S&P Global
Market Intelligence

Chubb Limited NYSE:CB

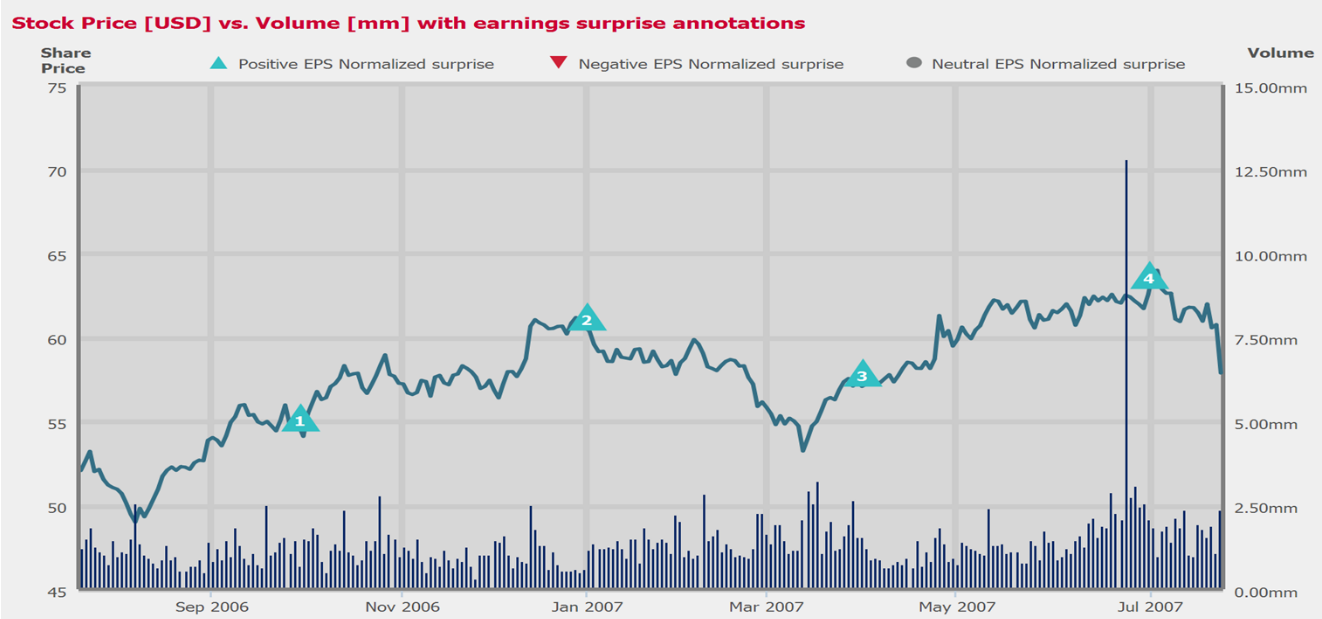
FQ3 2007 Earnings Call Transcripts

Wednesday, October 24, 2007 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2007-			-FQ4 2007-	-FY 2007-	-FY 2008-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.82	2.06	▲13.19	1.82	7.62	7.30
Revenue	-	-	▲(2.74 %)	-	-	-
Revenue (mm)	2879.02	2800.00	-	2886.44	11983.55	12125.62

Currency: USD
Consensus as of Oct-24-2007 11:45 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2006	1.64	1.96	▲1 19.51 %
FQ4 2006	1.74	1.92	▲2 10.34 %
FQ1 2007	1.75	1.98	▲3 13.14 %
FQ2 2007	1.84	1.98	▲4 7.61 %

Table of Contents

Call Participants

EXECUTIVES

Brian Dowd

Evan G. Greenberg

Helen M. Wilson

Philip V. Bancroft

ANALYSTS

Brian Meredith
UBS Securities

Charles Gates
Credit Suisse

David Small
Bear Stearns

Ian Gutterman
Adage Capital

Jay Cohen
Merrill Lynch

Jay Gelb
Lehman Brothers

Josh Smith
TIAA-CREF

Joshua Shanker
Citigroup

Ken Zuckerberg
Fontana Capital

Matt Heimermann
J P Morgan

Steve Labbe
Langen McAlenney

Thomas Mitchell
Miller Tabak

Todd Bault
Alliance Bernstein

Tom Cholnoky
Goldman Sachs

William Wilt
Morgan Stanley

Presentation

Operator

Good day and welcome to ACE Limited Third Quarter 2007 Earnings Conference Call. Today's call is being recorded. All lines are in a listen-only mode for the duration of the presentation. We will be conducting a question and answer session at the end of today's presentation. [Operator Instructions]. And now for opening remarks and introduction, I would like to turn the call over to Ms. Helen Wilson, Director of Investor Relations. Helen, please go ahead.

Helen M. Wilson

Thank you and welcome to the ACE Limited September 30, 2007 third quarter earnings conference call. Our report today will contain forward-looking statements such as statements relating to our financial outlook and guidance, business strategy and practices, growth prospects, legislations, competition, pricing and market conditions, renewals, exposures, losses and reserves, and reinsurance recoverable. Actual results may differ materially. Please refer to our most recent SEC filings as well as our earnings press release and financial supplements which are available on our website for more information on factors that could affect the forward-looking statements. This call is being webcast live and will be available for replay for one month.

All remarks made during the call are current as the time of the call and will not be updated to reflect subsequent material development. Now I'd like to introduce our speakers. First we have Evan Greenberg, Chairman and Chief Executive Officer, followed by Phil Bancroft, our Chief Financial Officer. Then we'll take your questions. Also with us to assist with your questions are several members of our management team.

And now it's my pleasure to turn the call over to Evan.

Evan G. Greenberg

Good morning. As you can see from the numbers, we had an excellent third quarter. Earnings were strong with all divisions of the company performing well. After-tax operating income and net income were up 6% and 13% respectively over prior year's third quarter, which as you recall was an outstanding quarter. Our combined ratio for the third quarter was 88.5 and book value increased by $851 million. Modest catastrophe losses in the period contributed to the favorable results and we also had $70 million of pre-tax benefit from prior period development. Phil will comment further about this in a moment. Adjusting for the favorable impact of the light CATs in prior period, we produced a combined ratio of about 90%, a very good result.

Looking back on the year so far, I believe our 9-month numbers tell an excellent story about ACE's performance across the board. To date book value was increased by nearly $2 billion or 12%. Our return on equity for the year so far is over 18%. 9 months operating income is up 18% over the prior year with strong contributions from both underwriting income and investment income. And year-to-date operating cash flow was almost $4 billion adding to our invested asset which now stands at $42 billion.

Expense discipline has been excellent across the organization resulting in a 9-month expense ratio that is below prior year. Our loss ratio year-to-date is up about 1 point. This year we have taken approximately $128 million in positive pre-tax prior period development over three-fourths of which is from short-tail lines.

On the other hand our CAT losses have been approximately $125 million greater than in the same nine-month period last year. So, that 1 point or about 1 point year-to-date increase is truly an accident year increase and reflective of market conditions.

Speaking of the market, the market is soft and softening conditions are a reality around the world. Reflecting these conditions revenue growth in the quarter was essentially flat to down with some areas growing while other shrinking in line with our underwriting discipline. Our insurance business grew roughly 2% in the period while reinsurance shrank by 24%. Specifically on the insurance side, our wholesale or excess and surplus lines businesses around the world, namely ACE Global Markets, ACE Westchester and ACE Bermuda in aggregate shrank 7% while our retail businesses overall for both U.S. and international grew 7%.

Our retail insurance business in the U.S. was up modestly in the quarter, driven in part by higher customer retention rates in our large account business which is somewhat less price sensitive and more service oriented and by growth in our middle market specialty lines driven by higher customer retention rates and the expansion of our business with second and third tier producers as we take advantage of our full service local presence nationally.

Overseas, our retail P&C insurance business was up modestly, in Asia Pacific, Latin America and Continental Europe. Our international A&H or personal accident business had another good quarter, growing nearly 18%, while our life insurance and life reinsurance businesses had a fine quarter. Operating income for life insurance and reinsurance as you can see now stands at $133 million for nine months. And we had a good quarter in spite of the mark-to-market volatility and the impact that has on our variable annuity reinsurance lines.

Not withstanding the soft market, we are very confident in our ability to continue growing book value in all market conditions. Our organization is built for that. We have the underwriting insight and disciplined to know how and where to grow, and our geographic footprint and broad product breadth gives us the ability to execute our vision. We are confident in our execution and we will continue to take advantage of opportunities without sacrificing underwriting profit.

We are also confident in our ability to maintain a reasonable ROE over the medium and long-term by deploying our capital wisely, efficiently, patiently.

Turning to one other matter, I would like to make a comment on the TRIA extension bills that were recently introduced in both houses of Congress. We are encouraged by the bills and applaud the leadership in both the house and senate. We think both bills continue the public private partnership that is successfully increased the availability and affordability of terrorism coverage in the United States. Importantly the bills provide some measure of financial certainty for American business and they diminish the financial impact from a catastrophic terrorist event. We are optimistic that a single piece of legislation will ultimately be passed before it re-expires at the end of this year.

With that, I will turn the call over to Phil and will comeback and take your questions.

Philip V. Bancroft

Thank you, Evan and good morning. Our third quarter results were very strong, was contributed to continued improvement in our balance sheet strength. Both financial and operating leverage continued to improve. Our tangible book value grew by $851 million or 7% for the quarter. Our operating cash flow was almost $1.5 billion resulting in a very strong and sustainable liquidity position.

Our cash and invested assets grew by $2 billion or 5% for the quarter to $42 billion. This included realized and unrealized gains which increased the value of our portfolio by $274 million. The value of our portfolio increased despite the difficult credit markets during the period. This quarter we realized a $50 million loss relating to our 28% share of the negative mark on derivatives reported in our unconsolidated investment in assured guarantee. We also realized a $50 million loss related to derivatives embedded in the variable annuity reinsurance liabilities included in our life segment. This charge related principally to rising equity volatility and declining interest rates during the quarter.

The credit quality of our overall portfolio remains a AA and our duration decreased modestly to 3.6 years. Our net loss reserves increased approximately $600 million for the quarter and now stand at $22.6 billion with IVR representing 61% of total reserves.

During the quarter we had CAT losses of $21 million and favorable prior period development of $70 million. This development related primarily to short-tail lines but also included approximately $30 million principally relating to long-tail claims made financial lines business from accident years 2003 and prior. Our tax rate for the quarter was 17.1% which resulted from higher income emerging in low tax jurisdictions driven mainly by favorable prior period development and the low level of CAT losses. As Evan mentioned our loss ratios increased in the quarter for the current accident year before CAT losses of prior period development. This increase result of both from decline in prices in 2007 and from unusually strong results in our short tail lines in 2006. I will also note that we plan to provide 2008 guidance in December.

Now I'll turn the call back to Helen.

Helen M. Wilson

Thank you Phil. At this point, we'd be happy to take your questions.
Question And Answer

Question and Answer

Operator

Ladies and gentlemen our question and answer session is conducted electronically. [Operator Instructions]. We will go first to Josh Smith with CREF.

Josh Smith
TIAA-CREF

Hello, can you hear me?

Evan G. Greenberg

Yes we can hear you Josh, how are you?

Josh Smith
TIAA-CREF

Good. Just a quick question on the capital of your favorite topic Evan. If you can continue doing high teen to 80% ROE you can have all the capital you want in my book. But just for comparison purposes I was looking at Travelers and Chubs, two of your comps, and since the fourth quarter of '05 they've... you have grown book value to 38% versus high teens for them. They've bought back about 3 billion in stock each negligible increase in rolling that written premium for all three of you. By comparison I think people are looking for you to do more in the capital initiative given what some of your peers are doing. My vote would be to do more with acquisitions that accretive than buybacks. But if you could just comment on how you are faring related to your peers in those... in that regard?

Evan G. Greenberg

I am going to make two comments. First of all each company has its own strategy and so I am really not looking right and left in deciding what's best for ACE. And, so I am not really looking at to play book of others to determine that. We have a strategy and I think you have to view your capital in terms of your strategy. Our strategy is clearly endorsed by both, our board, the management and our shareholders and we speak regularly with our major long-term shareholders.

It's correct, we have capital flexibility to execute our strategy and our strategy does call for diversification; either it's going to be done organically or through acquisition or a combination of both over a medium and longer-term period. We don't simply view the short-term. And that's our plan to continue to enhance our franchise and we will do both. That kind of diversification is both geographic and line-of-business oriented.

And as I say, we have the capital to do that, we're earning a reasonable return on capital at this time and we have no plans at this time for share buybacks. And I might add we've done our own studies of which share buybacks ultimately do. And we think, it's quite transient and really doesn't do much; it's more of a question of are we good stewards of capital, and so are we the fiduciaries that shareholders want to entrust with capital.

Josh Smith
TIAA-CREF

I agree with that. As long as you keep delivering that ROE, I think you are fine.

Evan G. Greenberg

Thank you.

Josh Smith
TIAA-CREF

Thanks.

Operator

Our next question is comes from Matt Heimermann with J.P. Morgan.

Matt Heimermann
J P Morgan

Hi, good morning, everyone. Two questions, one was, was there anything unusual in the current period that drove the sequential and increase in the overseas general segment?

Philip V. Bancroft

Are you talking about in the combined ratio?

Matt Heimermann
J P Morgan

The loss ratios specifically.

Evan G. Greenberg

The loss ratios. Yeah, there's two things to recognize. One is that in 2006 we had a very strong year particularly on a short-tail lines. And 2007 hasn't run as well. The other point I would make is that in 2006 there was a current accident year reserve adjustment that took place in the third quarter and that there was a positive. In this quarter we had a negative adjustment for the current accident year. And if you look at it net of those two adjustments you actually see a slight in-tick... uptick in the loss ratio for that quarter for AOG. When you look at the overall organization and all the current accident year adjustments that we made, in 2006 those adjustments reduced our overall accident year results by about a point. In this year the current accident year adjustments actually increased the loss ratios by about 2 points. And if you look at adjusted for all those things our overall accident year loss ratio is up about 1.5 point.

Matt Heimermann
J P Morgan

Okay. I was... that's how I was focus more on just the sequential increase this year. So you are telling us based on your comment that you had... you increased... you had an adjustment on the third quarter to increase your full-year pick?

Evan G. Greenberg

That's exactly right.

Matt Heimermann
J P Morgan

Okay.

Philip V. Bancroft

There were two things... three things. We're telling you that number one, last year had a positive adjustment in the quarter downward and that benefited. Number two we did have an increase for a year-to-date loss ratio, so for the peg and that was a portion of it. And then a point and a half is simply the loss ratio increase for the current quarter.

Matt Heimermann
J P Morgan

Okay that's fair. And then what drove the decision to make the increase in the peg for this year.

Evan G. Greenberg

Well the overall peg for the year is that the... market conditions. Rates are going down and I think an overall increase of 1 point in the loss ratio for the nine month period which is how I think you ought to view this, is you could view is relatively modest. But then remember we have lines of business within there like crop or A&H or CAT business that would not be getting rate increases... that would not be getting loss ratio increases.

Evan G. Greenberg

Now that's fair.

Matt Heimermann
J P Morgan

Anything specifically related to some of the credit D&O, E&O issues out there?

Philip V. Bancroft

No.

Matt Heimermann
J P Morgan

Second question I had was on the investment portfolio. There was a significant decrease, 2Q versus 3Q and AVS agency treasury, and that corresponded to increases in corporate municipals and non-U.S. Government, anything... I guess, what drove the dramatic change?

Philip V. Bancroft

There was nothing strategic, it was just a tactical move. And we are a U.S. tax bearer and look to move into municipals to the extent that they are priced drive. So again there was no strategic intent.

Matt Heimermann
J P Morgan

Okay, thank you.

Operator

Our next question comes from Bryan Meredith with UBS.

Brian Meredith
UBS Securities

Yes, good morning. Just a quick question, looking at domestic gross in the quarter premium, it looks like there was more reinsurance buying particularly in the North American operations this quarter versus last year's third quarter, anything to read into that.

Philip V. Bancroft

If you look at North America the retention is down about 3 points and the change is almost entirely caused by the increase in written premiums in our crop business which has a very low retention, the retention there is about 26%. So it would... it makes it appear that the retention is down.

Evan G. Greenberg

Strong crop year.

Brian Meredith
UBS Securities

Strong crop, great. And one last, Evan, can you comment a little bit more on market editions particularly terms and conditions and what you are seeing out there?

Evan G. Greenberg

Yes. Let's see. I will give you some sense of rates and particularly... this is all in our book of business and on our renewals and I will give you a sense of what we see on the new business we are writing. The market as I said earlier is soft and has softened. The third quarter was more competitive than the second which was more competitive than the first. And so that trend continues and that's global. Casualty lines in the U.S. were down, all casualty lines together were down about 5% to 10% on renewals with pricing.

Property; when the physical lines were down in the 10% to 15% range and also remember that's CAT and non-CAT because last year the July pricing hit a zenith in CAT. General casualty renewals pricing is off about 5 to 9 and new business is off another 10 points on... from renewal pricing. Small workers comp which relates small not medium size risk trans for workers comp overall across the country was off about 12%, more in California, less in other territories.

Risk management, large account business was off about 11% on new business on renewals and new was off about an additional 8 points. Professional line D&O and FI was off about 11 on renewals and new business was off from that, an additional roughly 10 points. E&O was off 10 points on renewal, property was off about 13, energy related business was off about 13 and commercial marine was actually relatively flat off about 3 point. So, I give you all that so you got maybe a more granular sense of pricing.

And overseas, pretty much the same story, the physical lines were off a little less, more 3% to 7 % in the short tail lines on renewals, though new business was off an additional 10 points on pricing, and general casualty was off about 7 points on renewals and new business was off another 5 to 10 points on pricing and D&O was off roughly 11 on renewal and another 10 for new. So there it is around the globe.

Brian Meredith
UBS Securities

That's good. What about deductible coverage term, that kind of stuff, are they continuing to loosen up?

Evan G. Greenberg

They are on the margin, it's... in my own gut, it's a death by a thousand cuts. It's small... it's not... there's not a wholesale changing condition and conditions are holding... terms and conditions are holding pretty well. But we are seeing slides in deductibles, we are seeing broadening or wordings to include coverage that may have been chucked out before, wordings that were broadened what is on the risk exposure. So we are seeing it on the margin but we are seeing it.

Brian Meredith
UBS Securities

Thanks Evan.

Evan G. Greenberg

You are welcome

Operator

Next question from Jay Cohen with Merrill Lynch.

Jay Cohen
Merrill Lynch

Yes, just a question on the cash flow, I guess for Phil, it was particularly strong in the quarter, I am wondering what was behind that?

Evan G. Greenberg

One thing we did see in the quarter is petty strong collections of both premiums and reinsurance, particularly in the U.K. and U.S. So it was just a strong quarter.

Philip V. Bancroft

And paid losses continue. You can see the paid to incurreds, paid losses continue well.

Jay Cohen
Merrill Lynch

Great, thanks.

Operator

Our next question from Steve Labbe with Langen McAlenney.

Steve Labbe
Langen McAlenney

Good morning. I was wondering Evan if you could share with us what you believe are the odds that as the senate and house negotiates and come to an agreement on a total flood insurance reformed bill that when could potentially be added being that it's in one version and not the other?

Evan G. Greenberg

Well I have no real crystal ball for this, I can't tell you, I can't tell you what you all already know and that is particularly in the... the senate... the house is always much more of the hot handle, and the senate is a cooler longer term view. And when the house put up it's version, the senate and you been hearing calls in the senate that had being pushing back on this and not be so quick. To extent and put wind in there and particularly the comments I'd noticed focused on maybe almost a disbelief in the GAO report that said, adding wind would had a negligible cost, which we all know is fallacious. I don't know what kind of actuary they use, but I doubt he had all his exams.

And, so when your... I... my own sense is they are going to... specially they are looking for income, they already have a lot of them [ph], they already have a lot of pressure on the expense side, on the spending side. I... I would give it less rather than greater odds that it passes.

Steve Labbe
Langen McAlenney

Okay.

Evan G. Greenberg

Extended to include wind.

Steve Labbe
Langen McAlenney

And a second question... thank you, and I didn't know, I know it's been a few quarters now where the decline in reinsurance writings has been meaningful. I curious, is it possible that you are so opportunistic in reinsurance that you could see that actually get to zero. I mean in other words are you tied to having a business, if you get to a point where you say we just have to be in the market because we always want to be there or if the conditions lend itself to these type of declines almost indefinitely is it okay with you?

Evan G. Greenberg

You know I had a talk with the reinsurance management team yesterday, and I told them the few points which I will make right to you now. I am committed to our reinsurance business, I am committed to our team, I think we have got just a great team. We run it quite lean. We... at the end of the day it's an underwriting trading business, relationship aside we are going to make money on the trade. And we are going to make an underwriting profit and a reasonable return and where we can't, they will walk away and we will shrink this business as long as we have to in order to make that underwriting profit.

I think going to zero is a theoretical number, I don't believe it will go to zero, but it could go down significantly from where it is and I am very comfortable with that. There is no such thing as you have to stay in and the price of staying in is you have suffer a loss. We will not do that. And people will always want to buy reinsurance from ACE given the choice because of our balance sheet and our expertise in the business.

Steve Labbe
Langen McAlenney

Okay, great. Thanks for the answers.

Operator

And our next question today from Ian Gutterman with Adage Capital.

Evan G. Greenberg

Good morning Ian.

Ian Gutterman
Adage Capital

Hi Evan. I hate to do this but I need to ask about the capital.

Evan G. Greenberg

I thought I just answered.

Ian Gutterman
Adage Capital

Now... well let me... I just want to go through some act. I mean we have talked this before. I am at the same perspective as Josh and I want you to do a repurchase just to do one. So that's not really what I am trying to understand, I guess what I struggle with is just mathematically if you do 17 ROE minus say a 2% for dividends, you are growing book value 15% to maintain the ROE. Basically how do you maintain you ROE, the invested asset to surplus ratio is steady, it's not going up and the premium of the surplus shrinks.

Evan G. Greenberg

Ian I know...

Ian Gutterman
Adage Capital

It's just that mathematically the ROEs have to go down.

Evan G. Greenberg

I never said maintain the... I didn't say maintain the ROE, and we are perfectly willing to weather some ROE dilution for a period of time. We don't just measure it in a short term.

Ian Gutterman
Adage Capital

Okay. That was what I was wanting to make sure I understand. So since... so then the bet is that you take the ROE down short term so you can have a higher ROE over the cycle because you have the capacity to act when others don't down the road.

Evan G. Greenberg

You've got it.

Ian Gutterman
Adage Capital

Okay. Just want to make sure I am on the same page.

Evan G. Greenberg

As you take advantage of opportunities that will occur during the cycle.

Ian Gutterman
Adage Capital

Fair. Okay, I just wanted to make sure we are on the same page. Thank you.

Evan G. Greenberg

You got it. It's a big world out there Ian.

Operator

Our next question from Bill Wilt from Morgan Stanley.

William Wilt
Morgan Stanley

I had two questions for you. The first is professional liability, you probably addressed in some second quarter call, frankly I forgotten. Could you speak to professional liability exposure, D&O, E&O to the various actors in the sub-prime space, the companies, the lenders... other financial institutions mortgage brokers a general sense for your positioning there?

Evan G. Greenberg

Yes, first of all we are not a major writer of FI business, we write some. We are a more modest player in that area and in the business we do write, we deploy relatively modest limits. I could tell you there isn't a single digit millions on a net basis per account, they are not at the most part double digit. So I start with that as an overall picture.

We've accessed our exposure and we continue to and this is to continue... this is a story that is evolving. At this time we have all of our insurance put into potential for claim versus on a watch list, versus those that have given us notices. We are comfortable with our exposures, they fit within our pegs, as we know it all to be today and I don't see this as a major event phrase.

William Wilt
Morgan Stanley

That's helpful, thanks. So --

Evan G. Greenberg

If that could change then we could have to reassess but we're constantly looking at it and that's how I see it now.

William Wilt
Morgan Stanley

Okay, fair enough. Thanks for that. Part two, the ANH line, 17% to 18% growth, I think it's, I think it was that, I think it was... that was to promote the quarter and year-to-date. Main contributors to the growth, more producers, different countries, both the comments on the sources of growth and then expectations or reasonable expectations over the next year or two for that business.

C: Evan G. Greenberg: Yes, the growth is driven the fastest growth is coming out of Latin America followed by Asia, followed by the continent of Europe. They are all doing double digit growth. The business as you know is fundamentally driven by direct response marketing, we have call centers all over the world, we engage in direct mail activities as well. And we have build we believe franchise in that. We have a growing... we constantly are adding new sponsors because we need somebody with a brand and a customer base and a billing vehicle and we're constantly working on that and expanding that. Always some countries up some countries down a little bit, television response rates in Korea get better or get worse while something happens on the credit portfolio that we are marketing to in Thailand short-term. But overall it's pretty stable growth rates which are in as you know mid to upper teens and I envision that to continue as it is may be accelerate slightly in terms of growth over the next year or two.

William Wilt
Morgan Stanley

Thanks for that and in terms of when you add new sponsors, new relationships is the... are there meaning... typically meaningful fixed to incremental costs to ACE or is most of that borne by the sponsor or dependent on the strength of their brand or their normal marketing.

Evan G. Greenberg

You know it varies by sponsor. Are we taking the marketing risk or are they taking it in most cases we... and the vast majority cases we take the marketing risk. And so therefore you know we have to have the apparatus to execute against it but you know most of that is an incremental build out for us now where we just continue to add on to our plant and then we put up more marketing dollars as you grow this business and want to keep growing this business. You got to put up more marketing dollars every year, increase the absolute amount of marketing dollars you're spending versus the year before. And then that becomes a GAAP asset that you're constantly testing. And we are comfortable with that, so we continue to invest to grow that business.

William Wilt
Morgan Stanley

Thanks very much.

Evan G. Greenberg

You are welcome.

Operator

Our next question is from David Small with Bear Stearns.

David Small
Bear Stearns

Hey, good morning. Could you may help us understand how the changes in the proposed form bill would impact your crop insurance... you crop book.

Evan G. Greenberg

Yeah. I'm going to actually ask my crop expert Brian Dowd to give you a few words on that.

Brian Dowd

Hi. As you probably...

Evan G. Greenberg

Can you hear him?

David Small
Bear Stearns

Yes.

Brian Dowd

You probably read, there are actually two versions of the bill out there. There's a house bill and the senate bill. And they haven't gone to compromise yet. Both bills as they come to compromise will affect the '08 year. And it doesn't take affect into '09 or intend depending on the version or the bill. And depending what happens the house bill more or less affects the subsidies back on expense reimbursement. The Senate bill affects more of the premium side equation. I'd expect to compromise frankly in the next quarter or so that will probably have a little bit effect on both. So, I think those carriers that have large portfolios frankly will probably weather it pretty well. Those companies with small portfolios may have a difficult time if there's actually an increase in the farm bill.

David Small
Bear Stearns

And I guess just in terms of what that would do if the subsidies go down assuming that book becomes less profitable for you?

Brian Dowd

Marginally so, yes.

David Small
Bear Stearns

Okay. And then just in terms of this second question is as the cycle softens, the brokers try to get carriers to compete with each other more and more obviously. How do you prevent the Westchester unit, the U.S. business and the London business from all competing with each other?

Evan G. Greenberg

Well because we do, and that is just a rock bottom part of our, of the rules of the road and ACE and our ethos. So the culture, and where we operate each franchise has... is distinct and they are not in competition with each other. So for instance the Westchester only deals through wholesale brokers, whereas U.S.A. is retail and deals through retail brokers. ACE Global Markets in London wouldn't be competing really with the Westchester. There are some classes where they and U.S.A. actually compliment each other because they play on different layers, they write lines that would be complimentary and may actually coordinate all accounts. And we even have accounts for ACE Bermuda because they play in a different place maybe in a given line on an account. They and global markets and the U.S. coordinate. It's rare and almost I can't remember the last time I have heard about competition between any ACE units, it's just not what we do.

David Small
Bear Stearns

Okay, great. Thanks.

Evan G. Greenberg

You got it.

Operator

Our next question from Josh Shanker with Citi.

Joshua Shanker
Citigroup

Good morning. Listening to your discussion on favorable development and releasing some long-term reserves from 2003 prior. I was trying to do some reconciliation of scheduled P data with the global loss trials that you provided for us and I would like to know, A, the perils and the shortcomings of using the U.S. business that's comprised on scheduled P to understand that and, two, to understand... looking at the other liability claims made line of business there was according to schedule P substantial favorable from '04, '05, and '06 in the OLCM line. Wondering how that jives with what you have seen over the course or over the entire business and why those two things are different?

Evan G. Greenberg

If you don't mind because that's a... you are asking some very granular and technical which is fine. And we are happy to get into that with you. I am going to ask we take that offline and have Sean Ringstead, our Chief Actuary, talk with you about that and help you guide through that.

Joshua Shanker
Citigroup

Okay, that's fine. And the other question is can anyone talk about capital measure philosophy, what's ACE has thought on dividends in general? Regular dividends, raising that special what not?

Evan G. Greenberg

We like regular dividends and we like raising them and we have had a very clear steady policy of increasing our dividend in a steady rate year-by-year and I anticipate continuing that policy.

Joshua Shanker
Citigroup

Okay,thank you. I'll take it offline.

Evan G. Greenberg

Thank you.

Operator

We will go next to Tom Cholnoky with Goldman Sachs.

Tom Cholnoky
Goldman Sachs

Good morning Evan. Two unrelated questions if I can. As we think about your capital management in terms of you know potential acquisitions or potential investing for organic growth, should we think that in the next three to five years that ACE will just simply continue to grow out its current portfolio of products or would there be potentially new areas of the market as that might be of interest to you.

Evan G. Greenberg

There are some areas of the market that are of interest. You could see if it... we see it right, you will see more expansion. It depends what you call new areas. We are already in personal lines but in a modest way. So you will and we've talked about this before, you will see an expansion in that area in a targeted fashion not just really nearly around the world. We have... we know what geographies and areas of personal lines we have our eye on. You will see our A&H business continue to expand, you will see our Life business continue to expand and that could be with acquisition. You will see the small commercial business expand particularly in Asia and potentially in Latin America. So there will be a geographic end to this as well.

Tom Cholnoky
Goldman Sachs

Okay.

Evan G. Greenberg

You will not see us go beyond core insurance business. And you won't see us get into areas that we don't understand as management.

Tom Cholnoky
Goldman Sachs

Okay. That's fair enough. And just, I guess if you can make a comment on these California fires or how we ought to think about them with respect to ACE?

Evan G. Greenberg

Yes, it's just a tragedy obviously to all of us that's just unfolding before our eyes. I expect very little in the way of activity for ACE on the insurance side and I expect very little in the way of activity on the reinsurance side.

Tom Cholnoky
Goldman Sachs

Okay terrific. Thank you.

Evan G. Greenberg

You're welcome.

Operator

Our next question is from Thomas Miller, I'm sorry Thomas Mitchell at Miller Tabak.

Thomas Mitchell
Miller Tabak

I probably should remember how this works but I have forgotten.

Evan G. Greenberg

I'm Evan.

Thomas Mitchell
Miller Tabak

If rates decline this year and lower rates are embedded in this year's premiums written, then next year or with some lag the premiums earned will reflect the lower rates and presumably that would drive higher underwriting loss ratios and would also prompt some greater reserving relative to the amount of premiums that are written this year. If I haven't confused you at this point then my question is...

Evan G. Greenberg

You're... but go ahead.

Thomas Mitchell
Miller Tabak

Why... shouldn't we be looking not only for the industry but even for ACE to also reflect this... not this year but with a lag of 6 to 12 months, the pricing would become embedded in your book of business and theoretically then both your reserving as a percentage of premiums would go up and your loss ratios would go up, doesn't that make sense and what do I have wrong?

Evan G. Greenberg

Well let see if I say it simply to you, okay. Number one, when you want to get to the earned premium and figure that which is separate from loss ratio, right, so once the denominator, once the numerator, look at the written premiums, and that will give you, and they will become earned premiums and that will give you a sense for that pattern. On the loss ratio side which is a function of... which... increased loss ratio is a function of rates going down, it's true if your exposure stays the same and rates go down then the business you're writing as it earns its way in will have a higher loss ratio, that was the conversation at the beginning of this call about what's happening to ACE's accident year loss ratio. And that's what you're referring to and so when increase you would expect all things being equal as exposures stay the same and rates decline, the accident year loss ratio will increase, so as the written premium earns its way in there is loss ratio inflation.

Thomas Mitchell
Miller Tabak

Okay and the alternative is that you might find ways to reduce your exposures relative to the amount of premiums you're writing, is that...

Evan G. Greenberg

Yes different class, different mix of businesses, different geographies, that's right.

Thomas Mitchell
Miller Tabak

Okay. Thank you very much.

Evan G. Greenberg

You're welcome.

Operator

[Operator Instructions]. We'll go now to Jay Gelb with Lehman Brothers.

Jay Gelb
Lehman Brothers

Thanks. Good morning. First one just on the effective tax rate given... can you explain why it was a little lower in the third quarter, can you give us a sense of where that tax rate may be going forward?

Philip V. Bancroft

As you know it bounces around, right. In the past when we gave guidance on tax we said we'd expect it to be in the 20% to 22% range, but that's moved around quite a bit over the years, we've had times where we've been able to repatriate funds tax free, we have periods now where we have losses and taxable jurisdictions and low losses and taxable jurisdictions. So it's really going to be in reaction to what happens in the period. But as I say on balance maybe it probably averages 20% over time.

Jay Gelb
Lehman Brothers

Okay. And then separately can you give us an update about where you stand on some of the legacy liability issues like asbestos and lead paint and whether you have a reserve review coming up?

Evan G. Greenberg

As we do every year we reserve... we do an internal review of our asbestos and legacy reserves on an annual basis, we're in the middle of doing that. We did that last year, I mean all the years before and you know that every other year so last year we concluded an external review as well because that happens every other year and we concluded at the end of that study last year that our reserves were in good shape and there was less of a difference between us and the external actuaries who their loss pick came down. We are now in the middle of updating our study, it will be done at the end of the fourth quarter, but I can tell you that from the macro environment, the macro environment particularly in asbestos has been stable, I would say. And as you see, you can tell by the Manville reporteds and we see it in our own book, the number of new claims arising is at a relatively modest level and the number of mesos relative to all of the injured, all the impaired hasn't increased as a percentage and that's where the higher paids are. We do see tort reform having at that state level continuing to have an ameliorating effect. And so when you do your study your study is not based on the macro, it's based on your own individual cases within your book of business and we know that on a very granular level. So we're studying that but at this moment I don't see anything on the horizon that is giving me any concern.

Jay Gelb
Lehman Brothers

Great and the separately on...

Evan G. Greenberg

If we do, you guys will know.

Jay Gelb
Lehman Brothers

And then separately on lead paint, with the Rhode Island decision, does that change your... change the calculus of how you think about that exposure or is it just...

Evan G. Greenberg

No, it does not.

Jay Gelb
Lehman Brothers

All right. And then separately I don't know if you'd like to comment on some of the movement that's been going on with the Bermuda tax issue?

Evan G. Greenberg

Yes, I would like to comment on that, and I'm into, you know I might give you, actually once I start I'm going to give you a rather lengthy comment, but I'm going to give you a comment. The effort in my view is a protectionist reaction and rather than a competitive and free market proposal and I'm afraid if it was enacted it will raise cost to consumers. In fact the proposal to increase taxation on reinsurance to offshore affiliates strikes a chord with some in Congress because of its revenue raising potential though I think it flies in the face of calls being made in Congress, the state of New York and Treasury for greater competitiveness in financial services in the U.S.

In my judgment this proposal which is still taking shape and not yet in draft bill form could set a very dangerous precedent for taxing insurance companies not where the ultimate risk is taken and where the profit and loss is earned, but rather than... rather in the country where the risk resides. While this proposal might not affect those mostly U.S. insurers who are its primary backers, it could impact those insurance companies that do business globally, if other countries adopted a similar tax policy.

My company and I are opposed to this misguided proposal and fundamentally it's on the basis of principal, given that frankly it will have little financial impact on ACE; we reinsure less than 15% of our gross insurance business to offshore affiliates.

Jay Gelb
Lehman Brothers

Thanks very much for the answer.

Evan G. Greenberg

You're welcome.

Operator

We'll go next to Charles Gates with Credit Suisse.

Charles Gates
Credit Suisse

Hi, good morning. I just have one industry question. Seemingly if you went back to mid 80s, the property casualty industry if you marked bonds to market, didn't have any capital, today you seemingly... it's awash in capital, how do you see that getting resolved?

Evan G. Greenberg

Charles you're exactly right, it's everything in all industries, it's about supply demand and the supply is very high and until and that's what drives the cycle and until you remove that supply you're going to have a... you're going to have a continued softening or soft market conditions. And so it will resolve itself by removal of capital and that's going to happen in one of two or three ways.

Many who can't do anything with the capital return it to shareholders. That has been modest. People... some others deploy the capital wisely or erase the capital and you return it to policy holders through lousy underwriting which is been the history of this industry. I don't know any other way I think that is the bitter truth of it.

Charles Gates
Credit Suisse

Thank you.

Operator

We'll go next to Ken Zuckerberg with Fontana Capital.

Ken Zuckerberg
Fontana Capital

Yes. Good morning, Evan and Phil. Just wanted to ask you about progress being made with the rating agencies on your current financial strengths rating. And my... I guess my premise here is for few years we've seen the agencies reiterate the AA ratings on a certain few companies that have seemingly gone in the wrong direction and one of which is actually stepping up to the plate now to address a legacy liability. Tangible book value is growing tremendously we talked about capital in response to Evan and... Ian and Josh's question, your record is stellar. Just wondered where we are?

Evan G. Greenberg

I am going to give you their phone number. Our relationships with the rating agencies are very strong. We meet with them throughout the year, keep them up to speed with our progress and they understand where we are. And as you say I think we are stronger today than we've ever been. It's not part of our strategy to approach for an upgrade certainly, we're comfortable with the rating that we have and if from a business standpoint we're satisfied with that. So, I guess, if we were elected, we would... hopefully if we were asked we would run but its not really that important to us.

Ken Zuckerberg
Fontana Capital

So when it comes to the reinsurance business, fair to say there'd be no change in strategy with the higher rating, i.e., would you get paid any more incrementally in that business by being rated higher?

Philip V. Bancroft

No, we don't think that's true in any of our businesses.

Ken Zuckerberg
Fontana Capital

Great, thanks very much.

Operator

And our final question today will come from Todd Bault with Bernstein.

Todd Bault
Alliance Bernstein

Hi, guys.

Evan G. Greenberg

Good morning.

Todd Bault
Alliance Bernstein

Evan in light of some of the talks you had about capital and discipline I've got a hypothetical for you that I think is potentially relevant in the coming years. You've said that you have been disciplined with your capital and disciplined with your writings and you are still generating good returns. Let's layer on top of that, the assumption that you and most of your peers have right now good levels of loss reserve adequacy and my claim that the chief analytical problem in the last few years has been loss trends. Loss trends have been very favorable and the people don't quite know what the cause of that is and in general they've been just trusting of them. So right now discipline's been okay and there's been signs that pricing has been weakening now in line with lower loss trends. So here's the question. If some one like you stays disciplined with your pricing and your writings and you don't return as much capital as peers and some peers become more aggressive and start to grow that may put pressure on your stock relative to their stocks, and leaves you vulnerable to being acquired. So... now that, there could be other stocks that could apply to you too. But in your context the strategy you've laid out, it's a potential risk. How do you regard them?

Evan G. Greenberg

Toddif you have ever noticed, you may not know this that where ACE is a Cayman company. Have you ever seen maybe our articles of incorporation but anybody who buys and you can buy more than 10% of our stock but you can't vote more than 10% of it.

Todd Bault
Alliance Bernstein

Okay.

Evan G. Greenberg

Thanks for the question.

Todd Bault
Alliance Bernstein

Okay.

Evan G. Greenberg

You know what we live in a world of risk. That's all there is to it. Choose your poison, we are not insecure. If someone wants to come and buy ACE, big a... bring a big bankbook.

Todd Bault
Alliance Bernstein

Okay.

Evan G. Greenberg

Thanks a lot.

Helen M. Wilson

Thank you everyone for your time and attention.

Operator
Ladies and gentlemen, thank you for your participation. This does conclude the conference and you may now disconnect your line.