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Allied World Assurance Co Holdings, AG

Form 10-Q

May 10, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-Q**

**(Mark One)**

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

**For the quarterly period ended: March 31, 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)*

**98-0681223**

*(I.R.S. Employer  
Identification No.)*

**Lindenstrasse 8, 6340 Baar, Zug, Switzerland**

*(Address of Principal Executive Offices and Zip Code)*

**41-41-768-1080**

*(Registrant's Telephone Number, Including Area Code)*

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting  
company

**(Do not check if a smaller reporting company)**

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

As of May 2, 2011, 37,919,865 common shares were outstanding.

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**PART I**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**  
**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

as of March 31, 2011 and December 31, 2010

(Expressed in thousands of United States dollars, except share and per share amounts)

	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
<b>ASSETS</b>		
Fixed maturity investments available for sale, at fair value (amortized cost: 2011: \$505,638; 2010: \$828,544)	\$ 543,808	\$ 891,849
Fixed maturity investments trading, at fair value	5,960,830	5,769,097
Equity securities trading, at fair value	271,057	174,976
Other invested assets trading, at fair value	469,999	347,632
Total investments	7,245,694	7,183,554
Cash and cash equivalents	693,980	756,995
Restricted cash	52,022	96,373
Insurance balances receivable	569,836	529,927
Prepaid reinsurance	175,348	187,287
Reinsurance recoverable	975,523	927,588
Accrued investment income	41,328	40,520
Net deferred acquisition costs	113,097	96,803
Goodwill	268,376	268,376
Intangible assets	56,109	56,876
Balances receivable on sale of investments	363,151	188,408
Net deferred tax assets	20,618	19,740
Other assets	93,697	75,184
Total assets	\$ 10,668,779	\$ 10,427,631
<b>LIABILITIES:</b>		
Reserve for losses and loss expenses	\$ 5,100,643	\$ 4,879,188
Unearned premiums	1,096,260	962,203
Reinsurance balances payable	91,852	99,732
Balances due on purchases of investments	567,918	506,978
Senior notes	797,761	797,700
Accounts payable and accrued liabilities	63,392	106,010
Total liabilities	\$ 7,717,826	\$ 7,351,811
<b>SHAREHOLDERS EQUITY:</b>		
Common shares: par value CHF 15.00 per share (2011: 40,003,642; 2010: 40,003,642 shares issued and 2011: 37,899,699; 2010: 38,089,226 shares outstanding)	600,055	600,055
Additional paid-in capital	75,166	170,239

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Treasury shares, at cost (2011: 2,103,943; 2010: 1,914,416)	(127,053)	(112,811)
Retained earnings	2,369,822	2,361,202
Accumulated other comprehensive income: net unrealized gains on investments, net of tax	32,963	57,135
Total shareholders' equity	2,950,953	3,075,820
Total liabilities and shareholders' equity	\$ 10,668,779	\$ 10,427,631

See accompanying notes to the consolidated financial statements.

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

for the three months ended March 31, 2011 and 2010

(Expressed in thousands of United States dollars, except share and per share amounts)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>REVENUES:</b>		
Gross premiums written	\$ 560,688	\$ 504,163
Premiums ceded	(79,817)	(70,871)
Net premiums written	480,871	433,292
Change in unearned premiums	(145,995)	(94,968)
Net premiums earned	334,876	338,324
Net investment income	50,208	68,902
Net realized investment gains	50,376	77,487
Net impairment charges recognized in earnings:		
Total other-than-temporary impairment charges		(168)
Portion of loss recognized in other comprehensive income, before taxes		
Net impairment charges recognized in earnings		(168)
Other income		297
	435,460	484,842
<b>EXPENSES:</b>		
Net losses and loss expenses	304,452	232,154
Acquisition costs	38,082	40,784
General and administrative expenses	67,956	63,463
Amortization and impairment of intangible assets	767	892
Interest expense	13,742	9,528
Foreign exchange (gain) loss	(442)	1,076
	424,557	347,897
Income before income taxes	10,903	136,945
Income tax expense	2,283	3,205
<b>NET INCOME</b>	<b>8,620</b>	<b>133,740</b>
Other comprehensive income:		
Unrealized (losses) gains on investments arising during the period net of applicable deferred income tax (expense) benefit for the three months ended March 31, 2011: \$(964); 2010: \$219	(8,044)	37,470
Reclassification adjustment for net realized investment gains included in net income, net of applicable income tax	(16,128)	(45,035)

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Other comprehensive loss	(24,172)	(7,565)
COMPREHENSIVE (LOSS) INCOME	\$ (15,552)	\$ 126,175

PER SHARE DATA

Basic earnings per share	\$ 0.23	\$ 2.67
Diluted earnings per share	\$ 0.21	\$ 2.52
Weighted average common shares outstanding	38,199,867	50,023,816
Weighted average common shares and common share equivalents outstanding	40,383,523	53,115,756
Dividends declared per share	\$	\$ 0.20

See accompanying notes to the consolidated financial statements.

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**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

for the three months ended March 31, 2011 and 2010

(Expressed in thousands of United States dollars)

	Share Capital USD	Share Capital CHF	Additional Paid-in Capital	Treasury Shares	Accumulated Other Comprehensive Income	Retained Earnings	Total
December 31, 2010	\$	600,055	\$ 170,239	\$ (112,811)	\$ 57,135	\$ 2,361,202	\$ 3,075,820
Net income						8,620	8,620
Dividends							
Other comprehensive loss					(24,172)		(24,172)
Stock compensation			(41,453)	45,758			4,305
Share repurchases				(60,000)			(60,000)
Repurchase of founder warrants			(53,620)				(53,620)
March 31, 2011	\$	600,055	\$ 75,166	\$ (127,053)	\$ 32,963	\$ 2,369,822	\$ 2,950,953

  

	Share Capital USD	Share Capital CHF	Additional Paid-in Capital	Treasury Shares	Accumulated Other Comprehensive Income	Retained Earnings	Total
December 31, 2009	\$ 1,492		\$ 1,359,934	\$	\$ 149,849	\$ 1,702,020	\$ 3,213,295
Net income						133,740	133,740
Dividends						(10,092)	(10,092)
Other comprehensive loss					(7,565)		(7,565)
Stock compensation	22		9,407				9,429
March 31, 2010	\$ 1,514		\$ 1,369,341	\$	\$ 142,284	\$ 1,825,668	\$ 3,338,807

See accompanying notes to the consolidated financial statements.

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**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

for the three months ended March 31, 2011 and 2010

(Expressed in thousands of United States dollars)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:</b>		
Net income	\$ 8,620	\$ 133,740
Adjustments to reconcile net income to cash provided by operating activities:		
Net realized gains on sales of investments	(21,624)	(45,261)
Mark to market adjustments	(34,248)	(32,226)
Net impairment charges recognized in earnings		168
Stock compensation expense	5,850	9,527
Insurance balances receivable	(39,909)	(98,154)
Prepaid reinsurance	11,939	15,662
Reinsurance recoverable	(47,935)	(489)
Accrued investment income	(808)	(1,486)
Net deferred acquisition costs	(16,294)	(9,608)
Net deferred tax assets	86	4,779
Other assets	(978)	(6,073)
Reserve for losses and loss expenses	221,455	91,587
Unearned premiums	134,057	79,307
Reinsurance balances payable	(7,880)	(20,296)
Accounts payable and accrued liabilities	(42,618)	(33,695)
Other items, net	5,202	(2,182)
 Net cash provided by operating activities	 174,915	 85,300
 <b>CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES:</b>		
Purchases of fixed maturity investments available for sale	(352)	(85,767)
Purchases of fixed maturity investments trading	(2,332,315)	(2,075,196)
Purchases of equity securities	(97,893)	(19,517)
Purchases of other invested assets	(171,048)	(52,285)
Sales of fixed maturity investments available for sale	340,418	1,304,598
Sales of fixed maturity investments trading	2,036,961	960,823
Sales of equity securities	12,509	
Sales of other invested assets	40,135	884
Purchases of fixed assets	(1,639)	(3,168)
Change in restricted cash	44,351	42,123
 Net cash (used in) provided by investing activities	 (128,873)	 72,495
 <b>CASH FLOWS (USED IN) PROVIDED BY FINANCING ACTIVITIES:</b>		
Proceeds from the exercise of stock options	3,224	2,735
Share repurchase	(60,000)	
Repurchase of founder warrants	(53,620)	

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Net cash (used in) provided by financing activities	(110,396)	2,735
Effect of exchange rate changes on foreign currency cash	1,339	(584)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(63,015)	159,946
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	756,995	292,188
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 693,980	\$ 452,134
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$	\$ 3,627
Cash paid for interest expense	18,750	18,750

See accompanying notes to the consolidated financial statements.

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**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands 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.

On November 26, 2010, the Company received approval from the Supreme Court of Bermuda to change the place of incorporation of the ultimate parent company from Bermuda to Switzerland (the Redomestication ), which was completed on December 1, 2010. The ultimate parent company is now Allied World Switzerland which wholly owns Allied World Assurance Company Holdings, Ltd ( Allied World Bermuda ). After the Redomestication, the Company continues to report under accounting principles generally accepted in the United States of America ( U.S. GAAP ) and the Company s common shares continue to trade on the New York Stock Exchange under the symbol AWH, the same symbol under which the common shares were listed prior to the Redomestication. In addition, the Company remains subject to U.S. Securities and Exchange Commission ( SEC ) reporting requirements and continues to report consolidated financial results in U.S. dollars. The Company believes the Redomestication provides the ability to maintain a competitive worldwide effective corporate tax rate. See Note 11(b) for further details of the Redomestication.

**2. BASIS OF PREPARATION AND CONSOLIDATION**

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

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

The premium estimates for certain reinsurance agreements,

Recoverability of deferred acquisition costs,

The reserve for outstanding losses and loss expenses,

Valuation of ceded reinsurance recoverables,

Determination of impairment of goodwill and other intangible assets,

Valuation of financial instruments, and

Determination of other-than-temporary impairment of investments.

Inter-company accounts and transactions have been eliminated on consolidation and all entities meeting consolidation requirements have been included in the consolidation.

These unaudited condensed consolidated financial statements, including these notes, should be read in conjunction with the Company s audited consolidated financial statements, and related notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.



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**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

**3. NEW ACCOUNTING PRONOUNCEMENTS**

In July 2010, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( 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 are effective for the year ended December 31, 2010 and the income statement related disclosures are effective for 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 is currently evaluating the provisions of ASU 2010-26 and its potential 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 ( ASU 2011-01 ). 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. The Company is currently assessing the provisions of ASU 2011-02 and its potential impact on future financial statements.

**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 as of March 31, 2011 and December 31, 2010 are as follows:

	<b>Amortized</b>	<b>Gross</b>	<b>Gross</b>	
	<b>Cost</b>	<b>Unrealized</b>	<b>Unrealized</b>	<b>Fair</b>
		<b>Gains</b>	<b>Losses</b>	<b>Value</b>
<b>March 31, 2011</b>				
U.S. Government and Government agencies	\$ 37,745	\$ 985	\$ (2)	\$ 38,728
Non-U.S. Government and Government agencies	5,503	27		5,530
States, municipalities and political subdivisions	85,029	9,068		94,097
Corporate debt:				
Financial institutions	44,055	2,123	(33)	46,145
Industrials	222,470	15,460		237,930
Utilities	110,836	10,542		121,378
Total fixed maturity investments, available for sale	\$ 505,638	\$ 38,205	\$ (35)	\$ 543,808

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**December 31, 2010**

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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**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

**b) Trading Securities**

Securities accounted for at fair value with changes in fair value recognized in the consolidated income statements by category as of March 31, 2011 and December 31, 2010 are as follows:

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
U.S. Government and Government agencies	\$ 1,107,059	\$ 1,229,720
Non-U.S. Government and Government agencies	170,663	120,793
States, municipalities and political subdivisions	105,778	127,436
Corporate debt		
Financial institutions	1,461,364	1,261,219
Industrials	670,142	627,524
Utilities	117,440	101,472
Residential mortgage-backed		
Non-agency residential	369,757	371,935
Agency residential	1,089,883	1,195,905
Commercial mortgage-backed	242,979	184,043
Asset-backed	625,765	549,050
Total fixed maturity investments, trading	5,960,830	5,769,097
Equity securities	271,057	174,976
Hedge funds	469,999	347,632
Total	\$ 6,701,886	\$ 6,291,705

**c) Contractual Maturity Dates**

The contractual maturity dates of available for sale fixed maturity investments as of March 31, 2011 are as follows:

	<b>Amortized Cost</b>	<b>Fair Value</b>
Due within one year	\$ 31,931	\$ 32,270
Due after one year through five years	387,914	416,428
Due after five years through ten years	70,001	77,535
Due after ten years	15,792	17,575
	\$ 505,638	\$ 543,808