

December 19, 2008

Research Update:

ACE Ltd. And Core Operating Subsidiaries Outlook Revised To Positive; Ratings Affirmed

Primary Credit Analyst:

Laline Carvalho, New York (1) 212-438-7178;laline_carvalho@standardandpoors.com

Secondary Credit Analyst:

Dennis Sugrue, New York (1) 212-438-2635;dennis_sugrue@standardandpoors.com

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Rationale

On Dec. 19, 2008, Standard & Poor's Ratings Services revised its outlook on insurance and reinsurance holding company ACE Ltd. (ACE) and related core operating subsidiaries to positive from stable. At the same time, we affirmed our 'A+' counterparty credit and financial strength ratings on ACE's core operating insurance companies and our 'A-' counterparty credit rating on ACE. In addition, we revised our outlook on some of ACE's noncore operating subsidiaries to positive from stable (see ratings list). We also affirmed our 'A' counterparty credit and financial strength ratings on these companies.

The positive outlook is based on ACE's very strong operating performance over the past five years, which compares favorably with many global (re)insurance peers, both in terms of average returns as well as quality of earnings, as measured by earnings volatility. We also believe ACE's investment losses in the first nine months of 2008 (and related 7% drop in shareholders' equity relative to year-end 2007) have been moderate and compare favorably with a number of global (re)insurance peers'. Capital remains supportive of the ratings in the strong range, and the company's liquidity is also strong. Given the weakened competitive position of some of ACE's peers over the past year, we believe ACE is in a solid position to take advantage of current market dislocation. We view ACE's competitive position as very strong, supported by the group's extensive and well-diversified business platform.

The ratings on ACE are based on the group's very strong competitive position and operating performance, as well as its strong capitalization and liquidity. The negative rating factors are ACE's changing and increasing risk profile as it diversifies into new business lines and geographic locations, high reinsurance utilization in certain lines, and a large amount of reinsurance recoverables, run-off reserves, and intangibles on the balance sheet. We view enterprise risk management as strong and supportive of the ratings.

ACE's operating results through the first nine months of 2008 were reasonable and better than those of a number of its peers. The combination of modest catastrophe losses from Hurricanes Ike and Gustav (accounting for four percentage points in the combined ratio), as well as realized investment losses of about \$1 billion and unrealized losses of \$2 billion, led to a 7% decline in shareholders' equity as of Sept. 30, 2008 (relative to Dec. 31, 2007). But, the group's capital adequacy remains strong. In addition, ACE's unrealized investment losses largely reflect the widening of credit spreads in its fixed-income portfolio. ACE's investment portfolio traditionally has been very conservative, with relatively small amounts of equities or high-yield securities in the portfolio. The group has very little exposure to subprime, marginal exposure to hedge funds, and no investments in collateralized debt obligations or collateralized loan obligations. The investment portfolio is

also well diversified, with no major exposures to any one name or sector.

ACE's liquidity position is strong and supported by very strong operating cash flows, significant cash and short-term investments of \$3.4 billion as of Sept. 30, 2008, modest debt refinancing needs in the next five years, and ample credit facilities. The group also has significant dividend capacity from its operating subsidiaries relative to debt servicing needs. ACE has a modest amount of debt due over the next two years, and the group has the capacity to fund this maturing debt internally, if necessary.

During the first nine months of 2008, ACE reported realized losses of \$279 million related to its variable annuity reinsurance business, reflecting the adverse impact of recent movements in the capital markets relative to this product. Given the continued decline in the equity markets during the fourth quarter of 2008, we believe ACE could incur further moderate losses in this business during the fourth quarter and possibly in 2009. Although ACE's losses in this product line have been significant, they are moderate relative to the group's large equity base. We believe that the significant limits and caps that ACE places on this business will help moderate these losses if equity markets continue to deteriorate.

ACE has demonstrated a strong commitment to cycle management, as can be seen in the increase in premium volume in 2002-2004 and the slowdown in growth since 2005 (as market conditions in casualty and subsequently property began to soften). Gross writings increased by 10% through the first nine months of 2008, but this largely reflected the effect of the Combined Insurance acquisition (whose results are included in ACE's figures starting April 1, 2008), foreign exchange gains, and, to a lesser extent, ACE Private Risk Services, a relatively new (and small) unit that provides personal lines coverages to high-net-worth clients. A number of ACE's other businesses (in particular, certain property/casualty insurance and reinsurance businesses) saw significant premium declines through the first nine months of 2008, as ACE shed business that did not meet its pricing thresholds.

ACE has relatively large amounts of reinsurance recoverables, goodwill, and (to a lesser extent) asbestos and environmental reserves on its balance sheet. The proportion of these items relative to ACE's equity base increased as of Sept. 30, 2008, compared with year-end 2007. This resulted largely from the nearly \$1 billion increase in goodwill related to the Combined Insurance acquisition in April 2008, as well as the drop in GAAP shareholders' equity due to realized and unrealized losses in the investment portfolio. As of Sept. 30, 2008, reinsurance recoverables of \$14.5 billion amounted to 94% of ACE's shareholders' equity and 126% of tangible equity. This is up from 85% and 102% at year-end 2007, respectively. Excluding reinsurance agreements with Berkshire Hathaway subsidiary National Indemnity Co., reinsurance recoverables as of Sept. 30, 2008, amount to 81% of shareholders' equity and 113% of tangible equity, although they are still significant. Goodwill and intangibles of \$3.8 billion amounted to 25% of the equity base on Sept. 30, 2008, up from 17% at year-end 2007. We expect these assets to decrease as a proportion of shareholders' equity over the next two years as ACE rebuilds its capital position through operating earnings.

Outlook

In full-year 2008, we expect ACE's combined ratio to remain very strong, at 91%-93%, reflecting our expectation that underwriting results will remain strong in the fourth quarter of 2008. Assuming a normal level of catastrophe losses, we expect operating performance to remain strong in 2009, with returns on revenue of more than 20%, reflecting our expectation that the group will maintain underwriting discipline and that pricing conditions in ACE's lines will be flat or will improve next year.

Given continued volatility in the capital markets during the fourth quarter of 2008, we expect ACE to incur more realized and unrealized investment losses during the quarter. However, any impact that they may have on the group's shareholders' equity likely will be moderate.

We expect capital adequacy to return to the very strong range in 2009, reflecting our expectation that ACE will rebuild its capital position through strong operating earnings. Debt leverage and debt plus preferred leverage likely will remain at less than 20% and 35%, respectively, in the medium term in support of our nonstandard holding company notching.

Standard & Poor's believes that ACE will maintain a very strong global competitive position that is diversified by segment, location, and product. This global breadth is a strength to the rating. Despite a significant increase in submissions in many of ACE's lines in recent months, we expect ACE to continue to exercise significant underwriting prudence. We expect consolidated premium writings to be flat to modestly up in 2009, reflecting management's continued commitment to price adequacy. 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 2009.

If ACE continues to show strong operating performance and demonstrates that its risk management will evolve positively and in line with the complexity of its expanding business platform, we could raise the ratings in the next 12 to 24 months. However, an upgrade would need the support of a combined ratio near 92% (including any reserve charges), minimal asset impairments, and a very strong capital adequacy ratio, all while reinsurance recoverable, intangible, and run-off reserve leverage continue to decrease. We could revise the outlook to stable if ACE experiences significantly worse-than-expected operating performance, impairment charges in its investment portfolio, adverse reserve development, or a sizable change in its competitive position or capitalization.

Ratings List

Ratings Affirmed; Outlook Action

	To	From
ACE Ltd.		
Counterparty Credit Rating		
Local Currency	A-/Positive/A-2	A-/Stable/A-2

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ACE American Insurance Co.		
Westchester Surplus Lines Insurance Co.		
Westchester Fire Insurance Co.		
Pacific Employers Insurance Co.		
Insurance Co. of North America		
Indemnity Insurance Co. of North America		
Illinois Union Insurance Co.		
Corporate Officers and Directors Assurance Ltd.		
Bankers Standard Insurance Co.		
Bankers Standard Fire & Marine Co.		
Atlantic Employers Insurance Co.		
ACE Tempest Reinsurance Ltd.		
ACE Tempest Life Reinsurance Ltd.		
ACE Property & Casualty Insurance Co.		
ACE Insurance Co. of the Midwest		
ACE Indemnity Insurance Co.		
ACE Fire Underwriters Insurance Co.		
ACE European Group Ltd.		
ACE Bermuda International Reinsurance (Ireland) Ltd.		
ACE Bermuda International Insurance (Ireland) Ltd.		
ACE Bermuda Insurance Ltd.		
Counterparty Credit Rating		
Local Currency	A+/Positive/--	A+/Stable/--
Financial Strength Rating		
Local Currency	A+/Positive/--	A+/Stable/--
ACE Insurance (Switzerland) Ltd.		
Financial Strength Rating		
Local Currency	A+/Positive/--	A+/Stable/--
ACE Insurance Ltd. (Australia)		
Combined Life Insurance Co. of NY		
ACE Insurance Ltd. (Singapore)		
ACE Insurance Ltd. (Hong Kong)		
Counterparty Credit Rating		
Local Currency	A/Positive/--	A/Stable/--
Financial Strength Rating		
Local Currency	A/Positive/--	A/Stable/--
Combined Insurance Co. of America (New Zealand Branch)		
Combined Insurance Co. of America		
Financial Strength Rating		
Local Currency	A/Positive/--	A/Stable/--
Combined Insurance Co. of America		
Counterparty Credit Rating		
Local Currency	A/Positive/A-2	A/Stable/A-2

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