of the Irish Revenue Commissioners changes, Irish corporation tax could apply to such investment income at a higher rate (currently 25%) instead of the general 12.5% rate, and our results of operations could be materially adversely affected.

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*We may become subject to taxes in Bermuda after March 31, 2035, which may have a material adverse effect on our results of operations and our investment.*

The Bermuda Minister of Finance, under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, has given our Bermuda subsidiaries an assurance that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax will not be applicable to such entities or their operations, shares, debentures or other obligations until March 31, 2035. Given the limited duration of the Minister of Finance's assurance, we cannot be certain that we will not be subject to any Bermuda tax after March 31, 2035.

**Item 1B. Unresolved Staff Comments.**

None.

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**GLOSSARY OF SELECTED INSURANCE AND OTHER TERMS**

<b>Admitted insurer</b>	An insurer that is licensed or authorized to write insurance in a particular state; to be distinguished from an insurer eligible to write excess and surplus lines insurance on risks located within a jurisdiction.
<b>Assumed reinsurance</b>	That portion of a risk that a reinsurer accepts from an insurer in return for a stated premium.
<b>Attachment point</b>	The loss point of which an insurance or reinsurance policy becomes operative and below which any losses are retained by either the insured or other insurers or reinsurers, as the case may be.
<b>Capacity</b>	The maximum percentage of surplus, or the dollar amount of exposure, that an insurer or reinsurer is willing or able to place at risk. Capacity may apply to a single risk, a program, a line of business or an entire book of business. Capacity may be constrained by legal restrictions, corporate restrictions or indirect restrictions.
<b>Case reserves</b>	Loss reserves, established with respect to specific, individual reported claims.
<b>Casualty lines</b>	Insurance that is primarily concerned with losses due to injuries to persons and liability imposed on the insured for such injury or for damage to the property of others.
<b>Catastrophe exposure or event</b>	A severe loss, typically involving multiple claimants. Common perils include earthquakes, hurricanes, tsunamis, hailstorms, severe winter weather, floods, fires, tornadoes, explosions and other natural or man-made disasters. Catastrophe losses may also arise from acts of war, acts of terrorism and political instability.
<b>Catastrophe reinsurance</b>	A form of excess-of-loss reinsurance that, subject to a specified limit, indemnifies the ceding company for the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event. The actual reinsurance document is called a catastrophe cover. These reinsurance contracts are typically designed to cover property insurance losses but can be written to cover other types of insurance losses such as workers compensation policies.
<b>Cede, cedent, ceding company</b>	When an insurer transfers some or all of its risk to a reinsurer, it cedes business and is referred to as the ceding company or cedent.
<b>Commercial coverage</b>	Insurance products that are sold to entities and individuals in their business or professional capacity, and which are intended for other than the insured's personal or household use.

**Deductible**

The amount of exposure an insured retains on any one risk or group of risks. The term may apply to an insurance policy, where the insured is an individual or business, or a reinsurance contract, where the insured is an insurance company. See Retention.

**Direct insurance**

Insurance sold by an insurer that contracts directly with the insured, as distinguished from reinsurance.



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<b>Directors and officers liability</b>	Insurance that covers liability for corporate directors and officers for wrongful acts, subject to applicable exclusions, terms and conditions of the policy.
<b>Earned premiums or Premiums earned</b>	That portion of premiums written that applies to the expired portion of the policy term. Earned premiums are recognized as revenues under both statutory accounting practice and U.S. GAAP.
<b>Employment practices liability insurance</b>	Insurance that primarily provides liability coverage to organizations and their employees for losses arising from acts of discrimination, harassment and retaliation against current and prospective employees of the organization.
<b>Excess and surplus lines</b>	A risk or a part of a risk for which there is no insurance market available among admitted insurers; or insurance written by non-admitted insurance companies to cover such risks.
<b>Excess layer</b>	Insurance to cover losses in one or more layers above a certain amount with losses below that amount usually covered by the insured's primary policy and its self-insured retention.
<b>Excess-of-loss reinsurance</b>	Reinsurance that indemnifies the insured against all or a specified portion of losses over a specified amount or retention.
<b>Exclusions</b>	Provisions in an insurance or reinsurance policy excluding certain risks or otherwise limiting the scope of coverage.
<b>Exposure</b>	The possibility of loss. A unit of measure of the amount of risk a company assumes.
<b>Facultative reinsurance</b>	The reinsurance of all or a portion of the insurance provided by a single policy. Each policy reinsured is separately negotiated.
<b>Fiduciary liability insurance</b>	Insurance that primarily provides liability coverage to fiduciaries of employee benefit and welfare plans for losses arising from the breach of any fiduciary duty owed to plan beneficiaries.
<b>Frequency</b>	The number of claims occurring during a specified period of time.
<b>General casualty</b>	Insurance that is primarily concerned with losses due to injuries to persons and liability imposed on the insured for such injury or for damage to the property of others.
<b>Gross premiums written</b>	Total premiums for insurance and reinsurance written during a given period.

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<b>Healthcare liability or Healthcare lines</b>	Insurance coverage, often referred to as medical malpractice insurance, which addresses liability risks of doctors, surgeons, nurses, other healthcare professionals and the institutions (hospitals, clinics) in which they practice.
<b>Incurred but not reported ( IBNR ) reserves</b>	Reserves established by us for claims that have occurred but have not yet been reported to us as well as for changes in the values of claims that have been reported to us but are not yet settled.
<b>In-force</b>	Policies that have not expired or been terminated and for which the insurer remains on risk as of a given date.

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<b>Limits or gross maximum limits</b>	The maximum amount that an insurer or reinsurer will insure or reinsure for a specified risk, a portfolio of risks or on a single insured entity. The term also refers to the maximum amount of benefit payable for a given claim or occurrence.
<b>Loss development</b>	The difference between the original loss as initially reserved by an insurer or reinsurer and its subsequent evaluation at a later date or at the time of its closure. Loss development occurs because of inflation and time lags between the occurrence of claims and the time they are actually reported to an insurer or reinsurer. To account for these increases, a loss development factor or multiplier is usually applied to a claim or group of claims in an effort to more accurately project the ultimate amount that will be paid.
<b>Losses incurred</b>	The total losses and loss adjustment expenses paid, plus the change in loss and loss adjustment expense reserves, including IBNR, sustained by an insurance or reinsurance company under its insurance policies or other insurance or reinsurance contracts.
<b>Losses and loss expenses</b>	Losses are an occurrence that is the basis for submission or payment of a claim. Losses may be covered, limited or excluded from coverage, depending on the terms of the insurance policy or other insurance or reinsurance contracts. Loss expenses are the expenses incurred by an insurance or reinsurance company in settling a loss.
<b>Loss reserves</b>	Liabilities established by insurers and reinsurers to reflect the estimated cost of claims incurred that the insurer or reinsurer will ultimately be required to pay. Reserves are established for losses and for loss expenses, and consist of case reserves and IBNR reserves. As the term is used in this Form 10-K, loss reserves is meant to include reserves for both losses and for loss expenses.
<b>Loss year</b>	The year to which a claim is attributed based upon the terms in the underlying policy or contract. All years referred to are years ending December 31.
<b>Net premiums earned</b>	The portion of net premiums written during or prior to a given period that was recognized as income during such period.
<b>Net premiums written</b>	Gross premiums written, less premiums ceded to reinsurers.
<b>Paid losses</b>	Claim amounts paid to insureds or ceding companies.
<b>Per occurrence limitations</b>	The maximum amount recoverable under an insurance or reinsurance policy as a result of any one event, regardless of the number of claims.
<b>Primary insurance (primary layer)</b>	Insurance that absorbs the losses immediately above the insured's retention layer. A primary insurer will pay up to a certain dollar amount of losses over the insured's retention, at which point a higher layer excess insurer will be liable for additional losses. The coverage terms of a primary insurance layer typically assume an element of regular loss frequency.

**Probable maximum loss ( PML )**

An estimate of the loss on any given insurance policy or group of policies at some pre-defined probability of occurrence. The probability of occurrence is usually expressed in terms of the number of years between loss events of that size (e.g., 1 in 100 years or 1 in 200 years).

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<b>Producer</b>	A licensed professional, often referred to as either an insurance agent, insurance broker or intermediary, who acts as intermediary between the insurance carrier and the insured or reinsured (as the case may be).
<b>Product liability</b>	Insurance that provides coverage to manufacturer and/or distributors of tangible goods against liability for personal injury caused if such products are unsafe or defective.
<b>Professional liability</b>	Insurance that provides liability coverage to directors and officers, attorneys, doctors, accountants and other professionals who offer services to the general public and claim expertise in a particular area greater than the ordinary layperson for their negligence or malfeasance.
<b>Property catastrophe coverage</b>	In reinsurance, coverage that protects the ceding company against accumulated losses in excess of a stipulated sum that arise from a catastrophic event such as an earthquake, fire or windstorm. Catastrophe loss generally refers to the total loss of an insurer arising out of a single catastrophic event.
<b>Quota share reinsurance</b>	A proportional reinsurance treaty in which the ceding company cedes an agreed-on percentage of every risk it insures that falls within a class or classes of business subject to the treaty.
<b>Reinsurance</b>	The practice whereby one insurer, called the reinsurer, in consideration of a premium paid to that reinsurer, agrees to indemnify another insurer, called the ceding company, for part or all of the liability of the ceding company under one or more policies or contracts of insurance that it has issued.
<b>Reserves</b>	Liabilities established by insurers and reinsurers to reflect the estimated cost of claims incurred that the insurer or reinsurer will ultimately be required to pay. Reserves are established for losses and for loss expenses, and consist of case reserves and IBNR reserves. As the term is used in this report, reserves are meant to include reserves for both losses and for loss expenses.
<b>Retention</b>	The amount of exposure an insured retains on any one risk or group of risks. The term may apply to an insurance policy, where the insured is an individual or business, or a reinsurance contract, where the insured is an insurance company. See Deductible.
<b>Retrocessional coverage</b>	A transaction whereby a reinsurer cedes to another reinsurer, the retrocessionaire, all or part of the reinsurance that the first reinsurer has assumed. Retrocessional reinsurance does not legally discharge the ceding reinsurer from its liability with respect to its obligations to the reinsured. Reinsurance companies cede risks to retrocessionaires for reasons similar to those that cause insurers to purchase reinsurance: to reduce net liability on individual risks, to protect against catastrophic losses, to stabilize financial ratios and to obtain additional underwriting capacity.

**Run-off**

Liability of an insurance or reinsurance company for existing claims that it expects to pay in the future and for which a loss reserve has been established.

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<b>Self-insured</b>	A term which describes a risk, or part of a risk, retained by the insured in lieu of transferring the risk to an insurer. A policy deductible or retention feature allows a policyholder to self-insure a portion of an exposure and thereby reduce its risk-transfer costs.
<b>Specialty lines</b>	A term used in the insurance and reinsurance industry to describe types of insurance or classes of business that require specialized expertise to underwrite. Insurance and reinsurance for these classes of business is not widely available and is typically purchased from the specialty lines divisions of larger insurance companies or from small specialty lines insurers.
<b>Subpart F income</b>	Insurance and reinsurance income (including underwriting and investment income) and foreign personal holding company income (including interest, dividends and other passive investment income).
<b>Surplus (or statutory surplus)</b>	As determined under statutory accounting principles, the amount remaining after all liabilities, including loss reserves, are subtracted from all of the admitted assets (i.e., those permitted by regulation to be recognized on the statutory balance sheet). Surplus is also referred to as statutory surplus or surplus as regards policyholders for statutory accounting purposes.
<b>Surplus lines</b>	A risk or a part of a risk for which there is no insurance market available among admitted insurers or insurance written by non-admitted insurance companies to cover such risks.
<b>Swing-rated reinsurance contract</b>	A reinsurance contract, that links the ultimate amount of ceded premium to the ultimate loss ratio on the reinsured business. This type of reinsurance contract enables the cedent to retain a greater portion of premium if the ultimate loss ratio develops at a level below the initial loss threshold set by the reinsurers, but requires a higher amount of ceded premium if the ultimate loss ratio develops above the initial threshold.
<b>Treaties</b>	Reinsurance contracts under which the ceding company agrees to cede and the reinsurer agrees to assume risks of a particular class or classes of business.
<b>Treaty year</b>	The year in which the contract incepts. Exposure from contracts incepting during the current treaty year will potentially affect both the current loss year as well future loss years.
<b>Ultimate loss</b>	Total of all expected settlement amounts, whether paid or reserved together with any associated loss adjustment expenses, and is the estimated total amount of loss at the measurement date. For purposes of this Form 10-K, ultimate loss is the sum of paid losses, case reserves and IBNR.
<b>Underwriter</b>	An employee of an insurance or reinsurance company who examines, accepts or rejects risks and classifies accepted risks in order to charge an appropriate premium for each accepted risk. The underwriter is expected to select business that will produce an average

risk of loss no greater than that anticipated for the class of business.

**Underwriting results**

The pre-tax profit or loss experienced by an insurance company that is calculated by deducting net losses and loss expenses, net acquisition costs and general and administration expenses from net



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premiums earned. This profit or loss calculation includes reinsurance assumed and ceded but excludes investment income.

**Unearned premium**

The portion of premiums written that is allocable to the unexpired portion of the policy term or underlying risk.

**Working layer**

Primary insurance that absorbs the losses immediately above the insured's retention layer. A working layer insurer will pay up to a certain dollar amount of losses over the insured's retention, at which point a higher layer excess insurer will be liable for additional losses. The coverage terms of a working layer typically assume an element of loss frequency.

**Written premium**

The premium entered on an insurer's books for a policy issued during a given period of time, whether coverage is provided only during that period of time or also during subsequent periods.

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**Item 2. Properties.**

Our corporate headquarters are located in offices we lease in Switzerland. We also lease space in Bermuda, England, Hong Kong, Ireland, Singapore and the United States for the operation of our U.S. insurance, international insurance and reinsurance segments. Our leases have remaining terms ranging from six months to approximately ten years in length. We renew and enter into new leases in the ordinary course of business as needed. While we believe that the office space from these leased properties is sufficient for us to conduct our operations for the foreseeable future, we may need to expand into additional facilities to accommodate future growth. For more information on our leasing arrangements, please see Note 15 of the notes to the consolidated financial statements in this Form 10-K.

**Item 3. Legal Proceedings.***New Cingular Wireless*

In April 2006, a complaint was filed in the U.S. District Court for the Northern District of Georgia (Atlanta Division) entitled *New Cingular Wireless Headquarters, LLC et al. v. Marsh & McLennan Companies, Inc., et al.* Among the 78 insurers named as defendants is our insurance subsidiary in Bermuda, Allied World Assurance Company, Ltd. Plaintiffs allege that the broker defendants used a variety of illegal schemes and anti-competitive practices that resulted in the plaintiffs either paying more for insurance *products* or receiving less beneficial terms than the competitive market would have produced. Plaintiffs seek equitable and legal remedies, including injunctive relief, consequential and punitive damages, treble damages and attorneys' fees. In October 2006, the litigation was transferred to the U.S. District Court for the District of New Jersey for pretrial purposes. The District Court subsequently stayed the litigation while its decision to grant motions to dismiss the related class actions was being appealed. On appeal, the District Court's dismissals were affirmed in large part but were vacated in part and remanded to the District Court. In October 2011, the District Court lifted the stay and authorized the filing of renewed class action motions to dismiss, and it is expected to issue an order governing the timing of discovery and motions in this litigation. Because of the stay and the pending order, neither our subsidiary nor any of the other defendants have responded to the complaint and written discovery that had begun has not been completed. While it is not possible to predict the outcome of the litigation, the Company does not believe that the outcome will have a material adverse effect on its operations or financial position.

*Litigation Related to the Terminated Merger Agreement with Transatlantic*

In connection with our proposed merger with Transatlantic Holdings, Inc. ( *Transatlantic* ), which was mutually terminated by the parties on September 15, 2011, two putative stockholder class action lawsuits filed against Holdings, and the members of the Transatlantic board of directors challenging the merger, remained outstanding as of December 31, 2011: *Ivers v. Transatlantic Holdings, Inc., et al.* (filed June 17, 2011 in the Court of Chancery of the State of Delaware) and *Kramer v. Transatlantic Holdings, Inc., et al.* (filed June 30, 2011 in the Court of Chancery of the State of Delaware) (collectively, the *Lawsuits* ). Each of the Lawsuits was filed against Transatlantic, the members of the Transatlantic board of directors, and Holdings and/or its subsidiaries. Alleghany Corporation and Shoreline Merger Sub, LLC were later added as defendants. Plaintiffs in each Lawsuit asserted that the members of the Transatlantic board of directors breached their fiduciary duties and that Holdings and/or its subsidiaries, or Alleghany Corporation and/or its subsidiaries, aided and abetted the alleged breaches of fiduciary duties. On January 30, 2012, the defendants entered into a memorandum of understanding with the plaintiffs regarding the settlement of the Lawsuits against Transatlantic and Transatlantic's directors, Holdings and its subsidiaries, and Alleghany Corporation and Shoreline Merger Sub, LLC. The memorandum of understanding contemplates that the parties will enter into a stipulation of settlement. The stipulation of settlement will be subject to customary conditions, including court approval. In the event that the parties enter into a stipulation of settlement, a hearing will be scheduled at which the Court of Chancery of the State of Delaware will consider the fairness, reasonableness and adequacy of the settlement. If the settlement is approved by the court, it will resolve and release all claims in all actions that were or could have been brought challenging any aspect of the proposed merger, the merger agreement, and any disclosure made in connection therewith (but excluding claims for appraisal under Section 262 of the Delaware General Corporation Law),

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among other claims. In addition, in connection with the settlement, the parties contemplate that plaintiffs' counsel will file a petition in the Court of Chancery of the State of Delaware for an award of attorneys' fees and expenses to be paid by Transatlantic or its successor, which the defendants may oppose. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the Court of Chancery of the State of Delaware will approve the settlement even if the parties were to enter into such stipulation. In such event, the proposed settlement as contemplated by the memorandum of understanding may be terminated.

We may become involved in various claims and legal proceedings that arise in the normal course of our business, which are not likely to have a material adverse effect on our results of operations.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common shares began publicly trading on the New York Stock Exchange under the symbol AWH on July 12, 2006. The following table sets forth, for the periods indicated, the high and low sales prices per share of our common shares as reported on the New York Stock Exchange Composite Tape.

	High	Low
<b>2011:</b>		
First quarter	\$ 63.95	\$ 57.67
Second quarter	\$ 65.70	\$ 53.70
Third quarter	\$ 59.00	\$ 49.00
Fourth quarter	\$ 63.33	\$ 51.00
<b>2010:</b>		
First quarter	\$ 47.05	\$ 43.77
Second quarter	\$ 47.96	\$ 40.60
Third quarter	\$ 57.25	\$ 44.42
Fourth quarter	\$ 61.24	\$ 54.53

On February 21, 2012, the last reported sale price for our common shares was \$68.02 per share. At February 21, 2012, there were 36 holders of record of our common shares.

During the year ended December 31, 2010, we declared a regular quarterly dividend of \$0.20 per common share for each quarter. Additionally, on November 4, 2010, the Board declared a special dividend of \$ 0.25 per share. Because Swiss law prevented the company from paying a regular dividend until at least two months following the annual shareholder meeting in May 2011, the special dividend provided a distribution to shareholders for the interim period between the effectiveness of the redomestication and the next available regular dividend payment date. At the Annual Shareholder Meeting in May 2011, our shareholders approved the payment of a cash dividend to shareholders in four installments in the form of distributions through par value reductions. During the year ended December 31, 2011, we paid regular dividends of \$0.375 per common share in August and October. We also paid a regular dividend of \$0.375 on January 6, 2012 to shareholders of record December 23, 2011. The fourth installment of the dividend is anticipated to be paid in April 2012.

The continued declaration and payment of dividends to holders of common shares is expected but will be at the discretion of our Board of Directors and subject to legal, regulatory, financial and other restrictions. Specifically, any future declaration and payment of any cash dividends by the company will:

depend upon its results of operations, financial condition, cash requirements and other relevant factors;

be subject to shareholder approval;

be subject to restrictions contained in our credit facilities and other debt covenants; and

be subject to other restrictions on dividends imposed by Swiss law.

Under Swiss law, our shareholders have the power to declare dividends without the agreement of the Board of Directors. Consequently, dividends may be declared by resolution of the shareholders even if our Board of Directors and management do not believe it is in the best interest of the company or the shareholders. As a holding company, our principal source of income is dividends or other statutorily permissible payments from our subsidiaries. The ability of our subsidiaries to pay dividends is limited by the applicable laws and regulations of the various

countries in which we operate, including Bermuda, the United States and Ireland. See Item 1.

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Business Regulatory Matters, Item 1A. Risk Factors Our holding company structure and regulatory and other constraints affect our ability to pay dividends and make other payments, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Restrictions and Specific Requirements and Note 16 of the notes to consolidated financial statements included in this Form 10-K.

**Issuer Purchases of Equity Securities**

The following table summarizes our repurchases of our common shares during the three months ended December 31, 2011:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value (or Approximate Dollar Value) of Shares that May Yet be Purchased Under the Plans or Programs
October 1 - 31, 2011		\$		\$ 200,872,527
November 1 - 30, 2011				200,872,527
December 1 - 31, 2011	450,000	59.33	450,000	174,172,769
Total	450,000	\$ 59.33	450,000	\$ 174,172,769

- (1) In May 2010, the company established a share repurchase program in order to repurchase Holdings' common shares. Repurchases may be effected from time to time through open market purchases, privately negotiated transactions and tender offers or otherwise. We received shareholder approval for the capacity that remained available under this share repurchase program at the time of Holdings' redomestication to Switzerland.

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**PERFORMANCE GRAPH**

The following information is not deemed to be soliciting material or to be filed with the SEC or subject to the liabilities of Section 18 of the Exchange Act, and the report shall not be deemed to be incorporated by reference into any prior or subsequent filing by the company under the Securities Act or the Exchange Act.

The following graph shows the cumulative total return, including reinvestment of dividends, on the common shares compared to such return for Standard & Poor's 500 Composite Stock Price Index ( S&P 500 ), and Standard & Poor's Property & Casualty Insurance Index for the five year period beginning on December 31, 2006 and ending on December 31, 2011, assuming \$100 was invested on December 31, 2006. The measurement point on the graph represents the cumulative shareholder return as measured by the last reported sale price on such date during the relevant period.

**TOTAL RETURN TO SHAREHOLDERS**

**(INCLUDES REINVESTMENT OF DIVIDENDS)**

**Table of Contents****Item 6. Selected Financial Data.**

The following table sets forth our summary historical statement of operations data and summary balance sheet data as of and for the years ended December 31, 2011, 2010, 2009, 2008 and 2007. Statement of operations data and balance sheet data are derived from our audited consolidated financial statements, which have been prepared in accordance with U.S. GAAP. These historical results are not necessarily indicative of results to be expected from any future period. For further discussion of this risk see Item 1A. Risk Factors in this Form 10-K. You should read the following selected financial data in conjunction with the other information contained in this Form 10-K, including Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 8. Financial Statements and Supplementary Data.

	Year Ended December 31,				
	2011	2010	2009	2008	2007
	(\$ in millions, except per share amounts and ratios)				
<b>Summary Statement of Operations Data:</b>					
Gross premiums written	\$ 1,939.5	\$ 1,758.4	\$ 1,696.3	\$ 1,445.6	\$ 1,505.5
Net premiums written	\$ 1,533.8	\$ 1,392.4	\$ 1,321.1	\$ 1,107.2	\$ 1,153.1
Net premiums earned	\$ 1,457.0	\$ 1,359.5	\$ 1,316.9	\$ 1,117.0	\$ 1,159.9
Net investment income	195.9	244.1	300.7	308.8	297.9
Net realized investment gains (losses)	10.1	285.6	126.4	(60.0)	37.0
Net impairment charges recognized in earnings		(0.2)	(49.6)	(212.9)	(44.6)
Other income	101.7	0.9	1.5	0.7	
Net losses and loss expenses	959.2	707.9	604.1	641.1	682.3
Acquisition costs	167.3	159.5	148.9	112.6	119.0
General and administrative expenses	271.6	286.5	248.6	185.9	141.6
Amortization and impairment of intangible assets	3.0	3.5	11.1	0.7	
Interest expense	55.0	40.2	39.0	38.7	37.8
Foreign exchange loss (gain)	3.1	0.4	0.7	(1.4)	(0.8)
Income tax expense (benefit)	31.0	26.9	36.6	(7.6)	1.1
Net income	\$ 274.5	\$ 665.0	\$ 606.9	\$ 183.6	\$ 469.2
<b>Per Share Data:</b>					
<b>Earnings per share(1) :</b>					
Basic	\$ 7.21	\$ 14.30	\$ 12.26	\$ 3.75	\$ 7.84
Diluted	6.92	13.32	11.67	3.59	7.53
<b>Weighted average number of common shares outstanding:</b>					
Basic	38,093,351	46,491,279	49,503,438	48,936,912	59,846,987
Diluted	39,667,905	49,913,317	51,992,674	51,147,215	62,331,165
Dividends paid per share	\$ 0.75	\$ 1.05	\$ 0.74	\$ 0.72	\$ 0.63



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	Year Ended December 31,				
	2011	2010	2009	2008	2007
<b>Selected Ratios:</b>					
Loss and loss expense ratio(2)	65.8%	52.1%	45.9%	57.4%	58.8%
Acquisition cost ratio(3)	11.5%	11.7%	11.3%	10.1%	10.3%
General and administrative expense ratio(4)	18.6%	21.1%	18.9%	16.6%	12.2%
Expense ratio(5)	30.1%	32.8%	30.2%	26.7%	22.5%
Combined ratio(6)	95.9%	84.9%	76.1%	84.1%	81.3%

	Year Ended December 31,				
	2011	2010	2009	2008	2007
<b>Summary Balance Sheet Data:</b>					
(\$ in millions, except per share amounts and ratios)					
Cash and cash equivalents	\$ 634.0	\$ 757.0	\$ 292.2	\$ 655.8	\$ 202.6
Investments at fair value	7,406.6	7,183.6	7,156.3	6,157.1	6,029.3
Reinsurance recoverable	1,002.9	927.6	920.0	888.3	682.8
Total assets	11,122.2	10,427.6	9,653.2	9,022.5	7,899.1
Reserve for losses and loss expenses	5,225.1	4,879.2	4,761.8	4,576.8	3,919.8
Unearned premium	1,078.4	962.2	928.6	930.4	811.1
Total debt	797.9	797.7	498.9	742.5	498.7
Total shareholders' equity	3,149.0	3,075.8	3,213.3	2,416.9	2,239.8

- (1) Please refer to Note 14 of the notes to consolidated financial statements for the calculation of basic and diluted earnings per share.
- (2) Calculated by dividing net losses and loss expenses by net premiums earned.
- (3) Calculated by dividing acquisition costs by net premiums earned.
- (4) Calculated by dividing general and administrative expenses by net premiums earned.
- (5) Calculated by combining the acquisition cost ratio and the general and administrative expense ratio.
- (6) Calculated by combining the loss ratio, acquisition cost ratio and general and administrative expense ratio.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

Some of the statements in this Form 10-K include forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995 that involve inherent risks and uncertainties. These statements include in general forward-looking statements both with respect to us and the insurance industry. Statements that are not historical facts, including statements that use terms such as anticipates, believes, expects, intends, plans, projects, seeks and will and that relate to our plans and objectives for future operations, are forward-looking statements. In light of the risks and uncertainties inherent in all forward-looking statements, the inclusion of such statements in this Form 10-K should not be considered as a representation by us or any other person that our objectives or plans will be achieved. These statements are based on current plans, estimates and expectations. Actual results may differ materially from those projected in such forward-looking statements and therefore you should not place undue reliance on them. Important factors that could cause actual results to differ materially from those in such forward-looking statements are set forth in Item 1A. Risk Factors in this Form 10-K. We undertake no obligation to release publicly the results

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*of any future revisions we make to the forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.*

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**Overview**

**Our Business**

We write a diversified portfolio of property and casualty insurance and reinsurance internationally through our subsidiaries and branches based in Bermuda, Europe, Hong Kong, Singapore and the United States as well as our Lloyd's Syndicate 2232. We manage our business through three operating segments: U.S. insurance, international insurance and reinsurance. As of December 31, 2011, we had approximately \$11.1 billion of total assets, \$3.1 billion of total shareholders' equity and \$3.9 billion of total capital, which includes shareholders' equity and senior notes.

During the year ended December 31, 2011, we experienced rate increases on property lines that had experienced significant loss activity on a year-to-date basis. We also continued to see rate improvement on our general casualty line of business while rates continued to decline in some of our other casualty lines. We believe these premium rate decreases are generally due to increased competition and excess capacity over the past several years. Despite the challenging pricing environment, we believe that there are opportunities where certain products have adequate premium rates and that the expanded breadth of our operations allows us to target those classes of business. Given these trends, we continue to be selective in the insurance policies and reinsurance contracts we underwrite. Our consolidated gross premiums written increased by \$181.1 million, or 10.3%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. Our net income for the year ended December 31, 2011 decreased by \$390.5 million, or 58.7%, to \$274.5 million compared to \$665.0 million for the year ended December 31, 2010. The decrease in net income for the year ended December 31, 2011 compared to the year ended December 31, 2010 was primarily due to lower total return from investments and higher net losses and loss expenses from property catastrophe losses of \$171.8 million in the Asia-Pacific region, \$53.7 million from the Midwestern U.S. storms, \$43.0 million related to the Thailand floods and \$23.7 million from Hurricane Irene.

**Recent Developments**

On September 15, 2011, we reached a mutual agreement with Transatlantic to terminate our previously announced merger agreement. Under the terms of the termination agreement, we received a termination fee of \$35.0 million plus a \$13.3 million partial reimbursement for merger-related expenses. We received an additional fee of \$66.7 million from Transatlantic on November 23, 2011, upon its execution of a merger agreement with Alleghany Corporation.

**Table of Contents****Financial Highlights**

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions except share and per share data)		
Gross premiums written	\$ 1,939.5	\$ 1,758.4	\$ 1,696.3
Net income	274.5	665.0	606.9
Operating income	183.7	397.8	537.7
Basic earnings per share:			
Net income	\$ 7.21	\$ 14.30	\$ 12.26
Operating income	\$ 4.82	\$ 8.56	\$ 10.86
Diluted earnings per share:			
Net income	\$ 6.92	\$ 13.32	\$ 11.67
Operating income	\$ 4.63	\$ 7.97	\$ 10.34
Weighted average common shares outstanding:			
Basic	38,093,351	46,491,279	49,503,438
Diluted	39,667,905	49,913,317	51,992,674
Basic book value per common share	\$ 83.44	\$ 80.75	\$ 64.61
Diluted book value per common share	\$ 80.11	\$ 74.29	\$ 59.56
Annualized return on average equity (ROAE), net income	8.9%	21.9%	22.6%
Annualized ROAE, operating income	6.0%	13.1%	20.0%

**Non-GAAP Financial Measures**

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

**Table of Contents****Operating income & 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 impairment charges recognized in earnings, net foreign exchange gain or loss, impairment of intangible assets and other non-recurring items. We exclude net realized investment gains or losses, net impairment charges recognized in earnings, net foreign exchange gain or loss and 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. We exclude impairment of intangible assets as these are non-recurring charges. We have excluded from our operating income the aggregate \$101.7 million termination fee received resulting from our previously announced merger agreement with Transatlantic as this is a non-recurring item. In addition to presenting net income determined in accordance with U.S. GAAP, we believe that showing operating income enables investors, analysts, rating agencies and other users of our financial information to more easily analyze our results of operations and our underlying business performance. Operating income should not be viewed as a substitute for U.S. GAAP net income. The following is a reconciliation of operating income to its most closely related U.S. GAAP measure, net income.

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions except per share data)		
Net income	\$ 274.5	\$ 665.0	\$ 606.9
Add after tax affect of:			
Net realized investment gains	(0.2)	(267.7)	(126.4)
Net impairment charges recognized in earnings		0.1	49.6
Impairment of intangible assets			6.9
Other income termination fee	(93.7)		
Foreign exchange loss	3.1	0.4	0.7
Operating income	\$ 183.7	\$ 397.8	\$ 537.7
<b>Basic per share data:</b>			
Net income	\$ 7.21	\$ 14.30	\$ 12.26
Add after tax affect of:			
Net realized investment gains	(0.01)	(5.75)	(2.55)
Net impairment charges recognized in earnings			1.00
Impairment of intangible assets			0.14
Other income termination fee	(2.46)		
Foreign exchange loss	0.08	0.01	0.01
Operating income	\$ 4.82	\$ 8.56	\$ 10.86
<b>Diluted per share data:</b>			
Net income	\$ 6.92	\$ 13.32	\$ 11.67
Add after tax affect of:			
Net realized investment gains	(0.01)	(5.36)	(2.43)
Net impairment charges recognized in earnings			0.96
Impairment of intangible assets			0.13
Other income termination fee	(2.36)		
Foreign exchange loss	0.08	0.01	0.01
Operating income	\$ 4.63	\$ 7.97	\$ 10.34

**Table of Contents*****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.

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions except share and per share data)		
Price per share at period end	\$ 62.93	\$ 59.44	\$ 46.07
Total shareholders' equity	\$ 3,149.0	\$ 3,075.8	\$ 3,213.3
Basic common shares outstanding	37,742,131	38,089,226	49,734,487
Add:			
Unvested restricted share units	249,251	571,178	915,432
Performance based equity awards	889,939	1,440,017	1,583,237
Employee purchase plan	11,053	10,576	
Dilutive options/warrants outstanding	1,525,853	3,272,739	6,805,157
Weighted average exercise price per share	\$ 45.72	\$ 35.98	\$ 34.44
Deduct:			
Options bought back via treasury method	(1,108,615)	(1,980,884)	(5,087,405)
Common shares and common share equivalents outstanding	39,309,612	41,402,852	53,950,908
Basic book value per common share	\$ 83.44	\$ 80.75	\$ 64.61
Diluted book value per common share	\$ 80.11	\$ 74.29	\$ 59.56

***Annualized return on average equity***

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

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

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions)		
Opening shareholders' equity	\$ 3,075.8	\$ 3,213.3	\$ 2,416.9
Deduct: accumulated other comprehensive income	(57.1)	(149.8)	(105.6)
Adjusted opening shareholders' equity	\$ 3,018.7	\$ 3,063.5	\$ 2,311.3
Closing shareholders' equity	\$ 3,149.0	\$ 3,075.8	\$ 3,213.3
Deduct: accumulated other comprehensive income	(14.5)	(57.1)	(149.8)
Adjusted closing shareholders' equity	\$ 3,134.5	\$ 3,018.7	\$ 3,063.5
Average shareholders' equity	\$ 3,076.6	\$ 3,041.1	\$ 2,687.3
Net income available to shareholders	\$ 274.5	\$ 665.0	\$ 606.9
Annualized return on average shareholders' equity - net income available to shareholders	8.9%	21.9%	22.6%
Operating income available to shareholders	\$ 183.7	\$ 397.8	\$ 537.7
Annualized return on average shareholders' equity - operating income available to shareholders	6.0%	13.1%	20.0%



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**Relevant Factors**

**Revenues**

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

Due to changes in the recognition and presentation of other-than-temporary impairments ( OTTI ) of our available for sale debt securities based on guidance issued by the FASB in April 2009, OTTI, which was previously included in net realized investment gains or losses , has been presented separately in the consolidated income statements as net impairment charges recognized in earnings . See -Critical Accounting Policies-Other-Than-Temporary Impairments of Investments for further discussion of the recognition and presentation of OTTI.

**Expenses**

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

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

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

reserves for losses incurred but not reported, or IBNR , which are reserves (in addition to case reserves) established by us that we believe are needed for the future settlement of claims. The portion recoverable from reinsurers is deducted from the gross estimated loss. Acquisition costs are comprised of commissions, brokerage fees and insurance taxes. Commissions and brokerage fees are usually calculated as a percentage of premiums and depend on the market and line of business. Acquisition costs are reported after (1) deducting commissions received on ceded reinsurance, (2) deducting the part of acquisition costs relating to unearned premiums and (3) including the amortization of previously deferred acquisition costs.

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

**Ratios**

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



**Table of Contents****Critical Accounting Policies**

It is important to understand our accounting policies in order to understand our financial position and results of operations. Our 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. The following are the accounting estimates that, in management's judgment, are critical due to the judgments, assumptions and uncertainties underlying the application of those estimates and the potential for results to differ from management's assumptions.

**Reserve for Losses and Loss Expenses**

Reserves for losses and loss expenses by segment as of December 31, 2011, 2010 and 2009 were comprised of the following:

	U.S. Insurance December 31,			International Insurance December 31,			Reinsurance December 31,			Total December 31,		
	2011	2010	2009	2011	2010	2009	2011	2010	2009	2011	2010	2009
	(\$ in millions)											
Case reserves	\$ 387.6	\$ 295.3	\$ 268.1	\$ 522.6	\$ 498.3	\$ 570.4	\$ 456.2	\$ 373.0	\$ 313.5	\$ 1,366.4	\$ 1,166.5	\$ 1,152.0
IBNR	1,274.8	1,136.4	985.6	1,726.4	1,728.4	1,786.0	857.5	847.8	838.2	3,858.7	3,712.7	3,609.8
Reserve for losses and loss expenses	1,662.4	1,431.7	1,253.7	2,249.0	2,226.7	2,356.4	1,313.7	1,220.8	1,151.7	5,225.1	4,879.2	4,761.8
Reinsurance recoverables	(438.3)	(396.6)	(351.8)	(564.3)	(531.0)	(566.3)	(0.3)		(1.9)	(1,002.9)	(927.6)	(920.0)
Net reserve for losses and loss expenses	\$ 1,224.1	\$ 1,035.1	\$ 901.9	\$ 1,684.7	\$ 1,695.7	\$ 1,790.1	\$ 1,313.4	\$ 1,220.8	\$ 1,149.8	\$ 4,222.2	\$ 3,951.6	\$ 3,841.8

The reserve for losses and loss expenses is comprised of two main elements: outstanding loss reserves, also known as case reserves, and reserves for IBNR. Outstanding loss reserves relate to known claims and represent management's best estimate of the likely loss settlement. IBNR reserves relate primarily to unreported events that, based on industry information, management's experience and actuarial evaluation, can reasonably be expected to have occurred and are reasonably likely to result in a loss to our company. IBNR reserves also relate to estimated development of reported events that based on industry information, management's experience and actuarial evaluation, can reasonably be expected to reach our attachment point and are reasonably likely to result in a loss to our company. We also include IBNR changes in the values of claims that have been reported to us but are not yet settled. Each claim is settled individually based upon its merits and it is not unusual for a claim to take years after being reported to settle, especially if legal action is involved. As a result, reserves for losses and loss expenses include significant estimates for IBNR reserves.

The reserve for IBNR is estimated by management for each line of business based on various factors, including underwriters' expectations about loss experience, actuarial analysis, comparisons with the results of industry benchmarks and loss experience to date. The reserve for IBNR is calculated as the ultimate amount of losses and loss expenses less cumulative paid losses and loss expenses and case reserves. Our actuaries employ generally accepted actuarial methodologies to determine estimated ultimate loss reserves.

While management believes that our case reserves and IBNR are sufficient to cover losses assumed by us, there can be no assurance that losses will not deviate from our reserves, possibly by material amounts. The methodology of estimating loss reserves is periodically reviewed to ensure that the assumptions made continue to be appropriate. To the extent actual reported losses exceed estimated losses, the carried estimate of the ultimate losses will be increased (i.e., unfavorable reserve development), and to the extent actual reported losses are less than estimated losses, the carried estimate of ultimate losses will be reduced (i.e., favorable reserve development). We record any changes in our loss reserve estimates and the related reinsurance recoverables in the periods in which they are determined.

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The estimate of reserves for our property insurance and property reinsurance lines of business relies primarily on traditional loss reserving methodologies, utilizing selected paid and reported loss development factors. In the property lines of business, claims are generally reported and paid within a relatively short period of time ( shorter tail lines ) during and following the policy coverage period. This generally enables us to determine with greater certainty our estimate of ultimate losses and loss expenses.

Our casualty insurance and casualty reinsurance lines of business include general liability risks, healthcare and professional liability risks. Claims may be reported or settled several years after the coverage period has terminated for these lines of business ( longer tail lines ), which increases uncertainties of our reserve estimates in such lines. In addition, our attachment points for these longer tail lines are often relatively high, making reserving for these lines of business more difficult than shorter tail lines due to having to estimate whether the severity of the estimated losses will exceed our attachment point. We establish a case reserve when sufficient information is gathered to make a reasonable estimate of the liability, which often requires a significant amount of information and time. Due to the lengthy reporting pattern of these casualty lines, reliance is placed on industry benchmarks supplemented by our own experience. For expected loss ratio selections, we are giving greater consideration to our existing experience supplemented with analysis of loss trends, rate changes and experience of peer companies.

Our reinsurance treaties are reviewed individually, based upon individual characteristics and loss experience emergence. Loss reserves on assumed reinsurance have unique features that make them more difficult to estimate than direct insurance. We establish loss reserves upon receipt of advice from a cedent that a reserve is merited. Our claims staff may establish additional loss reserves where, in their judgment, the amount reported by a cedent is potentially inadequate. The following are the most significant features that make estimating loss reserves on assumed reinsurance difficult:

Reinsurers have to rely upon the cedents and reinsurance intermediaries to report losses in a timely fashion.

Reinsurers must rely upon cedents to price the underlying business appropriately.

Reinsurers have less predictable loss emergence patterns than direct insurers, particularly when writing excess-of-loss reinsurance. For excess-of-loss reinsurance, cedents generally are required to report losses that either exceed 50% of the retention, have a reasonable probability of exceeding the retention or meet serious injury reporting criteria. All reinsurance claims that are reserved are reviewed at least every six months. For quota share reinsurance treaties, cedents are required to give a periodic statement of account, generally monthly or quarterly. These periodic statements typically include information regarding written premiums, earned premiums, unearned premiums, ceding commissions, brokerage amounts, applicable taxes, paid losses and outstanding losses. They can be submitted 60 to 90 days after the close of the reporting period. Some quota share reinsurance treaties have specific language regarding earlier notice of serious claims.

Reinsurance generally has a greater time lag than direct insurance in the reporting of claims. The time lag is caused by the claim first being reported to the cedent, then the intermediary (such as a broker) and finally the reinsurer. This lag can be up to six months or longer in certain cases. There is also a time lag because the insurer may not be required to report claims to the reinsurer until certain reporting criteria are met. In some instances this could be several years while a claim is being litigated. We use reporting factors based on data from the Reinsurance Association of America to adjust for time lags. We also use historical treaty-specific reporting factors when applicable. Loss and premium information are entered into our reinsurance system by our claims department and our accounting department on a timely basis.

We record the individual case reserves sent to us by the cedents through the reinsurance intermediaries. Individual claims are reviewed by our reinsurance claims department and adjusted as deemed appropriate. The loss data received from the intermediaries is checked for reasonableness and for known events. Details of the loss listings are reviewed during routine claim audits.

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The expected loss ratios that we assign to each treaty are based upon analysis and modeling performed by a team of actuaries. The historical data reviewed by the team of pricing actuaries is considered in setting the reserves for each cedent. The historical data in the submissions is matched against our carried reserves for our historical treaty years.

Loss reserves do not represent an exact calculation of liability. Rather, loss reserves are estimates of what we expect the ultimate resolution and administration of claims will cost. These estimates are based on actuarial and statistical projections and on our assessment of currently available data, as well as estimates of future trends in claims severity and frequency, judicial theories of liability and other factors. Loss reserve estimates are refined as experience develops and as claims are reported and resolved. In addition, the relatively long periods between when a loss occurs and when it may be reported to our claims department for our casualty insurance and casualty reinsurance lines of business increase the uncertainties of our reserve estimates in such lines.

We utilize a variety of standard actuarial methods in our analysis. The selections from these various methods are based on the loss development characteristics of the specific line of business. For lines of business with long reporting periods such as casualty reinsurance, we may rely more on an expected loss ratio method (as described below) until losses begin to develop. For lines of business with short reporting periods such as property insurance, we may rely more on a paid loss development method (as described below) as losses are reported relatively quickly. The actuarial methods we utilize include:

***Paid Loss Development Method.*** We estimate ultimate losses by calculating past paid loss development factors and applying them to exposure periods with further expected paid loss development. The paid loss development method assumes that losses are paid at a consistent rate. The paid loss development method provides an objective test of reported loss projections because paid losses contain no reserve estimates. In some circumstances, paid losses for recent periods may be too varied for accurate predictions. For many coverages, especially casualty coverages, claim payments are made slowly and it may take years for claims to be fully reported and settled. These payments may be unreliable for determining future loss projections because of shifts in settlement patterns or because of large settlements in the early stages of development. Choosing an appropriate tail factor to determine the amount of payments from the latest development period to the ultimate development period may also require considerable judgment, especially for coverages that have long payment patterns. As we have limited payment history, we have had to supplement our paid loss development patterns with appropriate benchmarks.

***Reported Loss Development Method.*** We estimate ultimate losses by calculating past reported loss development factors and applying them to exposure periods with further expected reported loss development. Since reported losses include payments and case reserves, changes in both of these amounts are incorporated in this method. This approach provides a larger volume of data to estimate ultimate losses than the paid loss development method. Thus, reported loss patterns may be less varied than paid loss patterns, especially for coverages that have historically been paid out over a long period of time but for which claims are reported relatively early and have case loss reserve estimates established. This method assumes that reserves have been established using consistent practices over the historical period that is reviewed. Changes in claims handling procedures, large claims or significant numbers of claims of an unusual nature may cause results to be too varied for accurate forecasting. Also, choosing an appropriate tail factor to determine the change in reported loss from the latest development period to the ultimate development period may require considerable judgment. As we have limited reported history, we have had to supplement our reported loss development patterns with appropriate benchmarks.

***Expected Loss Ratio Method.*** To estimate ultimate losses under the expected loss ratio method, we multiply earned premiums by an expected loss ratio. The expected loss ratio is selected utilizing industry data, historical company data and professional judgment. This method is particularly useful for new insurance companies or new lines of business where there are no historical losses or where past loss experience is not credible.

***Bornhuetter-Ferguson Paid Loss Method.*** The Bornhuetter-Ferguson paid loss method is a combination of the paid loss development method and the expected loss ratio method. The amount of losses yet to be paid is based upon the expected loss ratios and the expected percentage of losses unpaid. These

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expected loss ratios are modified to the extent paid losses to date differ from what would have been expected to have been paid based upon the selected paid loss development pattern. This method avoids some of the distortions that could result from a large development factor being applied to a small base of paid losses to calculate ultimate losses. This method will react slowly if actual loss ratios develop differently because of major changes in rate levels, retentions or deductibles, the forms and conditions of reinsurance coverage, the types of risks covered or a variety of other changes.

*Bornhuetter-Ferguson Reported Loss Method.* The Bornhuetter-Ferguson reported loss method is similar to the Bornhuetter-Ferguson paid loss method with the exception that it uses reported losses and reported loss development factors.

During 2011, 2010 and 2009, we adjusted our reliance on actuarial methods utilized for certain casualty lines of business and loss years within our U.S. insurance and international insurance segments from using a blend of the Bornhuetter-Ferguson reported loss method and the expected loss ratio method to using only the Bornhuetter-Ferguson reported loss method. We also began adjusting our reliance on actuarial methods utilized for certain other casualty lines of business and loss years within all of our operating segments including the reinsurance segment, by placing greater reliance on the Bornhuetter-Ferguson reported loss method than on the expected loss ratio method. Placing greater reliance on more responsive actuarial methods for certain casualty lines of business and loss years within each of our operating segments is a natural progression as we mature as a company and gain sufficient historical experience of our own that allows us to further refine our estimate of the reserve for losses and loss expenses. We believe utilizing only the Bornhuetter-Ferguson reported loss method for older loss years will more accurately reflect the reported loss activity we have had thus far in our ultimate loss ratio selections, and will better reflect how the ultimate losses will develop over time. We will continue to utilize the expected loss ratio method for the most recent loss years until we have sufficient historical experience to utilize other acceptable actuarial methodologies.

We expect that the trend of placing greater reliance on more responsive actuarial methods, for example from the expected loss ratio method to the Bornhuetter-Ferguson reported loss method, to continue as both (1) our loss years mature and become more statistically reliable and (2) as we build databases of our internal loss development patterns. The expected loss ratio remains a key assumption as the Bornhuetter-Ferguson methods rely upon an expected loss ratio selection and a loss development pattern selection.

The key assumptions used to arrive at our best estimate of loss reserves are the expected loss ratios, rate of loss cost inflation, selection of benchmarks and reported and paid loss emergence patterns. Our reporting factors and expected loss ratios are based on a blend of our own experience and industry benchmarks for longer tailed business and primarily our own experience for shorter tail business. The benchmarks selected were those that we believe are most similar to our underwriting business.

Our expected loss ratios for shorter tail lines change from year to year. As our losses from shorter tail lines of business are reported relatively quickly, we select our expected loss ratios for the most recent years based upon our actual loss ratios for our older years adjusted for rate changes, inflation, cost of reinsurance and average storm activity. For the shorter tail lines, we initially used benchmarks for reported and paid loss emergence patterns. As we mature as a company, we have begun supplementing those benchmark patterns with our actual patterns as appropriate. For the longer tail lines, we continue to use benchmark patterns, although we update the benchmark patterns as additional information is published regarding the benchmark data.

For shorter tail lines, the primary assumption that changed during both 2011 as compared to 2010 and 2010 as compared to 2009 as it relates to prior year losses was actual paid and reported loss emergence patterns were generally less severe than estimated for each year due to lower frequency and severity of reported losses. As a result of this change, we recognized net favorable prior year reserve development in both 2011 and 2010. However, we did experience significant property insurance and property reinsurance losses, which resulted in us increasing our reserves related to current year losses. Of the \$304.8 million of reserve increases for the year ended December 31, 2011 in our property insurance and property reinsurance lines of business for current year losses, \$292.2 million was catastrophe related (New Zealand earthquake, Japan earthquake and tsunami, Australian storms, Midwestern U.S. storms, Thailand floods and Hurricane Irene), and \$12.6 million related to attritional losses. Of the \$121.0 million of reserve increases for the year ended December 31, 2010 in our

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property insurance and property reinsurance lines of business, \$98.3 million was catastrophe related (Chilean and New Zealand earthquakes and the Australian floods), and \$22.7 million related to attritional losses. We will continue to evaluate and monitor the development of these losses and the impact it has on our current and future assumptions. We believe recognition of the reserve changes in the period they were recorded was appropriate since a pattern of reported losses had not emerged and the loss years were previously too immature to deviate from the expected loss ratio method in prior periods.

The selection of the expected loss ratios for the longer tail lines is our most significant assumption. Due to the lengthy reporting pattern of longer tail lines, we supplement our own experience with industry benchmarks of expected loss ratios and reporting patterns in addition to our own experience. For our longer tail lines, the primary assumption that changed during both 2011 as compared to 2010 and 2010 as compared to 2009 as it relates to prior year losses was using the Bornhuetter-Ferguson loss development method for certain casualty lines of business and loss years as discussed above. This method calculated a lower projected loss ratio based on loss emergence patterns to date. As a result of the change in the expected loss ratio, we recognized net favorable prior year reserve development in 2011, 2010 and 2009. We believe that recognition of the reserve changes in the period they were recorded was appropriate since a pattern of reported losses had not emerged and the loss years were previously too immature to deviate from the expected loss ratio method in prior periods.

Our overall change in the loss reserve estimates related to prior years decreased as a percentage of total carried reserves during 2011. On an opening carried reserve base of \$3,951.6 million, after reinsurance recoverable, we had a net decrease of \$253.5 million, or 6.4%, during 2011, and for 2010 we had a net decrease of \$313.3 million, or 8.2%, on an opening carried reserve base of \$3,841.8 million, after reinsurance recoverables. We believe that these changes are reasonable given the long-tail nature of our business.

There is potential for significant variation in the development of loss reserves, particularly for the casualty lines of business due to their long tail nature and high attachment points. The maturing of our casualty insurance and reinsurance loss reserves have caused us to reduce what we believe is a reasonably likely variance in the expected loss ratios for older loss years. As of December 31, 2011 and 2010, we believe reasonably likely variances in our expected loss ratio in percentage points for our loss years are as follows:

Loss Year	As of December 31,	
	2011	2010
2004	2.0%	4.0%
2005	4.0%	6.0%
2006	6.0%	8.0%
2007	8.0%	10.0%
2008	10.0%	10.0%
2009	10.0%	10.0%
2010	10.0%	10.0%
2011	10.0%	

The change in the reasonably likely variance for the 2004 through 2007 loss years in 2011 compared to 2010 is due to giving greater weight to the Bornhuetter-Ferguson loss development method for additional lines of business during 2011 and additional development of losses. The reasonably likely variance of our expected loss ratio for all loss years for our casualty insurance and casualty reinsurance lines of business was seven percentage points as of December 31, 2011 and 2010. If our final casualty insurance and reinsurance loss ratios vary by seven percentage points from the expected loss ratios in aggregate, our required net reserves after reinsurance recoverable would increase or decrease by approximately \$598.1 million. Because we expect a small volume of large claims, it is more difficult to estimate the ultimate loss ratios, so we believe the variance of our loss ratio selection could be relatively wide. This would result in either an increase or decrease to income, before income taxes, and total shareholders' equity of approximately \$598.1 million. As of December 31, 2011, this represented approximately 19% of total shareholders' equity. In terms of liquidity, our contractual obligations for reserves for losses and loss expenses would also increase or decrease by approximately \$598.1 million after reinsurance recoverable. If our obligations were to increase by \$598.1 million, we believe we currently have sufficient cash

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and investments to meet those obligations. We believe showing the impact of an increase or decrease in the expected loss ratios is useful information despite the fact that we have realized only net favorable prior year loss development each calendar year. We continue to use industry benchmarks to supplement our expected loss ratios, and these industry benchmarks have implicit in them both favorable and unfavorable loss development, which we incorporate into our selection of the expected loss ratios.

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

	<b>Reserve for Losses and Loss Expenses Gross of Reinsurance Recoverable(1)</b>		
	<b>Carried Reserves</b>	<b>Low Estimate</b>	<b>High Estimate</b>
	(\$ in millions)		
U.S. insurance	\$ 1,662.4	\$ 1,342.3	\$ 1,857.5
International insurance	2,249.0	1,696.9	2,527.8
Reinsurance	1,313.7	1,067.7	1,511.2

	<b>Reserve for Losses and Loss Expenses Net of Reinsurance Recoverable(2)</b>		
	<b>Carried Reserves</b>	<b>Low Estimate</b>	<b>High Estimate</b>
	(\$ in millions)		
U.S. insurance	\$ 1,224.1	\$ 984.3	\$ 1,360.2
International insurance	1,684.7	1,262.7	1,899.0
Reinsurance	1,313.4	1,067.4	1,510.4

(1) For statistical reasons, it is not appropriate to add together the ranges of each business segment in an effort to determine the low and high range around the consolidated loss reserves. On a gross basis, the consolidated low estimate is \$4,369.0 million and the consolidated high estimate is \$5,634.4 million.

(2) For statistical reasons, it is not appropriate to add together the ranges of each business segment in an effort to determine the low and high range around the consolidated loss reserves. On a net basis, the consolidated low estimate is \$3,527.5 million and the consolidated high estimate is \$4,556.4 million.

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

Our selection of the actual carried reserves has typically been above the midpoint of the range. As of December 31, 2011, we were 4.5% above the midpoint of the consolidated net loss reserve range. We believe that we should be prudent in our reserving practices due to the lengthy reporting patterns and relatively large limits of net liability for any one risk of our direct excess casualty business and of our casualty reinsurance business. Thus, due to this uncertainty regarding estimates for reserve for losses and loss expenses, we have carried our consolidated reserve for losses and loss expenses, net of reinsurance recoverable, above the midpoint of the low and high estimates for the consolidated net losses and loss expenses. We believe that relying on the more prudent actuarial indications is appropriate for these lines of business.

**Ceded Reinsurance**

We cede insurance to reinsurers in order to limit our maximum loss, to protect against concentration of risk within our portfolio and to manage our exposure to catastrophic events. Because the ceding of insurance does not discharge us from our primary obligation to the insureds, we

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remain liable to the extent that our reinsurers do not meet their obligations under the reinsurance agreements. Therefore, we regularly evaluate the financial condition of our reinsurers and monitor concentration of credit risk. No provision has been made for unrecoverable reinsurance as of December 31, 2011 and 2010 as we believe that all reinsurance balances will be recovered.

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When we reinsure a portion of our exposures, we pay reinsurers a portion of premiums received on the reinsured policies. Total premiums ceded pursuant to reinsurance contracts entered into by our company with a variety of reinsurers were \$405.8 million, \$365.9 million and \$375.2 million for the years ended December 31, 2011, 2010 and 2009, respectively.

The following table illustrates our gross premiums written and ceded for the years ended December 31, 2011, 2010 and 2009:

	Gross Premiums Written and Premiums Ceded Year Ended December 31,		
	2011	2010	2009
	(\$ in millions)		
Gross	\$ 1,939.5	\$ 1,758.4	\$ 1,696.3
Ceded	(405.8)	(365.9)	(375.2)
Net	\$ 1,533.8	\$ 1,392.5	\$ 1,321.1
Ceded as percentage of gross	20.9%	20.8%	22.1%

The following table illustrates the effect of our reinsurance ceded strategies on our results of operations:

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions)		
Premiums written ceded	405.8	365.9	375.2
Premiums earned ceded	366.3	365.3	381.2
Losses and loss expenses ceded	214.6	165.8	196.6
Acquisition costs ceded	92.6	81.5	79.6

We had net cash outflows relating to ceded reinsurance activities (premiums paid less losses recovered and net ceding commissions received) of approximately \$148.3 million, \$128.5 million and \$116.0 million for the years ended December 31, 2011, 2010 and 2009, respectively. The net cash outflows in all years are reflective of fewer losses that were recoverable under our reinsurance coverages.

Our reinsurance treaties are generally purchased on an annual basis and are therefore subject to yearly renegotiation. The treaties typically specify ceding commissions, and include provisions for required reporting to the reinsurers, responsibility for taxes, arbitration of disputes and the posting of security for the reinsurance recoverable under certain circumstances, such as a downgrade in the reinsurer's financial strength rating. The amount of risk ceded by us to reinsurers is subject to maximum limits which vary by line of business and by type of coverage. We also purchase a limited amount of facultative reinsurance, which provides cover for specified policies, rather than for whole classes of business.

The examples below illustrate the types of treaty reinsurance arrangements in force at December 31, 2011:

*General Property:* We purchased both quota share reinsurance for our general property business written in our U.S. insurance and international insurance segments, as well as excess-of-loss cover providing protection for specified classes of catastrophe. We have also purchased a limited amount of facultative reinsurance, which provides cover for specified general property policies.

*General Casualty:* We have purchased variable quota share reinsurance for our general casualty business since December 2002. At year-end 2011, the percentage ceded varied by both location of writing office and by limits reinsured, with a significantly larger cession being effective for policies above \$25 million in limits. We also have excess-of-loss cover in place for general casualty business written in our Asian branch offices.



*Professional Liability:* For professional liability policies, our reinsurance varied by writing office and by policy type. Professional liability policies written in our Bermuda, European and U.S. offices were quota-

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share reinsured with cession percentages dependent upon location. Additionally, the professional liability policies written in the United States, as well as those originating within our Asian branch offices were reinsured on an excess-of-loss basis.

*Healthcare:* We purchased quota share and excess-of-loss reinsurance protection for our healthcare line of business written by our Bermuda and U.S. offices, respectively. As is the case with general casualty and professional liability, our healthcare business originating in Asia is under an excess-of-loss reinsurance arrangement.

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

	Reinsurance Recoverable as of December 31,	
	2011	2010
	(\$ in millions)	
Ceded case reserves	\$ 196.5	\$ 206.2
Ceded IBNR reserves	806.4	721.4
<b>Reinsurance recoverable</b>	<b>\$ 1,002.9</b>	<b>\$ 927.6</b>

As noted above, we remain obligated for amounts ceded in the event our reinsurers do not meet their obligations. Accordingly, we have evaluated the reinsurers that are providing reinsurance protection to us and will continue to monitor their credit ratings and financial stability. We generally have the right to terminate our treaty reinsurance contracts at any time, upon prior written notice to the reinsurer, under specified circumstances, including the assignment to the reinsurer by A.M. Best of a financial strength rating of less than A-. As of December 31, 2011, approximately 98% of ceded case reserves and 99% of our ceded IBNR were recoverable from reinsurers who had an A.M. Best rating of A- or higher.

We determine what portion of the losses will be recoverable under our reinsurance policies by reference to the terms of the reinsurance protection purchased. This determination is necessarily based on the underlying loss estimates and, accordingly, is subject to the same uncertainties as the estimate of case reserves and IBNR reserves.

The following table shows our reinsurance recoverables by operating segment as of December 31, 2011 and 2010:

	As of December 31,	
	2011	2010
	(\$ in millions)	
U.S. insurance	\$ 438.3	\$ 396.6
International insurance	564.3	531.0
Reinsurance	0.3	
<b>Total reinsurance recoverable</b>	<b>\$ 1,002.9</b>	<b>\$ 927.6</b>

Historically, our reinsurance recoverables related primarily to our property lines of business, which being short tail in nature, are not subject to the same variations as our casualty lines of business. However, during 2011 and 2010 we have increased the amount of reinsurance we utilize for our casualty lines of business in the U.S. insurance and international insurance segments; and as such, the reinsurance recoverables from our casualty lines of business have increased over the past several years. As the reinsurance recoverables are subject to the same uncertainties as the estimate of case reserves and IBNR reserves, if our final casualty insurance ceded loss ratios vary by eight percentage points from the expected loss ratios in aggregate, our required reinsurance recoverable would increase or decrease by approximately \$134.6 million. This would result in either an increase or decrease to income before income taxes and shareholders' equity of approximately \$134.6 million. As of December 31, 2011, this amount represented approximately 4% of total shareholders' equity.



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### **Premiums and Acquisition Costs**

Premiums are recognized as written on the inception date of a policy. For certain types of business written by us, notably reinsurance, premium income may not be known at the contract inception date. In the case of quota share reinsurance assumed by us, the underwriter makes an estimate of premium income at inception as the premium income is typically derived as a percentage of the underlying policies written by the cedents. The underwriter's estimate is based on statistical data provided by reinsureds and the underwriter's judgment and experience. Such estimations are refined over the reporting period of each treaty as actual written premium information is reported by ceding companies and intermediaries. Management reviews estimated premiums at least quarterly and any adjustments are recorded in the period in which they become known. As of December 31, 2011, our changes in premium estimates have been adjustments ranging from approximately negative 6% for the 2009 treaty year to approximately 22% for the 2005 treaty year. Applying this range to our 2011 quota share reinsurance treaties, our gross premiums written in the reinsurance segment could decrease by approximately \$13.9 million or increase by approximately \$47.7 million over the next three years. Given the recent trend of downward adjustments on premium estimates, we believe a reasonably likely change in our premium estimate would be the midpoint of the 6% and 22%, or 8%, for a change of \$16.9 million. There would also be a related increase in loss and loss expenses and acquisition costs due to the increase in gross premiums written. It is reasonably likely as our historical experience develops that we may have fewer or smaller adjustments to our estimated premiums, and therefore could have changes in premium estimates lower than the range historically experienced. Total premiums estimated on quota share reinsurance contracts for the years ended December 31, 2011, 2010 and 2009 represented approximately 11%, 13% and 12%, respectively, of total gross premiums written.

Other insurance and reinsurance policies can require that the premium be adjusted at the expiry of a policy to reflect the risk assumed by us. Premiums resulting from such adjustments are estimated and accrued based on available information.

### **Fair Value of Financial Instruments**

In accordance with U.S. GAAP, we are required to recognize certain assets at their fair value in our consolidated balance sheets. This includes our fixed maturity investments and other invested assets. 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 which are unobservable for the asset or liability.

At each measurement date, we estimate the fair value of the financial instruments using various valuation techniques. We utilize, to the extent available, quoted market prices in active markets or observable market inputs in estimating the fair value of our financial instruments. When quoted market prices or observable market inputs are not available, we utilize valuation techniques that rely on unobservable inputs to estimate the fair value of financial instruments. The following describes the valuation techniques we used to determine the fair value of financial instruments held as of December 31, 2011 and what level within the U.S. GAAP fair value hierarchy the valuation technique resides.

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*U.S. government and U.S. government agencies:* Comprised primarily of bonds issued by the U.S. Treasury, the Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. The fair values of U.S. government securities are based on quoted market prices in active markets, and are included in the Level 1 fair value hierarchy. We believe 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 corporations that are diversified across a wide range of issuers and industries. The fair values of corporate bonds that pay a floating rate coupon are priced using the spread above the London Interbank Offered Rate yield curve and the fair values of corporate bonds that are long term are priced using the spread above the risk-free yield curve. The spreads are sourced from broker-dealers, trade prices and the new issue market. As the significant inputs used to price corporate bonds are observable market inputs, the fair values of corporate bonds are included in the Level 2 fair value hierarchy.

*Mortgage-backed:* Principally 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 agency originators. The fair values of mortgage-backed securities originated by U.S. government agencies and non-U.S. government agencies are based on a pricing model that incorporates prepayment speeds and spreads to determine 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 we are 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 fair value 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 we are 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 fair value hierarchy.

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

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

*Senior notes:* The fair value of the senior notes is based on trades as reported in Bloomberg. As of December 31, 2011, the 7.50% Senior Notes and 5.50% Senior Notes (each as defined in Note 9 of the notes to consolidated financial statements) were traded at 114.3% and 100.4% of their principal amount, providing an effective yield of 4.0% and 5.4%, respectively. The fair value of the senior notes is included in the Level 2 fair value hierarchy.

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The following table shows the pricing sources of our fixed maturity investments held as of December 31, 2011:

<b>Pricing Sources</b>	<b>Fair Value of Fixed Maturity Investments as of December 31, 2011 (\$ in millions)</b>	<b>Percentage of Total Fixed Maturity Investments</b>	<b>Fair Value Hierarchy Level</b>
Barclays indices	\$ 4,044.1	62.2%	1 and 2
Interactive Data Pricing	996.5	15.3	2
Reuters pricing service	458.8	7.1	2
Broker-dealer quotes	343.9	5.3	3
Merrill Lynch indices	160.0	2.5	2
International indices	115.4	1.8	2
Other sources	380.0	5.8	2
	\$ 6,498.7	100.0%	

The following table shows the pricing sources of our fixed maturity investments held as of December 31, 2010:

<b>Pricing Sources</b>	<b>Fair Value of Fixed Maturity Investments as of December 31, 2010 (\$ in millions)</b>	<b>Percentage of Total Fixed Maturity Investments</b>	<b>Fair Value Hierarchy Level</b>
Barclays indices	\$ 4,684.6	70.3%	1 and 2
Interactive Data Pricing	997.7	15.0	2
Reuters pricing service	252.8	3.8	2
Broker-dealer quotes	221.3	3.3	3
Merrill Lynch indices	166.9	2.5	2
International indices	68.6	1.0	2
Other sources	269.1	4.1	2
	\$ 6,661.0	100.0%	

*Barclays indices:* We use Barclays indices to price our U.S. government, U.S. government agencies, corporate debt, agency and non-agency mortgage-backed and asset-backed securities. There are several observable inputs that the Barclays indices use in determining its prices which include among others, treasury yields, new issuance and secondary trades, information provided by broker-dealers, security cash flows and structures, sector and issuer level spreads, credit rating, underlying collateral and prepayment speeds. For U.S. government securities, traders that act as market makers are the primary source of pricing; as such, for U.S. government securities we believe the Barclays indices reflect quoted prices (unadjusted) for identical securities in active markets.

*Interactive Data Pricing:* We use Interactive Data Pricing to price our U.S. government agencies, municipalities, non-agency mortgage-backed and asset-backed securities. There are several observable inputs that Interactive Data Pricing uses in determining its prices which include among others, benchmark yields, reported trades and issuer spreads.

*Reuters pricing service:* We use the Reuters pricing service to price our U.S. government agencies, corporate debt, agency and non-agency mortgage-backed and asset-backed securities. There are several observable inputs that the Reuters pricing service uses in determining its prices which include among others, option-adjusted spreads, treasury yields, new issuance and secondary trades, sector and issuer level spreads, underlying collateral and prepayment speeds.

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*Broker-dealer quotes:* We also utilize broker-dealers to price our agency and non-agency mortgage-backed and asset-backed securities. The pricing sources include JP Morgan Securities Inc., Bank of America

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Securities LLC, Deutsche Bank Securities Inc. and other broker-dealers. When broker-dealer quotes are utilized it is primarily due to the fact that the particular broker-dealer was involved in the initial pricing of the security.

*Merrill Lynch Index:* We use the Merrill Lynch indices to price our non-U.S. government and government agencies securities, corporate debt, municipalities and asset-backed securities. There are several observable inputs that the Merrill Lynch indices use in determining its prices, which include reported trades and other sources.

*Standard & Poor's Securities Evaluation:* We use Standard & Poor's to price our U.S. government agencies, corporate debt, municipalities, mortgage-backed and asset-backed securities. There are several observable inputs that Standard & Poor's uses in determining its prices which include among others, benchmark yields, reported trades and issuer spreads.

*International indices:* We use international indices, which include the FTSE, Deutsche Teleborse and the Scotia Index, to price our non-U.S. government and government agencies securities. The observable inputs used by international indices to determine its prices are based on new issuance and secondary trades and information provided by broker-dealers.

*Other sources:* We utilize other indices and pricing services to price various securities. These sources use observable inputs consistent with indices and pricing services discussed above.

We utilize independent pricing sources to obtain market quotations for securities that have quoted prices in active markets. In general, the independent pricing sources use observable market inputs, including, but not limited to, investment yields, credit risks and spreads, benchmarking of like securities, non-binding broker-dealer quotes, reported trades and sector groupings to determine the fair value. For a majority of the portfolio, we obtained two or more prices per security as of December 31, 2011. When multiple prices are obtained, a price source hierarchy is utilized to determine which price source is the best estimate of the fair value of the security. The price source hierarchy emphasizes more weighting to significant observable inputs such as index pricing and less weighting towards non-binding broker quotes. In addition, to validate all prices obtained from these pricing sources including non-binding broker quotes, we also obtain prices from our investment portfolio managers and other sources (e.g., another pricing vendor), and compare the prices obtained from the independent pricing sources to those obtained from our investment portfolio managers and other sources. We investigate any material differences between the multiple sources and determine which price best reflects the fair value of the individual security. There were no material differences between the prices from the independent pricing sources and the prices obtained from our investment portfolio managers and other sources as of December 31, 2011.

There have been no material changes to any of our valuation techniques from those used as of December 31, 2010. Based on all reasonably available information received, we believe the prices that were obtained from inactive markets were orderly transactions and therefore, reflected the current price a market participant would pay for the asset. Since fair valuing a financial instrument is an estimate of what a willing buyer would pay for our asset if we sold it, we will not know the ultimate value of our financial instruments until they are sold. We believe the valuation techniques utilized provide us with the best estimate of the price that would be received to sell our assets in an orderly transaction between participants at the measurement date.

### **Other-Than-Temporary Impairment of Investments**

Effective April 1, 2009, we are required to recognize OTTI in the consolidated income statements if we intend to sell the debt security or if it is more likely than not we will be required to sell a debt security before the recovery of its amortized cost basis. In addition, we are required to recognize OTTI if the present value of the expected cash flows of a debt security is less than the amortized cost basis of the debt security ( credit loss ).

For our debt securities that are within the scope of the new guidance we have applied the following policy to determine if OTTI exists at each reporting period:

Our debt securities are managed by external investment portfolio managers. We require them to provide us with a list of debt securities they intend to sell at the end of the reporting period. Any impairment in these securities is recognized as OTTI, as the difference between the amortized cost and fair value and is recognized in the income statement.



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At each reporting period we determine if it is more likely than not we will be required to sell a debt security before the recovery of its amortized cost basis. We analyze our current and future contractual and non-contractual obligations and our expectation of future cash flows to determine if we will need to sell debt securities to fund our obligations. We consider factors such as trends in underwriting profitability, cash flows from operations, return on our invested assets, property catastrophe losses, timing of payments and other specific contractual obligations that are coming due.

For debt securities that are in an unrealized loss position that we do not intend to sell, we assess whether a credit loss exists. The amount of the credit loss is recognized in the income statement. The assessment involves consideration of several factors including: (i) the significance of the decline in value and the resulting unrealized loss position, (ii) the time period for which there has been a significant decline in value and (iii) an analysis of the issuer of the investment, including its liquidity, business prospects and overall financial position.

Following the Company's review of the securities in the investment portfolio during the year ended December 31, 2011, no securities were considered to be other-than-temporarily impaired due to the present value of the expected cash flows being lower than the amortized cost. During the year ended December 31, 2010, we had one mortgage-backed security that was considered to be other-than-temporarily impaired due to the present value of the expected cash flows being lower than the amortized cost. The \$0.2 million of OTTI was recognized through earnings due to credit related losses.

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

Prior to April 1, 2009, we reviewed the carrying value of our investments to determine if a decline in value was considered to be other than temporary. This review involved consideration of several factors including: (i) the significance of the decline in value and the resulting unrealized loss position; (ii) the time period for which there has been a significant decline in value; (iii) an analysis of the issuer of the investment, including its liquidity, business prospects and overall financial position; and (iv) our intent and ability to hold the investment for a sufficient period of time for the value to recover. For certain investments, our investment portfolio managers had the discretion to sell those investments at any time. As such, we recognized OTTI for those securities in an unrealized loss position each quarter as we could not assert that we had the intent to hold those investments until anticipated recovery. The identification of potentially impaired investments involves significant management judgment that included the determination of their fair value and the assessment of whether any decline in value was other than temporary. If the decline in value was determined to be other than temporary, then we recorded a realized loss in the statements of operations and comprehensive income in the period that it was determined, and the cost basis of that investment was reduced.

Based on our review of the debt securities, for the year ended December 31, 2009 we recognized a total of \$68.2 million in OTTI, of which \$18.6 million was recognized in accumulated other comprehensive income in the consolidated balance sheets and \$49.6 million was recognized in the income statement. Of the \$49.6 million of OTTI recognized in the income statement, \$7.7 million was due to credit related losses where the anticipated discounted cash flows of various debt securities were lower than the amortized cost, and \$41.9 million in the first quarter of 2009 related to net impairment charges for those securities in an unrealized loss position where our investment managers had the discretion to sell. The \$7.7 million of credit related OTTI recognized consisted of \$6.0 million related to mortgage-backed securities and \$1.7 million related to a corporate bond. We did not have securities with an unrealized loss as of December 31, 2009 that we intended to sell or that we were required to sell.

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We classify intangible assets into three categories: (1) intangible assets with finite lives subject to amortization; (2) intangible assets with indefinite lives not subject to amortization and (3) goodwill. Intangible assets, other than goodwill, consist of renewal rights, internally generated software, non-compete covenants and insurance licenses held by subsidiaries domiciled in the United States. The following is a summary of our goodwill and other intangible assets as of December 31, 2011 and 2010:

Source of Goodwill or Intangible Asset	Year Acquired	Finite or Indefinite	Estimated Useful Life	Carrying Value December 31, 2011	Carrying Value December 31, 2010 (In millions)
Insurance licenses(1)	2002	Indefinite	N/A	\$ 3.9	\$ 3.9
Insurance licenses(2)	2008	Indefinite	N/A	12.0	12.0
Goodwill(2)	2008	Indefinite	N/A	3.9	3.9
Distribution Network(3)	2008	Finite	15 years	30.0	32.5
Internally developed computer software(3)	2008	Finite	3 years	0.0	0.4
Insurance licenses(3)	2008	Indefinite	N/A	8.0	8.0
Goodwill(3)	2008	Indefinite	N/A	264.5	264.5
Total goodwill and other intangible assets				\$ 322.3	\$ 325.2

(1) Related to the acquisition of Allied World National Assurance Company and Allied World Assurance Company (U.S.) Inc.

(2) Related to the acquisition of Finial Insurance Company

(3) Related to the acquisition of Darwin

For intangible assets with finite lives, the value is amortized over their useful lives. We also test intangible assets with finite lives for impairment if conditions exist that indicate the carrying value may not be recoverable. Such factors include, but are not limited to:

A significant decrease in the market price of the intangible asset;

A significant adverse change in the extent or manner in which the intangible asset is being used or in its physical condition;

A significant adverse change in legal factors or in the business climate that could affect the value of the intangible asset, including an adverse action or assessment by a regulator;

An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the intangible asset;

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A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of the intangible asset; and

A current expectation that, more likely than not, the intangible asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

As a result of our evaluation, we determined that there was no impairment to the carrying value of our intangible assets with finite lives for the year ended December 31, 2011.

For indefinite lived intangible assets we do not amortize the intangible asset but test these intangible assets for impairment by comparing the fair value of the assets to their carrying values on an annual basis or more frequently if circumstances warrant. The factors we consider to determine if an impairment exists are similar to factors noted above. As a result of our evaluation, we determined that there was no impairment to the carrying value of our indefinite lived intangible assets for the year ended December 31, 2011.

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Goodwill represents the excess of the cost of acquisitions over the fair value of net assets acquired and is not amortized. Goodwill is assigned at acquisition to the applicable reporting unit(s) based on the expected benefit to be received by the reporting unit(s) from the business combination. We determine the expected benefit based on several factors including the purpose of the business combination, the strategy of the company subsequent to the business combination and structure of the acquired company subsequent to the business combination. A reporting unit is a component of our business that has discrete financial information which is reviewed by management. In determining the reporting unit, we analyze the inputs, processes, outputs and overall operating performance of the reporting unit.

During our annual goodwill impairment assessment for the year ended December 31, 2009, we determined that for purposes of the goodwill recorded from the acquisition of Darwin that the Darwin reporting unit expected to receive the benefit of the business combination and as such we allocated all the goodwill to the Darwin reporting unit.

For the annual goodwill impairment assessment for the year ended December 31, 2010, we reassessed our reporting units and determined that the U.S. insurance segment is the reporting unit expected to receive the benefit of the business combination. The reason for the change in reporting units is due to the fact that since the acquisition of Darwin, we have integrated Darwin in several ways, which has made stand-alone Darwin company financial information no longer meaningful and not consistent with how we manage our business. Some of the integration efforts include, among others:

The inclusion of Darwin senior management into the U.S. insurance segment senior management.

The inclusion of Darwin head product line managers into the U.S. insurance segment product line managers.

We have moved a significant number of employees into and out of the acquired Darwin legal entities. Former Darwin underwriters now underwrite for historical Allied World companies and vice versa.

Any new business written, with a few limited exceptions, is recorded in one underwriting system, which is the legacy Darwin underwriting system.

Based on the above, the lines have blurred to what cash flow streams are related to the acquisition and what are related to our legacy business. We believe this constitutes a reorganization of the reporting structure under U.S. GAAP. In applying the requirements, we have concluded all the goodwill that was originally allocated to the Darwin reporting unit should be allocated to the U.S. insurance segment reporting unit as the assets employed and the liabilities relate to the U.S. insurance operations. All the insurance operations of Darwin are included into the U.S. insurance segment.

For goodwill, we perform a two-step impairment test on an annual basis or more frequently if circumstances warrant. The first step is to compare the fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount of the reporting unit exceeds its fair value then the second step of the goodwill impairment test is performed. In determining the fair value of the reporting units discounted cash flow models and market multiple models are utilized. The discounted cash flow models apply a discount to projected cash flows including a terminal value calculation. The market multiple models apply earnings and book value multiples of similar publicly-traded companies to the reporting unit's projected earnings or book value. We select the weighting of the models utilized to determine the fair value of the reporting units based on judgment, considering such factors as the reliability of the cash flow projections and the entities included in the market multiples.

The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill in order to determine the amount of impairment to be recognized. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit's identifiable assets and liabilities from the fair value of the reporting unit as a whole. The excess of the carrying value of goodwill above the implied goodwill, if any, would be recognized as an impairment charge in amortization and impairment of intangible assets in the consolidated income statements.

During 2011, we performed the first step of the goodwill impairment testing on the goodwill. We use both market based and non-market based valuations. Our market based valuations are based on market multiples of



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book value and earnings. Our non-market based valuations are based on the present value of estimated future cash flows. Our overall point estimate is a weighted average of these valuations. Based on our analysis, the point estimate fair value of the U.S. insurance segment reporting unit was in excess of its carrying value by approximately 14%. As a result, we concluded there was no implied goodwill impairment, and therefore, no step two goodwill impairment testing was required.

**Results of Operations**

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

	2011	Year Ended December 31, 2010 (\$ in millions)	2009
Gross premiums written	\$ 1,939.5	\$ 1,758.4	\$ 1,696.3
Net premiums written	\$ 1,533.8	\$ 1,392.4	\$ 1,321.1
Net premiums earned	1,457.0	1,359.5	1,316.9
Net investment income	195.9	244.1	300.7
Net realized investment gains	10.1	285.6	126.4
Net impairment charges recognized in earnings		(0.2)	(49.6)
Other income	101.7	0.9	1.5
	\$ 1,764.7	\$ 1,889.9	\$ 1,695.9
Net losses and loss expenses	959.2	707.9	604.1
Acquisition costs	167.3	159.5	148.9
General and administrative expenses	271.6	286.5	248.6
Amortization and impairment of intangible assets	3.0	3.5	11.1
Interest expense	55.0	40.2	39.0
Foreign exchange loss	3.1	0.4	0.7
	\$ 1,459.2	\$ 1,198.0	\$ 1,052.4
Income before income taxes	\$ 305.5	\$ 691.9	\$ 643.5
Income tax expense	31.0	26.9	36.6
Net income	\$ 274.5	\$ 665.0	\$ 606.9
<b>Ratios</b>			
Loss and loss expense ratio	65.8%	52.1%	45.9%
Acquisition cost ratio	11.5%	11.7%	11.3%
General and administrative expense ratio	18.6%	21.1%	18.9%
Expense ratio	30.1%	32.8%	30.2%
Combined ratio	95.9%	84.9%	76.1%

**Comparison of Years Ended December 31, 2011 and 2010****Premiums**

Gross premiums written increased by \$181.1 million, or 10.3%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The overall increase in gross premiums written was primarily the result of the following:

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Gross premiums written in our U.S. insurance segment increased by \$109.3 million, or 15.0%. The increase in gross premiums written was primarily due to increased new business, including from new

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products, for the year ended December 31, 2011 compared to the year ended December 31, 2010. This growth was partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition.

Gross premiums written in our international insurance segment increased by \$25.5 million, or 5.1%, due to increased premiums in our general property and healthcare lines and new business including new products. This growth was partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition.

Gross premiums written in our reinsurance segment increased by \$46.3 million, or 8.8%. The increase in gross premiums written was primarily due to increased new business, including gross premiums written by our new global marine and specialty division and the continued build-out of our international platform, particularly in Asia. This growth was partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions).

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

	Year Ended December 31,		Dollar Change	Percentage Change
	2011	2010		
	(\$ in millions)			
United States	\$ 1,080.1	\$ 993.5	\$ 86.6	8.7%
Bermuda	565.8	545.6	20.2	3.7
Europe	210.4	193.0	17.4	9.0
Singapore	68.4	17.0	51.4	302.4
Hong Kong	14.8	9.3	5.5	59.1
	\$ 1,939.5	\$ 1,758.4	\$ 181.1	10.3%

Net premiums written increased by \$141.4 million, or 10.2%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in net premiums written was primarily due to the increase in gross premiums written. During the twelve months ended December 31, 2011, premiums ceded were reduced by \$12.4 million due to the commutation of certain variable-rated reinsurance contracts that have swing-rated provisions. A swing-rated reinsurance contract links the ultimate amount of ceded premium to the ultimate loss ratio on the reinsured business. It enables the cedent to retain a greater portion of premium if the ultimate loss ratio develops at a level below the initial loss threshold set by the reinsurers, but requires a higher amount of ceded premium if the ultimate loss ratio develops above the initial threshold. In commuting these swing-rated reinsurance contracts, we reduced certain premiums previously ceded and also reduced ceded IBNR by \$11.5 million in accordance with the terms of the contracts. During the twelve months ended December 31, 2010, net premiums written included a \$9.3 million reduction in premiums ceded for the commutation of certain variable-rated reinsurance contracts.

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 20.9% of gross premiums written for the year ended December 31, 2011 compared to 20.8% for the year ended December 31, 2010.

Net premiums earned increased by \$97.5 million, or 7.2%, for the year ended December 31, 2011 compared to the year ended December 31, 2010 as a result of higher net premiums earned for the U.S. insurance and reinsurance segments. This is driven by increased net premiums written in the current and prior periods, as well as the impact of the commutation of the swing-rated reinsurance contracts, which are fully earned.



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

	Gross Premiums Written		Net Premiums Earned	
	Year Ended December 31,			
	2011	2010	2011	2010
U.S. insurance	43.2%	41.5%	40.1%	38.1%
International insurance	27.4%	28.7%	21.8%	24.9%
Reinsurance	29.4%	29.8%	38.1%	37.0%
Total	100.0%	100.0%	100.0%	100.0%

**Net Investment Income**

Net investment income decreased by \$48.2 million, or 19.7%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The decrease was due to lower yields on our fixed maturity investments as well as an increased allocation to equity securities and other invested assets which contribute to our total return but carry little or no current yield. We increased our equity and other invested assets by \$385.3 million between December 31, 2011 and December 31, 2010. The annualized period book yield of the investment portfolio for the years ended December 31, 2011 and 2010 was 2.5% and 3.3%, respectively. Since we believe that there could be a rise in interest rates in 2012, there remains a risk of loss in the value of the company's fixed income portfolio. We have reduced our investment duration in 2011 to mitigate this risk. Investment management expenses of \$14.2 million and \$11.7 million were incurred during the years ended December 31, 2011 and 2010, respectively. The increase in investment management expenses was due to the increase in the size of our investment portfolio as well as expenses from higher expense asset classes (equities).

As of December 31, 2011, approximately 92.6% of our fixed income investments consisted of investment grade securities. The average credit rating of our fixed income portfolio was AA- as rated by Standard & Poor's and Aa3 as rated by Moody's, with an average duration of approximately 1.9 years as of December 31, 2011. The average duration of the investment portfolio was 2.7 years as of December 31, 2010.

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

During the year ended December 31, 2011, we recognized \$10.1 million in net realized investment gains compared to net realized investment gains of \$285.6 million during the year ended December 31, 2010. During the year ended December 31, 2011, we did not recognize any net impairment charges compared to \$0.2 million in net impairment charges recognized in earnings during the year ended December 31, 2010. Net realized investment gains of \$10.1 million for the year ended December 31, 2011 were comprised of the following:

Net realized investment gains of \$32.7 million primarily from the sale of fixed maturity securities due to the rebalancing of our portfolio.

Net realized investment losses of \$22.6 million primarily related to the mark-to-market adjustments for our other invested assets, equity securities and fixed maturity investments that are accounted for as trading securities.

	Mark-to-Market Adjustments for the Year Ended December 31, 2011 (\$ in millions)
Fixed maturity investments accounted for as trading securities	\$ 8.1
Other invested assets and equity securities	4.5

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Interest rate futures and foreign exchange forwards	5.9
Put options	4.1
Total	\$ 22.6

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Net realized investment gains of \$285.6 million for the year ended December 31, 2010 were comprised of the following:

Net realized investment gains of \$217.7 million from the sale of securities.

Net realized investment gains of \$71.9 million related to the mark-to-market adjustments of our other invested assets and fixed maturity investments that are accounted for as trading securities.

Net realized investment loss of \$0.4 million related to a U.S. Treasury yield hedge transaction that terminated in June 2010.

**Other Income**

The other income of \$101.7 million for the year ended December 31, 2011 represented a termination fee from our previously announced merger agreement with Transatlantic.

The other income of \$0.9 million for the year ended December 31, 2010 represents fee income from our program administrator operations and wholesale brokerage operations. We sold these operations during the year ended December 31, 2010.

**Net Losses and Loss Expenses**

Net losses and loss expenses increased by \$251.3 million, or 35.5%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in net losses and loss expenses was due to lower prior year net favorable reserve development and higher catastrophe loss activity in the current period totaling \$292.2 million, which included estimated net losses and loss expenses incurred of \$96.5 million for the Tohoku earthquake and tsunami, \$58.6 million for the New Zealand earthquake, \$53.7 million for the Midwestern U.S. storms, \$43.0 million related to the Thailand floods, \$23.7 million for Hurricane Irene and \$16.7 million for the Australian storms. During the year ended December 31, 2010, we incurred \$98.4 million of catastrophe-related losses, of which \$66.8 million was from the Chilean earthquake, \$17.0 million from the New Zealand earthquake and \$14.6 million from the Australian floods.

We recorded net favorable reserve development related to prior years of \$253.5 million and \$313.3 million during the years ended December 31, 2011 and 2010, respectively. The following table shows the net favorable reserve development of \$253.5 million by loss year for each of our segments for the year ended December 31, 2011. In the table, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	<b>Loss Reserve Development by Loss Year For the Year Ended December 31, 2011</b>									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
	(\$ in millions)									
U.S. insurance	\$ (0.4)	\$ (2.9)	\$ (4.6)	\$ (20.5)	\$ 19.1	\$ (7.6)	\$ (4.7)	\$ (7.2)	\$ 5.6	\$ (23.2)
International insurance	0.8	4.1	(6.7)	(33.3)	(45.3)	(40.5)	(14.6)	(10.1)	27.1	(118.5)
Reinsurance	(0.4)	(2.5)	(10.9)	(35.6)	(16.0)	(20.7)	(2.3)	(10.8)	(12.6)	(111.8)
	\$	\$ (1.3)	\$ (22.2)	\$ (89.4)	\$ (42.2)	\$ (68.8)	\$ (21.6)	\$ (28.1)	\$ 20.1	\$ (253.5)

The net favorable reserve development is a result of actual loss emergence being lower than anticipated. The unfavorable reserve development in our U.S. insurance segment for the 2006 loss year was primarily due to directors and officers claims within our professional liability line of business related to a class action suit filed against a number of private equity firms alleging collusion. The unfavorable reserve development in our international insurance segment for the 2010 loss year was primarily due to a casualty claim emanating from an oil field service risk.

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The following table shows the favorable reserve development of \$313.3 million by loss year for each of our segments for the year ended December 31, 2010. In the table, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	<b>Loss Reserve Development by Loss Year For the Year Ended December 31, 2010</b>								
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>Total</b>
	<b>(\$ in millions)</b>								
U.S. insurance	\$ (1.6)	\$ (3.2)	\$ (25.6)	\$ (26.2)	\$ (5.3)	\$ (1.7)	\$ (2.5)	\$ (2.4)	\$ (68.5)
International insurance	6.8	(6.7)	(21.6)	(87.5)	(36.7)	(19.3)	(23.1)	7.5	(180.6)
Reinsurance	(0.9)	(1.0)	(9.8)	(33.0)	(12.4)	(3.8)	3.0	(6.3)	(64.2)
	\$ 4.3	\$ (10.9)	\$ (57.0)	\$ (146.7)	\$ (54.4)	\$ (24.8)	\$ (22.6)	\$ (1.2)	\$ (313.3)

The loss and loss expense ratio for the year ended December 31, 2011 was 65.8% compared to 52.1% for the year ended December 31, 2010. Net favorable reserve development recognized in the year ended December 31, 2011 and the impact of the commutation adjustment to ceded IBNR decreased the loss and loss expense ratio by 17.5 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 83.3%. Net favorable reserve development recognized in the year ended December 31, 2010 and the impact of the commutation adjustment to ceded IBNR reduced the loss and loss expense ratio by 23.1 percentage points. Thus, the loss and loss expense ratio related to that loss year was 75.2%. The increase in the loss and loss expense ratio for the current loss year was primarily due to \$292.2 million of losses from global catastrophes during the year ended December 31, 2011, which contributed 20.1 points to the current loss year's loss and loss expense ratio. In comparison, \$164.6 million of large individual losses, including catastrophes, contributed 12.1 points to the loss and loss expense ratio for the twelve months ended December 31, 2010.

The following table shows the components of the increase in net losses and loss expenses for the year ended December 31, 2011 compared to the year ended December 31, 2010.

	<b>Year Ended December 31,</b>		<b>Dollar Change</b>
	<b>2011</b>	<b>2010</b>	
	<b>(\$ in millions)</b>		
Net losses paid	\$ 684.8	\$ 596.7	\$ 88.1
Net change in reported case reserves	213.3	76.2	137.1
Net change in IBNR	61.1	35.0	26.1
Net losses and loss expenses	\$ 959.2	\$ 707.9	\$ 251.3

The increase in net losses paid for the year ended December 31, 2011 was due to higher paid losses in our U.S. insurance and reinsurance segments as a result of continued growth in these segments, combined with higher current period property catastrophe paid losses. The increase in reported case reserves was primarily due to higher case reserves in each of our operating segments. The increase in IBNR was due to higher IBNR in our international insurance segment as a result of lower net favorable reserve development.

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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.

	Year Ended December 31,	
	2011	2010
Net reserves for losses and loss expenses, January 1	\$ 3,951.6	\$ 3,841.8
Incurred related to:		
Commutation of variable-rated reinsurance contracts	11.5	8.9
Current period non-catastrophe	909.0	913.9
Current period property catastrophe	292.2	98.4
Prior period non-catastrophe	(239.2)	(300.0)
Prior period property catastrophe	(14.3)	(13.3)
Total incurred	\$ 959.2	\$ 707.9
Paid related to:		
Current period non-catastrophe	72.1	61.0
Current period property catastrophe	70.1	37.6
Prior period non-catastrophe	516.2	475.3
Prior period property catastrophe	26.4	22.8
Total paid	\$ 684.8	\$ 596.7
Foreign exchange revaluation	(3.8)	(1.4)
Net reserve for losses and loss expenses, December 31	4,222.2	3,951.6
Losses and loss expenses recoverable	1,002.9	927.6
Reserve for losses and loss expenses, December 31	\$ 5,225.1	\$ 4,879.2

**Acquisition Costs**

Acquisition costs increased by \$7.8 million, or 4.9%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in acquisition costs was primarily due to the increase in net premiums earned in our U.S. insurance segment and reinsurance segment. Acquisition costs as a percentage of net premiums earned were 11.5% for the year ended December 31, 2011 compared to 11.7% for the same period in 2010.

**General and Administrative Expenses**

General and administrative expenses decreased by \$14.9 million, or 5.2%, for the year ended December 31, 2011 compared to the same period in 2010. The decrease in general and administrative expenses was primarily due to the following:

A decrease of \$5.9 million in incentive-based compensation due to higher loss activity during the year ended December 31, 2011.

A decrease of \$7.0 million in stock related compensation due to a decrease in overall awards granted during the year ended December 31, 2011, in addition to a one-time increase of \$4.3 million during the year ended December 31, 2010 to recognize expected performance above the target level for our performance-based awards granted in 2009.

During the year ended December 31, 2010 we incurred a one-time 1% capital stamp duty of \$1.6 million related to a capital contribution of \$160.0 million from Allied World Bermuda to Allied World Switzerland.

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Our general and administrative expense ratio was 18.6% for the year ended December 31, 2011, which was lower than the 21.1% for the year ended December 31, 2010. The decrease was primarily due to the factors discussed above in addition to the increase in net premiums earned.

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Our expense ratio was 30.1% for the year ended December 31, 2011 compared to 32.8% for the year ended December 31, 2010 primarily due to a decrease in the general and administrative expense ratio.

### ***Amortization and Impairment of Intangible Assets***

The amortization and impairment of intangible assets decreased \$0.5 million, or 14.3%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The decrease was due to the non-compete covenants related to the acquisition of Darwin being fully amortized during 2010. No impairments were recognized during the year ended December 31, 2011.

### ***Interest Expense***

Interest expense increased \$14.8 million, or 36.8%, for the year ended December 31, 2011 compared to the year ended December 31, 2010 primarily as a result of additional interest expense on our 5.5% senior notes that were issued by Allied World Bermuda in November 2010.

### ***Income Tax Expense***

Tax expense increased \$4.1 million, or 15.2%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in tax expense is primarily due to higher taxable income for our Swiss holding company of approximately \$90.6 million partially offset by lower taxable income for our U.S. operations of approximately \$12.9 million. In addition, 2010 included a \$5.0 million loss for tax purposes on the sale of our program administrator and wholesale brokerage operation which caused a reduction in tax expense in 2010 of \$1.7 million. Our consolidated effective tax rates for the years ended December 31, 2011 and 2010 were 10.1% and 3.9%, respectively.

### ***Net Income***

Net income for the year ended December 31, 2011 was \$274.5 million compared to \$665.0 million for the year ended December 31, 2010. The decrease was primarily the result of lower net realized investment gains, higher net loss and loss expenses, and lower net investment income. Net income for the year ended December 31, 2011 included a net foreign exchange loss of \$3.1 million compared to \$0.4 million for the year ended December 31, 2010.

## **Comparison of Years Ended December 31, 2010 and 2009**

### ***Premiums***

Gross premiums written increased by \$62.1 million, or 3.7%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The overall increase in gross premiums written was primarily the result of the following:

Gross premiums written in our U.S. insurance segment increased by \$54.5 million, or 8.1%. The increase in gross premiums written was primarily due to increased new business, including from new products, for the year ended December 31, 2010 compared to the year ended December 31, 2009. This increase was partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition.

Gross premiums written in our international insurance segment decreased by \$51.1 million, or 9.2%, due to the continued trend of the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition.

Gross premiums written in our reinsurance segment increased by \$58.6 million, or 12.6%. The increase in gross premiums written was primarily due to increased participation on one property reinsurance treaty for \$23.6 million in 2010 from \$9.0 million in 2009, one new treaty in our general casualty reinsurance line of business for \$31.4 million and other new business from the build-out of our international platform. These increases were partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions), increased competition and increased cedent retention.





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The table below illustrates our gross premiums written by geographic location for the years ended December 31, 2010 and 2009.

	Year Ended December 31,		Dollar Change	Percentage Change
	2010	2009		
	(\$ in millions)			
United States	\$ 993.5	\$ 929.9	\$ 63.6	6.8%
Bermuda	545.6	574.4	(28.8)	(5.0)
Europe	193.0	186.5	6.5	3.5
Hong Kong	9.3	5.5	3.8	69.1
Singapore	17.0		17.0	n/a*
	\$ 1,758.4	\$ 1,696.3	\$ 62.1	3.7%

\* n/a: not applicable

Net premiums written increased by \$71.3 million, or 5.4%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in net premiums written was primarily due to a reduction in premiums ceded. 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 20.8% of gross premiums written for the year ended December 31, 2010 compared to 22.1% for the year ended December 31, 2009. The reduction in premiums ceded was due to lower premiums ceded under our property catastrophe reinsurance coverage, as well as the commutation and adjustment of \$9.3 million of certain variable-rated reinsurance contracts that have swing-rated provisions. In commuting these swing-rated reinsurance contracts, we reduced certain premiums previously ceded and also reduced ceded losses by \$8.9 million in accordance with the terms of the contracts.

Net premiums earned increased by \$42.6 million, or 3.2%, for the year ended December 31, 2010 compared to the year ended December 31, 2009 as a result of higher net premiums earned for the U.S. insurance and reinsurance segments. This is driven by increased net premiums written in the current and prior periods, as well as the impact of the commutation of the swing-rated reinsurance contracts which are fully earned.

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

	Gross Premiums Written		Net Premiums Earned	
	Year Ended December 31,			
	2010	2009	2010	2009
U.S. insurance	41.5%	39.8%	38.1%	34.0%
International insurance	28.7%	32.8%	24.9%	31.4%
Reinsurance	29.8%	27.4%	37.0%	34.6%
Total	100.0%	100.0%	100.0%	100.0%

**Net Investment Income**

Net investment income decreased by \$56.6 million, or 18.8%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The decrease was due to a combination of lower accretion of book value to par value for our fixed maturity investments, lower yields on our fixed maturity investments and an increased allocation to other invested assets, which contribute to our total return but carry no current yield. We increased our other invested assets by \$162.9 million between December 31, 2010 and December 31, 2009. In response to new OTTI

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guidance issued by the FASB in April 2009, we increased the book value of our fixed maturity investments for any non-credit OTTI previously recognized, which resulted in higher book values and

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lower future accretions. Please see Note 2(e) of the notes to the consolidated financial statements regarding the change in OTTI policy. The annualized period book yield of the investment portfolio for the year ended December 31, 2010 and 2009 was 3.3% and 4.2%, respectively. The decrease in book yield was due to the overall market interest rate environment being at historically low levels during most of 2010. The decrease in the book yield was also due to increased investment turnover as a result of more active management of the investment portfolio given interest rate and spread volatility. The higher sales and purchases of investment securities resulted in us recognizing \$217.7 million of net realized investment gains for the year ended December 31, 2010 and the proceeds being re-invested at lower yield levels. Investment management expenses of \$11.7 million and \$9.0 million were incurred during the year ended December 31, 2010 and 2009, respectively. The increase in investment management expenses was due to the increase in the size of our investment portfolio, the addition of a new portfolio manager and additional fees paid to investment advisors for higher cost investment strategies.

As of December 31, 2010, approximately 96% of our fixed income investments consisted of investment grade securities. The average credit rating of our fixed income portfolio was AA as rated by Standard & Poor's and Aa2 as rated by Moody's, with an average duration of approximately 2.7 years as of December 31, 2010. The average duration of the investment portfolio was 3.0 years as of December 31, 2009.

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

During the year ended December 31, 2010, we recognized \$285.6 million in net realized investment gains compared to net realized investment gains of \$126.4 million during the year ended December 31, 2009. During the year ended December 31, 2010, we recognized \$0.2 million in net impairment charges recognized in earnings compared to \$49.6 million during the year ended December 31, 2009. Net realized investment gains of \$285.6 million for the year ended December 31, 2010 were comprised of the following:

Net realized investment gains of \$217.7 million primarily from the sale of fixed maturity securities due to the rebalancing of our portfolio from U.S. Treasury and agency securities into other asset classes and shortening the overall duration of our investment portfolio as discussed above. The realization of gains is not an explicit strategy of the company but a by-product of actively managing the portfolio. During 2010 active management consisted of managing the duration (increasing the duration to 3.5 years as of March 31, 2010 and decreasing the duration for the remainder of the year) and sector exposures of the portfolio in anticipation of potential interest rate movements and sector spread levels. During 2010, we hired an additional fixed income manager. The transition from the existing manager to our newest manager also contributed to the higher turnover and level of realized investment gains. While we expect to continue to actively manage the portfolio during 2011, we would expect somewhat lower turnover.

Net realized investment gains of \$71.9 million primarily related to the mark-to-market adjustments for our other invested assets, equity securities and fixed maturity investments that are accounted for as trading securities. We expect the mark-to-market adjustments on our fixed maturity investments that are accounted for as trading securities to increase as we continue to increase the balance of these securities. From December 31, 2009 to December 31, 2010, we have increased the balance of fixed maturity investments accounted for as trading by \$3.3 billion, or 126.7%, from \$2.5 billion as of December 31, 2009 to \$5.8 billion as of December 31, 2010. Contributing to the increase was the reclassification of all of our mortgage-backed and asset-backed securities from available for sale to trading on July 1, 2010 as part of the adoption of ASU 2010-11.

	<b>Mark-to-Market Adjustments for the Year Ended December 31, 2010 (\$ in millions)</b>	
Fixed maturity investments accounted for as trading securities	\$	42.2
Other invested assets and equity securities		29.7
<b>Total</b>	<b>\$</b>	<b>71.9</b>

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Net realized investment loss of \$4.0 million related to a U.S. Treasury yield hedge transaction we purchased in May 2010 and terminated in June 2010.

Net realized investment gains of \$126.4 million for the year ended December 31, 2009 were comprised of the following:

Net realized investment gains of \$94.5 million from the sale of securities, primarily due to the sale of fixed maturity bonds partially offset by a realized loss of \$21.9 million due to the sale of our global high-yield bond fund.

Net realized investment gains of \$31.9 million related to the mark-to-market adjustments of our other invested assets and fixed maturity investments that are accounted for as trading securities.

During the year ended December 31, 2009, we had \$49.6 million of net impairment charges recognized in earnings, \$7.7 million was due to credit related losses where the anticipated discounted cash flows of various debt securities were lower than the amortized cost, and \$41.9 million was due to net impairment charges for those securities in an unrealized loss position where our investment managers had the discretion to sell.

**Other Income**

The other income of \$0.9 million and \$1.5 million for the years ended December 31, 2010 and 2009, respectively, represents fee income from the program administrator and wholesale brokerage operation. We sold these operations during the year ended December 31, 2010 for a gain of \$1.9 million.

**Net Losses and Loss Expenses**

Net losses and loss expenses increased by \$103.8 million, or 17.2%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in net losses and loss expenses was due to a number of individual losses totaling \$164.6 million in the current year, with no comparable events having occurred during the year ended December 31, 2009. We incurred \$98.4 million of catastrophe related losses, of which \$66.8 million was from the Chilean earthquake, \$17.0 million from the New Zealand Earthquake and \$14.6 million from the Australian floods. The increase due to higher loss activity was partially offset by higher net favorable prior year reserve development.

We recorded net favorable reserve development related to prior years of \$313.3 million and \$248.0 million during the years ended December 31, 2010 and 2009, respectively. The following table shows the net favorable reserve development of \$313.3 million by loss year for each of our segments for the year ended December 31, 2010. In the table, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	<b>Loss Reserve Development by Loss Year</b>								
	<b>For the Year Ended December 31, 2010</b>								
	2002	2003	2004	2005	2006	2007	2008	2009	Total
	(\$ in millions)								
U.S. insurance	\$ (1.6)	\$ (3.2)	\$ (25.6)	\$ (26.2)	\$ (5.3)	\$ (1.7)	\$ (2.5)	\$ (2.4)	\$ (68.5)
International insurance	6.8	(6.7)	(21.6)	(87.5)	(36.7)	(19.3)	(23.1)	7.5	(180.6)
Reinsurance	(0.9)	(1.0)	(9.8)	(33.0)	(12.4)	(3.8)	3.0	(6.3)	(64.2)
	\$ 4.3	\$ (10.9)	\$ (57.0)	\$ (146.7)	\$ (54.4)	\$ (24.8)	\$ (22.6)	\$ (1.2)	\$ (313.3)

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The following table shows the favorable reserve development of \$248.0 million by loss year for each of our segments for the year ended December 31, 2009. In the table, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	Loss Reserve Development by Loss Year For the Year Ended December 31, 2009 (\$ in millions)							
	2002	2003	2004	2005	2006	2007	2008	Total
U.S. insurance	\$ (6.7)	\$ (22.3)	\$ (36.3)	\$ (19.6)	\$ 1.4	\$ 5.8	\$ 7.3	\$ (70.4)
International insurance	(5.8)	(18.7)	(61.1)	(78.7)	11.3	(8.5)	22.0	(139.5)
Reinsurance	(4.0)	(16.2)	(20.7)	(4.2)	(1.1)	5.2	2.9	(38.1)
Total	\$ (16.5)	\$ (57.2)	\$ (118.1)	\$ (102.5)	\$ 11.6	\$ 2.5	\$ 32.2	\$ (248.0)

The loss and loss expense ratio for the year ended December 31, 2010 was 52.1% compared to 45.9% for the year ended December 31, 2009. Net favorable reserve development recognized in the year ended December 31, 2010 reduced the loss and loss expense ratio by 23.1 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 75.2%. Net favorable reserve development recognized in the year ended December 31, 2009 reduced the loss and loss expense ratio by 18.8 percentage points. Thus, the loss and loss expense ratio related to that loss year was 64.7%. The increase in the loss and loss expense ratio for the current loss year was primarily due to a net increase in loss reserves of \$164.6 million from a number of earthquakes, explosions and other weather related events during the year ended December 31, 2010, which contributed 12.1 points to the current loss year's loss and loss expense ratio.

The following table shows the components of the increase in net losses and loss expenses of \$103.8 million for the year ended December 31, 2010 compared to the year ended December 31, 2009.

	Year Ended December 31,		Dollar Change
	2010	2009 (\$ in millions)	
Net losses paid	\$ 596.7	\$ 458.2	\$ 138.5
Net change in reported case reserves	76.2	76.0	0.2
Net change in IBNR	35.0	69.9	(34.9)
Net losses and loss expenses	\$ 707.9	\$ 604.1	\$ 103.8

The increase in net losses paid for the year ended December 31, 2010 was due to higher paid losses in each of our operating segments. The decrease in reported case reserves was primarily due to lower case reserves in our international insurance segment due to the payment of claims partially offset by increased case reserves in our U.S. insurance and reinsurance segments. The decrease in IBNR was due to lower IBNR in our international insurance and reinsurance segments primarily due to net favorable reserve development partially offset by higher IBNR in our U.S. insurance segment due to the growth of U.S. operations.

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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.

	Year Ended December 31,	
	2010	2009
	(\$ in millions)	
Net reserves for losses and loss expenses, January 1	\$ 3,841.8	\$ 3,688.5
Incurred related to:		
Commutation of variable-rated reinsurance contracts	8.9	
Current period non-catastrophe	913.9	852.1
Current period property catastrophe	98.4	
Prior period non-catastrophe	(300.0)	(251.7)
Prior period property catastrophe	(13.3)	3.7
<b>Total incurred</b>	<b>\$ 707.9</b>	<b>\$ 604.1</b>
Paid related to:		
Current period non-catastrophe	61.0	42.3
Current period property catastrophe	37.6	
Prior period non-catastrophe	475.3	343.4
Prior period property catastrophe	22.8	72.5
<b>Total paid</b>	<b>\$ 596.7</b>	<b>\$ 458.2</b>
Foreign exchange revaluation	(1.4)	7.4
<b>Net reserve for losses and loss expenses, December 31</b>	<b>3,951.6</b>	<b>3,841.8</b>
<b>Losses and loss expenses recoverable</b>	<b>927.6</b>	<b>920.0</b>
<b>Reserve for losses and loss expenses, December 31</b>	<b>\$ 4,879.2</b>	<b>\$ 4,761.8</b>

**Acquisition Costs**

Acquisition costs increased by \$10.6 million, or 7.2%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in acquisition costs was primarily due to the increase in net premiums earned in our U.S. insurance segment and reinsurance segment, which typically have higher acquisition costs than our international insurance segment and represent a higher proportion of net premiums earned during the year ended December 31, 2010 compared to the same period in 2009. Acquisition costs as a percentage of net premiums earned were 11.7% for the year ended December 31, 2010 compared to 11.3% for the same period in 2009.

**General and Administrative Expenses**

General and administrative expenses increased by \$37.9 million, or 15.2%, for the year ended December 31, 2010 compared to the same period in 2009. The increase in general and administrative expenses was primarily due to the following:

An overall increase in global headcount from 652 at December 31, 2009 to 689 at December 31, 2010 resulting in an overall increase in salary and related costs of \$18.0 million, excluding stock-related compensation.

Increased stock-related compensation of \$8.5 million, which included a one-time increase of \$4.3 million for performance-based awards granted under the Company's equity plans in 2009 to recognize expected performance above the target level. For all performance-based awards, we initially recognize the stock compensation expense at 100% of the fair market value of our common shares on the date of grant and reassess, at least annually, the projected growth in book value to determine whether an adjustment to the initial estimate of the

expense should be made. During the year ended December 31, 2010, we have

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accrued 150% of the fair market value of Allied World Switzerland's common shares awarded, as we believe it is probable that we will achieve the maximum performance criteria when these performance-based awards vest at the end of 2011. For additional information on our performance-based awards, see Note 13 "Employee Benefit Plans" in our notes to the consolidated financial statements.

A one-time increase of \$12.5 million in professional fees during the year ended December 31, 2010 primarily related to the establishment and operation of Syndicate 2232 and our efforts to effect our redomestication to Switzerland.

Also related to our redomestication to Switzerland, we incurred a 1% capital stamp duty of \$1.6 million related to a capital contribution of \$160.0 million from Allied World Bermuda to Allied World Switzerland, which was a one-time expense.

Decrease of \$5.0 million related to the Darwin Long-Term Incentive Plan ("Darwin LTIP"). We recognized an increase in the Darwin LTIP of \$0.9 million during the year ended December 31, 2010 compared to an increase of \$5.9 million during the year ended December 31, 2009. The amount incurred for the Darwin LTIP is a result of pre-acquisition underwriting profitability, including any subsequent loss reserve development. The reduction in the Darwin LTIP during the year ended December 31, 2010 was due to lower favorable reserve development experienced during the year.

Our general and administrative expense ratio was 21.1% for the year ended December 31, 2010, which was higher than the 18.9% for the year ended December 31, 2009. The increase was primarily due to the factors discussed above.

Our expense ratio was 32.8% for the year ended December 31, 2010 compared to 30.2% for the year ended December 31, 2009 due to an increase in both acquisition cost ratio and general and administrative expense ratio.

### ***Amortization and Impairment of Intangible Assets***

The amortization and impairment of intangible assets decreased \$7.6 million, or 68.5%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The decrease is primarily the result of no longer amortizing the trademark intangible asset that was fully impaired for \$6.9 million during the year ended December 31, 2009. No impairments were recognized during the year ended December 31, 2010.

### ***Interest Expense***

Interest expense increased \$1.2 million, or 3.0%, for the year ended December 31, 2010 compared to the year ended December 31, 2009 primarily as a result of additional interest expense on our 5.5% senior notes that were issued in November 2010.

### ***Income Tax Expense***

Tax expense decreased \$9.7 million, or 26.5%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. Overall our tax expense is driven by our U.S. operations, which represents the largest taxable operation of the company. The decrease in tax expense is primarily due to lower taxable income for our U.S. operations of approximately \$19.5 million, which resulted in approximately \$6.9 million lower tax expense during the year ended December 31, 2010 compared to the year ended December 31, 2009. The lower tax expense was also caused by a \$5.0 million loss for tax purposes on the sale of our program administrator and wholesale brokerage operation during 2010 which caused a reduction of tax expense in 2010 of \$1.7 million. Our consolidated effective tax rates for the years ended December 31, 2010 and 2009 were 3.9% and 5.7%, respectively. The decrease in the effective tax rate was due to the factors discussed above.

### ***Net Income***

Net income for the year ended December 31, 2010 was \$665.0 million compared to \$606.9 million for the year ended December 31, 2009. The increase was primarily the result of higher net realized investment gains, higher net premiums earned and lower OTTI, partially offset by increased general and administrative expenses and higher current year catastrophe losses. Net income for the year ended December 31, 2010 included a net foreign exchange loss of \$0.4 million compared to a net foreign exchange loss of \$0.7 million for the year ended December 31, 2009.





**Table of Contents****Underwriting Results by Operating Segments**

Our company is organized into three operating segments:

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

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

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

**U.S. Insurance Segment**

The following table summarizes the underwriting results and associated ratios for the U.S. insurance segment for the years ended December 31, 2011, 2010 and 2009.

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions)		
<b>Revenues</b>			
Gross premiums written	\$ 838.6	\$ 729.3	\$ 674.8
Net premiums written	639.2	551.1	493.1
Net premiums earned	584.3	518.4	447.5
Other income		0.9	1.5
<b>Expenses</b>			
Net losses and loss expenses	387.1	297.5	211.4
Acquisition costs	75.0	67.8	58.1
General and administrative expenses	124.4	128.5	115.8
Underwriting (loss) income	(2.2)	25.5	63.7
<b>Ratios</b>			
Loss and loss expense ratio	66.2%	57.4%	47.2%
Acquisition cost ratio	12.8%	13.1%	13.0%
General and administrative expense ratio	21.3%	24.8%	25.9%
Expense ratio	34.1%	37.9%	38.9%
Combined ratio	100.3%	95.3%	86.1%

**Comparison of Years Ended December 31, 2011 and 2010**

*Premiums.* Gross premiums written increased by \$109.3 million, or 15.0%, for the year ended December 31, 2011 compared to the same period in 2010. The increase in gross premiums written was primarily due to new business from existing products, \$55.1 million in premiums from new products, specifically in our general casualty, environmental and inland marine lines of business and rate increases in our general property and general casualty lines of business. This growth was partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions), rate reductions in our other lines of business and increased competition.

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

	Year Ended December 31,		Dollar Change	Percentage Change
	2011	2010		
	(\$ in millions)			
Professional liability	\$ 235.4	\$ 211.1	\$ 24.3	11.5%
General casualty	205.3	145.7	59.6	40.9
Healthcare	201.7	179.8	21.9	12.2
Programs	87.1	105.6	(18.5)	(17.5)
General property	78.5	73.7	4.8	6.5
Other*	30.6	13.4	17.2	128.4
	\$ 838.6	\$ 729.3	\$ 109.3	15.0%

\* Includes our inland marine and environmental lines of business

Net premiums written increased by \$88.1 million, or 16.0%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in net premiums written was primarily due to higher gross premiums written and the commutation of certain variable-rated reinsurance contracts that have swing-rated provisions, which reduced premiums ceded by \$12.4 million. In commuting these swing-rated reinsurance contracts, we reduced certain premiums previously ceded and also reduced ceded losses by \$11.5 million in accordance with the terms of the contracts. The net impact of the commutation was a net gain of \$0.9 million. For the year ended December 31, 2010, the commutation of certain variable-rated reinsurance contracts reduced premiums ceded by \$9.3 million. Overall, we ceded 23.8% of gross premiums written for the year ended December 31, 2011 compared to 24.4% for the year ended December 31, 2010. The decrease in the cession percentage was primarily due to the reduction of premiums ceded related to the commutation of the swing-rated reinsurance contracts. Excluding the impact of the commutation, we ceded 25.3% and 25.7% of gross premiums written during the years ended December 31, 2011 and 2010, respectively.

Net premiums earned increased \$65.9 million, or 12.7%, resulting from the growth of our U.S. insurance operations during 2010 and 2011. Additionally, the commutation of swing-rated reinsurance contracts during the year ended December 31, 2011 added \$12.4 million to net premiums earned compared to \$9.3 million during the year ended December 31, 2010.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$89.6 million, or 30.1%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in net losses and loss expenses was primarily due to the growth of the U.S. insurance operations, lower prior year net favorable reserve development and unfavorable prior year reserve development in the 2006 loss year related to directors and officers claims within our professional liability line of business concerning a class action suit filed against a number of private equity firms alleging collusion. We recognized estimated losses from catastrophes of \$8.3 million, which included \$3.8 million developing from the Midwestern U.S. storms earlier in the year and \$4.5 million from Hurricane Irene during the year ended December 31, 2011.

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Overall, our U.S. insurance segment recorded net favorable reserve development of \$23.2 million during the year ended December 31, 2011 compared to net favorable reserve development of \$68.5 million for the year ended December 31, 2010 as shown in the tables below. The \$23.2 million of net favorable reserve development excludes the impact of the commutation of the swing-rated reinsurance contracts of \$11.5 million discussed above and the \$68.5 million of net favorable reserve development for the year ended December 31, 2010 excludes the impact of the commutation of the swing-rated reinsurance contracts of \$8.9 million. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	<b>Loss Reserve Development by Loss Year For the Year Ended December 31, 2011</b>									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
	(\$ in millions)									
General casualty	\$	\$ (0.9)	\$ (1.5)	\$ (17.4)	\$ (2.9)	\$ 2.5	\$ (1.9)	\$ (0.9)	\$ 0.5	\$ (22.5)
Healthcare	(0.4)	(1.8)	(2.7)		(1.4)	0.1	(0.9)	0.3	(2.6)	(9.4)
General property Programs			(0.1)	(0.4)	0.1	(1.1)	(0.3)	(1.0)	(1.2)	(4.0)
Professional liability		(0.2)	(0.3)	(2.5)	23.4	(7.0)	(0.8)	(6.4)	7.1	13.3
	\$ (0.4)	\$ (2.9)	\$ (4.6)	\$ (20.5)	\$ 19.1	\$ (7.6)	\$ (4.7)	\$ (7.2)	\$ 5.6	\$ (23.2)

	<b>Loss Reserve Development by Loss Year for the Year Ended December 31, 2010</b>									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
	(\$ in millions)									
General casualty		\$ (1.4)	\$ (1.4)	\$ (2.6)	\$ (6.6)	\$ (1.4)	\$ (1.7)	\$ (1.5)	\$ (3.2)	\$ (19.8)
Healthcare		(0.2)	(1.6)	(21.9)	(7.3)		(0.6)	3.2		(28.4)
General property Programs			(0.8)	(10.5)	(3.6)	(1.8)	(1.9)	5.6		(13.0)
Professional liability			(0.2)	(0.3)	(1.8)	(0.2)	0.9	(2.3)	(3.7)	(7.6)
	\$ (1.6)	\$ (3.2)	\$ (25.6)	\$ (26.3)	\$ (5.3)	\$ (1.6)	\$ (2.5)	\$ (2.4)		\$ (68.5)

The loss and loss expense ratio for the year ended December 31, 2011 was 66.2% compared to 57.4% for the year ended December 31, 2010. Net favorable reserve development recognized and the impact of the commutation adjustment to ceded IBNR in the year ended December 31, 2011 decreased the loss and loss expense ratio by 3.8 percentage points. Thus, the loss and loss expense ratio for the current loss year was 70.0%, which includes \$8.3 million in losses from catastrophes. In comparison, net favorable reserve development recognized and the impact of the commutation adjustment to ceded IBNR in the year ended December 31, 2010 decreased the loss and loss expense ratio by 13.2 percentage points. Thus, the loss and loss expense ratio for that loss year was 70.6% which included a \$12.0 million net loss on a Connecticut power plant explosion.

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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.

	Year Ended December 31,	
	2011	2010
Net reserves for losses and loss expenses, January 1	\$ 1,035.1	\$ 901.9
Incurred related to:		
Commutation of variable-rated reinsurance contracts	11.5	8.9
Current period non-catastrophe	390.5	357.1
Current period catastrophe	8.3	
Prior period non-catastrophe	(22.0)	(68.8)
Prior period catastrophe	(1.2)	0.3
Total incurred	\$ 387.1	\$ 297.5
Paid related to:		
Current period non-catastrophe	37.3	22.2
Current period catastrophe	2.9	
Prior period non-catastrophe	157.5	137.0
Prior period catastrophe	0.4	5.1
Total paid	\$ 198.1	\$ 164.3
Net reserve for losses and loss expenses, December 31	1,224.1	1,035.1
Losses and loss expenses recoverable	438.3	396.6
Reserve for losses and loss expenses, December 31	\$ 1,662.4	\$ 1,431.7

*Acquisition costs.* Acquisition costs increased by \$7.2 million or 10.6% for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase was primarily caused by increased net premiums earned. The acquisition cost ratio decreased slightly to 12.8% for the year ended December 31, 2011 from 13.1% for the same period in 2010.

*General and administrative expenses.* General and administrative expenses decreased by \$4.1 million, or 3.2%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The decrease in general and administrative expenses was primarily due to a decrease in performance based incentive compensation expenses. The decrease in the general and administrative expense ratio from 24.8% for the year ended December 31, 2010 to 21.3% for the same period in 2011 was primarily caused by increased net premiums earned and the decrease in expenses as discussed above.

**Comparison of Years Ended December 31, 2010 and 2009**

*Premiums.* Gross premiums written increased by \$54.5 million, or 8.1%, for the year ended December 31, 2010 compared to the same period in 2009. The increase in gross premiums written was primarily due to increases to our underwriting staff and a higher volume of gross premiums written from new products in our general casualty and other lines of business where we believe attractive underwriting opportunities exist. In addition, we experienced rate increases within our general casualty and general property lines of business. These increases were partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition, particularly for public directors and officers liability products in our professional liability line of business.

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

	Year Ended December 31,		Dollar Change	Percentage Change
	2010	2009		
	(\$ in millions)			
Professional liability	\$ 211.1	\$ 202.0	\$ 9.1	4.5%
Healthcare	179.8	177.7	2.1	1.2
General casualty Programs	145.7	122.0	23.7	19.4
General property	105.6	101.5	4.1	4.0
Other	73.7	71.5	2.2	3.1
	13.4	0.1	13.3	n/m*
	\$ 729.3	\$ 674.8	\$ 54.5	8.1%

\* n/m: not meaningful

Net premiums written increased by \$58.0 million, or 11.8%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in net premiums written was primarily due to higher gross premiums written, as well as a reduction of premiums ceded. The reduction in premiums ceded was primarily due to lower cessions in our general casualty and general property lines of business, as well as the commutation and adjustment of certain variable-rated reinsurance contracts that have swing-rated provisions of \$9.3 million. Overall, we ceded 24.4% of gross premiums written for the year ended December 31, 2010 compared to 26.9% for the year ended December 31, 2009. The decrease in the cession percentage was primarily due to the reduction of premiums ceded related to the commutation of the swing-rated reinsurance contracts. Excluding the impact of the commutation, we ceded 25.7% of gross premiums written during the year ended December 31, 2010.

Net premiums earned increased \$70.9 million, or 15.8%, primarily due to the growth of our U.S. insurance operations during 2009 and 2010 and \$9.3 million from the commutation, which was fully earned.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$86.1 million, or 40.7%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in net losses and loss expenses was primarily due to the continued growth of our U.S. operations, current year losses of \$25.8 million primarily in our general property and programs lines of business, as well as the reduction of ceded IBNR for the commutation of the swing-rated reinsurance contracts of \$8.9 million and lower net favorable reserve development recognized.

Overall, our U.S. insurance segment recorded net favorable reserve development of \$68.5 million during the year ended December 31, 2010 compared to net favorable reserve development of \$70.4 million for the year ended December 31, 2009 as shown in the tables below. The \$68.5 million of net favorable reserve development excludes the impact of the commutation of the swing-rated reinsurance contracts of \$8.9 million discussed above. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	Loss Reserve Development by Loss Year for the Year Ended December 31, 2010								
	2002	2003	2004	2005	2006	2007	2008	2009	Total
	(\$ in millions)								
General casualty	\$ (1.4)	\$ (1.4)	\$ (2.6)	\$ (6.6)	\$ (1.4)	\$ (1.7)	\$ (1.5)	\$ (3.2)	\$ (19.8)
Healthcare	(0.2)	(1.6)	(21.9)	(7.3)		(0.6)	3.2		(28.4)
General property			(0.8)	(10.5)	(3.6)	(1.8)	(1.9)	5.6	(13.0)
Programs				(0.1)	(0.1)	1.6		(1.1)	0.3

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Professional liability	(0.2)	(0.3)	(1.8)	(0.2)	0.9	(2.3)	(3.7)	(7.6)	
	\$ (1.6)	\$ (3.2)	\$ (25.6)	\$ (26.3)	\$ (5.3)	\$ (1.6)	\$ (2.5)	\$ (2.4)	\$ (68.5)

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	Loss Reserve Development by Loss Year for the Year Ended December 31, 2009							Total
	2002	2003	2004	2005	2006	2007	2008	
	(\$ in millions)							
General casualty	\$ (3.7)	\$ (19.7)	\$ (17.8)	\$ 1.2	\$ 3.7	\$ 1.2	\$ 13.4	\$ (21.7)
Healthcare	(1.4)	(0.5)	(10.5)	(11.5)	(6.0)	(2.6)	(8.1)	(40.6)
General property	(1.6)	(2.0)	(3.6)	(4.5)	(1.5)	(0.4)	7.0	(6.6)
Programs				(0.7)	(2.5)	(0.9)	(6.5)	(10.6)
Professional liability		(0.1)	(4.4)	(4.1)	7.8	8.4	1.5	9.1
	\$ (6.7)	\$ (22.3)	\$ (36.3)	\$ (19.6)	\$ 1.5	\$ 5.7	\$ 7.3	\$ (70.4)

The loss and loss expense ratio for the year ended December 31, 2010 was 57.4% compared to 47.2% for the year ended December 31, 2009. Net favorable reserve development recognized and the impact of the commutation adjustment to ceded IBNR in the year ended December 31, 2010 decreased the loss and loss expense ratio by 13.2 percentage points. Thus, the loss and loss expense ratio for the current loss year was 70.6%. In comparison, net favorable reserve development recognized in the year ended December 31, 2009 decreased the loss and loss expense ratio by 15.7 percentage points. In addition, the \$3.0 million decrease in premiums ceded for variable-rated reinsurance contracts of Darwin that have swing-rated provisions increased the loss and loss expense ratio by 0.4 percentage points. Thus, the loss and loss expense ratio for that loss year was 63.3%. The increase in the loss and loss expense ratio for the current loss year was primarily due to losses of \$25.8 million noted above. These losses contributed 5.0 percentage points to the current loss year's loss and loss expense ratio, after adjusting for the \$9.3 million impact to ceded earned premium of the commuted swing-rated reinsurance contracts previously discussed.

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.

	Year Ended December 31,	
	2010	2009
Net reserves for losses and loss expenses, January 1	\$ 901.9	\$ 819.4
Incurred related to:		
Commutation of variable-rated reinsurance contracts	8.9	
Current period non-catastrophe	357.1	281.8
Current period catastrophe		
Prior period non-catastrophe	(68.8)	(74.9)
Prior period catastrophe	0.3	4.5
Total incurred	\$ 297.5	\$ 211.4
Paid related to:		
Current period non-catastrophe	22.2	12.1
Current period catastrophe		
Prior period non-catastrophe	137.0	99.2
Prior period catastrophe	5.1	17.6
Total paid	\$ 164.3	\$ 128.9
Net reserve for losses and loss expenses, December 31	1,035.1	901.9
Losses and loss expenses recoverable	396.6	351.8
Reserve for losses and loss expenses, December 31	\$ 1,431.7	\$ 1,253.7





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*Acquisition costs.* Acquisition costs increased by \$9.7 million for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase was primarily caused by increased net premiums earned. The acquisition cost ratio increased slightly to 13.1% for the year ended December 31, 2010 from 13.0% for the same period in 2009.

*General and administrative expenses.* General and administrative expenses increased by \$12.7 million, or 11.0%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in general and administrative expenses was primarily due to higher salary and related costs from increased headcount offset by the reduction in the Darwin LTIP of \$5.0 million. The decrease in the general and administrative expense ratio from 25.9% for the year ended December 31, 2009 to 24.8% for the same period in 2010 was the result of the increase in net premiums earned.

**International Insurance Segment**

The following table summarizes the underwriting results and associated ratios for the international insurance segment for the years ended December 31, 2011, 2010 and 2009.

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions)		
<b>Revenues</b>			
Gross premiums written	\$ 530.4	\$ 504.9	\$ 555.9
Net premiums written	325.1	319.1	362.9
Net premiums earned	317.0	338.8	413.2
<b>Expenses</b>			
Net losses and loss expenses	206.6	160.2	158.1
Acquisition costs	(2.8)	(0.5)	2.7
General and administrative expenses	84.3	94.2	84.4
Underwriting income	28.9	84.9	168.0
<b>Ratios</b>			
Loss and loss expense ratio	65.2%	47.3%	38.3%
Acquisition cost ratio	(0.9)%	(0.1)%	0.7%
General and administrative expense ratio	26.6%	27.8%	20.4%
Expense ratio	25.7%	27.7%	21.1%
Combined ratio	90.9%	75.0%	59.4%

**Comparison of Years Ended December 31, 2011 and 2010**

*Premiums.* Gross premiums written increased by \$25.5 million, or 5.1%, for the year ended December 31, 2011 compared to the same period in 2010. The increase in gross premiums written was primarily a result of new business, including \$12.5 million from new products, specifically related to our trade credit line of business and small to mid-sized enterprise (SME) insurance products. In addition, we increased premiums in our healthcare line of business and experienced rate increases within our general property line of business. This growth was partially offset by the continued trend of the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) including the non-renewal of one general property policy that was previously written during the year ended December 31, 2010 for \$5.1 million and the non-renewal of several policies totaling \$15.7 million in our general casualty line of business.

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

	Year Ended December 31,		Dollar Change	Percentage Change
	2011	2010		
	(\$ in millions)			
Professional liability*	\$ 164.4	\$ 160.7	\$ 3.7	2.3%
General property	159.4	150.7	8.7	5.8
General casualty	127.2	132.3	(5.1)	(3.9)
Healthcare	68.1	59.3	8.8	14.8
Other**	11.3	1.9	9.4	n/m
	\$ 530.4	\$ 504.9	\$ 25.5	5.1%

\* Includes our SME line of business

\*\* Includes our trade credit line of business

Net premiums written increased \$6.0 million, or 1.9%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. Net premiums written increased at a lower percentage than gross premiums written due to an increase in ceded premiums written on our professional lines treaty as well as the establishment of a trade credit treaty. We ceded to reinsurers 38.7% of gross premiums written for the year ended December 31, 2011 compared to 36.8% for the year ended December 31, 2010. The increase is primarily due to increased cessions on our general casualty and professional liability lines of business.

Net premiums earned decreased \$21.8 million, or 6.4%, primarily due to lower net premiums written during 2010.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$46.4 million, or 29.0%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in net losses and loss expenses was primarily due to higher loss activity in the current period and lower net favorable reserve development recognized. Catastrophe loss activity recognized during the year ended December 31, 2011 included net losses and loss expenses of \$45.0 million related to the Tohoku earthquake and tsunami, \$17.7 million related to the storms in the Midwestern United States, \$12.7 million related to the New Zealand earthquake, \$22.8 million related to the Thailand floods, \$8.0 million related to Hurricane Irene and \$1.4 million related to the Australian storms.

Overall, our international insurance segment recorded net favorable reserve development of \$118.5 million during the year ended December 31, 2011 compared to net favorable reserve development of \$180.6 million for the year ended December 31, 2010, as shown in the tables below. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	Loss Reserve Development by Loss Year For the Year Ended December 31, 2011									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
	(\$ in millions)									
General property	\$	\$(0.1)	\$(1.6)	\$(2.7)	\$(0.7)	\$(1.1)	\$(28.9)	\$(17.5)	\$ 4.6	\$(48.0)
General casualty	(1.0)	(4.2)	2.8	(16.0)	(16.0)	(14.1)	(7.3)	7.2	22.5	(26.1)
Healthcare	(0.2)	(0.1)	(1.8)	(2.0)	(9.7)	(10.5)		0.2		(24.1)
Professional liability	2.0	8.5	(6.1)	(12.6)	(18.9)	(14.8)	21.6			(20.3)

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\$ 0.8	\$ 4.1	\$ (6.7)	\$ (33.3)	\$ (45.3)	\$ (40.5)	\$ (14.6)	\$ (10.1)	\$ 27.1	\$ (118.5)
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The unfavorable reserve development in our professional liability segment for the 2008 loss year related primarily to a greater reliance on the Bornhuetter-Ferguson reported loss method than on the expected loss ratio

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method. The unfavorable reserve development in our international insurance segment for the 2010 loss year was primarily due to a casualty claim emanating from an oil field service risk.

	<b>Loss Reserve Development by Loss Year For the Year Ended December 31, 2010</b>								
	2002	2003	2004	2005	2006	2007	2008	2009	Total
	(\$ in millions)								
General property	\$	\$ (0.1)	\$	\$ (6.0)	\$ (6.4)	\$ (12.8)	\$ (34.4)	\$ (0.3)	\$ (60.0)
General casualty	5.1	(2.3)	(15.3)	(29.8)	(7.6)	(6.5)	11.3	7.8	(37.3)
Healthcare	(0.3)	(1.5)	(2.2)	(9.9)	(22.5)				(36.4)
Professional liability	2.0	(2.8)	(4.1)	(41.8)	(0.2)				(46.9)
	\$ 6.8	\$ (6.7)	\$ (21.6)	\$ (87.5)	\$ (36.7)	\$ (19.3)	\$ (23.1)	\$ 7.5	\$ (180.6)

The loss and loss expense ratio for the year ended December 31, 2011 was 65.2%, compared to 47.3% for the year ended December 31, 2010. The net favorable reserve development recognized during the year ended December 31, 2011 decreased the loss and loss expense ratio by 37.4 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 102.6%. Comparatively, the net favorable reserve development recognized during the year ended December 31, 2010 decreased the loss and loss expense ratio by 53.3 percentage points. Thus, the loss and loss expense ratio related to that loss year was 100.6%. The increase in the loss and loss expense ratio for the current loss year was primarily due to net incurred catastrophe losses of \$107.6 million which occurred during the year ended December 31, 2011 and contributed 33.9 percentage points to the current year's loss and loss expense ratio compared to \$112.3 million of large individual losses during the year ended December 31, 2010 which contributed 33.1 percentage points to the prior year's loss and loss expense ratio.

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.

	Year Ended December 31,	
	2011	2010
Net reserves for losses and loss expenses, January 1	\$ 1,695.7	\$ 1,790.1
Incurred related to:		
Current period non-catastrophe	217.5	276.7
Current period catastrophe	107.6	64.1
Prior period non-catastrophe	(110.0)	(168.5)
Prior period catastrophe	(8.5)	(12.1)
<b>Total incurred</b>	<b>\$ 206.6</b>	<b>\$ 160.2</b>
Paid related to:		
Current period non-catastrophe	8.1	22.0
Current period catastrophe	18.0	36.5
Prior period non-catastrophe	173.4	181.7
Prior period catastrophe	14.3	13.0
<b>Total paid</b>	<b>\$ 213.8</b>	<b>\$ 253.2</b>
Foreign exchange revaluation	(3.8)	(1.4)
<b>Net reserve for losses and loss expenses, December 31</b>	<b>1,684.7</b>	<b>1,695.7</b>
Losses and loss expenses recoverable	564.3	531.0
<b>Reserve for losses and loss expenses, December 31</b>	<b>\$ 2,249.0</b>	<b>\$ 2,226.7</b>



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**Acquisition costs.** Acquisition costs decreased \$2.3 million for the year ended December 31, 2011 compared to the year ended December 31, 2010. The negative cost represents ceding commissions received on ceded premiums in excess of the brokerage fees and commissions paid on gross premiums written. The acquisition cost ratio decreased from negative 0.1% for the year ended December 31, 2010 to negative 0.9% for the year ended December 31, 2011.

**General and administrative expenses.** General and administrative expenses decreased \$9.9 million, or 10.5%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The decrease in general and administrative expenses was primarily due to a decrease in incentive-based compensation due to higher loss activity as well as a decrease in staffing and related salaries and benefits. The year ended December 31, 2010 included one-time expenses in professional fees related to the establishment of Syndicate 2232 and our efforts to effect our redomestication to Switzerland. These decreases were offset by an increase in fees for a full year of operating our Lloyd's Syndicate 2232 of \$4.4 million in 2011 versus six months of operation in 2010. The general and administrative expense ratios for the years ended December 31, 2011 and 2010 were 26.6% and 27.8%, respectively, due to lower general and administrative expenses.

**Comparison of Years Ended December 31, 2010 and 2009**

**Premiums.** Gross premiums written decreased by \$51.0 million, or 9.2%, for the year ended December 31, 2010 compared to the same period in 2009. The decrease in gross premiums written was due to the continued trend of the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions) and increased competition in our international insurance segment.

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

	Year Ended December 31,		Dollar	Percentage
	2010	2009	Change	Change
	(\$ in millions)			
Professional liability	\$ 160.7	\$ 180.6	\$ (19.9)	(11.0)%
General property	150.7	171.7	(21.0)	(12.2)
General casualty	134.2	147.1	(12.9)	(8.8)
Healthcare	59.3	56.5	2.8	5.0
	\$ 504.9	\$ 555.9	\$ (51.0)	(9.2)%

Net premiums written decreased \$43.8 million, or 12.1%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The decrease in net premiums written was primarily due to the decrease in gross premiums written partially offset by lower premiums ceded on our property catastrophe reinsurance coverage. We ceded to reinsurers 36.8% of gross premiums written for the year ended December 31, 2010 compared to 34.7% for the year ended December 31, 2009. The increase is primarily due to increased cessions on our general casualty and professional liability lines of business. Net premiums earned decreased \$74.4 million, or 18.0%, primarily due to lower net premiums written during 2009 and 2010.

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*Net losses and loss expenses.* Net losses and loss expenses increased by \$2.1 million, or 1.3%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in net losses and loss expenses was primarily due to higher loss activity in the current period partially offset by higher net favorable reserve development recognized. During the year ended December 31, 2010, we experienced net losses and loss expenses of \$112.3 million from a number of earthquakes, explosions and weather related events. Overall, our international insurance segment recorded net favorable reserve development of \$180.6 million during the year ended December 31, 2010 compared to net favorable reserve development of \$139.5 million for the year ended December 31, 2009, as shown in the tables below. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	Loss Reserve Development by Loss Year For the Year Ended December 31, 2010								
	2002	2003	2004	2005	2006	2007	2008	2009	Total
	(\$ in millions)								
General property	\$	\$(0.1)	\$	\$(6.0)	\$(6.4)	\$(12.8)	\$(34.4)	\$(0.3)	\$(60.0)
General casualty	5.1	(2.3)	(15.3)	(29.8)	(7.6)	(6.5)	11.3	7.8	(37.3)
Healthcare	(0.3)	(1.5)	(2.2)	(9.9)	(22.5)				(36.4)
Professional liability	2.0	(2.8)	(4.1)	(41.8)	(0.2)				(46.9)
	\$ 6.8	\$(6.7)	\$(21.6)	\$(87.5)	\$(36.7)	\$(19.3)	\$(23.1)	\$ 7.5	\$(180.6)

	Loss Reserve Development by Loss Year For the Year Ended December 31, 2009							Total
	2002	2003	2004	2005	2006	2007	2008	
	(\$ in millions)							
General property	\$(0.3)	\$(1.4)	\$(3.9)	\$(3.5)	\$(7.4)	\$(8.6)	\$14.2	\$(10.9)
General casualty	(5.0)	(18.0)	(30.1)	(3.0)	18.7	0.1	7.6	(29.7)
Healthcare	(0.5)	(1.0)	(6.3)	(21.7)				(29.5)
Professional liability		1.7	(20.8)	(50.5)			0.2	(69.4)
	\$(5.8)	\$(18.7)	\$(61.1)	\$(78.7)	\$11.3	\$(8.5)	\$22.0	\$(139.5)

The loss and loss expense ratio for the year ended December 31, 2010 was 47.3%, compared to 38.3% for the year ended December 31, 2009. The net favorable reserve development recognized during the year ended December 31, 2010 decreased the loss and loss expense ratio by 53.3 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 100.6%. Comparatively, the net favorable reserve development recognized during the year ended December 31, 2009 decreased the loss and loss expense ratio by 33.8 percentage points. Thus, the loss and loss expense ratio related to that loss year was 72.1%. The increase in the loss and loss expense ratio for the current loss year was primarily due to net incurred losses of \$112.3 million in the preceding paragraph, which occurred during the year ended December 31, 2010 and contributed 33.1 percentage points to the current year's loss and loss expense ratio.



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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.

	Year Ended December 31,	
	2010	2009
Net reserves for losses and loss expenses, January 1	\$ 1,790.1	\$ 1,797.0
Incurred related to:		
Current period non-catastrophe	276.7	297.5
Current period catastrophe	64.1	
Prior period non-catastrophe	(168.5)	(136.5)
Prior period catastrophe	(12.1)	(2.9)
<b>Total incurred</b>	<b>\$ 160.2</b>	<b>\$ 158.1</b>
Paid related to:		
Current period non-catastrophe	22.0	16.1
Current period catastrophe	36.5	
Prior period non-catastrophe	181.7	119.0
Prior period catastrophe	13.0	37.3
<b>Total paid</b>	<b>\$ 253.2</b>	<b>\$ 172.4</b>
Foreign exchange revaluation	(1.4)	7.4
<b>Net reserve for losses and loss expenses, December 31</b>	<b>1,695.7</b>	<b>1,790.1</b>
Losses and loss expenses recoverable	531.0	566.3
<b>Reserve for losses and loss expenses, December 31</b>	<b>\$ 2,226.7</b>	<b>\$ 2,356.4</b>

*Acquisition costs.* Acquisition costs decreased \$3.2 million for the year ended December 31, 2010 compared to the year ended December 31, 2009. The decrease in acquisition costs was due to lower net premiums earned. The acquisition cost ratio decreased from 0.7% for the year ended December 31, 2009 to a negative 0.1% for the year ended December 31, 2010.

*General and administrative expenses.* General and administrative expenses increased \$9.8 million, or 11.6%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in general and administrative expenses was primarily due to an increase in salary and related costs, including stock-based compensation. The general and administrative expense ratios for the years ended December 31, 2010 and 2009 were 27.8% and 20.4%, respectively, due to higher general and administrative expenses and lower net premiums earned.

**Table of Contents****Reinsurance Segment**

The following table summarizes the underwriting results and associated ratios for the reinsurance segment for the years ended December 31, 2011, 2010 and 2009.

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions)		
<b>Revenues</b>			
Gross premiums written	\$ 570.5	\$ 524.2	\$ 465.6
Net premiums written	569.5	522.3	465.2
Net premiums earned	555.7	502.3	456.2
<b>Expenses</b>			
Net losses and loss expenses	365.5	250.2	234.6
Acquisition costs	95.1	92.1	88.0
General and administrative expenses	62.9	63.8	48.4
Underwriting income	32.2	96.2	85.2
<b>Ratios</b>			
Loss and loss expense ratio	65.8%	49.8%	51.4%
Acquisition cost ratio	17.1%	18.3%	19.3%
General and administrative expense ratio	11.3%	12.7%	10.6%
Expense ratio	28.4%	31.0%	29.9%
Combined ratio	94.2%	80.8%	81.3%

**Comparison of Years Ended December 31, 2011 and 2010**

*Premiums.* Gross premiums written increased by \$46.3 million, or 8.8%, for the year ended December 31, 2011 compared to the same period in 2010. The increase in gross premiums written was primarily due to increased writings in our international reinsurance lines of business with the continuing build out of our London and Singapore offices, including business written through Syndicate 2232, as well as \$25.4 million of new business from our new global marine and specialty division. This growth was partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions). In addition, the increase in gross premiums written was partially offset by a two year treaty we wrote in our general casualty reinsurance line of business for \$31.4 million in the year ended December 31, 2010.

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

	Year Ended		Dollar Change	Percentage Change
	2011	December 31, 2010		
	(\$ in millions)			
Bermuda	\$ 204.7	\$ 210.1	\$ (5.4)	(2.6)%
United States	241.6	264.2	(22.6)	(8.6)
Singapore	66.6	16.6	50.0	301.2
Europe	57.6	33.3	24.3	73.0
	\$ 570.5	\$ 524.2	\$ 46.3	8.8%

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

	Year Ended December 31,		Dollar Change	Percentage Change
	2011	2010		
	(\$ in millions)			
International reinsurance	\$ 153.2	\$ 109.0	\$ 44.2	40.6%
Property reinsurance	153.1	133.8	19.3	14.4
General casualty reinsurance*	142.8	174.6	(31.8)	(18.2)
Specialty reinsurance**	64.2	28.8	35.4	122.9
Professional liability reinsurance	57.2	78.0	(20.8)	(26.7)
	\$ 570.5	\$ 524.2	\$ 46.3	8.8%

\* Includes our facultative reinsurance line of business

\*\* Includes our workers compensation catastrophe reinsurance and accident and health reinsurance

Net premiums written increased by \$47.2 million, or 9.0%, consistent with the increase in gross premiums written. Net premiums earned increased \$53.4 million, or 10.6%. Premiums related to our reinsurance business generally earn at a slower rate than those related to our direct insurance business. Direct insurance premiums typically earn ratably over the term of a policy. Reinsurance premiums under a quota share reinsurance contract are typically earned over the same period as the underlying policies, or risks, covered by the contract. As a result, the earning pattern of a quota share reinsurance contract may extend up to 24 months, reflecting the inception dates of the underlying policies. Property catastrophe premiums and premiums for other treaties written on a losses occurring basis earn ratably over the term of the reinsurance contract.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$115.3 million, or 46.1%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in net losses and loss expenses was due to loss activity incurred from the Tohoku earthquake and tsunami of \$51.5 million, \$45.9 million from the New Zealand earthquake, \$32.2 million related to the Midwestern U.S. storms, \$20.2 million related to the Thailand floods, \$11.2 million related to Hurricane Irene and \$15.3 million related to the Australian storms compared to \$26.6 million from a number of earthquakes and other weather related events during the year ended December 31, 2010. The increase in losses and loss expenses from catastrophe losses was partially offset by greater net favorable reserve development during the year ended December 31, 2011.

Overall, our reinsurance segment recorded net favorable reserve development of \$111.8 million and \$64.2 million during the years ended December 31, 2011 and 2010, respectively, as shown in the tables below. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	Loss Reserve Development by Loss Year For the Year Ended December 31, 2011									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
	(\$ in millions)									
Professional liability reinsurance	\$ (0.1)	\$ (0.8)	\$ (3.6)	\$ (9.7)	\$ (12.9)	\$ (7.1)	\$ (1.2)	\$ (0.2)	\$	\$ (35.6)
International reinsurance		(0.2)	(4.2)	(10.9)	(0.2)	(2.8)	(0.3)	(3.5)	(10.8)	(32.9)
General casualty reinsurance	(0.1)	(0.9)	(1.8)	(12.4)	(1.5)	(7.9)	(0.6)		2.9	(22.3)
Specialty reinsurance			(0.2)			(0.8)	(0.2)	(5.7)	(4.1)	(11.0)
Property reinsurance	(0.2)	(0.6)	(1.1)	(2.6)	(1.4)	(2.1)		(1.4)	(0.6)	(10.0)
	\$ (0.4)	\$ (2.5)	\$ (10.9)	\$ (35.6)	\$ (16.0)	\$ (20.7)	\$ (2.3)	\$ (10.8)	\$ (12.6)	\$ (111.8)



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	Loss Reserve Development by Loss Year For the Year Ended December 31, 2010								
	2002	2003	2004	2005	2006	2007	2008	2009	Total
	(\$ in millions)								
Professional liability reinsurance	\$ (0.3)	\$ (0.5)	\$ (5.4)	\$ (10.3)	\$ (9.0)	\$ (1.3)	\$ (0.7)	\$	\$ (27.5)
International reinsurance	(0.1)	(0.3)	(0.7)	(1.5)	(0.4)	0.2	5.7	1.2	4.1
General casualty reinsurance	(0.1)	0.4	(2.3)	(17.7)	(2.6)	(1.5)	(0.3)		(24.1)
Specialty reinsurance			(0.6)	(0.1)		(1.2)	(2.7)		(4.6)
Property reinsurance	(0.3)	(0.7)	(0.9)	(3.4)	(0.4)		1.1	(7.5)	(12.1)
	\$ (0.8)	\$ (1.1)	\$ (9.9)	\$ (33.0)	\$ (12.4)	\$ (3.8)	\$ 3.1	\$ (6.3)	\$ (64.2)

The loss and loss expense ratio for the year ended December 31, 2011 was 65.8%, compared to 49.8% for the year ended December 31, 2010. Net favorable reserve development recognized during the year ended December 31, 2010 reduced the loss and loss expense ratio by 20.1 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 85.9%. In comparison, net favorable reserve development recognized in the year ended December 31, 2010 reduced the loss and loss expense ratio by 12.8 percentage points. Thus, the loss and loss expense ratio related to that loss year was 62.6%. The increase in the loss and loss expense ratio for the current loss year was primarily due to the \$176.3 million of global catastrophe losses discussed above, which contributed 31.7 percentage points to the loss and loss expense ratio for the year ended December 31, 2011. Earthquakes and other weather related events discussed above during the year ended December 31, 2010 contributed \$26.6 million or 5.3 percentage points to the prior year's loss and loss expense ratio.

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.

	Year Ended December 31,	
	2011	2010
Net reserves for losses and loss expenses, January 1	\$ 1,220.8	\$ 1,149.8
Incurred related to:		
Current period non-catastrophe	301.0	280.1
Current period property catastrophe	176.3	34.3
Prior period non-catastrophe	(107.2)	(62.7)
Prior period property catastrophe	(4.6)	(1.5)
<b>Total incurred</b>	<b>\$ 365.5</b>	<b>\$ 250.2</b>
Paid related to:		
Current period non-catastrophe	26.7	16.8
Current period property catastrophe	49.2	1.0
Prior period non-catastrophe	185.3	156.7
Prior period property catastrophe	11.7	4.7
<b>Total paid</b>	<b>\$ 272.9</b>	<b>\$ 179.2</b>
Net reserve for losses and loss expenses, December 31	1,313.4	1,220.8
Losses and loss expenses recoverable	0.3	
<b>Reserve for losses and loss expenses, December 31</b>	<b>\$ 1,313.7</b>	<b>\$ 1,220.8</b>

*Acquisition costs.* Acquisition costs increased by \$3.0 million, or 3.3%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase was primarily a result of higher net premiums earned partially offset by a decrease in profit commissions due to loss activity. The acquisition cost



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ratio was 17.1% for the year ended December 31, 2011, slightly lower than the 18.3% for the year ended December 31, 2010. The decrease in the acquisition cost ratio is due to more business written on an excess-of-loss basis, which typically carries a lower acquisition cost ratio than quota share business.

*General and administrative expenses.* General and administrative expenses decreased \$0.9 million, or 1.4%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The decrease in general and administrative expenses was primarily due to a decrease in performance based incentive compensation expenses partially offset by additional professional fees related to the operation of the Lloyd's Syndicate which was operational for only six months in the prior year. The general and administrative expense ratios for the years ended December 31, 2011 and 2010 were 11.3% and 12.7%, respectively, due to lower general and administrative expenses and higher net premiums earned.

**Comparison of Years Ended December 31, 2010 and 2009**

*Premiums.* Gross premiums written increased by \$58.6 million, or 12.6%, for the year ended December 31, 2010 compared to the same period in 2009. The increase in gross premiums written was primarily due to increased writings in our property and international reinsurance lines of business with the build out of our London and Singapore offices, including business written through Syndicate 2232. We increased our participation on one property reinsurance treaty for \$23.6 million in 2010 from \$9.0 million in 2009, and we wrote one new treaty in our general casualty reinsurance line of business for \$31.4 million. These increases were partially offset by the non-renewal of business that did not meet our underwriting requirements (which included inadequate pricing and/or terms and conditions), increased competition and increased cedent retention.

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

	Year Ended December 31,		Dollar Change	Percentage Change
	2010	2009		
	(\$ in millions)			
Bermuda	\$ 210.1	\$ 192.3	\$ 17.8	9.3%
United States	264.2	255.1	9.1	3.6
Europe	33.3	18.2	15.1	83.0%
Singapore	16.6		16.6	n/a
	\$ 524.2	\$ 465.6	\$ 58.6	12.6%

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

	Year Ended December 31,		Dollar Change	Percentage Change
	2010	2009		
	(\$ in millions)			
General casualty reinsurance	\$ 160.2	\$ 138.5	\$ 21.7	15.7%
Property reinsurance	133.8	100.5	33.3	33.1
International reinsurance	109.0	84.2	24.8	29.5
Professional liability reinsurance	78.0	102.8	(24.8)	(24.1)
Specialty reinsurance	28.8	23.5	5.3	22.6
Facultative reinsurance	14.4	16.1	(1.7)	(10.6)
	524.2	465.6	58.6	12.6%

The specialty reinsurance line of business includes the workers compensation catastrophe reinsurance and accident and health reinsurance.





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Net premiums written increased by \$57.1 million, or 12.3%, which is consistent with the increase in gross premiums written. Net premiums earned increased \$46.1 million, or 10.1% due to earnings on prior writings.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$15.6 million, or 6.6%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in net losses and loss expenses was primarily due to the growth of the reinsurance operations and higher loss activity of \$26.6 million from a number of earthquakes and other weather related events, partially offset by higher net favorable prior year reserve development. Overall, our reinsurance segment recorded net favorable reserve development of \$64.2 million and \$38.1 million during the years ended December 31, 2010 and 2009, respectively, as shown in the tables below. In the tables, a negative number represents net favorable reserve development and a positive number represents net unfavorable reserve development.

	Loss Reserve Development by Loss Year For the Year Ended December 31, 2010								Total
	2002	2003	2004	2005	2006	2007	2008	2009	
	(\$ in millions)								
Professional liability reinsurance	\$ (0.3)	\$ (0.5)	\$ (5.4)	\$ (10.3)	\$ (9.0)	\$ (1.3)	\$ (0.7)	\$	\$ (27.5)
International reinsurance	(0.1)	(0.3)	(0.7)	(1.5)	(0.4)	0.2	5.7	1.2	4.1
General casualty reinsurance	(0.1)	0.4	(2.3)	(17.7)	(2.6)	(1.5)	(0.3)		(24.1)
Specialty reinsurance			(0.6)	(0.1)		(1.2)	(2.7)		4.6
Property reinsurance	(0.3)	(0.7)	(0.9)	(3.4)	(0.4)		1.1	(7.5)	(12.1)
	\$ (0.8)	\$ (1.1)	\$ (9.9)	\$ (33.0)	\$ (12.4)	\$ (3.8)	\$ 3.1	\$ (6.3)	\$ (64.2)

	Loss Reserve Development by Loss Year For the Year Ended December 31, 2009							Total
	2002	2003	2004	2005	2006	2007	2008	
	(\$ in millions)							
Professional liability reinsurance	\$ (3.1)	\$ (6.8)	\$ (13.2)	\$ (1.5)	\$ (0.1)	\$ 8.1	\$ 3.5	\$ (13.1)
International reinsurance	(0.2)	(0.6)	1.1	(0.1)		4.6	3.2	8.0
General casualty reinsurance	(0.6)	(9.1)	(7.7)	(7.1)	(0.9)			(25.4)
Specialty reinsurance			(0.9)	1.2				0.3
Property reinsurance	(0.1)	0.2		3.3		(7.6)	(3.7)	(7.9)
	\$ (4.0)	\$ (16.3)	\$ (20.7)	\$ (4.2)	\$ (1.0)	\$ 5.1	\$ 3.0	\$ (38.1)

The loss and loss expense ratio for the year ended December 31, 2010 was 49.8%, compared to 51.4% for the year ended December 31, 2009. Net favorable reserve development recognized during the year ended December 31, 2010 reduced the loss and loss expense ratio by 12.8 percentage points. Thus, the loss and loss expense ratio related to the current loss year was 62.6%. In comparison, net favorable reserve development recognized in the year ended December 31, 2009 reduced the loss and loss expense ratio by 8.4 percentage points. Thus, the loss and loss expense ratio related to that loss year was 59.8%. The increase in the loss and loss expense ratio for the current loss year was primarily due to net incurred losses of \$26.6 million noted above, which contributed 5.3 percentage points to the current loss year's loss and loss expense ratio.

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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.

	<b>Year Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
Net reserves for losses and loss expenses, January 1	\$ 1,149.8	\$ 1,072.1
Incurred related to:		
Current period non-catastrophe	280.1	272.7
Current period property catastrophe	34.3	
Prior period non-catastrophe	(62.7)	(40.2)
Prior period property catastrophe	(1.5)	2.1
<b>Total incurred</b>	<b>\$ 250.2</b>	<b>\$ 234.6</b>
Paid related to:		
Current period non-catastrophe	16.8	14.1
Current period property catastrophe	1.0	
Prior period non-catastrophe	156.7	125.2
Prior period property catastrophe	4.7	17.6
<b>Total paid</b>	<b>\$ 179.2</b>	<b>\$ 156.9</b>
Net reserve for losses and loss expenses, December 31	1,220.8	1,149.8
Losses and loss expenses recoverable		1.9
<b>Reserve for losses and loss expenses, December 31</b>	<b>\$ 1,220.8</b>	<b>\$ 1,151.7</b>

*Acquisition costs.* Acquisition costs increased by \$4.1 million, or 4.7%, for the year ended December 31, 2010 compared to the year ended December 31, 2009 primarily as a result of higher net premiums earned. The acquisition cost ratio was 18.3% for the year ended December 31, 2010, slightly lower than the 19.3% for the year ended December 31, 2009. The decrease in the acquisition cost ratio is due to more business written on an excess-of-loss basis, which typically carries a lower acquisition cost ratio than quota share business.

*General and administrative expenses.* General and administrative expenses increased \$15.4 million, or 31.8%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in general and administrative expenses was primarily due to an increase in salary and related costs included stock-based compensation. The 2.1 percentage point increase in the general and administrative expense ratio from 10.6% for the year ended December 31, 2009 to 12.7% for the year ended December 31, 2010 was due to higher general and administrative expense partially offset by higher net premiums earned.

**Liquidity and Capital Resources****General**

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

Historically, our operating subsidiaries have generated sufficient cash flows to meet all of their obligations. Because of the inherent volatility of our business, the seasonality in the timing of payments by insureds and cedents, the irregular timing of loss payments, the impact of a change in interest rates and credit spreads on the investment income as well as seasonality in coupon payment dates for fixed income securities, cash flows from operating activities may vary between periods. We expect that annual positive cash flows from operating activities will be sufficient to cover claims payments. In the unlikely event that paid losses exceed operating cash flows in any given period, we would use our cash balances available, or liquidate a portion of our high quality



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and liquid investment portfolio in order to meet our short term liquidity needs. As discussed in Item 1 Business, our total investments and cash totaled \$8.1 billion at December 31, 2011, the main components of which were investment grade fixed income securities and cash and cash equivalents.

As of December 31, 2011 and December 31, 2010, our shareholders equity was \$3.1 billion.

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

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

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

***Capital Activities***

In May 2010, the company established a share repurchase program in order to repurchase Holdings common shares. Repurchases under the authorization may be effected from time to time through open market purchases, privately negotiated transactions, and tender offers or otherwise. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the company's capital position, legal requirements and other factors. During the year ended December 31, 2011, we repurchased through open market purchases 1,419,163 shares at a total cost of \$86.7 million, for an average price of \$61.09 per share. We have classified the repurchased shares as treasury shares, at cost on the consolidated balance sheets.

In November 2010, Allied World Bermuda issued \$300 million senior notes due in 2020. The senior notes bear interest at an annual rate of 5.50% per year and were priced to yield 5.56%. Interest on the senior notes is payable semi-annually on May 15 and November 15 of each year commencing on May 15, 2011. The net proceeds from the offering of the senior notes were and will be used for general corporate purposes, including the repurchase of the company's outstanding common shares. The senior notes are the company's unsecured and unsubordinated obligations and rank equally in right of payment with all existing and future unsecured and unsubordinated indebtedness. We may redeem the senior notes at any time or from time to time in whole or in part at a redemption price equal to the greater of the principal amount of the senior notes to be redeemed or a make-whole price, plus accrued and unpaid interest. The senior notes include covenants and events of default that are usual and customary, but do not contain any financial covenants. In addition, these senior notes as well as the 7.50% senior notes issued in 2006 have been unconditionally and irrevocably guaranteed for the payment of the principal and interest by Holdings.

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

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

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**Restrictions and Specific Requirements**

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

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

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

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

We entered into an \$800 million five-year senior credit facility (the Credit Facility ) with a syndication of lenders that will terminate on November 27, 2012. The Credit Facility consists of a \$400 million secured letter of credit facility for the issuance of standby letters of credit (the Secured Facility ) and a \$400 million unsecured facility for the making of revolving loans and for the issuance of standby letters of credit (the Unsecured Facility ). Both the Secured Facility and the Unsecured Facility have options to increase the aggregate commitments by up to \$200 million, subject to approval of the lenders. The Credit Facility will be used for

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general corporate purposes and to issue standby letters of credit. The Credit Facility contains representations, warranties and covenants customary for similar bank loan facilities, including a covenant to maintain a ratio of consolidated indebtedness to total capitalization as of the last day of each fiscal quarter or fiscal year of not greater than 0.35 to 1.0 and a covenant under the Unsecured Facility to maintain a certain consolidated net worth. In addition, each material insurance subsidiary must maintain a financial strength rating from A.M. Best Company of at least A- under the Unsecured Facility and of at least B++ under the Secured Facility. As of December 31, 2011 we had a consolidated indebtedness to total capitalization of 0.21 to 1.0 and all of our subsidiaries had a financial strength rating from A.M. Best of A. The Unsecured Facility required a minimum net worth as of December 31, 2011 of \$1.4 billion and our net worth as calculated according to the Unsecured Facility was \$3.1 billion as of December 31, 2011. Based on the results of these financial calculations, we were in compliance with all covenants under the Credit Facility as of December 31, 2011.

In May 2010, Allied World Capital (Europe) Limited established an irrevocable standby letter of credit in order to satisfy funding requirements of our Lloyd's Syndicate 2232. As of December 31, 2011, the amount of the letter of credit was £59.0 million (\$90.9 million).

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

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

	As of December 31, 2011	As of December 31, 2010
	(\$ in millions)	
Total trust accounts on deposit	\$ 2,029.1	\$ 1,657.4
Total letter of credit facilities:		
Citibank Europe plc	900.0	900.0
Credit Facility	800.0	800.0
<b>Total letters of credit facilities</b>	<b>1,700.0</b>	<b>1,700.0</b>
Total letter of credit facilities outstanding:		
Citibank Europe plc	675.6	689.8
Credit Facility	141.4	159.0
<b>Total letter of credit facilities outstanding</b>	<b>817.0</b>	<b>848.8</b>
Total letter of credit facilities remaining:		
Citibank Europe plc	224.4	210.2
Credit Facility(1)	658.6	641.0
<b>Total letter of credit facilities remaining</b>	<b>883.0</b>	<b>851.2</b>
Collateral committed to support the letter of credit facilities	\$ 1,044.2	\$ 1,121.3

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

As of December 31, 2011, we had a combined unused letters of credit capacity of \$883.0 million from the Credit Facility and Citibank Europe plc. We believe that this remaining capacity is sufficient to meet our future letter of credit needs.

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

**Sources and Uses of Funds**

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

Cash flows from operations for the year ended December 31, 2011 were \$548.1 million compared to \$451.3 million for the year ended December 31, 2010 and \$668.2 million for the year ended December 31, 2009. The increase in cash flows from operations was impacted by increased premium writings in the year ended December 31, 2011 compared to the year ended December 31, 2010. The decrease in cash flows from operations for the year ended December 31, 2010 compared to the year ended December 31, 2009 was primarily due to an increase in net paid losses of \$138.5 million and an increase in insurance balances receivable primarily related to a funds held balance of \$73.9 million for a property catastrophe reinsurance treaty entered into in 2010. The funds held balance can be used by the cedent to pay claims, if any. Any balance remaining after the expiry of the reinsurance treaty is returned to us.

Cash flows from investing activities consist primarily of proceeds on the sale of investments and payments for investments acquired. We had cash flows used in investing activities of \$509.1 million for the year ended December 31, 2011, \$500.1 million of cash flows provided by investing activities for the year ended December 31, 2010 and \$582.6 million of cash flows used in investing activities of for the year ended December 31, 2009. The increase in cash flows used in investing activities for the year ended December 31, 2011 reflects additional investment of our operating cash flow. The cash flows provided by investing activities for the year ended December 31, 2010 compared to net cash used in investment activities for the year ended December 31, 2009 was primarily due to the turnover of the investment portfolio during 2010 in order to manage the overall market interest rate exposure and moving securities to our new portfolio manager.

Cash flows from financing activities consist primarily of capital raising activities, which include the issuance or repurchase of common shares or debt and the payment of dividends or the repayment of debt. Cash flows used in financing activities were \$162.1 million for the year ended December 31, 2011 compared to net cash used in financing activities of \$486.1 million and \$450.0 million for the year ended December 31, 2010 and 2009, respectively. During the year ended December 31, 2011 we paid dividends of \$28.6 million, repurchased \$86.7 million of our common shares and repurchased \$53.6 million in warrants. During the year ended December 31, 2010, we paid dividends of \$47.7 million, repurchased \$674.7 million of our common shares, which included the repurchase of all the common shares owned by Goldman Sachs, and repurchased \$70.0 million in warrants to purchase our common shares from Chubb and Goldman Sachs. The reduction in share repurchases was impacted by the previously pending merger agreement with Transatlantic. During 2010, we issued 5.50% Senior Notes for net proceeds of \$298.6 million, which we used for share repurchases and other general corporate purposes.

In addition to our quarterly dividends declared and paid during 2010, the Board of Directors declared a special dividend of \$0.25 per common share related to the redomestication. Under Swiss law, we were not able to pay a dividend until two months after our annual meeting. This special dividend provided a dividend to shareholders for the interim period. This special dividend was paid on November 26, 2010 to shareholders of record on November 15, 2010.

Our funds are primarily invested in liquid, high-grade fixed income securities. As of December 31, 2011 and 2010, 92.6% and 96.2%, respectively, of our fixed income portfolio consisted of investment grade securities. As of December 31, 2011 and December 31, 2010, net accumulated unrealized gains on our available for sale fixed



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maturity investments were \$14.5 million and \$57.1 million, respectively. The decrease in net unrealized gains resulted from the sale of certain available for sale securities during the year ended December 31, 2011 and reinvesting the proceeds in fixed maturity investments where mark-to-market changes are reflected in the consolidated income statement. The maturity distribution of our fixed income portfolio (on a fair value basis) as of December 31, 2011 and December 31, 2010 was as follows:

	As of December 31, 2011	As of December 31, 2010
	(\$ in millions)	
Due in one year or less	\$ 661.6	\$ 249.3
Due after one year through five years	2,686.1	3,119.9
Due after five years through ten years	725.5	867.9
Due after ten years	94.2	122.9
Mortgage-backed	1,818.1	1,751.9
Asset-backed	513.2	549.0
<b>Total</b>	<b>\$ 6,498.7</b>	<b>\$ 6,660.9</b>

We have investments in various other invested assets, the market value of which was \$540.4 million as of December 31, 2011. Each of these funds has redemption notice requirements. For each of our funds, liquidity is allowed after certain defined periods based on the terms of each fund. See Note 4(d) Investments - Other Invested Assets to our consolidated financial statements for additional details on our other invested assets.

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

**Financial Strength Ratings**

Financial strength ratings and senior unsecured debt ratings represent the opinions of rating agencies on our capacity to meet our obligations. The rating agencies consider a number of quantitative and qualitative factors in determining an insurance company's financial strength and credit ratings. Quantitative considerations of an insurance company include the evaluation of financial statements, historical operating results and, through the use of proprietary capital models, the measure of investment and insurance risks relative to capital. Among the qualitative considerations are management strength, business profile, market conditions and established risk management practices used, among other things, to manage risk exposures and limit capital volatility. Some of our reinsurance treaties contain special funding and termination clauses that are triggered in the event that we or one of our subsidiaries is downgraded by one of the major rating agencies to levels specified in the treaties, or our capital is significantly reduced. If such an event were to happen, we would be required, in certain instances, to post collateral in the form of letters of credit and/or trust accounts against existing outstanding losses, if any, related to the treaty. In a limited number of instances, the subject treaties could be cancelled retroactively or commuted by the cedent and might affect our ability to write business.

For additional information on our financial strength ratings refer to *Our Financial Strength Ratings* in Item 1 - Business .

In 2010, we established Syndicate 2232 and commenced underwriting activities through the Lloyd's market. All Lloyd's syndicates benefit from Lloyd's central resources, including Lloyd's brand, its network of global licenses and the central fund. As all of Lloyd's policies are ultimately backed by this common security, a single market rating can be applied. A. M. Best has assigned Lloyd's a financial strength rating of A (Excellent) and Standard & Poor's and Fitch Ratings have assigned Lloyd's a financial strength rating of A+ (Strong).

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

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

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

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

**Aggregate Contractual Obligations**

The following table shows our aggregate contractual obligations by time period remaining until due date as of December 31, 2011:

	Total	Payment Due by Period			More Than 5 Years
		Less Than 1 Year	1-3 Years (\$ in millions)	3-5 Years	
<b>Contractual Obligations</b>					
Senior notes (including interest)	\$ 1,136.0	\$ 54.0	\$ 108.0	\$ 608.0	\$ 366.0
Operating lease obligations	94.0	12.9	24.2	19.2	37.7
Investment commitments outstanding	245.9		27.0	42.5	176.4
Darwin LTIP	3.4	3.4			
Gross reserve for losses and loss expenses*	5,225.1	1,098.1	1,343.3	793.2	1,990.5
<b>Total</b>	<b>\$ 6,704.4</b>	<b>\$ 1,168.4</b>	<b>\$ 1,502.5</b>	<b>\$ 1,462.9</b>	<b>\$ 2,570.6</b>

\*Our unpaid losses and loss expenses represent our best estimate of the cost to settle the ultimate liabilities based on information available as of December 31, 2011, and are not fixed amounts payable pursuant to contractual commitments. The timing and amounts of actual loss payments related to these reserves might vary significantly from our current estimate of the expected timing and amounts of loss payments based on many factors, including large individual losses as well as general market conditions.

The investment commitments outstanding represent unfunded commitments related to our other invested assets.

As part of the acquisition of Darwin, we assumed the Darwin LTIP that Darwin had implemented for certain of its key employees. Initially, the Darwin LTIP allocated 20% of the underwriting profit for each year (premiums net of losses and expenses) plus 20% of the investment income based on average net assets outstanding in each year (at a deemed interest rate equal to the 10 year U.S. Treasury note rate) to the Darwin LTIP participants, based on their assigned percentage interests. Effective January 1, 2006, the Darwin LTIP was modified to reflect changes in the calculation of the underwriting profitability allocated to the participants of the Darwin LTIP. For 2006 and later years, the amount allocated to the participants is calculated as an amount equal to 20% of the underwriting profit less an amount equal to 5% of net premiums earned. In addition, imputed investment income will no longer be credited to the pool participants. Interests in these profit pools vest over a four-year period. The payments due are made in increments over the fourth, fifth and sixth years. This plan is in run-off.

The amounts included for reserve for losses and loss expenses reflect the estimated timing of expected loss payments on known claims and anticipated future claims as of December 31, 2011 and do not take reinsurance recoverables into account. Both the amount and timing of cash flows are uncertain and do not have contractual payout terms. For a discussion of these uncertainties, refer to Critical Accounting Policies Reserve for Losses and Loss Expenses. Due to the inherent uncertainty in the process of estimating the timing of these



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payments, there is a risk that the amounts paid in any period will differ significantly from those disclosed. Total estimated obligations will be funded by existing cash and investments.

**Off-Balance Sheet Arrangements**

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

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

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

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

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

	Interest Rate Shift in Basis Points						
	-200	-100	-50	0	+50	+100	+200
	(\$ in millions)						
Total market value	\$ 7,282.4	\$ 7,278.0	\$ 7,264.8	\$ 7,215.3	\$ 7,147.2	\$ 7,075.2	\$ 6,924.6
Market value change from base	67.1	62.7	49.5	0.0	(68.1)	(140.1)	(290.7)
Change in unrealized appreciation/(depreciation)	0.9%	0.9%	0.7%	0.0%	(0.9)%	(1.9)%	(4.0)%

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

	Credit Spread Shift in Basis Points						
	-200	-100	-50	0	+50	+100	+200
	(\$ in millions)						
Total market value	\$ 5,644.4	\$ 5,527.7	\$ 5,469.4	\$ 5,411.1	\$ 5,352.7	\$ 5,294.4	\$ 5,177.8
Market value change from base	233.3	116.6	58.3	0.0	(58.4)	(116.7)	(233.3)
Change in unrealized appreciation/(depreciation)	4.3%	2.2%	1.1%	0.0%	(1.1)%	(2.2)%	(4.3)%

In addition to credit spread risk, our portfolio is also exposed to risk of securities being downgraded or of issuers defaulting. In an effort to minimize this risk, our investment guidelines have been defined to ensure that the assets held are well diversified and are primarily high-quality securities. As of December 31, 2011 we held assets totaling \$6.5 billion of fixed income securities. Of those assets, approximately 7.4% were rated below investment grade (Ba1/BB+ or lower) with the remaining 92.6% rated in the investment grade category. The average credit quality of the investment grade portfolios was AA- by S&P.

As of December 31, 2011, we held \$2,431.4 million, or 29.9%, of our total investments and cash and cash equivalents in corporate bonds, \$1,179.4 million of which were issued by entities within the financial services industry. These corporate bonds had an average credit rating of A+ by Standards & Poor s.

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As of December 31, 2011, we held \$1,818.1 million, or 22.5%, of our total investments and cash and cash equivalents in mortgage-backed securities, which included agency pass-through mortgage-backed securities (14.6%),

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non-agency residential mortgage-backed securities (3.8%) and non-agency commercial mortgage-backed securities (4.1%). The agency pass-through mortgage-backed securities are exposed to prepayment risk, which occurs when holders of individual mortgages increase the frequency with which they prepay the outstanding principal before the maturity date to refinance at a lower interest rate cost, and extension risk when payments occur slower than expected. Given the proportion that these securities comprise of the overall portfolio, and the current interest rate environment and condition of the credit market, prepayment risk is not considered significant at this time.

We held \$331.4 million of non-agency commercial mortgage backed securities. These securities are subject to the risk of non-payment due to increased levels of delinquencies, defaults and losses on commercial loans which cumulatively create shortfalls beyond the level of subordination in our specific securities. As of December 31, 2011, 9.5% of our non-agency commercial mortgage backed securities were rated below Aaa/AAA.

Additionally as of December 31, 2011, we held \$120.3 million in non-agency residential mortgage backed securities and \$182.5 million of high yield (below investment grade) non-agency residential mortgage-backed securities, which is included in the \$1,818.1 million referenced in the preceding paragraph. As of December 31, 2011, the average credit rating of the non-agency residential mortgage backed securities was A+. As of December 31, 2011, 91.4% of the high yield non-agency residential mortgage-backed securities were rated below investment grade, and the average credit rating was CCC by S&P.

As of December 31, 2011, we held investments in other invested assets with a fair value of \$540.4 million. Investments in these funds may involve certain risks related to, among other things, the illiquid nature of the fund shares, the limited operating history of the fund, as well as risks associated with the strategies employed by the managers of the funds. The funds' objectives are generally to seek attractive long-term returns with lower volatility by investing in a range of diversified investment strategies. As our reserves and capital continue to build, we may consider additional investments in these or other alternative investments.

During 2011, concerns about sovereign and corporate credits throughout the European Monetary Zone became elevated. As of December 31, 2011, our direct exposure to European credit across all of Europe was \$806.8 million and is included within fixed maturity investments available for sale, at fair value, fixed maturity investments trading, at fair value and equity securities trading, at fair value in the consolidated balance sheets. Of that approximately \$231.3 million was invested in debt issued or guaranteed by European nations, \$17.5 million was invested in structured products in the United Kingdom and \$558.0 million was invested in debt and equity securities of European corporations (not guaranteed by a sovereign nation) as outlined in the table below. As of December 31, 2011, we had no direct sovereign exposure to Greece, Ireland, Italy, Portugal or Spain.

	Sovereign and Sovereign Guaranteed	Total Exposure by European Country		
		Structured Products	Corporate Bonds and Equities	Total Exposure
		(\$ in millions)		
Belgium	\$ 21.2	\$	\$ 13.3	\$ 34.5
Denmark	34.8			34.8
France			51.0	51.0
Germany	71.8		19.4	91.2
Italy			1.6	1.6
Luxembourg			9.9	9.9
Netherlands	63.3		51.5	114.8
Norway			79.2	79.2
Russia			17.0	17.0
Spain			22.0	22.0
Sweden			37.2	37.2
Switzerland	10.9		53.2	64.1
United Kingdom	29.3	17.5	202.7	249.5
Total Exposure	\$ 231.3	\$ 17.5	\$ 558.0	\$ 806.8

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The U.S. dollar is our reporting currency and the functional currency of all of our operating subsidiaries. We enter into insurance and reinsurance contracts where the premiums receivable and losses payable are denominated in currencies other than the U.S. dollar. In addition, we maintain a portion of our investments and liabilities in currencies other than the U.S. dollar, primarily Euro, British Sterling, Swiss Franc and the Canadian dollar. Receivables in non-U.S. currencies are generally converted into U.S. dollars at the time of receipt. When we incur a liability in a non-U.S. currency, we carry such liability on our books in the original currency. These liabilities are converted from the non-U.S. currency to U.S. dollars at the time of payment. As a result, we have an exposure to foreign currency risk resulting from fluctuations in exchange rates. We utilize a hedging strategy whose objective is to minimize the potential loss of value caused by currency fluctuations by using foreign currency forward contract derivatives that expire in 90 days from purchase.

As of December 31, 2011 and 2010, 3.1% and 1.7%, respectively, of our total investments and cash and cash equivalents were denominated in currencies other than the U.S. dollar. Of our business written during the year ended December 31, 2011 and 2010, approximately 12% and 11%, respectively was written in currencies other than the U.S. dollar. The increase in the amount of gross premiums written in currencies other than the U.S. dollar is due to the increased business written by our international offices.

Our foreign exchange (loss) gain for the years ended December 31, 2011, 2010 and 2009 is set forth in the chart below.

	Year Ended December 31,		
	2011	2010	2009
	(\$ in millions)		
Realized exchange (loss) gain	\$ (0.8)	\$ (2.0)	\$ 5.9
Unrealized exchange (loss) gain	(2.3)	1.6	(6.6)
Foreign exchange loss	\$ (3.1)	\$ (0.4)	\$ (0.7)

**Item 8. Financial Statements and Supplementary Data.**

See our consolidated financial statements and notes thereto and required financial statement schedules commencing on pages F-1 through F-62 and S-1 through S-5 below.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.*****Disclosure Controls and Procedures***

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

***Management's Annual Report on Internal Control Over Financial Reporting***

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Our management is responsible for establishing and maintaining internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our management, with the participation of our Chief



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Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2011, based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). Based on an evaluation under the framework in Internal Control – Integrated Framework issued by COSO, our management concluded that our internal control over financial reporting was effective as of December 31, 2011.

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

The effectiveness of internal control over financial reporting as of December 31, 2011 has been audited by Deloitte & Touche Ltd., an independent registered public accounting firm, as stated in their report which is included below.

***Changes in Internal Control Over Financial Reporting***

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

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of

Allied World Assurance Company Holdings, AG

Zug, Switzerland

We have audited the internal control over financial reporting of Allied World Assurance Company Holdings, AG and subsidiaries (the Company) as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets and related consolidated statements of operations and comprehensive income, shareholders' equity, and cash flows and financial statement schedules as of and for the year ended December 31, 2011 of the Company and our report dated February 29, 2012 expressed an unqualified opinion on those financial statements and financial statement schedules, and included an explanatory paragraph regarding the Company's required adoption, as of April 1, 2009 of new FASB guidance in relation to its method of accounting for other-than-temporary impairments of debt securities.

/s/ Deloitte & Touche Ltd.

Hamilton, Bermuda

February 29, 2012



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### **Item 9B. Other Information.**

None.

## **PART III**

### **Item 10. Directors, Executive Officers and Corporate Governance.**

The information required by this item is incorporated by reference from a definitive proxy statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2011 pursuant to Regulation 14A.

We have adopted a Code of Ethics for the Chief Executive Officer and Senior Financial Officers that applies specifically to such persons. The Code of Ethics for the Chief Executive Officer and Senior Financial Officers is available free of charge on our website at [www.awac.com](http://www.awac.com) and is available in print to any shareholder who requests it. We intend to disclose any amendments to this code by posting such information on our website, as well as disclosing any waivers of this code applicable to our principal executive officer, principal financial officer, principal accounting officer or controller and other executive officers who perform similar functions through such means or by filing a Form 8-K.

### **Item 11. Executive Compensation.**

The information required by this item is incorporated by reference from a definitive proxy statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2011 pursuant to Regulation 14A.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by this item is incorporated by reference from a definitive proxy statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2011 pursuant to Regulation 14A.

### **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information required by this item is incorporated by reference from a definitive proxy statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2011 pursuant to Regulation 14A.

### **Item 14. Principal Accountant Fees and Services.**

The information required by this item is incorporated by reference from a definitive proxy statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2011 pursuant to Regulation 14A.

## **PART IV**

### **Item 15. Exhibits and Financial Statement Schedules.**

Financial statement schedules listed in the accompanying index to our consolidated financial statements starting on page F-1 are filed as part of this Form 10-K, and are included in Item 8.

The exhibits listed in the accompanying exhibit index starting on page E-1 are filed as part of this Form 10-K.



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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Zug, Switzerland on February 29, 2012.

**ALLIED WORLD ASSURANCE COMPANY HOLDINGS,  
AG**

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Scott A. Carmilani	President, Chief Executive Officer and	February 29, 2012
Scott A. Carmilani	Chairman of the Board <i>(Principal Executive Officer)</i>	
/s/ Joan H. Dillard	Executive Vice President and Chief	February 29, 2012
Joan H. Dillard	Financial Officer <i>(Principal Financial and Accounting Officer)</i>	
/s/ Barbara T. Alexander	Director	February 29, 2012
Barbara T. Alexander		
/s/ James F. Duffy	Director	February 29, 2012
James F. Duffy	Vice Chairman of the Board	
Bart Friedman		
/s/ Scott Hunter	Director	February 29, 2012
Scott Hunter	Director	
Mark R. Patterson		

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/s/ Patrick de Saint-Aignan

Director

February 29, 2012

Patrick de Saint-Aignan

/s/ Samuel J. Weinhoff

Director

February 29, 2012

Samuel J. Weinhoff

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<b>Exhibit Number</b>	<b>Description</b>
3.1(1)	Articles of Association of Allied World Assurance Company Holdings, AG, as amended and restated
3.2(2)	Organizational Regulations of Allied World Assurance Company Holdings, AG, as amended and restated
4.1(3)	Specimen Common Share Certificate
4.2(4)	Indenture, dated as of July 26, 2006, by and between Allied World Assurance Company Holdings, Ltd, as issuer, and The Bank of New York, as trustee, with regard to Allied World Assurance Company Holdings, Ltd's outstanding 7.50% Senior Notes due 2016
4.3(4)	First Supplemental Indenture, dated as of July 26, 2006, by and between Allied World Assurance Company, Ltd, as issuer, and The Bank of New York, as trustee, with regard to Allied World Assurance Company Holdings, Ltd's outstanding 7.50% Senior Notes due 2016
4.4(5)	Second Supplemental Indenture, dated as of December 30, 2010, by and among Allied World Assurance Company Holdings, AG, Allied World Assurance Company Holdings, Ltd and The Bank of New York Mellon, as trustee, with regard to Allied World Assurance Company Holdings, Ltd's outstanding 7.50% Senior Notes due 2016
4.5(4)	Form of 7.50% Senior Note (Included as part of Exhibit 4.3)
4.6(6)	Senior Indenture, dated November 15, 2010, by and between Allied World Assurance Company Holdings, Ltd and The Bank of New York Mellon, as trustee, with regard to Allied World Assurance Company Holdings, Ltd's outstanding 5.50% Senior Notes due 2020
4.7(6)	First Supplemental Indenture, dated November 15, 2010, by and between Allied World Assurance Company Holdings, Ltd and The Bank of New York Mellon, as trustee, with regard to Allied World Assurance Company Holdings, Ltd's outstanding 5.50% Senior Notes due 2020
4.8(5)	Second Supplemental Indenture, dated as of December 30, 2010, by and among Allied World Assurance Company Holdings, AG, Allied World Assurance Company Holdings, Ltd and The Bank of New York Mellon, as Trustee, with regard to Allied World Assurance Company Holdings, Ltd's outstanding 5.50% Senior Notes due 2020
4.9(6)	Form of 5.50% Senior Note (Included as part of Exhibit 4.7)
10.1(7)	Insurance Letters of Credit-Master Agreement, dated February 28, 2007, by and among Allied World Assurance Company, Ltd, Citibank N.A. and Citibank Europe plc
10.2(7)	Pledge Agreement, dated as of February 28, 2007, by and between Allied World Assurance Company, Ltd and Citibank Europe plc
10.3(7)	Account Control Agreement, dated March 5, 2007, by and among Citibank Europe plc, as secured party; Allied World Assurance Company, Ltd, as pledgor; and Mellon Bank, N.A
10.4(8)	Letter Agreement, dated December 30, 2008, by and among Allied World Assurance Company, Ltd, Citibank Europe plc and The Bank of New York Mellon, with respect to the types of securities that may be pledged under the letter of credit facility with Citibank Europe plc
10.5(9)	Credit Agreement, dated as of November 27, 2007, by and among Allied World Assurance Company Holdings, Ltd, Allied World Assurance Company, Ltd, the lenders a party thereto, Bank of America, N.A., as syndication agent, and Wachovia Bank, National Association, as administrative agent, fronting bank and letter of credit agent under the Unsecured Senior Revolving Credit Facility
10.6(9)	Credit Agreement, dated as of November 27, 2007, by and among Allied World Assurance Company Holdings, Ltd, Allied World Assurance Company, Ltd, the lenders a party thereto, Bank of America, N.A., as syndication agent, and Wachovia Bank, National Association, as administrative agent, fronting bank and letter of credit agent under the Senior Secured Letter of Credit Facility



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<b>Exhibit Number</b>	<b>Description</b>
10.7(9)	Pledge and Security Agreement, dated as of November 27, 2007, by and between Allied World Assurance Company, Ltd, as pledgor, and Wachovia Bank, National Association, as administrative agent
10.8(9)	Account Control Agreement, dated November 27, 2007, by and among Allied World Assurance Company, Ltd, as pledgor, Mellon Bank, N.A., as custodian, and Wachovia Bank, National Association, as administrative agent
10.9(10)	First Amendment to Credit Agreement, dated as of February 25, 2010, by and among Allied World Assurance Company Holdings, Ltd, Allied World Assurance Company, Ltd, the lenders a party thereto and Wachovia Bank, National Association, as administrative agent and fronting bank under the Unsecured Senior Revolving Credit Facility
10.10(11)	First Amendment to Credit Agreement, dated as of February 25, 2010, by and among Allied World Assurance Company Holdings, Ltd, Allied World Assurance Company, Ltd, the lenders a party thereto and Wachovia Bank, National Association, as administrative agent and fronting bank under the Senior Secured Letter of Credit Facility
10.11(11)	Second Amendment to Credit Agreement, dated as of November 30, 2010, by and among Allied World Assurance Company Holdings, AG, Allied World Assurance Company Holdings, Ltd, Allied World Assurance Company, Ltd, the lenders a party thereto, and Wells Fargo Bank, National Association, as administrative agent and fronting bank under the Unsecured Facility
10.12(11)	Second Amendment to Credit Agreement, dated as of November 30, 2010, by and among Allied World Assurance Company Holdings, AG, Allied World Assurance Company Holdings, Ltd, Allied World Assurance Company, Ltd, the lenders a party thereto, and Wells Fargo Bank, National Association, as administrative agent and fronting bank under the Secured Facility
10.13(3)	Repurchase Agreement, dated as of November 5, 2010, by and among Allied World Assurance Company Holdings, Ltd and certain affiliates of The Goldman Sachs Group, Inc. named therein
10.14(12)	Repurchase Agreement, dated as of August 6, 2010, by and among Allied World Assurance Company Holdings, Ltd and certain affiliates of The Goldman Sachs Group, Inc. named therein
10.15(13)	Warrant Repurchase Agreement, dated as of August 13, 2010, by and between Allied World Assurance Company Holdings, Ltd and The Chubb Corporation
10.16(14)	Contribution-in-Kind Agreement, dated November 30, 2010
10.17(14)	Registration Rights Assignment and Assumption Agreement, dated as of December 1, 2010, by and between Allied World Assurance Company Holdings, Ltd and Allied World Assurance Company Holdings, AG
10.18(14)	Benefit Plan Assignment and Assumption Agreement, dated as of December 1, 2010, by and among Allied World Assurance Company Holdings, Ltd, Allied World Assurance Company, Ltd, Newmarket Administrative Services, Inc. n/k/a AWAC Services Company and Allied World Assurance Company Holdings, AG
10.19(14)	Warrant Assignment and Assumption Agreement, dated as of December 1, 2010, by and between Allied World Assurance Company Holdings, Ltd and Allied World Assurance Company Holdings, AG
10.20(15)	Warrant Purchase Agreement, dated as of February 3, 2011, by and between Allied World Assurance Company Holdings, Ltd and American International Group, Inc.
10.21(14)	Form of Indemnification Agreement for directors and executive officers of Allied World Assurance Company Holdings, AG
10.22(16)	Amended and Restated Employment Agreement Form for Bermuda Executive Officers
10.23(17)	Amended and Restated Employment Agreement, dated as of October 1, 2008, by and between Allied World National Assurance Company and W. Gordon Knight
10.24(18)	Second Amended and Restated Employment Agreement, dated as of March 1, 2009, by and between Allied World Assurance Company Holdings, Ltd and Scott A. Carmilani

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<b>Exhibit Number</b>	<b>Description</b>
10.25(19)	Amended and Restated Employment Agreement, dated as of November 5, 2009, by and between Allied World Assurance Company Holdings, Ltd and John L. Sennott, Jr.
10.26(20)	Employment Agreement, dated as of July 1, 2010, by and between Newmarket Administrative Services, Inc. n/k/a AWAC Services Company and John J. Gauthier
10.27(3)	Form of Employment Agreement Amendment with regard to Swiss requirements for certain officers of Allied World Assurance Company Holdings, AG
10.28(3)	Employment Agreement Amendment with regard to Swiss requirements for John Gauthier
10.29(21)	Allied World Assurance Company Holdings, AG Third Amended and Restated Long-Term Incentive Plan
10.30(22)	Form of Participation Agreement under the Allied World Assurance Company Holdings, AG Third Amended and Restated Long-Term Incentive Plan
10.31(21)	Allied World Assurance Company Holdings, AG Third Amended and Restated 2001 Employee Stock Option Plan
10.32(23)	Form of Option Grant Notice and Option Agreement under Allied World Assurance Company Holdings, AG Third Amended and Restated 2001 Employee Stock Option Plan
10.33(26)	Form of Option Grant Notice and Option Agreement under Allied World Assurance Company Holdings, AG Third Amended and Restated 2001 Employee Stock Option Plan, as amended in August 2011
10.34(21)	Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan
10.35(23)	Form of RSU Award Agreement for employees under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan
10.36(22)	Form of RSU Award Agreement for non-employee directors under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan
10.37(24)	Form of RSU Award Agreement for employees under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan, as amended in May 2009
10.38(25)	Form of RSU Award Agreement for employees under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan, as amended in November 2009
10.39(26)	Form of RSU Award Agreement for employees under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan, as amended in August 2011
10.40(26)	Form of RSU Award Agreement for non-employee directors under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan, as amended in August 2011
10.41(27)	Form of Performance-Based RSU Award Agreement under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan
10.42(26)	Form of Performance-Based RSU Award Agreement under the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan, as amended in August 2011
10.43(28)	Form of Performance-Based Equity Award Agreement
10.44(29)	Allied World Assurance Company Holdings, AG Amended and Restated 2008 Employee Share Purchase Plan
10.45(30)	Amended and Restated Long-Term Incentive Plan of Darwin Professional Underwriters, Inc., effective as of November 11, 2005
10.46(25)	Allied World Assurance Company (U.S.) Inc. Second Amended and Restated Supplemental Executive Retirement Plan
10.47(25)	Amended and Restated Accounting Services Agreement, dated as of April 1, 2009, by and between Allied World Assurance Company, Ltd and BlackRock Financial Management, Inc.

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<b>Exhibit Number</b>	<b>Description</b>
10.48	Investment Management Agreement, dated as of September 27, 2011, by and between Allied World Assurance Company, Ltd and BlackRock Financial Management, Inc.
21.1	Subsidiaries of the Registrant
23.1	Consent of Deloitte & Touche Ltd., an independent registered public accounting firm
31.1	Certification by Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification by Chief Executive Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification by Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002
101.1**	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of December 31, 2011 and 2010, (ii) the Consolidated Statements of Operations and Comprehensive Income for the years ended December 31, 2011, 2010 and 2009, (iii) the Consolidated Statements of Shareholders Equity for the years ended December 31, 2011, 2010 and 2009, (iv) the Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009, (v) the Notes to the Consolidated Financial Statements and (vi) Schedules II, III and IV, tagged as blocks of text

- (1) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on January 20, 2012.
- (2) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on February 28, 2012.
- (3) Incorporated herein by reference to the Annual Report on Form 10-K of Allied World Assurance Company Holdings, AG filed with the SEC on March 1, 2011.
- (4) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on August 1, 2006.
- (5) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on January 5, 2011.
- (6) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on November 15, 2010.
- (7) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on March 6, 2007.
- (8) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on January 5, 2009.
- (9) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on December 3, 2007.

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- (10) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on March 3, 2010.
- (11) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on December 6, 2010.
- (12) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on August 9, 2010.
- (13) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on August 13, 2010.
- (14) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on December 1, 2010.

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- (15) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on February 3, 2011.
- (16) Incorporated herein by reference to the Annual Report on Form 10-K of Allied World Assurance Company Holdings, AG filed with the SEC on February 27, 2009. Other than with respect to title, base salary and housing allowance, the amended and restated employment agreements, dated as of October 1, 2008, for David Bell, Joan Dillard, Frank D Orazio, Wesley Dupont and Marshall Grossack are identical to the form filed as Exhibit 10.41 thereto.
- (17) Incorporated herein by reference to the Annual Report on Form 10-K of Allied World Assurance Company Holdings, AG filed with the SEC on February 27, 2009.
- (18) Incorporated herein by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on March 5, 2009.
- (19) Incorporated herein by reference to the Quarterly Report on Form 10-Q of Allied World Assurance Company Holdings, AG filed with the SEC on November 6, 2009.
- (20) Incorporated herein by reference to the Quarterly Report on Form 10-Q of Allied World Assurance Company Holdings, AG filed with the SEC on November 5, 2010.
- (21) Incorporated herein by reference to the Post-Effective Amendment No. 1 to the Registration Statement on Form S-8 (Registration No. 333-136420) of Allied World Assurance Company Holdings, AG filed with the SEC on December 1, 2010.
- (22) Incorporated herein by reference to the Registration Statement on Form S-1 (Registration No. 333-132507) of Allied World Assurance Company Holdings, AG filed with the SEC on March 17, 2006, as amended, and declared effective by the SEC on July 11, 2006.
- (23) Incorporated herein by reference to the Quarterly Report on Form 10-Q of Allied World Assurance Company Holdings, AG filed with the SEC on May 9, 2008.
- (24) Incorporated by reference to the Quarterly Report on Form 10-Q of Allied World Assurance Company Holdings, AG filed with the SEC on May 8, 2009.
- (25) Incorporated herein by reference to the Annual Report on Form 10-K of Allied World Assurance Company Holdings, AG filed with the SEC on March 1, 2010.
- (26) Incorporated herein by reference to the Quarterly Report on Form 10-Q of Allied World Assurance Company Holdings, AG filed with the SEC on August 9, 2011.

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- (27) Incorporated herein by reference to the Quarterly Report on Form 10-Q of Allied World Assurance Company Holdings, AG filed with the SEC on May 7, 2010.
- (28) Incorporated by reference to the Current Report on Form 8-K of Allied World Assurance Company Holdings, AG filed with the SEC on September 18, 2009.
- (29) Incorporated herein by reference to the Post-Effective Amendment No. 1 to the Registration Statement on Form S-8 (Registration No. 333-151298) of Allied World Assurance Company Holdings, AG filed with the SEC on December 1, 2010.
- (30) Incorporated herein by reference to the Registration Statement on Form S-1 (Registration No. 333-132355) of Darwin Professional Underwriters, Inc. filed with the SEC on March 10, 2006, as amended, and declared effective by the SEC on May 16, 2006.

Management contract or compensatory plan, contract or arrangement.

\* These certifications are being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, chapter 63 of title 18 United States Code) and are not being filed as part of this report.

\*\* In accordance with Rule 406T of Regulation S-T, the information in Exhibit 101.1 to this Annual Report on Form 10-K is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, is deemed not filed for purposes of Section 18 of the Exchange Act and otherwise is not subject to liability under these sections.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of

Allied World Assurance Company Holdings, AG

Zug, Switzerland

We have audited the accompanying consolidated balance sheets of Allied World Assurance Company Holdings, AG and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations and comprehensive income, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedules listed in the Index at Item 15. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Allied World Assurance Company Holdings, AG and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for other-than-temporary impairments of debt securities as of April 1, 2009 due to the required adoption of new FASB guidance.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 29, 2012 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche Ltd.

Hamilton, Bermuda

February 29, 2012



**Table of Contents****ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****CONSOLIDATED BALANCE SHEETS**

as of December 31, 2011 and 2010

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

	As of December 31, 2011	As of December 31, 2010
<b>ASSETS:</b>		
Fixed maturity investments available for sale, at fair value (amortized cost: 2011: \$226,397; 2010: \$828,544)	\$ 244,016	\$ 891,849
Fixed maturity investments trading, at fair value (amortized cost: 2011: \$6,207,991; 2010: \$5,714,322)	6,254,686	5,769,097
Equity securities trading, at fair value (cost: 2011: \$356,370; 2010: \$160,513)	367,483	174,976
Other invested assets trading, at fair value	540,409	347,632
Total investments	7,406,594	7,183,554
Cash and cash equivalents	633,996	756,995
Restricted cash	82,608	96,373
Insurance balances receivable	652,158	529,927
Prepaid reinsurance	226,721	187,287
Reinsurance recoverable	1,002,919	927,588
Accrued investment income	38,263	40,520
Net deferred acquisition costs	100,334	96,803
Goodwill	268,376	268,376
Intangible assets	53,898	56,876
Balances receivable on sale of investments	580,443	188,408
Net deferred tax assets	22,646	19,740
Other assets	53,202	75,184
Total assets	\$ 11,122,158	\$ 10,427,631
<b>LIABILITIES:</b>		
Reserve for losses and loss expenses	\$ 5,225,143	\$ 4,879,188
Unearned premiums	1,078,412	962,203
Reinsurance balances payable	124,539	99,732
Balances due on purchases of investments	616,728	506,978
Dividends payable	14,302	
Senior notes	797,949	797,700
Accounts payable and accrued liabilities	116,063	106,010
Total liabilities	\$ 7,973,136	\$ 7,351,811
<b>SHAREHOLDERS EQUITY:</b>		
Common shares, 2011: par value CHF 14.03 per share and 2010: par value CHF 15.00 per share (2011: 40,003,642; 2010: 40,003,642 shares issued and 2011: 37,742,131; 2010: 38,089,226 shares outstanding)	557,153	600,055
Additional paid-in capital	78,225	170,239
Treasury shares, at cost (2011: 2,261,511; 2010: 1,914,416)	(136,590)	(112,811)
Retained earnings	2,635,750	2,361,202
Accumulated other comprehensive income: net unrealized gains on investments, net of tax	14,484	57,135
Total shareholders equity	3,149,022	3,075,820
Total liabilities and shareholders equity	\$ 11,122,158	\$ 10,427,631

See accompanying notes to the consolidated financial statements.



**Table of Contents****ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**

for the years ended December 31, 2011, 2010 and 2009

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

	2011	2010	2009
<b>REVENUES:</b>			
Gross premiums written	\$ 1,939,521	\$ 1,758,397	\$ 1,696,345
Premiums ceded	(405,755)	(365,942)	(375,220)
Net premiums written	1,533,766	1,392,455	1,321,125
Change in unearned premiums	(76,774)	(32,907)	(4,233)
Net premiums earned	1,456,992	1,359,548	1,316,892
Net investment income	195,948	244,143	300,675
Net realized investment gains	10,077	285,612	126,352
Net impairment charges recognized in earnings:			
Total other-than-temporary impairment charges		(168)	(68,236)
Portion of loss recognized in other comprehensive income, before taxes			18,659
Net impairment charges recognized in earnings		(168)	(49,577)
Other income	101,744	913	1,506
	1,764,761	1,890,048	1,695,848
<b>EXPENSES:</b>			
Net losses and loss expenses	959,156	707,883	604,060
Acquisition costs	167,295	159,489	148,847
General and administrative expenses	271,656	286,557	248,592
Amortization and impairment of intangible assets	2,978	3,483	11,051
Interest expense	54,989	40,242	39,019
Foreign exchange loss	3,159	444	748
	1,459,233	1,198,098	1,052,317
Income before income taxes	305,528	691,950	643,531
Income tax expense	30,980	26,945	36,644
<b>NET INCOME</b>	<b>274,548</b>	<b>665,005</b>	<b>606,887</b>
Other comprehensive (loss) income:			
Unrealized gains on investments arising during the year net of applicable deferred income tax expense 2011: \$3,035; 2010: \$10,209; and 2009: \$1,064	5,243	162,653	243,188
Portion of other-than-temporary impairment losses recognized in other comprehensive income			(18,659)
Reclassification adjustment for net realized investment gains included in net income, net of applicable income tax	(47,894)	(213,478)	(43,464)
Other comprehensive (loss) income	(42,651)	(50,825)	181,065
<b>COMPREHENSIVE INCOME</b>	<b>\$ 231,897</b>	<b>\$ 614,180</b>	<b>\$ 787,952</b>
<b>PER SHARE DATA</b>			
Basic earnings per share	\$ 7.21	\$ 14.30	\$ 12.26

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Diluted earnings per share	\$ 6.92	\$ 13.32	\$ 11.67
Weighted average common shares outstanding	38,093,351	46,491,279	49,503,438
Weighted average common shares and common share equivalents outstanding	39,667,905	49,913,317	51,992,674
Dividends paid per share	\$ 0.75	\$ 1.05	\$ 0.74

See accompanying notes to the consolidated financial statements.

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**Table of Contents****ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

for the years ended December 31, 2011, 2010 and 2009

(Expressed in thousands of United States dollars)

	Share Capital	Additional Paid-in Capital	Treasury Shares	Accumulated Other Comprehensive Income	Retained Earnings	Total
<b>December 31, 2008</b>	\$ 1,471	\$ 1,314,785	\$	\$ 105,632	\$ 994,974	\$ 2,416,862
Cumulative effect adjustment(1)				(136,848)	136,848	
Net income					606,887	606,887
Dividends					(36,689)	(36,689)
Other comprehensive income:						
Net unrealized gains, net of deferred income tax				199,724		199,724
Portion of OTTI losses recognized in other comprehensive income, net of deferred income tax				(18,659)		(18,659)
Total other comprehensive income				181,065		181,065
Stock compensation	21	45,149				45,170
<b>December 31, 2009</b>	\$ 1,492	\$ 1,359,934	\$	\$ 149,849	\$ 1,702,020	\$ 3,213,295
Cumulative effect adjustment(2)				(41,889)	41,889	
Net income					665,005	665,005
Dividends					(47,712)	(47,712)
Other comprehensive loss				(50,825)		(50,825)
Stock compensation	38	40,697				40,735
Share repurchases			(674,662)			(674,662)
Shares cancelled		(561,851)	561,851			
Recapitalization (3)	598,525	(598,525)				
Repurchase of founder warrants		(70,016)				(70,016)
<b>December 31, 2010</b>	\$ 600,055	\$ 170,239	\$ (112,811)	\$ 57,135	\$ 2,361,202	\$ 3,075,820
Net income					274,548	274,548
Dividends partial par value reduction	(42,902)					(42,902)
Other comprehensive loss				(42,651)		(42,651)
Stock compensation		(38,394)	62,921			24,527
Share repurchases			(86,700)			(86,700)
Repurchase of founder warrants		(53,620)				(53,620)
<b>December 31, 2011</b>	\$ 557,153	\$ 78,225	\$ (136,590)	\$ 14,484	\$ 2,635,750	\$ 3,149,022

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- (1) Cumulative effect adjustment reflects adoption of ASC 320-10-65 as of April 1, 2009.
- (2) Cumulative effect adjustment reflects adoption of ASU 2010-11 as of July 1, 2010.
- (3) As a result of the redomestication, share capital was increased on a net basis by \$598,525. For additional details refer to Note 11.  
See accompanying notes to the consolidated financial statements.

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**Table of Contents****ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****CONSOLIDATED STATEMENTS OF CASH FLOWS**

for the years ended December 31, 2011, 2010 and 2009

(Expressed in thousands of United States dollars)

	2011	2010	2009
<b>CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:</b>			
Net income	\$ 274,548	\$ 665,005	\$ 606,887
Adjustments to reconcile net income to cash provided by operating activities:			
Net realized gains on sales of investments	(82,764)	(217,661)	(94,466)
Mark to market adjustments	22,654	(71,909)	(31,886)
Net impairment charges recognized in earnings		168	49,577
Stock compensation expense	22,294	34,243	40,399
Insurance balances receivable	(122,231)	(134,306)	(47,680)
Prepaid reinsurance	(39,434)	(677)	5,972
Reinsurance recoverable	(75,331)	(7,597)	(31,677)
Accrued investment income	2,257	12,526	(2,375)
Net deferred acquisition costs	(3,531)	(8,982)	(1,640)
Net deferred tax assets	129	12,364	(507)
Other assets	22,421	3,390	(26,966)
Reserve for losses and loss expenses	345,955	117,416	184,944
Unearned premiums	116,209	33,584	(1,739)
Reinsurance balances payable	24,807	(3,105)	7,708
Accounts payable and accrued liabilities	10,053	13,969	5,035
Other items, net	30,072	2,836	6,603
Net cash provided by operating activities	548,108	451,264	668,189
<b>CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES:</b>			
Purchases of fixed maturity investments available for sale	(727)	(133,079)	(6,504,094)
Purchases of fixed maturity investments trading	(7,472,926)	(12,637,892)	(4,338,454)
Purchases of equity securities	(381,127)	(178,451)	(9,541)
Purchases of other invested assets	(281,957)	(165,505)	(157,307)
Sales of fixed maturity investments available for sale	609,833	2,687,129	8,346,180
Sales of fixed maturity investments trading	6,757,787	10,917,962	1,818,736
Sales of equity securities	184,504	18,539	97,505
Sales of other invested assets	71,543	9,746	35,552
Changes in securities lending collateral received			171,026
Purchases of fixed assets	(9,819)	(9,576)	(5,075)
Change in restricted cash	13,765	(8,810)	(37,124)
Net cash (used in) provided by investing activities	(509,124)	500,063	(582,596)
<b>CASH FLOWS USED IN FINANCING ACTIVITIES:</b>			
Dividends paid		(47,712)	(36,689)
Partial par value reduction	(28,600)		
Proceeds from the exercise of stock options	6,837	9,598	7,442
Share repurchase	(86,700)	(674,662)	
Proceeds from senior notes		298,632	
Debt issuance costs		(1,950)	
Purchase of founder warrants	(53,620)	(70,016)	
Repayment of syndicated loan			(243,750)
Changes in securities lending collateral			(177,010)
Net cash used in financing activities	(162,083)	(486,110)	(450,007)

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Effect of exchange rate changes on foreign currency cash	100	(410)	774
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(122,999)	464,807	(363,640)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	756,995	292,188	655,828
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 633,996	\$ 756,995	\$ 292,188
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	\$ 14,132	\$ 22,556	\$ 42,170
Cash paid for interest expense	54,000	37,500	39,115

See accompanying notes to the consolidated financial statements

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**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**1. GENERAL**

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

**2. SIGNIFICANT ACCOUNTING POLICIES**

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( U.S. GAAP ). The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant estimates reflected in the Company s financial statements include, but are not limited to:

The premium estimates for certain reinsurance agreements,

Recoverability of deferred acquisition costs,

The reserve for outstanding losses and loss expenses,

Valuation of ceded reinsurance recoverables,

Determination of impairment of goodwill and other intangible assets,

Valuation of financial instruments, and

Determination of other-than-temporary impairment of investments.

Intercompany accounts and transactions have been eliminated on consolidation and all entities meeting consolidation requirements have been included in the consolidation. Certain immaterial reclassifications in the consolidated statements of operations and comprehensive income ( consolidated income statements ), consolidated statements of cash flows and notes to the consolidated financial statements have been made to prior years amounts to conform to the current year s presentation.

The significant accounting policies are as follows:

***a) Premiums and Acquisition Costs***

Premiums are recorded as written on the inception date of the policy. For certain types of business written by the Company, notably reinsurance, premium income may not be known at the policy inception date. In the case of quota share reinsurance treaties assumed by the Company, the underwriter makes an estimate of premium income at inception. The underwriter s estimate is based on statistical data provided by reinsureds and

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the underwriter's judgment and experience. Such estimations are refined over the reporting period of each treaty as actual written premium information is reported by ceding companies and intermediaries. Premiums resulting from such adjustments are estimated and accrued based on available information. Certain insurance and reinsurance contracts may require that the premium be adjusted at the expiry of the contract to reflect the change in exposure or loss experience of the insured or reinsured.

Premiums are recognized as earned over the period of policy coverage in proportion to the risks to which they relate. Premiums relating to the unexpired periods of coverage are recorded on the balance sheets as unearned premiums. Reinsurance premiums under a quota share reinsurance contract are typically earned over the same period as the underlying policies, or risks, covered by the contract. As a result, the earning pattern of a quota share reinsurance contract may extend up to 24 months, reflecting the inception dates of the underlying policies.

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

Acquisition costs, comprised of commissions, brokerage fees and insurance taxes, are costs that are directly related to the successful acquisition of new and renewal business. While permitted under U.S. GAAP to defer certain internal costs that are directly related to the successful acquisition of new and renewal business, the Company does not defer such costs. Acquisition costs that are deferred are expensed as the premiums to which they relate are earned. Acquisition costs relating to the reserve for unearned premiums are deferred and carried on the balance sheets as an asset and are amortized over the period of coverage. Expected losses and loss expenses, other costs and anticipated investment income related to these unearned premiums are considered in determining the recoverability or deficiency of deferred acquisition costs. If it is determined that deferred acquisition costs are not recoverable, they are expensed. Further analysis is performed to determine if a liability is required to provide for losses which may exceed the related unearned premiums.

***b) Reserve for Losses and Loss Expenses***

The reserve for losses and loss expenses is comprised of two main elements: outstanding loss reserves ( OSLR, also known as case reserves) and reserves for losses incurred but not reported ( IBNR ). OSLR relate to known claims and represent management's best estimate of the likely loss payment. IBNR relates to reserves established by the Company for claims that have occurred but have not yet been reported to us as well as for changes in the values of claims that have been reported to us but are not yet settled.

The reserve for IBNR is estimated by management for each line of business based on various factors including underwriters' expectations about loss experience, actuarial analysis, comparisons with the results of industry benchmarks and loss experience to date. The Company's actuaries employ generally accepted actuarial methodologies to determine estimated ultimate loss reserves. The adequacy of the reserves is re-evaluated quarterly by the Company's actuaries. At the completion of each quarterly review of the reserves, a reserve analysis is prepared and reviewed with the Company's loss reserve committee. This committee determines management's best estimate for loss and loss expense reserves based upon the reserve analysis.

While management believes that the reserves for OSLR and IBNR are sufficient to cover losses assumed by the Company, there can be no assurance that losses will not deviate from the Company's reserves, possibly by material amounts. The methodology of estimating loss reserves is periodically reviewed to ensure that the assumptions made continue to be appropriate. The Company recognizes any changes in its loss reserve estimates and the related reinsurance recoverables in the consolidated income statements in the periods in which they are determined and are recorded in net losses and loss expenses .

***c) Ceded Reinsurance***

In the ordinary course of business, the Company uses both treaty and facultative reinsurance to minimize its net loss exposure to any one catastrophic loss event or to an accumulation of losses from a number of smaller events. Reinsurance premiums ceded are expensed and any commissions recorded thereon are earned over the period the reinsurance coverage is provided in proportion to the risks to which they relate. Any unearned ceding commission is included in net deferred acquisitions costs on the consolidated balance sheets and is recorded as a reduction to the overall net deferred acquisition cost balance. Prepaid reinsurance represents unearned premiums ceded to reinsurance companies. Reinsurance recoverable includes the balances due from those reinsurance companies under the terms of the Company's reinsurance agreements for unpaid losses and loss reserves, including IBNR. Amounts recoverable from reinsurers are estimated in a manner consistent with the estimated claim liability associated with the reinsured policy.

The Company determines the portion of the IBNR liability that will be recoverable under its reinsurance contracts by reference to the terms of the reinsurance protection purchased. This determination is necessarily based on the estimate of IBNR and accordingly, is subject to the same uncertainties as the estimate of IBNR.

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

The Company remains liable to the extent that its reinsurers do not meet their obligations under the reinsurance contracts; therefore, the Company regularly evaluates the financial condition of its reinsurers and monitors concentration of credit risk. No material provision has been made for unrecoverable reinsurance as of December 31, 2011 and 2010.

***d) Investments***

The Company holds certain fixed maturity investments that are classified as available for sale and carried at fair value with the difference between amortized cost and fair value, net of the effect of deferred taxes, included as a separate component of accumulated other comprehensive income on the consolidated balance sheets. These securities are included in fixed maturity investments available for sale, at fair value on the consolidated balance sheets.

Beginning in April 2009, the Company elected the fair value option for certain newly acquired fixed maturity investments. When the Company first acquires financial instruments, U.S. GAAP permits the Company to choose to measure the financial instruments at fair value, with changes in fair value recognized in earnings. The Company has elected the fair value option for certain newly acquired fixed maturity investments as the Company believes this approach provides more meaningful and relevant information about the overall performance of its fixed maturity investments as all gains or losses, whether realized or unrealized, are included in net income versus split between net income and accumulated other comprehensive income. As a result of electing the fair value option, any change in unrealized gains or losses is recognized in the consolidated income statements and included in net realized investment gains and those securities are included in fixed maturity investments trading, at fair value on the consolidated balance sheets.

In March 2010, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2010-11 Derivatives and Hedging: Scope Exception Related to Embedded Credit Derivatives ( ASU 2010-11 ). ASU 2010-11 clarifies the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements, specifically one that is related only to the subordination of one financial instrument to another. As permitted under the transitional provisions of ASU 2010-11, effective July 1, 2010 the Company elected the fair value option for any investment in a beneficial interest in a securitized asset. As a result, the Company elected the fair value option for all of its mortgage-backed and asset-backed securities held as of June 30, 2010. On July 1, 2010, the Company reclassified net unrealized gains of \$41,889 from accumulated other comprehensive income to retained earnings . As a result of the fair value election, any change in fair value of the mortgage-backed and asset-backed securities is recognized in net realized investment gains on the consolidated income statement. On July 1, 2010, these investments, which totaled \$968,825, were classified as fixed maturity investments trading, at fair value on the consolidated balance sheets.

Also included in the Company s trading securities are to-be-announced mortgage-backed securities, fixed maturity investments that the Company accounts for as derivatives in accordance with U.S. GAAP. As a result, these securities are included in fixed maturity investments trading, at fair value on the consolidated balance sheets and any change in unrealized gains or losses is recognized in the consolidated income statements and included in net realized investment gains .

Any alternative investments, such as hedge funds and private equity funds, have been accounted for as trading securities with any change in unrealized gains or losses recognized in the consolidated income statements and included in net realized investment gains .

At each measurement date the Company estimates the fair value of the financial instruments using various valuation techniques. The Company utilizes, to the extent available, quoted market prices in active markets or observable market inputs in estimating the fair value of financial instruments. When quoted market prices or observable market inputs are not available, the Company may utilize valuation techniques that rely on

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**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

unobservable inputs to estimate the fair value of financial instruments. The Company bases its determination of whether a market is active or inactive on the spread between what a seller is asking for a security and what a buyer is bidding for that security. Spreads that are significantly above historical spreads are considered inactive markets. The Company also considers the volume of trading activity in the determination of whether a market is active or inactive.

The Company utilizes independent pricing sources to obtain market quotations for securities that have quoted prices in active markets. In general, the independent pricing sources use observable market inputs including, but not limited to, investment yields, credit risks and spreads, benchmarking of like securities, reported trades and sector groupings to determine the fair value. For a majority of the portfolio, the Company obtained two or more prices per security as of December 31, 2011. When multiple prices are obtained, a price source hierarchy is utilized to determine which price source is the best estimate of the fair value of the security. The price source hierarchy emphasizes more weighting to significant observable inputs such as index pricing and less weighting towards non-binding broker-dealer quotes. In addition, to validate all prices obtained from these pricing sources including non-binding broker-dealer quotes, the Company also obtains prices from its investment portfolio managers and other sources (e.g., another pricing vendor), and compares the prices obtained from the independent pricing sources to those obtained from the Company's investment portfolio managers and other sources. The Company investigates any material differences between the multiple sources and determines which price best reflects the fair value of the individual security. There were no material differences between the prices obtained from the independent pricing sources and the prices obtained from the Company's investment portfolio managers and other sources as of December 31, 2011 and 2010.

Investments are recorded on a trade date basis. Investment income is recognized when earned and includes the accrual of discount or amortization of premium on fixed maturity investments using the effective yield method and is net of related expenses. Interest income for debt securities where the Company has elected the fair value option is accrued and recognized based on the contractual terms of the debt securities and is included in net investment income in the consolidated income statements. Realized gains and losses on the disposition of investments, which are based upon the first-in first-out method of identification, are included in net realized investment gains in the consolidated income statements. For mortgage-backed and asset-backed securities and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised on a regular basis. Revised prepayment assumptions are applied to securities on a retrospective basis to the date of acquisition. The cumulative adjustments to amortized cost required due to these changes in effective yields and maturities are recognized in net investment income in the same period as the revision of the assumptions.

***e) Other-Than-Temporary Impairments on Available for Sale Securities***

The Company recognizes other-than-temporary impairments ( OTTI ) in the consolidated income statements if the Company intends to sell the debt security or if it is more likely than not that the Company will be required to sell a debt security before the recovery of its amortized cost basis. In addition, OTTI is recognized if the present value of the expected cash flows of a debt security is less than the amortized cost basis of the debt security ( credit loss ).

The Company has applied the following policy to determine if OTTI exists at each reporting period for its available for sale securities:

The Company's debt securities are managed by external investment portfolio managers. The Company requires them to provide a list of debt securities they intend to sell at the end of the reporting period. Any impairment in these securities is recognized as OTTI as the difference between the amortized cost and fair value and is recognized in the consolidated income statements and included in net impairment charges recognized in earnings .

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At each reporting period the Company determines if it is more likely than not that the Company will be required to sell a debt security before the recovery of its amortized cost basis. The Company analyzes its current and future contractual and non-contractual obligations and its expectation of future cash flows to determine if the Company will need to sell debt securities to fund its obligations. The Company considers factors such as trends in underwriting profitability, cash flows from operations, return on invested assets, property catastrophe losses, timing of payments and other specific contractual obligations that are coming due.

For debt securities that are in an unrealized loss position that the Company does not intend to sell, the Company assesses whether a credit loss exists. The amount of the credit loss is recognized in the consolidated income statements and is included in net impairment charges recognized in earnings. The assessment involves consideration of several factors including: (i) the significance of the decline in value and the resulting unrealized loss position, (ii) the time period for which there has been a significant decline in value and (iii) an analysis of the issuer of the investment, including its liquidity, business prospects and overall financial position.

In accordance with guidance issued by the FASB on OTTI in 2009, the Company was required to recognize a cumulative effect adjustment to retained earnings for all debt securities for which the Company had previously recognized OTTI and for which no credit loss existed. The cumulative effect adjustment was based on those fixed maturity securities that the Company held at April 1, 2009. The amount of the cumulative effect adjustment was determined by comparing the present value of the expected cash flows of each security with the amortized cost basis of the security as of April 1, 2009. The discount rate used to calculate the present value of the cash flows of securities that have fixed interest and principal payments was the rate in effect at the acquisition date. The discount rate used to calculate the present value of the cash flows of securities that have variable interest and principal payments was the rate in effect immediately prior to recognizing OTTI. The cumulative effect adjustment had the effect of re-establishing unrealized losses that were previously recognized in the consolidated income statement as OTTI. On April 1, 2009, Company recognized a cumulative effect adjustment of \$136,848, net of applicable deferred income taxes of \$1,677, as an increase to retained earnings and a reduction to accumulated other comprehensive income on the consolidated balance sheets.

***f) Translation of Foreign Currencies***

Monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the exchange rates in effect on the balance sheet date. Foreign currency revenues and expenses are translated at the average exchange rates prevailing during the period. Exchange gains and losses, including those arising from forward exchange contracts, are included in the consolidated income statements. The Company's functional currency, and that of its operating subsidiaries, is the U.S. dollar as it is the single largest currency in which the Company transacts its business and holds its invested assets.

***g) Cash and Cash Equivalents***

Cash and cash equivalents include amounts held in banks, time deposits, commercial paper, discount notes and U.S. Treasury Bills with maturities of less than three months from the date of purchase.

***h) Income Taxes***

Allied World Switzerland and certain of its subsidiaries operate in jurisdictions where they are subject to income taxation. Current and deferred income taxes are charged or credited to operations, or to accumulated other comprehensive income in certain cases, based upon enacted tax laws and rates applicable in the relevant jurisdiction in the period in which the tax becomes payable. Deferred income taxes are provided for all temporary differences between the bases of assets and liabilities used in the financial statements and those used in the various jurisdictional tax returns.



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It is the Company's policy to recognize interest accrued related to unrecognized tax benefits in interest expense and penalties in general and administrative expenses in the consolidated income statements. The Company has not recorded any interest or penalties during the years ended December 31, 2011, 2010 and 2009 and the Company has not accrued any payment of interest and penalties as of December 31, 2011 and 2010.

***i) Employee Stock Option Compensation Plan***

The Company has an employee stock option plan in which the amount of Company shares received as compensation through the issuance of stock options is determined by reference to the value of the shares. Compensation expense for stock options granted to employees is recorded on a straight-line basis over the option vesting period and is based on the fair value of the stock options on the grant date. The fair value of each stock option on the grant date is determined by using the Black-Scholes option-pricing model.

***j) Restricted Stock Units***

The Company has granted restricted stock units (RSUs) to certain employees. These RSUs generally vest pro-rata over four years from the date of grant or vest in either the fourth or fifth year from the date of the original grant. The compensation expense for the RSUs is based on the market value of Allied World Switzerland's common shares on the grant date, and is recognized on a straight-line basis over the applicable vesting period.

The Company has also granted cash-equivalent RSUs to certain employees that vest pro-rata over four years from the date of grant. The amount payable per unit awarded will be equal to the price per share of Allied World Switzerland's common shares and as such we measure 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 increases or decreases in compensation expense ratably over the service period.

***k) Performance-Based Equity Awards***

The Company implemented the Third Amended and Restated Long-Term Incentive Plan (LTIP), which provides for performance-based equity awards to key employees in order to promote the long-term growth and profitability of the Company. Each award represents the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during the applicable performance period, which is generally the ending of the third fiscal year from the date of grant or either the ending of the fourth or fifth fiscal year from the date of grant. The compensation expense for these awards is based on the market value of Allied World Switzerland's common shares on the grant date, and is recognized on a straight-line basis over the applicable performance and vesting period.

In addition, the Company has granted performance-based RSUs that provide performance-based equity awards to key employees in order to promote the long-term growth and profitability of the Company. Each award represents the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during the applicable performance period, which is generally the ending of the third fiscal year from the date of grant. The compensation expense for these awards is based on the market value of Allied World Switzerland's common shares on the grant date, and is recognized on a straight-line basis over the applicable performance and vesting period.

The Company has also granted cash-equivalent performance-based awards to certain employees that vest based upon the achievement of established performance criteria during the applicable performance period. These cash-equivalent performance-based 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 we



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measure 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.

***l) Goodwill and Intangible Assets***

The Company classifies its intangible assets into three categories: (1) intangible assets with finite lives subject to amortization, (2) intangible assets with indefinite lives not subject to amortization, and (3) goodwill. Intangible assets, other than goodwill, generally consist of trademarks, renewal rights, internally generated software, non-compete covenants and insurance licenses held by subsidiaries domiciled in the United States.

For intangible assets with finite lives, the value of the assets is amortized over their useful lives and the expense is included in amortization and impairment of intangible assets in the consolidated income statements. The Company tests assets for impairment if conditions exist that indicate the carrying value may not be recoverable. If, as a result of the evaluation, the Company determines that the value of the intangible assets is impaired, then the value of the assets will be written-down in the period in which the determination of the impairment is made.

For indefinite lived intangible assets the Company does not amortize the intangible asset but evaluates and compares the fair value of the assets to their carrying values on an annual basis or more frequently if circumstances warrant. If, as a result of the evaluation, the Company determines that the value of the intangible assets is impaired, then the value of the assets will be written-down in the period in which the determination of the impairment is made.

Goodwill represents the excess of the cost of acquisitions over the fair value of net assets acquired and is not amortized. Goodwill is assigned at acquisition to the applicable reporting unit(s) based on the expected benefit to be received by the reporting units from the business combination. The Company determines the expected benefit based on several factors including the purpose of the business combination, the strategy of the Company subsequent to the business combination and structure of the acquired company subsequent to the business combination. A reporting unit is a component of the Company's business that has discrete financial information that is reviewed by management. In determining the reporting unit, the Company analyzes the inputs, processes, outputs and overall operating performance of the reporting unit. The Company has determined that for purposes of the acquisition of Darwin Professional Underwriters, Inc. ( Darwin ) the U.S. insurance segment is the reporting unit that is expected to receive the benefit of the business combination and as such all of the goodwill has been allocated to this reporting unit.

For goodwill, the Company performs a two-step impairment test on an annual basis or more frequently if circumstances warrant. The first step is to compare the fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount of the reporting unit exceeds its fair value then the second step of the goodwill impairment test is performed.

The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill in order to determine the amount of impairment to be recognized. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit's identifiable assets and liabilities from the fair value of the reporting unit as a whole. The excess of the carrying value of goodwill above the implied goodwill, if any, would be recognized as an impairment charge in amortization and impairment of intangible assets in the consolidated income statements.

***m) Derivative Instruments***

The Company utilizes derivative financial instruments as part of its overall risk management strategy. The Company recognizes all derivative financial instruments at fair value as either assets or liabilities on the

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consolidated balance sheets. The accounting for gains and losses associated with changes in the fair value of a derivative and the effect on the consolidated financial statements depends on its hedge designation and whether the hedge is highly effective in achieving offsetting changes in the fair value of the asset or liability hedged.

The Company uses currency forward contracts and foreign currency swaps to manage currency exposure. The Company also utilizes various derivative instruments such as interest rate futures and index options, for the purpose of managing market exposures, interest rate volatility, portfolio duration, hedging certain investments, or enhancing investment performance. These derivatives are not designated as hedges and accordingly are carried at fair value on the consolidated balance sheets with realized and unrealized gains and losses included in the consolidated income statements. Refer to Note 5 for the Company's related disclosure.

***n) Earnings Per Share***

Basic earnings per share is defined as net income available to common shareholders divided by the weighted average number of common shares outstanding for the period, giving no effect to dilutive securities. Diluted earnings per share is defined as net income available to common shareholders divided by the weighted average number of common and common share equivalents outstanding calculated using the treasury stock method for all potentially dilutive securities, including share warrants, employee stock options, employee share repurchase plan, RSUs and LTIP awards. When the effect of dilutive securities would be anti-dilutive, these securities are excluded from the calculation of diluted earnings per share.

***o) New Accounting Pronouncements***

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

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

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

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 provides a consistent

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meaning for the term fair value between the FASB and International Accounting Standards Board and establishes common requirements for measuring and disclosing information related thereto. ASU 2011-04 is effective on a prospective basis for interim and annual periods beginning on or after December 15, 2011 and early adoption is prohibited. The Company is currently assessing the provisions of ASU 2011-04 and its potential impact on future financial statements.

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income ( ASU 2011-05 ). ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity, requires consecutive presentation of the statement of net income and other comprehensive income and requires the presentation of reclassification adjustments on the face of the financial statements from other comprehensive income to net income. ASU 2011-05 is effective on a retrospective basis for interim and annual periods beginning on or after December 15, 2011. In December 2011, ASU 2011-05 was updated by ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 ( ASU 2011-12 ) to defer the presentation requirements of reclassification adjustments required by ASU 2011-05. ASU 2011-05 and the related updates from ASU 2011-12 will not have an impact on the presentation of future financial statements.

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment ( ASU 2011-08 ). ASU 2011-08 simplifies how goodwill is tested for impairment by permitting entities to assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The qualitative assessment will determine if an entity needs to proceed with the two-step goodwill impairment test. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 and early adoption is permitted. The Company has not elected early adoption and is currently evaluating the provisions of ASU 2011-08 and its potential impact on future financial statements. The Company does not anticipate that this will have a material impact on future financial statements once adopted.

In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities ( ASU 2011-11 ). ASU 2011-11 requires an entity to disclose information about offsetting and related arrangements to enable financial statement users to understand the effect of those arrangements on its financial position. ASU 2011-11 is effective on a retrospective basis for annual reporting periods beginning on or after January 1, 2013 and interim periods therein. The Company is currently assessing the provisions of ASU 2011-11 and its potential impact on future financial statements.

### **3. ACQUISITIONS**

Allied World Assurance Company Holdings, Ltd ( Allied World Bermuda ) entered into a definitive agreement and plan of merger (the Merger Agreement ) on June 27, 2008 with Allied World Merger Company, a Delaware corporation and an indirect, wholly-owned subsidiary of the Company ( Merger Sub ), and Darwin, a Delaware corporation. The Merger Agreement provided for the merger of Merger Sub with and into Darwin, with Darwin continuing as the surviving corporation and an indirect wholly-owned subsidiary of Allied World Bermuda. Darwin is a holding company whose subsidiaries are engaged in the executive and professional liability insurance business with an emphasis on coverage for the healthcare industry. The transaction was completed on October 20, 2008 and has been accounted for as a purchase. Under the purchase method of accounting for a business combination, the assets and liabilities of Darwin were recorded at their fair values on the acquisition date. The total cash consideration paid by the Company was \$558,755, including direct costs of the acquisition of \$8,478. There was no contingent consideration related to this acquisition.

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The following table shows the fair value of the separately identifiable intangible assets at the time of acquisition and the period over which each intangible asset will be amortized, if applicable.

	<b>Intangible Assets</b>	
	<b>Fair Value</b>	<b>Amortization Period</b>
Renewal rights	\$ 38,000	15 years
Trademarks	7,400	15 years
Internally developed software	1,600	3 years
Non-compete covenants	1,200	2 years
Insurance licenses	8,000	N/A
	\$ 56,200	

The intangible assets that are subject to amortization had a weighted average useful life of 14.3 years at the time of the acquisition. The insurance licenses have been determined to have indefinite useful lives and as such are not amortizable.

The \$264,615 of goodwill has been allocated to the U.S. insurance segment as Darwin is fully integrated with the Company's U.S. insurance segment. We do not expect any amount of the goodwill to be deductible for tax purposes.

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**4. INVESTMENTS***a) Available for Sale Securities*

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2011</b>				
U.S. Government and Government agencies	\$ 31,309	\$ 2,321	\$	\$ 33,630
States, municipalities and political subdivisions	29,128	4,351		33,479
Corporate debt:				
Financial institutions	17,431	348	(292)	17,487
Industrials	73,539	4,268		77,807
Utilities	74,990	6,623		81,613
Total fixed maturity investments, available for sale	\$ 226,397	\$ 17,911	\$ (292)	\$ 244,016
<b>December 31, 2010</b>				
U.S. Government and Government agencies	\$ 85,030	\$ 6,923	\$	\$ 91,953
Non-U.S. Government and Government agencies	138,386	9,539	(2,541)	145,384
States, municipalities and political subdivisions	107,289	10,901	(13)	118,177
Corporate debt:				
Financial institutions	66,660	6,776	(38)	73,398
Industrials	310,664	20,548	(2)	331,210
Utilities	120,515	11,212		131,727
Total fixed maturity investments, available for sale	\$ 828,544	\$ 65,899	\$ (2,594)	\$ 891,849

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**b) Trading Securities**

Securities accounted for at fair value with changes in fair value recognized in the consolidated income statements by category are as follows:

	December 31, 2011		December 31, 2010	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
U.S. Government and Government agencies	\$ 1,278,265	\$ 1,263,948	\$ 1,229,720	\$ 1,219,233
Non-U.S. Government and Government agencies	256,756	251,784	120,793	115,969
States, municipalities and political subdivisions	133,902	128,633	127,436	128,995
Corporate debt:				
Financial institutions	1,161,904	1,174,308	1,261,219	1,247,895
Industrials	987,006	974,731	627,524	629,360
Utilities	105,564	103,262	101,472	101,622
Residential mortgage-backed:				
Non-agency residential	302,827	314,077	371,935	340,545
Agency residential	1,183,893	1,156,913	1,195,905	1,200,430
Commercial mortgage-backed	331,371	326,697	184,043	184,380
Asset-backed	513,198	513,638	549,050	545,893
<b>Total fixed maturity investments, trading</b>	<b>\$ 6,254,686</b>	<b>\$ 6,207,991</b>	<b>\$ 5,769,097</b>	<b>\$ 5,714,322</b>

	December 31, 2011		December 31, 2010	
	Fair Value	Original Cost	Fair Value	Original Cost
Equity securities	\$ 367,483	\$ 356,370	\$ 174,976	\$ 160,513
Other invested assets <sup>(1)</sup>	540,409	529,851	347,632	331,772
	<b>\$ 907,892</b>	<b>\$ 886,221</b>	<b>\$ 522,608</b>	<b>\$ 492,285</b>

(1) Within the Company's financial statements and footnotes other invested assets include the Company's investments in both hedge funds and private equity funds.

**c) Contractual Maturity Dates**

The contractual maturity dates of available for sale fixed maturity investments are as follows:

	December 31, 2011	
	Amortized Cost	Fair Value
Due within one year	\$ 31,492	\$ 31,981
Due after one year through five years	164,329	176,592
Due after five years through ten years	27,561	31,634

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Due after ten years	3,015	3,809
	\$ 226,397	\$ 244,016

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

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**d) Other Invested Assets**

Included in other invested assets are the Company's hedge fund and private equity investments. As of the balance sheet date, the Company held 21 hedge fund investments with a total fair value of \$540,409, which comprised 6.7% of the total fair value of its investments and cash and cash equivalents and are summarized as follows by type of investment strategy:

Fund Type	Fair Value as of		Long	Short	Gross Exposure(3)	Net Exposure(4)
	December 31, 2011	Unfunded Commitments	Exposure(1) (% of funded)	Exposure(2) (% of funded)		
Private equity (primary and secondary)	\$ 83,787	\$ 111,566	100%	0%	100%	100%
Mezzanine debt	14,535	100,344	100%	0%	100%	100%
Distressed	10,543	33,968	100%	0%	100%	100%
Total private equity	108,865	245,878				
Distressed	42,849		61%	31%	92%	30%
Equity long/short	159,615		75%	49%	124%	26%
Multi-strategy	157,251		98%	20%	118%	78%
Event driven	71,829		81%	66%	147%	15%
Total hedge funds	431,544					
Total other invested assets	\$ 540,409	\$ 245,878				

(1) Long exposure represents the ratio of the fund's long investments in securities to the fund's equity capital (over 100% may denote explicit borrowing). Four of the Company's hedge funds, two multi-strategy funds, one event driven fund and one equity long/short fund had long exposure greater than 100% of the funds' net asset value (indicating explicit leverage). The funds had long exposure of 145%, 103%, 139% and 103%, respectively, as of December 31, 2011.

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

(3) Gross exposure is the addition of the long and short exposures.



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

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

**Mezzanine debt funds:** Mezzanine debt funds invest primarily in privately negotiated mezzanine investments. The funds' strategies will focus primarily on providing capital to upper middle market and middle market companies, and private equity sponsors, in connection with leveraged buyouts, mergers and acquisitions, recapitalizations, growth financings and other corporate transactions. The most common position in the capital structure will be between the senior secured debt holder and the equity; however,

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the funds will utilize a flexible approach when structuring investments, which may include secured debt, subordinated debt, preferred stock and/or private equity. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in two mezzanine debt funds that cannot be redeemed at this time because the investments include restrictions that do not allow for redemption until termination of the fund. The restriction period for these funds from initial investment is ten years.

**Distressed funds:** In distressed debt investing, managers take positions in the debt of companies experiencing significant financial difficulties, including bankruptcy, or in certain positions of the capital structure of structured securities. The manager relies on the fundamental analysis of these securities, including the claims on the assets and the likely return to bondholders. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in five distressed funds, three of which (representing approximately 28% of the value of the funds in this class) are not currently eligible for redemption due to imposed lock-up periods ranging from one to eight years from initial investments. The remaining funds representing approximately 47% and 25% of the value of the funds in this class are currently eligible for quarterly redemption with a 65-day and 45-day notification period, respectively.

**Equity long/short funds:** In equity long/short funds, managers take long positions in companies they deem to be undervalued and short positions in companies they deem to be overvalued. Long/short managers may invest in countries, regions or sectors and vary by their use of leverage and target net long position. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in four equity long/short funds, one of which (representing approximately 26% of the value of the funds in this class) is not currently eligible for redemption due to an imposed lock-up period of eighteen months from initial investment, at which time the fund will be eligible for quarterly redemption with a 45-day notification period. The remaining three funds, representing approximately 74% of the value of the funds in this class, are currently eligible for quarterly redemption, one with a 30-day notification period or monthly redemption with a 30-day notification period and redemption fee, one with a 45-day notification period and one with a 60-day notification period.

**Multi-strategy funds:** These funds may utilize many strategies employed by specialized funds including distressed investing, equity long/short, merger arbitrage, convertible arbitrage, fixed income arbitrage and macro trading. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in four multi-strategy funds, all of which are currently eligible for quarterly redemption. Three of the funds require notification periods before redemption which range from 45 days to 90 days. The remaining fund is currently eligible for redemption of one third of the net asset value with a 65-day notification period.

**Event driven funds:** Event driven strategies seek to deploy capital into specific securities whose returns are affected by a specific event that affects the value of one or more securities of a company. Returns for such securities are linked primarily to the specific outcome of the events and not by the overall direction of the bond or stock markets. Examples could include mergers and acquisitions (arbitrage), corporate restructurings and spin-offs and capital structure arbitrage. The fair values of the funds in this class have been estimated using the net asset value per share of the funds. The Company has invested in two event driven funds. Approximately 61% of the value of the funds is not currently eligible for redemption due to an imposed two year lock-up period from initial investment. The remaining 39% of the value of the funds in this class is currently eligible for quarterly redemption, but is subject to redemption fees and limitations.

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**e) Net Investment Income**

	For the year ended December 31,		
	2011	2010	2009
Fixed maturity investments	\$ 194,093	\$ 245,407	\$ 306,578
Equity securities and other invested assets	15,088	9,800	1,506
Cash and cash equivalents	963	671	1,570
Expenses	(14,196)	(11,735)	(8,979)
Net investment income	\$ 195,948	\$ 244,143	\$ 300,675

**f) Components of Realized Gains and Losses**

Components of realized gains and losses are summarized in the following table:

	For the year ended December 31,		
	2011	2010	2009
Gross realized gains on sale of invested assets	\$ 154,941	\$ 242,421	\$ 185,322
Gross realized losses on sale of invested assets	(62,169)	(26,621)	(90,856)
Treasury yield hedge		(3,958)	
Futures not designated as hedges	(57,234)		
Foreign exchange forwards not designated as hedges	(2,807)		
Mark-to-market changes: debt securities trading	(8,078)	42,172	12,603
Mark-to-market changes: foreign exchange forwards and futures not designated as hedges	(5,924)		
Mark-to-market changes: put options	(4,125)		
Mark-to-market changes: other invested assets and equity securities	(4,527)	29,738	19,283
Gain on sale of Program Administrator		1,860	
Net realized investment gains	\$ 10,077	\$ 285,612	\$ 126,352
Proceeds from sale of available for sale securities	\$ 646,479	\$ 2,703,695	\$ 8,402,666
Proceeds from sale of trading securities	6,841,666	11,042,968	1,870,625

Included in gross realized losses for the year ended December 31, 2010 is a realized loss of \$3,958 related to a U.S. Treasury yield hedge transaction that was purchased in May 2010 and terminated in June 2010.

In July 2010, the Company sold its program administrator and wholesale brokerage operations for \$2,395 in cash and recognized a gain on the sale of \$1,860.

Included in gross realized losses for the year ended December 31, 2009 is a realized loss of \$21,923 from the sale of the investment in the global high-yield bond fund.

**g) Pledged Assets**

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As of December 31, 2011 and 2010, \$288,664 and \$280,175, respectively, of cash and cash equivalents and investments were on deposit with various state or government insurance departments or pledged in favor of

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ceding companies in order to comply with relevant insurance regulations. In addition, the Company has set up trust accounts to meet security requirements for inter-company reinsurance transactions. These trusts contained assets of \$1,740,474 and \$1,377,266 as of December 31, 2011 and 2010, respectively, and are included in fixed maturity investments.

The Company also has facilities available for the issuance of letters of credit collateralized against the Company's investment portfolio. See Note 9 Debt and Financing Arrangements for details on the facilities.

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

	<b>As of December 31, 2011</b>	<b>As of December 31, 2010</b>
Total trust accounts on deposit	\$ 2,029,138	\$ 1,657,441
Total letter of credit facilities:		
Citibank Europe plc Credit Facility	900,000	900,000
	800,000	800,000
<b>Total letter of credit facilities</b>	<b>1,700,000</b>	<b>1,700,000</b>
Total letter of credit facilities outstanding:		
Citibank Europe plc Credit Facility	675,636	689,851
	141,351	158,983
<b>Total letter of credit facilities outstanding</b>	<b>816,987</b>	<b>848,834</b>
Total letter of credit facilities remaining:		
Citibank Europe plc Credit Facility(1)	224,364	210,149
	658,649	641,017
<b>Total letter of credit facilities remaining</b>	<b>883,013</b>	<b>851,166</b>
Collateral committed to support the letter of credit facilities	\$ 1,044,236	\$ 1,121,345

(1) Net of any borrowing or repayments under the Unsecured Facility (as defined in Note 9). See Note 9 for further details on the Unsecured Facility.

Total trust accounts on deposit includes available for sale securities, trading securities and cash and cash equivalents. The fair value of the combined total cash and cash equivalents and investments held under trust were \$3,073,374 and \$2,778,786 as of December 31, 2011 and 2010, respectively. Of the total letter of credit facilities outstanding as of December 31, 2011 and 2010, \$7,295 was used to meet security requirements for inter-company transactions. The remaining letter of credit facilities outstanding was used primarily for third-party ceding companies.

*h) Analysis of Unrealized Losses*

The Company's primary investment objective is the preservation of capital. Although the Company has been successful in meeting this objective, shifts in interest rates and credit spreads affecting valuation can temporarily place some investments in an unrealized loss position.

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The following table summarizes the market value of those available for sale investments in an unrealized loss position for periods less than and greater than 12 months:

	December 31, 2011		December 31, 2010	
	Gross Fair Value	Unrealized Loss	Gross Fair Value	Unrealized Loss
<b>Less than 12 months</b>				
Non-U.S. Government and Government agencies	\$	\$	\$ 34,204	\$ (1,116)
States, municipalities and political subdivisions			472	(13)
Corporate debt				
Financial institutions	9,440	(292)	2,796	(38)
Industrials			2,150	(2)
	\$ 9,440	\$ (292)	\$ 39,622	\$ (1,169)
<b>More than 12 months</b>				
Non-U.S. Government and Government agencies	\$	\$	\$ 10,998	\$ (1,425)
	\$	\$	\$ 10,998	\$ (1,425)
	\$ 9,440	\$ (292)	\$ 50,620	\$ (2,594)

As of December 31, 2011 and 2010, there were approximately three and nine securities, respectively, in an unrealized loss position. The gross unrealized loss of \$2,594 as of December 31, 2010 was primarily related to bonds issued by the governments of the United Kingdom and Germany, respectively, for which the Company believes the unrealized losses will be recovered. The decrease in the gross unrealized loss from December 31, 2010 to December 31, 2011 is primarily due to selling available for sale debt securities and reinvesting proceeds in trading debt securities thereby reducing unrealized gains/losses recognized in accumulated other comprehensive income.

**i) Other-Than-Temporary Impairment Charges**

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

Of the \$68,236 recognized as OTTI for the year ended December 31, 2009, \$7,614, was recognized through earnings due to credit related losses, \$41,963 was recognized through earnings for those securities in an unrealized loss position where the Company's investment managers had the discretion to sell and \$18,659 was recognized in accumulated other comprehensive income on the consolidated balance sheets.

For the mortgage-backed security for which OTTI was recognized due to credit loss during the year ended December 31, 2010, the significant inputs utilized to determine a credit loss were the estimated frequency and severity of losses of the underlying mortgages that comprise the mortgage-backed security. The frequency of losses was measured as the credit default rate, which includes factors such as loan-to-value ratios and credit scores of borrowers. The severity of losses includes such factors as trends in overall housing prices and house





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prices that are obtained at foreclosure. The frequency and severity inputs were used in projecting the future cash flows of the mortgage backed security. For the security in which the Company recognized an OTTI due to credit loss, the credit default rate was 10.3% and the severity rate was 49.0%.

The following table shows the range of the credit default rates and severity rates for the mortgage-backed securities for which an OTTI was recognized through earnings during the year ended December 31, 2009 as well as the weighted average rates.

Significant Input	Range of Inputs		Weighted Average of Input
Credit default rate	0.6%	11.0%	6.1%
Severity rate	30.1%	100.0%	37.2%

The following table summarizes the amounts related to credit losses on debt securities for which a portion of the OTTI was recognized in other comprehensive income in the consolidated income statements:

	For the Year Ended December 31, 2010
Beginning balance of credit losses	\$ 1,096
Additions for credit loss for which OTTI was not previously recognized	168
Reductions for securities sold during the period (realized)	
Reductions for OTTI previously recognized due to intent to sell	
Additions resulting from the increase in credit losses	
Reductions resulting from the improvement in expected cash flows	
Adoption of ASU 2010-11	(1,264)
Ending balance of credit losses	\$

The following shows the net impairment charges recognized in earnings for the Company's fixed maturity investments by category for the years ended December 31, 2011, 2010, and 2009:

	2011	2010	2009
Asset backed	\$	\$	\$ 31,545
Mortgage backed		168	18,027
U.S. government and government agencies			5
Non-U.S. government and government agencies			
Corporate			
States, municipalities and political subdivisions			
Total other-than-temporary impairment charges	\$	\$ 168	\$ 49,577



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**5. DERIVATIVE INSTRUMENTS**

The following table summarizes information on the location and amounts of derivative fair values in the consolidated balance sheets:

	December 31, 2011				December 31, 2010			
	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
<b>Derivatives not designated as hedging instruments</b>								
<i>Relating to investment portfolio:</i>								
Put options (1)	\$ 4,461	\$ 336	\$	\$	\$	\$	\$	\$
Foreign exchange contracts (2)	64,580	1,754	233,801	5,188				
Interest rate futures (2)	680,650	977	292,000	3,467				
	\$ 749,691	\$ 3,067	\$ 525,801	\$ 8,655	\$	\$	\$	\$
<i>Relating to operating activities and capital management:</i>								
Foreign exchange contracts (2)	\$ 26,582	\$ 276	\$ 105,732	\$ 3,746	\$ 26,758	\$ 858	\$ 51,308	\$ 1,629
<b>Total derivatives</b>	<b>\$ 776,273</b>	<b>\$ 3,343</b>	<b>\$ 631,533</b>	<b>\$ 12,401</b>	<b>\$ 26,758</b>	<b>\$ 858</b>	<b>\$ 51,308</b>	<b>\$ 1,629</b>

(1) Asset and liability derivatives relating to the put options are classified within equity securities trading, at fair value on the consolidated balance sheets.

(2) All other asset and liability derivatives are classified within other assets or accounts payable and accrued liabilities on the consolidated balance sheets.

The following table provides the total unrealized and realized gains (losses) on derivatives recorded in the consolidated income statements:

	Location of Gain (Loss) Recognized in the Consolidated Income Statements	For the year ended December 31,		
		2011	2010	2009
<b>Derivatives not designated as hedging instruments</b>				
<i>Relating to investment portfolio:</i>				
Put options	Net realized investment losses	\$ (4,125)	\$	\$
Foreign exchange contracts	Net realized investment losses	(6,242)		
Interest rate futures	Net realized investment losses	(59,723)		

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		\$ (70,090)	\$	\$
<i>Relating to operating activities and capital management:</i>				
Foreign exchange contracts	Foreign exchange (losses) gains	\$ (6,005)	\$ 3,403	\$ 6,904
Treasury yield hedge	Net realized investment losses		(3,958)	
<b>Total derivatives</b>		\$ (76,095)	\$ (555)	\$ 6,904

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***Derivative Instruments not Designated as Hedging Instruments***

***a) Relating to Investment Portfolio***

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. The Company entered into foreign currency forward contracts to manage the effect of this foreign currency risk. These foreign currency hedging activities have not been designated as specific hedges for financial reporting purposes.

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

During the year ended December 31, 2011, the Company purchased index put options to actively manage the Company's equity portfolio.

***b) Relating to Operating Activities and Capital Management***

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.

In addition, the Company entered into a treasury yield hedge during the year ended December 31, 2010 to mitigate the potential rise in interest rates.

**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 which are unobservable for the asset or liability.

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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:

December 31, 2011	Carrying amount	Total fair value	Fair value measurement using:		
			Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Available for sale securities:</b>					
U.S. Government and Government agencies	\$ 33,630	\$ 33,630	\$ 33,630	\$	\$
States, municipalities and political subdivisions	33,479	33,479		33,479	
Corporate debt	176,907	176,907		176,907	
<b>Total available for sale fixed maturity investments</b>	<b>244,016</b>	<b>244,016</b>			
<b>Trading securities:</b>					
U.S. Government and Government agencies	\$ 1,278,265	\$ 1,278,265	\$ 1,054,003	\$ 224,262	\$
Non-U.S. Government and Government agencies	256,756	256,756		256,756	
States, municipalities and political subdivisions	133,902	133,902		133,902	
Corporate debt	2,254,474	2,254,474		2,254,474	
Mortgage-backed	1,818,091	1,818,091		1,568,887	249,204
Asset-backed	513,198	513,198		418,453	94,745
<b>Total trading fixed maturity investments</b>	<b>6,254,686</b>	<b>6,254,686</b>			
<b>Total fixed maturity investments</b>	<b>6,498,702</b>	<b>6,498,702</b>			
Equity securities	367,483	367,483	367,483		
Other invested assets	540,409	540,409			540,409
<b>Total investments</b>	<b>7,406,594</b>	<b>7,406,594</b>	<b>1,455,116</b>	<b>5,067,120</b>	<b>884,358</b>
Senior notes	797,949	872,731		872,731	

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December 31, 2010	Carrying amount	Total fair value	Fair value measurement using:		
			Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Available for sale securities:</b>					
U.S. Government and Government agencies	\$ 91,953	\$ 91,953	\$ 65,234	\$ 26,719	\$
Non-U.S. Government and Government agencies	145,384	145,384		145,384	
States, municipalities and political subdivisions	118,177	118,177		118,177	
Corporate debt	536,335	536,335		536,335	
<b>Total available for sale fixed maturity investments</b>	<b>891,849</b>	<b>891,849</b>			
<b>Trading securities:</b>					
U.S. Government and Government agencies	\$ 1,229,720	\$ 1,229,720	\$ 1,088,967	\$ 140,753	\$
Non-U.S. Government and Government agencies	120,793	120,793		120,793	
States, municipalities and political subdivisions	127,436	127,436		127,436	
Corporate debt	1,990,215	1,990,215		1,990,215	
Mortgage-backed	1,751,883	1,751,883		1,579,324	172,559
Asset-backed	549,050	549,050		500,343	48,707
<b>Total trading fixed maturity investments</b>	<b>5,769,097</b>	<b>5,769,097</b>			
<b>Total fixed maturity investments</b>	<b>6,660,946</b>	<b>6,660,946</b>			
Equity securities	174,976	174,976	174,976		
Other invested assets	347,632	347,632			347,632
<b>Total investments</b>	<b>7,183,554</b>	<b>7,183,554</b>	<b>1,329,177</b>	<b>5,285,479</b>	<b>568,898</b>
Senior notes	797,700	850,570		850,570	

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.

**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.



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**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.

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

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

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

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

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

**Senior notes:** The fair value of the senior notes is based on trades as reported in Bloomberg. As of December 31, 2011, the 7.50% Senior Notes and 5.50% Senior Notes (each as defined in Note 9) were traded at 114.3% and 100.4% of their principal amount, providing an effective yield of 4.0% and 5.4%, respectively. The fair value of the senior notes is included in the Level 2 fair value hierarchy.

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

	Fair value measurement using significant unobservable inputs (Level 3):		
	Other invested assets	Mortgage-backed	Asset-backed
<b>Year Ended December 31, 2011</b>			
Opening balance	\$ 347,632	\$ 172,559	\$ 48,707
Total realized and unrealized gains included in net income	22,059	4,472	90
Total realized and unrealized losses included in net income	(25,679)	(6,603)	(452)
Purchases	311,185	101,302	24,056
Sales	(114,788)	(44,549)	(3,204)
Transfers into Level 3		63,717	30,536
Transfers out of Level 3		(41,694)	(4,988)
<b>Ending balance</b>	<b>\$ 540,409</b>	<b>\$ 249,204</b>	<b>\$ 94,745</b>
<b>Year Ended December 31, 2010</b>			
Opening balance	\$ 184,725	\$ 253,979	\$ 104,871
Total realized and unrealized gains included in net income	18,368	24,983	818
Total realized and unrealized losses included in net income	(965)	(9,247)	(233)
Change in unrealized gains included in OCI		5,781	70
Change in unrealized losses included in OCI		(3,026)	(6)
Purchases	155,504	138,995	64,275
Sales	(10,000)	(252,769)	(21,944)
Cumulative effect adjustment related to the adoption of ASU 2010-11		1,796	(19)
Transfers into Level 3		56,582	56,033
Transfers out of Level 3		(44,515)	(155,158)
<b>Ending balance</b>	<b>\$ 347,632</b>	<b>\$ 172,559</b>	<b>\$ 48,707</b>

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

Of the total realized and unrealized gains and losses included in net income for the year ended December 31, 2011, \$(5,302), \$(353) and \$(2,902) related to hedge funds, asset-backed and mortgage-backed securities, respectively, are attributable to the change in unrealized gains and losses for securities still held as of

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December 31, 2011. Of the total realized and unrealized gains and losses included in net income and OCI for the year ended December 31, 2010, \$15,372, \$9,282 and \$(145) related to hedge funds, mortgage-backed and asset-backed securities, respectively, are attributable to the change in unrealized gains and losses for securities still held as of December 31, 2010. The change in unrealized gains and losses are included in net realized investment gains on the consolidated income statement.

During the year ended December 31, 2011, the Company transferred \$41,694 of mortgage-backed securities and \$4,988 of asset-backed securities from Level 3 to Level 2 in the fair value hierarchy. During the year ended December 31, 2010, the Company transferred \$44,515 of mortgage-backed securities and \$155,158 of asset-backed securities from Level 3 to Level 2 in the fair value hierarchy. The Company transferred those securities as it no longer utilized broker-dealer quotes and instead used other pricing sources that have significant observable inputs. The Company recognizes transfers between levels at the end of the reporting period.

**7. RESERVE FOR LOSSES AND LOSS EXPENSES**

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

	2011	2010
OSLR	\$ 1,366,466	\$ 1,166,516
IBNR	3,858,677	3,712,672
Reserve for losses and loss expenses	\$ 5,225,143	\$ 4,879,188

The table below is a reconciliation of the beginning and ending liability for unpaid losses and loss expenses for the years ended December 31, 2011, 2010 and 2009. Losses incurred and paid are reflected net of reinsurance recoveries.

	2011	2010	2009
Gross liability at beginning of year	\$ 4,879,188	\$ 4,761,772	\$ 4,576,828
Reinsurance recoverable at beginning of year	(927,588)	(919,991)	(888,314)
Net liability at beginning of year	3,951,600	3,841,781	3,688,514
Net losses incurred related to:			
Commutation of variable-rated reinsurance contracts	11,529	8,864	
Current year	1,201,155	1,012,374	852,052
Prior years	(253,528)	(313,355)	(247,992)
Total incurred	959,156	707,883	604,060
Net paid losses related to:			
Current year	142,162	98,646	42,320
Prior years	542,649	498,084	415,901
Total paid	684,811	596,730	458,221

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Foreign exchange revaluation	(3,721)	(1,334)	7,428
Net liability at end of year	4,222,224	3,951,600	3,841,781
Reinsurance recoverable at end of year	1,002,919	927,588	919,991
Gross liability at end of year	\$ 5,225,143	\$ 4,879,188	\$ 4,761,772

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The commutation of variable-rated reinsurance contracts of \$11,529 and \$8,864 for the years ended December 31, 2011 and 2010, respectively, represents the reduction of ceded IBNR related to the commutation of swing-rated reinsurance contracts.

For the year ended December 31, 2011, the Company had net favorable reserve development in each of its segments due to actual loss emergence being lower than initial expected. The majority of the net favorable reserve development was recognized in the international insurance and reinsurance segments in the 2005 through 2007 loss years related to the general casualty and professional liability insurance and reinsurance lines of business and the healthcare insurance line of business.

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

For the year ended December 31, 2009, the Company had net favorable reserve development in each of its segments due to actual loss emergence being lower than initial expected. The majority of the net favorable reserve development was recognized in the international insurance segment in the 2004 and 2005 loss years related to the general casualty, healthcare and professional liability lines of business.

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

**8. CEDED REINSURANCE**

The Company purchases reinsurance to reduce its net exposure to losses. Reinsurance provides for recovery of a portion of gross losses and loss expenses from its reinsurers. The Company remains liable to the extent that its reinsurers do not meet their obligations under these agreements. The Company therefore regularly evaluates the financial condition of its reinsurers and monitors concentration of credit risk. The Company believes that as of December 31, 2011 its reinsurers are able to meet, and will meet, all of their obligations under the agreements. The amount of reinsurance recoverable is as follows:

	2011	2010
OSLR recoverable	\$ 196,484	\$ 206,130
IBNR recoverable	806,435	721,458
<b>Reinsurance recoverable</b>	<b>\$ 1,002,919</b>	<b>\$ 927,588</b>

The Company purchases both facultative and treaty reinsurance. For facultative reinsurance, the amount of reinsurance recoverable on paid losses as of December 31, 2011 and 2010 was \$11,774 and \$8,300, respectively. For treaty reinsurance, the right of offset between losses and premiums generally exists within the treaties. As a result, the net balance of reinsurance recoverable from or payable to the reinsurer has been included in insurance balances receivable or reinsurance balances payable, respectively, on the consolidated balance sheets. The amounts representing the reinsurance recoverable on paid losses included in these balances as of December 31, 2011 and 2010 were \$42,266 and \$40,794, respectively. The Company also has excess-of-loss reinsurance structured on a variable-rate basis, which provides for the refund of a portion of premium if the ultimate loss ratio is lower than an initial provisional loss ratio set out in the reinsurance contract. For these variable-rate reinsurance treaties, the ceded premium incurred is determined by the loss ratio on the business subject to the reinsurance treaty. As the expected ultimate loss ratio increases or decreases, the ceded premiums and losses recoverable from reinsurers will also increase or decrease



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within a minimum and maximum range for ceded premium and subject to a loss ratio cap for losses recoverable. During the year ending December 31, 2011 and 2010, the Company commuted certain variable-rated excess-of-loss reinsurance contracts and recognized a reduction to ceded premium of \$12,393 and \$9,296, respectively. In addition, during the year ended December 31, 2011, the Company recognized a decrease to ceded premium for recurring business of \$2,392 for a net reduction of \$14,785, and during the year ended December 31, 2010, the Company recognized an increase to ceded premium for recurring business of \$508 for a net reduction of \$8,788. The adjustments were fully earned and resulted in a net increase in net premiums earned.

The Company monitors the overall credit quality of its reinsurers to ensure the recoverables will be collected. The following table shows a breakdown of our reinsurance recoverables by credit rating as of December 31, 2011:

<u>A.M. Best Rating</u>	Ceded		Reinsurance Recoverable on Paid
	OSLR	IBNR	Losses
A++	\$ 32,306	\$ 48,351	\$ 1,115
A+	63,414	278,100	15,391
A	90,057	467,892	32,824
A-	5,886	2,371	4,219
B++	242	5,363	276
NR	4,579	4,358	215
Total	\$ 196,484	\$ 806,435	\$ 54,040

Direct, assumed and ceded premiums written, earned and losses and loss expenses incurred for the years ended December 31, 2011, 2010 and 2009 are as follows:

	Premiums Written	Premiums Earned	Losses and Loss Expenses
	<b>December 31, 2011</b>		
Direct	\$ 1,369,017	\$ 1,266,068	\$ 807,721
Assumed	570,504	557,244	365,990
Ceded	(405,755)	(366,320)	(214,555)
	\$ 1,533,766	\$ 1,456,992	\$ 959,156
<b>December 31, 2010</b>			
Direct	\$ 1,234,204	\$ 1,221,536	\$ 623,585
Assumed	524,193	503,277	250,070
Ceded	(365,942)	(365,265)	(165,772)
	\$ 1,392,455	\$ 1,359,548	\$ 707,883



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<b>December 31, 2009</b>			
Direct	\$ 1,230,770	\$ 1,241,488	\$ 565,401
Assumed	465,575	456,596	235,237
Ceded	(375,220)	(381,192)	(196,578)
	\$ 1,321,125	\$ 1,316,892	\$ 604,060

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Of the premiums ceded during the years ended December 31, 2011, 2010 and 2009, approximately 54%, 56% and 57% were ceded to four reinsurers, respectively.

**9. DEBT AND FINANCING ARRANGEMENTS**

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

In 2006, Allied World Bermuda issued \$500,000 aggregate principal amount of 7.50% Senior Notes due August 1, 2016 ( 7.50% Senior Notes ), with interest on the notes payable on August 1 and February 1 of each year, commencing on February 1, 2007. The 7.50% Senior Notes were offered by the underwriters at a price of 99.71% of their principal amount, providing an effective yield to investors of 7.54%. Interest payable on the 7.50% Senior Notes at December 31, 2011 and 2010 was \$15,625 and is included in accounts payable and accrued liabilities on the consolidated balance sheets. The 7.50% Senior Notes can be redeemed by Allied World Bermuda prior to maturity subject to payment of a make-whole premium. Allied World Bermuda has no current expectations of redeeming the notes prior to maturity. The 7.50% Senior Notes includes covenants and events of default that are usual and customary, but do not contain any financial covenants.

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

Accrued interest associated with the Company's outstanding debt obligations was \$17,688 and \$17,687 as of December 31, 2011 and 2010, respectively, and included in accounts payable and accrued liabilities within the consolidated balance sheets. Consolidated interest expense associated with the Company's outstanding debt obligations was \$54,989, \$40,242 and \$39,019 for the years ended December 31, 2011, 2010 and 2009, respectively.

Allied World Bermuda has a collateralized amended letter of credit facility with Citibank Europe plc. that has been and will continue to be used to issue standby letters of credit. The maximum aggregate amount available under this credit facility is \$900,000 on an uncommitted basis.

In addition, Allied World Bermuda entered into an \$800,000 five-year senior credit facility (the Credit Facility ) with a syndication of lenders that will terminate on November 27, 2012. The Credit Facility consists of a \$400,000 secured letter of credit facility for the issuance of standby letters of credit (the Secured Facility ) and a \$400,000 unsecured facility for the making of revolving loans and for the issuance of standby letters of credit (the Unsecured Facility ). Both the Secured Facility and the Unsecured Facility have options to increase the aggregate commitments by up to \$200,000, subject to approval of the lenders. The Credit Facility will be used for general corporate purposes and to issue standby letters of credit. The Credit Facility contains representations, warranties and covenants customary for similar bank loan facilities, including certain covenants

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that, among other things, require the Company to maintain certain leverage ratios, consolidated net worth and financial strength rating. Allied World Bermuda is in compliance with all covenants under the Facility as of December 31, 2011.

In May 2010, Allied World Capital (Europe) Limited established an irrevocable standby letter of credit in order to satisfy funding requirements of the Company's Lloyd's Syndicate 2232. As of December 31, 2011 the amount of the letter of credit was £59,000 (\$90,955).

**10. GOODWILL AND INTANGIBLE ASSETS**

The following table shows an analysis of goodwill and intangible assets:

	Goodwill	Intangible assets with indefinite lives	Intangible assets with finite lives	Total
Net balance at December 31, 2009	\$ 268,376	\$ 23,920	\$ 36,439	\$ 328,735
Additions				
Amortization			(3,483)	(3,483)
Net balance at December 31, 2010	268,376	23,920	32,956	325,252
Additions				
Amortization			(2,978)	(2,978)
Net balance December 31, 2011	\$ 268,376	\$ 23,920	\$ 29,978	\$ 322,274
Gross balance	268,532	23,920	48,200	340,652
Accumulated amortization			(11,356)	(11,356)
Impairments	(156)		(6,866)	(7,022)
Net balance	\$ 268,376	\$ 23,920	\$ 29,978	\$ 322,274

On October 20, 2008, the Company completed the purchase of Darwin. The fair value of the insurance licenses acquired was \$8,000 at acquisition and was recorded as an intangible asset with an indefinite life. The fair value of the trademark, renewal rights, covenants-not-to-compete and the internally developed software acquired was \$48,200 at acquisition and was recorded as intangible assets with finite lives. At the end of 2009, the Company made a strategic decision to market all products, with few limited exceptions, under the Allied World brand instead of under the Darwin brand. This resulted in a significant change in the extent and manner in which the trademark would be utilized. As such, a \$6,866 impairment was incurred and included in amortization and impairment of intangible assets in the Company's consolidated income statements for the year ended December 31, 2009 to write off the unamortized balance of the Darwin trademark. No additional impairment was incurred as the Company will continue to utilize and benefit from the existing renewal rights, covenants-not-to-compete and internally developed software. The amortization of the intangible assets with definite lives for the years ended December 31, 2012, 2013, 2014, 2015, 2016 and thereafter will be \$2,533, \$2,533, \$2,533, \$2,533, \$2,533 and \$17,313, respectively. The intangible assets will be amortized over a remaining useful life of 11.8 years. The Company also recognized goodwill of \$264,615 related to the acquisition.

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**11. 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 resident of the Canton of Zug and, as such, is subject to an annual cantonal and communal capital tax on the taxable equity of Allied World Switzerland in Switzerland. Allied World Switzerland has a Swiss operating company resident in the Canton of Zug. The operating company is subject to federal, cantonal, and communal income tax and to annual cantonal and communal capital tax.

Under current Bermuda law, Allied World Bermuda and its Bermuda subsidiaries are not required to pay taxes in Bermuda on either income or capital gains. Allied World Bermuda and Allied World Assurance Company, Ltd have received an assurance from the Bermuda Minister of Finance under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, that in the event of any such taxes being imposed, Allied World Bermuda and Allied World Assurance Company, Ltd will be exempted until March 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 the United Kingdom, Ireland, Switzerland, Hong Kong and Singapore. The following tax years by jurisdiction are open to examination:

	<b>Fiscal Years</b>	
U.S. Internal Revenue Service ( IRS ) for the U.S. subsidiaries	2008	2011
Inland Revenue for the U.K. branches	2010	2011
Irish Revenue Commissioners for the Irish subsidiaries	2007	2011
Swiss Federal Tax Administration for the Swiss branch	2008	2011
Inland Revenue Department for the Hong Kong branch	2009	2011
Inland Revenue Authority for the Singapore branch	2010	2011

To the best of the Company's knowledge, there are no 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 December 31, 2011.

Income tax expense for the years ended December 31, 2011, 2010 and 2009 are as follows:

	<b>2011</b>	<b>2010</b>	<b>2009</b>
Current income tax expense	\$ 30,851	\$ 14,560	\$ 38,763
Deferred income tax expense (benefit)	129	12,385	(2,119)
<b>Income tax expense</b>	<b>\$ 30,980</b>	<b>\$ 26,945</b>	<b>\$ 36,644</b>

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Our income is sourced from our Bermuda, U.S. and European operations. The income before income taxes for these operations for the years ended December 31, 2011, 2010 and 2009 are as follows:

	2011	2010	2009
Bermuda	\$ 133,553	\$ 609,880	\$ 537,333
U.S.	63,175	76,084	95,631
Europe	108,800	5,986	10,567
Income before income taxes	\$ 305,528	\$ 691,950	\$ 643,531

As of December 31, 2011 and 2010, the current tax receivable was \$6,287 and \$15,614, respectively, and has been included in other assets on the consolidated balance sheets. As of December 31, 2011, the current tax payable was \$8,856 and has been included in other liabilities on the consolidated balance sheets.

Deferred income taxes reflect the tax impact of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. The significant components of the net deferred tax assets as of December 31, 2011 and 2010 are as follows:

	2011	2010
Deferred tax assets:		
Reserve for losses and loss expenses	\$ 20,580	\$ 19,213
Equity compensation	15,920	13,230
Unearned premium	11,382	10,654
Deferred acquisition costs	8,506	6,228
Other-than-temporary impairments	506	514
Mark-to-market on securities acquired	80	1,251
Total deferred tax assets	56,974	51,090
Deferred tax liabilities:		
Intangible assets	(16,500)	(17,448)
Realized gains	(6,317)	(1,803)
Depreciation	(4,391)	(2,496)
Unrealized appreciation and timing difference on investments	(3,135)	(6,168)
Market discount on bonds	(1,032)	(1,301)
Other deferred tax liabilities	(2,953)	(2,134)
Total deferred tax liabilities	(34,328)	(31,350)
Net deferred tax assets	\$ 22,646	\$ 19,740

Management believes it is more likely than not that the tax benefit of the net deferred tax assets will be realized.



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The expected tax provision has been calculated using the pre-tax accounting income in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate. The actual income tax rate for the years ended December 31, 2011 and 2010 differed from the amount computed by applying the effective tax rate of 7.8% under Swiss law to income before income taxes. For the year ended December 31, 2009, the actual income tax rate differed from the amount computed by applying the effective rate of 0% under Bermuda law to income before income taxes.

	2011	2010	2009
Income before taxes	\$ 305,528	\$ 691,950	\$ 643,531
Expected tax rate	7.8%	7.8%	0.0%
Income not subject to income tax	(3.4)%	(7.8)%	0.0%
Foreign taxes at local expected tax rates	6.0%	3.7%	5.6%
Loss on sale of subsidiary	0.0%	(0.3)%	0.0%
Disallowed expenses and capital allowances	0.1%	0.1%	0.1%
Prior year refunds and adjustments	(0.6)%	0.6%	(0.1)%
Other	0.2%	(0.2)%	0.1%
Effective tax rate	10.1%	3.9%	5.7%

During the year ended December 31, 2011, Allied World Switzerland had income tax expense of \$7,940, therefore its effective tax rate on income before taxes was 9.0%.

**12. SHAREHOLDERS EQUITY***a) Authorized Shares*

The issued share capital consists of the following:

	2011	2010
Common shares issued and fully paid, 2011: CHF 14.03 per share and 2010: CHF 15.00 per share	40,003,642	40,003,642
Share capital at end of year	557,153	600,055
		<b>Year Ended December 31, 2011</b>
Total shares issued at beginning and end of period		40,003,642
Treasury shares issued, balance at beginning of period		1,914,416
Shares repurchased		1,419,163
Shares issued out of treasury		(1,072,068)

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Total treasury shares at end of period	2,261,511
Total shares outstanding at end of period	37,742,131

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As of December 31, 2011, there were outstanding 37,712,891 voting common shares and 29,240 non-voting common shares.

Allied World Switzerland's articles of association authorize its Board of Directors to increase the share capital by a maximum amount of 20% of the share capital registered in the commercial register up to CHF 111,682 or 7,960,260 voting shares, and create conditional capital of 7,200,000 voting shares.

***b) Redomestication***

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

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

***c) Share Warrants***

In conjunction with the private placement offering at the formation of Allied World Bermuda, Allied World Bermuda granted warrant agreements to certain founding shareholders to acquire up to 5,500,000 common shares at an exercise price of \$34.20 per share. These warrants were exercisable in certain limited conditions, including a public offering of common shares, and were due to expire November 21, 2011. All warrants granted have been repurchased by the Company.

In August 2010, Allied World Bermuda repurchased a warrant owned by The Chubb Corporation ( Chubb ) in a privately negotiated transaction. The warrant entitled Chubb to purchase 2,000,000 of Allied World Bermuda's common shares for \$34.20 per share. Allied World Bermuda repurchased the warrant for an aggregate purchase price of \$32,819. In November 2010, Allied World Bermuda repurchased warrants owned by GS Capital Partners and other investment funds, which are affiliates of The Goldman Sachs Group, Inc. ( Goldman Sachs ) and founding shareholders in a privately negotiated transaction. The warrants entitled Goldman Sachs to purchase 1,500,000 of Allied World Bermuda's common shares for \$34.20 per share. Allied World Bermuda repurchased the warrants for an aggregate purchase price of \$37,197. In February 2011, the Company repurchased the last outstanding warrant owned by American International Group, Inc. ( AIG ) in a privately negotiated transaction. The warrant entitled AIG to purchase 2,000,000 of the Company's common shares for \$34.20 per share. The Company repurchased the warrant for an aggregate purchase price of \$53,620. The repurchases of the warrants were recognized as a reduction in additional paid-in capital on the consolidated balance sheets. The repurchases were executed separately from the share repurchase program discussed in Note 12(e) below. After these repurchases, Chubb, Goldman Sachs and AIG have no warrants remaining and no other disclosed equity interest in the Company.

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***d) Dividends***

Under Swiss law, distributions to shareholders may be paid only if the Company has sufficient distributable profits from previous fiscal years, or if the Company has freely distributable reserves, each as presented on the audited stand-alone statutory balance sheet. Distributions to shareholders out of the share and participation capital may be made by way of a capital reduction in the form of a reduction to par value to achieve a similar result as the payment of a dividend.

On May 5, 2011, the shareholders approved the Company's proposal to pay cash dividends in the form of a distribution by way of par value reductions. The aggregate reduction amount will be paid to shareholders in quarterly installments of \$0.375 per share. The Company made such quarterly dividend payments of \$14,295 on August 5, 2011, \$14,305 on October 7, 2011 and \$14,302 on January 6, 2012, to shareholders of record on July 27, 2011, October 3, 2011 and December 23, 2011, respectively. The amount of the par value reductions were CHF 0.30, CHF 0.32 and CHF 0.35 based on the exchange rate as of July 18, 2011, September 19, 2011 and December 19, 2011 respectively. The Company distributed the third quarterly installment in January 2012 and expects to distribute the fourth quarterly installment in April 2012. Dividend payments are subject to Swiss law and other related factors described in the Company's 2011 Proxy Statement and the Company's other filings with the SEC.

The Company paid quarterly dividends of \$0.20 per common share on each of April 1, 2010, June 10, 2010, September 9, 2010 and November 26, 2010, payable to shareholders of record on March 16, 2010, May 25, 2010, August 24, 2010 and November 15, 2010, respectively. Additionally, the Company paid a special dividend of \$0.25 per common share related to our redomestication to Switzerland on November 26, 2010 to shareholders of record on November 15, 2010.

***e) Share Repurchases***

In May 2010, the Company established a share repurchase program in order to repurchase its common shares. Repurchases may be effected from time to time through open market purchases, privately negotiated transactions, tender offers or otherwise. The timing, form and amount of the share repurchases under the program will depend on a variety of factors, including market conditions, the Company's capital position, legal requirements and other factors. During the year ended December 31, 2011, the Company repurchased through open market purchases 1,419,163 shares at a total cost of \$86,700 for an average price of \$61.09 per share. These repurchased shares have been classified as Treasury shares, at cost on the consolidated balance sheets. The Company will issue shares out of treasury principally related to the Company's employee benefit plans.

In August 2010, the Company repurchased 5,000,000 of its common shares for \$250,000, or \$50.00 per share, in a privately negotiated transaction from Goldman Sachs. The shares repurchased were classified as Treasury shares, at cost on the consolidated balance sheets. In November 2010, the Company repurchased the remaining 3,159,793 common shares from Goldman Sachs for \$185,448, or \$58.69 per share. The repurchase price per common share is based on and reflects a 0.5% discount from the volume-weighted average trading price of the Company's common shares on November 5, 2010. These repurchases were executed separately from the Company's share repurchase program discussed above.

**13. EMPLOYEE BENEFIT PLANS**

***a) Employee Option Plan***

The Company has implemented the Allied World Assurance Company Holdings, AG Third Amended and Restated 2001 Employee Stock Option Plan (the Plan). Under the Plan, up to 4,000,000 common shares may be issued. Options under the Plan are exercisable in certain limited conditions, expire after 10 years, and



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generally vest pro-rata over four years from the date of grant. The exercise price of options issued are recommended by the Compensation Committee to the Board of Directors for approval but shall not be less than 100% of the fair market value of the common shares of Allied World Switzerland on the date the option award is granted.

	Year Ended December 31, 2011			
	Options	Weighted Average Exercise Price	Weighted Average Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	1,272,739	\$ 38.77		
Granted	494,885	61.51		
Exercised	(179,807)	(38.02)		
Forfeited	(60,766)	(51.49)		
Expired	(1,198)	(43.00)		
Outstanding at end of year	1,525,853	45.72	6.9 years	\$ 26,255
Exercisable at end of year	681,870	\$ 36.35	5.0 years	\$ 18,127

The total intrinsic value of options exercised during the years ended December 31, 2011, 2010 and 2009 was \$4,070, \$5,888 and \$4,283, respectively.

Assumptions used in the option-pricing model for the options granted during the years presented are as follows:

	Options Granted During the Year Ended December 31, 2011	Options Granted During the Year Ended December 31, 2010	Options Granted During the Year Ended December 31, 2009
Expected term of option	5.48 years	5.47 years	4.75 years
Weighted average risk-free interest rate	2.33%	2.65%	2.03%
Weighted average expected volatility	31.51%	42.35%	42.96%
Dividend yield	1.00%	1.25%	1.71%
Weighted average fair value on grant date	\$ 18.27	\$ 17.34	\$ 12.80

Company specific information is used to determine the expected term of the option and the expected volatility. As a result, the expected term of the option is based on the historical terms of options granted since the inception of the Company and the expected volatility is based on the volatility of the fair market value of Allied World Switzerland's common shares. The Company has assumed a weighted average annual forfeiture rate of 6.72% in determining the compensation expense over the service period.

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Compensation expense of \$4,098, \$2,953 and \$2,556 relating to the options have been included in general and administrative expenses in the Company's consolidated income statements for the years ended December 31, 2011, 2010 and 2009, respectively. As of December 31, 2011 and 2010, the Company has recorded in additional paid-in capital on the consolidated balance sheets an amount of \$42,203 and \$41,505, respectively, in connection with all options granted. During the year ended December 31, 2011 and 2010, the Company received cash upon the exercise of stock options of \$6,837 and \$9,598, respectively.

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As of December 31, 2011, there was remaining \$10,887 of total unrecognized compensation expense related to unvested options granted under the Plan. This expense is expected to be recognized over a weighted-average period of 1.7 years.

**b) Stock Incentive Plan**

The Company has implemented the Allied World Assurance Company Holdings, AG Third Amended and Restated 2004 Stock Incentive Plan (the Stock Incentive Plan). The Stock Incentive Plan provides for grants of restricted stock, RSUs, dividend equivalent rights and other equity-based awards. A total of 2,000,000 common shares may be issued under the Stock Incentive Plan. To date, only RSUs have been granted. These RSUs generally vest pro-rata over four years from the date of grant or vest in the fourth or fifth year from the date of grant.

	Year Ended December 31, 2011	
	RSUs	Weighted Average Grant Date Fair Value
Outstanding RSUs at beginning of year	851,078	\$ 39.88
RSUs granted	47,198	61.18
Performance-based RSUs granted	139,210	61.51
RSUs forfeited	(41,252)	(34.32)
RSUs fully vested	(343,098)	(37.48)
Outstanding RSUs at end of year	653,136	\$ 47.23

Beginning in 2010 the Company granted performance-based RSUs in lieu of utilizing the LTIP. The performance-based RSUs are structured in exactly the same form as shares issued under the LTIP in terms of vesting restrictions and achievement of established performance criteria and are accounted for consistent with the accounting policy described in Note 2(k). For the performance-based RSUs granted in 2011 and 2010, the Company anticipates that the performance goals are likely to be achieved. Based on the performance goals, the performance-based RSUs granted in 2011 and 2010 are expensed at 100% of the fair market value of Allied World Switzerland's common shares on the date of grant. The expense is recognized over the performance period.

Compensation expense of \$13,140, \$13,473 and \$9,003 relating to the issuance of the RSUs has been recognized in general and administrative expenses in the Company's consolidated income statements for the years ended December 31, 2011, 2010 and 2009, respectively. 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 has assumed a weighted average annual forfeiture rate, excluding performance-based RSUs, of 2.80% in determining the compensation expense over the service period. The Company believes it is unlikely that performance-based RSUs will be forfeited as these awards are issued to senior management. Thus, no forfeiture rate is applied to the performance-based RSUs. The RSUs vested in 2011, 2010 and 2009 had intrinsic values of \$19,732, \$17,302 and \$6,212 at the time of vesting, based on average market values per share of \$57.52, \$47.49 and \$39.79, respectively.

As of December 31, 2011 and 2010, the Company has recorded \$28,380 and \$37,991, respectively, in additional paid-in capital on the consolidated balance sheets in connection with the RSUs awarded.



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As of December 31, 2011, there was remaining \$15,139 of total unrecognized compensation expense related to unvested RSUs awarded. This expense is expected to be recognized over a weighted-average period of 1.4 years. Based on a December 31, 2011 market value of \$62.93 per share, the outstanding RSUs had an intrinsic value of \$41,102.

**c) Long-Term Incentive Plan**

The Company has implemented the Allied World Assurance Company Holdings, AG Third Amended and Restated Long-Term Incentive Plan. Each award under the LTIP represents the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during the applicable three-year performance period. A total of 2,000,000 common shares may be issued under the LTIP. The awards granted in 2008 generally vested after the fiscal year ended December 31, 2010; however, a portion of this award will vest after the fourth or fifth year from the original grant date, subject to the achievement of the performance conditions and terms of the LTIP.

	<b>Year Ended December 31, 2011</b>	
	<b>LTIP</b>	<b>Weighted Average Grant Date Fair Value</b>
Outstanding LTIP awards at beginning of year	773,411	\$ 41.74
Additional LTIP awards granted due to the achievement of 2008 – 2010 performance criteria	212,938	43.27
LTIP awards forfeited	(19,750)	41.39
LTIP awards vested	(642,563)	43.25
Outstanding LTIP awards at end of year	324,036	\$ 39.78

Compensation expense of \$5,056, \$17,817 and \$25,580 relating to the LTIP has been recognized in general and administrative expenses in the Company's consolidated income statements for the years ended December 31, 2011, 2010 and 2009, respectively. The compensation expense for the LTIP is based on the fair market value of the Company's common shares at the time of grant. The LTIP is deemed to be an equity plan and as such, \$49,171 and \$77,728 have been included in additional paid-in capital on the consolidated balance sheets as of December 31, 2011 and 2010, respectively.

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

As of December 31, 2011, there was remaining \$375 of total unrecognized compensation expense related to unvested LTIP awards. This expense is expected to be recognized over a period of one year. Based on a December 31, 2011 market value of \$62.93 per share, the outstanding LTIP awards had an intrinsic value of \$30,587.

As part of the acquisition of Darwin, the Company assumed Darwin's Long-Term Incentive Plan ( Darwin LTIP ) that it had implemented for certain of its key employees. Initially, the Darwin LTIP allocated 20% of the underwriting profit for each year (premiums net of losses and expenses) plus 20% of the investment income based





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on average net assets outstanding in each year (at a deemed interest rate equal to the 10 year U.S. Treasury note rate) to the Darwin LTIP participants, based on their assigned percentage interests. Interests in these profit pools vest over a four-year period. The payments due are made in increments over the fourth, fifth and sixth years.

Effective January 1, 2006, the Darwin LTIP was modified to reflect changes in the calculation of the underwriting profitability allocated to the participants of the Darwin LTIP. For 2006 and later years, the amount allocated to the participants is calculated as an amount equal to 20% of the underwriting profit less an amount equal to 5% of net premiums earned. In addition, imputed investment income will no longer be credited to the pool participants.

The Darwin LTIP is intended to produce payouts consistent with long-term profitability. Accordingly, the right of offset exists where, in the event that any year produces a negative underwriting result, this negative amount would be offset against credits available under the profit pool established for another year. This offset can be applied against any of the unpaid year balances whether prior or subsequent to the year in question.

At December 31, 2011 and 2010, the Company had recorded liabilities of \$3,425 and \$4,919, respectively, for the LTIP in accounts payable and accrued expenses on the consolidated balance sheets. The Company recognized \$3,219, \$932 and \$5,851 in expenses related to the Darwin LTIP during the years ended December 31, 2011, 2010 and 2009, respectively, which have been included in general and administrative expenses in the Company's consolidated income statements. The Darwin LTIP is in run-off and any awards after 2008 to former participants in the Darwin LTIP are being granted under Allied World Switzerland's stock plans.

**d) Cash-Equivalent Stock Awards**

Since 2009, as part of the Company's annual year-end compensation awards, the Company granted both stock-based awards and cash-equivalent stock awards. The cash-equivalent awards were granted to employees who received RSU and performance-based awards and were granted in lieu of granting the full award as a stock-based award. The cash-equivalent RSU awards vest pro-rata over four years from the date of grant. The cash-equivalent performance-based awards vest after a three-year performance period. As the cash-equivalent awards are settled in cash, we establish a liability equal to the product of the fair market value of Allied World Switzerland's common shares as of the end of the reporting period and the total awards outstanding. The liability is included in accounts payable and accrued expenses in the balance sheets and changes in the liability are recorded in general and administrative expenses in the consolidated income statements. For the years ended December 31, 2011, 2010 and 2009, the expense recognized for the cash-equivalent stock awards was \$20,295, \$15,132 and \$3,260, respectively.

The following table shows the total stock related compensation expense relating to the stock options, RSUs, LTIP and cash equivalent awards for the years ended December 31, 2011, 2010 and 2009.

	<b>For the Years Ended December 31,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Stock Options	\$ 4,098	\$ 2,953	\$ 2,556
RSUs	13,140	13,473	9,003
LTIP	5,056	17,817	25,580
Cash-equivalent stock awards	20,295	15,132	3,260
<b>Total</b>	<b>\$ 42,589</b>	<b>\$ 49,375</b>	<b>\$ 40,399</b>



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**e) Pension Plans**

The Company provides defined contribution retirement plans for its employees and officers. Pursuant to the employees' plan, each participant can contribute 5% or more of their salary and the Company will contribute an amount equal to 5% of each participant's salary. Officers are also eligible to participate in one of various supplementary retirement plans, in which each participant may contribute up to 25% of their annual base salary. The Company will contribute to the officer plans an amount equal to 10% of each officer's annual base salary. The Company contributes under the Supplemental Executive Retirement Plan (SERP) up to 10% of a participant's annual base salary in excess of the then-effective maximum amount of annual compensation that could be taken into account under a qualified plan under the Internal Revenue Code, as established by the Internal Revenue Service from time to time, with an annual base salary cap of \$600. The amount that an individual employee or officer can contribute may also be subject to any regulatory requirements relating to the country of which the individual is a citizen. The amounts funded and expensed during the years ended December 31, 2011, 2010 and 2009 were \$7,165, \$8,011 and \$4,886, respectively.

**f) Employee Share Purchase Plan**

Under the Allied World Assurance Company Holdings, AG Amended and Restated 2008 Employee Share Purchase Plan (ESPP), eligible employees of the Company may purchase common shares of the Company at a 15% discount from the fair market value of one common share on the last trading day of each offering period. Employees purchase a variable number of common shares through payroll deductions elected as of the beginning of the offering period. The Company may sell up to 1,000,000 common shares to eligible employees under the ESPP. The amount expensed during the years ended December 31, 2011, 2010 and 2009 were \$207, \$160 and \$162, respectively.

**14. EARNINGS PER SHARE**

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

	2011	2010	2009
<b>Basic earnings per share</b>			
Net income	\$ 274,548	\$ 665,005	\$ 606,887
Weighted average common shares outstanding	38,093,351	46,491,279	49,503,438
Basic earnings per share	\$ 7.21	\$ 14.30	\$ 12.26
<b>Diluted earnings per share</b>			
Net income	\$ 274,548	\$ 665,005	\$ 606,887
Weighted average common shares outstanding	38,093,351	46,491,279	49,503,438
Share equivalents:			
Warrants and options	387,549	1,668,262	1,241,644
Restricted stock units	418,588	669,006	413,714
LTIP awards	767,176	1,084,389	833,878
Employee share repurchase plan	1,241	381	
Weighted average common shares and common share equivalents outstanding - diluted	39,667,905	49,913,317	51,992,674
Diluted earnings per share	\$ 6.92	\$ 13.32	\$ 11.67



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For the years ended December 31, 2011, 2010 and 2009, a weighted average of 557,039, 452,354 and 709,793 employee stock options, respectively, were considered anti-dilutive and were therefore excluded from the calculation of diluted earnings per share. For the years ended December 31, 2011, 2010 and 2009, a weighted average of 141,633, nil and 133,072 RSUs, respectively, were considered anti-dilutive and were therefore excluded from the calculation of diluted earnings per share.

**15. COMMITMENTS AND CONTINGENCIES****a) Concentrations of Credit Risk**

Credit risk arises out of the failure of a counterparty to perform according to the terms of the contract. The Company is exposed to credit risk in the event of non-performance by the counterparties to the Company's foreign exchange forward contracts and foreign currency swaps. However, because the counterparties to these agreements are high-quality international banks, the Company does not anticipate any non-performance. The difference between the contract amounts and the related market values is the Company's maximum credit exposure.

As of December 31, 2011 and 2010, substantially all of the Company's cash and investments were held with one custodian.

Of the \$1,002,919 of reinsurance recoverables as of December 31, 2011, 48% was recoverable from four reinsurers, of which two reinsurers are rated A+ by A.M. Best Company and two reinsurers are rated A by A.M. Best Company. Of the \$927,588 of reinsurance recoverables as of December 31, 2010, 48% was recoverable from four reinsurers, of which two reinsurers are rated A by A.M. Best Company and two reinsurers are rated A+ by Standard & Poor's. The Company believes that these reinsurers are able to meet, and will meet, all of their obligations under their reinsurance agreements.

Insurance balances receivable primarily consist of net premiums due from insureds and reinsureds. The Company believes that the counterparties to these receivables are able to meet, and will meet, all of their obligations. Consequently, the Company has not included any material allowance for doubtful accounts against the receivable balance. Of the \$652,158 in insurance balances receivable as of December 31, 2011, \$2,639 was past due over 90 days, which represented 0.4% of the total balance. Of the \$529,927 in insurance balances receivable as of December 31, 2010, \$2,658 was past due over 90 days, which represented 0.5% of the total balance.

**b) Operating Leases**

The Company leases office space under operating leases expiring in various years through 2022. The following are future minimum rental payments as of December 31, 2011:

2012	\$ 12,858
2013	13,105
2014	11,075
2015	9,640
2016	9,640
2017 through 2022	37,678
	<b>\$ 93,996</b>

Total rental expenses for the years ended December 31, 2011, 2010 and 2009 were \$12,807, \$13,750 and \$12,211, respectively. During the year ended December 31, 2010, the Company terminated one of its office leases and recognized a termination fee of \$1,128.



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**c) Producers**

For the year ended December 31, 2011, three producers individually accounted for 10% or more of total gross premiums written. These producers accounted for 23%, 21% and 11% of gross premiums written, respectively. For the year ended December 31, 2010, two producers individually accounted for 10% or more of total gross premiums written. These producers accounted for 24% and 20% of gross premiums written, respectively. For the year ended December 31, 2009, two producers individually accounted for 10% or more of total gross premiums written. These producers accounted for 26% and 21% of gross premiums written, respectively. Each of these producers intermediate on business written in all three segments, namely U.S. insurance, international insurance and reinsurance.

**d) Legal Proceedings**

In April 2006, a complaint entitled *New Cingular Wireless Headquarters, LLC et al. v. Marsh & McLennan Companies, Inc., et al.* was filed against numerous brokers and 78 insurers including our insurance subsidiary in Bermuda, Allied World Assurance Company, Ltd. Plaintiffs allege that the broker defendants used a variety of illegal schemes and anti-competitive practices that resulted in the plaintiffs either paying more for insurance products or receiving less beneficial terms than the competitive market would have produced. Plaintiffs seek equitable and legal remedies, including injunctive relief, consequential and punitive damages, treble damages and attorneys' fees. Due to various pending procedural matters, the litigation has not progressed beyond the discovery phase. While it is not possible to predict the outcome of the litigation, the Company does not believe that the outcome will have a material effect on its operations or financial position.

The Company may become involved in various claims and legal proceedings that arise in the normal course of our business, which are not likely to have a material effect on the Company's results of operations.

**16. STATUTORY CAPITAL AND SURPLUS**

Allied World Switzerland's ability to pay dividends is subject to certain regulatory restrictions on the payment of dividends by its subsidiaries. The payment of such dividends is limited by applicable laws and statutory requirements of the jurisdictions in which Allied World Switzerland and its subsidiaries operate.

The Company's Bermuda subsidiary, Allied World Assurance Company, Ltd, is registered under the Bermuda Insurance Act 1978 and Related Regulations as amended (the Insurance Act). As a Class 4 insurer, Allied World Assurance Company, Ltd is required to maintain minimum solvency standards and to hold available statutory capital and surplus equal to or exceeding the enhanced capital requirements as determined by the Bermuda Monetary Authority (BMA) under the Bermuda Solvency Capital Requirement model (BSCR model). The BSCR model is a risk-based capital model that provides a method for determining an insurer's capital requirements (statutory capital and surplus) taking into account the risk characteristics of different aspects of the company's business. The minimum solvency margin Allied World Assurance Company, Ltd is required to maintain is equal to the greatest of (1) \$100,000, (2) 50% of net premiums written (being gross written premium less ceded premiums, with a maximum of 25% of gross premiums considered as ceded premiums for the purpose of this calculation) and (3) 15% of the reserve for losses and loss expenses. In addition, this subsidiary is required to maintain a minimum liquidity ratio.

As of December 31, 2011 and 2010, this subsidiary had statutory capital and surplus of approximately \$3,184,294 and \$2,944,351, respectively. As of December 31, 2011 and 2010, the minimum solvency margin required was \$591,050 and \$551,203, respectively. The Insurance Act limits the maximum amount of annual dividends or distributions paid by this subsidiary to Allied World Bermuda without notification to the BMA of such payment (and in certain cases prior approval of the BMA). As of December 31, 2011 and 2010, the maximum amount of dividends that could be paid without such notification was \$796,074 and \$736,088, respectively. For the years ended December 31, 2011, 2010 and 2009, the statutory net income was \$197,624, \$666,372 and \$570,306, respectively.



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The Company's U.S. insurance subsidiaries are subject to the insurance laws and regulations of the states in which they are domiciled, and also states in which they are licensed or authorized to transact business. These laws also restrict the amount of dividends the subsidiaries can pay to the Company. The restrictions are generally based on statutory net income and/or certain levels of statutory surplus as determined in accordance with the relevant statutory accounting requirements of the individual domiciliary states. The U.S. subsidiaries are required to file annual statements with insurance regulatory authorities prepared on an accounting basis prescribed or permitted by such authorities. Statutory accounting differs from U.S. GAAP accounting in the treatment of various items, including reporting of investments, acquisition costs and deferred income taxes. The U.S. subsidiaries are also required to maintain minimum levels of solvency and liquidity as determined by law, and comply with capital requirements and licensing rules. As of December 31, 2011 and 2010, the actual levels of solvency, liquidity and capital of each U.S. subsidiary were in excess of the minimum levels required.

The amount of dividends that can be distributed by the U.S. subsidiaries without prior approval by the applicable insurance commissioners is \$80,900 and \$74,726 for the years ended December 31, 2011 and 2010, respectively. As of December 31, 2011 and 2010, these subsidiaries had a combined statutory capital and surplus of approximately \$1,054,441 and \$1,004,616, respectively. For the years ended December 31, 2011, 2010 and 2009, the combined statutory net income was \$44,974, \$63,304 and \$79,622, respectively.

The Company's Irish insurance subsidiary, Allied World Assurance Company (Europe) Limited, is regulated by the Irish Financial Regulator pursuant to the Insurance Acts 1909 to 2000, the Central Bank and Financial Services Authority of Ireland Acts 2003 and 2004 and all statutory instruments relating to insurance made or adopted under the European Communities Acts 1972 to 2009 (the Irish Insurance Acts and Regulations). This subsidiary's accounts are prepared in accordance with the Irish Companies Acts, 1963 to 2009 and the Irish Insurance Acts and Regulations. This subsidiary is obliged to maintain a minimum level of capital and a Minimum Guarantee Fund. The Minimum Guarantee Fund includes share capital and capital contributions. As of December 31, 2011 and 2010, this subsidiary met the requirements. The amount of dividends that this subsidiary is permitted to distribute is restricted to accumulated realized profits that have not been capitalized or distributed, less accumulated realized losses that have not been written off. The solvency and capital requirements must still be met following any distribution. As of December 31, 2011 and 2010, this subsidiary had statutory capital and surplus of approximately \$62,349 and \$59,300, respectively. As of December 31, 2011 and 2010 the minimum capital and surplus required to be held was \$12,907 and \$13,235, respectively. The statutory net income was \$3,049, \$4,514 and \$1,681 for the years ended December 31, 2011, 2010 and 2009, respectively.

The Company's Irish reinsurance subsidiary, Allied World Assurance Company (Reinsurance) Limited, is regulated by the Central Bank of Ireland pursuant to the Central Bank Acts 1942 to 2010 and the provision of the European Communities (Reinsurance) Regulations 2006 (which transposed the E.U. Reinsurance Directive into Irish law) and maintains branches in London, England and Zug, Switzerland. This subsidiary is obliged to maintain a minimum level of capital, the Required Minimum Margin. As of December 31, 2011 and 2010, this subsidiary met those requirements. The amount of dividends that this subsidiary is permitted to distribute is restricted to accumulated realized profits that have not been capitalized or distributed, less accumulated realized losses that have not been written off. The solvency and capital requirements must still be met following any distribution. As of December 31, 2011 and 2010, this subsidiary had statutory capital and surplus of approximately \$340,807 and \$329,266, respectively. The minimum capital and surplus requirement as of December 31, 2011 and 2010 was approximately \$9,150 and \$10,712, respectively. The statutory net income was \$11,541, \$4,864 and \$12,227 for the years ended December 31, 2011, 2010 and 2009, respectively.

The Company's Swiss insurance subsidiary, Allied World Assurance Company, AG, is regulated by the Swiss Financial Market Supervisory Authority (FINMA) pursuant to the Insurance Supervisory Law 2004 to 2006. This subsidiary's accounts are prepared in accordance with the Swiss Code of Obligation 1911 to 2012 and

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the Insurance Supervisory Law 2004 to 2006. This subsidiary is obligated to maintain a minimum level of capital based on the Swiss Code of Obligation, a minimum of tied assets based on the Insurance Supervisory Law and a minimum solvency margin based on the Solvency I and Swiss Solvency Test regulations as stipulated by the Insurance Supervisory Law. As of December 31, 2011, this subsidiary met the requirements. The amount of dividends that this subsidiary is permitted to distribute is restricted to freely distributable reserves which consist of retained earnings, the current year profit and legal reserves to a certain extent. Any dividend requires approval of the shareholders and in case of the dividend exceeding the current year profit, approval is also required from FINMA. The solvency and capital requirements must still be met following any distribution. As of December 31, 2011, this subsidiary had statutory capital and surplus of approximately \$57,195. The statutory net income was \$1,221 for the year ended December 31, 2011.

**17. SEGMENT INFORMATION**

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

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

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

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

The combined ratio is the sum of the loss and loss expense ratio, the acquisition cost ratio and the general and administrative expense ratio.

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The following table provides a summary of the segment results for the years ended December 31, 2011, 2010 and 2009.

<b>2011</b>	<b>U.S. Insurance</b>	<b>International Insurance</b>	<b>Reinsurance</b>	<b>Total</b>
Gross premiums written	\$ 838,567	\$ 530,450	\$ 570,504	\$ 1,939,521
Net premiums written	639,196	325,094	569,476	1,533,766
Net premiums earned	584,303	317,006	555,683	1,456,992
Net losses and loss expenses	(387,099)	(206,593)	(365,464)	(959,156)
Acquisition costs	(74,976)	2,781	(95,100)	(167,295)
General and administrative expenses	(124,434)	(84,290)	(62,932)	(271,656)
Underwriting (loss) income	(2,206)	28,904	32,187	58,885
Net investment income				195,948
Net realized investment gains				10,077
Other income termination fee				101,744
Net impairment charges recognized in earnings				
Amortization and impairment of intangible assets				(2,978)
Interest expense				(54,989)
Foreign exchange loss				(3,159)
Income before income taxes				\$ 305,528
Loss and loss expense ratio	66.2%	65.2%	65.8%	65.8%
Acquisition cost ratio	12.8%	(0.9)%	17.1%	11.5%
General and administrative expense ratio	21.3%	26.6%	11.3%	18.6%
Combined ratio	100.3%	90.9%	94.2%	95.9%

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

<b>2010</b>	<b>U.S. Insurance</b>	<b>International Insurance</b>	<b>Reinsurance</b>	<b>Total</b>
Gross premiums written	\$ 729,267	\$ 504,937	\$ 524,193	\$ 1,758,397
Net premiums written	551,063	319,083	522,309	1,392,455
Net premiums earned	518,444	338,791	502,313	1,359,548
Other income	913			913
Net losses and loss expenses	(297,517)	(160,153)	(250,213)	(707,883)
Acquisition costs	(67,797)	460	(92,152)	(159,489)
General and administrative expenses	(128,556)	(94,226)	(63,775)	(286,557)
Underwriting income	25,487	84,872	96,173	206,532
Net investment income				244,143
Net realized investment gains				285,612
Net impairment charges recognized in earnings				(168)
Amortization and impairment of intangible assets				(3,483)
Interest expense				(40,242)
Foreign exchange loss				(444)
<b>Income before income taxes</b>				<b>\$ 691,950</b>
Loss and loss expense ratio	57.4%	47.3%	49.8%	52.1%
Acquisition cost ratio	13.1%	(0.1)%	18.3%	11.7%
General and administrative expense ratio	24.8%	27.8%	12.7%	21.1%
<b>Combined ratio</b>	<b>95.3%</b>	<b>75.0%</b>	<b>80.8%</b>	<b>84.9%</b>

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

<b>2009</b>	<b>U.S. Insurance</b>	<b>International Insurance</b>	<b>Reinsurance</b>	<b>Total</b>
Gross premiums written	\$ 674,826	\$ 555,944	\$ 465,575	\$ 1,696,345
Net premiums written	493,067	362,893	465,165	1,321,125
Net premiums earned	447,491	413,170	456,231	1,316,892
Other income	1,506			1,506
Net losses and loss expenses	(211,363)	(158,062)	(234,635)	(604,060)
Acquisition costs	(58,114)	(2,742)	(87,991)	(148,847)
General and administrative expenses	(115,797)	(84,390)	(48,405)	(248,592)
Underwriting income	63,723	167,976	85,200	316,899
Net investment income				300,675
Net realized investment gains				126,352
Net impairment charges recognized in earnings				(49,577)
Amortization and impairment of intangible assets				(11,051)
Interest expense				(39,019)
Foreign exchange loss				(748)
Income before income taxes				\$ 643,531
Loss and loss expense ratio	47.2%	38.3%	51.4%	45.9%
Acquisition cost ratio	13.0%	0.7%	19.3%	11.3%
General and administrative expense ratio	25.9%	20.4%	10.6%	18.9%
Combined ratio	86.1%	59.4%	81.3%	76.1%

The following table shows an analysis of the Company's net premiums written by geographic location of the Company's subsidiaries for the years ended December 31, 2011, 2010 and 2009. All inter-company premiums have been eliminated.

	<b>2011</b>	<b>2010</b>	<b>2009</b>
United States	\$ 880,073	\$ 815,284	\$ 748,111
Bermuda	418,560	411,685	433,419
Europe	155,317	139,902	134,253
Hong Kong	11,696	8,553	5,342
Singapore	68,120	17,031	
Total net premiums written	\$ 1,533,766	\$ 1,392,455	\$ 1,321,125

**18. OTHER INCOME**

In late 2011, the Company reached a mutual agreement with Transatlantic Holdings, Inc. to terminate the previously announced merger agreement. Under the terms of the termination agreement, the Company received termination fees (net of expenses) of \$101,744, which have been included within Other income on the consolidated income statements.



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**19. CONDENSED CONSOLIDATED GUARANTOR FINANCIAL STATEMENTS**

The following tables present condensed consolidating financial information as of December 31, 2011, and 2010, and for the years ended December 31, 2011, 2010, and 2009, 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 5.50% Senior Notes and the 7.50% Senior Notes issued by the Subsidiary Issuer.

**Condensed Consolidating Balance Sheet:**

As of December 31, 2011	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating Adjustments	Allied World Switzerland Consolidated
<b>ASSETS:</b>					
Investments	\$	\$	\$ 7,406,594	\$	\$ 7,406,594
Cash and cash equivalents	112,672	8,886	512,438		633,996
Insurance balances receivable			652,158		652,158
Prepaid reinsurance			226,721		226,721
Reinsurance recoverable			1,002,919		1,002,919
Net deferred acquisition costs			100,334		100,334
Goodwill			268,376		268,376
Intangible assets			53,898		53,898
Balances receivable on sale of investments			580,443		580,443
Investments in subsidiaries	3,064,066	3,964,585		(7,028,651)	
Due (to) from subsidiaries	(4,853)	(6,769)	11,622		
Other assets	1,504	6,367	188,848		196,719
<b>Total assets</b>	<b>\$ 3,173,389</b>	<b>\$ 3,973,069</b>	<b>\$ 11,004,351</b>	<b>\$ (7,028,651)</b>	<b>\$ 11,122,158</b>
<b>LIABILITIES:</b>					
Reserve for losses and loss expenses	\$	\$	\$ 5,225,143	\$	\$ 5,225,143
Unearned premiums			1,078,412		1,078,412
Reinsurance balances payable			124,539		124,539
Balances due on purchases of investments			616,728		616,728
Senior notes		797,949			797,949
Accounts payable and accrued liabilities	24,367	17,688	88,310		130,365
<b>Total liabilities</b>	<b>24,367</b>	<b>815,637</b>	<b>7,133,132</b>		<b>7,973,136</b>
<b>Total shareholders' equity</b>	<b>3,149,022</b>	<b>3,157,432</b>	<b>3,871,219</b>	<b>(7,028,651)</b>	<b>3,149,022</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 3,173,389</b>	<b>\$ 3,973,069</b>	<b>\$ 11,004,351</b>	<b>\$ (7,028,651)</b>	<b>\$ 11,122,158</b>





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

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

	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating adjustments	Allied World Switzerland Consolidated
<b>As of December 31, 2010</b>					
<b>ASSETS:</b>					
Investments	\$	\$	\$ 7,183,554	\$	\$ 7,183,554
Cash and cash equivalents	138,488	125,663	492,844		756,995
Insurance balances receivable			529,927		529,927
Prepaid reinsurance			187,287		187,287
Reinsurance recoverable			927,588		927,588
Net deferred acquisition costs			96,803		96,803
Goodwill			268,376		268,376
Intangible assets			56,876		56,876
Balances receivable on sale of investments			188,408		188,408
Investments in subsidiaries	2,944,975	3,683,454		(6,628,429)	
Due (to) from subsidiaries	(7,143)	(9,419)	16,562		
Other assets		8,801	223,016		231,817
<b>Total assets</b>	<b>\$ 3,076,320</b>	<b>\$ 3,808,499</b>	<b>\$ 10,171,241</b>	<b>\$ (6,628,429)</b>	<b>\$ 10,427,631</b>
<b>LIABILITIES:</b>					
Reserve for losses and loss expenses	\$	\$	\$ 4,879,188	\$	\$ 4,879,188
Unearned premiums			962,203		962,203
Reinsurance balances payable			99,732		99,732
Balances due on purchases of investments			506,978		506,978
Senior notes		797,700			797,700
Accounts payable and accrued liabilities	500	18,111	87,399		106,010
<b>Total liabilities</b>	<b>500</b>	<b>815,811</b>	<b>6,535,500</b>		<b>7,351,811</b>
<b>Total shareholders equity</b>	<b>3,075,820</b>	<b>2,992,688</b>	<b>3,635,741</b>	<b>(6,628,429)</b>	<b>3,075,820</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 3,076,320</b>	<b>\$ 3,808,499</b>	<b>\$ 10,171,241</b>	<b>\$ (6,628,429)</b>	<b>\$ 10,427,631</b>

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

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**Condensed Consolidating Income Statement:**

For the year ended December 31, 2011	Allied World Switzerland (Parent Guarantor)	Allied World Bermuda (Subsidiary Issuer)	Other Allied World Subsidiaries	Consolidating adjustments	Allied World Switzerland Consolidated
<b>REVENUES:</b>					
Gross premiums written	\$	\$	\$ 1,939,521	\$	\$ 1,939,521
Premiums ceded			(405,755)		(405,755)
Net premiums written			1,533,766		1,533,766
Change in unearned premiums			(76,774)		(76,774)
Net premiums earned			1,456,992		1,456,992
Net investment income	64	26	195,858		195,948
Net realized investment gains (losses)		(53,620)	10,077	53,620	10,077
Net impairment charges recognized in earnings					
Other income	101,744				101,744
	101,808	(53,594)	1,662,927	53,620	1,764,761
<b>EXPENSES:</b>					
Net losses and loss expenses			959,156		959,156
Acquisition costs			167,295		167,295
General and administrative expenses	13,354	5,823	252,479		271,656
Amortization and impairment of intangible assets			2,978		2,978
Interest expense		54,989			54,989
Foreign exchange loss (gain)	(9)	978	2,190		3,159
Income tax expense	7,940		23,040		30,980
	21,285	61,790	1,407,138		1,490,213
Income (loss) before equity in earnings of consolidated subsidiaries	80,523	(115,384)	255,789	53,620	274,548
Equity in earnings of consolidated subsidiaries	194,025	309,920		(503,945)	
<b>NET INCOME</b>	<b>\$ 274,548</b>	<b>\$ 194,536</b>	<b>\$ 255,789</b>	<b>\$ (450,325)</b>	<b>\$ 274,548</b>

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

<b>For the Year Ended December 31, 2010</b>	<b>Allied World Switzerland (Parent Guarantor)</b>	<b>Allied World Bermuda (Subsidiary Issuer)</b>	<b>Other Allied World Subsidiaries</b>	<b>Consolidating adjustments</b>	<b>Allied World Switzerland Consolidated</b>
<b>REVENUES:</b>					
Gross premiums written	\$	\$	\$ 1,758,397	\$	\$ 1,758,397
Premiums ceded			(365,942)		(365,942)
Net premiums written			1,392,455		1,392,455
Change in unearned premiums			(32,907)		(32,907)
Net premiums earned			1,359,548		1,359,548
Net investment income	16	77	244,050		244,143
Net realized investment (losses) gains		(3,958)	289,570		285,612
Net impairment charges recognized in earnings			(168)		(168)
Other income			913		913
	16	(3,881)	1,893,913		1,890,048
<b>EXPENSES:</b>					
Net losses and loss expenses			707,883		707,883
Acquisition costs			159,489		159,489
General and administrative expenses	2,175	15,031	269,351		286,557
Amortization and impairment of intangible assets			3,483		3,483
Interest expense		40,242			40,242
Foreign exchange (gain) loss	(7)	(524)	975		444
Income tax expense			26,945		26,945
	2,168	54,749	1,168,126		1,225,043
(Loss) income before equity in earnings of consolidated subsidiaries	(2,152)	(58,630)	725,787		665,005
Equity in earnings of consolidated subsidiaries	667,157	725,787		(1,392,944)	
<b>NET INCOME (LOSS)</b>	<b>\$ 665,005</b>	<b>\$ 667,157</b>	<b>\$ 725,787</b>	<b>\$ (1,392,944)</b>	<b>\$ 665,005</b>

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<b>For the Year Ended December 31, 2009</b>	<b>Allied World Switzerland (Parent Guarantor)</b>	<b>Allied World Bermuda (Subsidiary Issuer)</b>	<b>Other Allied World Subsidiaries</b>	<b>Consolidating adjustments</b>	<b>Allied World Switzerland Consolidated</b>
<b>REVENUES:</b>					
Gross premiums written	\$	\$	\$ 1,696,345	\$	\$ 1,696,345
Premiums ceded			(375,220)		(375,220)
Net premiums written			1,321,125		1,321,125
Change in unearned premiums			(4,233)		(4,233)
Net premiums earned			1,316,892		1,316,892
Net investment income		297	300,378		300,675
Net realized investment gains			126,352		126,352
Net impairment charges recognized in earnings			(49,577)		(49,577)
Other income			1,506		1,506
		297	1,695,551		1,695,848
<b>EXPENSES:</b>					
Net losses and loss expenses			604,060		604,060
Acquisition costs			148,847		148,847
General and administrative expenses		6,477	242,115		248,592
Amortization and impairment of intangible assets			11,051		11,051
Interest expense		39,019			39,019
Foreign exchange loss			748		748
Income tax expense			36,644		36,644
		45,496	1,043,465		1,088,961
(Loss) income before equity in earnings of consolidated subsidiaries		(45,199)	652,086		606,887
Equity in earnings of consolidated subsidiaries		652,086		(652,086)	
<b>NET INCOME (LOSS)</b>	<b>\$</b>	<b>\$</b>	<b>606,887</b>		