ALLIED WORLD ASSURANCE CO HOLDINGS LTD
Form 10-Q
May 09, 2008

Table of Contents

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, 2008

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

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 5, 2008 was 48,847,487.

TABLE OF CONTENTS

Table of Contents

PART I
FINANCIAL INFORMATION

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

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
as of March 31, 2008 and December 31, 2007
(Expressed in thousands of United States dollars, except share and per share amounts)

	As of March 31, 2008	As of December 31, 2007
ASSETS:		
Fixed maturity investments available for sale, at fair value (amortized cost: 2008: $5,071,730; 2007: $5,595,943)	$ 5,218,726	$ 5,707,143
Other invested assets available for sale, at fair value (cost: 2008: $82,380; 2007: $291,458)	77,099	322,144
Other invested assets, at fair value	191,195	
Total investments	5,487,020	6,029,287
Cash and cash equivalents	774,337	202,582
Restricted cash	140,049	67,886
Securities lending collateral	337,567	147,241
Insurance balances receivable	376,788	304,499
Prepaid reinsurance	147,402	163,836
Reinsurance recoverable	758,723	682,765
Accrued investment income	42,389	55,763
Deferred acquisition costs	112,619	108,295
Intangible assets	14,714	3,920
Balances receivable on sale of investments	6,323	84,998
Net deferred tax assets	4,158	4,881
Other assets	42,341	43,155
Total assets	$ 8,244,430	$ 7,899,108
LIABILITIES:		
Reserve for losses and loss expenses	$ 4,048,187	$ 3,919,772
Unearned premiums	848,149	811,083
Unearned ceding commissions	26,666	28,831
Reinsurance balances payable	60,437	67,175
Securities lending payable	337,567	147,241
Balances due on purchase of investments		141,462
Dividends payable	8,788	
Senior notes	498,710	498,682
Accounts payable and accrued liabilities	21,306	45,020
Total liabilities	$ 5,849,810	$ 5,659,266
SHAREHOLDERS EQUITY:		

Common shares, par value $0.03 per share, issued and outstanding 2008: 48,841,837 shares and 2007: 48,741,927 shares	1,465	1,462
Additional paid-in capital	1,288,776	1,281,832
Retained earnings	968,753	820,334
Accumulated other comprehensive income: net unrealized gains on investments, net of tax	135,626	136,214
Total shareholders equity	2,394,620	2,239,842
Total liabilities and shareholders equity	$ 8,244,430	$ 7,899,108

See accompanying notes to the unaudited condensed consolidated financial statements.

-1-

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
for the three months ended March 31, 2008 and 2007
(Expressed in thousands of United States dollars, except share and per share amounts)

	Three Months Ended March 31, 2008	2007
REVENUES:		
Gross premiums written	$ 396,874	$ 438,406
Premiums ceded	(70,302)	(80,562)
Net premiums written	326,572	357,844
Change in unearned premiums	(53,500)	(71,278)
Net premiums earned	273,072	286,566
Net investment income	76,931	72,648
Net realized investment gains (losses)	3,465	(6,484)
	353,468	352,730
EXPENSES:		
Net losses and loss expenses	143,497	165,995
Acquisition costs	26,840	29,196
General and administrative expenses	43,271	33,203
Interest expense	9,510	9,374
Foreign exchange loss	476	32
	223,594	237,800
Income before income taxes	129,874	114,930
Income tax (recovery) expense	(1,071)	1,009
NET INCOME	130,945	113,921
Other comprehensive (loss) income		
Unrealized gains on investments arising during the period net of applicable deferred income tax expense 2008: ($251); 2007: ($817)	15,364	18,533
Reclassification adjustment for net realized (gains) losses included in net income	(15,952)	6,484
Other comprehensive (loss) income	(588)	25,017
COMPREHENSIVE INCOME	$ 130,357	$ 138,938
PER SHARE DATA		
Basic earnings per share	$ 2.68	$ 1.89
Diluted earnings per share	$ 2.55	$ 1.83

Weighted average common shares outstanding	48,811,932	60,333,209
Weighted average common shares and common share equivalents outstanding	51,380,423	62,207,941
Dividends declared per share	$ 0.18	$ 0.15

See accompanying notes to the unaudited condensed consolidated financial statements.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
for the three months ended March 31, 2008 and 2007
(Expressed in thousands of United States dollars)

	Share Capital	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
December 31, 2007	$ 1,462	$ 1,281,832	$ 136,214	$ 820,334	$ 2,239,842
Cumulative effect adjustment upon adoption of FAS 159			(26,262)	26,262	
Net income				130,945	130,945
Dividends				(8,788)	(8,788)
Other comprehensive income			25,674		25,674
Stock compensation	3	6,944			6,947
March 31, 2008	$ 1,465	$ 1,288,776	$ 135,626	$ 968,753	$ 2,394,620

	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

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
for the three months ended March 31, 2008 and 2007
(Expressed in thousands of United States dollars)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 130,945	$ 113,921
Adjustments to reconcile net income to cash provided by operating activities:		
Net realized gains on sales of investments	(27,322)	(2,898)
Impairment charges for other-than-temporary impairments on investments	11,370	9,382
Change in fair value of hedge fund investments	12,487	
Amortization of premiums net of accrual of discounts on fixed maturities	(1,005)	(88)
Amortization and depreciation of fixed assets	2,206	2,075
Amortization of discount and expenses on senior notes	111	104
Stock compensation expense	6,154	6,316
Insurance balances receivable	(72,289)	(95,970)
Prepaid reinsurance	16,434	5,258
Reinsurance recoverable	(75,958)	21,055
Accrued investment income	13,374	6,941
Deferred acquisition costs	(4,324)	(7,139)
Net deferred tax assets	472	79
Other assets	(1,450)	(2,228)
Reserve for losses and loss expenses	128,415	26,227
Unearned premiums	37,066	66,020
Unearned ceding commissions	(2,165)	1,438
Reinsurance balances payable	(6,738)	30,519
Accounts payable and accrued liabilities	(14,926)	(23,214)
Net cash provided by operating activities	152,857	157,798
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:		
Purchases of fixed maturity investments	(586,715)	(866,584)
Purchases of other invested assets	(18,845)	(3,873)
Sales of fixed maturity investments	1,067,763	698,521
Sales of other invested assets	83,206	2,976
Net cash used for acquisition	(44,052)	
Purchase of intangible assets	(10,794)	
Changes in securities lending collateral received	(190,326)	230,032
Purchase of fixed assets	(281)	(4,929)
Change in restricted cash	(72,163)	(62,590)
Net cash provided by (used in) investing activities	227,793	(6,447)
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:		
Proceeds from the exercise of stock options	550	
Changes in securities lending collateral	190,326	(230,032)

Net cash provided by (used in) financing activities	190,876	(230,032)
Effect of exchange rate changes on foreign currency cash	229	148
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	571,755	(78,533)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	202,582	366,817
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 774,337	$ 288,284
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$ 5,354	$ 1,600
Cash paid for interest expense	18,750	19,271
Change in balance receivable on sale of investments	78,675	(8,694)
Change in balance payable on purchase of investments	(141,462)	46,517

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

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 through operations in Bermuda, the United States, Ireland and the United Kingdom.

2. BASIS OF PREPARATION AND CONSOLIDATION

These unaudited 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,
- Valuation of financial instruments, and
- Determination of other-than-temporary impairment of investments.

Intercompany accounts and transactions have been eliminated on consolidation, and all entities meeting consolidation requirements have been included in the consolidation. Certain immaterial reclassifications in the unaudited condensed consolidated statements of cash flows 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, 2007.

3. NEW ACCOUNTING PRONOUNCEMENTS

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (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 will permit all entities to choose to measure eligible items at fair value at 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. The Company adopted FAS 159 as of January 1, 2008. See Note 7 Fair Value of Financial Instruments regarding the Company s adoption of FAS 159.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

In September 2006, the FASB issued 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 adopted FAS 157 as of January 1, 2008. See Note 7 Fair Value of Financial Instruments regarding the Company s adoption of FAS 157.

In December 2007, the FASB issued FAS No. 141(R) Business Combinations (FAS 141(R)). FAS 141(R) replaces FAS No. 141 Business Combinations (FAS 141), but retains the fundamental requirements in FAS 141 that the acquisition method of accounting be used for all business combinations and for an acquirer to be identified for each business combination. FAS 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. FAS 141(R) also requires acquisition-related costs to be recognized separately from the acquisition, requires assets acquired and liabilities assumed arising from contractual contingencies to be recognized at their acquisition-date fair values and requires goodwill to be recognized as the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired. FAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (January 1, 2009 for calendar year-end companies). The Company is currently evaluating the provisions of FAS 141(R) and its potential impact on future financial statements.

In December 2007, the FASB issued FAS No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (FAS 160). FAS 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. FAS 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. FAS 160 requires consolidated net income to be reported at the amounts that include the amounts attributable to both the parent and the noncontrolling interest. This statement also establishes a method of accounting for changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation and for changes in a parent s ownership interest in a subsidiary that does result in deconsolidation. FAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 (January 1, 2009 for calendar year-end companies). The presentation and disclosure requirements of FAS 160 shall be applied retrospectively for all periods presented. The Company is currently evaluating the provisions of FAS 160 and its potential impact on future financial statements.

In March 2008, the FASB issued FAS No. 161 Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (FAS 161). FAS 161 requires enhanced interim and annual disclosures about an entity s derivative and hedging activities including how and why the entity uses derivative instruments, how the entity accounts for its derivatives under FAS No. 133 (Accounting for Derivative Instruments and Hedging Activities), and how derivative instruments and related hedged items affect the entity s financial position, financial performance and cash flows. FAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008 (January 1, 2009 for calendar year-end companies). The Company is currently evaluating the provisions of FAS 161 and its potential impact on future financial statements.

4. ACQUISITION OF FINIAL INSURANCE COMPANY

In November 2007, Allied World Assurance Holdings (U.S.) Inc. entered into an agreement to purchase all of the outstanding stock of Finial Insurance Company (formerly known as Converium Insurance (North America) Inc.) from Finial Reinsurance Company, an affiliate of Berkshire Hathaway Inc. Finial Insurance Company was renamed Allied World Reinsurance Company, is currently licensed to write insurance and reinsurance in 49 states and the District of Columbia and has been used to launch the Company s new reinsurance operations in the United States. This transaction closed on February 29, 2008 for a purchase price of $12,000 plus the Finial Insurance Company s policyholders surplus of $47,082 and an adjustment for the difference between the fair values of investments acquired under U.S. GAAP and statutory reporting of $300. The total purchase price of $59,382 was paid in cash from existing resources. As a part of the acquisition, the Company recorded $10,794 of intangible assets with indefinite lives for the value of the insurance and reinsurance licenses acquired. The remaining assets and liabilities acquired were principally comprised of bonds, at fair value, of $31,690, cash of $15,330, other assets of $1,568, and a reserve for losses and loss expenses of $104,914, of which 100% are recorded as reinsurance recoverable as the entire reserve for losses and loss expenses is ceded to National Indemnity Company, an affiliate of Berkshire Hathaway Inc.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

5. INVESTMENTS

The amortized cost, gross unrealized gains, gross unrealized losses and fair value of total investments by category as of March 31, 2008 and December 31, 2007 are as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2008				
U.S. government and government agencies	$ 1,711,844	$ 105,983	$	$ 1,817,827
Non-U.S. government and government agencies	109,052	18,529	(20)	127,561
Corporate	1,131,653	22,119	(11,325)	1,142,447
Mortgage backed	1,977,417	21,692	(11,093)	1,988,016
Asset backed	141,764	1,350	(239)	142,875
Total fixed maturity investments, available for sale	5,071,730	169,673	(22,677)	5,218,726
Hedge funds	191,195			191,195
Global high-yield bond fund	81,220		(5,281)	75,939
Other invested assets	1,160			1,160
	$ 5,345,305	$ 169,673	$ (27,958)	$ 5,487,020
December 31, 2007				
U.S. government and government agencies	$ 1,987,577	$ 65,653	$ (6)	$ 2,053,224
Non-U.S. government and government agencies	100,440	18,694	(291)	118,843
Corporate	1,248,338	10,114	(5,835)	1,252,617
Mortgage backed	2,095,561	22,880	(902)	2,117,539
Asset backed	164,027	897	(4)	164,920
Total fixed maturity investments, available for sale	5,595,943	118,238	(7,038)	5,707,143
Hedge funds	215,173	27,250	(988)	241,435
Global high-yield bond fund	75,125	4,424		79,549
Other invested assets	1,160			1,160
	$ 5,887,401	$ 149,912	$ (8,026)	$ 6,029,287

Due to the adoption of FAS 159 as of January 1, 2008, the Company s investment in hedge funds is included in other invested assets, at fair value on the unaudited condensed consolidated balance sheet. As of March 31, 2008, the Company s investments in the global high-yield bond fund and other invested assets are included in other invested assets available for sale, at fair value on the unaudited condensed consolidated balance sheet. As of December 31, 2007, the Company s investment in hedge funds, the global high-yield bond fund and other invested assets were included in other invested assets available for sale, at fair value on the unaudited condensed consolidated balance sheet.

On a quarterly basis, the Company 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 consolidated statements of operations and comprehensive income in the period that it is determined.

As of March 31, 2008, the Company s investment portfolio had gross unrealized losses of $27,958 and were primarily the result of the widening of overall sector credit spreads for our fixed maturity investments. Following the Company s review of the securities in its investment portfolio, 83 securities were considered to be other-than-temporarily impaired for the three months ended March 31, 2008. Consequently, the Company recorded an other-than-temporary impairment charge within net realized investment gains (losses) on the unaudited condensed consolidated statement of operations and comprehensive income of $11,370 for the three months ended March 31, 2008. The declines in market value of these securities were primarily due to the write-down of residential and commercial mortgage-backed securities due to the widening of credit spreads caused by the continued decline in the U.S. housing

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

market. All of the residential and commercial mortgage-backed securities written down were AAA rated securities. Given the current market environment for mortgage-backed securities, it is difficult to determine when recovery will occur and as such the Company recorded an other-than-temporary charge. During the three months ended March 31, 2007, 302 securities were considered to be other-than-temporarily impaired and as a result the Company recorded a charge of $9,382 within net realized investment gains (losses) on the unaudited condensed consolidated statement of operations and comprehensive income.

During 2007, the Company submitted a redemption notice to sell its shares in the Goldman Sachs Global Equity Opportunities Fund, plc. The Company sold its shares on February 29, 2008 and recognized a loss on the sale of $278, which is included in net realized investment gains (losses) in the unaudited condensed consolidated statements of operations and comprehensive income.

6. 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 99.71% of their principal amount, providing an effective yield to investors of 7.54%. The Company used a portion of the proceeds from the Senior Notes to repay the outstanding amount of its then existing credit agreement as well as to provide additional capital to its subsidiaries and for other general corporate purposes.

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. The Company was in compliance with all covenants related to its Senior Notes as of March 31, 2008 and December 31, 2007.

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.

In March 2007, the Company entered into a collateralized $750,000 amended letter of credit facility (the Credit Facility) with Citibank Europe plc. The Credit Facility will be used to issue standby letters of credit.

In November 2007, the Company entered into a $800,000 five-year senior credit facility (the Facility) with a syndication of lenders. The Facility consists of a $400,000 secured letter of credit facility for the issuance of standby letters of credit (the Secured Facility) and a $400,000 unsecured facility for the making of revolving loans and for the issuance of standby letters of credit (the Unsecured Facility). Both the Secured Facility and the Unsecured Facility have options to increase the aggregate commitments by up to $200,000, subject to approval of the lenders. The Facility will be used for general corporate purposes and to issue standby letters of credit. The Facility contains representations, warranties and covenants customary for similar bank loan facilities, including a covenant to maintain a ratio of consolidated indebtedness to total capitalization as of the last day of each fiscal quarter or fiscal year of not greater than 0.35 to 1.0 and a covenant under the Unsecured Facility to maintain a certain consolidated net worth. In addition, each material insurance subsidiary must maintain a financial strength rating from A.M. Best Company of at least A- under the Unsecured Facility and of at least B++ under the Secured Facility. The Company is in compliance with all covenants under the Facility as of March 31, 2008 and December 31, 2007.

The Company currently has access to up to $1,550,000 in letters of credit under the two letter of credit facilities described above. These facilities are used to provide security to reinsureds and are collateralized by the Company, at least to the extent of letters of credit outstanding at any given time. As of March 31, 2008 and December 31, 2007, there were outstanding letters of credit totaling $872,033 and $922,206, respectively, under the two facilities. Collateral committed to support the letter of credit facilities was $1,341,765 as of March 31, 2008, compared to $1,170,731 as of December 31, 2007.

At this time, the Company uses trust accounts primarily to meet security requirements for inter-company and certain related-party reinsurance transactions. The Company also has cash and cash equivalents and investments on deposit with various state or government insurance departments or pledged in favor of ceding companies in order to comply with relevant insurance regulations. As of March 31, 2008, total trust account deposits were $742,644 compared to $802,737 as of December 31, 2007.

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company adopted FAS 159 as of January 1, 2008, and has elected the fair value option for its hedge fund investments, which are classified as other invested assets, at fair value in the unaudited condensed consolidated balance sheets. At the time of adoption, the fair value and carrying value of the hedge fund investments were $241,435 and the net unrealized gain was $26,262. These funds are comprised of liquid portfolios that have no fixed maturity with the objective of achieving current income and capital appreciation. The Company has elected the fair value option for its hedge fund investments as the Company believes that recognizing changes in the fair value of the hedge funds in the consolidated statements of operations and comprehensive income each period better reflects the results of the Company s investment in the hedge funds rather than recognizing changes in fair value in accumulated other comprehensive income.

Upon adoption of FAS 159, the Company reclassified the net unrealized gain related to the hedge funds of $26,262 from accumulated other comprehensive income and recorded a cumulative-effect adjustment in retained earnings . There was no net deferred tax liability associated with the net unrealized gain as the hedge fund investments are held by Holdings Bermuda insurance subsidiary, which pays no income tax. Any subsequent change in unrealized gain or loss of other invested assets, at fair value will be recognized in the consolidated statements of operations and comprehensive income and included in net realized investment gains (losses) . Prior to the adoption of FAS 159 any change in unrealized gain or loss was included in accumulated other comprehensive income in the unaudited condensed consolidated balance sheet. The net loss recognized for the change in fair value of the hedge fund investments in the unaudited condensed consolidated statements of operations and comprehensive income during the three months ended March 31, 2008 was $12,487.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

The Company adopted FAS 157 as of January 1, 2008. This statement defines fair value and establishes a framework for measuring fair value under U.S. GAAP. FAS 157 defines fair value 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. FAS 157 also established 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 FAS 157 fair value hierarchy the fair value measurements are included as of March 31, 2008.

			Fair value measurement using:		
	Carrying amount	Total fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
U.S. government and government agencies	$ 1,817,827	$ 1,817,827	$ 932,046	$ 885,781	
Non-U.S. government and government agencies	127,561	127,561		127,561	
Corporate	1,142,447	1,142,447		1,142,447	
Mortgage backed	1,988,016	1,988,016		1,988,016	
Asset backed	142,875	142,875		142,875	
Total fixed maturity investments, available for sale	5,218,726	5,218,726			
Total other invested assets, available for sale	77,099	77,099		77,099	
Total other invested assets, fair value	191,195	191,195			191,195

Total investments	5,487,020	5,487,020		
Senior notes	498,710	491,640		491,640

The following describes the valuation techniques used by the Company to determine the fair value of financial instruments held as of March 31, 2008.

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

Non-U.S. government and government agencies: Comprised of fixed income obligations of non-U.S. governmental entities. The fair values of these securities are based on broker-dealer quotes, and are included in the Level 2 fair value hierarchy.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

Corporate: Comprised of bonds issued by corporations that on acquisition are rated BBB-/Baa3 or higher provided that, in aggregate, corporate bonds with ratings of BBB-/Baa3 do not constitute more than 5% of the market value of the Company s fixed income securities and are diversified across a wide range of issuers and industries. The fair values of corporate bonds that are short-term are priced using spread above the London Interbank Offering Rate yield curve, and the fair value of corporate bonds that are long-term are priced using the spread above the risk-free yield curve. The spreads are sourced from dealer quotes, trade prices and the new issue market. As the inputs used to price corporate bonds are observable market inputs, the fair values of corporate bonds are included in the Level 2 fair value hierarchy.

Mortgage-backed: Principally comprised of AAA-rated pools of residential and commercial mortgages originated by both agency (such as the Federal National Mortgage Association) and non-agency originators. The fair values of mortgage-backed securities originated by U.S. government agencies and non-U.S. government agencies are based on a pricing model that incorporates prepayment speeds and spreads to determine appropriate average life of mortgage-backed securities. The spreads are sourced from dealer quotes, trade prices and the new issue market. As the inputs used to price the mortgage-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy.

Asset-backed: Comprised of primarily AAA-rated bonds backed by pools of automobile loan receivables, home equity loans and credit card receivables originated by a variety of financial institutions. The fair values of asset-backed securities are priced using prepayment speed and spread inputs that are sourced from the new issue market. As the inputs used to price the asset-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy.

Other invested assets available for sale: Principally comprised of an open-end global high-yield bond fund that invests in non-investment grade bonds issued by various issuers and industries. The fair value of the global high-yield bond fund is based on the net asset value as reported by the fund manager. The net asset value is an observable input as it is quoted on a market exchange on a daily basis. The fair value of the global high-yield bond fund is included in the Level 2 fair value hierarchy.

Other invested assets, at fair value: Comprised of several hedge funds with objectives to seek attractive long-term returns with lower volatility by investing in a range of diversified investment strategies. The fair values of the hedge funds are based on the net asset value of the funds as reported by the fund manager less a liquidity discount where hedge fund investments contain lock-up provisions that prevent immediate dissolution. The Company considers these lock-up provisions to be obligations that market participants would assign a value to in determining the price of these hedge funds, and as such have considered these obligations in determining the fair value measurement of the related hedge funds. The liquidity discount was estimated by calculating the value of a protective put over the lock-up period. The protective put measures the risk of holding a restricted asset over a certain time period. The Company used the Black-Scholes option-pricing model to estimate the value of the protective put for each hedge fund. The aggregate liquidity discount recorded during the three months ended March 31, 2008 was $215. The net asset value and the liquidity discount are significant unobservable inputs, and as such the fair values of the Company s hedge funds are included in the Level 3 fair value hierarchy.

Senior notes: The fair value of the senior notes is based on the price as published by Bloomberg, which was 98.33% of their principal amount, providing an effective yield of 7.77% as of March 31, 2008. The fair value of the senior notes is included in the Level 2 fair value hierarchy.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

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

	Fair value measurement using significant unobservable inputs (Level 3): hedge funds
Balance classified as Level 3, January 1, 2008	$ 241,435
Total gains or losses included in earnings:	
Net realized gains	1,229
Change in fair value of hedge fund investments	(12,487)
Purchases or sales	(38,982)
Transfers in and/or out of Level 3	
Ending balance, March 31, 2008	$ 191,195

8. INCOME TAXES

Certain subsidiaries of Holdings file U.S. federal income tax returns and various U.S. state income tax returns, as well as income tax returns in the U.K. and Ireland. The tax years open to examination by the U.S. Internal Revenue Service for the U.S. subsidiaries are the fiscal years from 2004 to the present. The tax years open to examination by the Inland Revenue for the U.K. branches are fiscal years from 2004 to the present. The tax years open to examination by Irish Revenue Commissioners for the Irish subsidiaries are the fiscal years from 2003 to the present. 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.

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, 2008 and 2007 and has not accrued any payment of interest and penalties as of March 31, 2008 and December 31, 2007.

The Company does not expect any material unrecognized tax benefits within 12 months of January 1, 2008.

9. SHAREHOLDERS EQUITY

a) Authorized shares

The authorized share capital of Holdings as of March 31, 2008 and December 31, 2007 was $10,000.

The issued share capital consists of the following:

	March 31, 2008	**December 31, 2007**
Common shares issued and fully paid, par value $0.03 per share	48,841,837	48,741,927
Share capital at end of period	$ 1,465	$ 1,462

As of March 31, 2008, there were outstanding 34,925,119 voting common shares and 13,916,718 non-voting common shares.

b) Dividends

In February 2008, the Company declared a quarterly dividend of $0.18 per common share payable on April 3, 2008 to shareholders of record on March 18, 2008. The total dividend payable amounted to $8,788 and has been included in the unaudited condensed consolidated balance sheets.

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.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

10. EMPLOYEE BENEFIT PLANS

a) Employee option plan

In 2001, the Company implemented the Allied World Assurance Company Holdings, Ltd Amended and Restated 2001 Employee Stock Option Plan (the Plan). Under the Plan, up to 2,000,000 common shares of Holdings may be issued. Holdings has filed a registration statement on Form S-8 under the Securities Act of 1933, as amended, to register common shares issued or reserved for issuance under the Plan. 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. The exercise price of options issued 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, 2008	
	Options	**Weighted Average Exercise Price**
Outstanding at beginning of period	1,223,875	$ 31.03
Granted	257,300	43.27
Exercised	(18,733)	29.35
Forfeited	(3,917)	37.04
Outstanding at end of period	1,458,525	$ 33.19

Assumptions used in the option-pricing model for the options granted during the three months ended March 31, 2008:

	Options granted during the three months ended March 31, 2008
Expected term of option	6.25 years
Weighted average risk-free interest rate	2.50 %
Expected volatility	23.46 %
Dividend yield	1.66 %
Weighted average fair value on grant date	$9.78

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 and 110. Likewise, as the Company became a public company in July 2006, there is limited historical data available on which to base the volatility of its common shares. As such, the Company used the average of five volatility statistics from comparable companies, as well as the Company s volatility, in order to derive the volatility value above. The Company has assumed a forfeiture rate of 4.91% in determining the compensation expense over the service period.

Compensation expense of $548 and $689 relating to the options has been recognized in general and administrative expenses in the Company s unaudited condensed consolidated statements of operations and comprehensive income for the three months ended March 31, 2008 and 2007, respectively. As of March 31, 2008 and December 31, 2007, the Company recorded in additional paid-in capital on the unaudited condensed consolidated balance sheets an amount of

$13,271 and $11,840, respectively, in connection with all options granted.

b) Stock incentive plan

In 2004, the Company implemented 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, restricted stock units (RSUs), dividend equivalent rights and other equity-based awards. A total of 2,000,000 common shares may be issued under the Stock Incentive Plan. To date only RSUs have been granted. These RSUs generally vest pro-rata over four years from the date of grant or in the fourth or fifth year from the original grant date.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

	Three months ended March 31, 2008	
	RSUs	Weighted Average Grant Date Fair Value
Outstanding RSUs at beginning of period	820,890	$ 36.09
RSUs granted	239,479	43.27
RSUs fully vested	(75,097)	34.00
RSUs forfeited	(26,834)	35.13
Outstanding RSUs at end of period	958,438	$ 38.07

Compensation expense of $1,476 and $1,987 relating to the issuance of the RSUs has been recognized in general and administrative expenses in the Company s unaudited condensed consolidated statements of operations and comprehensive income for the three months ended March 31, 2008 and 2007, respectively. The compensation expense for the RSUs is based on the fair market value of Holdings common shares at the time of grant. The Company has assumed a forfeiture rate of 4.30% in determining the compensation expense over the service period. As of March 31, 2008 and December 31, 2007, the Company has recorded $13,721 and $12,337, respectively, in additional paid-in capital on the unaudited condensed consolidated balance sheets in connection with the RSUs awarded.

c) Long-term incentive plan

In 2006, the Company implemented the Allied World Assurance Company Holdings, Ltd Amended and Restated Long-Term Incentive Plan (LTIP), which provides for performance based equity awards to key employees in order to promote the long-term growth and profitability of the Company. Each award represents the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during the applicable performance period. A total of 2,000,000 common shares may be issued under the LTIP. The awards granted in 2008 will generally vest after three years, or in the fourth or fifth year from the original grant date, subject to the achievement of the performance conditions and terms of the LTIP.

	Three months ended March 31, 2008	
	LTIP	Weighted Average Grant Date Fair Value
Outstanding LTIP awards at beginning of period	590,834	$ 40.09
LTIP awards granted	507,152	43.27
LTIP awards subjected to accelerated vesting	(11,667)	34.00
LTIP awards forfeited	(20,000)	43.40
Outstanding LTIP awards at end of period	1,066,319	$ 41.61

Compensation expense of $4,129 and $3,640 relating to the LTIP has been recognized in general and administrative expenses in the Company s unaudited condensed consolidated statements of operations and comprehensive income for the three months ended March 31, 2008 and 2007, respectively. The compensation expense for the LTIP is based on the fair market value of Holdings common shares at the time of grant. As of March 31, 2008 and December 31, 2007, the Company has recorded $20,532 and $16,403, respectively, in additional paid-in capital on the unaudited condensed consolidated balance sheets in connection with the LTIP awards.

In calculating the compensation expense, and in the determination of share equivalents for the purpose of calculating diluted earnings per share, it is estimated for the LTIP awards granted in 2006 and 2007 that the maximum performance goals as set by the LTIP are likely to be achieved over the performance period. For the LTIP awards granted in 2008 it is estimated that the target performance goals as set by the LTIP are likely to be achieved over the performance period. Based on the target performance goals the LTIP awards granted in 2008 are expensed at 100% of the fair market value of Holdings common shares on the date of grant. The expense is recognized over the performance period.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

The total stock compensation expense of $6,154 and $6,316 relating to the stock options, RSUs and LTIP awards has been recognized in general and administrative expenses in the Company s unaudited condensed consolidated statements of operations and comprehensive income for the three months ended March 31, 2008 and 2007, respectively.

11. EARNINGS PER SHARE

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

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Basic earnings per share		
Net income	$ 130,945	$ 113,921
Weighted average common shares outstanding	48,811,932	60,333,209
Basic earnings per share	$ 2.68	$ 1.89

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Diluted earnings per share		
Net income	$ 130,945	$ 113,921
Weighted average common shares outstanding	48,811,932	60,333,209
Share equivalents:		
Warrants and options	1,602,689	1,366,365
Restricted stock units	403,294	316,544
LTIP awards	562,508	191,823
Weighted average common shares and common share equivalents outstanding diluted	51,380,423	62,207,941
Diluted earnings per share	$ 2.55	$ 1.83

For the three-month period ended March 31, 2008, 23,000 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, 2007, 215,650 employee stock options were considered antidilutive and were therefore excluded from the calculation of the diluted earnings per share.

12. 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 provides direct coverage 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 provides direct coverage 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.

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.

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

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, 2008 and 2007.

Three Months Ended March 31, 2008	**Property**	**Casualty**	**Reinsurance**	**Total**
Gross premiums written	$ 86,060	$ 121,063	$ 189,751	$ 396,874
Net premiums written	46,597	90,634	189,341	326,572
Net premiums earned	43,581	109,115	120,376	273,072
Net losses and loss expenses	(14,747)	(73,115)	(55,635)	(143,497)
Acquisition costs	(549)	(3,270)	(23,021)	(26,840)
General and administrative expenses	(10,494)	(23,708)	(9,069)	(43,271)
Underwriting income	17,791	9,022	32,651	59,464
Net investment income				76,931
Net realized investment gains				3,465
Interest expense				(9,510)
Foreign exchange loss				(476)
Income before income taxes				$ 129,874
Loss and loss expense ratio	33.8%	67.0%	46.2%	52.5%
Acquisition cost ratio	1.3%	3.0%	19.1%	9.8%
General and administrative expense ratio	24.1%	21.7%	7.5%	15.9%
Combined ratio	59.2%	91.7%	72.8%	78.2%

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%

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, 2008 and 2007. All inter-company premiums have been eliminated.

	Three Months Ended March 31,	
	2008	**2007**
Bermuda	$ 263,541	$ 290,602
United States	23,120	22,910
Europe	39,911	44,332
Total net premiums written	$ 326,572	$ 357,844

-15-

Table of Contents

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share, per share and percentage information)

13. SUBSEQUENT EVENTS

On May 8, 2008, the Company declared a quarterly dividend of $0.18 per common share, payable on June 12, 2008 to shareholders of record on May 27, 2008. At the 2008 Annual General Meeting held on May 8, 2008, shareholders of Holdings approved the Second Amended and Restated 2001 Employee Stock Option Plan to increase by 2,000,000 common shares (from 2,000,000 to 4,000,000) the total number of Holdings common shares that may be issued thereunder, and extend the termination date from June 9, 2016 to May 8, 2018, after which date no awards may be granted.

Table of Contents

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this Form 10-Q. References in this Form 10-Q to the terms we, us, our, the company or other similar terms mean the consolidated operations of Allied World Assurance Company Holdings, 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 2007 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) on February 29, 2008. We are under no obligation (and expressly disclaim any such obligation) to update or revise any forward-looking statement that may be made from time to time, whether as a result of new information, future developments or otherwise.

Overview

Our Business

We write a diversified portfolio of property and casualty insurance and reinsurance lines of business internationally through our 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, 2008, we had $8.2 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 year ended December 31, 2007, we experienced rate declines from increased competition across all of our operating segments. This trend of increased competition and decreasing rates has continued during the three months ended March 31, 2008, and we expect this trend to continue during the remainder of 2008. Given this trend, we continue to be selective in the policies and reinsurance contracts we underwrite. Our consolidated gross premiums written decreased $41.5 million, or 9.5%, for the three months ended March 31, 2008 compared to the three months ended March 31, 2007. Our net income for the three months ended March 31, 2008 increased $17.0 million, or 15.0%, to $130.9 million compared to $113.9 million for the three months ended March 31, 2007. Net income for the three months ended March 31, 2008 included net investment income of $76.9 million compared to $72.6 million for the three months ended March 31, 2007.

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. Investment income is principally derived from interest and dividends earned on investments, partially offset by investment management fees and fees paid to our custodian bank. Net realized gains or losses include (1) net realized investment gains or losses from the sale of investments, (2) write-downs related to declines in the market value of securities on our available for sale portfolio that were considered to be other than temporary and (3) the change in the fair value of investments that we mark-to-market in the condensed consolidated statements of operations and comprehensive income.

Table of Contents

Expenses

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

- losses paid, which are actual cash payments to insureds or losses payable to insureds, net of recoveries from reinsurers;
- outstanding loss or case reserves, which represent management s best estimate of the likely settlement amount for known claims, less the portion that can be recovered from reinsurers; and
- reserves for losses incurred but not reported, or IBNR , which are reserves established by us for claims that are not yet reported but can reasonably be expected to have occurred based on industry information, management s experience and/or actuarial evaluation. The portion recoverable from reinsurers is deducted from the gross estimated loss.

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

General and administrative expenses include personnel expenses including stock-based compensation 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 U.S. offices and additional amortization expense for building-related and infrastructure expenditures. We believe this trend will continue during the remainder of 2008 as we continue to hire additional staff and build our infrastructure.

Ratios

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

Critical Accounting Policies

It is important to understand our accounting policies in order to understand our financial position and results of operations. Our unaudited condensed consolidated financial statements reflect determinations that are inherently subjective in nature and require management to make assumptions and best estimates to determine the reported values. If events or other factors cause actual results to differ materially from management s underlying assumptions or estimates, there could be a material adverse effect on our financial condition or results of operations. We believe that some of the more critical judgments in the areas of accounting estimates and assumptions that affect our financial condition and results of operations are related to reserves for losses and loss expenses, reinsurance recoverables, premiums and acquisition costs, valuation of financial instruments and 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, 2007 filed with the SEC. There were no material changes in the application of our critical accounting estimates subsequent to that report, except as discussed below related to the valuation of financial instruments.

Fair Value of Financial Instruments

Under existing accounting principles generally accepted in the United States (U.S. GAAP), we are required to recognize certain assets at their fair value in our condensed consolidated balance sheets. This includes our fixed maturity investments, global high-yield bond fund, hedge funds and other invested assets. Fair value, as defined in Financial Accounting Standard No. 157 Fair Value Measurements (FAS 157), is 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. FAS 157 also established 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.

At each measurement date, we estimate the fair value of the financial instruments using various valuation techniques. We utilize, to the extent available, quoted market prices in active markets or observable market inputs in estimating the fair value of our financial instruments. When quoted market prices or observable market inputs are not available, we utilize valuation techniques that rely on unobservable inputs to estimate the fair value of financial instruments. The following describes the valuation techniques used by us to determine the fair value of financial instruments held as of March 31, 2008 and what level within the FAS 157 fair value hierarchy the valuation technique resides.

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

Non-U.S. government and government agencies: Comprised of fixed income obligations of non-U.S. governmental entities. The fair values of these securities are based on broker-dealer quotes, and are included in the Level 2 fair value hierarchy.

Corporate: Comprised of bonds issued by corporations that on acquisition are rated BBB-/Baa3 or higher provided that, in aggregate, corporate bonds with ratings of BBB-/Baa3 do not constitute more than 5% of the market value of our fixed income securities and are diversified across a wide range of issuers and industries. The fair values of corporate bonds that are short-term are priced using spread above the London Interbank Offering Rate yield curve, and the fair value of corporate bonds that are long-term are priced using the spread above the risk-free yield curve. The spreads are sourced from dealer quotes, trade prices and the new issue market. As the inputs used to price corporate bonds are observable market inputs, the fair values of corporate bonds are included in the Level 2 fair value hierarchy.

Mortgage-backed: Principally comprised of AAA-rated pools of residential and commercial mortgages originated by both agency (such as the Federal National Mortgage Association) and non-agency originators. The fair values of mortgage-backed securities originated by U.S. government agencies and non-U.S. government agencies are based on a pricing model that incorporates prepayment speeds and spreads to determine appropriate average life of mortgage-backed securities. The spreads are sourced from dealer quotes, trade prices and the new issue market. As the inputs used to price the mortgage-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy.

Asset-backed: Comprised of primarily AAA-rated bonds backed by pools of automobile loan receivables, home equity loans and credit card receivables originated by a variety of financial institutions. The fair values of asset-backed securities are priced using prepayment speed and spread inputs that are sourced from the new issue market. As the inputs used to price the asset-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy.

Other invested assets available for sale: Principally comprised of an open-end global high-yield bond fund that invests in non-investment grade bonds issued by various issuers and industries. The fair value of the global high-yield bond fund is based on the net asset value as reported by the fund manager. The net asset value is an observable input as it is quoted on a market exchange on a daily basis. The fair value of the global high-yield bond fund is included in the Level 2 fair value hierarchy.

Other invested assets, at fair value: Comprised of several hedge funds with objectives to seek attractive long-term returns with lower volatility by investing in a range of diversified investment strategies. The fair values of the hedge funds are based on the net asset value of the funds as reported by the fund manager less a liquidity discount where hedge fund investments contain lock-up provisions that prevent immediate dissolution. We consider these lock-up provisions to be obligations that market participants would assign a value to in determining the price of these hedge funds, and as such have considered these obligations in determining the fair value measurement of the related hedge funds. The liquidity discount was estimated by calculating the value of a protective put over the lock-up period. The protective put measures the risk of holding a restricted asset over a certain time period. We used the Black-Scholes option-pricing model to estimate the value of the protective put for each hedge fund. The aggregate liquidity discount recorded during the three months ended March 31, 2008 was $0.2 million. The net asset value and the liquidity discount are significant unobservable inputs, and as such the fair values of the our hedge funds are included in the Level 3 fair value hierarchy. Our hedge funds are the only assets that use Level 3 inputs in determining fair value. The hedge funds represent 3.5% of our total investments.

There have been no material changes to any of our valuation techniques from what was used as of December 31, 2007. Since fair valuing a financial instrument is an estimate of what a willing buyer would pay for our asset if we sold it, we will not know the ultimate value of our financial instruments until they are sold. We believe the valuation techniques utilized provide us with the best estimate of the price that would be received to sell our assets in an orderly transaction between participants at the measurement date.

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,	
	2008	2007
	($ in millions)	
Gross premiums written	$ 396.9	$ 438.4
Net premiums written	326.6	357.8
Net premiums earned	273.1	286.6
Net investment income	76.9	72.6
Net realized investment gains (losses)	3.5	(6.5)