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ACE Ltd. And Core Operating Companies

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ACE Ltd. And Core Operating Companies

Major Rating Factors

Holding Company: ACE Ltd.
Counterparty Credit Rating
Local Currency
A/Stable/NR
Operating Companies Covered By This Report
Financial Strength Rating
Local Currency
AA-/Stable/--

Strengths:

- Very strong competitive position, with a global presence in more than 50 countries and significant diversification by product line and sector.
- Very strong operating performance.
- Experienced management team and successful corporate strategy that have produced strong earnings.
- Very strong capital adequacy.
- Conservative investment portfolio and very strong liquidity.

Weaknesses:

- Moderate amount of recoverables, runoff reserves, and intangibles on the balance sheet, though this risk is decreasing.
- Moderate reinsurance utilization in certain lines.
- Changing risk profile into new lines and geographies.

Rationale

The counterparty credit rating on ACE Ltd. and the insurer financial strength ratings on ACE Ltd.'s core operating companies (collectively referred to as ACE) reflect the group's very strong competitive position, very strong operating performance, and experienced management team. The ratings are also based on the group's successful strategy, which has produced strong earnings, as well as its very strong capital adequacy, conservative investment portfolio, and very strong liquidity. Partially offsetting these positive factors are ACE's moderate amount of reinsurance recoverables, runoff reserves, and intangibles as part of the balance sheet (though this risk is decreasing), moderate reinsurance utilization, and changing risk profile into new lines and geographic locations. The group's enterprise risk management (ERM) is strong and supportive of the ratings.

ACE's profits have been very strong in the past five years, with a five-year (2005-2009) combined ratio of 91%, a return on revenue of 21%, and a return on equity of 17%. These results are better than those of many global insurance and reinsurance peers during the same period. In addition, ACE's diversified platform has helped make the group's earnings volatility lower than many of its peers' in recent years.

ACE's very strong competitive position is a strength to the rating and is supported by its extensive and well-diversified business platform. ACE's brand name supports its competitive position, as do its market presence and global diversification. ACE has a competitive advantage in a number of product lines—including multiperil crop insurance and risk management in the U.S. and excess casualty written from Bermuda—and global capabilities for multi-national companies. The group is one of the few worldwide providers of commercial insurance and reinsurance coverage for global risks, supporting global and regional companies in most jurisdictions around the world.

We view ACE's management and corporate strategy as strengths to the rating. ACE's strategy of continued product and geographic diversification—combined with strong underwriting discipline—has delivered very strong profits for the organization in the past five years. Its top managers are actively involved in the operations of the business, backed by a strong staff with significant depth and breadth.

ACE's strong commitment to cycle management and strong ERM capabilities are also positive factors to its strategy. The organization focuses on cutting back writings when profit margins don't meet its minimum thresholds while growing the business in areas that it sees as less competitive or countercyclical to the current softening property/casualty cycle. We believe this focus on pricing discipline and active portfolio management has contributed significantly to the group's very strong operating performance over the last five years and should support very strong operating results in coming years, despite a softening pricing cycle in property/casualty lines.

We view ACE's capital adequacy as very strong. On a quantitative basis, the group's capital was redundant at the 'AAA' level as of Sept. 30, 2010, according to our capital adequacy model. On a qualitative basis, ACE's quality of capital is supported by its strong control of aggregations and other risks throughout the organization, the strong quality of its underwriting results (which is the key engine for earnings and capital growth at the organization), and its conservative investment posture, very strong liquidity, and low financial leverage. This is partially offset by moderate amounts of reinsurance recoverables, goodwill, and—to a lesser extent—asbestos and environmental (A&E) reserves on the balance sheet that, in our view, somewhat reduce the quality of capital. However, these assets have constituted a smaller proportion of the balance sheet and shareholders' equity in recent years, improving the quality of capital and financial flexibility in our opinion. ACE's financial flexibility is also helped by its low financial leverage on a tangible equity basis and ample access to the capital markets, as its recent $700 million senior notes issuance demonstrates.

In addition to its moderate exposure to reinsurance recoverables, runoff reserves, and intangibles as part of the balance sheet, we believe that ACE's moderate levels of reinsurance utilization could expose the company to counterparty credit risk and, to a lesser extent, to adverse changes in reinsurance purchase pricing or available reinsurance capacity, depending on market conditions in the reinsurance sector. However, we believe ACE has strong controls around counterparty credit risk and that the group has enough flexibility to either retain more of its gross writings or access nontraditional forms of reinsurance if market conditions for purchasing traditional reinsurance were to adversely change.

ACE's expansion into relatively new lines of business and geographic regions in the past decade has increased the complexity and—to some degree—the risk profile of the organization because its track record in some of its lines and regions is relatively limited. However, we believe this risk is mitigated by ACE's strong ERM and the relatively moderate pace of growth in the past five years. Furthermore, ACE's expansion into areas such as accident and health, agriculture, and emerging markets has decreased its exposure to the cyclicality of the property/casualty markets in the U.S. and Europe, which we believe should help the company maintain relatively stable and profitable results in coming years, despite the softening in property/casualty lines.

Factors Specific To Holding Company

Standard & Poor's applies nonstandard notching (two notches) between the financial strength ratings on the core members of the ACE group and the counterparty credit rating on the holding company, ACE Ltd. The two-notch difference reflects the holding company's dependence on dividends from its insurance subsidiaries, which are subject to regulatory guidelines and restrictions. The diversity of domiciles of ACE's operating companies provides the group with significant regulatory flexibility in making dividend payments to the holding company.

ACE has four primary credit facilities that together provide up to $2.5 billion in capacity. In June 2009, ACE entered into a five-year unsecured letter of credit facility of $500 million that expires in September 2014. Out of the remaining three, one facility provides up to $1 billion in letter-of-credit capacity, another consists of a $500 million revolver, and the third provides for up to £300 million ($465 million as of Sept. 30, 2010) in capacity to support ACE Global Markets underwriting capacity for Lloyd's Syndicate 2488. Of the total $2.5 billion capacity, about $1.3 billion had been drawn as of Sept. 30, 2010. The $1 billion letter-of-credit and revolver facilities expire in November 2012, and the Lloyd's facility expires in December 2013. Covenants under the four facilities (the same covenants in all four) require ACE to maintain a minimum amount of net worth and a maximum debt to total capitalization ratio. As of Sept. 30, 2010, ACE was well within these requirements.

Financial flexibility is strong. ACE has moderate financial leverage and a flexible capital structure. As of Sept. 30, 2010, its debt to total tangible capital was moderate at 15%, and debt plus preferred to total tangible capital was 16%. These figures constitute a reduction from 2009 and 2008 levels and reflect the group's increased capital base in 2010 as a result of strong earnings and unrealized investment gains.

In November 2010, ACE issued $700 million of 2.6% senior notes, maturing in 2015. It did so primarily to refinance bank debt (short-term debt of $155 million due in 2010 and long-term debt of $50 million due in 2011 and $450 million due in 2013) totaling about $655 million. As a result of these transactions, ACE has nominal debt maturities over the next four years. ACE's next debt maturity is $500 million in senior notes due in 2014 and $1.15 billion of obligations in 2015. We view these amounts as modest relative to ACE's balance sheet and cash resources. We expect the company to finance these amounts externally or pay them down through internal funds.

Outlook

The outlook is stable. Assuming a normal level of catastrophe losses, we expect operating performance to remain very strong in 2011, with a combined ratio of about 92% and a return on revenue of more than 18%, reflecting our expectation that the group will maintain underwriting discipline and that pricing conditions in ACE's lines will be flat or slightly deteriorate next year. Furthermore, we expect ACE's diversified business mix to reduce the group's exposure to any one line of business and for the group's earnings to be among the least volatile in its peer group.

We expect ACE's capital adequacy to remain very strong over the next two years, supported by the expectation of continued very strong operating results. We do not expect management to engage in meaningful share repurchases or other forms of capital return to shareholders, reflecting ACE's conservative capital-management strategy. Debt plus preferred leverage (measured on a tangible capital basis) likely will remain at less than 25% in the medium term.

We expect reinsurance recoverables, goodwill, and run-off reserves to continue to decline as a proportion of shareholders equity in the coming years as ACE's equity base increases. In addition, we do not expect ACE's A&E reserves to affect the group's earnings materially.

Standard & Poor's believes that ACE will maintain a very strong global competitive position that is diversified by segment, location, and product. We also expect ACE to continue to exercise significant underwriting prudence, with consolidated premium writings flat to modestly up in 2011, reflecting management's continued pruning in competitive lines of business and the expected incremental impact on premium volume of recently announced acquisitions. We believe that ACE could grow more significantly, particularly in property/casualty lines, if its lines of business were to experience significant premium rate increases in coming years.

Factors that could place negative pressure on the ratings include significantly worse-than-expected operating performance, significant impairment charges in its investment portfolio, material adverse loss reserve development, or a sizable change in its competitive position or capitalization. We do not see further upside potential to the ratings in the near future, reflecting our view that softening pricing conditions on property/casualty lines will place some pressure on ACE's returns in these segments of their business over the next one to two years and our view that ACE's competitive position is unlikely to improve substantially beyond our current favorable view in the near term.

Competitive Position: Very Strong Because Of Well-Diversified Product Lines And Significant Market Presence

ACE's competitive position is very strong. It writes insurance business in more than 50 countries, and its product lines and sectors are well diversified. ACE's brand name supports its competitive position, as does its market presence and global diversification. With gross writings of $19.2 billion at year-end 2009, ACE is a leading provider of property/casualty insurance and reinsurance worldwide. In addition, in recent years, the group has become a growing provider of accident and health (A&H) coverage. Life insurance, though a smaller proportion of the book of business (about 4% of current net earned premiums), and high-net-worth personal lines will likely continue to grow over time; as with the A&H book, they offer good diversification relative to ACE's property/casualty exposures (ACE does not write any traditional U.S. life insurance, excluding Combined, and its U.S. life reinsurance business is currently not writing any new business).

Table 1

ACE Ltd. Operating Cos./Business Statistics

	--Nine months ended Sept. 30--	--Year ended Dec. 31--				
(Mil. $)	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**
Gross written premiums	14,946	19,164	19,242	17,740	17,401	16,811
Change in gross written premiums (%)	2.0	(0.4)	8.5	1.9	3.5	4.5
Net written premiums	10,286	13,299	13,080	11,979	12,030	11,792
Change in net written premiums (%)	2.9	1.7	9.2	(0.4)	2.0	2.6
Nonlife net premiums earned/total net premiums earned (%)	88.4	89.2	91.1	97.1	97.7	97.9
Life net premiums earned/total net premiums earned (%)	11.6	10.8	8.9	2.9	2.3	2.1
Other revenue/total revenue (%)	(1.0)	(1.0)	(1.0)	0.0	0.0	0.0
Nonlife EBITDA/total EBITDA (%)	94.7	95.3	97.2	99.0	99.0	81.9
Life EBITDA/total EBITDA (%)	10.4	9.8	6.0	4.7	4.3	7.0
Other income/EBITDA (%)	(5.1)	(5.1)	(3.2)	(3.5)	(3.3)	11.1
Split of premiums (gross or net) by largest five business lines						
Casualty (%)	42.0	42.0	44.0	52.6	55.0	55.9
Property and all other (%)	29.0	30.0	30.0	30.8	30.6	27.7
Personal accident (%)	25.0	24.0	22.0	13.6	12.1	10.6
Financial services (%)	0.0	0.0	0.0	0.0	0.0	3.8

Table 1

ACE Ltd. Operating Cos./Business Statistics (cont.)						
Life insurance and reinsurance (%)	4.0	4.0	4.0	2.9	2.3	2.1

ACE's competitive position benefited from the capital market disruption of 2008, as clients' increasing concern with counterparty credit risk and their relatively favorable view of ACE led to the company receiving substantially higher levels of submissions in 2009. Despite this, ACE showed significant restraint in writing new business over the past two years, given management's strong commitment to cycle management and its view that the property/casualty markets remain very competitive. Furthermore, in recent years, ACE has cut back writings dramatically in a number of property/casualty lines of business showing the weakest profit margins and strong competitive pressures, while growing the business in areas that it sees as less competitive or countercyclical to the current softening property/casualty cycle. This has included growth in areas such as A&H (mostly comprising accident business), agriculture, and some property/casualty and life insurance businesses in emerging markets. This strategy to increase diversification into noncyclical lines of business has been at the core of ACE's 2008 acquisition of the Combined Insurance Cos. and the 2010 acquisitions of Rain & Hail (the second-largest crop insurer in the U.S.), Jerneh Insurance Berhad (a small property/casualty insurer in Malaysia), and New York Life's Hong Kong and Korea life insurance operations.

Historical

ACE has a competitive advantage in a number of product lines, including multiperil crop insurance and risk management in the U.S., excess casualty written from Bermuda, and global capabilities for multi-national companies. The group is one of the few worldwide providers of commercial insurance and reinsurance coverage for global risks, supporting global and regional companies in most jurisdictions around the world. In April 2008, ACE completed the acquisition of Combined Insurance Co. of America (Combined Insurance), an underwriter and distributor of specialty individual accident and supplemental health insurance products globally, from Aon Corp. for $2.56 billion in cash. This acquisition has nearly doubled ACE's A&H business, which accounted for approximately 25% of ACE's total earned premiums as of Sept. 30, 2010, compared with about 14% at year-end 2007. Combined Insurance has not only increased ACE's presence in the A&H segment outside of the U.S. but it has also brought a sizeable U.S. A&H book to ACE. In addition, it has introduced a different distribution network for these products through Combined's sizable agency force. This is expected to continue to be an area of growth for ACE.

ACE's expansion into relatively new lines of business and geographic regions in the past decade has increased the complexity and—to some degree—the risk profile of the organization because its track record in some of its lines and regions is relatively limited. However, we believe ACE's strong ERM and the relatively moderate pace of growth in the past five years mitigate this risk. Furthermore, ACE's expansion into areas such as A&H, agriculture, and emerging markets has decreased its exposure to the cyclicality of the property/casualty markets in the U.S. and Europe. A&H is mostly accident business, and a significant portion of it is being produced in emerging markets where there is less competition. Agriculture is also a relatively stable and less-cyclical business, and ACE is now one of the main providers of this product in the U.S. Finally, life insurance, which constitutes a small portion of ACE's total premiums writings, is mostly growing in emerging markets where the nature of the products is very simple and competition is significantly lower. Approximately half of the life book consists of simple one-year term life policies.

Among ACE's areas of expansion in recent years are its life insurance businesses in the United Arab Emirates, Peru, China and Indonesia; its commercial property/casualty insurance and reinsurance business in Bahrain; property/casualty reinsurance business in Brazil; and property/casualty reinsurance and risk-management consulting in China. In addition, ACE has established international units to manage energy, technical, and construction risks worldwide. Specifically, ACE Asia-Pacific, ACE Latin America, and China should be significant areas of growth for the group over next five years. With the benefit of the acquisition of Combined Insurance in April 2008, we expect that ACE will further expand its A&H business in the U.S., Europe, Canada, Latin America, and Asia-Pacific.

In September 2010, ACE signed a definitive agreement to acquire the 80% of the outstanding common stock of Rain and Hail Insurance Service Inc. that it does not already own for approximately $1.1 billion in cash. Rain and Hail is the second-largest crop insurer in the U.S. ACE expects to complete the transaction in the fourth quarter of 2010. ACE intends to operate the acquired company as a unit of ACE Westchester division in the Insurance-North American segment. In our opinion, ACE's intended acquisition of Rain and Hail will significantly enhance its market position in the crop insurance segment, a specialty area that has historically performed well for ACE and that has been less prone to underwriting cyclicality than many of ACE's other property/casualty lines. We also believe the group's long-standing relationship with Rain and Hail as an insurer and shareholder should help minimize any integration risks related to the acquisition. Following the acquisition, we expect key staff at Rain and Hail to remain in place, minimizing any business disruption.

In addition, in October 2010, ACE announced the acquisition of 100% of Jerneh Insurance Berhad, a general insurance company in Malaysia that is majority owned by Jerneh Asia Berhad, an investment holding company listed on Bursa Malaysia Securities Berhad. The acquisition was completed in December 2010 for approximately $200 million in cash. In the same month, ACE announced the acquisition of New York Life's Hong Kong and Korea life insurance operations for approximately $425 million. The transaction is expected to close in the first quarter of 2011. We expect that the Jerneh acquisition will add to ACE's capabilities in Malaysia and provide for cross-selling opportunities (particularly of its A&H policies with acquired property/casualty clients). The two life insurance operations acquired from New York Life were also strategic in nature, as ACE believes they will provide valuable systems and an existing platform for life insurance writings in Hong Kong and Korea that ACE can improve and expand into other emerging markets where the company is growing its life business.

Cycle management

For the past eight years, ACE has demonstrated a strong commitment to cycle management by prudently adjusting its writings according to prevailing market conditions. We expect this to continue into 2011, as the group continues to curtail writings in business that fails to meet its minimum underwriting thresholds, while growing in other areas that offer better profitability prospects. For 2011, these few areas of expansion include U.S. agriculture, international A&H, some life insurance and property/casualty in certain emerging markets, and a few pockets in the U.S. and Europe (such as the expected growth in the high-net-worth personal lines area in the U.S.). We expect that ACE will continue to emphasize underwriting profitability as a central focus, with one of the group's main underwriting tenets consisting of only writing business at below 100% combined ratios.

The group posted very strong growth rates of 26% and 14%, for its gross writings in 2002 and 2003, respectively, reflecting significantly improved market conditions following large catastrophe losses related to the Sept. 11, 2001, events. Starting in 2004, ACE's growth rates began to decline, falling to low-single-digit levels in 2005-2007, reflecting softening market conditions. Gross writings grew by 9% in 2008, but this largely reflected the effect of the Combined Insurance acquisition (the results of which are included in ACE's figures starting April 1, 2008), foreign exchange gains, and—to a lesser extent—ACE Private Risk Services, a unit that provides personal lines coverages to high-net-worth clients. In 2009, gross writings declined marginally (0.4%) to $19.2 billion compared with 2008, reflecting the combination of the adverse impact of the recessionary conditions and a strong U.S. dollar in the

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group's portfolio as well as continued underwriting prudence given continued competitive conditions in property/casualty insurance lines. ACE did grow in certain lines of its business such as property catastrophe reinsurance, however, where management saw better pricing opportunities as well as areas in which ACE was able to benefit from market dislocation because of the weaker position of some of its competitors and related higher demand for ACE's capacity (including a number of such opportunities in Europe).

Through the first nine months of 2010, gross writings grew by 2% to $15 billion, mainly reflecting growth in the Global Reinsurance segment, international property/casualty business, as well as personal lines (specifically the high-net-worth market), international life insurance, and financial solutions business.

Operating segments

ACE operates through four main divisions: Insurance—North American (50% of gross premiums through the first nine months of 2010), which houses most of the group's domestic primary commercial writings; Insurance—Overseas General for international insurance writings (35%); Global Reinsurance (7%); and Life Insurance and Reinsurance (8%).

The Insurance—North American division includes ACE's operations in the U.S., Canada, and Bermuda through ACE USA, ACE Westchester, and ACE Bermuda brands. This segment offers a broad array of commercial property/casualty insurance, excess and surplus lines, A&H, risk-management products, risk-control services, and (as of March 31, 2008) personal lines coverages through ACE Private Risk Services. Through the first nine months of 2010, this segment recorded a modest increase of 1% in net writings to $4.3 billion. This was primarily because of growth in its high-net-worth personal lines and a large transaction within its financial solutions unit.

Insurance—Overseas General includes the operations of ACE International, ACE Global Markets, and the international business of Combined Insurance. This division experienced a 3% increase in net writings through the first nine months of 2010, to $3.9 billion. This was mostly driven by growth in the Asia-Pacific and Latin America region, partially offset by the unfavorable foreign exchange impact, particularly in the third quarter of 2010. On a constant-dollar basis, ACE experienced growth in property/casualty writings in U.K. and benefited from new accounts and increased A&H writings in Asia-Pacific and Latin America as well as emerging markets. This was partially offset by lower writings at ACE's London market unit.

The Global Reinsurance division has experienced significant premium volume declines in recent years, as continued competitive conditions in reinsurance led ACE to curtail its reinsurance net writings to $914 million in 2008 from $1.2 billion in gross writings in 2007. This trend reversed in 2009, with this division reporting a 14% growth to $1 billion, primarily reflecting a higher proportion of property catastrophe writings. Through the first nine months of 2010, year-to-date net writings increased by 4% to $932 million, primarily reflecting a large workers' compensation treaty written in its U.S. operations and increased new business. This was partially offset by continued competitive pricing pressures in this line.

The Life Insurance and Reinsurance division experienced a significant increase in premium writings over the last two years, primarily reflecting the inclusion of Combined Insurance's domestic business as part of this reporting segment. For the first nine months of 2010, net writings in this segment increased by 6% to $1.2 billion from $1.1 billion during the first nine months of 2009. ACE does not write any traditional U.S. life insurance (excluding Combined; a significant portion of the portfolio consists of providing life insurance products to emerging markets), and its U.S. life reinsurance business is currently not writing any new business.

ACE maintains a significant amount of run-off exposures stemming from its purchase of CIGNA's Property & Casualty business for $3.5 billion in 1999 (goodwill of $2.1 billion). This included Brandywine Holdings Corp.'s (Brandywine) run-off operation (mostly A&E exposures), which is included in the Insurance—North American division. ACE maintains other run-off exposures, predominately U.S. workers' compensation run-off liabilities, within its operations.

Prospective

Standard & Poor's believes that ACE will maintain a very strong global competitive position that is diversified by segment, location, and product. We also expect ACE to continue to exercise significant underwriting prudence, with consolidated premium writings flat to modestly up in 2011, reflecting management's continued pruning in competitive lines of business and the expected incremental impact on premium volume of recently announced acquisitions. We believe that ACE could grow more significantly, particularly in property/casualty lines, if its lines of business were to experience significant premium rate increases in coming years.

Management And Corporate Strategy: Consistent Strategy Has Produced Strong Operating Performance

We view ACE's management and corporate strategy as a strength to the rating. ACE's strategy of continued product and geographic diversification and strong underwriting discipline has delivered strong profits for the organization in the past five years. The group has reported a five-year combined ratio (2005-2009) of 91%, an ROR of 21%, and an ROE of 17%. Its diversified platform has helped lower earnings volatility at the organization. ACE's operating performance over the last five years has been better than that of many of its peers, and it performed relatively well in 2005 and 2008, which were challenging years for the industry. We expect management's strategy to remain entwined with ACE's objective to provide a 15% ROE to investors over a cycle and maintain a combined ratio of 100% or lower.

Evan Greenberg, ACE's Chairman and CEO, is very involved in the operations of the business and is backed by a management team with significant depth and breadth. ACE's management and corporate strategy has improved the company's global brand name and led the expansion of its insurance platform globally. The strategy is based on maintaining a conservative underwriting posture, which focuses on producing underwriting profits, while keeping a conservative investment profile and modest financial leverage. The group also focuses on maintaining significant balance-sheet liquidity and very strong levels of capital at the operating level.

ACE's strong commitment to cycle management is also a positive aspect of its strategy, with the organization focused on taking significant opportunities to grow in its markets when pricing is strong (such as 2002 and 2003) and significantly retrenching when pricing is not viewed as adequate. Examples of the latter include management's decision to substantially curtail its ACE Westchester, global reinsurance (particularly in casualty reinsurance), and middle-market workers' compensation books in recent years, given its view that pricing in these segments are highly competitive. At the same time, ACE has focused on expanding into countercyclical lines of business outside commercial insurance and reinsurance, such as A&H, U.S. agriculture, and (to a lesser extent) international life insurance, and geographic regions such as Latin America, Asia-Pacific, the Middle East and emerging markets in Europe.

Although ACE's platform has been relatively stable over the last five years, the group has grown significantly over the past decade. Its rising global presence has increased the complexity of the organization, creating additional risk-management challenges. ACE's senior management team has significant industry experience. Even so, the company has had to increase its underwriting staff significantly in recent years, and the group's track record in some of its lines and regions is relatively limited. However, the group's strong risk-management capabilities as well as its moderating rate of growth in recent years offset these concerns.

Operational management

ACE's global breadth—diversified by segment, location, and product—is based on a very well-developed operational platform. ACE has the ability to see most global insurance markets across lines of businesses and within each line of business and move quickly and efficiently to provide the products needed by a wide and diversified international customer base. Based on global underwriting and pricing capabilities, existing multi-distribution channels, interconnected IT systems, and a management team with international business development expertise, ACE can coordinate technology, people, and work throughout the world and act quickly to satisfy the increasing international demand for insurance products. This is a strength to the rating.

ACE's risk controls are now very centralized, with final control for pricing, capital management, and underwriting guidelines through global product boards at the corporate level. We consider the operations as distribution channels and profit centers. Final actuarial determination over reserves includes a committee review incorporating views such as actuarial, business-development, claims, underwriting, and other areas. ACE's corporate functions provide key support in other areas, including claims, finance, legal, actuarial, and investment management.

Financial management

We view financial management as conservative. ACE has traditionally maintained a conservative investment portfolio with a modest amount of equities and speculative-grade securities, very little subprime exposure, and none to riskier asset classes such as CDOs and CLOs. The group does not offer credit derivatives. ACE's exposure to variable annuity reinsurance is significant but is manageable relative to the group's equity base. The group avoided deeper losses in this product by imposing significant caps and limits to all treaties.

Financial leverage is viewed as moderate to the rating, with total debt to total tangible capital at 15% and total debt plus preferreds to total tangible capital at 16% as of Sept. 30, 2010.

Enterprise Risk Management: Strong, With Effective Management Of Key Risks

Given the complexity of the firm's risk profile and the size of its exposures, ERM is of high importance to the rating. The overall ERM assessment for ACE is strong. Supporting this view are ACE's strong risk culture, overall risk control, emerging risk management, risk models, and strategic risk management. In addition, we view ACE's risk controls for property/casualty underwriting, pricing, cycle management, and catastrophe risk as excellent.

We view ACE's risk culture as strong. The Risk Committee of the Board (formed in 2009) provides risk-management oversight. The firm's senior leadership is highly engaged in risk management and has been providing direction and oversight via a formal ERM committee. The Chief Risk Officer reports directly to the CEO and leads a team of ERM and risk-modeling specialists. The ERM function is aligned with other risk-related functions such as compliance and internal audit. The firm has a robust risk-assessment process, with risk ownership assigned, mitigation steps identified, and progress tracked via risk-based internal audits. Extensive scenario analyses help evaluate and prioritize the risks. The company has a robust risk-appetite framework that views risks in their aggregation and carefully weighs opportunities against the risks while effectively containing the risks within the bounds of clearly defined risk tolerances.

Risk controls in property/casualty underwriting, pricing, cycle management, and catastrophe management are viewed as excellent. ACE has continued to adhere to underwriting and pricing discipline—despite the ongoing soft-market pressures. The success of the firm's underwriting can be partially attributed to the strong analytical support, especially in the form of predictive, catastrophe, and capital modeling. Risk-adjusted profitability targets help assure price adequacy and comparability across the various lines of business. The risk of adverse loss development is also thoroughly modeled and well understood. It appears well contained, but because of the intrinsic uncertainty and high sensitivity to claim-cost inflation, this might be a concern in the future. Reserving risk controls are viewed as strong.

ACE's exposure to market risks is quite moderate and mostly comes from the fixed-income assets' sensitivity to interest rates. Overall, the company has been careful not to carry too much credit and market risks in the investment portfolio, and the portfolio's performance throughout the recent financial-market turmoil is evidence of strong investment-risk management.

The strong score for credit/counterparty risk controls reflects a range of enhancements the company has implemented over the last two years. The recent global credit crisis has accentuated ACE's exposure to financial—mostly reinsurance—counterparties. Nevertheless, the firm's risk limits and policies, including those implemented before the crisis, appear effective in controlling the risk. The revised analytical framework (risk assessment, measurement and modeling) is helping to explicitly account for the existing and future counterparty/credit risks and their contagions, as ACE continues to rely on reinsurance counterparties and invest in high-yield bonds.

Efforts to identify and assess potential emerging and latent risks are also strong, which is evidenced by the proactive/forward-looking management within each function (e.g. Product Boards, credit and investment management), coupled with the detailed risk-assessment (risk matrix) process, and cross-functionally integrated via the ERM committee.

Reflecting the firm's size, complexity, and acquisitive strategy, operational risk management is among ACE's top priorities. Its policies and practices are well documented. We view ACE's controls related to information technology, business continuity, outsourcing, and payment processing as strong and continue to improve.

The company continues to enhance its risk and capital modeling, and we view its approach to risk modeling and analytics as strong. The internal capital model is the main risk-aggregation tool, and it has been supporting risk-adjusted profitability targets, capital-adequacy analyses, and portfolio optimization. ACE also recognizes that it needs to do more work and the envisioned enhancements should expand the models' decision-making applications and ensure compliance with future regulatory solvency regimes.

Risk/reward optimization is a key element of ACE's strategic risk management (SRM). The firm's SRM is supported by an actively used internal capital model. Planning and key underwriting strategies are predicated on a risk-based use of capital to ensure that it meets return hurdles. At the same time, risk and capital modeling is supplemented with thoughtful strategic and underwriting judgment. Strategic judgment and due diligence have resulted in an overall successful track record of M&A, new-venture, and new-product decisions. However, it should be noted that those decisions have also been exposing the firm to a range of execution, integration, and legacy issues. Along with the potential benefits could come the risk of extreme-event contagions, and we expect it to be fully reflected in the consolidated capital model.

Overall, it is considered unlikely that the insurer will have losses outside of its risk tolerances or that it will experience major risk-control failures. With a sustained track record of effective execution of its ERM process, coupled with recent and expected enhancements, the firm's ERM appears on course to eventually transition to an excellent ERM score.

Accounting

Effective July 18, 2008, ACE Ltd. obtained all necessary regulatory approvals to become a Switzerland-based company. As a result, the company deregistered in the Cayman Islands and is now subject to Swiss corporate law. The redomestication is neutral to the rating, and we do not expect it to have a material effect on the way ACE operates its business or on its financial condition or results of operations.

We view accounting as neutral to the rating because the company has established appropriate accounting and internal controls since the restatement of its financials in 2005, which was mainly due to finite reinsurance-related business. ACE established appropriate accounting controls for future finite reinsurance contract acquisitions in 2004. It can't acquire buy-side finite-risk contracts without prior approval from the CEO. Guidelines and restrictions had been established for accounting and marketing of so-called sell-side finite-risk contracts. Other controls include personnel changes and the formation of an internal structured transaction review committee.

Operating Performance: Peer-Leading Operating Performance For The Last Five Years, Supported By Very Strong Underwriting Results

ACE's profits have been strong for the past five years, with the group reporting a five-year combined ratio (2005-2009) of 91%, an ROR of 21%, and an ROE of 17%. These results are better than those of many global insurance and reinsurance peers during the same period. In addition, ACE's diversified platform has contributed to the group experiencing lower volatility in earnings relative to many peers in recent years.

Table 2

ACE Ltd. Operating Cos./Operating Statistics						
	--Nine months ended Sept. 30--	--Year ended Dec. 31--				
(Mil. $)	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**
Total revenue	11,470	15,271	15,265	14,215	13,426	13,012
EBITDA	2,568	3,498	3,430	3,389	3,101	1,399
EBITDA including realized gains	2,695	3,302	1,797	3,328	3,003	1,475
Net income	2,107	2,549	1,197	2,578	2,305	1,028
Return on adjusted equity (%)	16.2	18.8	9.5	19.7	21.7	12.1
Return on equity (%)	16.5	19.3	9.7	20.2	22.3	12.6
Return on assets (%)	4.5	4.5	2.2	4.9	4.9	2.5
Return on revenue (%)	22.4	22.9	22.5	23.8	23.1	10.8
Return on revenue Including realized gains (%)	23.5	21.6	11.8	23.4	22.4	11.3
Realized gains/EBITDA (%)	4.9	(5.6)	(47.6)	(1.8)	(3.2)	5.4
Administrative expense ratio (%)	13.7	13.7	12.9	12.5	12	10.5
Nonlife administrative expense ratio (%)	13.5	13.3	12.8	11.8	12.3	10.8

Table 2

ACE Ltd. Operating Cos./Operating Statistics (cont.)						
Commissions expense ratio (%)	17.1	16.1	16.2	14.4	14.5	14.2
Nonlife commissions expense ratio (%)	17.1	16.2	16.2	14.5	14.6	14.2
Nonlife loss ratio (%)	59.6	58.8	60.6	61.6	61.2	74.5
Loss ratio (%)	59.1	58.5	60.6	61.1	60.8	74.2
Combined ratio (%)	89.9	88.3	89.6	88.0	87.3	98.9
Nonlife combined ratio (%)	90.2	88.3	89.6	87.9	88.1	99.5
Cash flows						
Net cash flow from operating activities	2,775	3,335	4,101	4,701	4,105	4,308
Net cash flow from investing activities	(2,668)	(3,224)	(4,124)	(4,530)	(3,770)	(5,593)
Net cash flow from financing activities	(282)	(321)	314	(253)	(284)	1,328

ACE performed well relative to many global (re)insurers in 2005 despite record-high industry catastrophe losses in that year, posting a 99.5% combined ratio and an ROR of 10.8% in 2005. In addition, ACE's performance in 2008 was strong, given the considerable challenges it faced from capital market-related volatility and, to a lesser extent, catastrophe losses. Operating results for full-year 2009 and through the first nine months of 2010 were very strong, with the group reporting a combined ratio of 88.3% and 90.2% and an ROR of 22.9% and 22.4%, respectively.

Historical

ACE's combined ratio was 102% in 2002, resulting from a $516 million pretax A&E charge ($354 million, after tax; 8 percentage points on loss ratio). ACE's net income in 2003 was $1.5 billion, with a combined ratio of 91%. In 2004, ACE's net income totaled $1.2 billion, with a combined ratio of 97%, including A&E and catastrophe charges. Excluding A&E and catastrophe charges, the combined ratio was 88%.

In 2005, ACE's combined ratio was 99% on an 11% ROR because of pretax losses of $1.3 billion (11% points on loss ratio) from Hurricanes Katrina, Rita, and Wilma. Net income totaled $1 billion, primarily because of $1.3 billion in investment income. ACE's net income in 2006 was $2.3 billion on a combined ratio of 87%. ACE continued to report strong net income of $2.6 billion and a combined ratio of 88% for the year ended Dec. 31, 2007, in part because of the lack of catastrophe activities during the year.

On a purely underwriting basis, ACE's 2008 combined ratio remained strong at 89.6%, and the ROR was 22.5% compared with 87.9% and 23.8%, respectively, in 2007. ACE's catastrophe losses, primarily related to Hurricanes Ike and Gustav during 2008, were modest relative to the size of the event for the property/casualty industry, amounting to $567 million on a pretax basis ($450 million on an after-tax basis, and four percentage points to the combined ratio). This reflects the group's strong control of its aggregate exposures and well-diversified portfolio, which has reduced the group's earnings volatility. ACE's 2008 net income of $1.2 billion declined significantly relative to 2007, primarily reflecting a very high $1.6 billion in pretax realized losses incurred during the year.

ACE reported very strong operating results during 2009, with a consolidated combined ratio of 88.3% and an ROR of 22.9% for full-year 2009. Earnings were very strong, with pretax income of $3.1 billion compared with $1.6 billion in 2008. The strong earnings improvement during 2009 was attributable to very strong underwriting performance, partially offset by realized losses of $196 million (though much improved compared with realized losses of $1.6 billion for 2008). Pretax unrealized investment gains of $3.1 billion reported by the group in 2009 did not directly affect net income, as they are reported as part of comprehensive income, but this gain was the main contributor to the 36% increase in GAAP shareholders' equity as of Dec. 31, 2009, compared with Dec. 31, 2008. These unrealized gains were primarily a function of the tightening of credit spreads in ACE's investment portfolio and aided the group in recovering most of its capital market losses in 2008.

Current performance

ACE reported strong pretax income of $2.5 billion through Sept. 30, 2010, compared with $1.9 billion for the same period in 2009. This reflected a combination of strong underwriting performance for the first nine months of the year and return to realized gains of $127 million (compared with realized losses of $569 million through the first nine months in 2009).

ACE's nine-month consolidated combined ratio was very strong at 90.2% compared with 87.8% for the same period in 2009. Excluding favorable reserve development of $453 million incurred through the first nine months of 2010, ACE's accident-year combined ratio is still strong at about 94.8%. Return on revenue remained strong at 22.4%, reflecting a combination of strong underwriting gains and strong investment income.

Prospective

Assuming a normal level of catastrophe losses, we expect the company's operating performance to remain very strong in 2011, with a combined ratio of about 92% and a return on revenue of more than 18%. This reflects our expectation that the group will maintain underwriting discipline and that pricing conditions in ACE's lines will be flat or slightly deteriorate next year. Furthermore, we expect ACE's diversified business mix to reduce the group's exposure to any one line of business and for the group's earnings to be less volatile than most peers'.

Investments And Liquidity: Conservative Investment Portfolio And Very Strong Operating Cash Flows

ACE's investments and liquidity are collectively very strong because of its conservative investment portfolio and very strong cash-flow generation capabilities.

Table 3

ACE Ltd. Operating Cos./Investments And Liquidity Statistics

	--Nine months ended Sept. 30--	--Year ended Dec. 31--				
(Mil. $)	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**
Total invested assets	51,458	47,184	40,582	42,289	37,166	32,354
Net investment income	1,538	2,031	2,062	1,918	1,601	1,264
Net investment income/total revenue (%)	13.4	13.3	13.5	13.5	11.9	9.7
Realized gains/(losses)	127	(196)	(1,633)	(61)	(98)	76
Unrealized gains/(losses)	1,677	3,092	(1,712)	(3)	289	(251)
Net investment yield (%)	4.2	4.6	5.0	4.8	4.6	4.2
Net investment yield including realized gains (%)	4.5	4.2	1.0	4.7	4.3	4.5
Net investment yield including realized and unrealized gains (%)	9.1	11.2	(3.1)	4.7	5.1	3.6
Portfolio composition						
Shares and variable-yield securities (%)	0.8	1.0	2.4	4.3	4.6	4.7
Bonds (%)	91.5	91.1	83.8	85.5	85.0	84.6
Cash and bank deposits (%)	4.6	5.0	10.4	7.4	8.1	8.7

Table 3

ACE Ltd. Operating Cos./Investments And Liquidity Statistics (cont.)						
Other invested assets including hedge funds (%)	3.1	2.9	3.4	2.7	2.3	2.1

Investments

The group has traditionally maintained a very conservative investment strategy, with a small allocation of its investment portfolio in equities, speculative-grade securities, and nominal alternative investments. The group has also traditionally not invested in CDOs or CLOs, and it entered 2008 with relatively little subprime securities in its portfolio. This has helped curb ACE's investment losses amid turbulent capital market conditions over the past three years.

Because a significant portion of ACE's unrealized investment losses in 2008 related to the widening of credit spreads in its bond portfolio, through 2009 and first nine months of 2010, ACE had substantially recovered these losses as a result of improved capital market conditions. The group reported strong pretax unrealized investment gains of $1.7 billion for the first nine months of 2010 and $3.1 billion for full-year 2009. On a realized basis, ACE reported $196 million in realized investment gains for full-year 2009. The group reported $127 million in realized gains for the first nine months of 2009, reflecting gains on sales of fixed-income and equity securities coupled with losses in the group's variable annuity reinsurance business resulting substantially from the impact of falling interest rates.

ACE continued to maintain a very conservative investment portfolio as of Sept. 30, 2010, with 91.5% of the total invested asset portfolio of $51.5 billion consisting of bonds and 4.5% invested in cash and short-term investments. The remaining 4% consisted of 1% in equities and 3% in other invested assets. Other investments primarily consisted of investment funds, limited partnerships, partially owned investment companies, life insurance policies, and trading securities.

As of Sept. 30, 2010, ACE fixed-maturity and short-term investment portfolio had average credit quality of 'AA', with more than half of the portfolio invested in 'AAA' securities. In 2010, the group moderately increased its proportion of holdings in speculative-grade bonds to 14% as of Sept. 30, 2010, compared with 6% as of Dec. 31, 2008. This reflected the company's strategy of perceived good-value opportunities, particularly among 'BB' rated bonds (which increased to 7% of total fixed-income holdings versus 3% at year-end 2008). We don't expect the fixed-income portfolio to change much further, and its overall credit quality should remain very high.

The quality of ACE's investment portfolio is strengthened by its relatively small exposure to subprime, with only $54 million in subprime asset-backed securities as of Dec. 31, 2009, constituting only 0.1% of its invested asset portfolio. The fixed-income portfolio is well diversified, with limited exposure to any one name or asset class. Mortgage- and asset-backed securities accounted for 25% and 1%, respectively, of the fixed-income portfolio as of Sept. 30, 2010. In the MBS portfolio, about 88% of ACE's residential mortgage is held in federal agencies' securities (Freddie Mac and Fannie Mae).

As of Sept. 30, 2010, ACE's fixed-income investment portfolio had a 3.6-year duration. Management believes the diversity of its portfolio and the significant portions of it maturing each year—combined with strong cash flow supporting new cash to be invested every year—provide significant flexibility for ACE to modify its investment allocation as needed if there is a rise in inflation over the next two to five years. We do believe ACE will be able to maneuver through such an inflationary environment, given its strong focus on maintaining a diverse investment asset allocation and significant resources allocated to monitor and control its investment-management function.

ACE continued to maintain investment income at prior-year levels, with $1.5 billion through the first nine months of 2010. This differs from a number of (re)insurers that have seen a fall in investment income (particularly in 2008) and reflects ACE's relatively small investments in alternative assets and hedge funds. The group reported a net investment yield of 4.2% through the first nine months of 2010, which further increases to a total yield of 9.1% when including realized and unrealized gains in the group's investment portfolio. The increase is primarily attributable to pretax unrealized investment gains of $1.7 billion during this period, reflecting tightening of credit spreads.

Liquidity

We view ACE's liquidity position as very strong and supported by strong operating cash flows, significant cash and short-term investments of $2.3 billion as of Sept. 30, 2010, no debt-refinancing needs in the next three years, and ample credit facilities. The group has significant dividend capacity from its operating subsidiaries relative to its debt-servicing needs.

ACE has continued to report very strong operating cash flows in the last five years, with operating cash flow of $3.3 billion at year-end 2009 and $2.8 billion as of the first nine months of 2010. Through the first nine months of 2010, cash flow strengthened compared with $2.3 billion for the same period in 2009, reflecting higher net collections and absence of the adverse impact of collateral adjustments related to its variable annuity business as incurred in 2009. We expect that ACE's cash flow will remain strong through the remainder of 2010 and improve further in 2011.

ACE has four primary credit facilities that together provide up to $2.5 billion in capacity. In June 2009, ACE entered into a five-year unsecured letter-of-credit facility of $500 million that expires in September 2014. Out of the remaining three, one facility provides up to $1 billion in letter-of-credit capacity, another consists of a $500 million revolver, and the third facility provides for up to £300 million ($465 million as of Sept. 30, 2010) in capacity to support ACE Global Markets underwriting capacity for Lloyd's Syndicate 2488. Of the total $2.5 billion capacity, about $1.3 billion had been drawn as of Sept. 30, 2010. The $1 billion letter-of-credit and revolver facilities expire in November 2012, require ACE to maintain a minimum net worth and a maximum debt-to-total-capitalization ratio. As of Sept. 30, 2010, ACE was well within these requirements. The minimum-net-worth requirement calculated was $12.6 billion as of Sept. 30, 2010, versus ACE's net worth of $19 billion. The debt to total capital ratio was calculated at 14.2% as per covenant requirements. The maximum allowed is 35%.

Capitalization: Very Strong, With An Increasing Capital Base And Improving Balance-Sheet Quality

We view ACE's capital adequacy as very strong. On a purely quantitative basis, the group displayed a redundancy at the 'AAA' level as of Sept. 30, 2010, according to Standard & Poor's capital adequacy model. On a qualitative basis, ACE's quality of capital is supported by its strong control of aggregations and other risks throughout the organization, the strong quality of its underwriting results (which is the key engine for earnings and capital growth at the organization), its conservative investment posture, its very strong liquidity, and its low financial leverage. This is partially offset by moderate amounts of reinsurance recoverables, goodwill, and—to a lesser extent—A&E reserves on the balance sheet that in our view somewhat reduce the quality of capital.

Table 4

ACE Ltd. Operating Cos./Capitalization Statistics						
	--Nine months ended Sept. 30--	--Year ended Dec. 31--				
(Mil. $)	2010	2009	2008	2007	2006	2005
Total assets	82,388	77,980	72,057	72,090	67,135	62,440
Adjusted total assets (excluding goodwill and reinsurance recoverables)	64,717	60,156	54,134	54,997	49,824	44,274
Equity (excluding goodwill)	18,939	15,736	10,699	13,946	11,547	9,109
Total adjusted equity (excluding goodwill)	19,248	16,045	11,008	14,255	11,856	9,418
Total capital (excluding goodwill)	22,561	19,364	14,285	16,438	13,994	11,529
Change in adjusted equity (%)	26.1	45.8	(22.8)	51.4	25.9	24.6
Hybrid equity/total capital (%)	1.4	1.6	2.2	5.3	6.2	7.5
Interest coverage (x)	15.9	15.5	14.9	19.4	17.6	8.0
Fixed-charge coverage (x)	15.9	15.5	13.2	14.7	13.4	6.1
Debt/total capital (including intangible asset) (%)	12.5	14.2	18.2	11.4	12.8	14.8
Debt/total capital (excluding intangible asset) (%)	14.7	17.1	22.9	13.3	15.3	18.3
Debt plus preferred plus mezzanine/total capital (including intangible assets) (%)	13.7	15.6	19.9	15.9	18.0	20.9
Debt plus preferred plus mezzanine/total capital (excluding intangible asset) (%)	16.1	18.7	25.1	18.5	21.5	25.8
Investment leverage (%)	1.8	2.4	6.8	11.0	12.0	12.8

ACE's capital position improved substantially as of Sept. 30, 2010, relative to the prior year, reflecting strong net earnings of $2.1 billion and $1.7 billion in pretax unrealized investment gains in the first nine months of 2010. These factors contributed to a 16% increase in ACE's reported GAAP shareholders' equity as of Sept. 30, 2010, compared with year-end 2009. On a tangible equity basis, ACE experienced a 20% increase in its adjusted shareholders' equity position as of Sept. 30, 2010, to $19.3 billion compared with $16.0 billion as of Dec. 31, 2009.

As of Sept. 30, 2010, reinsurance recoverables of $13.8 billion amounted to 60% of ACE's shareholders' equity and 73% of tangible equity. This has improved significantly from 71% and 88%, respectively, at year-end 2009 and 98% and 132%, respectively, at year-end 2008. This reflects higher GAAP shareholders' equity as of Sept. 30, 2010. These figures exclude credit for collateral of approximately $2.8 billion available to ACE, which would further improve reinsurance recoverables as a proportion of shareholders' equity and tangible equity to 47% and 59%, respectively, as of Sept. 30, 2010.

Excluding reinsurance agreements with Berkshire Hathaway subsidiary National Indemnity Co. (NICO, discussed in the reserve section), reinsurance recoverables as of Sept. 30, 2010, are 53% of shareholder' equity and 64% of tangible equity which was a significant reduction compared with 83% and 110%, respectively, for the same period in 2008 (figures are gross of collateral).

Goodwill and intangibles of $3.9 billion amounted to 17% of the $22.9 billion equity base as of Sept. 30, 2010. This was a decline from 20% in 2009 and 26% in 2008. Goodwill and intangibles relative to ACE's equity had spiked in 2008 from 17% in 2007, primarily as a result of the group's Combined Insurance's acquisition and a decrease in ACE's 2008 equity base because of unrealized investment losses.

Prospective

We expect ACE's capital adequacy to remain very strong over the next two years, supported by the expectation of continued very strong operating results. We do not expect management to engage in meaningful share repurchases or other forms of capital return to shareholders, reflecting ACE's conservative capital-management strategy. Debt plus preferred leverage (measured on a tangible capital basis) likely will remain at less than 25% in the medium term.

We expect ACE's reinsurance recoverables, goodwill, and A&E reserves to continue to decline as a proportion of shareholders equity in the coming years as ACE's equity base increases.

Reserves

We believe the quality of reserves at ACE has improved significantly in recent years, reflecting a reversal in the group's prior history of adverse loss reserve development. We also believe ACE's exposure to A&E reserves is moderate on a net basis (about $1.4 billion as of Dec. 31, 2009, excluding further recoveries from reinsurance agreements provided by NICO described below) relative to its $19.7 billion GAAP shareholders' equity as of Dec. 31, 2009 ($22.9 billion as of Sept. 30, 2010) and should not be a significant drag on the group's earnings in future years.

Following a period of continued loss-reserve strengthening in 2001-2005 (including significant reserve charges in 2002 and 2004), ACE began to report modest favorable reserve development in 2006 and 2007 (reserve releases of $12 million and $217 million, respectively). At year-end 2008, ACE reported favorable reserve development of $814 million, of which 66% was related to short-tail lines, while 34% was related to long-tail lines. This trend continued into 2009, with ACE reporting favorable reserve development of $579 million, 53% of which related to long-tail lines and the remaining 47% relating to short-tail business. Through the first nine months of 2010, ACE reported a favorable development of $453 million, 58% of which related to long-tail lines and the remaining 42% to short-tail businesses. We expect this favorable trend to continue into the fourth quarter of 2010 and full-year 2011, reflecting ACE's conservative initial loss-reserve picks.

ACE has moderate exposures to A&E liabilities, which it acquired in conjunction with its purchase of CIGNA's property/casualty business in 1999 and, to a lesser extent, the purchase of Westchester Specialty in 1998. However, the group's exposure to these liabilities are substantially reduced after accounting for third-party reinsurance and several reinsurance protection agreements with Berkshire Hathaway subsidiary NICO.

Most of ACE's A&E exposures currently reside within Brandywine Holdings, which it acquired as part of the 1999 CIGNA acquisition. As of Dec. 31, 2009, ACE's total A&E reserves (at Brandywine and other ACE subsidiaries, particularly ACE Westchester) amounted to $2.5 billion on a gross basis and $1.4 billion on a net basis. These amounts, however, exclude reinsurance coverages provided by NICO.

As part of the acquisition of CIGNA's property/casualty business, NICO provided $2.5 billion on all Brandywine losses and allocated loss adjustment expenses and on the A&E reserves of various ACE INA subsidiaries (which were contributed to Brandywine). This agreement was exhausted on an incurred basis in the fourth quarter of 2002. All in all, the NICO agreement covers A&E and other run-off reserves (including workers' compensation and non-A&E general liability losses) at Brandywine, which as of Dec. 31, 2009, amount to $2 billion (after accounting for all third-party reinsurance). Net of the NICO coverage, reserves for these liabilities are significantly lower at $878 million.

ACE Westchester also carries A&E exposures. It purchased two reinsurance programs from NICO (the 1992 and 1998 NICO agreements). The 1992 NICO agreement is exhausted on an incurred basis. The remaining unused incurred limit (available only for losses and loss adjustment expenses) under the 1998 NICO agreement was $529 million as of Dec 31, 2009. The agreement provided a 75% pro rata share of $1 billion of reinsurance protection on losses and loss-adjustment expenses that were incurred on or before Dec. 31, 1996, in excess of a retention of $721 million. As of Dec. 31, 2009, A&E and other run-off reserves at ACE Westchester amounted to $217 million. Net of the NICO coverage, reserves for these liabilities were nominal at $29 million.

Reinsurance

ACE's reinsurance utilization is moderate, with a reinsurance utilization ratio of 31% as of Sept. 30, 2010. However, the group's reinsurance use is in line with its strategy to use reinsurance to manage down net lines and aggregates and to ultimately reduce earnings and balance sheet volatility. The group is also a large writer of U.S. crop business, which requires high levels of retrocession to the federal government. A few other lines written by ACE—such as captive business—also have a naturally high cession rate. Finally, ACE is also using significant levels of reinsurance currently as a cycle-management strategy, as management believes that given current pricing in the reinsurance markets, it makes sense to cede some of the business in exchange for a fee and reduced earnings volatility.

In recent years, the group has been successful in significantly managing down its overall exposure to reinsurance recoverables, with total net recoverables declining to 60% of ACE's equity base as of Sept. 30, 2010, from 131% in 2005. On a net-of-collateral basis, the proportion of total reinsurance recoverables from investment-grade reinsurers is relatively good at about 79% as of June 30, 2010. In addition, the group has been very proactive in managing its prospective exposure to reinsurance recoverables by strictly monitoring reinsurers it does business with, engaging into global trading agreements with a number of its reinsurers, and requiring collateral from speculative-grade reinsurers, among others. The group continually monitors its total exposures to any one reinsurer, and in one recent case where it had indentified more significant concentration risk, ACE used credit default swaps to decrease its exposure to the identified reinsurer.

Financial Flexibility: A Flexible Capital Structure And Modest Leveraging Lend Support

ACE's financial flexibility is very strong because of its modest financial leverage and flexible capital structure. As of Sept. 30, 2010, debt to total tangible capital was a moderate 15%, and debt plus preferred to total tangible capital was 16%. These figures are a reduction from 2009 and 2008 levels and reflect the group's increased capital base in 2010 as a result of strong earnings and unrealized investment gains.

In recent years, ACE had historically maintained a strategy of spreading out its debt maturity dates to keep debt maturing in any one year at or less than one quarter of operating earnings. Historically, this has significantly reduced the holding company's exposure to refinancing risk. In November 2010, ACE took advantage of the significantly low interest rates and issued $700 million of 2.6% senior notes, maturing in 2015. It issued this debt primarily to refinance bank debt (short-term debt of $155 million due in 2010 and long-term debt of $50 million due in 2011 & $450 million due in 2013) totaling about $655 million. As a result of these transactions, ACE does not have any debt repayments until 2014. ACE's next debt maturity is $500 million senior notes due in 2014 and $1.15 billion of obligations ($450 million notes plus $700 million senior notes) in 2015. We view these amounts as modest relative to ACE's balance sheet and cash resources.

ACE's leverage had increased moderately in 2008 as a result of the issuance of $750 million in senior notes as a part of the financing of the Combined Insurance acquisition ($300 million issuance in February 2008 and $450 million issuance in April 2008). In addition, ACE issued $450 million in senior notes in May 2008, the proceeds of which it used to redeem its preferred shares in the second quarter of 2008. In the three months ended March 31, 2008, ACE executed $1 billion in reverse repurchase agreements as part of Combined Insurance's acquisition. These agreements were settled in 2008.

In June 2009, ACE issued $500 million senior unsecured notes due 2019, primarily to refinance various notes maturing in 2009. In addition, in September 2009, ACE repaid a nine-month term loan of $16 million. The group repaid $200 million in short-term debt (subordinated notes) in December 2009.

Ratings Detail (As Of December 30, 2010)*	
Holding Company: ACE Ltd.	
Issuer Credit Rating	
Local Currency	A/Stable/NR
Preferred Stock (3 Issues)	BBB+
Senior Unsecured (8 Issues)	A
Operating Companies Covered By This Report	
ACE American Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Counterparty Credit Rating	
Local Currency	AA-/Stable/--
ACE Bermuda Insurance Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
ACE Bermuda International Insurance (Ireland) Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
ACE Bermuda International Reinsurance (Ireland) Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
ACE European Group Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--

Ratings Detail (As Of December 30, 2010)* **(cont.)**	
ACE Fire Underwriters Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
ACE Indemnity Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
ACE Insurance Co. of the Midwest	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
ACE Insurance (Switzerland) Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
ACE Property & Casualty Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
ACE Tempest Life Reinsurance Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
ACE Tempest Reinsurance Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Atlantic Employers Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Bankers Standard Fire & Marine Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--

Ratings Detail (As Of December 30, 2010)***(cont.)**	
Bankers Standard Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Corporate Officers and Directors Assurance Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Illinois Union Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Indemnity Insurance Co. of North America	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Insurance Co. of North America	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Pacific Employers Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Westchester Fire Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Westchester Surplus Lines Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Domicile	Pennsylvania

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.