

### Summary:

## ACE Ltd. And Core Operating Companies

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### Table Of Contents

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Rationale

Factors Specific To Holding Company

Outlook

## Summary:

# ACE Ltd. And Core Operating Companies

**Local Currency**

**Credit Rating:** AA-/Stable/--

## 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 cyclicity 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.

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