

Allied World Assurance Co Holdings, AG
Form 10-Q
April 22, 2015
Table of Contents

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

Form 10-Q
(Mark One)

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

For the quarterly period ended: March 31, 2015

OR

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

For the transition period from _____ to _____

Commission file number: 001-32938

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

(Exact Name of Registrant as Specified in Its Charter)

Switzerland

98-0681223

(State or Other Jurisdiction of

(I.R.S. Employer

Incorporation or Organization)

Identification No.)

Gubelstrasse 24, Park Tower, 15th Floor, 6300 Zug, Switzerland

(Address of Principal Executive Offices and Zip Code)

41-41-768-1080

(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

As of April 13, 2015, 95,444,669 common shares were outstanding.

Table of Contents

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

| | | |
|---------|--|-----------|
| Item 1. | <u>Financial Statements</u> | <u>1</u> |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>29</u> |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | <u>55</u> |
| Item 4. | <u>Controls and Procedures</u> | <u>58</u> |

PART II OTHER INFORMATION

| | | |
|----------|--|-----------|
| Item 1. | <u>Legal Proceedings</u> | <u>59</u> |
| Item 1A. | <u>Risk Factors</u> | <u>59</u> |
| Item 2. | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>60</u> |
| Item 3. | <u>Defaults Upon Senior Securities</u> | <u>61</u> |
| Item 4. | <u>Mine Safety Disclosures</u> | <u>61</u> |
| Item 5. | <u>Other Information</u> | <u>61</u> |
| Item 6. | <u>Exhibits</u> | <u>62</u> |

| | |
|-------------------|-----------|
| <u>SIGNATURES</u> | <u>63</u> |
|-------------------|-----------|

EXHIBIT INDEX

Table of Contents

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

as of March 31, 2015 and December 31, 2014

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

| | As of March 31, 2015 | As of December 31, 2014 |
|---|----------------------------|-------------------------------|
| ASSETS: | | |
| Fixed maturity investments trading, at fair value (amortized cost: 2015: \$6,229,608; 2014: \$6,035,240) | \$6,288,897 | \$6,069,010 |
| Equity securities trading, at fair value (cost: 2015: \$798,275; 2014: \$791,206) | 856,652 | 844,163 |
| Other invested assets | 926,407 | 955,509 |
| Total investments | 8,071,956 | 7,868,682 |
| Cash and cash equivalents | 515,070 | 589,339 |
| Restricted cash | 49,931 | 80,971 |
| Insurance balances receivable | 773,394 | 664,815 |
| Funds held | 479,909 | 724,021 |
| Prepaid reinsurance | 318,838 | 360,732 |
| Reinsurance recoverable | 1,350,311 | 1,340,256 |
| Reinsurance recoverable on paid losses | 107,071 | 86,075 |
| Accrued investment income | 28,267 | 28,456 |
| Net deferred acquisition costs | 187,246 | 151,546 |
| Goodwill | 280,725 | 278,258 |
| Intangible assets | 49,274 | 46,298 |
| Balances receivable on sale of investments | 46,822 | 47,149 |
| Net deferred tax assets | 29,922 | 33,615 |
| Other assets | 329,050 | 121,350 |
| Total assets | \$12,617,786 | \$12,421,563 |
| LIABILITIES: | | |
| Reserve for losses and loss expenses | \$5,905,110 | \$5,881,165 |
| Unearned premiums | 1,717,399 | 1,555,313 |
| Reinsurance balances payable | 184,322 | 180,060 |
| Balances due on purchases of investments | 34,396 | 5,428 |
| Senior notes | 798,881 | 798,802 |
| Other long-term debt | 19,730 | 19,213 |
| Dividends payable | 21,528 | 21,669 |
| Accounts payable and accrued liabilities | 107,353 | 181,622 |
| Total liabilities | \$8,788,719 | \$8,643,272 |
| Commitments and contingencies | | |
| SHAREHOLDERS' EQUITY: | | |
| Common shares: 2015 and 2014: par value CHF 4.10 per share (2015: 100,299,454; 2014: 100,775,256 shares issued and 2015: 95,444,669; 2014: 96,195,482 shares outstanding) | 406,088 | 408,020 |
| Treasury shares, at cost (2015: 4,854,785; 2014: 4,579,774) | (162,356 |) (143,075 |
| Retained earnings | 3,585,335 | 3,513,346 |
| Total shareholders' equity | 3,829,067 | 3,778,291 |

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

| | | |
|--|--------------|--------------|
| Total liabilities and shareholders' equity | \$12,617,786 | \$12,421,563 |
|--|--------------|--------------|

See accompanying notes to the consolidated financial statements.

1

Table of Contents

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

for the three months ended March 31, 2015 and 2014

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

| | Three Months Ended March 31, | |
|---|---------------------------------|-------------|
| | 2015 | 2014 |
| REVENUES: | | |
| Gross premiums written | \$880,614 | \$901,393 |
| Premiums ceded | (108,086) | (129,779) |
| Net premiums written | 772,528 | 771,614 |
| Change in unearned premiums | (203,980) | (241,329) |
| Net premiums earned | 568,548 | 530,285 |
| Net investment income | 44,551 | 47,619 |
| Net realized investment gains | 45,025 | 54,205 |
| Other income | 854 | — |
| Total revenue | 658,978 | 632,109 |
| EXPENSES: | | |
| Net losses and loss expenses | 325,176 | 275,286 |
| Acquisition costs | 78,699 | 67,722 |
| General and administrative expenses | 97,138 | 80,340 |
| Other expense | 1,823 | — |
| Amortization of intangible assets | 633 | 633 |
| Interest expense | 14,337 | 14,534 |
| Foreign exchange loss | 9,897 | 49 |
| Total expenses | 527,703 | 438,564 |
| Income before income taxes | 131,275 | 193,545 |
| Income tax expense | 6,919 | 16,573 |
| NET INCOME | 124,356 | 176,972 |
| Other comprehensive income | — | — |
| COMPREHENSIVE INCOME | \$ 124,356 | \$ 176,972 |
| PER SHARE DATA | | |
| Basic earnings per share | \$ 1.30 | \$ 1.78 |
| Diluted earnings per share | \$ 1.27 | \$ 1.74 |
| Weighted average common shares outstanding | 95,935,551 | 99,545,187 |
| Weighted average common shares and common share equivalents outstanding | 97,577,029 | 101,584,662 |
| Dividends paid per share | \$0.225 | \$0.167 |
| 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 three months ended March 31, 2015 and 2014
 (Expressed in thousands)

| | Share Capital | Treasury Shares | Retained Earnings | Total |
|--------------------|------------------|--------------------|----------------------|-------------|
| December 31, 2014 | \$408,020 | \$(143,075) |) \$3,513,346 | \$3,778,291 |
| Net income | — | — | 124,356 | 124,356 |
| Dividends | — | — | (21,522) |) (21,522) |
| Stock compensation | — | 12,288 | (13,397) |) (1,109) |
| Share repurchases | — | (50,949) |) — | (50,949) |
| Shares canceled | (1,932) |) 19,380 | (17,448) |) — |
| March 31, 2015 | \$406,088 | \$(162,356) |) \$3,585,335 | \$3,829,067 |
| December 31, 2013 | \$418,988 | \$(79,992) |) \$3,180,830 | \$3,519,826 |
| Net income | — | — | 176,972 | 176,972 |
| Dividends | — | — | (16,489) |) (16,489) |
| Stock compensation | — | 11,236 | (6,208) |) 5,028 |
| Share repurchases | — | (68,659) |) — | (68,659) |
| Shares canceled | (8,168) |) 68,659 | (60,491) |) — |
| March 31, 2014 | \$410,820 | \$(68,756) |) \$3,274,614 | \$3,616,678 |

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 three months ended March 31, 2015 and 2014
 (Expressed in thousands)

| | Three Months Ended March 31, | |
|---|---------------------------------|-------------|
| | 2015 | 2014 |
| CASH FLOWS PROVIDED BY OPERATING ACTIVITIES: | | |
| Net income | \$124,356 | \$176,972 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Net realized gains on sales of investments | (32,536) | (49,756) |
| Mark to market adjustments | (22,694) | (13,956) |
| Stock compensation expense | 4,002 | 4,240 |
| Undistributed income of equity method investments | 9,767 | (2,292) |
| Changes in: | | |
| Reserve for losses and loss expenses, net of reinsurance recoverables | 13,890 | 44,248 |
| Unearned premiums, net of prepaid reinsurance | 203,980 | 241,329 |
| Insurance balances receivable | (108,579) | (175,739) |
| Reinsurance recoverable on paid losses | (20,996) | 840 |
| Funds held | 244,112 | 184,629 |
| Reinsurance balances payable | 4,262 | (12,982) |
| Net deferred acquisition costs | (35,700) | (40,443) |
| Net deferred tax assets | 3,693 | 521 |
| Accounts payable and accrued liabilities | (75,008) | (83,745) |
| Other items, net | 5,027 | 29,230 |
| Net cash provided by operating activities | 317,576 | 303,096 |
| CASH FLOWS USED IN INVESTING ACTIVITIES: | | |
| Purchases of trading securities | (1,723,443) | (1,568,993) |
| Purchases of other invested assets | (233,252) | (779,934) |
| Sales of trading securities | 1,561,890 | 1,494,648 |
| Sales of other invested assets | 56,535 | 663,237 |
| Purchases of fixed assets | (8,374) | (2,336) |
| Net cash paid on acquisition | (3,543) | — |
| Change in restricted cash | 31,040 | 4,823 |
| Net cash used in investing activities | (319,147) | (188,555) |
| CASH FLOWS USED IN FINANCING ACTIVITIES: | | |
| Dividends paid | (21,669) | (16,732) |
| Proceeds from the exercise of stock options | 4,223 | 3,030 |
| Share repurchases | (50,273) | (68,659) |
| Net cash used in financing activities | (67,719) | (82,361) |
| Effect of exchange rate changes on foreign currency cash | (4,979) | 1,686 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (74,269) | 33,866 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 589,339 | 531,936 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$515,070 | \$565,802 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | \$717 | \$529 |
| Cash paid for interest expense | \$18,750 | \$18,750 |
| See accompanying notes to the consolidated financial statements. | | |

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)

1. GENERAL

Allied World Assurance Company Holdings, AG, a Swiss holding company (“Allied World Switzerland”), through its wholly-owned subsidiaries (collectively, the “Company”), is a global provider of a diversified portfolio of property and casualty insurance and reinsurance products with operations in Australia, Bermuda, Canada, Europe Hong Kong, Singapore and the United States as well as Lloyd's Syndicate 2232. References to \$ are to the lawful currency of the United States and to CHF are to the lawful currency of Switzerland.

In January 2015, the Company acquired Latin American Underwriters Holdings Ltd. (“LAU”) for \$5,105. LAU had previously underwritten trade credit insurance and political risk coverages solely for the Company since 2010. As part of the acquisition, the Company recorded goodwill of \$2,467 and customer relationship intangibles of \$3,610, which have a five-year amortization period. The Company also recorded \$1,000 of contingent consideration related to certain earn-out payments.

During the fourth quarter of 2014, the Company reorganized how it manages its business, and as a result it realigned its executive management team and changed its reportable segments to correspond to the reorganization. The Company's Bermuda insurance operations, except for the trade credit line of business, which had previously been included in the international insurance segment, was combined with the U.S. insurance segment, with the new segment renamed the "North American Insurance" segment. The remaining direct insurance operations of the international insurance segment was renamed the "Global Markets Insurance" segment. The Reinsurance segment remained unchanged. The newly created segments are included in Note 12 and prior periods have been recast to conform to the new presentation.

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

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.

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, 2014.

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)

3. NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). ASU 2014-09 provides a framework, through a five-step process, for recognizing revenue from customers, improves comparability and consistency of recognizing revenue across entities, industries, jurisdictions and capital markets, and requires enhanced disclosures. Certain contracts with customers are specifically excluded from the scope of ASU 2014-09, including, among others, insurance contracts accounted for under Accounting Standard Codification 944, Financial Services - Insurance. ASU 2014-09 is effective on January 1, 2017 with retrospective adoption required for the comparative periods. In recent re-deliberations, the FASB has decided to propose a one-year deferral of the effective date of ASU 2014-09, such that it will become effective on January 1, 2018. The Company is currently assessing the impact the adoption of ASU 2014-09 will have on future financial statements and related disclosures.

In August 2014, the FASB issued Accounting Standards Update 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern" ("ASU 2014-15"). Currently, there is no guidance under U.S. GAAP regarding management's responsibility to assess whether there is substantial doubt about an entity's ability to continue as a going concern. Under ASU 2014-15, the Company will be required to assess its ability to continue as a going concern each interim and annual reporting period and provide certain disclosures if there is substantial doubt about the entity's ability to continue as a going concern, including management's plan to alleviate the substantial doubt. ASU 2014-15 is effective for the year ended December 31, 2016 and early adoption is permitted. The Company early adopted ASU 2014-15 on January 1, 2015.

In February 2015, the FASB issued Accounting Standards Update 2015-02, "Amendments to the Consolidation Analysis" ("ASU 2015-02"). ASU 2015-02 amends certain aspects of the consolidation guidance in U.S. GAAP. In particular, it will modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities and also eliminates the presumption that a general partner should consolidate a limited partnership. The new guidance will also affect the consolidation analysis of the Company's interests in VIEs, particularly those that have fee arrangements and related party relationships. ASU 2015-02 is effective on January 1, 2016 and retrospectively adoption is required either through a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the year of adoption or retrospectively for all comparative periods. Early adoption is permitted. The Company is currently assessing the impact the adoption of ASU 2015-02 will have on future financial statements and related disclosures.

4. INVESTMENTS**a) Trading Securities**

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

| | March 31, 2015 | | December 31, 2014 | |
|---|----------------|----------------|-------------------|----------------|
| | Fair Value | Amortized Cost | Fair Value | Amortized Cost |
| U.S. government and government agencies | \$ 1,577,775 | \$ 1,569,317 | \$ 1,610,502 | \$ 1,610,880 |
| Non-U.S. government and government agencies | 189,448 | 204,867 | 188,199 | 196,332 |
| States, municipalities and political subdivisions | 178,551 | 172,339 | 170,567 | 165,615 |
| Corporate debt: | | | | |
| Financial institutions | 1,107,108 | 1,094,338 | 1,024,667 | 1,018,777 |
| Industrials | 1,107,548 | 1,105,744 | 1,029,729 | 1,037,820 |
| Utilities | 113,383 | 113,280 | 110,997 | 111,599 |

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

| | | | | |
|----------------------------------|----------------|---------------|-------------------|---------------|
| Mortgage-backed | 1,286,210 | 1,238,165 | 1,263,517 | 1,219,712 |
| Asset-backed | 728,874 | 731,558 | 670,832 | 674,505 |
| Total fixed maturity investments | \$6,288,897 | \$6,229,608 | \$6,069,010 | \$6,035,240 |
| | March 31, 2015 | | December 31, 2014 | |
| | Fair Value | Original Cost | Fair Value | Original Cost |
| Equity securities | \$856,652 | \$798,275 | \$844,163 | \$791,206 |
| Other invested assets | 792,569 | 701,637 | 812,543 | 725,069 |
| | \$1,649,221 | \$1,499,912 | \$1,656,706 | \$1,516,275 |

6

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)

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 exclude other private securities described below in Note 4(b) that are accounted for using the equity method of accounting.

b) Other Invested Assets

Details regarding the carrying value, redemption characteristics and unfunded investment commitments of the other invested assets portfolio as of March 31, 2015 and December 31, 2014 were as follows:

| Investment Type | Carrying Value as of March 31, 2015 | Investments with Redemption Restrictions | Estimated Remaining Restriction Period | Investments without Redemption Restrictions | Redemption Frequency(1) | Redemption Notice Period(1) | Unfunded Commitments |
|---|-------------------------------------|--|--|---|--------------------------|-----------------------------|----------------------|
| Private equity | \$196,090 | \$196,090 | 2 - 8 Years | \$— | | | \$ 191,382 |
| Mezzanine debt | 163,357 | 163,357 | 5 - 9 Years | — | | | 200,804 |
| Distressed | 5,545 | 5,545 | 3 Years | — | | | 5,347 |
| Real estate | — | — | 9 Years | — | | | 150,000 |
| Total private equity | 364,992 | 364,992 | | — | | | 547,533 |
| Distressed | 173,122 | 173,122 | | — | Based on net asset value | 60 Days | — |
| Equity long/short | 87,644 | — | 1 Year | 87,644 | Quarterly | 30 -60 Days | — |
| Multi-strategy | 15,996 | — | | 15,996 | Quarterly | 45 -90 Days | — |
| Relative value credit | 120,460 | — | | 120,460 | Quarterly | 60 Days | — |
| Total hedge funds | 397,222 | 173,122 | | 224,100 | | | — |
| High yield loan fund | 30,355 | — | | 30,355 | Monthly | 30 days | — |
| Total other invested assets at fair value | 792,569 | 538,114 | | 254,455 | | | 547,533 |
| Other private securities | 133,838 | — | | 133,838 | | | — |
| Total other invested assets | \$926,407 | \$538,114 | | \$388,293 | | | \$ 547,533 |

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)

| Investment Type | Carrying Value as of December 31, 2014 | Investments with Redemption Restrictions | Estimated Remaining Restriction Period | Investments without Redemption Restrictions | Redemption Frequency(1) | Redemption Notice Period(1) | Unfunded Commitments |
|---|--|--|--|---|--------------------------|-----------------------------|----------------------|
| Private equity | \$184,576 | \$184,576 | 2 - 8 Years | \$— | | | \$ 223,802 |
| Mezzanine debt | 166,905 | 166,905 | 5 - 9 Years | — | | | 204,232 |
| Distressed | 5,869 | 5,869 | 3 Years | — | | | 5,180 |
| Real estate | — | — | 9 Years | — | | | 50,000 |
| Total private equity | 357,350 | 357,350 | | — | | | 483,214 |
| Distressed | 170,169 | 170,169 | | — | Based on net asset value | 60 Days | — |
| Equity long/short | 84,198 | — | | 84,198 | Quarterly | 30 -60 Days | — |
| Multi-strategy | 51,507 | — | | 51,507 | Quarterly | 45 -90 Days | — |
| Relative value credit | 119,156 | — | | 119,156 | Quarterly | 60 Days | — |
| Total hedge funds | 425,030 | 170,169 | | 254,861 | | | — |
| High yield loan fund | 30,163 | — | | 30,163 | Monthly | 30 days | — |
| Total other invested assets at fair value | 812,543 | 527,519 | | 285,024 | | | 483,214 |
| Other private securities | 142,966 | — | | 142,966 | | | — |
| Total other invested assets | \$955,509 | \$527,519 | | \$427,990 | | | \$ 483,214 |

(1) The redemption frequency and notice periods only apply to the investments without redemption restrictions. Some or all of these investments may be subject to a gate as described below.

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

The following describes each investment type:

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

for redemption until termination of the fund.

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

Distressed funds: In distressed debt investing, managers take positions in the debt of companies experiencing significant financial difficulties, including bankruptcy, or in certain positions of the capital structure of structured

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)

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.

Real estate funds: Private real estate funds invest directly in commercial real estate (multifamily units, industrial buildings, office spaces and retail stores) and some residential property. Real estate managers have diversified portfolios that generally follow core, core-plus, value-added or opportunistic strategies. These 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.

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

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

Other private securities: These securities mostly 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.

c) Net Investment Income

| | Three Months Ended | |
|---|--------------------|----------|
| | March 31, | |
| | 2015 | 2014 |
| Fixed maturity investments | \$36,258 | \$36,299 |
| Equity securities | 3,563 | 3,253 |
| Other invested assets: hedge funds and private equity | 8,380 | 3,992 |
| Other invested assets: other private securities | 866 | 7,416 |
| Cash and cash equivalents | 462 | 439 |
| Expenses | (4,978 |) (3,780 |
| Net investment income | \$44,551 | \$47,619 |

d) Components of Realized Gains and Losses

| | Three Months Ended | |
|---|--------------------|-----------|
| | March 31, | |
| | 2015 | 2014 |
| Gross realized gains on sale of invested assets | \$45,289 | \$62,292 |
| Gross realized losses on sale of invested assets | (13,004 |) (12,247 |
| Net realized and unrealized losses on derivatives | (11,632 |) (12,920 |
| Mark-to-market gains (losses): | | |
| Fixed maturity investments, trading | 25,517 | 22,455 |
| Equity securities, trading | 5,420 | (21,605 |
| Other invested assets, trading | (6,565 |) 16,230 |
| Net realized investment gains | \$45,025 | \$54,205 |

e) Pledged Assets

As of March 31, 2015 and December 31, 2014, \$3,114,066 and \$3,585,792, 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.

9

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)

In addition, as of March 31, 2015 and December 31, 2014, a further \$599,724 and \$571,750, respectively, of cash and cash equivalents and investments were pledged as collateral for the Company's letter of credit facilities. See Note 10(f) to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 for details on the Company's credit facilities.

5. DERIVATIVE INSTRUMENTS

As of March 31, 2015 and December 31, 2014, 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"):

| | March 31, 2015 | | | | December 31, 2014 | | | |
|----------------------------|---|-----------------------------------|---|---------------------------------------|---|-----------------------------------|---|---------------------------------------|
| | Asset Derivative Notional Amount | Asset Derivative Fair Value | Liability Derivative Notional Amount | Liability Derivative Fair Value | Asset Derivative Notional Amount | Asset Derivative Fair Value | Liability Derivative Notional Amount | Liability Derivative Fair Value |
| Foreign exchange contracts | \$32,833 | \$ 123 | \$24,857 | \$ 203 | \$33,875 | \$ 1,274 | \$ 167,376 | \$ 991 |
| Interest rate swaps | — | — | 662,200 | 1,119 | — | — | 571,500 | 683 |
| Total derivatives | \$32,833 | \$ 123 | \$687,057 | \$ 1,322 | \$33,875 | \$ 1,274 | \$738,876 | \$ 1,674 |

Derivative assets and derivative liabilities are classified within "other assets" or "accounts payable and accrued liabilities" on the consolidated balance sheets.

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

| | Three Months Ended March 31, | |
|---|---------------------------------|--------------|
| | 2015 | 2014 |
| Foreign exchange contracts | \$ (7,352) | \$ (868) |
| Total included in foreign exchange loss | (7,352) | (868) |
| Foreign exchange contracts | 1,050 | (558) |
| Interest rate futures | (12,682) | (12,362) |
| Total included in net realized investment gains | (11,632) | (12,920) |
| Total realized and unrealized losses on derivatives | \$ (18,984) | \$ (13,788) |

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. For example, the Company purchased a forward contract to hedge a portion of its foreign currency exposure related to the consideration that was paid for the Hong Kong and Singapore operations of RSA.

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

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)

decrease the overall duration of the portfolio. Additionally, interest rate future and interest rate swap contracts can be utilized to obtain the desired position along the yield curve in order to protect against certain future yield curve shapes.

The Company also purchases options to actively manage its equity portfolio.

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

The following table shows the fair value of the Company's financial instruments and where in the fair value hierarchy the fair value measurements are included as of the dates indicated below:

| March 31, 2015 | Carrying Amount | Total Fair Value | Level 1 | Level 2 | Level 3 |
|---|-----------------|------------------|-------------|-------------|-------------|
| Fixed maturity investments: | | | | | |
| U.S. government and government agencies | \$1,577,775 | \$1,577,775 | \$1,467,357 | \$110,418 | \$— |
| Non-U.S. government and government agencies | 189,448 | 189,448 | — | 189,448 | — |
| States, municipalities and political subdivisions | 178,551 | 178,551 | — | 178,551 | — |
| Corporate debt | 2,328,039 | 2,328,039 | — | 2,328,039 | — |
| Mortgage-backed | 1,286,210 | 1,286,210 | — | 1,153,512 | 132,698 |
| Asset-backed | 728,874 | 728,874 | — | 635,942 | 92,932 |
| Total fixed maturity investments | 6,288,897 | 6,288,897 | 1,467,357 | 4,595,910 | 225,630 |
| Equity securities | 856,652 | 856,652 | 807,885 | — | 48,767 |
| Other invested assets | 792,569 | 792,569 | — | — | 792,569 |
| Total investments | \$7,938,118 | \$7,938,118 | \$2,275,242 | \$4,595,910 | \$1,066,966 |
| Derivative assets: | | | | | |
| Foreign exchange contracts | \$123 | \$123 | \$— | \$123 | \$— |
| Derivative liabilities: | | | | | |
| Foreign exchange contracts | \$203 | \$203 | \$— | \$203 | \$— |

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

| | | | | | |
|----------------------|-----------|-----------|-----|-----------|-----|
| Interest rate swaps | 1,119 | 1,119 | — | 1,119 | — |
| Senior notes | \$798,881 | \$877,027 | \$— | \$877,027 | \$— |
| Other long-term debt | \$19,730 | \$27,175 | \$— | \$27,175 | \$— |

11

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)

| December 31, 2014 | Carrying Amount | Total Fair Value | Level 1 | Level 2 | Level 3 |
|---|-----------------|------------------|-------------|-----------|---------|
| Fixed maturity investments: | | | | | |
| U.S. Government and Government agencies | \$1,610,502 | \$1,610,502 | \$1,499,347 | \$111,155 | \$— |
| Non-U.S. Government and Government agencies | 188,199 | 188,199 | — | 188,199 | — |
| States, municipalities and political subdivisions | 170,567 | 170,567 | — | 170,567 | — |
| Corporate debt | 2,165,393 | 2,165,393 | — | 2,165,393 | — |
| Mortgage-backed | 1,263,517 | 1,263,517 | — | 1,081,734 | 181,783 |
| Asset-backed | 670,832 | 670,832 | — | 615,419 | 55,413 |
| Total fixed maturity investments | 6,069,010 | 6,069,010 | 1,499,347 | 4,332,467 | 237,196 |
| Equity securities | 844,163 | 844,163 | 800,833 | — | 43,330 |
| Other invested assets | 812,543 | 812,543 | — | — | 812,543 |
| Total investments | \$7,725,716 | \$7,725,716 | \$2,300,180 | \$ | |