

Allied World Assurance Co Holdings, AG  
Form 10-Q  
October 23, 2013  
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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: September 30, 2013**

**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**

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*(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 October 14, 2013, 33,761,646 common shares were outstanding.

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**Table of Contents****PART I****FINANCIAL INFORMATION****Item 1. Financial Statements.****ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

as of September 30, 2013 and December 31, 2012

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

|  | <b>As of<br/>September 30,<br/>2013</b> | <b>As of<br/>December 31,<br/>2012</b> |
|--|---|--|
| <b>ASSETS:</b>   |   |  |
| Fixed maturity investments trading, at fair value (amortized cost: 2013: \$5,996,065; 2012: \$6,473,429) | \$ 6,047,883                            | \$ 6,626,454                           |
| Equity securities trading, at fair value (cost: 2013: \$679,228; 2012: \$480,312)                        | 708,929                                 | 523,949                                |
| Other invested assets  | 905,025                                 | 783,534                                |
| <b>Total investments</b>   | <b>7,661,837</b>                        | <b>7,933,937</b>                       |
| Cash and cash equivalents  | 953,047                                 | 681,879                                |
| Restricted cash  | 257,517                                 | 183,485                                |
| Insurance balances receivable  | 740,112                                 | 510,532                                |
| Funds held   | 375,131                                 | 336,368                                |
| Prepaid reinsurance  | 327,052                                 | 277,406                                |
| Reinsurance recoverable  | 1,226,034                               | 1,141,110                              |
| Accrued investment income  | 25,471                                  | 29,135                                 |
| Net deferred acquisition costs   | 145,951                                 | 108,010                                |
| Goodwill   | 268,376                                 | 268,376                                |
| Intangible assets  | 49,464                                  | 51,365                                 |
| Balances receivable on sale of investments   | 237,031                                 | 418,879                                |
| Net deferred tax assets  | 41,832                                  | 25,580                                 |
| Other assets   | 68,665                                  | 63,884                                 |
| <b>Total assets</b>  | <b>\$ 12,377,520</b>                    | <b>\$ 12,029,946</b>                   |
| <b>LIABILITIES:</b>  |   |  |
| Reserve for losses and loss expenses   | \$ 5,780,781                            | \$ 5,645,549                           |
| Unearned premiums  | 1,515,746                               | 1,218,021                              |
| Reinsurance balances payable   | 193,643                                 | 136,264                                |
| Balances due on purchases of investments   | 497,974                                 | 759,934                                |

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|   |               |               |
|---|---------------|---------------|
| Senior notes  | 798,426       | 798,215       |
| Dividends payable   | 16,952        |               |
| Accounts payable and accrued liabilities  | 130,070       | 145,628       |
| Total liabilities   | \$ 8,933,592  | \$ 8,703,611  |
| <b>Commitments and contingencies</b>  |               |               |
| <b>SHAREHOLDERS EQUITY:</b>   |               |               |
| Common shares: 2013: par value CHF 12.30 per share and 2012: par value CHF 12.64 per share (2013: 34,972,795; 2012: 36,369,868 shares issued and 2013: 33,814,920; 2012: 34,797,781 shares outstanding) | 424,837       | 454,980       |
| Treasury shares, at cost (2013: 1,157,875; 2012: 1,572,087)   | (85,845)      | (113,818)     |
| Retained earnings   | 3,104,936     | 2,985,173     |
| Total shareholders equity   | 3,443,928     | 3,326,335     |
| Total liabilities and shareholders equity   | \$ 12,377,520 | \$ 12,029,946 |

See accompanying notes to the consolidated financial statements.

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

for the three and nine months ended September 30, 2013 and 2012

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

|  | <b>Three Months Ended</b> |                | <b>Nine Months Ended</b> |                |
|--|---------------------------|----------------|--------------------------|----------------|
|  | <b>September 30,</b>      |                | <b>September 30,</b>     |                |
|  | <b>2013</b>               | <b>2012</b>    | <b>2013</b>              | <b>2012</b>    |
| <b>REVENUES:</b>   |                           |                |                          |                |
| Gross premiums written   | \$ 580,893                | \$ 504,420     | \$ 2,183,174             | \$ 1,832,219   |
| Premiums ceded   | (127,816)                 | (112,883)      | (453,823)                | (357,019)      |
| Net premiums written   | 453,077                   | 391,537        | 1,729,351                | 1,475,200      |
| Change in unearned premiums  | 57,696                    | 49,480         | (248,079)                | (202,546)      |
| Net premiums earned  | 510,773                   | 441,017        | 1,481,272                | 1,272,654      |
| Net investment income  | 39,271                    | 39,121         | 110,294                  | 128,781        |
| Net realized investment gains (losses)   | 27,487                    | 149,813        | (8,074)                  | 292,057        |
|  | 577,531                   | 629,951        | 1,583,492                | 1,693,492      |
| <b>EXPENSES:</b>   |                           |                |                          |                |
| Net losses and loss expenses   | 276,970                   | 258,948        | 807,276                  | 724,530        |
| Acquisition costs  | 65,114                    | 51,086         | 186,416                  | 149,812        |
| General and administrative expenses  | 88,553                    | 78,572         | 251,818                  | 222,917        |
| Amortization of intangible assets  | 633                       | 633            | 1,900                    | 1,900          |
| Interest expense   | 14,094                    | 13,822         | 42,416                   | 41,579         |
| Foreign exchange loss (gain)   | 4,353                     | 1,023          | 7,361                    | (77)           |
|  | 449,717                   | 404,084        | 1,297,187                | 1,140,661      |
| Income before income taxes   | 127,814                   | 225,867        | 286,305                  | 552,831        |
| Income tax expense   | 4,971                     | 6,220          | 6,332                    | 18,677         |
| <b>NET INCOME</b>  | <b>122,843</b>            | <b>219,647</b> | <b>279,973</b>           | <b>534,154</b> |
| <b>Other comprehensive loss:</b>   |                           |                |                          |                |
| Unrealized (losses) gains on investments arising during the period net of applicable deferred income tax benefit (expense) for the three and nine months ended September |                           | (29)           |                          | 150            |

30, 2012: \$15 and (\$81), respectively

|  |  |  |  |  |  |          |
|--|--|--|--|--|--|----------|
| Reclassification adjustment for net realized investment gains included in net income, net of applicable income tax |  |  |  |  |  | (13,249) |
|--|--|--|--|--|--|----------|

|                          |  |  |      |  |  |          |
|--------------------------|--|--|------|--|--|----------|
| Other comprehensive loss |  |  | (29) |  |  | (13,099) |
|--------------------------|--|--|------|--|--|----------|

|                             |    |         |    |         |    |         |    |         |
|-----------------------------|----|---------|----|---------|----|---------|----|---------|
| <b>COMPREHENSIVE INCOME</b> | \$ | 122,843 | \$ | 219,618 | \$ | 279,973 | \$ | 521,055 |
|-----------------------------|----|---------|----|---------|----|---------|----|---------|

**PER SHARE DATA**

|                          |    |      |    |      |    |      |    |       |
|--------------------------|----|------|----|------|----|------|----|-------|
| Basic earnings per share | \$ | 3.61 | \$ | 6.16 | \$ | 8.15 | \$ | 14.68 |
|--------------------------|----|------|----|------|----|------|----|-------|

|                            |    |      |    |      |    |      |    |       |
|----------------------------|----|------|----|------|----|------|----|-------|
| Diluted earnings per share | \$ | 3.54 | \$ | 6.00 | \$ | 7.97 | \$ | 14.28 |
|----------------------------|----|------|----|------|----|------|----|-------|

|  |  |            |  |            |  |            |  |            |
|--|--|------------|--|------------|--|------------|--|------------|
| Weighted average common shares outstanding |  | 33,991,359 |  | 35,652,768 |  | 34,340,227 |  | 36,379,514 |
|--|--|------------|--|------------|--|------------|--|------------|

|   |  |            |  |            |  |            |  |            |
|---|--|------------|--|------------|--|------------|--|------------|
| Weighted average common shares and common share equivalents outstanding |  | 34,728,193 |  | 36,616,734 |  | 35,131,092 |  | 37,393,093 |
|---|--|------------|--|------------|--|------------|--|------------|

|                          |    |       |    |       |    |       |    |       |
|--------------------------|----|-------|----|-------|----|-------|----|-------|
| Dividends paid per share | \$ | 0.500 | \$ | 0.750 | \$ | 0.875 | \$ | 1.500 |
|--------------------------|----|-------|----|-------|----|-------|----|-------|

See accompanying notes to the consolidated financial statements.

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

for the nine months ended September 30, 2013 and 2012

(Expressed in thousands)

|                                  | Share<br>Capital | Additional<br>Paid-in<br>Capital | Treasury<br>Shares | Accumulated<br>Other<br>Comprehensive<br>Income | Retained<br>Earnings | Total        |
|----------------------------------|------------------|----------------------------------|--------------------|---|----------------------|--------------|
| December 31,<br>2012             | \$ 454,980       | \$                               | \$ (113,818)       | \$  | \$ 2,985,173         | \$ 3,326,335 |
| Net income                       |                  |                                  |                    |   | 279,973              | 279,973      |
| Dividends par<br>value reduction | (12,981)         |                                  |                    |   |                      | (12,981)     |
| Dividends                        |                  |                                  |                    |   | (34,069)             | (34,069)     |
| Stock<br>compensation<br>(1)     |                  |                                  | 26,093             |   | (18,278)             | 7,815        |
| Share<br>repurchases             |                  |                                  | (123,145)          |   |                      | (123,145)    |
| Shares<br>cancelled              | (17,162)         |                                  | 125,025            |   | (107,863)            |              |
| September 30,<br>2013            | \$ 424,837       | \$                               | \$ (85,845)        | \$  | \$ 3,104,936         | \$ 3,443,928 |
| December 31,<br>2011             | \$ 557,153       | \$ 78,225                        | \$ (136,590)       | \$ 14,484                                       | \$ 2,635,750         | \$ 3,149,022 |
| Net income                       |                  |                                  |                    |   | 534,154              | 534,154      |
| Dividends par<br>value reduction | (40,419)         |                                  |                    |   |                      | (40,419)     |
| Other<br>comprehensive<br>loss   |                  |                                  |                    | (13,099)  |                      | (13,099)     |
| Stock<br>compensation<br>(1)     |                  | (23,050)                         | 36,226             |   |                      | 13,176       |
| Share<br>repurchases             |                  |                                  | (207,048)          |   |                      | (207,048)    |
| Shares<br>cancelled              | (39,488)         | (55,175)                         | 186,468            |   | (91,805)             |              |
|                                  | \$ 477,246       | \$                               | \$ (120,944)       | \$ 1,385  | \$ 3,078,099         | \$ 3,435,786 |



September 30,  
2012

- (1) Includes stock compensation expense for the period and shares issued out of treasury for awards exercised or vested.

See accompanying notes to the consolidated financial statements.

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

for the nine months ended September 30, 2013 and 2012

(Expressed in thousands)

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2013</b>                                | <b>2012</b> |
| <b>CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:</b>                           |  |             |
| Net income  | \$ 279,973                                 | \$ 534,154  |
| Adjustments to reconcile net income to cash provided by operating activities: |  |             |
| Net realized gains on sales of investments                                    | (76,104)                                   | (63,625)    |
| Mark to market adjustments  | 80,136                                     | (225,425)   |
| Stock compensation expense  | 9,282                                      | 13,118      |
| Undistributed income of equity method investments                             | (4,313)                                    |             |
| Changes in:   |  |             |
| Reserve for losses and loss expenses, net of reinsurance recoverables         | 50,308                                     | 151,041     |
| Unearned premiums, net of prepaid reinsurance                                 | 248,079                                    | 202,545     |
| Insurance balances receivable   | (229,580)                                  | (121,422)   |
| Funds held  | (38,763)                                   | 18,602      |
| Reinsurance balances payable  | 57,379                                     | (4,107)     |
| Net deferred acquisition costs  | (37,941)                                   | (27,193)    |
| Net deferred tax assets   | (16,252)                                   | 1,850       |
| Accounts payable and accrued liabilities                                      | (18,540)                                   | (2,996)     |
| Other items, net  | 34,508                                     | 23,677      |
| Net cash provided by operating activities                                     | 338,172                                    | 500,219     |
| <b>CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:</b>                 |  |             |
| Purchases of trading securities   | (4,955,817)                                | (6,328,719) |
| Purchases of other invested assets  | (211,501)                                  | (52,578)    |
| Sales of available for sale securities  |  | 215,318     |
| Sales of trading securities   | 5,137,280                                  | 5,778,138   |
| Sales of other invested assets  | 189,155                                    | 110,429     |
| Purchases of fixed assets   | (4,171)                                    | (2,041)     |
| Change in restricted cash   | (74,032)                                   | 35,685      |
| Net cash provided by (used in) investing activities                           | 80,914                                     | (243,768)   |
| <b>CASH FLOWS USED IN FINANCING ACTIVITIES:</b>                               |  |             |
| Dividends paid - partial par value reduction                                  | (12,981)                                   | (54,721)    |
| Dividends paid  | (17,117)                                   |             |
| Proceeds from the exercise of stock options                                   | 8,465                                      | 9,104       |

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|  |                   |                   |
|--|-------------------|-------------------|
| Share repurchases  | (120,163)         | (204,746)         |
| Net cash used in financing activities                    | (141,796)         | (250,363)         |
| Effect of exchange rate changes on foreign currency cash | (6,122)           | (567)             |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>         | <b>271,168</b>    | <b>5,521</b>      |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>    | <b>681,879</b>    | <b>633,996</b>    |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>          | <b>\$ 953,047</b> | <b>\$ 639,517</b> |

Supplemental disclosure of cash flow information:

|                                |           |           |
|--------------------------------|-----------|-----------|
| Cash paid for income taxes     | \$ 17,249 | \$ 18,912 |
| Cash paid for interest expense | \$ 45,750 | \$ 45,750 |

See accompanying notes to the consolidated financial statements.

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**ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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

**1. GENERAL**

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

**2. BASIS OF PREPARATION AND CONSOLIDATION**

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

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

The premium estimates for certain reinsurance agreements,

Recoverability of deferred acquisition costs,

The reserve for outstanding losses and loss expenses,

Valuation of ceded reinsurance recoverables,

Determination of impairment of goodwill and other intangible assets, and

Valuation of financial instruments.

Intercompany accounts and transactions have been eliminated on consolidation and all entities meeting consolidation requirements have been included in the unaudited condensed consolidated financial statements. To facilitate comparison of information across periods, certain reclassifications have been made to prior year amounts to conform to the current year's presentation.

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, 2012.

### **3. NEW ACCOUNTING PRONOUNCEMENTS**

In December 2011 (with a clarification amendment issued in January 2013), the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2011-11, Disclosures about Offsetting Assets and Liabilities (ASU 2011-11). The objective of ASU 2011-11 was to enhance disclosures about derivatives, repurchase agreements and reverse repurchase agreements, securities borrowing and securities lending transactions to the extent they are subject to master netting arrangements or similar agreements. The Company adopted ASU 2011-11 on January 1, 2013. The adoption of ASU 2011-11 did not have an impact on the presentation of the financial statements.

In July 2013, the FASB issued Accounting Standards Update 2013-10, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (ASU 2013-10). Prior to the issuance of ASU 2013-10, only interest rates on U.S. Treasury securities and the London Interbank Offered Rate (LIBOR) swap rate were considered benchmark interest rates in the application of hedge accounting under U.S. GAAP. ASU 2013-10 permits the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes in addition to U.S. Treasury securities and LIBOR. ASU 2013-10 was effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. ASU 2013-10 did not have any impact on the financial statements upon adoption, as the Company does not apply hedge accounting.

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

**4. INVESTMENTS****a) Trading Securities**

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

|   | <b>September 30, 2013</b> |                       | <b>December 31, 2012</b> |                       |
|---|---------------------------|-----------------------|--------------------------|-----------------------|
|   | <b>Fair Value</b>         | <b>Amortized Cost</b> | <b>Fair Value</b>        | <b>Amortized Cost</b> |
| U.S. Government and Government agencies           | \$ 1,850,335              | \$ 1,851,002          | \$ 1,865,913             | \$ 1,854,198          |
| Non-U.S. Government and Government agencies       | 209,625                   | 214,114               | 261,627                  | 253,657               |
| States, municipalities and political subdivisions | 95,381                    | 95,661                | 40,444                   | 39,342                |
| Corporate debt:                                   |                           |                       |                          |                       |
| Financial institutions                            | 841,930                   | 826,763               | 866,140                  | 835,587               |
| Industrials                                       | 1,146,793                 | 1,140,636             | 1,153,909                | 1,139,706             |
| Utilities   | 74,764                    | 74,865                | 69,153                   | 67,463                |
| Mortgage-backed                                   | 1,373,161                 | 1,341,303             | 1,958,373                | 1,877,854             |
| Asset-backed                                      | 455,894                   | 451,721               | 410,895                  | 405,622               |
| Total fixed maturity investments                  | \$ 6,047,883              | \$ 5,996,065          | \$ 6,626,454             | \$ 6,473,429          |

|                       | <b>September 30, 2013</b> |                      | <b>December 31, 2012</b> |                      |
|-----------------------|---------------------------|----------------------|--------------------------|----------------------|
|                       | <b>Fair Value</b>         | <b>Original Cost</b> | <b>Fair Value</b>        | <b>Original Cost</b> |
| Equity securities     | \$ 708,929                | \$ 679,228           | \$ 523,949               | \$ 480,312           |
| Other invested assets | 767,071                   | 680,986              | 655,888                  | 606,521              |
|                       | \$ 1,476,000              | \$ 1,360,214         | \$ 1,179,837             | \$ 1,086,833         |

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



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

**b) Other Invested Assets**

Details regarding the carrying value, redemption characteristics and unfunded investment commitments of the other invested assets portfolio as of September 30, 2013 were as follows:

| <b>Fund Type</b>                | <b>Carrying Value as of September 30, 2013</b> | <b>Investments with Redemption Restrictions</b> | <b>Estimated Remaining Restriction Period</b> | <b>Investments without Redemption Restrictions</b> | <b>Redemption Frequency</b> | <b>Redemption Notice Period</b> | <b>Unfunded Commitments</b> |
|---------------------------------|--|---|---|--|-----------------------------|---------------------------------|-----------------------------|
| Private equity                  | \$ 131,449                                     | \$ 131,449                                      | 3 - 10 Years                                  | \$   |                             |                                 | \$ 252,571                  |
| Mezzanine debt                  | 58,116   | 58,116  | 8 - 10 Years                                  |  |                             |                                 | 203,969                     |
| Distressed                      | 8,991  | 8,991   | 4 - 5 Years                                   |  |                             |                                 | 5,102                       |
| Total private equity structures | 198,556  | 198,556   |   |  |                             |                                 | 461,642                     |
| Distressed                      | 150,775  | 134,127   | 1 - 2 Years                                   | 16,648   | Quarterly                   | 45 - 65 Days                    |                             |
| Equity long/short               | 116,019  |   |   | 116,019  | Quarterly                   | 30 - 60 Days                    |                             |
| Multi-strategy                  | 131,224  |   |   | 131,224  | Quarterly                   | 45 - 90 Days                    |                             |
| Global macro                    | 19,641   |   |   | 19,641   | Monthly                     | 3 Days                          |                             |
| Event driven                    | 18,445   |   |   | 18,445   | Annual                      | 60 Days                         |                             |
| Relative value credit           | 101,311  |   |   | 101,311  | Quarterly                   | 60 Days                         |                             |
| Total hedge funds               | 537,415  | 134,127   |   | 403,288  |                             |                                 |                             |
| Other private securities        | 137,954  |   |   | 137,954  |                             |                                 | 5,000                       |
| High yield loan fund            | 31,100   |   |   | 31,100   | Monthly                     | 30 Days                         |                             |
| Total other invested assets     | \$ 905,025                                     | \$ 332,683                                      |   | \$ 572,342   |                             |                                 | \$ 466,642                  |

(1)



The redemption frequency and notice periods only apply to the investments without redemption restrictions.

Some or all of these investments may be subject to a gate.

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

The following describes each investment type:

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

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

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

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

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

**Global macro funds:** These funds focus on a top-down analysis of global markets as influenced by major political and economic trends or events. Global macro managers develop investment strategies that aim to forecast movements in interest rates, fund flows, political changes and other wide-ranging systematic factors. The portfolios of these funds can include long or short positions in equities, fixed-income securities, currencies and commodities in the form of cash or derivatives instruments.

**Event driven funds:** Event driven strategies seek to deploy capital into specific securities whose returns are affected by a specific event that affects the value of one or more securities of a company. Returns for such securities are linked primarily to the specific outcome of the events and not by the overall direction of the bond or stock markets. Examples could include mergers and acquisitions (arbitrage), corporate restructurings and spin-offs, and capital structure arbitrage.

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

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

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

**c) Net Investment Income**

|                            | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|----------------------------|---------------------------|-------------|--------------------------|-------------|
|                            | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                            | <b>2013</b>               | <b>2012</b> | <b>2013</b>              | <b>2012</b> |
| Fixed maturity investments | \$ 31,179                 | \$ 36,778   | \$ 96,366                | \$ 120,883  |
| Equity securities          | 6,110                     | 5,211       | 13,718                   | 13,706      |
| Other invested assets      | 5,809                     | 164         | 11,116                   | 4,387       |
| Cash and cash equivalents  | 302                       | 640         | 1,319                    | 1,797       |
| Expenses                   | (4,129)                   | (3,672)     | (12,225)                 | (11,992)    |
| Net investment income      | \$ 39,271                 | \$ 39,121   | \$ 110,294               | \$ 128,781  |

Net investment income from other invested assets included the distributed and undistributed net income from investments accounted for using the equity method of accounting for the three and nine months ended September 30, 2013.

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***d) Components of Realized Gains and Losses***

|   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2013</b>                                 | <b>2012</b> | <b>2013</b>                                | <b>2012</b> |
| Gross realized gains on sale of invested assets           | \$ 51,915                                   | \$ 27,210   | \$ 154,387                                 | \$ 119,154  |
| Gross realized losses on sale of invested assets          | (40,770)                                    | (6,686)     | (82,812)                                   | (43,355)    |
| Net realized and unrealized (losses) gains on derivatives | (4,169)                                     | (962)       | 3,392                                      | (192)       |
| Mark-to-market gains (losses):                            |   |             |  |             |
| Fixed maturity investments, trading                       | 30,383                                      | 99,821      | (101,205)                                  | 144,024     |
| Equity securities, trading                                | (17,198)                                    | 18,913      | (18,555)                                   | 38,516      |
| Other invested assets, trading                            | 7,326                                       | 11,517      | 36,719                                     | 33,910      |
| Net realized investment gains (losses)                    | \$ 27,487                                   | \$ 149,813  | \$ (8,074)                                 | \$ 292,057  |
| Proceeds from sale of available for sale securities       | \$  | \$ 1,000    | \$   | \$ 214,716  |

***e) Pledged Assets***

As of September 30, 2013 and December 31, 2012, \$ 2,556,660 and \$2,141,249, respectively, of cash and cash equivalents and investments were deposited, pledged or held in trust accounts in favor of ceding companies and other counterparties or government authorities to comply with reinsurance contract provisions, insurance laws and other contract provisions.

In addition, as of September 30, 2013 and December 31, 2012, a further \$ 1,063,086 and \$1,225,155, respectively, of cash and cash equivalents and investments were pledged as collateral for the Company's letter of credit facilities. See Note 8(d) to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 for details on the Company's credit facilities.

**5. DERIVATIVE INSTRUMENTS**

As of September 30, 2013 and December 31, 2012, none of the Company's derivatives were designated as hedges for accounting purposes. The following table summarizes information on the location and amounts of derivative fair values on the unaudited condensed consolidated balance sheets ( consolidated balance sheets ):

|                                  | September 30, 2013                        |                                   |   |                                       | December 31, 2012                         |                                   |   |                                       |
|----------------------------------|---|-----------------------------------|---|---------------------------------------|---|-----------------------------------|---|---------------------------------------|
|                                  | Asset<br>Derivative<br>Notional<br>Amount | Asset<br>Derivative<br>Fair Value | Liability<br>Derivative<br>Notional<br>Amount | Liability<br>Derivative<br>Fair Value | Asset<br>Derivative<br>Notional<br>Amount | Asset<br>Derivative<br>Fair Value | Liability<br>Derivative<br>Notional<br>Amount | Liability<br>Derivative<br>Fair Value |
| Put options                      | \$  | \$                                | \$  | \$                                    | \$ 5,152                                  | \$ 532                            | \$  | \$                                    |
| Foreign<br>exchange<br>contracts | 197,811                                   | 2,493                             | 279,050                                       | 7,062                                 | 127,712                                   | 1,713                             | 194,566                                       | 2,656                                 |
| Interest rate<br>swaps           | 33,000                                    | 5                                 | 327,000                                       | 172                                   |   |                                   |   |                                       |
| Total<br>derivatives             | \$ 230,811                                | \$ 2,498                          | \$ 606,050                                    | \$ 7,234                              | \$ 132,864                                | \$ 2,245                          | \$ 194,566                                    | \$ 2,656                              |

Derivative assets and derivative liabilities relating to the put options are classified within equity securities trading, at fair value on the consolidated balance sheets. All other asset and liability derivatives are classified within other assets or accounts payable and accrued liabilities on the consolidated balance sheets.

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

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2013</b>               | <b>2012</b> | <b>2013</b>              | <b>2012</b> |
| Foreign exchange contracts                                  | \$ (2,336)                | \$ (676)    | \$ (1,091)               | \$ (96)     |
| Total included in foreign exchange (loss) gain              | (2,336)                   | (676)       | (1,091)                  | (96)        |
| Put options   |                           |             | (3,822)                  | (336)       |
| Foreign exchange contracts                                  | (4,164)                   | (2,751)     | 1,925                    | (641)       |
| Interest rate futures and swaps                             | (5)                       | 1,789       | 5,289                    | 785         |
| Total included in net realized investment gains             | (4,169)                   | (962)       | 3,392                    | (192)       |
| Total realized and unrealized (losses) gains on derivatives | \$ (6,505)                | \$ (1,638)  | \$ 2,301                 | \$ (288)    |

***Derivative Instruments Not Designated as Hedging Instruments***

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

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

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

The Company also purchases options to actively manage the Company's equity portfolio.

## 6. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

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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:

| <b>September 30, 2013</b>                            | <b>Carrying<br/>Amount</b> | <b>Total<br/>Fair Value</b> | <b>Level 1</b>      | <b>Level 2</b>      | <b>Level 3</b>      |
|--|----------------------------|-----------------------------|---------------------|---------------------|---------------------|
| <b>Fixed maturity investments:</b>                   |                            |                             |                     |                     |                     |
| U.S. Government and<br>Government agencies           | \$ 1,850,335               | \$ 1,850,335                | \$ 1,522,185        | \$ 328,150          | \$                  |
| Non-U.S. Government and<br>Government agencies       | 209,625                    | 209,625                     |                     | 209,625             |                     |
| States, municipalities and<br>political subdivisions | 95,381                     | 95,381                      |                     | 95,381              |                     |
| Corporate debt                                       | 2,063,487                  | 2,063,487                   |                     | 2,063,487           |                     |
| Mortgage-backed                                      | 1,373,161                  | 1,373,161                   |                     | 1,183,907           | 189,254             |
| Asset-backed   | 455,894                    | 455,894                     |                     | 375,861             | 80,033              |
| <b>Total fixed maturity investments</b>              | <b>6,047,883</b>           | <b>6,047,883</b>            | <b>1,522,185</b>    | <b>4,256,411</b>    | <b>269,287</b>      |
| Equity securities                                    | 708,929                    | 708,929                     | 641,458             |                     | 67,471              |
| Other invested assets                                | 767,071                    | 767,071                     |                     |                     | 767,071             |
| <b>Total investments</b>                             | <b>\$ 7,523,883</b>        | <b>\$ 7,523,883</b>         | <b>\$ 2,163,643</b> | <b>\$ 4,256,411</b> | <b>\$ 1,103,829</b> |
| <b>Derivative assets:</b>                            |                            |                             |                     |                     |                     |
| Foreign exchange contracts                           | \$ 2,493                   | \$ 2,493                    | \$                  | \$ 2,493            | \$                  |
| Interest rate futures                                | 5                          | 5                           |                     | 5                   |                     |
| <b>Derivative liabilities:</b>                       |                            |                             |                     |                     |                     |
| Foreign exchange contracts                           | \$ 7,062                   | \$ 7,062                    | \$                  | \$ 7,062            | \$                  |
| Interest rate swaps                                  | 172                        | 172                         |                     | 172                 |                     |
| Senior notes   | \$ 798,426                 | \$ 904,010                  | \$                  | \$ 904,010          | \$                  |

**Carrying                  Total**



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| <b>December 31, 2012</b>                          | <b>Amount</b>       | <b>Fair Value</b>   | <b>Level 1</b>      | <b>Level 2</b>      | <b>Level 3</b>    |
|---|---------------------|---------------------|---------------------|---------------------|-------------------|
| <b>Fixed maturity investments:</b>                |                     |                     |                     |                     |                   |
| U.S. Government and Government agencies           | \$ 1,865,913        | \$ 1,865,913        | \$ 1,529,158        | \$ 336,755          | \$                |
| Non-U.S. Government and Government agencies       | 261,627             | 261,627             |                     | 261,627             |                   |
| States, municipalities and political subdivisions | 40,444              | 40,444              |                     | 40,444              |                   |
| Corporate debt                                    | 2,089,202           | 2,089,202           |                     | 2,089,202           |                   |
| Mortgage-backed                                   | 1,958,373           | 1,958,373           |                     | 1,790,548           | 167,825           |
| Asset-backed                                      | 410,895             | 410,895             |                     | 348,649             | 62,246            |
| <b>Total fixed maturity investments</b>           | <b>6,626,454</b>    | <b>6,626,454</b>    | <b>1,529,158</b>    | <b>4,867,225</b>    | <b>230,071</b>    |
| Equity securities                                 | 523,949             | 523,949             | 469,269             |                     | 54,680            |
| Other invested assets                             | 655,888             | 655,888             |                     |                     | 655,888           |
| <b>Total investments</b>                          | <b>\$ 7,806,291</b> | <b>\$ 7,806,291</b> | <b>\$ 1,998,427</b> | <b>\$ 4,867,225</b> | <b>\$ 940,639</b> |
| <b>Derivative assets:</b>                         |                     |                     |                     |                     |                   |
| Foreign exchange contracts                        | \$ 1,713            | \$ 1,713            | \$                  | \$ 1,713            | \$                |
| <b>Derivative liabilities:</b>                    |                     |                     |                     |                     |                   |
| Foreign exchange contracts                        | \$ 2,656            | \$ 2,656            | \$                  | \$ 2,656            | \$                |
| Senior notes                                      | \$ 798,215          | \$ 918,627          | \$                  | \$ 918,627          | \$                |

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

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

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

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

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

**Corporate debt:** Comprised of bonds issued by or loan obligations of corporations that are diversified across a wide range of issuers and industries. The fair values of corporate debt that are short-term are priced using spread above the LIBOR yield curve, and the fair values of corporate debt that are long-term are priced using the spread above the risk-free yield curve. The spreads are sourced from broker-dealers, trade prices and the new issue market. As the significant inputs used to price corporate bonds are observable market inputs, the fair values of corporate debt are included in the Level 2 fair value hierarchy.

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

based on observable market inputs, in which case the fair value is included in the Level 3 hierarchy.

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

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

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

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

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

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

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

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

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

|   | Other invested |                 |              |           |
|---|----------------|-----------------|--------------|-----------|
|   | assets         | Mortgage-backed | Asset-backed | Equities  |
| <b>Three Months Ended September 30, 2013</b>                  |                |                 |              |           |
| Opening balance   | \$ 714,391     | \$ 198,003      | \$ 61,285    | \$ 53,499 |
| Realized and unrealized gains (losses) included in net income | 9,403          | 464             | (313)        | 3,972     |
| Purchases   | 67,554         | 69,775          | 16,969       | 10,000    |
| Sales   | (24,277)       | (79,001)        | (1,302)      |           |
| Transfers into Level 3 from Level 2                           |                | 13              | 3,394        |           |
| Transfers out of Level 3 into Level 2 (1)                     |                |                 |              |           |
| Ending balance  | \$ 767,071     | \$ 189,254      | \$ 80,033    | \$ 67,471 |

**Three Months Ended September 30, 2012**

|  |    |         |    |          |    |          |    |
|--|----|---------|----|----------|----|----------|----|
| Opening balance                                      | \$ | 520,890 | \$ | 157,959  | \$ | 117,586  | \$ |
| Realized and unrealized gains included in net income |    | 11,871  |    | 4,855    |    | 988      |    |
| Purchases  |    | 34,800  |    | 40,481   |    | 7,466    |    |
| Sales  |    | (2,859) |    | (48,728) |    | (7,326)  |    |
| Transfers into Level 3 from Level 2                  |    |         |    | 14,730   |    | 12,495   |    |
| Transfers out of Level 3 into Level 2 (1)            |    |         |    | (27)     |    | (55,442) |    |
| Ending balance                                       | \$ | 564,702 | \$ | 169,270  | \$ | 75,767   | \$ |

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|   | <b>Other invested<br/>assets</b> | <b>Mortgage-backed</b> | <b>Asset-backed</b> | <b>Equities</b> |
|---|----------------------------------|------------------------|---------------------|-----------------|
| <b>Nine Months Ended September 30, 2013</b>                   |                                  |                        |                     |                 |
| Opening balance   | \$ 655,888                       | \$ 167,825             | \$ 62,246           | \$ 54,680       |
| Realized and unrealized gains (losses) included in net income | 53,365                           | (5,910)                | (791)               | 2,791           |
| Purchases   | 237,506                          | 102,369                | 42,956              | 10,000          |
| Sales   | (179,688)                        | (69,968)               | (26,728)            |                 |
| Transfers into Level 3 from Level 2                           |                                  | 5,073                  | 2,350               |                 |
| Transfers out of Level 3 into Level 2 (1)                     |                                  | (10,135)               |                     |                 |
| Ending balance  | \$ 767,071                       | \$ 189,254             | \$ 80,033           | \$ 67,471       |
| <b>Nine Months Ended September 30, 2012</b>                   |                                  |                        |                     |                 |
| Opening balance   | \$ 540,409                       | \$ 249,204             | \$ 94,745           | \$              |
| Realized and unrealized gains included in net income          | 26,753                           | 10,951                 | 1,643               |                 |
| Purchases   | 52,578                           | 50,302                 | 32,573              |                 |
| Sales   | (55,038)                         | (124,940)              | (57,325)            |                 |
| Transfers into Level 3 from Level 2                           |                                  | 18,461                 | 15,835              |                 |
| Transfers out of Level 3 into Level 2 (1)                     |                                  | (34,708)               | (11,704)            |                 |
| Ending balance  | \$ 564,702                       | \$ 169,270             | \$ 75,767           | \$              |

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

Level 2 during the period.

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

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

The Company records the unadjusted price provided and validates this price through a process that includes, but is not limited to, monthly and/or quarterly: (i) comparison of prices between two independent sources, with significant differences requiring additional price sources; (ii) quantitative analysis (e.g., comparing the quarterly return for each managed portfolio to their target benchmark, with

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significant differences identified and investigated); (iii) evaluation of methodologies used by external parties to calculate fair value, including a review of the inputs used for pricing; (iv) comparing the price to the Company's knowledge of the current investment market; and (v) back-testing, which includes randomly selecting purchased or sold securities and comparing the executed prices to the fair value estimates from the pricing service. In addition to internal controls, management relies on the effectiveness of the valuation controls in place at the Company's external investment accounting service provider (supported by a Statement on Standards for Attestation Engagements No. 16 report) in conjunction with regular discussion and analysis of the investment portfolio's structure and performance.

**7. RESERVE FOR LOSSES AND LOSS EXPENSES**

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

|   | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|-------------------------------|------------------------------|
| Outstanding loss reserves                     | \$ 1,517,049                  | \$ 1,539,114                 |
| Reserves for losses incurred but not reported | 4,263,732                     | 4,106,435                    |
| Reserve for losses and loss expenses          | \$ 5,780,781                  | \$ 5,645,549                 |

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

|  | <b>Three Months Ended<br/>September 30,</b> |              | <b>Nine Months Ended<br/>September 30,</b> |              |
|--|---|--------------|--|--------------|
|  | <b>2013</b>                                 | <b>2012</b>  | <b>2013</b>                                | <b>2012</b>  |
| Gross liability at beginning of period         | \$ 5,696,865                                | \$ 5,377,518 | \$ 5,645,549                               | \$ 5,225,143 |
| Reinsurance recoverable at beginning of period | (1,179,525)                                 | (1,073,612)  | (1,141,110)                                | (1,002,919)  |
| Net liability at beginning of period           | 4,517,340                                   | 4,303,906    | 4,504,439                                  | 4,222,224    |
| Net losses incurred related to:                |   |              |  |              |
| Current year                                   | 338,420                                     | 315,102      | 961,224                                    | 862,088      |
| Prior years                                    | (61,450)                                    | (56,154)     | (153,948)                                  | (137,558)    |



|  |              |              |              |              |
|--|--------------|--------------|--------------|--------------|
| Total incurred                           | 276,970      | 258,948      | 807,276      | 724,530      |
| Net paid losses related to:              |              |              |              |              |
| Current year                             | 30,399       | 16,323       | 54,983       | 36,163       |
| Prior years                              | 213,252      | 179,666      | 696,137      | 542,077      |
| Total paid                               | 243,651      | 195,989      | 751,120      | 578,240      |
| Foreign exchange revaluation             | 4,088        | 6,400        | (5,848)      | 4,751        |
| Net liability at end of period           | 4,554,747    | 4,373,265    | 4,554,747    | 4,373,265    |
| Reinsurance recoverable at end of period | 1,226,034    | 1,077,522    | 1,226,034    | 1,077,522    |
| Gross liability at end of period         | \$ 5,780,781 | \$ 5,450,787 | \$ 5,780,781 | \$ 5,450,787 |

For the three months ended September 30, 2013, the Company had net favorable reserve development in its international insurance and reinsurance segments due to actual loss emergence being lower than initially expected. The majority of the net favorable reserve development was recognized in the 2007 through 2011 loss years across most lines of business. In addition, the reinsurance segment recognized net favorable reserve development for the 2012 loss year due to the low level of reported property losses. This was partially offset by adverse development in the U.S. insurance segment in the 2011 and 2012 loss years primarily caused by adverse development on reported claims for certain healthcare, errors and omissions and private/not for profit directors and officers .

For the nine months ended September 30, 2013, the Company had net favorable reserve development in its international insurance and reinsurance segments due to actual loss emergence being lower than initially expected, for most loss years. The reinsurance segment recognized net favorable reserve development for the 2012 loss year due to the low level of reported property losses. This was partially offset by adverse development in the U.S. insurance segment in the 2011 and 2012 loss years for certain healthcare, errors and omissions and not-for-profit director s and officers classes of business.

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For the three months ended September 30, 2012, the Company had net favorable reserve development in each of its segments due to actual loss emergence being lower than initially expected. The majority of the net favorable reserve development was recognized by each segment in the 2004 through 2008 loss years. The Company had net unfavorable reserve development in its U.S. insurance segment in the 2010 and 2011 loss years, primarily due to higher than expected losses on a terminated program, and in its international insurance segment in the 2011 loss year, primarily due to an individual full-limit general casualty claim.

For the nine months ended September 30, 2012, the Company had net favorable reserve development in each of its segments due to actual loss emergence being lower than initially expected. The majority of the net favorable reserve development was recognized in the international insurance and reinsurance segments in the 2004 through 2008 loss years.

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

**8. INCOME TAXES**

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

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

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

Management has deemed all material tax positions to have a greater than 50% likelihood of being sustained based on technical merits if challenged. The Company does not expect any material unrecognized tax benefits within 12 months of September 30, 2013.

## 9. SHAREHOLDERS EQUITY

### a) Authorized shares

The issued share capital consists of the following:

|   | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|-------------------------------|------------------------------|
| Common shares issued and fully paid, 2013: CHF 12.30 per share; 2012: CHF 12.64 per share | 34,972,795                    | 36,369,868                   |
| Share capital at end of period  | \$ 424,837                    | \$ 454,980                   |

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|  | <b>Nine Months<br/>Ended<br/>September 30,<br/>2013</b> |
|--|---|
| Shares issued at beginning of period             | 36,369,868  |
| Shares cancelled                                 | (1,397,073)   |
| <b>Total shares issued at end of period</b>      | <b>34,972,795</b>                                       |
| Treasury shares issued at beginning of period    | 1,572,087   |
| Shares repurchased                               | 1,367,833   |
| Shares issued out of treasury                    | (384,972)   |
| Shares cancelled                                 | (1,397,073)   |
| <b>Total treasury shares at end of period</b>    | <b>1,157,875</b>  |
| <b>Total shares outstanding at end of period</b> | <b>33,814,920</b>                                       |

During the nine months ended September 30, 2013, 1,367,833 voting shares repurchased and designated for cancellation were constructively retired and cancelled.

Effective July 9, 2013, the Company cancelled 29,240 non-voting shares held in treasury and 1,538,686 shares previously repurchased and constructively retired, following a required filing with the Swiss Commercial Register in Zug.

Allied World Switzerland's articles of association authorized its Board of Directors to increase the share capital by a maximum of up to CHF 92,259 or 7,500,728 voting shares.

**b) Dividends**

The Company paid the following dividends during the nine months ended September 30, 2013:

| <b>Partial<br/>Par Value<br/>Reduction</b> | <b>Dividend<br/>Per</b> | <b>Total<br/>Amount</b> |
|--|-------------------------|-------------------------|
|--|-------------------------|-------------------------|

| <b>Dividend Paid</b> | <b>Per Share</b> |      | <b>Share</b> |       | <b>Paid</b> |
|----------------------|------------------|------|--------------|-------|-------------|
| March 12, 2013       | CHF              | 0.34 | \$           | 0.375 | \$ 12,981   |
| July 3, 2013         | -                | -    | \$           | 0.500 | \$ 17,117   |

On May 3, 2012, 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 was paid to shareholders in four installments of \$0.375 per share, with the last of such quarterly dividend payments being made on March 12, 2013.

On May 2, 2013, the shareholders approved the Company's proposal to pay cash dividends in the form of a distribution out of general legal reserve from capital contributions. The distribution amount will be paid to shareholders in quarterly dividends of \$0.50 per share. The first dividend was paid on July 3, 2013. The second dividend was paid on October 3, 2013. The Company expects to pay the remaining dividends in January 2014 and April 2014.

### *c) Share Repurchases*

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

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

The Company's share repurchases were as follows:

|                                  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|----------------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                                  | 2013                                | 2012      | 2013                               | 2012       |
| Common shares repurchased        | 427,388                             | 605,898   | 1,367,833                          | 2,942,085  |
| Total cost of shares repurchased | \$ 40,574                           | \$ 47,590 | \$ 123,145                         | \$ 207,048 |
| Average price per share          | \$ 94.93                            | \$ 78.54  | \$ 90.03                           | \$ 70.37   |

**10. EARNINGS PER SHARE**

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

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2013                                | 2012       | 2013                               | 2012       |
| <b>Basic earnings per share:</b>           |                                     |            |                                    |            |
| Net income                                 | \$ 122,843                          | \$ 219,647 | \$ 279,973                         | \$ 534,154 |
| Weighted average common shares outstanding | 33,991,359                          | 35,652,768 | 34,340,227                         | 36,379,514 |
| Basic earnings per share                   | \$ 3.61                             | \$ 6.16    | \$ 8.15                            | \$ 14.68   |

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2013                                | 2012       | 2013                               | 2012       |
| <b>Diluted earnings per share:</b>         |                                     |            |                                    |            |
| Net income                                 | \$ 122,843                          | \$ 219,647 | \$ 279,973                         | \$ 534,154 |
| Weighted average common shares outstanding | 33,991,359                          | 35,652,768 | 34,340,227                         | 36,379,514 |

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Weighted average common shares outstanding  |            |            |            |            |
| Share equivalents:  |            |            |            |            |
| Options   | 500,114    | 461,373    | 497,458    | 429,393    |
| Restricted stock units and performance-based equity awards                        | 236,133    | 501,633    | 292,369    | 583,226    |
| Employee share purchase plan  | 587        | 960        | 1,038      | 960        |
|   |            |            |            |            |
| Weighted average common shares and common share equivalents outstanding - diluted | 34,728,193 | 36,616,734 | 35,131,092 | 37,393,093 |
|   |            |            |            |            |
| Diluted earnings per share  | \$ 3.54    | \$ 6.00    | \$ 7.97    | \$ 14.28   |

For the three and nine months ended September 30, 2013, no employee stock options and restricted stock units ( RSUs ) were considered anti-dilutive.

For the three and nine months ended September 30, 2012, a weighted average of 221,008 and 338,395 employee stock options and RSUs were considered anti-dilutive and were therefore excluded from the calculation of the diluted earnings per share, respectively.

## 11. 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.

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

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

Management measures results for each segment on the basis of the loss and loss expense ratio, acquisition cost ratio, general and administrative expense ratio and the combined ratio. The loss and loss expense ratio is derived by dividing net losses and loss expenses by net premiums earned. The acquisition cost ratio is derived by dividing acquisition costs by net premiums earned. The general and administrative expense ratio is derived by dividing general and administrative expenses by net premiums earned. The combined ratio is the sum of the loss and loss expense ratio, the acquisition cost ratio and the general and administrative expense ratio.

The following tables provide a summary of the segment results:

| Three Months Ended September 30, 2013 | International  |            |             | Total      |
|---------------------------------------|----------------|------------|-------------|------------|
|                                       | U.S. Insurance | Insurance  | Reinsurance |            |
| Gross premiums written                | \$ 308,709     | \$ 132,881 | \$ 139,303  | \$ 580,893 |
| Net premiums written                  | 238,792        | 75,632     | 138,653     | 453,077    |
| Net premiums earned                   | 207,602        | 87,554     | 215,617     | 510,773    |
| Net losses and loss expenses          | (141,222)      | (31,094)   | (104,654)   | (276,970)  |
| Acquisition costs                     | (28,426)       | 282        | (36,970)    | (65,114)   |
| General and administrative expenses   | (41,616)       | (26,450)   | (20,487)    | (88,553)   |
| Underwriting (loss) income            | (3,662)        | 30,292     | 53,506      | 80,136     |



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|                                   |          |
|-----------------------------------|----------|
| Net investment income             | 39,271   |
| Net realized investment gains     | 27,487   |
| Amortization of intangible assets | (633)    |
| Interest expense                  | (14,094) |
| Foreign exchange loss             | (4,353)  |

|                            |            |
|----------------------------|------------|
| Income before income taxes | \$ 127,814 |
|----------------------------|------------|

|  |        |        |       |       |
|--|--------|--------|-------|-------|
| Loss and loss expense ratio              | 68.0%  | 35.5%  | 48.5% | 54.2% |
| Acquisition cost ratio                   | 13.7%  | (0.3%) | 17.1% | 12.7% |
| General and administrative expense ratio | 20.0%  | 30.2%  | 9.5%  | 17.3% |
| Combined ratio                           | 101.7% | 65.4%  | 75.1% | 84.2% |

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| <b>Three Months Ended September 30, 2012</b> | <b>U.S.</b>      |                  | <b>International</b> |    | <b>Total</b> |
|--|------------------|------------------|----------------------|----|--------------|
|  | <b>Insurance</b> | <b>Insurance</b> | <b>Reinsurance</b>   |    |              |
| Gross premiums written                       | \$ 263,129       | \$ 121,315       | \$ 119,976           | \$ | \$ 504,420   |
| Net premiums written                         | 200,779          | 71,199           | 119,559              |    | 391,537      |
| Net premiums earned                          | 173,948          | 85,329           | 181,740              |    | 441,017      |
| Net losses and loss expenses                 | (109,111)        | (15,099)         | (134,738)            |    | (258,948)    |
| Acquisition costs                            | (22,696)         | 266              | (28,656)             |    | (51,086)     |
| General and administrative expenses          | (37,388)         | (22,920)         | (18,264)             |    | (78,572)     |
| Underwriting income                          | 4,753            | 47,576           | 82                   |    | 52,411       |
| Net investment income                        |                  |                  |                      |    | 39,121       |
| Net realized investment gains                |                  |                  |                      |    | 149,813      |
| Amortization of intangible assets            |                  |                  |                      |    | (633)        |
| Interest expense                             |                  |                  |                      |    | (13,822)     |
| Foreign exchange loss                        |                  |                  |                      |    | (1,023)      |
| Income before income taxes                   |                  |                  |                      | \$ | \$ 225,867   |
| Loss and loss expense ratio                  | 62.7%            | 17.7%            | 74.1%                |    | 58.7%        |
| Acquisition cost ratio                       | 13.0%            | (0.3%)           | 15.8%                |    | 11.6%        |
| General and administrative expense ratio     | 21.5%            | 26.9%            | 10.0%                |    | 17.8%        |
| Combined ratio                               | 97.2%            | 44.3%            | 99.9%                |    | 88.1%        |

| <b>Nine Months Ended September 30, 2013</b> | <b>U.S.</b>      |                  | <b>International</b> |    | <b>Total</b> |
|---|------------------|------------------|----------------------|----|--------------|
|   | <b>Insurance</b> | <b>Insurance</b> | <b>Reinsurance</b>   |    |              |
| Gross premiums written                      | \$ 872,024       | \$ 453,990       | \$ 857,160           | \$ | \$ 2,183,174 |
| Net premiums written                        | 652,464          | 259,771          | 817,116              |    | 1,729,351    |
| Net premiums earned                         | 593,477          | 258,809          | 628,986              |    | 1,481,272    |
| Net losses and loss expenses                | (398,910)        | (90,997)         | (317,369)            |    | (807,276)    |
| Acquisition costs                           | (78,824)         | 1,489            | (109,081)            |    | (186,416)    |
| General and administrative expenses         | (119,514)        | (75,374)         | (56,930)             |    | (251,818)    |
| Underwriting (loss) income                  | (3,771)          | 93,927           | 145,606              |    | 235,762      |

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|                                   |  |  |    |          |
|-----------------------------------|--|--|----|----------|
| Net investment income             |  |  |    | 110,294  |
| Net realized investment losses    |  |  |    | (8,074)  |
| Amortization of intangible assets |  |  |    | (1,900)  |
| Interest expense                  |  |  |    | (42,416) |
| Foreign exchange loss             |  |  |    | (7,361)  |
| Income before income taxes        |  |  | \$ | 286,305  |

|  |        |        |       |       |
|--|--------|--------|-------|-------|
| Loss and loss expense ratio              | 67.2%  | 35.2%  | 50.5% | 54.5% |
| Acquisition cost ratio                   | 13.3%  | (0.6%) | 17.3% | 12.6% |
| General and administrative expense ratio | 20.1%  | 29.1%  | 9.1%  | 17.0% |
| Combined ratio                           | 100.6% | 63.7%  | 76.9% | 84.1% |

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| <b>Nine Months Ended September 30, 2012</b> | <b>International</b>  |                  |                    | <b>Total</b> |
|---|-----------------------|------------------|--------------------|--------------|
|   | <b>U.S. Insurance</b> | <b>Insurance</b> | <b>Reinsurance</b> |              |
| Gross premiums written                      | \$ 733,314            | \$ 418,498       | \$ 680,407         | \$ 1,832,219 |
| Net premiums written                        | 551,286               | 255,150          | 668,764            | 1,475,200    |
| Net premiums earned                         | 490,091               | 247,805          | 534,758            | 1,272,654    |
| Net losses and loss expenses                | (309,889)             | (75,432)         | (339,209)          | (724,530)    |
| Acquisition costs                           | (63,918)              | 1,376            | (87,270)           | (149,812)    |
| General and administrative expenses         | (103,162)             | (66,969)         | (52,786)           | (222,917)    |
| Underwriting income                         | 13,122                | 106,780          | 55,493             | 175,395      |
| Net investment income                       |                       |                  |                    | 128,781      |
| Net realized investment gains               |                       |                  |                    | 292,057      |
| Amortization of intangible assets           |                       |                  |                    | (1,900)      |
| Interest expense                            |                       |                  |                    | (41,579)     |
| Foreign exchange gain                       |                       |                  |                    | 77           |
| Income before income taxes                  |                       |                  |                    | \$ 552,831   |
| Loss and loss expense ratio                 | 63.2%                 | 30.4%            | 63.4%              | 56.9%        |
| Acquisition cost ratio                      | 13.0%                 | (0.6%)           | 16.3%              | 11.8%        |
| General and administrative expense ratio    | 21.0%                 | 27.0%            | 9.9%               | 17.5%        |
| Combined ratio                              | 97.2%                 | 56.8%            | 89.6%              | 86.2%        |

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

|               | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |              |
|---------------|---------------------------|-------------|--------------------------|--------------|
|               | <b>September 30,</b>      |             | <b>September 30,</b>     |              |
|               | <b>2013</b>               | <b>2012</b> | <b>2013</b>              | <b>2012</b>  |
| United States | \$ 377,618                | \$ 312,807  | \$ 1,296,212             | \$ 1,051,355 |
| Bermuda       | 111,103                   | 108,955     | 550,815                  | 484,313      |
| Europe        | 52,004                    | 46,836      | 198,747                  | 182,220      |

|           |        |        |         |         |
|-----------|--------|--------|---------|---------|
| Singapore | 35,515 | 31,902 | 122,546 | 101,213 |
| Hong Kong | 4,653  | 3,920  | 14,854  | 13,118  |

|                              |            |            |              |              |
|------------------------------|------------|------------|--------------|--------------|
| Total gross premiums written | \$ 580,893 | \$ 504,420 | \$ 2,183,174 | \$ 1,832,219 |
|------------------------------|------------|------------|--------------|--------------|

Europe includes gross premiums written attributable to Switzerland of \$10,509 and \$7,039 for the three months ended September 30, 2013 and 2012, respectively, and \$57,183 and \$40,474 for the nine months ended September 30, 2013 and 2012, respectively.

## 12. COMMITMENTS AND CONTINGENCIES

The Company, in common with the insurance industry in general, is subject to litigation and arbitration in the normal course of its business. These legal proceedings generally relate to claims asserted by or against the Company in the ordinary course of insurance or reinsurance operations. Estimated amounts payable under these proceedings are included in the reserve for losses and loss expenses in the Company's consolidated balance sheets. As of September 30, 2013, the Company was not a party to any material legal proceedings arising outside the ordinary course of business that management believes will have a material adverse effect on the Company's results of operations, financial position or cash flow.

## 13. CONDENSED CONSOLIDATED GUARANTOR FINANCIAL STATEMENTS

The following tables present unaudited condensed consolidating financial information as of September 30, 2013 and December 31, 2012 and for the three and nine months ended September 30, 2013 and 2012 for Allied World Switzerland (the Parent Guarantor) and Allied World Bermuda (the Subsidiary Issuer). The Subsidiary Issuer is a direct, 100%-owned subsidiary of the Parent Guarantor. Investments in subsidiaries are accounted for by the Parent Guarantor under the equity method for purposes of the supplemental consolidating presentation. Earnings of subsidiaries are reflected in the Parent Guarantor's investment accounts and earnings. The Parent Guarantor fully and unconditionally guarantees the senior notes issued by the Subsidiary Issuer.

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

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

**Unaudited Condensed Consolidating Balance Sheet:**

| <b>As of September 30, 2013</b>               | <b>Allied World<br/>Switzerland<br/>(Parent<br/>Guarantor)</b> | <b>Allied World<br/>Bermuda<br/>(Subsidiary<br/>Issuer)</b> | <b>Other Allied<br/>World<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Allied World<br/>Switzerland<br/>Consolidated</b> |
|---|--|---|--|--------------------------------------|--|
| <b>ASSETS:</b>                                |  |   |  |                                      |  |
| Investments                                   | \$   | \$  | \$ 7,661,837                                   | \$                                   | \$ 7,661,837   |
| Cash and cash equivalents                     | 56,060   | 8,388   | 888,599  |                                      | 953,047  |
| Insurance balances<br>receivable              |  |   | 740,112  |                                      | 740,112  |
| Funds held                                    |  |   | 375,131  |                                      | 375,131  |
| Reinsurance recoverable                       |  |   | 1,226,034                                      |                                      | 1,226,034  |
| Net deferred acquisition<br>costs             |  |   | 145,951  |                                      | 145,951  |
| Goodwill and intangible<br>assets             |  |   | 317,840  |                                      | 317,840  |
| Balances receivable on sale<br>of investments |  |   | 237,031  |                                      | 237,031  |
| Investments in subsidiaries                   | 3,407,988  | 4,509,074   |  | (7,917,062)                          |  |
| Due (to) from subsidiaries                    | (967)  | (14,679)  | 15,646   |                                      |  |
| Other assets                                  | 1,897  | 5,038   | 713,602  |                                      | 720,537  |
| <b>Total assets</b>                           | <b>\$ 3,464,978</b>  | <b>\$ 4,507,821</b>   | <b>\$ 12,321,783</b>                           | <b>\$ (7,917,062)</b>                | <b>\$ 12,377,520</b>                                 |
| <b>LIABILITIES:</b>                           |  |   |  |                                      |  |
| Reserve for losses and loss<br>expenses       | \$   | \$  | \$ 5,780,781                                   | \$                                   | \$ 5,780,781   |
| Unearned premiums                             |  |   | 1,515,746                                      |                                      | 1,515,746  |
| Reinsurance balances<br>payable               |  |   | 193,643  |                                      | 193,643  |
| Balances due on purchases<br>of investments   |  |   | 497,974  |                                      | 497,974  |
| Senior notes                                  |  | 798,426   |  |                                      | 798,426  |
| Other liabilities                             | 21,050   | 17,457  | 108,515  |                                      | 147,022  |
| <b>Total liabilities</b>                      | <b>21,050</b>  | <b>815,883</b>  | <b>8,096,659</b>                               |                                      | <b>8,933,592</b>                                     |

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|   |              |              |               |                |               |
|---|--------------|--------------|---------------|----------------|---------------|
| Total shareholders equity                 | 3,443,928    | 3,691,938    | 4,225,124     | (7,917,062)    | 3,443,928     |
| Total liabilities and shareholders equity | \$ 3,464,978 | \$ 4,507,821 | \$ 12,321,783 | \$ (7,917,062) | \$ 12,377,520 |

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

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

| As of December 31, 2012                       | Allied World<br>Switzerland<br>(Parent<br>Guarantor) | Allied World<br>Bermuda<br>(Subsidiary<br>Issuer) | Other Allied<br>World<br>Subsidiaries | Consolidating<br>Adjustments | Allied World<br>Switzerland<br>Consolidated |
|---|--|---|---------------------------------------|------------------------------|---|
| <b>ASSETS:</b>                                |  |   |                                       |                              |   |
| Investments                                   | \$   | \$  | \$ 7,933,937                          | \$                           | \$ 7,933,937                                |
| Cash and cash equivalents                     | 19,997   | 11,324  | 650,558                               |                              | 681,879                                     |
| Insurance balances<br>receivable              |  |   | 510,532                               |                              | 510,532                                     |
| Funds held                                    |  |   | 336,368                               |                              | 336,368                                     |
| Reinsurance recoverable                       |  |   | 1,141,110                             |                              | 1,141,110                                   |
| Net deferred acquisition<br>costs             |  |   | 108,010                               |                              | 108,010                                     |
| Goodwill and intangible<br>assets             |  |   | 319,741                               |                              | 319,741                                     |
| Balances receivable on<br>sale of investments |  |   | 418,879                               |                              | 418,879                                     |
| Investments in subsidiaries                   | 3,337,446  | 4,768,769   |                                       | (8,106,215)                  |   |
| Due (to) from subsidiaries                    | (23,864)   | (7,173)   | 31,037                                |                              |   |
| Other assets                                  | 1,499  | 6,081   | 571,910                               |                              | 579,490                                     |
| <b>Total assets</b>                           | <b>\$ 3,335,078</b>                                  | <b>\$ 4,779,001</b>                               | <b>\$ 12,022,082</b>                  | <b>\$ (8,106,215)</b>        | <b>\$ 12,029,946</b>                        |
| <b>LIABILITIES:</b>                           |  |   |                                       |                              |   |
| Reserve for losses and loss<br>expenses       | \$   | \$  | \$ 5,645,549                          | \$                           | \$ 5,645,549                                |
| Unearned premiums                             |  |   | 1,218,021                             |                              | 1,218,021                                   |
| Reinsurance balances<br>payable               |  |   | 136,264                               |                              | 136,264                                     |
| Balances due on purchases<br>of investments   |  |   | 759,934                               |                              | 759,934                                     |
| Senior notes                                  |  | 798,215   |                                       |                              | 798,215                                     |
| Other liabilities                             | 8,743  | 17,727  | 119,158                               |                              | 145,628                                     |
| <b>Total liabilities</b>                      | <b>8,743</b>   | <b>815,942</b>                                    | <b>7,878,926</b>                      |                              | <b>8,703,611</b>                            |
| Total shareholders' equity                    | 3,326,335  | 3,963,059   | 4,143,156                             | (8,106,215)                  | 3,326,335                                   |



|   |              |              |               |                |               |
|---|--------------|--------------|---------------|----------------|---------------|
| Total liabilities and shareholders equity | \$ 3,335,078 | \$ 4,779,001 | \$ 12,022,082 | \$ (8,106,215) | \$ 12,029,946 |
|---|--------------|--------------|---------------|----------------|---------------|

**Unaudited Condensed Consolidating Income Statement:**

| Three Months Ended September 30, 2013           | Allied World<br>Switzerland<br>(Parent<br>Guarantor) | Allied World<br>Bermuda<br>(Subsidiary<br>Issuer) | Other Allied<br>World<br>Subsidiaries | Consolidating<br>Adjustments | Allied World<br>Switzerland<br>Consolidated |
|---|--|---|---------------------------------------|------------------------------|---|
| Net premiums earned                             | \$   | \$  | \$ 510,773                            | \$                           | \$ 510,773                                  |
| Net investment income                           | 3  |   | 39,268                                |                              | 39,271                                      |
| Net realized investment losses                  |  |   | 27,487                                |                              | 27,487                                      |
| Net losses and loss expenses                    |  |   | (276,970)                             |                              | (276,970)                                   |
| Acquisition costs                               |  |   | (65,114)                              |                              | (65,114)                                    |
| General and administrative expenses             | (7,323)  | (4,961)   | (76,269)                              |                              | (88,553)                                    |
| Amortization of intangible assets               |  |   | (633)                                 |                              | (633)                                       |
| Interest expense                                |  | (13,838)  | (256)                                 |                              | (14,094)                                    |
| Foreign exchange gain (loss)                    | (13)   | (212)   | (4,128)                               |                              | (4,353)                                     |
| Income tax (expense) benefit                    |  |   | (4,971)                               |                              | (4,971)                                     |
| Equity in earnings of consolidated subsidiaries | 130,176  | 150,653   |                                       | (280,829)                    |   |
| <b>NET INCOME (LOSS)</b>                        | \$ 122,843   | \$ 131,642  | \$ 149,187                            | \$ (280,829)                 | \$ 122,843                                  |
| Other comprehensive income                      |  |   |                                       |                              |   |
| <b>COMPREHENSIVE INCOME (LOSS)</b>              | \$ 122,843   | \$ 131,642  | \$ 149,187                            | \$ (280,829)                 | \$ 122,843                                  |

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

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

| <b>Three Months Ended September 30, 2012</b>   | <b>Allied World<br/>Switzerland<br/>(Parent<br/>Guarantor)</b> | <b>Allied World<br/>Bermuda<br/>(Subsidiary<br/>Issuer)</b> | <b>Other Allied<br/>World<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Allied World<br/>Switzerland<br/>Consolidated</b> |
|--|--|---|--|--------------------------------------|--|
| Net premiums earned  | \$   | \$  | \$ 441,017                                     | \$                                   | \$ 441,017   |
| Net investment income  | 7  | 6   | 39,108   |                                      | 39,121   |
| Net realized investment gains  |  |   | 149,813  |                                      | 149,813  |
| Net losses and loss expenses   |  |   | (258,948)                                      |                                      | (258,948)  |
| Acquisition costs  |  |   | (51,086)                                       |                                      | (51,086)   |
| General and administrative expenses  | (6,013)  | (235)   | (72,324)                                       |                                      | (78,572)   |
| Amortization of intangible assets  |  |   | (633)  |                                      | (633)  |
| Interest expense   |  | (13,822)  |  |                                      | (13,822)   |
| Foreign exchange gain (loss)   | (206)  | (83)  | (734)  |                                      | (1,023)  |
| Income tax (expense) benefit   |  |   | (6,220)  |                                      | (6,220)  |
| Equity in earnings of consolidated subsidiaries  | 225,859  | 231,471   |  | (457,330)                            |  |
| <b>NET INCOME (LOSS)</b>   | <b>\$ 219,647</b>  | <b>\$ 217,337</b>   | <b>\$ 239,993</b>                              | <b>\$ (457,330)</b>                  | <b>\$ 219,647</b>                                    |
| Unrealized losses on investments arising during the period net of applicable deferred income tax benefit of \$15   | (29)   |   | (29)   | 29                                   | (29)   |
| Reclassification adjustment for net realized investment gains included in net income, net of applicable income tax |  |   |  |                                      |  |
| Other comprehensive loss   | (29)   |   | (29)   | 29                                   | (29)   |
| <b>COMPREHENSIVE INCOME (LOSS)</b>   | <b>\$ 219,618</b>  | <b>\$ 217,337</b>   | <b>\$ 239,964</b>                              | <b>\$ (457,301)</b>                  | <b>\$ 219,618</b>                                    |

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

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

| <b>Nine Months Ended September 30, 2013</b>     | <b>Allied World<br/>Switzerland<br/>(Parent<br/>Guarantor)</b> | <b>Allied World<br/>Bermuda<br/>(Subsidiary<br/>Issuer)</b> | <b>Other Allied<br/>World<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Allied World<br/>Switzerland<br/>Consolidated</b> |
|---|--|---|--|--------------------------------------|--|
| Net premiums earned                             | \$   | \$  | \$ 1,481,272                                   | \$                                   | \$ 1,481,272   |
| Net investment income                           | 11   | 4   | 110,279  |                                      | 110,294  |
| Net realized investment losses                  |  |   | (8,074)  |                                      | (8,074)  |
| Net losses and loss expenses                    |  |   | (807,276)                                      |                                      | (807,276)  |
| Acquisition costs                               |  |   | (186,416)                                      |                                      | (186,416)  |
| General and administrative expenses             | (26,875)   | (5,873)   | (219,070)                                      |                                      | (251,818)  |
| Amortization of intangible assets               |  |   | (1,900)  |                                      | (1,900)  |
| Interest expense                                |  | (41,503)  | (913)  |                                      | (42,416)   |
| Foreign exchange loss (gain)                    | 261  | (935)   | (6,687)  |                                      | (7,361)  |
| Income tax (expense) benefit                    |  |   | (6,332)  |                                      | (6,332)  |
| Equity in earnings of consolidated subsidiaries | 306,576  | 353,280   |  | (659,856)                            |  |
| <b>NET INCOME (LOSS)</b>                        | \$ 279,973   | \$ 304,973  | \$ 354,883                                     | \$ (659,856)                         | \$ 279,973   |
| Other comprehensive income                      |  |   |  |                                      |  |
| <b>COMPREHENSIVE INCOME (LOSS)</b>              | \$ 279,973   | \$ 304,973  | \$ 354,883                                     | \$ (659,856)                         | \$ 279,973   |

| <b>Nine Months Ended September 30, 2012</b> | <b>Allied World<br/>Switzerland<br/>(Parent<br/>Guarantor)</b> | <b>Allied World<br/>Bermuda<br/>(Subsidiary<br/>Issuer)</b> | <b>Other Allied<br/>World<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Allied World<br/>Switzerland<br/>Consolidated</b> |
|---|--|---|--|--------------------------------------|--|
| Net premiums earned                         | \$   | \$  | \$ 1,272,654                                   | \$                                   | \$ 1,272,654   |
| Net investment income                       | 21   | 17  | 128,743  |                                      | 128,781  |
| Net realized investment gains               |  |   | 292,057  |                                      | 292,057  |
| Net losses and loss expenses                |  |   | (724,530)                                      |                                      | (724,530)  |
| Acquisition costs                           |  |   | (149,812)                                      |                                      | (149,812)  |
| General and administrative expenses         | (14,247)   | (2,689)   | (205,981)                                      |                                      | (222,917)  |
| Amortization of intangible assets           |  |   | (1,900)  |                                      | (1,900)  |
| Interest expense                            |  | (41,579)  |  |                                      | (41,579)   |

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|  |            |            |             |                           |
|--|------------|------------|-------------|---------------------------|
| Foreign exchange gain (loss)   | 343        | (150)      | (116)       | 77                        |
| Income tax (expense) benefit   | 71         |            | (18,748)    | (18,677)                  |
| Equity in earnings of consolidated subsidiaries  | 547,966    | 580,880    | (1,128,846) |                           |
| <b>NET INCOME (LOSS)</b>   | \$ 534,154 | \$ 536,479 | \$ 592,367  | \$ (1,128,846) \$ 534,154 |
| Unrealized gains on investments arising during the period net of applicable deferred income tax expense of \$81    | 150        |            | 150         | (150) 150                 |
| Reclassification adjustment for net realized investment gains included in net income, net of applicable income tax | (13,249)   |            | (13,249)    | 13,249 (13,249)           |
| Other comprehensive loss   | (13,099)   |            | (13,099)    | 13,099 (13,099)           |
| <b>COMPREHENSIVE INCOME (LOSS)</b>   | \$ 521,055 | \$ 536,479 | \$ 579,268  | \$ (1,115,747) \$ 521,055 |

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

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

**Unaudited Condensed Consolidating Cash Flows:**

|   | <b>Allied World<br/>Switzerland<br/>(Parent<br/>Guarantor)</b> | <b>Allied World<br/>Bermuda<br/>(Subsidiary<br/>Issuer)</b> | <b>Other Allied<br/>World<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Allied World<br/>Switzerland<br/>Consolidated</b> |
|---|--|---|--|--------------------------------------|--|
| <b>Nine Months Ended September 30, 2013</b>                   |  |   |  |                                      |  |
| <b>CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>  | \$ 177,859   | \$ (2,936)  | \$ 157,127                                     | \$                                   | \$ 332,050   |
| <b>CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:</b> |  |   |  |                                      |  |
| Purchases trading securities                                  |  |   | (4,955,817)                                    |                                      | (4,955,817)  |
| Purchases of other invested assets                            |  |   | (211,501)                                      |                                      | (211,501)  |
| Sales of available for sale securities                        |  |   |  |                                      |  |
| Sales of trading securities                                   |  |   | 5,137,280                                      |                                      | 5,137,280  |
| Sales of other invested assets                                |  |   | 189,155  |                                      | 189,155  |
| Other   |  |   | (78,203)                                       |                                      | (78,203)   |
| Net cash provided by (used in) investing activities           |  |   | 80,914   |                                      | 80,914   |
| <b>CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:</b> |  |   |  |                                      |  |
| Dividends paid - partial par value reduction                  | (12,981)   |   |  |                                      | (12,981)   |
| Dividends paid  | (17,117)   |   |  |                                      | (17,117)   |
| Proceeds from the exercise of stock options                   | 8,465  |   |  |                                      | 8,465  |
| Share repurchases   | (120,163)  |   |  |                                      | (120,163)  |
| Net cash provided by (used in) financing activities           | (141,796)  |   |  |                                      | (141,796)  |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>   | 36,063   | (2,936)   | 238,041  |                                      | 271,168  |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>         | 19,997   | 11,324  | 650,558  |                                      | 681,879  |

|   |    |        |    |       |    |         |    |         |
|---|----|--------|----|-------|----|---------|----|---------|
| <b>CASH AND CASH EQUIVALENTS,<br/>END OF PERIOD</b> | \$ | 56,060 | \$ | 8,388 | \$ | 888,599 | \$ | 953,047 |
|---|----|--------|----|-------|----|---------|----|---------|

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

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

| Nine Months Ended September 30, 2012                          | Allied World<br>Switzerland<br>(Parent<br>Guarantor) | Allied World<br>Bermuda<br>(Subsidiary<br>Issuer) | Other Allied<br>World<br>Subsidiaries | Consolidating<br>Adjustments | Allied World<br>Switzerland<br>Consolidated |
|---|--|---|---------------------------------------|------------------------------|---|
| <b>CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:</b> | \$ 162,141   | \$ 687  | \$ 336,824                            | \$                           | \$ 499,652                                  |
| <b>CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:</b> |  |   |                                       |                              |   |
| Purchases of available for sale securities                    |  |   |                                       |                              |   |
| Purchases of trading securities                               |  |   | (6,328,719)                           |                              | (6,328,719)                                 |
| Purchases of other invested assets                            |  |   | (52,578)                              |                              | (52,578)                                    |
| Sales of available for sale securities                        |  |   | 215,318                               |                              | 215,318                                     |
| Sales of trading securities                                   |  |   | 5,778,138                             |                              | 5,778,138                                   |
| Sales of other invested assets                                |  |   | 110,429                               |                              | 110,429                                     |
| Other   |  |   | 33,644                                |                              | 33,644                                      |
| Net cash provided by (used in) investing activities           |  |   | (243,768)                             |                              | (243,768)                                   |
| <b>CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:</b> |  |   |                                       |                              |   |
| Partial par value reduction                                   | (54,721)   |   |                                       |                              | (54,721)                                    |
| Proceeds from the exercise of stock options                   | 9,104  |   |                                       |                              | 9,104                                       |
| Share repurchases   | (204,746)  |   |                                       |                              | (204,746)                                   |
| Net cash provided by (used in) financing activities           | (250,363)  |   |                                       |                              | (250,363)                                   |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>   | (88,222)   | 687   | 93,056                                |                              | 5,521                                       |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>         | 112,672  | 8,886   | 512,438                               |                              | 633,996                                     |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>               | \$ 24,450  | \$ 9,573  | \$ 605,494                            | \$                           | \$ 639,517                                  |

*Notes to Parent Company Condensed Financial Information*

*a) Dividends*

Allied World Switzerland received cash dividends from its subsidiaries of \$237,000 and \$285,000 for the nine months ended September 30, 2013 and 2012, respectively. Such dividends are included in cash flows provided by (used in) operating activities in the unaudited condensed consolidating cash flows.

**14. SUBSEQUENT EVENTS**

On October 3, 2013, the Company paid a quarterly dividend of \$0.50 per share to shareholders of record on September 24, 2013.



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

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

**Note on Forward-Looking Statement**

This Form 10-Q and other publicly available documents may include, and our officers and representatives may from time to time make, projections concerning financial information and statements concerning future economic performance and events, plans and objectives relating to management, operations, products and services, and assumptions underlying these projections and statements. These projections and statements are forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995 and are not historical facts but instead represent only our belief regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These projections and statements may address, among other things, our strategy for growth, product development, financial results and reserves. Actual results and financial condition may differ, possibly materially, from these projections and statements and therefore you should not place undue reliance on them. Factors that could cause our actual results to differ, possibly materially, from those in the specific projections and statements are discussed throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations and in Risk Factors in Item 1A. of Part I of our 2012 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) on February 26, 2013 (the 2012 Form 10-K). We are under no obligation (and expressly disclaim any such obligation) to update or revise any forward-looking statement that may be made from time to time, whether as a result of new information, future developments or otherwise.

**Overview****Our Business**

We write a diversified portfolio of property and casualty insurance and reinsurance internationally through our subsidiaries and branches based in Bermuda, Europe, Hong Kong, Singapore and the United States as well as our Lloyd's Syndicate 2232. We manage our business through three operating segments: U.S. insurance, international insurance and reinsurance. As of September 30, 2013, we had approximately \$12.4 billion of total assets, \$3.4 billion of total shareholders' equity and \$4.2 billion of total capital, which includes shareholders' equity and senior notes.

During the three months ended September 30, 2013, we continued to see rate improvement during the quarter on some lines of business in certain jurisdictions, particularly in our U.S. insurance segment. Rates on property lines, across our segments, have begun to flatten, particularly those accounts that had experienced loss activity in the prior year. We believe that there are opportunities where certain products have attractive premium rates and that the expanded breadth of our operations allows us to target those classes of business.

Our consolidated gross premiums written increased by \$76.5 million, or 15.2%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. Our net income decreased by \$96.8

million to \$122.8 million compared to the three months ended September 30, 2012. The decrease was due to lower net realized investment gains (losses) of \$122.3 million for the three months ended September 30, 2013 compared to the same period in 2012, partially offset by an increase in underwriting income of \$27.7 million.

Our consolidated gross premiums written increased by \$351.0 million, or 19.2%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. Our net income decreased by \$254.2 million to \$280.0 million compared to the nine months ended September 30, 2012. The decrease was due to lower net realized investment gains (losses) of \$300.1 million for the nine months ended September 30, 2013 compared to the same period in 2012, partially offset by an increase in underwriting income of \$60.4 million.

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

|   | Three Months Ended<br>September 30,                          |            | Nine Months Ended<br>September 30, |            |
|---|--|------------|------------------------------------|------------|
|   | 2013   | 2012       | 2013                               | 2012       |
|   | (\$ in millions except share, per share and percentage data) |            |                                    |            |
| Gross premiums written                                    | \$ 580.9   | \$ 504.4   | \$ 2,183.2                         | \$ 1,832.2 |
| Underwriting income                                       | 80.1   | 52.4       | 235.8                              | 175.4      |
| Net income  | 122.8  | 219.6      | 280.0                              | 534.2      |
| Operating income  | 101.8  | 79.2       | 289.5                              | 258.0      |
| Basic earnings per share:                                 |  |            |                                    |            |
| Net income  | \$ 3.61  | \$ 6.16    | \$ 8.15                            | \$ 14.68   |
| Operating income  | \$ 2.99  | \$ 2.22    | \$ 8.43                            | \$ 7.09    |
| Diluted earnings per share:                               |  |            |                                    |            |
| Net income  | \$ 3.54  | \$ 6.00    | \$ 7.97                            | \$ 14.28   |
| Operating income  | \$ 2.93  | \$ 2.16    | \$ 8.24                            | \$ 6.90    |
| Weighted average common shares<br>outstanding:            |  |            |                                    |            |
| Basic   | 33,991,359   | 35,652,768 | 34,340,227                         | 36,379,514 |
| Diluted   | 34,728,193   | 36,616,734 | 35,131,092                         | 37,393,093 |
| Basic book value per common share                         | \$ 101.85  | \$ 97.05   | \$ 101.85                          | \$ 97.05   |
| Diluted book value per common share                       | \$ 99.16   | \$ 93.82   | \$ 99.16                           | \$ 93.82   |
| Annualized return on average equity<br>(ROAE), net income | 14.4%  | 26.2%      | 11.0%                              | 21.7%      |
| Annualized ROAE, operating income                         | 11.9%  | 9.4%       | 11.4%                              | 10.5%      |

**Non-GAAP Financial Measures**

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

***Operating income and operating income per share***

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

income.

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|  | Three Months Ended<br>September 30,                           |          | Nine Months Ended<br>September 30, |          |
|--|---|----------|------------------------------------|----------|
|  | 2013  | 2012     | 2013                               | 2012     |
|  | (\$ in millions, except share, per share and percentage data) |          |                                    |          |
| Net income                             | \$ 122.8  | \$ 219.6 | \$ 280.0                           | \$ 534.2 |
| Add after tax effect of:               |   |          |                                    |          |
| Net realized investment (gains) losses | (25.4)  | (141.4)  | 2.2                                | (276.1)  |
| Foreign exchange loss (gain)           | 4.4   | 1.0      | 7.3                                | (0.1)    |
| Operating income                       | \$ 101.8  | \$ 79.2  | \$ 289.5                           | \$ 258.0 |
| <b>Basic per share data:</b>           |   |          |                                    |          |
| Net income                             | \$ 3.61   | \$ 6.16  | \$ 8.15                            | \$ 14.68 |
| Add after tax effect of:               |   |          |                                    |          |
| Net realized investment (gains) losses | (0.75)  | (3.97)   | 0.06                               | (7.59)   |
| Foreign exchange loss (gain)           | 0.13  | 0.03     | 0.22                               |          |
| Operating income                       | \$ 2.99   | \$ 2.22  | \$ 8.43                            | \$ 7.09  |
| <b>Diluted per share data:</b>         |   |          |                                    |          |
| Net income                             | \$ 3.54   | \$ 6.00  | \$ 7.97                            | \$ 14.28 |
| Add after tax effect of:               |   |          |                                    |          |
| Net realized investment (gains) losses | (0.73)  | (3.86)   | 0.06                               | (7.38)   |
| Foreign exchange loss (gain)           | 0.12  | 0.02     | 0.21                               |          |
| Operating income                       | \$ 2.93   | \$ 2.16  | \$ 8.24                            | \$ 6.90  |

***Diluted book value per share***

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

|                                 | As of September 30,                               |            |
|---------------------------------|---|------------|
|                                 | 2013  | 2012       |
|                                 | (\$ in millions, except share and per share data) |            |
| Price per share at period end   | \$ 99.39  | \$ 77.25   |
| Total shareholders' equity      | \$ 3,443.9  | \$ 3,435.8 |
| Basic common shares outstanding | 33,814,920  | 35,402,558 |
| Add:                            |   |            |
| Unvested restricted stock units | 83,240  | 179,986    |
| Performance based equity awards | 270,853   | 508,130    |
| Employee share purchase plan    | 15,320  | 5,925      |
| Dilutive options outstanding    | 1,050,832   | 1,306,837  |

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|  |    |            |    |            |
|--|----|------------|----|------------|
| Weighted average exercise price per share              | \$ | 47.77      | \$ | 46.14      |
| Deduct:  |    |            |    |            |
| Options bought back via treasury method                |    | (505,057)  |    | (780,502)  |
| Common shares and common share equivalents outstanding |    | 34,730,108 |    | 36,622,934 |
| Basic book value per common share                      | \$ | 101.85     | \$ | 97.05      |
| Diluted book value per common share                    | \$ | 99.16      | \$ | 93.82      |
| <b><i>Annualized return on average equity</i></b>      |    |            |    |            |

Annualized return on average shareholders' equity ( ROAE ) is calculated using average shareholders' 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.

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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.

|  | <b>Three Months Ended</b>                      |             | <b>Nine Months Ended</b> |             |
|--|--|-------------|--------------------------|-------------|
|  | <b>September 30,</b>                           |             | <b>September 30,</b>     |             |
|  | <b>2013</b>                                    | <b>2012</b> | <b>2013</b>              | <b>2012</b> |
|  | <b>(\$ in millions except percentage data)</b> |             |                          |             |
| Opening shareholders' equity   | \$ 3,373.2                                     | \$ 3,283.9  | \$ 3,326.3               | \$ 3,149.0  |
| Deduct: accumulated other comprehensive income   | -  | (1.4)       | -                        | (14.5)      |
| Adjusted opening shareholders' equity  | \$ 3,373.2                                     | \$ 3,282.5  | \$ 3,326.3               | \$ 3,134.5  |
| Closing shareholders' equity   | \$ 3,443.9                                     | \$ 3,435.8  | \$ 3,443.9               | \$ 3,435.8  |
| Deduct: accumulated other comprehensive income   | -  | (1.4)       | -                        | (1.4)       |
| Adjusted closing shareholders' equity  | \$ 3,443.9                                     | \$ 3,434.4  | \$ 3,443.9               | \$ 3,434.4  |
| Average shareholders' equity   | \$ 3,408.6                                     | \$ 3,358.4  | \$ 3,385.1               | \$ 3,284.5  |
| Net income available to shareholders   | \$ 122.8                                       | \$ 219.6    | \$ 280.0                 | \$ 534.2    |
| Annualized return on average shareholders' equity net income available to shareholders       | 14.4%  | 26.2%       | 11.0%                    | 21.7%       |
| Operating income available to shareholders   | \$ 101.8                                       | \$ 79.2     | \$ 289.5                 | \$ 258.0    |
| Annualized return on average shareholders' equity operating income available to shareholders | 11.9%  | 9.4%        | 11.4%                    | 10.5%       |

**Relevant Factors****Revenues**

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

## Expenses

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

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

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

reserves for losses incurred but not reported, or IBNR, which are reserves (in addition to case reserves) established by us that we believe are needed for the future settlement of claims. The portion recoverable from reinsurers is deducted from the gross estimated loss.

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



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

## **Ratios**

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

## **Critical Accounting Policies**

It is important to understand our accounting policies in order to understand our financial position and results of operations. Our unaudited condensed consolidated financial statements reflect determinations that are inherently subjective in nature and require management to make assumptions and best estimates to determine the reported values. If events or other factors cause actual results to differ materially from management's underlying assumptions or estimates, there could be a material adverse effect on our financial condition or results of operations. We believe that some of the more critical judgments in the areas of accounting estimates and assumptions that affect our financial condition and results of operations are related to reserves for losses and loss expenses, reinsurance recoverables, premiums and acquisition costs, valuation of financial instruments and goodwill and other intangible asset impairment valuation. For a detailed discussion of our critical accounting policies, please refer to our 2012 Form 10-K. There were no material changes in the application of our critical accounting estimates subsequent to that report.

**Table of Contents****Results of Operations**

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

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|----------|------------------------------------|------------|
|  | 2013                                | 2012     | 2013                               | 2012       |
|  | (\$ in millions)                    |          |                                    |            |
| <b>Revenues</b>                          |                                     |          |                                    |            |
| Gross premiums written                   | \$ 580.9                            | \$ 504.4 | \$ 2,183.2                         | \$ 1,832.2 |
| Net premiums written                     | \$ 453.1                            | \$ 391.5 | \$ 1,729.4                         | \$ 1,475.2 |
| Net premiums earned                      | \$ 510.8                            | \$ 441.0 | \$ 1,481.3                         | \$ 1,272.7 |
| Net investment income                    | 39.3                                | 39.1     | 110.3                              | 128.8      |
| Net realized investment gains (losses)   | 27.5                                | 149.8    | (8.1)                              | 292.0      |
|  | \$ 577.6                            | \$ 629.9 | \$ 1,583.5                         | \$ 1,693.5 |
| <b>Expenses</b>                          |                                     |          |                                    |            |
| Net losses and loss expenses             | \$ 277.0                            | \$ 258.9 | \$ 807.3                           | \$ 724.5   |
| Acquisition costs                        | 65.1                                | 51.1     | 186.4                              | 149.8      |
| General and administrative expenses      | 88.6                                | 78.6     | 251.8                              | 223.0      |
| Amortization of intangible assets        | 0.7                                 | 0.6      | 1.9                                | 1.9        |
| Interest expense                         | 14.1                                | 13.8     | 42.4                               | 41.6       |
| Foreign exchange loss (gain)             | 4.4                                 | 1.0      | 7.4                                | (0.1)      |
|  | \$ 449.9                            | \$ 404.0 | \$ 1,297.2                         | \$ 1,140.7 |
| Income before income taxes               | 127.7                               | 225.9    | 286.3                              | 552.8      |
| Income tax expense                       | 4.9                                 | 6.3      | 6.3                                | 18.6       |
| Net income                               | \$ 122.8                            | \$ 219.6 | \$ 280.0                           | \$ 534.2   |
| <b>Ratios</b>                            |                                     |          |                                    |            |
| Loss and loss expense ratio              | 54.2%                               | 58.7%    | 54.5%                              | 56.9%      |
| Acquisition cost ratio                   | 12.7%                               | 11.6%    | 12.6%                              | 11.8%      |
| General and administrative expense ratio | 17.3%                               | 17.8%    | 17.0%                              | 17.5%      |
| Expense ratio                            | 30.0%                               | 29.4%    | 29.6%                              | 29.3%      |
| Combined ratio                           | 84.2%                               | 88.1%    | 84.1%                              | 86.2%      |

**Comparison of Three Months Ended September 30, 2013 and 2012**

**Premiums**

Gross premiums written increased by \$76.5 million, or 15.2%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The overall increase in gross premiums written was primarily the result of the following:

**U.S. insurance:** Gross premiums written increased by \$45.6 million, or 17.3%. The increase in gross premiums written was primarily due to new business across existing lines that added \$102.9 million during the quarter combined with premium rate increases in all lines of business. The increase in new business for the quarter was primarily driven by our general casualty, programs, and inland marine lines of business. Our new lines of business, primary construction and surety, contributed a further \$8.1 million in new business;

**International insurance:** Gross premiums written increased by \$11.6 million, or 9.6%. The increase was primarily due to new business written of \$13.1 million in our new aviation line of business. Effective October 1, 2013, we acquired the renewal rights to a book of aviation business from Markel International that was written through Lloyd's Syndicate 1400 and Markel Europe plc. In conjunction with the renewal rights agreement, in August we assumed the unexpired inforce aviation business from Markel International, which resulted in gross premiums written of \$13.1 million this quarter. This business encompasses

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airlines, aerospace (primarily airports and aviation products) and general aviation classes. In addition, we had continued growth in our professional liability line of business, driven by the expansion of new initiatives. However, this growth was partially offset by \$7.1 million of non-recurring premiums in our trade credit line of business recorded in 2012; and

**Reinsurance:** Gross premiums written increased by \$19.3 million, or 16.1%. The increase was driven by new business in the specialty lines primarily written out of Asia and Latin America, combined with increased participations on renewing business and rate increases for certain lines of business.

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

|               | Three Months Ended<br>September 30, |          | Dollar<br>Change | Percentage<br>Change |
|---------------|-------------------------------------|----------|------------------|----------------------|
|               | 2013                                | 2012     |                  |                      |
|               | (\$ in millions)                    |          |                  |                      |
| United States | \$ 377.6                            | \$ 312.9 | \$ 64.7          | 20.7%                |
| Bermuda       | 111.1                               | 108.9    | 2.2              | 2.0%                 |
| Europe        | 51.9                                | 46.8     | 5.1              | 10.9%                |
| Singapore     | 35.5                                | 31.9     | 3.6              | 11.3%                |
| Hong Kong     | 4.8                                 | 3.9      | 0.9              | 23.1%                |
|               | \$ 580.9                            | \$ 504.4 | \$ 76.5          | 15.2%                |

Net premiums written increased by \$61.6 million, or 15.7%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase in net premiums written was due to the increase in gross premiums written. 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 22.0% of gross premiums written for the three months ended September 30, 2013 compared to 22.4% for the same period in 2012.

Net premiums earned increased by \$69.8 million, or 15.8%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012 as a result of higher net premiums written in 2012 and 2013.

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

|                | Gross Premiums Written<br>Three Months Ended<br>September 30, |       | Net Premiums Earned<br>Three Months Ended<br>September 30, |       |
|----------------|---|-------|--|-------|
|                | 2013  | 2012  | 2013   | 2012  |
| U.S. insurance | 53.1%   | 52.2% | 40.7%  | 39.5% |

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|                         |        |        |        |        |
|-------------------------|--------|--------|--------|--------|
| International insurance | 22.9%  | 24.0%  | 17.1%  | 19.3%  |
| Reinsurance             | 24.0%  | 23.8%  | 42.2%  | 41.2%  |
| Total                   | 100.0% | 100.0% | 100.0% | 100.0% |

***Net Investment Income***

Net investment income increased by \$0.2 million, or 0.5%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase was due to an increase in the distributed and undistributed earnings of our equity method investments that we invested in at the end of 2012, as well as higher income from our hedge fund and private equity investments. This increase was partially offset by lower net investment income for our fixed maturity investments as we increased the allocation of our investment portfolio to other invested assets that contribute to our total return but carry little or no current yield. The annualized period book yield of the investment portfolio for the three months ended September 30, 2013 and 2012 was 1.9% and 1.9%, respectively.

As of September 30, 2013, we held 10.3% of our total investments and cash equivalents in other invested assets compared to 6.4% as of September 30, 2012.

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Investment management expenses of \$4.1 million and \$3.7 million were incurred during the three months ended September 30, 2013 and 2012, respectively.

As of September 30, 2013, approximately 89.1% of our fixed income investments consisted of investment grade securities. As of September 30, 2013 and December 31, 2012, the average credit rating of our fixed income portfolio was AA- as rated by Standard & Poor's.

**Realized Investment Gains (Losses)**

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

|  | <b>Three Months Ended<br/>September 30,</b> |              |
|--|---|--------------|
|  | <b>2013</b>                                 | <b>2012</b>  |
|  | <b>(\$ in millions)</b>                     |              |
| Net realized gains (losses) on sale:                           |   |              |
| Fixed maturity investments, trading                            | \$ (4.8)                                    | \$ 12.9      |
| Equity securities, trading                                     | 13.9  | 7.5          |
| Other invested assets: hedge funds and private equity, trading | 2.1   | 0.2          |
| <b>Total net realized gains on sale</b>                        | <b>11.2</b>                                 | <b>20.6</b>  |
| Net realized and unrealized losses on derivatives              | (4.2)                                       | (1.0)        |
| Mark-to-market gains (losses):                                 |   |              |
| Fixed maturity investments, trading                            | 30.4  | 99.8         |
| Equity securities, trading                                     | (17.2)                                      | 18.9         |
| Other invested assets: hedge funds and private equity, trading | 7.3   | 11.5         |
| <b>Total mark-to-market gains</b>                              | <b>20.5</b>                                 | <b>130.2</b> |
| Net realized investment gains                                  | \$ 27.5                                     | \$ 149.8     |

The total return of our investment portfolio was 0.8% and 2.2% for the three months ended September 30, 2013 and 2012, respectively. The decrease in total return is primarily due to lower mark-to-market gains on our fixed maturity, mark-to-market losses on our equity securities and lower realized gains from the sale of investments. The lower mark-to-market gains on our fixed maturity securities were caused by modest increases in interest rates on our fixed income portfolio during the three months ended September 30, 2013 compared to the same period in 2012. The rising interest rate environment also negatively impacted our dividend focused equity portfolio, which underperformed the S&P 500 for the quarter.

**Net Losses and Loss Expenses**

Net losses and loss expenses increased by \$18.1 million, or 7.0%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The loss and loss expense ratio decreased by 4.5 percentage

points for the same period. The increase in net loss and loss expenses was due to growth in net premiums earned, partially offset by higher net favorable prior year reserve development in 2013.

Excluding the prior year reserve development, the loss and loss expense ratios would have been 66.2% and 71.4% for the three months ended September 30, 2013 and 2012, respectively. The decrease in the loss and loss expense ratio of 5.2 points was primarily due to fewer current year reported large losses in the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The reported large losses were \$25.2 million for the three months ended September 30, 2013 compared to \$53.7 million for the same period in 2012. The reported large losses in the three months ended September 30, 2012 included approximately \$40.0 million of crop reinsurance-related losses and loss expenses related to drought conditions across much of the United States and \$5.0 million for Hurricane Isaac.

We classify catastrophe losses as those losses that result from a major singular event or series of similar events (such as tornadoes) which are assigned a catastrophe loss number by industry data services, where our consolidated losses are expected to be at least \$10 million per loss event or series of similar events and where we believe it is important to our investors' understanding of our operations.

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|                                 | Three Months Ended<br>September 30, 2013 |              | Three Months Ended<br>September 30, 2012 |              | Dollar<br>Change | Change in<br>Percentage<br>Points |
|---------------------------------|--|--------------|--|--------------|------------------|-----------------------------------|
|                                 | Amount                                   | % of NPE (1) | Amount                                   | % of NPE (1) |                  |                                   |
|                                 | (\$ in millions)                         |              |  |              |                  |                                   |
| Non-catastrophe                 | \$ 338.4                                 | 66.2%        | \$ 310.1                                 | 70.3%        | \$ 28.3          | (4.1)Pts                          |
| Property<br>catastrophe         |  |              | 5.0                                      | 1.1          | (5.0)            | (1.1)                             |
| Current period                  | 338.4                                    | 66.2         | 315.1                                    | 71.4         | 23.3             | (5.2)                             |
| Prior period                    | (61.4)                                   | (12.0)       | (56.2)                                   | (12.7)       | (5.2)            | 0.7                               |
| Net losses and<br>loss expenses | \$ 277.0                                 | 54.2%        | \$ 258.9                                 | 58.7%        | \$ 18.1          | (4.5)Pts                          |

(1) NPE means net premiums earned.

We recorded net favorable reserve development related to prior years of \$61.4 million during the three months ended September 30, 2013 compared to net favorable reserve development of \$56.2 million for the three months ended September 30, 2012, as shown in the tables below.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Three Months Ended September 30, 2013**

|                            | 2003 and<br>Prior | 2004     | 2005     | 2006      | 2007      | 2008     | 2009      | 2010      | 2011     | 2012    | Total     |
|----------------------------|-------------------|----------|----------|-----------|-----------|----------|-----------|-----------|----------|---------|-----------|
|                            | (\$ in millions)  |          |          |           |           |          |           |           |          |         |           |
| U.S.<br>insurance          | \$ (3.0)          | \$ (0.6) | \$ (1.1) | \$ (6.1)  | \$ (5.5)  | \$ (2.9) | \$ (3.5)  | \$ (4.8)  | \$ 13.2  | \$ 18.1 | \$ 3.8    |
| International<br>insurance | 0.2               | (1.2)    | 3.2      | (4.0)     | (8.6)     | (4.7)    | (5.9)     | (4.1)     | (2.1)    | (2.5)   | (29.7)    |
| Reinsurance                | (1.6)             | (2.4)    | 1.5      |           | 0.2       | (2.1)    | (2.0)     | (2.6)     | (12.1)   | (14.4)  | (35.5)    |
|                            | \$ (4.4)          | \$ (4.2) | \$ 3.6   | \$ (10.1) | \$ (13.9) | \$ (9.7) | \$ (11.4) | \$ (11.5) | \$ (1.0) | \$ 1.2  | \$ (61.4) |

The unfavorable reserve development for the 2011 loss year for our U.S. insurance segment was primarily due to adverse development on reported claims in our healthcare and errors and omissions ( E&O ) products. The unfavorable reserve development for the 2012 loss year for our U.S. insurance segment was primarily due to adverse development on reported claims in our healthcare, private/not for profit directors and officers ( D&O ) and lawyers E&O. In response to the underwriting experience in these lines, we continue to take rate action, as well as make changes to policy terms and conditions, resulting in flat or reduced gross premiums written but reduced exposures.

The additions to the 2011 and 2012 loss years noted above are consistent with our practice of addressing unfavorable loss emergence early in our long-tail lines of business. We tend to recognize favorable loss emergence more slowly in our long-tail lines once actual loss emergence and data provides greater confidence around the adequacy of ultimate



estimates.

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

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The following table shows the net favorable reserve development by loss year for each of our segments for the three months ended September 30, 2012.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Three Months Ended September 30, 2012**

|                            | <b>2003 and<br/>Prior</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>Total</b> |
|----------------------------|---------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
|                            | <b>(\$ in millions)</b>   |             |             |             |             |             |             |             |             |              |
| U.S.<br>insurance          | \$ 0.1                    | \$          | \$ (1.7)    | \$ (7.1)    | \$ (6.0)    | \$ (2.7)    | \$ 1.7      | \$ 4.4      | \$ 3.1      | \$ (8.2)     |
| International<br>insurance | (1.0)                     | (2.7)       | 9.9         | (15.5)      | (12.7)      | (8.9)       | (1.9)       | (0.8)       | (5.4)       | (39.0)       |
| Reinsurance                | (1.0)                     | (0.2)       | 2.8         | (1.7)       | (6.7)       | (2.4)       | (0.8)       | 7.5         | (6.5)       | (9.0)        |
|                            | \$ (1.9)                  | \$ (2.9)    | \$ 11.0     | \$ (24.3)   | \$ (25.4)   | \$ (14.0)   | \$ (1.0)    | \$ 11.1     | \$ (8.8)    | \$ (56.2)    |

The unfavorable reserve development in our U.S. insurance segment for loss years 2009 to 2011 was primarily due to adverse development on a program that commenced writing in 2008 and was terminated during 2011. The unfavorable reserve development in our international insurance segment for the 2005 loss year was primarily due to two product liability claims within our general casualty line of business. The unfavorable reserve development in our reinsurance segment for the 2010 loss year was primarily due to adverse emergence on certain classes of U.S. casualty business.

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

|                                      | <b>Three Months Ended<br/>September 30,</b> |             | <b>Dollar<br/>Change</b> |
|--------------------------------------|---|-------------|--------------------------|
|                                      | <b>2013</b>                                 | <b>2012</b> |                          |
|                                      | <b>(\$ in millions)</b>                     |             |                          |
| Net losses paid                      | \$ 243.7                                    | \$ 195.8    | \$ 47.9                  |
| Net change in reported case reserves | (15.7)                                      | 4.9         | (20.6)                   |
| Net change in IBNR                   | 49.0  | 58.2        | (9.2)                    |
| Net losses and loss expenses         | \$ 277.0                                    | \$ 258.9    | \$ 18.1                  |

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

**Three Months Ended**

|  | <b>September 30,</b>    |             |
|--|-------------------------|-------------|
|  | <b>2013</b>             | <b>2012</b> |
|  | <b>(\$ in millions)</b> |             |
| Net reserves for losses and loss expenses, July 1      | \$ 4,517.3              | \$ 4,303.9  |
| Incurred related to:                                   |                         |             |
| Current period non-catastrophe                         | 338.4                   | 310.1       |
| Current period property catastrophe                    |                         | 5.0         |
| Prior period   | (61.4)                  | (56.2)      |
| Total incurred   | 277.0                   | 258.9       |
| Paid related to:                                       |                         |             |
| Current period non-catastrophe                         | 30.5                    | 16.3        |
| Prior period   | 213.2                   | 179.5       |
| Total paid   | 243.7                   | 195.8       |
| Foreign exchange revaluation                           | 4.1                     | 6.3         |
| Net reserve for losses and loss expenses, September 30 | 4,554.7                 | 4,373.3     |
| Losses and loss expenses recoverable                   | 1,226.1                 | 1,077.5     |
| Reserve for losses and loss expenses, September 30     | \$ 5,780.8              | \$ 5,450.8  |

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### ***Acquisition Costs***

Acquisition costs increased by \$14.0 million, or 27.4%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase in acquisition costs was consistent with the growth in premiums, as well as higher profit commission accruals during the current quarter as compared to the same period last year. Acquisition costs as a percentage of net premiums earned were 12.7% for the three months ended September 30, 2013 compared to 11.6% for the same period in 2012. The increase in the acquisition cost ratio is driven by the increased profit commission accruals in our U.S. insurance and reinsurance segments, as well as the impact of the retrocessional reinsurance catastrophe cover in our reinsurance segment put in place in the current year. The retrocessional reinsurance catastrophe cover reduced net premiums earned but did not have any offsetting ceding commission income, and therefore resulted in an increase to the acquisition cost ratio.

### ***General and Administrative Expenses***

General and administrative expenses increased by \$10.0 million, or 12.7%, for the three months ended September 30, 2013 compared to the same period in 2012. Our general and administrative expense ratio was 17.3% and 17.8% for the three months ended September 30, 2013 and 2012, respectively. The increase in general and administrative expenses was primarily due to increased salary and related costs as average headcount increased by 15% to support our continued growth as well as higher stock-based compensation expense. We have granted cash equivalent restricted stock units and performance-based equity awards to certain key employees, and we measure the value of each award at the period ending share price. Changes in our share price are recognized as increases or decreases in our compensation expense ratably over the service period. Our share price increased 9% for the three months ended September 30, 2013, compared to a 3% decrease for the same period in 2012. We also increased stock-based compensation expense for our performance-based compensation as profitability is expected to exceed targeted levels.

### ***Amortization of Intangible Assets***

The amortization of intangible assets was unchanged for the three months ended September 30, 2013 compared to the three months ended September 30, 2012.

### ***Interest Expense***

Interest expense increased by \$0.3 million, or 2.2%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012.

### ***Net Income***

Net income for the three months ended September 30, 2013 was \$122.8 million compared to net income of \$219.6 million for the three months ended September 30, 2012. The \$96.8 million decrease was primarily the result of the \$122.3 million decrease in realized investment gains for the three months ended September 30, 2013 compared to the same period in 2012. This was partially offset by an increase in underwriting income of \$27.7 million. Income tax expense for the three months ended September 30, 2013 decreased by \$1.4 million, or 20.0%, compared to the three months ended September 30, 2012. The decrease in income tax expense is due to lower taxable income in our U.S. operations.

## **Comparison of Nine Months Ended September 30, 2013 and 2012**

### ***Premiums***

Gross premiums written increased by \$351.0 million, or 19.2%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The overall increase in gross premiums written was primarily the result of the following:

**U.S. insurance:** Gross premiums written increased by \$138.7 million, or 18.9%. The increase in gross premiums written was primarily due to new business across existing lines that added \$296.8 million, combined with premium rate increases in all lines of business. Growth from new lines of business introduced in 2013, such as primary construction and surety, contributed a further \$8.2 million for the period;

**International insurance:** Gross premiums written increased by \$35.5 million, or 8.5%, primarily as a result of increased premiums from new initiatives, such as retail property and small- to medium-sized enterprise ( SME ) insurance products, and our expansion into aviation during the third quarter. This was combined with growth in existing lines of business, such as healthcare and professional liability, and premium rate increases in select lines of business; and

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**Reinsurance:** Gross premiums written increased by \$176.8 million, or 26.0%. The increase in gross premiums written was primarily due to new business in the specialty lines primarily written out of Asia and Latin America, as well as increased participations on renewing business combined with premium rate increases. The table below illustrates our gross premiums written by underwriter location for each of the periods indicated.

|               | Nine Months Ended<br>September 30, |            | Dollar<br>Change | Percentage<br>Change |
|---------------|------------------------------------|------------|------------------|----------------------|
|               | 2013                               | 2012       |                  |                      |
|               | (\$ in millions)                   |            |                  |                      |
| United States | \$ 1,296.2                         | \$ 1,051.4 | \$ 244.8         | 23.3%                |
| Bermuda       | 550.8                              | 484.3      | 66.5             | 13.7%                |
| Europe        | 198.7                              | 182.2      | 16.5             | 9.1%                 |
| Singapore     | 122.5                              | 101.2      | 21.3             | 21.0%                |
| Hong Kong     | 15.0                               | 13.1       | 1.9              | 14.5%                |
|               | \$ 2,183.2                         | \$ 1,832.2 | \$ 351.0         | 19.2%                |

Net premiums written increased by \$254.2 million, or 17.2%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase in net premiums written was due to the increase in gross premiums written. 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 nine months ended September 30, 2013 compared to 19.5% for the same period in 2012. The increase was primarily due to our purchase of a new collateralized retrocessional catastrophe cover in our reinsurance segment and a new property catastrophe coverage for U.S. insurance and international insurance segments. Both of these reinsurance coverages increased the ceded percentage by 1.4 percentage points.

Net premiums earned increased by \$208.6 million, or 16.4%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 as a result of higher net premiums written in 2012 and 2013.

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

|                         | Gross Premiums Written<br>Nine Months Ended<br>September 30, |        | Net Premiums Earned<br>Nine Months Ended<br>September 30, |        |
|-------------------------|--|--------|---|--------|
|                         | 2013   | 2012   | 2013  | 2012   |
| U.S. insurance          | 39.9%  | 40.1%  | 40.0%   | 38.5%  |
| International insurance | 20.8%  | 22.8%  | 17.5%   | 19.5%  |
| Reinsurance             | 39.3%  | 37.1%  | 42.5%   | 42.0%  |
| Total                   | 100.0%   | 100.0% | 100.0%  | 100.0% |

***Net Investment Income***

Net investment income decreased by \$18.5 million, or 14.4%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The decrease was due to lower net investment income on our fixed maturity investments as we have increased the allocation of our investment portfolio to other invested assets, which contribute to our total return but carry little or no current yield. This was partially offset by the distributed and undistributed earnings of the equity method investments that we invested in at the end of 2012, as well as higher net investment income from our hedge fund and private equity investments. The annualized period book yield of the investment portfolio for the nine months ended September 30, 2013 and 2012 was 1.8% and 2.1%, respectively.

Investment management expenses of \$12.2 million and \$12.0 million were incurred during the nine months ended September 30, 2013 and 2012, respectively.

**Table of Contents****Realized Investment Gains (Losses)**

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

|  | <b>Nine Months Ended<br/>September 30,</b> |              |
|--|--|--------------|
|  | <b>2013</b>                                | <b>2012</b>  |
|  | (\$ in millions)                           |              |
| Net realized gains (losses) on sale:                           |  |              |
| Fixed maturity investments, trading                            | \$ 24.7                                    | \$ 77.4      |
| Equity securities, trading                                     | 30.1                                       | 6.5          |
| Other invested assets: hedge funds and private equity, trading | 16.8                                       | (8.1)        |
| <b>Total net realized gains on sale</b>                        | <b>71.6</b>                                | <b>75.8</b>  |
| Net realized and unrealized gains (losses) on derivatives      | 3.4  | (0.2)        |
| Mark-to-market gains (losses):                                 |  |              |
| Fixed maturity investments, trading                            | (101.2)                                    | 144.0        |
| Equity securities, trading                                     | (18.6)                                     | 38.5         |
| Other invested assets: hedge funds and private equity, trading | 36.7                                       | 33.9         |
| <b>Total mark-to-market gains</b>                              | <b>(83.1)</b>                              | <b>216.4</b> |
| Net realized investment (losses) gains                         | \$ (8.1)                                   | \$ 292.0     |

The total return of our investment portfolio was 1.2% and 4.9% for the nine months ended September 30, 2013 and 2012, respectively. The decrease in total return is primarily due to mark-to-market losses on our fixed maturity investments and equity securities. The mark-to-market losses on our fixed maturity investments were caused by higher interest rates combined with widening credit spreads on our fixed income portfolio. During the period, the yield on the 10-year U.S. treasury increased by 78 basis points, which contributed to the higher interest rates. The rising interest rate environment also negatively impacted our dividend focused equity portfolio, which underperformed the S&P 500 for the period.

**Net Losses and Loss Expenses**

Net losses and loss expenses increased by \$82.8 million, or 11.4%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The loss and loss expense ratio decreased by 2.4 percentage points for the same period. The increase in net loss and loss expenses was due to the growth in net premiums earned, partially offset by higher net favorable prior year reserve development.

Excluding the prior year reserve development, the loss and loss expense ratios would have been 64.9% and 67.7% for the nine months ended September 30, 2013 and 2012, respectively. The decrease in the loss and loss expense ratio of 2.8 points was primarily due to fewer reported current year severe losses in the nine months ended September 30, 2013 compared to the same period in 2012.



|                                 | Nine Months Ended<br>September 30, 2013 |          | Nine Months Ended<br>September 30, 2012 |          | Dollar<br>Change | Change in<br>Percentage<br>Points |
|---------------------------------|---|----------|---|----------|------------------|-----------------------------------|
|                                 | Amount                                  | % of NPE | Amount<br>(\$ in millions)              | % of NPE |                  |                                   |
| Non-catastrophe                 | \$ 961.2                                | 64.9%    | \$ 857.1                                | 67.3%    | \$ 104.1         | (2.4)Pts                          |
| Property<br>catastrophe         |   |          | 5.0                                     | 0.4      | (5.0)            | (0.4)                             |
| Current period                  | 961.2                                   | 64.9     | 862.1                                   | 67.7     | 99.1             | (2.8)                             |
| Prior period                    | (153.9)                                 | (10.4)   | (137.6)                                 | (10.8)   | (16.3)           | 0.4                               |
| Net losses and<br>loss expenses | \$ 807.3                                | 54.5%    | \$ 724.5                                | 56.9%    | \$ 82.8          | (2.4)Pts                          |

We recorded net favorable reserve development related to prior years of \$153.9 million during the nine months ended September 30, 2013 compared to net favorable reserve development of \$137.6 million for the nine months ended September 30, 2012, as shown in the tables below.

**Table of Contents****(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Nine Months Ended September 30, 2013**

|                         | 2003 and<br>Prior | 2004      | 2005     | 2006      | 2007      | 2008      | 2009      | 2010      | 2011    | 2012    |    |
|-------------------------|-------------------|-----------|----------|-----------|-----------|-----------|-----------|-----------|---------|---------|----|
|                         | (\$ in millions)  |           |          |           |           |           |           |           |         |         |    |
| U.S. Insurance          | \$ (3.1)          | \$ (2.7)  | \$ (4.6) | \$ (7.2)  | \$ (18.5) | \$ (17.1) | \$ (6.5)  | \$ (12.1) | \$ 30.9 | \$ 52.3 | \$ |
| International Insurance | 6.1               | (4.1)     | (1.1)    | (14.9)    | (18.9)    | (14.6)    | (6.5)     | (9.6)     | (11.8)  | (9.7)   |    |
| Reinsurance             | (1.4)             | (3.8)     | (1.6)    | 1.1       | (2.0)     | (9.0)     | (1.6)     | (4.7)     | (15.0)  | (42.2)  |    |
|                         | \$ 1.6            | \$ (10.6) | \$ (7.3) | \$ (21.0) | \$ (39.4) | \$ (40.7) | \$ (14.6) | \$ (26.4) | \$ 4.1  | \$ 0.4  | \$ |

The unfavorable reserve development for the 2011 and 2012 loss years for our U.S. insurance segment was due to higher than expected loss emergence, primarily in our private/not for profit D&O, healthcare and E&O products. The healthcare emergence was largely driven by three severe claims, as well as higher than expected loss emergence on reported claims. The emergence in the E&O and private/not for profit D&O is due to higher than expected loss frequency, as well as higher than expected loss emergence on reported claims. In response to the underwriting experience in these lines, we continue to take rate action, as well as make changes to policy terms and conditions, resulting in flat or reduced gross premiums written but reduced exposures.

The additions to the 2011 and 2012 loss years noted above are consistent with our practice of addressing unfavorable loss emergence early in our long-tail lines of business. We tend to recognize favorable loss emergence more slowly in our long-tail lines once actual loss emergence and data provides greater confidence around the adequacy of ultimate estimates.

The favorable reserve development for our reinsurance segment was due to lower than expected reported losses in our property reinsurance line of business, including favorable loss reserve development related to recent catastrophic events that occurred in 2010 through 2012.

The following table shows the net favorable reserve development by loss year for each of our segments for the nine months ended September 30, 2012.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Nine Months Ended September 30, 2012**

|                         | 2003 and<br>Prior | 2004     | 2005     | 2006      | 2007      | 2008     | 2009     | 2010    | 2011    | Total     |
|-------------------------|-------------------|----------|----------|-----------|-----------|----------|----------|---------|---------|-----------|
|                         | (\$ in millions)  |          |          |           |           |          |          |         |         |           |
| U.S. Insurance          | \$                | \$ (1.2) | \$ (5.5) | \$ (17.5) | \$ (24.4) | \$ (1.6) | \$ (3.6) | \$ 13.7 | \$ 18.5 | \$ (21.6) |
| International Insurance | 2.3               | (8.5)    | (0.6)    | (43.8)    | (30.1)    | (14.3)   | (3.7)    | (7.4)   | 17.7    | (88.4)    |
| Reinsurance             | (0.2)             | (1.0)    | (4.8)    | (8.7)     | (18.2)    | (4.0)    | 1.1      | 6.2     | 2.0     | (27.6)    |

\$ 2.1 \$ (10.7) \$ (10.9) \$ (70.0) \$ (72.7) \$ (19.9) \$ (6.2) \$ 12.5 \$ 38.2 \$ (137.6)

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 2010 and 2011 loss years was primarily due to adverse development on a program that commenced writing in 2008 and was terminated during 2011. We also experienced adverse development for the 2011 loss year for certain E&O products. The unfavorable reserve development in our international insurance segment for loss year 2011 was due to adverse development on an individual claim, estimated to reach our full limit of \$20.0 million, net of reinsurance.

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

|                                      | <b>Nine Months Ended</b> |                               | <b>Dollar</b> |
|--------------------------------------|--------------------------|-------------------------------|---------------|
|                                      | <b>2013</b>              | <b>September 30,<br/>2012</b> |               |
|                                      | (\$ in millions)         |                               |               |
| Net losses paid                      | \$ 751.2                 | \$ 578.1                      | \$ 173.1      |
| Net change in reported case reserves | (24.9)                   | 51.9                          | (76.8)        |
| Net change in IBNR                   | 81.0                     | 94.5                          | (13.5)        |
| Net losses and loss expenses         | \$ 807.3                 | \$ 724.5                      | \$ 82.8       |

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>Nine Months Ended</b> |                               |
|--|--------------------------|-------------------------------|
|  | <b>2013</b>              | <b>September 30,<br/>2012</b> |
|  | (\$ in millions)         |                               |
| Net reserves for losses and loss expenses, January 1   | \$ 4,504.4               | \$ 4,222.2                    |
| Incurred related to:                                   |                          |                               |
| Current period non-catastrophe                         | 961.2                    | 857.1                         |
| Current period property catastrophe                    |                          | 5.0                           |
| Prior period   | (153.9)                  | (137.6)                       |
| Total incurred   | 807.3                    | 724.5                         |
| Paid related to:                                       |                          |                               |
| Current period non-catastrophe                         | 55.0                     | 36.1                          |
| Prior period   | 696.2                    | 542.0                         |
| Total paid   | 751.2                    | 578.1                         |
| Foreign exchange revaluation                           | (5.8)                    | 4.7                           |
| Net reserve for losses and loss expenses, September 30 | 4,554.7                  | 4,373.3                       |
| Losses and loss expenses recoverable                   | 1,226.1                  | 1,077.5                       |
| Reserve for losses and loss expenses, September 30     | \$ 5,780.8               | \$ 5,450.8                    |

**Acquisition Costs**

Acquisition costs increased by \$36.6 million, or 24.4%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase in acquisition costs was consistent with the growth in premiums. Acquisition costs as a percentage of net premiums earned were 12.6% for the nine months ended September 30, 2013 compared to 11.8% for the same period in 2012. The increase in the acquisition cost ratio is driven by the increased profit commission accruals in our U.S. insurance and reinsurance segments, as well as the impact of the retrocessional reinsurance catastrophe cover in our reinsurance segment put in place in the current year. The retrocessional reinsurance catastrophe cover reduced net premiums earned but did not have any offsetting ceding commission income, and therefore resulted in an increase to the acquisition cost ratio.

***General and Administrative Expenses***

General and administrative expenses increased by \$28.8 million, or 12.9%, for the nine months ended September 30, 2013 compared to the same period in September 30, 2012. The increase in general and administrative expenses was primarily due to increased salary and related costs as average headcount increased by 15% during the nine months ended September 30, 2013 compared to the same period in 2012 as well as higher stock-based compensation expense. Our share price increased 26% for the nine months ended September 30, 2013, compared to a 23% increase for the same period in 2012. We also increased stock-based compensation expense for our performance-based compensation as profitability is expected to exceed targeted levels.

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Our general and administrative expense ratio was 17.0% for the nine months ended September 30, 2013 compared to 17.5% for the nine months ended September 30, 2012. The decrease was due to the growth in net premiums earned being greater than the increase in expenses.

### ***Amortization of Intangible Assets***

The amortization of intangible assets was unchanged for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012.

### ***Interest Expense***

Interest expense increased by \$0.8 million, or 1.9%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012.

### ***Net Income***

Net income for the nine months ended September 30, 2013 was \$280.0 million compared to \$534.2 million for the nine months ended September 30, 2012. The \$254.2 million decrease was primarily the result of the \$300.1 million decrease in realized investment gains for the nine months ended September 30, 2013 compared to the same period in 2012, partially offset by the \$60.4 million increase in underwriting income. Income tax expense for the nine months ended September 30, 2013 decreased by \$12.3 million, or 66.1%, compared to the nine months ended September 30, 2012. The decrease in income tax expense is due to lower taxable income in our U.S. operations.

## **Underwriting Results by Operating Segments**

Our company is organized into three operating segments:

*U.S. Insurance Segment.* The U.S. insurance segment includes our direct specialty insurance operations in the United States. 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 from our Bermuda office and direct property and specialty casualty to our non-North American domiciled accounts from our European, Singapore and Hong Kong offices.

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

**Table of Contents****U.S. Insurance Segment**

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

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2013</b>                                 | <b>2012</b> | <b>2013</b>                                | <b>2012</b> |
|  | (\$ in millions)                            |             |  |             |
| <b>Revenues</b>                          |   |             |  |             |
| Gross premiums written                   | \$ 308.7                                    | \$ 263.1    | \$ 872.0                                   | \$ 733.3    |
| Net premiums written                     | 238.8                                       | 200.8       | 652.5                                      | 551.3       |
| Net premiums earned                      | 207.6                                       | 174.0       | 593.5                                      | 490.1       |
| <b>Expenses</b>                          |   |             |  |             |
| Net losses and loss expenses             | \$ 141.2                                    | \$ 109.1    | \$ 398.9                                   | \$ 309.9    |
| Acquisition costs                        | 28.4  | 22.7        | 78.8                                       | 63.9        |
| General and administrative expenses      | 41.7  | 37.4        | 119.5                                      | 103.2       |
| Underwriting (loss) income               | (3.7)                                       | 4.8         | (3.7)                                      | 13.1        |
| <b>Ratios</b>                            |   |             |  |             |
| Loss and loss expense ratio              | 68.0%                                       | 62.7%       | 67.2%                                      | 63.2%       |
| Acquisition cost ratio                   | 13.7%                                       | 13.0%       | 13.3%                                      | 13.0%       |
| General and administrative expense ratio | 20.0%                                       | 21.5%       | 20.1%                                      | 21.0%       |
| Expense ratio                            | 33.7%                                       | 34.5%       | 33.4%                                      | 34.0%       |
| Combined ratio                           | 101.7%                                      | 97.2%       | 100.6%                                     | 97.2%       |

**Comparison of Three Months Ended September 30, 2013 and 2012**

*Premiums.* Gross premiums written increased by \$45.6 million, or 17.3%, for the three months ended September 30, 2013 compared to the same period in 2012. The increase in gross premiums written was primarily due to new business across existing lines that added \$102.9 million during the quarter combined with premium rate increases in all lines of business. The increase in new business for the quarter was primarily driven by our general casualty, programs, and inland marine lines of business. Our new lines of business, primary construction and surety, contributed a further \$8.1 million in new business.

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

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Dollar<br/>Change</b> | <b>Percentage<br/>Change</b> |
|--|---|-------------|--------------------------|------------------------------|
|  | <b>2013</b>                                 | <b>2012</b> |                          |                              |
|  | (\$ in millions)                            |             |                          |                              |

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|                        |    |       |    |       |    |       |         |
|------------------------|----|-------|----|-------|----|-------|---------|
| General casualty       | \$ | 107.2 | \$ | 77.9  | \$ | 29.3  | 37.6%   |
| Professional liability |    | 66.2  |    | 66.4  |    | (0.2) | (0.3%)  |
| Healthcare             |    | 43.4  |    | 52.3  |    | (8.9) | (17.0%) |
| Programs               |    | 41.1  |    | 32.2  |    | 8.9   | 27.6%   |
| General property       |    | 18.7  |    | 15.7  |    | 3.0   | 19.1%   |
| Other*                 |    | 32.1  |    | 18.6  |    | 13.5  | 72.6%   |
|                        | \$ | 308.7 | \$ | 263.1 | \$ | 45.6  | 17.3%   |

\* Includes our inland marine, environmental, primary construction, mergers and acquisitions and surety lines of business

Net premiums written increased by \$38.0 million, or 18.9%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase in net premiums written was primarily due to higher gross premiums written. We ceded 22.6% of gross premiums written for the three months ended September 30, 2013 compared to 23.7% for the same period in 2012.



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Net premiums earned increased by \$33.6 million, or 19.3%, for the three months ended September 30, 2013 compared to the same period in 2012. The increase was primarily due to the growth of our U.S. insurance operations during 2012 and 2013.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$32.1 million, or 29.4%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The loss and loss expense ratio increased by 5.3 percentage points for the same period. The increase in net losses and loss expenses was mostly due to growth in the U.S. insurance segment, combined with unfavorable prior year reserve development in the three months ended September 30, 2013 compared to favorable prior year reserve development in the three months ended September 30, 2012.

Excluding the prior year reserve development, the loss and loss expense ratios would have been 66.2% and 67.4% for the three months ended September 30, 2013 and 2012, respectively. The decrease in the loss and loss expense ratio of 1.2 points was due to the absence of any reported significant losses in the three months ended September 30, 2013 compared to the three months ended September 30, 2012, which had recorded significant losses of \$6.5 million, which included a loss from Hurricane Isaac of \$1.7 million.

|                                 | Three Months Ended<br>September 30, 2013 |          | Three Months Ended<br>September 30, 2012 |          | Dollar<br>Change | Change in<br>Percentage<br>Points |
|---------------------------------|--|----------|--|----------|------------------|-----------------------------------|
|                                 | Amount                                   | % of NPE | Amount                                   | % of NPE |                  |                                   |
|                                 | (\$ in millions)                         |          |  |          |                  |                                   |
| Non-catastrophe                 | \$ 137.4                                 | 66.2%    | \$ 115.6                                 | 66.4%    | \$ 21.8          | (0.2)Pts                          |
| Property<br>catastrophe         |  |          | 1.7                                      | 1.0      | (1.7)            | (1.0)                             |
| Current period                  | 137.4                                    | 66.2     | 117.3                                    | 67.4     | 20.1             | (1.2)                             |
| Prior period                    | 3.8                                      | 1.8      | (8.2)                                    | (4.7)    | 12.0             | 6.5                               |
| Net losses and<br>loss expenses | \$ 141.2                                 | 68.0%    | \$ 109.1                                 | 62.7%    | \$ 32.1          | 5.3Pts                            |

Overall, our U.S. insurance segment recorded net unfavorable reserve development of \$3.8 million during the three months ended September 30, 2013 compared to net favorable reserve development of \$8.2 million for the three months ended September 30, 2012, as shown in the tables below.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Three Months Ended September 30, 2013**

|                     | 2003 and<br>Prior | 2004 | 2005 | 2006 | 2007     | 2008 | 2009     | 2010 | 2011   | 2012   | Total    |
|---------------------|-------------------|------|------|------|----------|------|----------|------|--------|--------|----------|
|                     | (\$ in millions)  |      |      |      |          |      |          |      |        |        |          |
| General<br>casualty | \$                | \$   | \$   | \$   | \$ (4.6) | \$   | \$ (0.3) | \$   | \$ 0.6 | \$ 3.0 | \$ (1.3) |

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|                        |          |          |          |          |          |          |          |          |         |         |        |
|------------------------|----------|----------|----------|----------|----------|----------|----------|----------|---------|---------|--------|
| Programs               |          |          |          | (0.2)    | (1.7)    | (1.2)    | (1.4)    | 0.5      | 0.5     | (3.5)   |        |
| General property       |          | 0.6      | (0.2)    | 3.2      |          |          | 0.2      | (0.2)    | (1.0)   | 2.6     |        |
| Healthcare             | (3.0)    | (0.8)    | 0.2      |          | (2.1)    | (2.3)    |          | 10.1     | 5.1     | 7.2     |        |
| Professional liability |          | (0.4)    | (1.1)    | (9.3)    | (0.7)    | 0.9      | 0.3      | (3.6)    | 2.4     | 10.5    |        |
| Other                  |          |          |          |          |          |          |          | (0.2)    |         | (0.2)   |        |
|                        | \$ (3.0) | \$ (0.6) | \$ (1.1) | \$ (6.1) | \$ (5.5) | \$ (2.9) | \$ (3.5) | \$ (4.8) | \$ 13.2 | \$ 18.1 | \$ 3.8 |

The unfavorable reserve development for the 2011 loss year was primarily due to adverse development on reported claims in our healthcare and E&O products. The unfavorable reserve development for the 2012 loss year was primarily due to adverse development on reported claims in our healthcare, private/not for profit D&O and lawyers E&O. In response to the underwriting experience in these lines, we continue to take rate action, as well as make changes to policy terms and conditions, resulting in flat or reduced gross premiums written but reduced exposures. We also recorded unfavorable loss reserve development in our general property line of business for the 2006 loss year due to adverse development on an individual claim.

The additions to the 2011 and 2012 loss years noted above are consistent with our practice of addressing unfavorable loss emergence early in our long-tail lines of business. We tend to recognize favorable loss emergence more slowly in our long-tail lines once actual loss emergence and data provides greater confidence around the adequacy of ultimate estimates.

**Table of Contents****(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Three Months Ended September 30, 2012**

|                           | 2003 and<br>Prior | 2004     | 2005     | 2006     | 2007     | 2008     | 2009     | 2010   | 2011   | Total    |
|---------------------------|-------------------|----------|----------|----------|----------|----------|----------|--------|--------|----------|
|                           | (\$ in millions)  |          |          |          |          |          |          |        |        |          |
| General casualty Programs | \$ (0.3)          | \$ (0.6) | \$ (0.2) | \$ (3.9) | \$ (0.2) | \$ (1.4) | \$ (0.2) | \$     | \$     | \$ (6.8) |
|                           |                   |          |          | (0.7)    | (0.9)    | 0.6      | 3.5      | 6.5    | 4.3    | 13.3     |
| General property          |                   | 0.3      |          | (0.1)    |          |          |          | (0.1)  | (0.1)  |          |
| Healthcare                | 1.4               | 1.7      | (0.7)    | (1.5)    | (1.6)    | (0.8)    | (0.1)    | (0.4)  | (0.7)  | (2.7)    |
| Professional liability    | (1.0)             | (1.4)    | (0.8)    | (0.9)    | (3.3)    | (1.1)    | (1.5)    | (1.6)  | (0.4)  | (12.0)   |
| Other                     |                   |          |          |          |          |          |          |        |        |          |
|                           | \$ 0.1            | \$       | \$ (1.7) | \$ (7.1) | \$ (6.0) | \$ (2.7) | \$ 1.7   | \$ 4.4 | \$ 3.1 | \$ (8.2) |

The unfavorable reserve development for loss years 2009 to 2011 was due to continued adverse development on a program that commenced writing in 2008 and was terminated during 2011. This program continues to experience unfavorable loss emergence and during the quarter we performed a detailed review of all open claims as part of our reserve review. This was partially offset by favorable development on our active programs.

*Acquisition costs.* Acquisition costs increased by \$5.7 million, or 25.1%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase was driven by the growth in premiums and increased profit commission accruals in our program line of business. The acquisition cost ratio was 13.7% and 13.0% for the three months ended September 30, 2013 and 2012, respectively, due to the increased profit commission accruals.

*General and administrative expenses.* General and administrative expenses increased by \$4.3 million, or 11.5%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase was due to the continued growth of the U.S. insurance operations as we continue to increase our headcount, as well as increased stock compensation expense. The general and administrative ratio decreased to 20.0% for the three months ended September 30, 2013 from 21.5% for the same period in 2012, reflecting the higher growth in net premiums earned relative to expenses in 2013.

**Comparison of Nine Months Ended September 30, 2013 and 2012**

*Premiums.* Gross premiums written increased by \$138.7 million, or 18.9%, for the nine months ended September 30, 2013 compared to the same period in 2012. The increase in gross premiums written was primarily due to new business across existing lines that added \$296.8 million during the nine months ended September 30, 2013, combined with premium rate increases in all lines of business. Growth from new products introduced in 2013, such as primary construction and surety, contributed a further \$16.2 million for the period.

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

|                        | Nine Months Ended<br>September 30, |          | Dollar<br>Change | Percentage<br>Change |
|------------------------|------------------------------------|----------|------------------|----------------------|
|                        | 2013                               | 2012     |                  |                      |
|                        | (\$ in millions)                   |          |                  |                      |
| General casualty       | \$ 271.5                           | \$ 204.6 | \$ 66.9          | 32.7%                |
| Professional liability | 193.7                              | 192.3    | 1.4              | 0.7%                 |
| Healthcare             | 143.4                              | 145.6    | (2.2)            | (1.5%)               |
| Programs               | 107.7                              | 81.1     | 26.6             | 32.8%                |
| General property       | 74.0                               | 71.3     | 2.7              | 3.8%                 |
| Other*                 | 81.7                               | 38.4     | 43.3             | 112.8%               |
|                        | \$ 872.0                           | \$ 733.3 | \$ 138.7         | 18.9%                |

\* Includes our inland marine, environmental, primary construction, mergers and acquisitions and surety lines of business

Net premiums written increased by \$101.2 million, or 18.4%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase in net premiums written was primarily due to higher gross premiums written. We ceded 25.2% of gross premiums written for the nine months ended September 30, 2013 compared to 24.8% for the same period in 2012. The increase in the ceded written percentage is primarily due to the purchase of new reinsurance in our program line of business as well as in our surety and primary general liability construction lines of business. We also purchased a new property catastrophe coverage during 2013.

Net premiums earned increased by \$103.4 million, or 21.1%, for the nine months ended September 30, 2013 compared to the same period in 2012. The increase was primarily due to the growth of our U.S. insurance operations during 2013 and 2012.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$89.0 million, or 28.7%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The loss and loss expense ratio increased by 4.0 percentage points for the same period. The increase in net losses and loss expenses was primarily due to growth in the U.S. insurance segment and unfavorable prior year reserve development in 2013 compared to favorable prior year reserve development in 2012.

Excluding the prior year reserve development, the loss and loss expense ratios would have been 65.3% and 67.6% for the nine months ended September 30, 2013 and 2012, respectively. The decrease in the loss and loss expense ratio of 2.3 points was primarily due to fewer reported current year large losses in the nine months ended September 30, 2013 compared to the same period in 2012.

**Nine Months Ended**

**Nine Months Ended**

**Change in**

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|                              | September 30, 2013 |          | September 30, 2012 |          | Dollar Change | Percentage Points |
|------------------------------|--------------------|----------|--------------------|----------|---------------|-------------------|
|                              | Amount             | % of NPE | Amount             | % of NPE |               |                   |
|                              | (\$ in millions)   |          |                    |          |               |                   |
| Non-catastrophe              | \$ 387.5           | 65.3%    | \$ 329.8           | 67.3%    | \$ 57.7       | (2.0)Pts          |
| Property catastrophe         |                    |          | 1.7                | 0.3      | (1.7)         | (0.3)             |
| Current period               | 387.5              | 65.3     | 331.5              | 67.6     | 56.0          | (2.3)             |
| Prior period                 | 11.4               | 1.9      | (21.6)             | (4.4)    | 33.0          | 6.3               |
| Net losses and loss expenses | \$ 398.9           | 67.2%    | \$ 309.9           | 63.2%    | \$ 89.0       | 4.0Pts            |

Overall, our U.S. insurance segment recorded net unfavorable reserve development of \$11.4 million during the nine months ended September 30, 2013 compared to net favorable reserve development of \$21.6 million for the nine months ended September 30, 2012, as shown in the tables below.

**Table of Contents****(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Nine Months Ended September 30, 2013**

|                           | <b>2003 and<br/>Prior</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>2012</b> | <b>Total</b> |
|---------------------------|---------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| (\$ in millions)          |                           |             |             |             |             |             |             |             |             |             |              |
| General casualty Programs | \$                        | \$ (0.7)    | \$ (0.5)    | \$          | \$ (9.1)    | \$ (3.1)    | \$ (0.2)    | \$          | \$ 2.6      | \$ 3.5      | \$ (7.5)     |
|                           |                           |             |             | (1.4)       | (3.5)       | (1.5)       | (1.9)       | (4.1)       | (0.1)       | 3.3         | (9.2)        |
| General property          |                           | 0.7         | (0.2)       | 3.5         | (0.2)       | (1.3)       | (1.3)       |             | 1.3         | 1.0         | 3.5          |
| Healthcare                | (3.1)                     | (1.8)       | (1.4)       | (2.7)       | (2.3)       | (8.3)       | (3.5)       | (1.6)       | 23.2        | 14.1        | 12.6         |
| Professional liability    |                           | (0.9)       | (2.5)       | (6.6)       | (3.4)       | (2.9)       | 0.4         | (6.3)       | 4.5         | 28.8        | 11.1         |
| Other                     |                           |             |             |             |             |             |             | (0.1)       | (0.6)       | 1.6         | 0.9          |
|                           | \$ (3.1)                  | \$ (2.7)    | \$ (4.6)    | \$ (7.2)    | \$ (18.5)   | \$ (17.1)   | \$ (6.5)    | \$ (12.1)   | \$ 30.9     | \$ 52.3     | \$ 11.4      |

The unfavorable reserve development for the 2011 and 2012 loss years was due to adverse development on reported claims, primarily in our healthcare, private/not for profit D&O and E&O products. The healthcare emergence was largely driven by three large claims, as well as adverse development on reported claims. The emergence in the E&O and private/not for profit D&O is due to higher than expected loss frequency, as well as adverse development on reported claims. In response to the underwriting experience in these lines, we continue to take rate action, as well as make changes to policy terms and conditions, resulting in flat or reduced gross premiums written but reduced exposures.

The additions to the 2011 and 2012 loss years noted above are consistent with our practice of addressing unfavorable loss emergence early in our casualty lines of business. We tend to recognize favorable loss emergence more slowly in our casualty lines once actual loss emergence and data provides greater confidence around the adequacy of ultimate estimates.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Nine Months Ended September 30, 2012**

|                           | <b>2003 and<br/>Prior</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>Total</b> |
|---------------------------|---------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| (\$ in millions)          |                           |             |             |             |             |             |             |             |             |              |
| General casualty Programs | \$ (0.7)                  | \$ 0.3      | \$ (0.8)    | \$ (12.0)   | \$ (0.3)    | \$ (2.4)    | \$ (0.6)    | \$ (0.1)    | \$          | \$ (16.6)    |
|                           |                           |             |             | (0.8)       | (1.1)       |             | 3.5         | 13.8        | 8.1         | 23.5         |
| General property          |                           | 1.0         | (0.3)       | (0.1)       | (0.2)       | 1.7         | (0.4)       | (0.6)       | 1.0         | 2.1          |
| Healthcare                | 1.7                       | (1.0)       | (3.3)       | (3.8)       | (4.4)       | 0.3         | (1.8)       | 3.1         | (0.2)       | (9.4)        |
| Professional liability    | (1.0)                     | (1.5)       | (1.1)       | (0.8)       | (18.4)      | (1.2)       | (4.3)       | (2.5)       | 9.8         | (21.0)       |

|       |    |          |          |           |           |          |          |         |         |           |
|-------|----|----------|----------|-----------|-----------|----------|----------|---------|---------|-----------|
| Other |    |          |          |           |           |          |          | (0.2)   | (0.2)   |           |
|       | \$ | \$ (1.2) | \$ (5.5) | \$ (17.5) | \$ (24.4) | \$ (1.6) | \$ (3.6) | \$ 13.7 | \$ 18.5 | \$ (21.6) |

The unfavorable reserve development for the 2010 and 2011 loss years was primarily due to adverse development on a program that commenced writing in 2008 and was terminated during 2011. This was partially offset by favorable development on our active programs. We also experienced adverse development for the 2011 loss year for certain E&O products.

*Acquisition costs.* Acquisition costs increased by \$14.9 million, or 23.3%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase was driven by the growth in premiums and increased profit commission accruals in our program line of business. The acquisition cost ratio increased to 13.3% for the nine months ended September 30, 2013 from 13.0% for the same period in 2012 due to the increase in the profit commission accruals.

*General and administrative expenses.* General and administrative expenses increased by \$16.3 million, or 15.8%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, due to the continued growth of our U.S. insurance operations and higher stock compensation expenses. The general and administrative expense ratio decreased to 20.1% for the nine months ended September 30, 2013 from 21.0% in the same period in 2012 as a result of our increased net premiums earned.

**Table of Contents****International Insurance Segment**

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

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2013                                | 2012     | 2013                               | 2012     |
| (\$ in millions)                         |                                     |          |                                    |          |
| <b>Revenues</b>                          |                                     |          |                                    |          |
| Gross premiums written                   | \$ 132.9                            | \$ 121.3 | \$ 454.0                           | \$ 418.5 |
| Net premiums written                     | 75.7                                | 71.1     | 259.8                              | 255.1    |
| Net premiums earned                      | 87.6                                | 85.3     | 258.8                              | 247.8    |
| <b>Expenses</b>                          |                                     |          |                                    |          |
| Net losses and loss expenses             | \$ 31.1                             | \$ 15.1  | \$ 91.0                            | \$ 75.4  |
| Acquisition costs                        | (0.3)                               | (0.3)    | (1.5)                              | (1.4)    |
| General and administrative expenses      | 26.5                                | 22.9     | 75.4                               | 67.0     |
| Underwriting income                      | 30.3                                | 47.6     | 93.9                               | 106.8    |
| <b>Ratios</b>                            |                                     |          |                                    |          |
| Loss and loss expense ratio              | 35.5%                               | 17.7%    | 35.2%                              | 30.4%    |
| Acquisition cost ratio                   | (0.3%)                              | (0.3%)   | (0.6%)                             | (0.6%)   |
| General and administrative expense ratio | 30.2%                               | 26.9%    | 29.1%                              | 27.0%    |
| Expense ratio                            | 29.9%                               | 26.6%    | 28.5%                              | 26.4%    |
| Combined ratio                           | 65.4%                               | 44.3%    | 63.7%                              | 56.8%    |

**Comparison of Three Months Ended September 30, 2013 and 2012**

*Premiums.* Gross premiums written increased by \$11.6 million, or 9.6%, for the three months ended September 30, 2013 compared to the same period in 2012. The increase was primarily due to premiums of \$13.1 million in our new aviation line of business. Effective October 1, 2013, we acquired the renewal rights to a book of aviation business from Markel International that was written through Lloyd's Syndicate 1400 and Markel Europe plc. In conjunction with the renewal rights agreement, in August we assumed the unexpired inforce aviation business from Markel International, which resulted in gross premiums written of \$13.1 million this quarter. This business encompasses airlines, aerospace (primarily airports and aviation products) and general aviation classes. In addition, professional liability added \$6.0 million, driven by the expansion of new initiatives, such as our Bermuda employment practices liability and European SME insurance products. However, this growth was partially offset by \$7.1 million of non-recurring premiums for our trade credit line of business recorded in 2012.

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



|                        | <b>Three Months Ended</b> |             | <b>Dollar</b> | <b>Percentage</b> |
|------------------------|---------------------------|-------------|---------------|-------------------|
|                        | <b>2013</b>               | <b>2012</b> |               |                   |
|                        | <b>September 30,</b>      |             |               |                   |
|                        | <b>(\$ in millions)</b>   |             |               |                   |
| Professional liability | \$ 43.8                   | \$ 37.8     | \$ 6.0        | 15.9%             |
| General casualty       | 28.7                      | 32.6        | (3.9)         | (12.0%)           |
| General property       | 22.6                      | 22.2        | 0.4           | 1.8%              |
| Healthcare             | 18.6                      | 17.8        | 0.8           | 4.5%              |
| Aviation               | 13.1                      |             | 13.1          | n/a               |
| Other*                 | 6.1                       | 10.9        | (4.8)         | (44.0%)           |
|                        | \$ 132.9                  | \$ 121.3    | \$ 11.6       | 9.6%              |

\* Includes our trade credit line of business

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Net premiums written increased by \$4.6 million, or 6.5%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase in net premiums written was due to higher gross premiums written, partially offset by higher ceded premiums. We ceded 43.0% of gross premiums written for the three months ended September 30, 2013 compared to 41.4% for the three months ended September 30, 2012. The increase was due to higher quota share cessions on our 2013 renewals for general casualty, general property and trade credit lines of business.

Net premiums earned increased by \$2.3 million, or 2.7%, primarily due to higher net premiums written in the latter half of 2012 and the nine months ended September 30, 2013.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$16.0 million, or 106.0%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The loss and loss expense ratio increased by 17.8 percentage points for the same period. The increase in net losses and loss expenses was primarily due to higher net premiums earned and lower net favorable prior year reserve development in 2013 compared to the same period in 2012. This was partially offset by the \$2.3 million property catastrophe loss from Hurricane Isaac in 2012.

Excluding the prior year reserve development, the loss and loss expense ratios would have been 69.4% and 63.4% for the three months ended September 30, 2013 and 2012, respectively. The increase was primarily due to \$8.2 million of significant reported losses in 2013 which increased the loss and loss expense ratio by 9.4 percentage points, partially offset by lower property catastrophe losses in 2013.

|                              | <b>Three Months Ended<br/>September 30, 2013</b> |                 | <b>Three Months Ended<br/>September 30, 2012</b> |                 | <b>Dollar<br/>Change</b> | <b>Change in<br/>Percentage<br/>Points</b> |
|------------------------------|--|-----------------|--|-----------------|--------------------------|--|
|                              | <b>Amount</b>                                    | <b>% of NPE</b> | <b>Amount<br/>(\$ in<br/>millions)</b>           | <b>% of NPE</b> |                          |  |
| Non-catastrophe              | \$ 60.8  | 69.4%           | \$ 51.8  | 60.7%           | \$ 9.0                   | 8.7Pts                                     |
| Property catastrophe         |  |                 | 2.3  | 2.7             | (2.3)                    | (2.7)                                      |
| Current period               | 60.8   | 69.4            | 54.1   | 63.4            | 6.7                      | 6.0  |
| Prior period                 | (29.7)   | (33.9)          | (39.0)   | (45.7)          | 9.3                      | 11.8                                       |
| Net losses and loss expenses | \$ 31.1  | 35.5%           | \$ 15.1  | 17.7%           | \$ 16.0                  | 17.8Pts                                    |

Overall, our international insurance segment recorded net favorable reserve development of \$29.7 million during the three months ended September 30, 2013 compared to net favorable reserve development of \$39.0 million for the three months ended September 30, 2012, as shown in the tables below.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Three Months Ended September 30, 2013**

|                           | 2003 and<br>Prior | 2004     | 2005     | 2006     | 2007     | 2008     | 2009     | 2010     | 2011     | 2012     | Total     |
|---------------------------|-------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|-----------|
|                           | (\$ in millions)  |          |          |          |          |          |          |          |          |          |           |
| General<br>casualty       | \$ 0.7            | \$ (0.6) | \$ (1.4) | \$ (2.3) | \$ (1.8) | \$ (4.1) | \$ (0.6) | \$ (2.9) | \$ (0.1) | \$       | \$ (13.1) |
| General<br>property       |                   |          | 3.4      | (0.1)    | (0.1)    | (0.1)    | (0.1)    | (0.8)    | (1.3)    | (2.5)    | (1.6)     |
| Professional<br>liability | 0.2               | (0.4)    | 1.4      | (1.1)    | (3.6)    | (0.2)    | (0.3)    | (0.2)    | (0.4)    |          | (4.6)     |
| Healthcare                | (0.7)             | (0.2)    | (0.2)    | (0.5)    | (3.1)    | (0.3)    | (4.9)    | (0.2)    | (0.3)    |          | (10.4)    |
|                           | \$ 0.2            | \$ (1.2) | \$ 3.2   | \$ (4.0) | \$ (8.6) | \$ (4.7) | \$ (5.9) | \$ (4.1) | \$ (2.1) | \$ (2.5) | \$ (29.7) |

We recorded unfavorable loss reserve development in our general property line of business for the 2005 loss year due to adverse development on an individual energy claim.

**Table of Contents****(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Three Months Ended September 30, 2012**

|                        | 2003 and<br>Prior | 2004     | 2005    | 2006      | 2007      | 2008     | 2009     | 2010     | 2011     | Total     |
|------------------------|-------------------|----------|---------|-----------|-----------|----------|----------|----------|----------|-----------|
|                        | (\$ in millions)  |          |         |           |           |          |          |          |          |           |
| General casualty       | \$ (0.8)          | \$ (2.6) | \$ 12.8 | \$ (3.5)  | \$ (9.5)  | \$ (1.1) | \$ (1.6) | \$       | \$       | \$ (6.3)  |
| General property       |                   | 0.6      | (0.1)   | 1.3       | (0.5)     |          | (0.3)    | (0.8)    | (5.4)    | (5.2)     |
| Professional liability |                   | (0.5)    | (1.9)   | (12.5)    | (2.0)     | (4.1)    |          |          |          | (21.0)    |
| Healthcare             | (0.2)             | (0.2)    | (0.9)   | (0.8)     | (0.7)     | (3.7)    |          |          |          | (6.5)     |
|                        | \$ (1.0)          | \$ (2.7) | \$ 9.9  | \$ (15.5) | \$ (12.7) | \$ (8.9) | \$ (1.9) | \$ (0.8) | \$ (5.4) | \$ (39.0) |

The unfavorable reserve development for the 2005 loss year for the three months ended September 30, 2012 was primarily due to two product liability claims within our general casualty line of business.

*Acquisition costs.* Acquisition costs were unchanged, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The acquisition cost ratio was negative 0.3% for the three months ended September 30, 2013 and 2012. The negative cost represents ceding commissions received on ceded premiums in excess of the brokerage fees and commissions paid on gross premiums written.

*General and administrative expenses.* General and administrative expenses increased by \$3.6 million, or 15.7%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The increase in general and administrative expenses was primarily due to higher compensation costs as we increased headcount, particularly in our London office, and the impact of the 9% increase in our share price during the quarter on stock compensation expense. The general and administrative expense ratio was 30.2% and 26.9% for the three months ended September 30, 2013 and 2012, respectively. The increase in the general and administrative expense ratio was due to the higher expenses that outpaced the growth in net premiums earned.

**Comparison of Nine Months Ended September 30, 2013 and 2012**

*Premiums.* Gross premiums written increased by \$35.5 million, or 8.5%, for the nine months ended September 30, 2013 compared to the same period in 2012. The increase was driven by the continued expansion of new initiatives, such as SME, and the aviation business we assumed from Markel International during the third quarter, which added \$13.1 million of gross premiums written. The professional liability and healthcare lines of business added \$12.6 million and \$8.2 million, respectively, with increased participations on renewing business, as well as new business and rate increases.

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

**Nine Months Ended**

|                        | <b>September 30,</b> |             | <b>Dollar<br/>Change</b> | <b>Percentage<br/>Change</b> |
|------------------------|----------------------|-------------|--------------------------|------------------------------|
|                        | <b>2013</b>          | <b>2012</b> |                          |                              |
|                        | (\$ in millions)     |             |                          |                              |
| Professional liability | \$ 134.2             | \$ 121.6    | \$ 12.6                  | 10.4%                        |
| General property       | 126.5                | 120.2       | 6.3                      | 5.2%                         |
| General casualty       | 97.0                 | 97.5        | (0.5)                    | (0.5%)                       |
| Healthcare             | 66.3                 | 58.1        | 8.2                      | 14.1%                        |
| Aviation               | 13.1                 |             | 13.1                     | n/a                          |
| Other*                 | 16.9                 | 21.1        | (4.2)                    | (19.9%)                      |
|                        | \$ 454.0             | \$ 418.5    | \$ 35.5                  | 8.5%                         |

\* Includes our trade credit line of business

Net premiums written increased by \$4.7 million, or 1.8%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. We ceded to reinsurers 42.8% of gross premiums written for the nine months ended September 30, 2013 compared to 39.0% for the nine months ended September 30, 2012. The increase was due to the higher quota share cessions on our 2013 renewals for general casualty, general property and trade credit lines of business.

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Net premiums earned increased by \$11.0 million, or 4.4%, primarily due to higher net premiums written in the latter half of 2012 and for the nine months ended September 30, 2013.

*Net losses and loss expenses.* Net losses and loss expenses increased by \$15.6 million, or 20.7%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase in net losses and loss expenses was primarily due to higher net premiums earned and lower net favorable prior year reserve development. The loss and loss expense ratio increased by 4.8 percentage points for the same period driven by lower net favorable prior year reserve development and higher large reported losses during the nine months ended September 30, 2013 compared to the same period in 2012.

Excluding the prior year reserve development, the loss and loss expense ratios would have been 68.1% and 66.1% for the nine months ended September 30, 2013 and 2012, respectively. The increase was due to higher large reported losses in 2013 compared to 2012. The reported large losses of \$14.4 million in 2013 added 5.6 percentage points to the loss and loss expense ratio. The reported large losses of \$9.1 million in 2012, of which \$2.3 million related to Hurricane Isaac, added 3.7 percentage points to the loss and loss expense ratio.

|                                 | Nine Months Ended<br>September 30, 2013 |          | Nine Months Ended<br>September 30, 2012 |          | Dollar<br>Change | Change in<br>Percentage<br>Points |
|---------------------------------|---|----------|---|----------|------------------|-----------------------------------|
|                                 | Amount                                  | % of NPE | Amount                                  | % of NPE |                  |                                   |
|                                 | (\$ in millions)                        |          |   |          |                  |                                   |
| Non-catastrophe                 | \$ 176.1                                | 68.1%    | \$ 161.5                                | 65.2%    | \$ 14.6          | 2.9Pts                            |
| Property<br>catastrophe         |   |          | 2.3                                     | 0.9      | (2.3)            | (0.9)                             |
| Current period                  | 176.1                                   | 68.1     | 163.8                                   | 66.1     | 12.3             | 2.0                               |
| Prior period                    | (85.1)                                  | (32.9)   | (88.4)                                  | (35.7)   | 3.3              | 2.8                               |
| Net losses and<br>loss expenses | \$ 91.0                                 | 35.2%    | \$ 75.4                                 | 30.4%    | \$ 15.6          | 4.8Pts                            |

Overall, our international insurance segment recorded net favorable reserve development of \$85.1 million during the nine months ended September 30, 2013 compared to net favorable reserve development of \$88.4 million for the nine months ended September 30, 2012, as shown in the tables below.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Nine Months Ended September 30, 2013**

|                     | 2003 and<br>Prior | 2004   | 2005     | 2006     | 2007      | 2008     | 2009     | 2010     | 2011     | 2012   | Total     |
|---------------------|-------------------|--------|----------|----------|-----------|----------|----------|----------|----------|--------|-----------|
|                     | (\$ in millions)  |        |          |          |           |          |          |          |          |        |           |
| General<br>casualty | \$ 7.0            | \$ 1.8 | \$ (8.4) | \$ (9.0) | \$ (10.5) | \$ (8.8) | \$ (1.8) | \$ (3.1) | \$ (0.1) | \$ 0.9 | \$ (32.0) |
|                     |                   |        | 3.3      | (0.3)    | 1.0       | (1.1)    | (3.6)    | (4.8)    | (10.8)   | (10.6) | (26.9)    |

|                           |        |          |          |           |           |           |          |          |           |          |           |
|---------------------------|--------|----------|----------|-----------|-----------|-----------|----------|----------|-----------|----------|-----------|
| General<br>property       |        |          |          |           |           |           |          |          |           |          |           |
| Professional<br>liability | (0.1)  | (5.4)    | 4.7      | (4.0)     | (14.5)    | 0.1       | (6.8)    | (0.6)    | (0.5)     |          | (27.1)    |
| Healthcare                | (0.8)  | (0.5)    | (0.7)    | (1.6)     | 5.1       | (4.8)     | 5.7      | (1.1)    | (0.4)     |          | 0.9       |
|                           | \$ 6.1 | \$ (4.1) | \$ (1.1) | \$ (14.9) | \$ (18.9) | \$ (14.6) | \$ (6.5) | \$ (9.6) | \$ (11.8) | \$ (9.7) | \$ (85.1) |

The net favorable reserve development for loss years 2004 to 2012 is a result of actual loss emergence being lower than anticipated, in particular for our general property line of business for the 2011 and 2012 loss years. The unfavorable reserve development in our healthcare line in the 2007 and 2009 loss years was due to adverse development on individual claims.

**Table of Contents****(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Nine Months Ended September 30, 2012**

|                        | 2003 and<br>Prior | 2004     | 2005     | 2006      | 2007      | 2008      | 2009     | 2010     | 2011    | Total     |
|------------------------|-------------------|----------|----------|-----------|-----------|-----------|----------|----------|---------|-----------|
|                        | (\$ in millions)  |          |          |           |           |           |          |          |         |           |
| General casualty       | \$ 3.4            | \$ (5.7) | \$ 8.0   | \$ (14.9) | \$ (16.7) | \$ (8.7)  | \$ (1.6) | \$       | \$ 20.0 | \$ (16.2) |
| General property       |                   | 0.8      | (1.6)    | 0.3       | 0.6       | (2.2)     | (2.1)    | (7.4)    | (2.3)   | (13.9)    |
| Professional liability | (0.2)             | (2.8)    | (5.0)    | (27.6)    | (9.2)     | 2.9       |          |          |         | (41.9)    |
| Healthcare             | (0.9)             | (0.8)    | (2.0)    | (1.6)     | (4.8)     | (6.3)     |          |          |         | (16.4)    |
|                        | \$ 2.3            | \$ (8.5) | \$ (0.6) | \$ (43.8) | \$ (30.1) | \$ (14.3) | \$ (3.7) | \$ (7.4) | \$ 17.7 | \$ (88.4) |

The net favorable reserve development for loss years 2004 to 2010 is a result of actual loss emergence being lower than anticipated. The unfavorable reserve development in our general casualty line for loss year 2011 was due to adverse development on an individual claim, estimated to reach our full limit of \$20.0 million, net of reinsurance.

*Acquisition costs.* Acquisition costs decreased by \$0.1 million, or 7.1%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The acquisition cost ratio was negative 0.6% for the nine months ended September 30, 2013 and 2012.

*General and administrative expenses.* General and administrative expenses increased by \$8.4 million, or 12.5%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase in general and administrative expenses was primarily due to increased salary and related costs incurred as we continue to expand internationally. The general and administrative expense ratios for the nine months ended September 30, 2013 and 2012 were 29.1% and 27.0%, respectively.

**Reinsurance Segment**

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

|                                     | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|-------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                     | 2013                                | 2012     | 2013                               | 2012     |
|                                     | (\$ in millions)                    |          |                                    |          |
| <b>Revenues</b>                     |                                     |          |                                    |          |
| Gross premiums written              | \$ 139.3                            | \$ 120.0 | \$ 857.2                           | \$ 680.4 |
| Net premiums written                | 138.6                               | 119.6    | 817.1                              | 668.8    |
| Net premiums earned                 | 215.6                               | 181.7    | 629.0                              | 534.8    |
| <b>Expenses</b>                     |                                     |          |                                    |          |
| Net losses and loss expenses        | \$ 104.7                            | \$ 134.7 | \$ 317.4                           | \$ 339.2 |
| Acquisition costs                   | 37.0                                | 28.7     | 109.1                              | 87.3     |
| General and administrative expenses | 20.4                                | 18.3     | 56.9                               | 52.8     |
| Underwriting income                 | 53.5                                |          | 145.6                              | 55.5     |



**Ratios**

|  |       |       |       |       |
|--|-------|-------|-------|-------|
| Loss and loss expense ratio              | 48.5% | 74.1% | 50.5% | 63.4% |
| Acquisition cost ratio                   | 17.1% | 15.8% | 17.3% | 16.3% |
| General and administrative expense ratio | 9.5%  | 10.0% | 9.1%  | 9.9%  |
| Expense ratio                            | 26.6% | 25.8% | 26.4% | 26.2% |
| Combined ratio                           | 75.1% | 99.9% | 76.9% | 89.6% |

**Table of Contents****Comparison of Three Months Ended September 30, 2013 and 2012**

*Premiums.* Gross premiums written increased by \$19.3 million, or 16.1%, for the three months ended September 30, 2013 compared to the same period in 2012. The increase was driven by new business in the specialty lines primarily written out of Asia and Latin America combined with increased participations on renewing business and rate increases. Property reinsurance gross premiums written increased by \$13.2 million as North American property reinsurance grew by \$5.2 million. International property reinsurance gross premiums written contributed a further \$8.0 million. This increase in gross premiums written for our specialty reinsurance line of business was due to downward premium estimates on our crop reinsurance business of \$11.7 million during the three months ended September 30, 2012 that did not occur in the current quarter.

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

|               | <b>Three Months Ended<br/>September 30,</b> |             | <b>Dollar<br/>Change</b> | <b>Percentage<br/>Change</b> |
|---------------|---|-------------|--------------------------|------------------------------|
|               | <b>2013</b>                                 | <b>2012</b> |                          |                              |
|               | (\$ in millions)                            |             |                          |                              |
| United States | \$ 68.9                                     | \$ 49.7     | \$ 19.2                  | 38.6%                        |
| Bermuda       | 27.2  | 26.3        | 0.9                      | 3.4%                         |
| Europe        | 9.3   | 14.1        | (4.8)                    | (34.0%)                      |
| Singapore     | 33.9  | 29.9        | 4.0                      | 13.4%                        |
|               | \$ 139.3                                    | \$ 120.0    | \$ 19.3                  | 16.1%                        |

The decline in Europe was due to the transfer of business from Europe to the United States as we established our Lloyd's coverholder in Miami, Florida.

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

|           | <b>Three Months Ended<br/>September 30,</b> |             | <b>Dollar<br/>Change</b> | <b>Percentage<br/>Change</b> |
|-----------|---|-------------|--------------------------|------------------------------|
|           | <b>2013</b>                                 | <b>2012</b> |                          |                              |
|           | (\$ in millions)                            |             |                          |                              |
| Property  | \$ 72.6                                     | \$ 59.4     | \$ 13.2                  | 22.2%                        |
| Casualty  | 56.0  | 60.7        | (4.7)                    | (7.7%)                       |
| Specialty | 10.7  | (0.1)       | 10.8                     | n/a                          |
|           | \$ 139.3                                    | \$ 120.0    | \$ 19.3                  | 16.1%                        |

Net premiums written increased by \$19.0 million, or 15.9%, consistent with the increase in gross premiums written.

Net premiums earned increased by \$33.9 million, or 18.7%, as a result of the increase in net premiums written during 2012 and the nine months ended September 30, 2013. Premiums related to our reinsurance business 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 risks-attaching 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 risks-attaching reinsurance contract may extend up to 24 months, reflecting the inception dates of the underlying policies. Property catastrophe premiums, crop reinsurance premiums and premiums from other treaties written on a losses-occurring basis generally earn ratably over the term of the reinsurance contract.

*Net losses and loss expenses.* Net losses and loss expenses decreased by \$30.0 million, or 22.3%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The loss and loss expense ratio decreased by 25.6 percentage points for the same period. The decrease in net losses and loss expenses was due to higher prior year net favorable reserve development for the three months ended September 30, 2013 compared to the same period in 2012, partially offset by growth in business written.

Excluding the prior year reserve development, the loss and loss expense ratios would have been 65.0% and 79.1% for the three months ended September 30, 2013 and 2012, respectively. The decrease was due to lower significant reported property losses of \$14.9 million compared to \$41.4 million in 2012, which included \$40.0 million of crop reinsurance-related losses and loss expenses related to drought conditions across much of the United States.

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|                                 | Three Months Ended<br>September 30, 2013 |          | Three Months Ended<br>September 30, 2012 |          | Dollar<br>Change | Change in<br>Percentage<br>Points |
|---------------------------------|--|----------|--|----------|------------------|-----------------------------------|
|                                 | Amount                                   | % of NPE | Amount<br>(\$ in<br>millions)            | % of NPE |                  |                                   |
| Non-catastrophe                 | \$ 140.2                                 | 65.0%    | \$ 142.7                                 | 78.5%    | \$ (2.5)         | (13.5)Pts                         |
| Property<br>catastrophe         |  |          | 1.0                                      | 0.6      | (1.0)            | (0.6)                             |
| Current period                  | 140.2                                    | 65.0     | 143.7                                    | 79.1     | (3.5)            | (14.1)                            |
| Prior period                    | (35.5)                                   | (16.5)   | (9.0)                                    | (5.0)    | (26.5)           | (11.5)                            |
| Net losses and<br>loss expenses | \$ 104.7                                 | 48.5%    | \$ 134.7                                 | 74.1%    | \$ (30.0)        | (25.6)Pts                         |

Overall, our reinsurance segment recorded net favorable reserve development of \$35.5 million during the three months ended September 30, 2013 compared to net favorable reserve development of \$9.0 million for the three months ended September 30, 2012, as shown in the tables below.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Three Months Ended September 30, 2013**

|           | 2003 and<br>Prior | 2004     | 2005   | 2006  | 2007   | 2008     | 2009     | 2010     | 2011      | 2012      | Total     |
|-----------|-------------------|----------|--------|-------|--------|----------|----------|----------|-----------|-----------|-----------|
|           | (\$ in millions)  |          |        |       |        |          |          |          |           |           |           |
| Property  | \$                | \$ 0.1   | \$ 1.0 | \$    | \$     | \$       | \$ (0.4) | \$ (2.2) | \$ (6.0)  | \$ (14.2) | \$ (21.7) |
| Casualty  | (1.6)             | (2.4)    | 0.6    | 0.1   | 0.3    | (2.0)    | (1.4)    | (0.7)    | (0.2)     | 0.4       | (6.9)     |
| Specialty |                   | (0.1)    | (0.1)  | (0.1) | (0.1)  | (0.1)    | (0.2)    | 0.3      | (5.9)     | (0.6)     | (6.9)     |
|           | \$ (1.6)          | \$ (2.4) | \$ 1.5 | \$    | \$ 0.2 | \$ (2.1) | \$ (2.0) | \$ (2.6) | \$ (12.1) | \$ (14.4) | \$ (35.5) |

The favorable reserve development for the 2011 and 2012 loss years for our reinsurance segment was largely due to lower than expected reported losses in our property line of business.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Three Months Ended September 30, 2012**

|           | 2003 and<br>Prior | 2004     | 2005   | 2006     | 2007     | 2008     | 2009     | 2010   | 2011     | Total     |
|-----------|-------------------|----------|--------|----------|----------|----------|----------|--------|----------|-----------|
|           | (\$ in millions)  |          |        |          |          |          |          |        |          |           |
| Property  | \$ 0.1            | \$ (0.1) | \$ 0.2 | \$ 0.1   | \$ (2.5) | \$ (1.5) | \$ (1.6) | \$ 0.2 | \$ (7.4) | \$ (12.5) |
| Casualty  | (0.9)             | 0.1      | 2.9    | (1.1)    | (2.8)    | (0.9)    | 0.5      | 6.2    | 1.9      | 5.9       |
| Specialty | (0.2)             | (0.2)    | (0.3)  | (0.7)    | (1.4)    |          | 0.3      | 1.1    | (1.0)    | (2.4)     |
|           | \$ (1.0)          | \$ (0.2) | \$ 2.8 | \$ (1.7) | \$ (6.7) | \$ (2.4) | \$ (0.8) | \$ 7.5 | \$ (6.5) | \$ (9.0)  |

The unfavorable reserve development for the 2010 loss year was primarily due to adverse emergence on certain classes of U.S. casualty business.

*Acquisition costs.* Acquisition costs increased by \$8.3 million, or 28.9%, for the three months ended September 30, 2013 compared to the three months ended 2012. The increase was due to the increase in net premiums written, as well as higher profit commission accruals. The acquisition cost ratio was 17.1% for the three months ended September 30, 2013 compared to 15.8% for the three months ended September 30, 2012. The increase is due to the increase in profit commission accruals, as well as the impact of the retrocessional reinsurance catastrophe cover put in place in the current year. The retrocessional reinsurance catastrophe cover reduced net premiums earned but did not have any offsetting ceding commission income, and therefore resulted in an increase to the acquisition cost ratio.

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*General and administrative expenses.* General and administrative expenses increased by \$2.1 million, or 11.5%, for the three months ended September 30, 2013 compared to the same period in 2012. The increase in general and administrative expenses is primarily due to increased stock-based compensation. The general and administrative expense ratios for the three months ended September 30, 2013 and 2012 were 9.5% and 10.0%, respectively, reflecting the higher growth in net premiums earned relative to expenses in 2013.

**Comparison of Nine Months Ended September 30, 2013 and 2012**

*Premiums.* Gross premiums written increased by \$176.8 million, or 26.0%, for the nine months ended September 30, 2013 compared to the same period in 2012. The increase in gross premiums written was primarily due to new business in the specialty lines primarily written out of Asia and Latin America, as well as increased participations on renewing business combined with premium rate increases. Property reinsurance gross premiums written increased by \$101.9 million as North American property reinsurance grew by \$71.4 million as we increased our participation on a large property catastrophe account. International property reinsurance gross premiums written contributed a further \$30.5 million. Within our specialty unit, crop reinsurance gross premiums written increased by \$39.7 million due to new business, increased participations and rate increases following the U.S. drought conditions in 2012 and marine and aviation reinsurance gross premiums written also increased \$9.5 million. Casualty gross premiums written increased by \$21.2 million due to a combination of increased exposures, rates and new business.

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

|               | Nine Months Ended<br>September 30, |          | Dollar<br>Change | Percentage<br>Change |
|---------------|------------------------------------|----------|------------------|----------------------|
|               | 2013                               | 2012     |                  |                      |
|               | (\$ in millions)                   |          |                  |                      |
| United States | \$ 424.2                           | \$ 318.0 | \$ 106.2         | 33.4%                |
| Bermuda       | 245.4                              | 195.9    | 49.5             | 25.3%                |
| Singapore     | 118.3                              | 97.2     | 21.1             | 21.7%                |
| Europe        | 69.3                               | 69.3     |                  | 0.0%                 |
|               | \$ 857.2                           | \$ 680.4 | \$ 176.8         | 26.0%                |

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

|           | Nine Months Ended<br>September 30, |          | Dollar<br>Change | Percentage<br>Change |
|-----------|------------------------------------|----------|------------------|----------------------|
|           | 2013                               | 2012     |                  |                      |
|           | (\$ in millions)                   |          |                  |                      |
| Property  | \$ 436.6                           | \$ 334.7 | \$ 101.9         | 30.4%                |
| Casualty  | 230.3                              | 209.1    | 21.2             | 10.1%                |
| Specialty | 190.3                              | 136.6    | 53.7             | 39.3%                |

|    |       |    |       |    |       |       |
|----|-------|----|-------|----|-------|-------|
| \$ | 857.2 | \$ | 680.4 | \$ | 176.8 | 26.0% |
|----|-------|----|-------|----|-------|-------|

Net premiums written increased by \$148.3 million, or 22.2%, for the nine months ended September 30, 2013 compared to the same period in 2012. The increase in net premiums written is lower than the increase in gross premiums due to purchasing a new collateralized retrocessional catastrophe cover during the nine months ended September 30, 2013, which provides \$25 million limit per occurrence on a worldwide basis, with attachment points varying by risk and geography and a maximum indemnity of \$100 million.

Net premiums earned increased by \$94.2 million, or 17.6%, as a result of the increase in net premiums written during 2012 and the nine months ended September 30, 2013 partially offset by the impact of the new retrocessional catastrophe cover.

*Net losses and loss expenses.* Net losses and loss expenses decreased by \$21.8 million, or 6.4%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The loss and loss expense ratio decreased by 12.9 percentage points for the same period. The decrease in net losses and loss expenses was due to higher net favorable prior year reserve development for the nine months ended September 30, 2013 compared to the same period in 2012, partially offset by growth in business written.

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Excluding the prior year reserve development, the loss and loss expense ratios would have been 63.3% and 68.6% for the nine months ended September 30, 2013 and 2012, respectively. The decrease was due to \$26.5 million of large reported property losses in 2013 compared to \$57.9 million in 2012, which included \$40.0 million of crop reinsurance-related losses and loss expenses related to drought conditions across much of the United States.

|                              | Nine Months Ended<br>September 30, 2013 |          | Nine Months Ended<br>September 30, 2012 |          | Dollar<br>Change | Change in<br>Percentage<br>Points |
|------------------------------|---|----------|---|----------|------------------|-----------------------------------|
|                              | Amount                                  | % of NPE | Amount                                  | % of NPE |                  |                                   |
|                              | (\$ in millions)                        |          |   |          |                  |                                   |
| Non-catastrophe              | \$ 397.6                                | 63.3%    | \$ 365.8                                | 68.4%    | \$ 31.8          | (5.1)Pts                          |
| Property catastrophe         |   |          | 1.0                                     | 0.2      | (1.0)            | (0.2)                             |
| Current period               | 397.6                                   | 63.3     | 366.8                                   | 68.6     | 30.8             | (5.3)                             |
| Prior period                 | (80.2)                                  | (12.8)   | (27.6)                                  | (5.2)    | (52.6)           | (7.6)                             |
| Net losses and loss expenses | \$ 317.4                                | 50.5%    | \$ 339.2                                | 63.4%    | \$ (21.8)        | (12.9)Pts                         |

Overall, our reinsurance segment recorded net favorable reserve development of \$80.2 million during the nine months ended September 30, 2013 compared to net favorable reserve development of \$27.6 million for the nine months ended September 30, 2012, as shown in the tables below.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Nine Months Ended September 30, 2013**

|           | 2003 and<br>Prior | 2004     | 2005     | 2006     | 2007     | 2008     | 2009      | 2010      | 2011      | 2012      | Total     |
|-----------|-------------------|----------|----------|----------|----------|----------|-----------|-----------|-----------|-----------|-----------|
|           | (\$ in millions)  |          |          |          |          |          |           |           |           |           |           |
| Property  | \$ 0.2            | \$ (1.3) | \$ 0.1   | \$ (0.2) | \$ (0.5) | \$ (5.1) | \$ (14.5) | \$ (49.7) | \$ (71.0) |           |           |
| Casualty  | (1.4)             | (3.6)    | 0.3      | 0.8      | (1.9)    | (5.6)    | (1.8)     | 0.2       | 3.1       | 5.7       | (4.2)     |
| Specialty | (0.4)             | (0.6)    | 0.2      | (0.1)    | (3.2)    | 0.7      | 0.2       | (3.6)     | 1.8       | (5.0)     |           |
|           | \$ (1.4)          | \$ (3.8) | \$ (1.6) | \$ 1.1   | \$ (2.0) | \$ (9.0) | \$ (1.6)  | \$ (4.7)  | \$ (15.0) | \$ (42.2) | \$ (80.2) |

The favorable loss reserve development for the 2011 and 2012 loss years for our reinsurance segment was largely due to lower than expected reported losses in our property line of business. The unfavorable loss reserve development in our casualty reinsurance line of business for the 2011 and 2012 loss years was primarily due to the frequency of claims being greater than anticipated.

**(Favorable) and Unfavorable Loss Reserve Development by Loss Year  
For the Nine Months Ended September 30, 2012**



|           | <b>2003 and<br/>Prior</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>Total</b> |
|-----------|---------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
|           | <b>(\$ in millions)</b>   |             |             |             |             |             |             |             |             |              |
| Property  | \$ 0.1                    | \$ (0.9)    | \$ 0.4      | \$          | \$ (2.4)    | \$ (1.8)    | \$ 0.4      | \$ (1.0)    | \$ (1.9)    | \$ (7.1)     |
| Casualty  | 0.2                       | 3.3         | 0.2         | (6.2)       | (12.2)      | (2.1)       | 0.4         | 6.1         | 6.9         | (3.4)        |
| Specialty | (0.5)                     | (3.4)       | (5.4)       | (2.5)       | (3.6)       | (0.1)       | 0.3         | 1.1         | (3.0)       | (17.1)       |
|           | \$ (0.2)                  | \$ (1.0)    | \$ (4.8)    | \$ (8.7)    | \$ (18.2)   | \$ (4.0)    | \$ 1.1      | \$ 6.2      | \$ 2.0      | \$ (27.6)    |

*Acquisition costs.* Acquisition costs increased by \$21.8 million, or 25.0%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase in acquisition costs was due to the increase in net premiums written, as well as higher profit commission accruals. The acquisition cost ratio was 17.3% for the nine months ended September 30, 2013, compared to 16.3% for the nine months ended September 30, 2012. The increase is due to the increase in profit commission accruals, as well as the impact of the retrocessional reinsurance catastrophe cover put in place in the current year. The retrocessional reinsurance catastrophe cover reduced net premiums earned but did not have any offsetting ceding commission income, and therefore resulted in an increase to the acquisition cost ratio.

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*General and administrative expenses.* General and administrative expenses increased by \$4.1 million, or 7.8%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The increase was due to higher salary and related costs due to higher headcount to support our growing operations, as well as higher stock-based compensation expense. The general and administrative expense ratios for the nine months ended September 30, 2013 and 2012 were 9.1% and 9.9%, respectively, reflecting the higher growth in net premiums earned relative to expenses in 2013.

**Reserves for Losses and Loss Expenses**

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

|  | U.S. Insurance   |                  | International Insurance |                  | Reinsurance      |                  | Total            |                  |
|--|------------------|------------------|-------------------------|------------------|------------------|------------------|------------------|------------------|
|  | Sep. 30,<br>2013 | Dec. 31,<br>2012 | Sep. 30,<br>2013        | Dec. 31,<br>2012 | Sep. 30,<br>2013 | Dec. 31,<br>2012 | Sep. 30,<br>2013 | Dec. 31,<br>2012 |
|  | (\$ in millions) |                  |                         |                  |                  |                  |                  |                  |
| Case reserves                            | \$ 575.6         | \$ 508.8         | \$ 477.3                | \$ 550.5         | \$ 464.2         | \$ 479.8         | \$ 1,517.1       | \$ 1,539.1       |
| IBNR                                     | 1,480.4          | 1,389.5          | 1,719.9                 | 1,716.1          | 1,063.4          | 1,000.8          | 4,263.7          | 4,106.4          |
| Reserve for losses and loss expenses     | 2,056.0          | 1,898.3          | 2,197.2                 | 2,266.6          | 1,527.6          | 1,480.6          | 5,780.8          | 5,645.5          |
| Reinsurance recoverables                 | (551.3)          | (517.3)          | (667.8)                 | (620.6)          | (7.0)            | (3.2)            | (1,226.1)        | (1,141.1)        |
| Net reserve for losses and loss expenses | \$ 1,504.7       | \$ 1,381.0       | \$ 1,529.4              | \$ 1,646.0       | \$ 1,520.6       | \$ 1,477.4       | \$ 4,554.7       | \$ 4,504.4       |

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

The following tables provide our ranges of loss and loss expense reserve estimates by business segment as of September 30, 2013:

| Reserve for Losses and Loss Expenses |              |               |
|--------------------------------------|--------------|---------------|
| Gross of Reinsurance Recoverable     |              |               |
| Carried Reserves                     | Low Estimate | High Estimate |

|                         | (\$ in millions) |            |            |
|-------------------------|------------------|------------|------------|
| U.S. insurance          | \$ 2,056.0       | \$ 1,629.3 | \$ 2,304.5 |
| International insurance | 2,197.2          | 1,695.1    | 2,438.1    |
| Reinsurance             | 1,527.6          | 1,237.4    | 1,747.4    |
| Consolidated (1)        | 5,780.8          | 4,670.1    | 6,381.6    |

**Reserve for Losses and Loss Expenses  
Net of Reinsurance Recoverable**

|                         | Carried<br>Reserves | Low<br>Estimate | High<br>Estimate |
|-------------------------|---------------------|-----------------|------------------|
|                         | (\$ in millions)    |                 |                  |
| U.S. insurance          | \$ 1,504.7          | \$ 1,191.5      | \$ 1,706.4       |
| International insurance | 1,529.4             | 1,165.4         | 1,705.0          |
| Reinsurance             | 1,520.6             | 1,231.0         | 1,739.5          |
| Consolidated (1)        | 4,554.7             | 3,684.2         | 5,054.6          |

- (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.

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

**Reinsurance Recoverable**

The following table illustrates our reinsurance recoverable as of September 30, 2013 and December 31, 2012:

|                                | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|--------------------------------|-------------------------------|------------------------------|
|                                | <b>(\$ in millions)</b>       |                              |
| Ceded case reserves            | \$ 242.9                      | \$ 234.2                     |
| Ceded IBNR reserves            | 983.2                         | 906.9                        |
| <b>Reinsurance recoverable</b> | <b>\$ 1,226.1</b>             | <b>\$ 1,141.1</b>            |

We remain obligated for amounts ceded in the event our reinsurers do not meet their obligations. Accordingly, we have evaluated the reinsurers that are providing reinsurance protection to us and will continue to monitor their credit ratings and financial stability. We generally have the right to terminate our treaty reinsurance contracts at any time, upon prior written notice to the reinsurer, under specified circumstances, including the assignment to the reinsurer by A.M. Best of a financial strength rating of less than A-. Approximately 99% of ceded reserves as of September 30, 2013 were recoverable from reinsurers who had an A.M. Best rating of A- or higher.

**Liquidity and Capital Resources****Liquidity**

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

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

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

Historically, our operating subsidiaries have generated sufficient cash flows to meet all of their obligations. Because of the inherent volatility of our business, the seasonality in the timing of payments by insureds and cedents, the irregular timing of loss payments, and the impact of a change in interest rates and credit spreads on the investment income as well as seasonality in coupon payment dates for fixed income securities, cash flows from operating activities may vary between periods. In the unlikely event that paid losses exceed operating cash flows in any given period, we would use our cash balances available, or liquidate a portion of our investment portfolio in order to meet our short-term liquidity needs. As of September 30, 2013, we held \$953.0 million of unrestricted cash and cash equivalents and \$709.2 million of fixed income securities with a maturity of less than one year to meet short-term liquidity needs. Our remaining fixed income securities, equity securities and other invested assets are available to meet our long-term liquidity needs.

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As of September 30, 2013, we had \$150 million available under our revolving loan facility.

***Dividend Restrictions***

The jurisdictions in which our operating subsidiaries are licensed to write business impose regulations requiring companies to maintain or meet various defined statutory ratios, including solvency and liquidity requirements. Some jurisdictions also place restrictions on the declaration and payment of dividends and other distributions. See Item 7.

Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources in the Company's 2012 Form 10-K.

***Cash Flows***

|  | <b>Nine Months Ended</b> |             |
|--|--------------------------|-------------|
|  | <b>September 30,</b>     |             |
|  | <b>2013</b>              | <b>2012</b> |
|  | <b>(\$ in millions)</b>  |             |
| Cash flows provided by operating activities              | \$ 338.2                 | \$ 500.2    |
| Cash flows provided by (used in) investing activities    | 80.9                     | (243.8)     |
| Cash flows used in financing activities                  | (141.8)                  | (250.4)     |
| Effect of exchange rate changes on foreign currency cash | (6.2)                    | (0.5)       |
| Net increase in cash and cash equivalents                | 271.1                    | 5.5         |
| Cash and cash equivalents, beginning of period           | 681.9                    | 634.0       |
| Cash and cash equivalents, end of period                 | \$ 953.0                 | \$ 639.5    |

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

The decrease in cash flows from operations was primarily due to the \$173.1 million increase in paid losses for the nine months ended September 30, 2013 as a result of the catastrophe losses from Superstorm Sandy and crop reinsurance losses combined with growth in operations. This was combined with the \$57.4 million increase in the cash outflow for funds held for the nine months ended September 30, 2013. The increase in funds held was due to our increased participation in a collateralized property catastrophe program.

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

significant and adverse effect on operating cash flow.

Cash flows from investing activities consist primarily of proceeds on the sale of investments and payments for investments acquired in addition to changes in restricted cash. The change in cash flows provided by investing activities reflects the net sale of securities during the nine months ended September 30, 2013 compared to net purchases during the same period in 2012.

Cash flows from financing activities consist primarily of capital raising activities, which include the issuance of common shares or debt, the repurchase of our shares, the payment of dividends and the repayment of debt. The decrease in cash flows used in financing activities was due to the \$84.6 million decrease in share repurchases for the nine months ended September 30, 2013 compared to the same period in 2012. Dividends paid decreased \$24.6 million as the dividend declared in September 2013 was not paid until after September 30, 2013.

**Table of Contents*****Investments***

Our funds are primarily invested in liquid, high-grade fixed income securities. As of September 30, 2013 and December 31, 2012, 89.1% and 89.2%, respectively, of our fixed income portfolio consisted of investment grade securities. The maturity distribution of our fixed-maturity portfolio (on a fair value basis) as of September 30, 2013 and December 31, 2012 was as follows:

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (\$ in millions)      |                      |
| Due in one year or less                | \$ 709.2              | \$ 573.9             |
| Due after one year through five years  | 2,872.0               | 2,835.9              |
| Due after five years through ten years | 571.8                 | 774.4                |
| Due after ten years                    | 65.8                  | 73.0                 |
| Mortgage-backed                        | 1,373.2               | 1,958.4              |
| Asset-backed                           | 455.9                 | 410.9                |
| <b>Total</b>                           | <b>\$ 6,047.9</b>     | <b>\$ 6,626.5</b>    |

We have investments in other invested assets, comprising interests in hedge funds, private equity funds, other private securities and high yield loan funds, the carrying value of which was \$905.0 million as of September 30, 2013. Some of these funds have redemption notice requirements. For each of our funds, liquidity is allowed after certain defined periods based on the terms of each fund. See Note 4(b) Investments Other Invested Assets to our unaudited condensed consolidated financial statements for additional details on our other invested assets.

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

***Credit Facilities***

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

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

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



any such additional period.

A portion of the Amended Secured Credit Facility may also be used for revolving loans for general corporate and working capital purposes, up to a maximum of \$150 million. We may request that existing lenders under the Amended Secured Credit Facility make additional commitments from time to time, up to \$150 million, subject to approval by the lenders. The Amended Secured Credit Facility contains representations, warranties and covenants customary for similar bank loan facilities, including certain covenants that, among other things, require us to maintain a certain leverage ratio and financial strength rating. We are in compliance with all covenants under the Amended Secured Credit Facility as of September 30, 2013.

As of September 30, 2013, we had a combined unused letters of credit capacity of \$ 564.8 million from the Amended Secured Credit Facility and Citibank Europe plc. We believe that this remaining capacity is sufficient to meet our future letter of credit needs. During the nine months ended September 30, 2013, we did not utilize the revolving loan available under the Amended Secured Credit Facility.

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### ***Pledged Assets***

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

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

As of September 30, 2013 and December 31, 2012, \$ 2,556.7 million and \$2,141.2 million, respectively, of cash and cash equivalents and investments were deposited, pledged or held in escrow accounts in favor of ceding companies and other counterparties or government authorities to comply with reinsurance contract provisions, insurance laws and other contract provisions.

In addition, as of September 30, 2013 and December 31, 2012, a further \$ 1,063.1 million and \$1,225.2 million, respectively, of cash and cash equivalents and investments were pledged as collateral for our credit facilities.

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

### ***Financial Strength Ratings***

Financial strength ratings represent the opinions of rating agencies on our capacity to meet our obligations. In the event of a significant downgrade in ratings, our ability to write business and to access the capital markets could be impacted. Our financial strength ratings as of September 30, 2013 have not changed since December 31, 2012. See Item 1. Business in our 2012 Form 10-K.

In May 2013, Standard & Poor's affirmed their financial strength rating of A of our rated operating subsidiaries with a stable outlook. In October 2013, Fitch Ratings affirmed their financial strength rating of A+ of our rated operating subsidiaries with a stable outlook.

### ***Capital Resources***

The table below sets forth the capital structure of the Company as of September 30, 2013 and December 31, 2012:

**As of                      As of**  
**September 30,      December 31,**

|                              | <b>2013</b>             | <b>2012</b>       |
|------------------------------|-------------------------|-------------------|
|                              | <b>(\$ in millions)</b> |                   |
| Senior notes                 | \$ 798.4                | \$ 798.2          |
| Shareholders' equity         | 3,443.9                 | 3,326.3           |
| <b>Total capitalization</b>  | <b>\$ 4,242.3</b>       | <b>\$ 4,124.5</b> |
| Debt to total capitalization | 18.8%                   | 19.4%             |

On September 10, 2012, we filed a shelf registration statement on Form S-3 with the U.S. Securities and Exchange Commission in which we may offer from time to time common shares of Allied World Switzerland, senior or subordinated debt securities of Allied World Bermuda, guarantees of debt securities of Allied World Bermuda, warrants to purchase common shares of Allied World Switzerland, warrants to purchase debt securities of Allied World Bermuda or units which may consist of any combination of the securities listed above. The registration statement is intended to provide us with additional flexibility to access capital markets for general corporate purposes, subject to market conditions and our capital needs.

**Table of Contents*****Share Repurchases***

In May 2012, we established a \$500 million share repurchase program. Under the terms of this new share repurchase program, common shares repurchased shall be designated for cancellation and shall be cancelled upon prior shareholder approval. As of September 30, 2013, approximately \$287.1 million remained under this share repurchase authorization.

During the three and nine months ended September 30, 2013, our share repurchases were as follows:

|                                  | <b>Three<br/>Months<br/>Ended<br/>September 30,<br/>2013</b> | <b>Nine Months<br/>Ended<br/>September 30,<br/>2013</b> |
|----------------------------------|--|---|
| Common shares repurchased        | 427,388  | 1,367,833   |
| Total cost of shares repurchased | \$ 40,574  | \$ 123,145  |
| Average price per share          | \$ 94.93   | \$ 90.03  |

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

***Long-Term Debt***

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

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

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

**Off-Balance Sheet Arrangements**

As of September 30, 2013, we did not have any off-balance sheet arrangements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

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

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

In the table below changes in fair values as a result of changes in interest rates are determined by calculating hypothetical September 30, 2013 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.

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|  | <b>Interest Rate Shift in Basis Points</b> |             |            |            |            |             |             |
|--|--|-------------|------------|------------|------------|-------------|-------------|
|  | <b>-200</b>                                | <b>-100</b> | <b>-50</b> |            | <b>+50</b> | <b>+100</b> | <b>+200</b> |
|  | <b>(\$ in millions)</b>                    |             |            |            |            |             |             |
| Total fair value                                 | \$ 7,496.2                                 | \$ 7,394.4  | \$ 7,331.1 | \$ 7,258.4 | \$ 7,181.3 | \$ 7,104.0  | \$ 6,950.6  |
| Fair value change from base                      | 237.8                                      | 136.0       | 72.7       |            | (77.1)     | (154.4)     | (307.8)     |
| Change in unrealized appreciation/(depreciation) | 3.3%                                       | 1.9%        | 1.0%       | 0%         | (1.1%)     | (2.1%)      | (4.2%)      |

In the table below changes in fair values as a result of changes in credit spreads are determined by calculating hypothetical September 30, 2013 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.

|  | <b>Credit Spread Shift in Basis Points</b> |             |            |            |            |             |             |
|--|--|-------------|------------|------------|------------|-------------|-------------|
|  | <b>-200</b>                                | <b>-100</b> | <b>-50</b> |            | <b>+50</b> | <b>+100</b> | <b>+200</b> |
|  | <b>(\$ in millions)</b>                    |             |            |            |            |             |             |
| Total fair value                                 | \$ 4,750.6                                 | \$ 4,638.2  | \$ 4,581.9 | \$ 4,525.7 | \$ 4,469.5 | \$ 4,413.2  | \$ 4,300.7  |
| Fair value change from base                      | 224.9                                      | 112.5       | 56.2       |            | (56.2)     | (112.5)     | (225.0)     |
| Change in unrealized appreciation/(depreciation) | 5.0%                                       | 2.5%        | 1.2%       | 0%         | (1.2%)     | (2.5%)      | (5.0%)      |

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

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The following table shows the types of securities in our portfolio, their fair market values, average rating and portfolio percentage as of September 30, 2013.

|  | <b>Fair Value<br/>September 30,<br/>2013<br/>(\$ in millions)</b> | <b>Average<br/>Rating</b> | <b>Portfolio<br/>Percentage</b> |
|--|---|---------------------------|---------------------------------|
| Cash and cash equivalents                        | \$ 1,210.6  | AAA                       | 13.6%                           |
| U.S. government securities                       | 1,522.2   | AA+                       | 17.0%                           |
| U.S. government agencies                         | 328.2   | AA+                       | 3.7%                            |
| Non-U.S. government and government agencies      | 209.6   | AA+                       | 2.4%                            |
| State, municipalities and political subdivisions | 95.4  | AA                        | 1.1%                            |
| Mortgage-backed securities ( MBS ):              |   |                           |                                 |
| Agency MBS                                       | 859.6   | AA+                       | 9.7%                            |
| Non-agency MBS                                   | 78.8  | A-                        | 0.9%                            |
| Non-agency high yield                            | 174.2   | CCC+                      | 2.0%                            |
| Commercial MBS                                   | 260.5   | AA+                       | 2.9%                            |
| <b>Total mortgage-backed securities</b>          | <b>1,373.1</b>  |                           | <b>15.5%</b>                    |
| Corporate securities:                            |   |                           |                                 |
| Financials                                       | 841.9   | A                         | 9.5%                            |
| Industrials                                      | 1,146.8   | BBB                       | 12.9%                           |
| Utilities  | 74.8  | BBB                       | 0.9%                            |
| <b>Total corporate securities</b>                | <b>2,063.5</b>  |                           | <b>23.3%</b>                    |
| Asset-backed securities:                         |   |                           |                                 |
| Credit cards                                     | 22.3  | AAA                       | 0.3%                            |
| Auto receivables                                 | 20.4  | AAA                       | 0.2%                            |
| Student Loans                                    | 114.2   | AA+                       | 1.3%                            |
| Collateralized loan obligations                  | 227.8   | AA+                       | 2.6%                            |
| Other  | 71.2  | AAA                       | 0.7%                            |
| <b>Total asset-backed securities</b>             | <b>455.9</b>  |                           | <b>5.1%</b>                     |
| Other invested assets:                           |   |                           |                                 |
| Private equity                                   | 198.6   | N/A                       | 2.2%                            |
| Hedge funds                                      | 537.4   | N/A                       | 6.1%                            |
| Other private securities                         | 138.0   | N/A                       | 1.6%                            |
| High yield loan fund                             | 31.0  | N/A                       | 0.4%                            |
| <b>Total other invested assets</b>               | <b>905.0</b>  |                           | <b>10.3%</b>                    |
| Equities   | 708.9   | N/A                       | 8.0%                            |
| <b>Total investment portfolio</b>                | <b>\$ 8,872.4</b>   |                           | <b>100.0%</b>                   |

As of September 30, 2013, we held \$6.0 billion of fixed income securities. Of those assets, approximately 89.1% were rated investment grade (Baa3/BBB- or higher) with the remaining 10.9% rated in the below investment grade

category. The average credit quality of the fixed maturity portfolios was AA- by Standard & Poor's.

Our 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. 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.

Our non-agency commercial mortgage-backed securities are subject to the risk of non-payment due to increased levels of delinquencies, defaults and losses on commercial loans that cumulatively create shortfalls beyond the level of subordination in our specific securities.



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As of September 30, 2013, we held investments in other invested assets with a carrying value of \$905.0 million. Included in other invested assets are private equity funds, hedge funds, other private securities and a high yield loan fund. Investments in these types of assets involve certain risks related to, among other things, the illiquid nature of the fund shares, the limited operating history of these investments, as well as risks associated with the strategies employed by the managers of these investments. 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.

As of September 30, 2013, our direct exposure to European credit across all of Europe was \$560.4 million as outlined in the table below and is included within fixed maturity investments trading, at fair value and equity securities trading, at fair value in the consolidated balance sheets. As of September 30, 2013, we had no direct sovereign exposure to Greece, Ireland, Italy, Portugal or Spain.

|                | September 30, 2013                       |                        |                                    | Total<br>Exposure |
|----------------|--|------------------------|------------------------------------|-------------------|
|                | Sovereign and<br>Sovereign<br>Guaranteed | Structured<br>Products | Corporate<br>Bonds and<br>Equities |                   |
|                | (\$ in millions)                         |                        |                                    |                   |
| Belgium        | \$ -                                     | \$ -                   | \$ 16.2                            | \$ 16.2           |
| France         | -  | 2.8                    | 55.7                               | 58.5              |
| Germany        | 29.7                                     | 2.0                    | 9.9                                | 41.6              |
| Ireland        | -  | 5.7                    | 0.6                                | 6.3               |
| Italy          | -  | -                      | 0.5                                | 0.5               |
| Luxembourg     | -  | 3.8                    | 17.9                               | 21.7              |
| Netherlands    | 35.0                                     | -                      | 62.4                               | 97.4              |
| Norway         | 6.8                                      | -                      | 24.5                               | 31.3              |
| Russia         | -  | -                      | 14.6                               | 14.6              |
| Spain          | -  | -                      | 19.2                               | 19.2              |
| Sweden         | 5.9                                      | -                      | 42.1                               | 48.0              |
| Switzerland    | 2.4                                      | -                      | 23.0                               | 25.4              |
| United Kingdom | 31.2                                     | 16.7                   | 131.8                              | 179.7             |
| Total exposure | \$ 111.0                                 | \$ 31.0                | \$ 418.4                           | \$ 560.4          |

The U.S. dollar is our reporting currency and the functional currency of all of our operating subsidiaries. However, 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 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 September 30, 2013 and December 31, 2012, approximately 4.2% and 3.4%, 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 nine months ended September 30, 2013 and 2012, approximately 13% and 12%, respectively, was written in currencies other than the U.S. dollar.

**Item 4. Controls and Procedures.**

In connection with the preparation of this quarterly 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 Securities Exchange Act of 1934 (the Exchange Act )) as of September 30, 2013. 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 September 30, 2013, 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 for timely decisions regarding required disclosures.

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Our management, including our 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.

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 quarter ended September 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

The Company, in common with the insurance industry in general, is subject to litigation and arbitration in the normal course of its business. These legal proceedings generally relate to claims asserted by or against the Company in the ordinary course of insurance or reinsurance operations. Estimated amounts payable under these proceedings are included in the reserve for losses and loss expenses in the Company's consolidated balance sheets. As of September 30, 2013, the Company was not a party to any material legal proceedings arising outside the ordinary course of business that management believes will have a material adverse effect on the Company's results of operations, financial position or cash flow.

**Item 1A. Risk Factors.**

Our business is subject to a number of risks, including those identified in Item 1A. of Part I of our 2012 Form 10-K, that could have a material adverse effect on our business, results of operations, financial condition and/or liquidity and that could cause our operating results to vary significantly from period to period. There have been no material changes to the risk factors described in our 2012 Form 10-K. The risks described in our 2012 Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also could have a material adverse effect on our business, results of operations, financial condition and/or liquidity.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

(c) The following table summarizes our repurchases of our common shares during the three months ended September 30, 2013:

|  | <b>Total Number of</b> | <b>Maximum Dollar Value<br/>(or Approximate</b> |
|--|------------------------|---|
|--|------------------------|---|

| <b>Period</b>        | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid per Share</b> | <b>Shares Purchased as Part of Publicly Announced Plans or Programs</b> | <b>Dollar Value) of Shares that May Yet be Purchased Under the Plans or Programs</b> |
|----------------------|---|-------------------------------------|---|--|
| July 1 31, 2013      | 192,388                                 | \$ 93.56                            | 192,388   | \$ 309.7 million   |
| August 1 31, 2013    | 40,000                                  | 94.89                               | 40,000  | 305.9 million  |
| September 1 30, 2013 | 195,000                                 | 96.30                               | 195,000   | 287.1 million  |
| Total                | 427,388                                 | \$ 94.93                            | 427,388   | \$ 287.1 million(1)  |

- (1) At the 2012 Annual Shareholder Meeting on May 3, 2012, Holdings shareholders approved a new, two-year \$500 million share repurchase program. Share repurchases may be effected from time to time through open market purchases, privately negotiated transactions, tender offers or otherwise.

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**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

**Exhibit  
Number**

**Description**

|         |  |
|---------|--|
| 10.1    | Employment Agreement, dated as of August 1, 2013, by and between AWAC Services Company and John J. Gauthier.   |
| 10.2(1) | Form of Indemnification Agreement for Eric S. Schwartz and Kent W. Ziegler.  |
| 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 September 30, 2013 and December 31, 2012, (ii) the Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2013 and 2012, (iii) the Consolidated Statements of Shareholders Equity for the nine months ended September 30, 2013 and 2012, (iv) the Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012 and (v) the Notes to the Consolidated Financial Statements. |

- (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 December 1, 2010. The Indemnification Agreements for Messrs. Schwartz and Ziegler, dated as of October 17 and 23, 2013, respectively, are materially identical to the form filed as Exhibit 10.4 thereto.

Management contract or compensatory plan, contract or arrangement.

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- \* 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 Quarterly Report on Form 10-Q 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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**SIGNATURES**

Pursuant to the requirements 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.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS,  
AG

Dated: October 23, 2013

By: /s/ Scott A. Carmilani  
Name: Scott A. Carmilani  
Title: President and Chief Executive Officer

Dated: October 23, 2013

By: /s/ Thomas A. Bradley  
Name: Thomas A. Bradley  
Title: Executive Vice President and Chief Financial  
Officer

Dated: October 23, 2013

By: /s/ Kent W. Ziegler  
Name: Kent W. Ziegler  
Title: Senior Vice President, Finance and Chief  
Accounting Officer

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**EXHIBIT INDEX**

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