ALLIED WORLD ASSURANCE CO HOLDINGS LTD
Form 424B3
May 11, 2007

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PROSPECTUS SUPPLEMENT NO. 2	Filed Pursuant to Rule 424(b)(3)
(To Prospectus dated May 1, 2007)	Registration No. 333-135464

$500,000,000

Allied World Assurance Company Holdings, Ltd

7.50% Senior Notes due 2016

This Prospectus Supplement No. 2 supplements the Market-Making Prospectus, dated May 1, 2007, relating to the public offering of the issuer s 7.50% senior notes due 2016, which closed on July 26, 2006. Goldman, Sachs & Co. is continuing to make a market in the senior notes pursuant to the Market-Making Prospectus.

This Prospectus Supplement No. 2 is comprised of a quarterly report on Form 10-Q filed with the SEC on May 11, 2007.

You should read this Prospectus Supplement No. 2 in conjunction with the Market-Making Prospectus. This Prospectus Supplement No. 2 updates information in the Market-Making Prospectus and, accordingly, to the extent inconsistent, the information in this Prospectus Supplement No. 2 supersedes the information contained in the Market-Making Prospectus.

Before you invest in the issuer s senior notes, you should read the Market-Making Prospectus and other documents the issuer has filed with the SEC for more complete information about the issuer and an investment in its senior notes. You may get these documents for free by visiting EDGAR on the SEC Website at www.sec.gov. Alternatively, you may obtain a copy of the Market-Making Prospectus by calling Goldman, Sachs & Co. toll-free at 1-866-471-2526.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement is truthful and complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus Supplement No. 2 is May 11, 2007.

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

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended: March 31, 2007

OR

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

Bermuda	**98-0481737**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

27 Richmond Road, Pembroke HM 08, Bermuda
(Address of Principal Executive Offices and Zip Code)

(441) 278-5400
(Registrant s Telephone Number, Including Area Code)

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

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

Large Accelerated Filer o   Accelerated Filer o   Non-Accelerated Filer þ

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

The number of outstanding common shares, par value $0.03 per share, of Allied World Assurance Company Holdings, Ltd as of May 8, 2007 was 60,393,442.

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PART I

FINANCIAL INFORMATION

Item 1. ***Financial Statements.***

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

as of March 31, 2007 and December 31, 2006
(Expressed in thousands of United States dollars, except share and per share amounts)

	As of March 31, 2007	As of December 31, 2006
ASSETS:		
Fixed maturity investments available for sale, at fair value (amortized cost: 2007: $5,392,983; 2006: $5,188,379)	$ 5,407,813	$ 5,177,812
Other invested assets available for sale, at fair value (cost: 2007: $246,500; 2006: $245,657)	263,993	262,557
Total investments	5,671,806	5,440,369
Cash and cash equivalents	288,284	366,817
Restricted cash	200,813	138,223
Securities lending collateral	534,774	304,742
Insurance balances receivable	400,231	304,261
Prepaid reinsurance	154,461	159,719
Reinsurance recoverable	668,050	689,105
Accrued investment income	44,171	51,112
Deferred acquisition costs	107,465	100,326
Intangible assets	3,920	3,920
Balances receivable on sale of investments	25,239	16,545
Net deferred tax assets	5,259	5,094
Other assets	44,934	40,347
Total assets	$ 8,149,407	$ 7,620,580
LIABILITIES:		
Reserve for losses and loss expenses	$ 3,663,224	$ 3,636,997
Unearned premiums	879,817	813,797
Unearned ceding commissions	25,352	23,914
Reinsurance balances payable	112,731	82,212
Securities lending payable	534,774	304,742
Balances due on purchase of investments	46,517	
Dividends payable	9,052	

Senior notes	498,602	498,577
Accounts payable and accrued liabilities	23,360	40,257
Total liabilities	$ 5,793,429	$ 5,400,496
SHAREHOLDERS EQUITY:		
Common shares, par value $0.03 per share, issued and outstanding 2007: 60,390,269 shares and 2006: 60,287,696 shares	1,812	1,809
Additional paid-in capital	1,828,612	1,822,607
Retained earnings	494,073	389,204
Accumulated other comprehensive income: net unrealized gains on investments, net of tax	31,481	6,464
Total shareholders equity	2,355,978	2,220,084
Total liabilities and shareholders equity	$ 8,149,407	$ 7,620,580

See accompanying notes to the unaudited condensed consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

for the three months ended March 31, 2007 and 2006
(Expressed in thousands of United States dollars, except share and per share amounts)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
REVENUES:		
Gross premiums written	$ 438,406	$ 498,120
Premiums ceded	(80,562)	(70,617)
Net premiums written	357,844	427,503
Change in unearned premiums	(71,278)	(118,560)
Net premiums earned	286,566	308,943
Net investment income	72,648	62,001
Net realized investment losses	(6,484)	(5,236)
	352,730	365,708
EXPENSES:		
Net losses and loss expenses	165,995	205,960
Acquisition costs	29,196	36,472
General and administrative expenses	33,203	20,322
Interest expense	9,374	6,451
Foreign exchange loss	32	545
	237,800	269,750
Income before income taxes	114,930	95,958
Income tax expense (recovery)	1,009	(2,163)
NET INCOME	113,921	98,121
Other comprehensive income (loss)		
Unrealized gains (losses) on investments arising during the period net of applicable deferred income tax (expense) recovery 2007: ($817); 2006: $344	18,533	(44,716)
Reclassification adjustment for net realized losses included in net income	6,484	5,236
Other comprehensive income (loss)	25,017	(39,480)
COMPREHENSIVE INCOME	$ 138,938	$ 58,641
PER SHARE DATA		

Basic earnings per share	$	1.89	$	1.96
Diluted earnings per share	$	1.83	$	1.94
Weighted average common shares outstanding		60,333,209		50,162,842
Weighted average common shares and common share equivalents outstanding		62,207,941		50,485,556
Dividends declared per share	$	0.15	$	

See accompanying notes to the unaudited condensed consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
for the three months ended March 31, 2007 and 2006
(Expressed in thousands of United States dollars)

	Share Capital	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
December 31, 2006	$ 1,809	$ 1,822,607	$ 6,464	$ 389,204	$ 2,220,084
Net income				113,921	113,921
Dividends				(9,052)	(9,052)
Other comprehensive income			25,017		25,017
Stock compensation	3	6,005			6,008
March 31, 2007	$ 1,812	$ 1,828,612	$ 31,481	$ 494,073	$ 2,355,978

	Share Capital	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings (Accumulated Deficit)	Total
December 31, 2005	$ 1,505	$ 1,488,860	$ (25,508)	$ (44,591)	$ 1,420,266
Net income				98,121	98,121
Other comprehensive loss			(39,480)		(39,480)
March 31, 2006	$ 1,505	$ 1,488,860	$ (64,988)	$ 53,530	$ 1,478,907

See accompanying notes to the unaudited condensed consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
for the three months ended March 31, 2007 and 2006
(Expressed in thousands of United States dollars)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 113,921	$ 98,121
Adjustments to reconcile net income to cash provided by operating activities:		
Net realized (gains) losses on sales of investments	(2,898)	5,236
Net realized losses for other-than-temporary impairment charges on investments	9,382	
Amortization of premiums net of accrual of discounts on fixed maturities	(88)	5,221
Amortization and depreciation of fixed assets	2,075	665
Deferred income taxes	(244)	6
Stock compensation expense	6,316	407
Debt issuance expense		49
Amortization of discount and expenses on senior notes	104	
Cash settlements on interest rate swaps		6,356
Mark to market on interest rate swaps		(5,917)
Insurance balances receivable	(95,970)	(92,278)
Prepaid reinsurance	5,258	6,002
Reinsurance recoverable	21,055	52,297
Accrued investment income	6,941	10,001
Deferred acquisition costs	(7,139)	(13,232)
Net deferred tax assets	79	(2,531)
Other assets	(1,984)	6,087
Reserve for losses and loss expenses	26,227	15,597
Unearned premiums	66,020	112,559
Unearned ceding commissions	1,438	(1,637)
Reinsurance balances payable	30,519	(7,234)
Accounts payable and accrued liabilities	(23,214)	(8,677)
Net cash provided by operating activities	157,798	187,098
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchases of fixed maturity investments	(866,584)	(2,086,409)
Purchases of other invested assets	(3,873)	(117,055)
Sales of fixed maturity investments	698,521	1,887,952
Sales of other invested assets	2,976	158,871
Purchase of fixed assets	(4,929)	(1,079)
Change in restricted cash	(62,590)	(13,373)
Net cash used in investing activities	(236,479)	(171,093)

CASH FLOWS USED IN FINANCING ACTIVITIES:				
Net cash used in financing activities				
Effect of exchange rate changes on foreign currency cash		148		215
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(78,533)		16,220
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		366,817		172,379
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	288,284	$	188,599
Supplemental disclosure of cash flow information:				
Cash paid for income taxes	$	1,600	$	
Cash paid for interest expense		19,271		6,395
Change in balance receivable on sale of investments		(8,694)		2,409
Change in balance payable on purchase of investments		46,517		

See accompanying notes to the unaudited condensed consolidated financial statements.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share and per share amounts)

1. GENERAL

Allied World Assurance Company Holdings, Ltd (Holdings) was incorporated in Bermuda on November 13, 2001. Holdings, through its wholly-owned subsidiaries (collectively, the Company), provides property and casualty insurance and reinsurance on a worldwide basis.

On July 11, 2006, the Company sold 8,800,000 common shares in its initial public offering (IPO) at a public offering price of $34.00 per share. On July 19, 2006, the Company sold an additional 1,320,000 common shares at $34.00 per share in connection with the exercise in full by the underwriters of their over-allotment option. In connection with the IPO, a 1-for-3 reverse stock split of the Company s common shares was consummated on July 7, 2006. All share and per share amounts related to common shares, warrants, options and restricted stock units (RSUs) included in these consolidated financial statements and footnotes have been restated to reflect the reverse stock split. The reverse stock split has been retroactively applied to the Company s consolidated financial statements.

2. BASIS OF PREPARATION AND CONSOLIDATION

These condensed consolidated financial statements include the accounts of Holdings and its subsidiaries 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 losses and loss expenses,
- Valuation of ceded reinsurance recoverables, and
- Determination of other-than-temporary impairment of investments.

Intercompany accounts and transactions have been eliminated on consolidation, and all entities meeting consolidation requirements have been included in the consolidation. Certain reclassifications have been made to the prior period s amounts to conform to the current period s presentation.

These unaudited condensed consolidated financial statements, including these notes, should be read in conjunction with the Company s audited consolidated financials statements, and related notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

3. NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (FAS) No. 157, Fair Value Measurements (FAS 157). This statement defines fair value, establishes a framework for measuring fair value under U.S. GAAP, and expands disclosures about fair value measurements. FAS 157 applies under other accounting pronouncements that require or permit fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has determined that FAS 157 will not have a material impact on its financial statements upon its adoption for the Company s fiscal year beginning January 1, 2008.

In February 2007, the FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (FAS 159). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is expected to expand the use of fair value measurement, which is consistent with the FASB s long-term measurement objectives for accounting for financial instruments. The fair value option established will permit all entities to choose to measure eligible items at fair value at a specified election dates. An entity shall record unrealized gains and losses on items for which the fair value option has been elected through net income in the statement of operations at each subsequent reporting date. This statement is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. The Company is currently evaluating the provisions of FAS 159 and its potential impact on future financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 prescribes detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise s financial statements in accordance with FASB Statement 109, Accounting for Income Taxes. Tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. The Company adopted the provisions FIN 48 on January 1, 2007. The adoption of FIN 48 did not have an effect on the Company s results of operations or financial condition as of March 31, 2007.

4. INVESTMENTS

The Company regularly reviews the carrying value of its investments to determine if a decline in value is considered to be other than temporary. This review involves consideration of several factors including: (i) the significance of the decline in value and the resulting unrealized loss position; (ii) the time period for which there has been a significant decline in value; (iii) an analysis of the issuer of the investment, including its liquidity, business prospects and overall financial position; and (iv) the Company s intent and ability to hold the investment for a sufficient period of time for the value to recover. The identification of potentially impaired investments involves significant management judgment that includes the determination of their fair value and the assessment of whether any decline in value is other than temporary. If the decline in value is determined to be other than temporary, then the Company records a realized loss in the statement of operations in the period that it is determined.

As of March 31, 2007, the unrealized losses from the securities held in the Company s investment portfolio were primarily the result of rising interest rates. Following the Company s review of the securities in its investment portfolio, 302 securities were considered to be other-than-temporarily impaired for the three months ended March 31, 2007. Consequently, the Company recorded an other-than-temporary impairment charge, within net realized investment losses on the condensed consolidated statement of operations, of $9,382

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

4. INVESTMENTS (continued)

for the three months ended March 31, 2007. There were no similar charges recognized during the three months ended March 31, 2006.

The following table summarizes the market value of those investments in an unrealized loss position for periods less than and greater than 12 months:

	March 31, 2007		December 31, 2006	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Less than 12 months				
U.S. Government and Government agencies	$ 45,583	$ (133)	$ 381,989	$ (2,961)
Non U.S. Government and Government agencies	56,940	(1,097)	51,330	(620)
Corporate	260,511	(1,090)	545,902	(3,115)
Mortgage backed	315,546	(1,815)	856,533	(6,243)
Asset backed				
	$ 678,580	$ (4,135)	$ 1,835,754	$ (12,939)
More than 12 months				
U.S. Government and Government agencies	$ 201,929	$ (3,159)	$ 338,072	$ (6,645)
Non U.S. Government and Government agencies	3,383	(72)	515	(9)
Corporate	277,561	(2,726)	316,526	(4,527)
Mortgage backed	192,018	(1,661)	389,761	(4,121)
Asset backed			107,049	(456)
	$ 674,891	$ (7,618)	$ 1,151,923	$ (15,758)
	$ 1,353,471	$ (11,753)	$ 2,987,677	$ (28,697)

5. DEBT AND FINANCING ARRANGEMENTS

On July 21, 2006, the Company issued $500,000 aggregate principal amount of 7.50% Senior Notes due August 1, 2016 (Senior Notes), with interest on the Senior Notes payable on August 1 and February 1 of each year, commencing on February 1, 2007. The Senior Notes were offered by the underwriters at a price of 99.707% of their principal amount, providing an effective yield to investors of 7.542%. The Company used a portion of the proceeds from the Senior Notes to repay the outstanding amount of the existing credit agreement as well as to provide additional capital to its subsidiaries and for other general corporate purposes. As of March 31, 2007, the fair value of the Senior Notes as published by Bloomberg was 108.77% of their principal amount, providing an effective yield of 6.24%.

The Senior Notes can be redeemed by the Company prior to maturity subject to payment of a make-whole premium. The Company has no current expectations of calling the Senior Notes prior to maturity. The Senior Notes contain certain covenants that include: (i) limitations on liens on stock of designated subsidiaries; (ii) limitation as to the disposition of stock of designated subsidiaries; and (iii) limitations on mergers, amalgamations, consolidations or sale of assets.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

5. DEBT AND FINANCING ARRANGEMENTS (continued)

Events of default include: (i) the default in the payment of any interest or principal on any outstanding notes, and the continuance of such default for a period of 30 days; (ii) the default in the performance, or breach, of any of the covenants in the indenture (other than a covenant added solely for the benefit of another series of debt securities) and continuance of such default or breach for a period of 60 days after the Company has received written notice specifying such default or breach; and (iii) certain events of bankruptcy, insolvency or reorganization. Where an event of default occurs and is continuing, either the trustee of the Senior Notes or the holders of not less than 25% in principal amount of the Senior Notes may have the right to declare that all unpaid principal amounts and accrued interest then outstanding be due and payable immediately.

6. INCOME TAXES

Certain subsidiaries of Holdings file U.S. federal income tax returns and various U.S. states income tax returns, as well as income tax returns in the United Kingdom (U.K.) and Ireland. Holdings Bermuda subsidiaries currently do not file tax returns in Bermuda. The tax years open to examination by the U.S. Internal Revenue Service for the U.S. subsidiaries are the fiscal years from 2003 to the present. The tax years open to examination by the Inland Revenue for the U.K. branches are fiscal years from 2005 to the present. The Company began operations in Ireland with the incorporation of Allied World Assurance Company (Europe) Limited on September 25, 2002, and remains subject to examinations by the Irish Revenue Commissioners for all years since the date of incorporation. To the best of the Company s knowledge, there are no examinations pending by the U.S. Internal Revenue Service, the Inland Revenue or the Irish Revenue Commissioners.

On January 1, 2007, the Company adopted the provisions of FIN 48. As a result of the implementation of FIN 48, the Company did not record any unrecognized tax benefits or expenses. Management has deemed all material tax provisions to have a greater than 50% likelihood of being sustained based on technical merits if challenged. The Company has not recorded any interest or penalties during the three-month periods ended March 31, 2007 and 2006 and has not accrued any payment of interest and penalties at March 31, 2007 and December 31, 2006.

The Company does not expect any material unrecognized tax benefits within 12 months of January 1, 2007.

7. SHAREHOLDERS EQUITY

a) Authorized shares

The authorized share capital of the Company as of March 31, 2007 and December 31, 2006 was $10,000.

On July 11, 2006, the Company sold 8,800,000 common shares in the IPO at a public offering price of $34.00 per share. On July 19, 2006, the Company sold an additional 1,320,000 common shares at $34.00 per share in connection with the exercise in full by the underwriters of their over-allotment option. In connection with the IPO, a 1-for-3 reverse stock split of the Company s common shares was consummated on July 7, 2006.

The issued share capital consists of the following:

	March 31, 2007	December 31, 2006
Common shares issued and fully paid, par value $0.03 per share	60,390,269	60,287,696
Share capital at end of period	$ 1,812	$ 1,809

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

7. SHAREHOLDERS EQUITY (continued)

a) Authorized shares (continued)

As of March 31, 2007, there were outstanding 31,319,784 voting common shares and 29,070,485 non-voting common shares.

b) Dividends

In March 2007, the Company declared a quarterly dividend of $0.15 per common share payable on April 5, 2007 to shareholders of record on March 20, 2007. The total dividend payable amounted to $9,052 and has been included in the condensed consolidated balance sheets.

8. EMPLOYEE BENEFIT PLANS

a) Employee option plan

In 2001, the Company implemented the Allied World Assurance Company Holdings, Ltd 2001 Employee Warrant Plan, which, after Holdings special general meeting of shareholders on June 9, 2006 and its IPO on July 11, 2006, was amended and restated and renamed the Allied World Assurance Company Holdings, Ltd Amended and Restated 2001 Employee Stock Option Plan (the Plan). The Plan was converted into a stock option plan as part of the IPO and the warrants that were previously granted thereunder were converted to options and remain outstanding with the same exercise price and vesting period. Under the Plan, up to 2,000,000 common shares of Holdings may be issued. These options are exercisable in certain limited conditions, expire after 10 years, and generally vest pro-rata over four years from the date of grant. During the period from November 13, 2001 to December 31, 2002, the exercise price of the options issued was $24.27 per share, after giving effect to the extraordinary dividend described below. The exercise prices of options issued subsequent to December 31, 2002 and prior to the IPO were based on the per share book value of the Company. In accordance with the Plan, the exercise prices of the options issued prior to the declaration of the extraordinary dividend in March 2005 were reduced by the per share value of the dividend declared. The exercise price of options issued subsequent to the IPO are determined by the compensation committee of the Board of Directors but shall not be less than 100% of the fair market value of the common shares of Holdings on the date the option award is granted.

	Three Months Ended March 31, 2007	Year Ended December 31, 2006
Outstanding at beginning of period	1,195,990	1,036,322
Granted	233,650	179,328
Exercised	(113,039)	(10,118)
Forfeited	(12,169)	(9,542)

Outstanding at end of period		1,304,432		1,195,990
Weighted average exercise price per option	$	30.60	$	27.59

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

8. EMPLOYEE BENEFIT PLANS (continued)

a) Employee option plan (continued)

The following table summarizes the exercise prices for outstanding employee stock options as of March 31, 2007.

Exercise Price Range	Options Outstanding	Weighted Average Remaining Contractual Life	Options Exercisable	Intrinsic Value on Options Exercisable
$23.61 - $26.94	456,083	5.21	450,914	8,352
$28.08 - $31.47	416,536	7.88	187,376	2,491
$31.77 - $35.01	192,663	7.93	80,710	809
$41.00 - $43.61	239,150	9.77		
	1,304,432		719,000	11,652

Prior to the second quarter of 2006, the calculation of the compensation expense associated with the options had been made by reference to the book value per share of the Company as of the end of each period, and was deemed to be the difference between such book value per share and the exercise price of the individual options. The book value of the Company approximated its fair value. The fair value of each option granted was determined at June 30, 2006 using the Black-Scholes option-pricing model. Although the IPO was subsequent to June 30, 2006, the best estimate of the fair value of the common shares at that time was the IPO price of $34.00 per share. This amount was used in the model for June 30, 2006, and the Plan was accounted for as a liability plan in accordance with FAS No. 123(R), Share Based Payment (FAS 123(R)).

The combined amendment to the Plan and the IPO constituted a modification to the Plan in accordance with FAS 123(R). Accordingly, the options outstanding at the time of the IPO were revalued using the Black-Scholes option-pricing model. The amendment to the Plan qualifies it as an equity plan in accordance with FAS 123(R) and as such, associated liabilities at the time of the modification have been, and future compensation expenses will be, included in additional paid-in capital on the consolidated balance sheets.

Assumptions used in the option-pricing model for the options revalued at the time of the IPO, and for those issued subsequent to the IPO are as follows:

	Options Granted

	Options Revalued as Part of the IPO July 11, 2006	Options Granted After the IPO and Prior to December 31, 2006	During the Three Months Ended March 31, 2007
Expected term of option	6.25 years	6.25 years	6.25 years
Weighted average risk-free interest rate	5.11%	4.64%	4.60%
Expected volatility	23.44%	23.68%	23.14%
Dividend yield	1.50%	1.50%	1.50%
Weighted average fair value on grant date	$11.08	$11.34	$12.08

There is limited historical data available for the Company to base the expected term of the options. As these options are considered to have standard characteristics, the Company has used the simplified method to determine the expected life as set forth in the SEC s Staff Accounting Bulletin 107. Likewise, as the Company became a public company in July 2006, there is limited historical data available to it on which to base the volatility of its common shares. As such, the Company used the average of five volatility statistics from comparable companies in order to derive the volatility values above. The Company has assumed a nil

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

8. EMPLOYEE BENEFIT PLANS (continued)

a) Employee option plan (continued)

forfeiture rate in determining the compensation expense. This assumption implies that all outstanding options are expected to fully vest over the vesting periods.

Compensation costs of $689 and nil relating to the options have been included in general and administrative expenses in the Company s condensed consolidated statements of operations for the three months ended March 31, 2007 and 2006, respectively. As of March 31, 2007 and December 31, 2006, the Company recorded in additional paid-in capital on the condensed consolidated balance sheets an amount of $9,794 and $9,349, respectively, in connection with all options granted.

As of March 31, 2007, there was remaining $6,221 of total unrecognized compensation costs related to non-vested options granted under the Plan. These costs are expected to be recognized over a weighted-average period of 1.7 years. The total intrinsic value of options exercised during the three months ended March 31, 2007 was $2,050.

b) Stock incentive plan

On February 19, 2004, the Company implemented the Allied World Assurance Holdings, Ltd 2004 Stock Incentive Plan which, after Holdings special general meeting of shareholders on June 9, 2006 and the IPO on July 11, 2006, was amended and restated and renamed the Allied World Assurance Company Holdings, Ltd Amended and Restated 2004 Stock Incentive Plan (the Stock Incentive Plan). The Stock Incentive Plan provides for grants of restricted stock, RSUs, dividend equivalent rights and other equity-based awards. A total of 2,000,000 common shares may be issued under the Stock Incentive Plan. To date only RSUs have been granted. These RSUs generally vest in the fourth or fifth year from the original grant date, or pro-rata over four years from the date of the grant.

	Three Months Ended March 31, 2007	Year Ended December 31, 2006
Outstanding RSUs at beginning of period	704,372	127,163
RSUs granted	186,558	586,708
RSUs fully vested	(33,957)	(1,666)
RSUs forfeited	(19,917)	(7,833)
Outstanding RSUs at end of period	837,056	704,372

For those RSUs outstanding at the time of the amendment, the modification to the Stock Incentive Plan required a revaluation of the RSUs based on the fair market value of the common shares at the time of the IPO. The vesting period remained the same. The compensation expense for the RSUs on a going-forward basis is based on the fair market value per common share of the Company as of the respective grant dates and is recognized over the vesting period. The modification of the Stock Incentive Plan changed the accounting from a liability plan to an equity plan in accordance with FAS 123(R). As such, all accumulated amounts due under the Stock Incentive Plan were transferred to additional paid-in capital on the consolidated balance sheet.

Compensation costs of $1,987 and $407 relating to the issuance of the RSUs have been recognized in the Company s consolidated statements of operations for the three months ended March 31, 2007 and 2006, respectively.

As of March 31, 2007 and December 31, 2006, the Company has recorded $6,952 and $5,031, respectively, in additional paid-in capital on the consolidated balance sheets in connection with the RSUs awarded. As of March 31, 2007, there was remaining $24,345 of total unrecognized compensation costs

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

8. EMPLOYEE BENEFIT PLANS (continued)

b) Stock incentive plan (continued)

related to non-vested RSUs awarded. These costs are expected to be recognized over a weighted-average period of 3.2 years.

c) Long-term incentive plan

On May 22, 2006, the Company implemented the Long-Term Incentive Plan (LTIP), which provides for performance based equity awards to key employees in order to promote the long-term growth and profitability of the Company. Each award represents the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during the applicable three-year performance period. A total of 2,000,000 common shares may be issued under the LTIP. To date, 590,834 of these performance based equity awards have been granted. The awards granted in 2007 and 2006 will vest after the fiscal year ending December 31, 2009 and 2008, respectively, in accordance with the terms and performance conditions of the LTIP.

	Three Months Ended March 31, 2007	Year Ended December 31, 2006
Outstanding LTIP awards at beginning of period	228,334	
LTIP awards granted	382,500	228,334
LTIP awards subjected to accelerated vesting	(20,000)	
LTIP awards forfeited		
Outstanding LTIP awards at end of period	590,834	228,334

Compensation expense of $3,640 and nil has been recognized in the Company s consolidated financial statements for the three months ended March 31, 2007 and 2006, respectively. The compensation expense for the LTIP is based on the fair market value of the Company s common shares at the time of grant. For 2006, the Company s IPO price per share of $34.00 was used. The LTIP is deemed to be an equity plan and as such, $7,522 and $3,882 has been included in additional paid-in capital on the condensed consolidated balance sheets as of March 31, 2007 and December 31, 2006, respectively. As of March 31, 2007, there was remaining $29,024 of total unrecognized compensation costs related to non-vested LTIP awards. These costs are expected to be recognized over a weighted-average period of 2.4 years.

In calculating the compensation expense, and in the determination of share equivalents for the purpose of calculating diluted earnings per share, it is estimated that the maximum performance goals as set by the LTIP are likely to be achieved over the performance period. The performance period for the LTIP awards issued in 2007 and 2006 is defined as the three consecutive fiscal-year period beginning January 1, 2007 and 2006, respectively. The expense is recognized over the performance period.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

9. EARNINGS PER SHARE

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Basic earnings per share		
Net income	$ 113,921	$ 98,121
Weighted average common shares outstanding	60,333,209	50,162,842
Basic earnings per share	$ 1.89	$ 1.96

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Diluted earnings per share		
Net income	$ 113,921	$ 98,121
Weighted average common shares outstanding	60,333,209	50,162,842
Share equivalents:		
Warrants and options	1,366,365	109,267
Restricted stock units	316,544	213,447
LTIP awards	191,823	
Weighted average common shares and common share equivalents outstanding diluted	62,207,941	50,485,556
Diluted earnings per share	$ 1.83	$ 1.94

For the three-month period ended March 31, 2007, 215,650 employee stock options were considered antidilutive and were therefore excluded from the calculation of the diluted earnings per share. For the three-month period ended March 31, 2006, all common share equivalents, consisting of warrants issued to certain of the Company s founding shareholders and stock option, RSU and LTIP awards, were considered dilutive and have been included in the calculation of the diluted earnings per share.

10. LEGAL PROCEEDINGS

On or about November 8, 2005, the Company received a Civil Investigative Demand (CID) from the Antitrust and Civil Medicaid Fraud Division of the Office of the Attorney General of Texas relating to an investigation into (1) the possibility of restraint of trade in one or more markets within the State of Texas arising out of our business relationships with American International Group, Inc. (AIG) and The Chubb Corporation (Chubb), and (2) certain insurance and insurance brokerage practices, including those relating to contingent commissions and false quotes, which are also the subject of industry-wide investigations and class action litigation. The CID also sought information regarding (i) contingent commission, placement service or other agreements that the Company may have had with brokers or producers, and (ii) the possibility of the provision of any non-competitive bids by the Company in connection with the placement of insurance. In April 2007, the Company reached a settlement of all matters under investigation by the Antitrust and Civil Medicaid Fraud Division of the Office of the Attorney General of Texas. This settlement amounted to $2,100 which had been reserved for and included in general and administrative expenses in the consolidated statement of operations and comprehensive income for the year ended December 31, 2006. This amount was paid to the State of Texas on April 16, 2007.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

10. LEGAL PROCEEDINGS (continued)

On April 4, 2006, a complaint was filed in the U.S. District Court for the Northern District of Georgia (Atlanta Division) by a group of several corporations and certain of their related entities in an action entitled New Cingular Wireless Headquarters, LLC et al, as plaintiffs, against certain defendants, including Marsh & McLennan Companies, Inc., Marsh Inc. and Aon Corporation, in their capacities as insurance brokers, and 78 insurers, including Holdings insurance subsidiary in Bermuda, Allied World Assurance Company, Ltd.

The action generally relates to broker defendants placement of insurance contracts for plaintiffs with the 78 insurer defendants. Plaintiffs maintain that the defendants used a variety of illegal schemes and practices designed to, among other things, allocate customers, rig bids for insurance products and raise the prices of insurance products paid by the plaintiffs. In addition, plaintiffs allege that the broker defendants steered policyholders business to preferred insurer defendants. Plaintiffs claim that as a result of these practices, policyholders either paid more for insurance products or received less beneficial terms than the competitive market would have charged. The eight counts in the complaint allege, among other things, (i) unreasonable restraints of trade and conspiracy in violation of the Sherman Act, (ii) violations of the Racketeer Influenced and Corrupt Organizations Act, or RICO, (iii) that broker defendants breached their fiduciary duties to plaintiffs, (iv) that insurer defendants participated in and induced this alleged breach of fiduciary duty, (v) unjust enrichment, (vi) common law fraud by broker defendants and (vii) statutory and consumer fraud under the laws of certain U.S. states. Plaintiffs seek equitable and legal remedies, including injunctive relief, unquantified consequential and punitive damages, and treble damages under the Sherman Act and RICO. On October 16, 2006, the Judicial Panel on Multidistrict Litigation ordered that the litigation be transferred to the U.S. District Court for the District of New Jersey for inclusion in the coordinated or consolidated pretrial proceedings occurring in that court. Neither Allied World Assurance Company, Ltd nor any of the other defendants have responded to the complaint. Written discovery has begun but has not been completed. As a result of the court granting motions to dismiss in the related putative class action proceeding, prosecution of this case is currently stayed pending the court s analysis of any amended pleading filed by the class action plaintiffs. While this matter is in an early stage, and it is not possible to predict its outcome, the Company does not currently believe that the outcome will have a material adverse effect on the Company s operations or financial position.

11. SEGMENT INFORMATION

The determination of reportable segments is based on how senior management monitors the Company s underwriting operations. The Company measures the results of its underwriting operations under three major business categories, namely property insurance, casualty insurance and reinsurance. All product lines fall within these classifications.

The property segment includes the insurance of physical property and energy-related risks. These risks generally relate to tangible assets and are considered short-tail in that the time from a claim being advised to the date when the claim is settled is relatively short. The casualty segment includes the insurance of general liability risks, professional liability risks and healthcare risks. Such risks are long-tail in nature since the emergence and settlement of a claim can take place many years after the policy period has expired. The reinsurance segment includes any reinsurance of other companies in the insurance and reinsurance industries. The Company writes reinsurance on both a treaty and facultative basis.

Responsibility and accountability for the results of underwriting operations are assigned by major line of business on a worldwide basis. Because the Company does not manage its assets by segment, investment income, interest expense and total assets are not allocated to individual reportable segments.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

11. SEGMENT INFORMATION (continued)

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 table provides a summary of the segment results for the three months ended March 31, 2007 and 2006.

Three Months Ended March 31, 2007	**Property**	**Casualty**	**Reinsurance**	**Total**
Gross premiums written	$ 101,865	$ 125,189	$ 211,352	$ 438,406
Net premiums written	46,132	100,645	211,067	357,844
Net premiums earned	44,491	124,409	117,666	286,566
Net losses and loss expenses	(6,865)	(90,367)	(68,763)	(165,995)
Acquisition costs	(332)	(6,038)	(22,826)	(29,196)
General and administrative expenses	(7,757)	(15,307)	(10,139)	(33,203)
Underwriting income	29,537	12,697	15,938	58,172
Net investment income				72,648
Net realized investment losses				(6,484)
Interest expense				(9,374)
Foreign exchange loss				(32)
Income before income taxes				$ 114,930
Loss and loss expense ratio	15.4%	72.6%	58.4%	57.9%
Acquisition cost ratio	0.8%	4.9%	19.4%	10.2%
General and administrative expense ratio	17.4%	12.3%	8.6%	11.6%
Combined ratio	33.6%	89.8%	86.4%	79.7%

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Expressed in thousands of United States dollars, except share and per share amounts)

11. SEGMENT INFORMATION (continued)

Three Months Ended March 31, 2006	Property	Casualty	Reinsurance	Total
Gross premiums written	$ 119,819	$ 130,494	$ 247,807	$ 498,120
Net premiums written	67,197	114,194	246,112	427,503
Net premiums earned	49,102	131,982	127,859	308,943
Net losses and loss expenses	(33,319)	(97,603)	(75,038)	(205,960)
Acquisition costs	1,481	(9,319)	(28,634)	(36,472)
General and administrative expenses	(5,115)	(9,862)	(5,345)	(20,322)
Underwriting income	12,149	15,198	18,842	46,189
Net investment income				62,001
Net realized investment losses				(5,236)
Interest expense				(6,451)
Foreign exchange loss				(545)
Income before income taxes				$ 95,958
Loss and loss expense ratio	67.9%	73.9%	58.7%	66.7%
Acquisition cost ratio	(3.0)%	7.1%	22.4%	11.8%
General and administrative expense ratio	10.4%	7.5%	4.2%	6.6%
Combined ratio	75.3%	88.5%	85.3%	85.1%

The following table shows an analysis of the Company s net premiums written by geographic location of the Company s subsidiaries for the three months ended March 31, 2007 and 2006. All inter-company premiums have been eliminated.

	Three Months Ended March 31,	
	2007	2006
Bermuda	$ 290,602	$ 356,390
United States	22,910	22,051
Europe	44,332	49,062
Total net premium written	$ 357,844	$ 427,503

12. SUBSEQUENT EVENT

On May 8, 2007, the Company declared a quarterly dividend of $0.15 per common share, payable on June 14, 2007 to shareholders of record on May 29, 2007.

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 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, our company, the company or other similar terms mean t consolidated operations of Allied World Assurance Company Holdings, Ltd and its subsidiaries, unless the context requires otherwise. References in this Form 10-Q to the term Holdings means Allied World Assurance Company Holdings, Ltd only.

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 2006 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) on March 19, 2007. We are under no obligation (and expressly disclaim any such obligation) to update or revise any forward-looking statement, whether written or oral, 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 lines of business internationally through our insurance subsidiaries or branches based in Bermuda, the United States, Ireland and the United Kingdom. We manage our business through three operating segments: property, casualty and reinsurance. As of March 31, 2007, we had $8.1 billion of total assets, $2.4 billion of shareholders equity and $2.9 billion of total capital, which includes shareholders equity and senior notes.

During the first three months of 2007, we have seen rate declines and increased competition across all of our operating segments. Increased competition results from increased capacity in the insurance and reinsurance marketplaces. We believe the trend of increased capacity and decreasing rates will continue during the remainder of 2007. We continue to be selective in the policies and reinsurance contracts we underwrite. As such, our consolidated gross premiums written decreased $59.7 million, or 12.0%, for the three months ended March 31, 2007 compared to the three months ended March 31, 2006. We capitalized on growth opportunities provided by our U.S. distribution platform, which partially offset the decline in gross premiums written. During the three months ended March 31, 2007, gross premiums written by our U.S. subsidiaries increased by $8.4 million or 34.7% compared to the three months ended March 31, 2006. Our net income for the three months ended March 31, 2007 increased $15.8 million, or 16.1%, to $113.9 million for the three months ended March 31, 2007 compared to $98.1 million for the three months ended March 31, 2006. Net income for the three months ended March 31, 2007 included net investment income of

$72.6 million compared to $62.0 million for the three months ended March 31, 2006.

Our direct insurance business (consisting of our property and casualty segments) grew to 51.8% of our business mix on a gross premiums written basis, compared to 50.3% for the three months ended March 31, 2006. Our property, casualty and reinsurance segments made up 23.2%, 28.6% and 48.2%, respectively, of

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gross premiums written for the three months ended March 31, 2007 compared to 24.1%, 26.2% and 49.7%, respectively, for the three months ended March 31, 2006.

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 gains or losses. Our investment portfolio is currently comprised primarily of fixed maturity investments, the income from which is a function of the amount of invested assets and relevant interest rates.

Expenses

Our expenses consist largely of net losses and loss expenses, acquisition costs and general and administrative expenses. Net losses and loss expenses are comprised of paid losses and reserves for losses less recoveries from reinsurers. Losses and loss expense reserves are estimated by management and reflect our best estimate of ultimate losses and costs arising during the reporting period and revisions of prior period estimates. In accordance with accounting principles generally accepted in the United States of America, we reserve for catastrophic losses as soon as the loss event is known to have occurred. Acquisition costs consist principally of commissions and brokerage fees that are typically a percentage of the premiums on insurance policies or reinsurance contracts written, net of any commissions received by us on risks ceded to reinsurers. General and administrative expenses include personnel expenses including stock-based compensation charges, rent expense, professional fees, information technology costs and other general operating expenses. We are experiencing increases in general and administrative expenses resulting from additional staff, increased stock-based compensation expense, increased rent expense for our new Bermuda premises and additional amortization expense for building-related and infrastructure expenditures. We believe this trend will continue during the remainder of 2007.

Critical Accounting Policies

It is important to understand our accounting policies in order to understand our financial position and results of operations. Our 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 and other-than-temporary impairment of investments. For a detailed discussion of our critical accounting policies, please refer to our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the SEC. There were no material changes in the application of our critical accounting estimates subsequent to that report.

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Results of Operations

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
	($ in millions)	
Gross premiums written	$ 438.4	$ 498.1
Net premiums written	357.8	427.5
Net premiums earned	286.6	308.9
Net investment income	72.6	62.0
Net realized investment (losses)	(6.5)	(5.2)
	$ 352.7	$ 365.7
Net losses and loss expenses	$ 166.0	$ 206.0
Acquisition costs	29.2	36.5
General and administrative expenses	33.2	20.3
Interest expense	9.4	6.5
Foreign exchange loss		0.5
	$ 237.8	$ 269.8
Income before income taxes	$ 114.9	$ 95.9
Income tax expense (recovery)	1.0	(2.2)
Net income	$ 113.9	$ 98.1
Ratios		
Loss and loss expense ratio	57.9%	66.7%
Acquisition cost ratio	10.2	11.8
General and administrative expense ratio	11.6	6.6
Expense ratio	21.8	18.4
Combined ratio	79.7	85.1

Comparison of Three Months Ended March 31, 2007 and 2006

Premiums

Gross premiums written decreased by $59.7 million, or 12.0%, for the three months ended March 31, 2007 compared to the three months ended March 31, 2006. The decrease was primarily the result of a reduction in the amount of upward adjustments to premium estimates for our reinsurance segment, non-renewal of business that did not meet our underwriting requirements (which included pricing and/or policy terms and conditions) and increased competition and decreasing rates for new and renewal business. This was most noticeable for our Bermuda operating subsidiary where gross premiums written decreased $63.9 million, or 16.1%, from $398.1 million for the three months ended March 31, 2006 to $334.2 million for the three months ended March 31, 2007. Net adjustments on estimated premiums resulted in a reduction in gross premiums written of approximately $1.1 million during the three months ended March 31, 2007 compared to a net increase of approximately $36.7 million for the three months ended March 31, 2006. Net adjustments on estimated premiums related to treaties written in prior periods. As our historical experience develops, we may have fewer or smaller adjustments to our estimated premiums. European gross premiums written also decreased by $4.2 million, or 5.5%, primarily due to non-renewal of business that did not meet our underwriting requirements (which included pricing and/or policy terms and conditions). The decrease in gross premiums written from our Bermuda and European operating subsidiaries was partially offset by new business written and an increase in gross premiums written for our U.S. operating subsidiaries of $8.4 million, or 34.7%, from $24.2 million for the three months ended March 31, 2006 to $32.6 million for the three months ended March 31, 2007. The increase in gross premiums written for our U.S. operations was a result of increased marketing efforts and additional staff in our expanded U.S. platform.

We employ a regional distribution strategy in the United States via wholesalers and brokers targeting middle-market clients. We believe that this business will be complementary to our current casualty and property direct insurance business produced through Bermuda and European markets, which primarily focus on underwriting risks for Fortune 1000 and large multi-national clients with complex insurance needs. The table below illustrates our gross premiums written by geographic location for the three months ended March 31, 2007 and 2006.

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Dollar Change	Percentage Change
	($ in millions)			
Bermuda	$ 334.2	$ 398.1	$ (63.9)	(16.1)%
Europe	71.6	75.8	(4.2)	(5.5)
United States	32.6	24.2	8.4	34.7
	$ 438.4	$ 498.1	$ (59.7)	(12.0)%

Net premiums written decreased by $69.7 million, or 16.3%, for the three months ended March 31, 2007 compared to the three months ended March 31, 2006, a higher percentage decrease than that of gross premiums written. The difference between gross and net premiums written is the cost to us of purchasing reinsurance, both on a proportional and a non-proportional basis, including the cost of property catastrophe reinsurance coverage. We ceded 18.4% of gross premiums written for the three months ended March 31, 2007 compared to 14.2% for the same period in 2006. In our property segment, we ceded 54.7% of gross premiums written for the three months ended March 31, 2007 compared to 43.9% for the three months ended March 31, 2006. In our casualty segment, we ceded 19.6% of gross premiums written for the three months ended March 31, 2007 compared to 12.5% for the three months ended March 31, 2006. We have increased the amount we ceded as we have been able to obtain adequate protection at cost-effective levels and in order to reduce the overall volatility of our insurance operations.

Net premiums earned decreased by $22.3 million, or 7.2%, for the three months ended March 31, 2007 compared to the three months ended March 31, 2006 as a result of lower net premiums written. Net premiums earned for the three months ended March 31, 2007 was reduced by $10.5 million due to the cost of our property catastrophe reinsurance protection compared to $4.5 million during the three months ended March 31, 2006. The reduction in the amount of upward adjustments to premium estimates for our reinsurance segment also caused net premiums earned to decrease. Since adjustments on estimated premiums relate to prior years   treaties, a larger portion of the associated premiums written are earned. The percentage decrease in net premiums earned was lower than that of net premiums written due to the continued earning of higher net premiums that were written prior to the three months ended March 31, 2007.

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

	Gross Premiums Written		Net Premiums Earned	
	Three Months Ended March 31,			
	2007	2006	2007	2006
Property	23.2%	24.1%	15.5%	15.9%
Casualty	28.6	26.2	43.4	42.7
Reinsurance	48.2	49.7	41.1	41.4

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The increase in the percentage of casualty gross premiums written reflects the continued growth of our U.S. operations, where casualty gross premiums written increased by $3.8 million, or 19.9%. The percentage of property net premiums earned was considerably less than for gross premiums written because we cede a larger portion of our property business compared to casualty and reinsurance.

Net Investment Income and Realized Gains/Losses

Our invested assets are managed by two investment mangers affiliated with Th