

# American International Group

---

## An Economic Analysis of the Insurance Industry using AIG as a Case Study



# Agenda

---

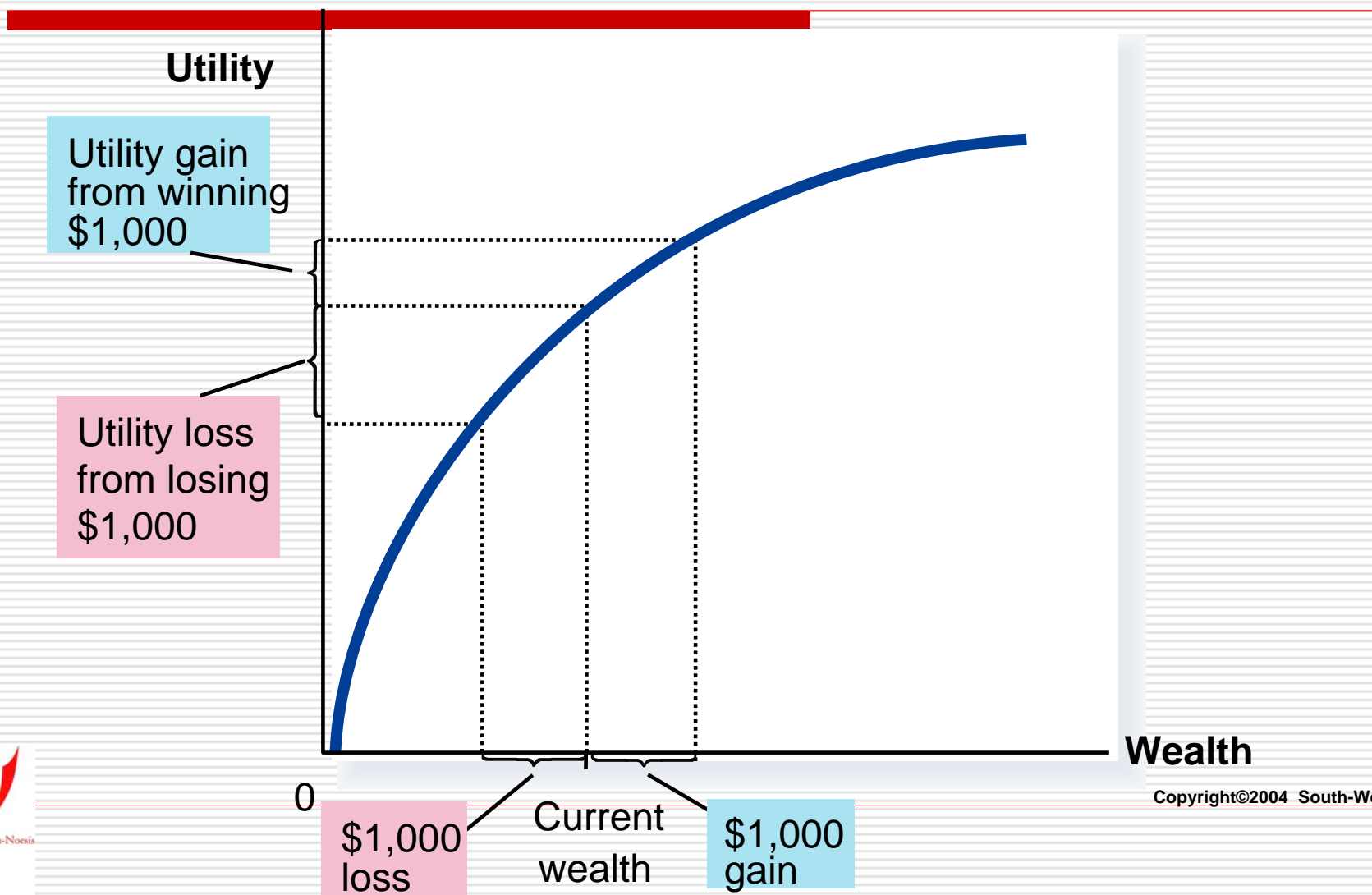
- Industry Analysis
- Firm Analysis
- Forecasts, Projections, Recommendations
- Economic Environment
- Macro Impact on Firm & Industry

# Industry Analysis

---

Economy & The Markets for  
Insurance

# Managing Risk: Life is Full of Gambles



# Managing Risks...

---

- Individuals/corporations can reduce risk by choosing any of the following:
  - Diversify
  - Accept a lower return on their investments
  - Buy Insurance

Is that all Or,

# The Markets for Insurance

---

- One way to deal with risk is to buy insurance.
- The general feature of insurance contracts is that a person facing a risk pays a fee to an insurance company, which in return agrees to accept all or part of the risk.

# Risk vs. Return

## Principle #1: Tradeoffs

---

- Amount of “coverage” vs. the (perceived) probability of loss...
- High Risk Aversion will drive higher coverage...
  - And hence higher insurance premiums!

# Role of Insurance Industry in the Economy

---

- NOT to eliminate Risk, BUT
  - To spread it around more efficiently
- Example:
  - Fire Insurance
    - Owning fire insurance does not REDUCE the risk of losing your home in fire
    - In case of the unlucky event, the insurance company compensates you for the loss
    - Risk is spread between all the shareholders.. (e.g. 10,000)
      - Easy to bear  $1/10,000^{\text{th}}$  of risk



# Problems in Spreading Risk

- Adverse Selection
  - A high risk person/corporation is more likely to apply for insurance than a low-risk person
    - Health Insurance – healthy people don't buy group insurance...
  
- Moral Hazard
  - People have less incentive to be careful about their risky behavior
    - Fire Extinguishers to get the discount, failure to maintain



Calm down Joe! Nothing can  
happen I am well insured...



Come on... this is real reason why  
Insurance is **NEEDED!**

---



# Insurance Categories...

---

- Property & Casualty
  - Auto, Home etc.
  - Catastrophes
- Life & Annuities, Disability
- Health – Medical, Dental, Vision
- Worker's Comp. Unemployment & Disability
- Specialty
  - Medical Malpractice
  - Product/Professional Liability
  - Fraud

# Babe Ruth: Specialty Coverage Sickness Policy

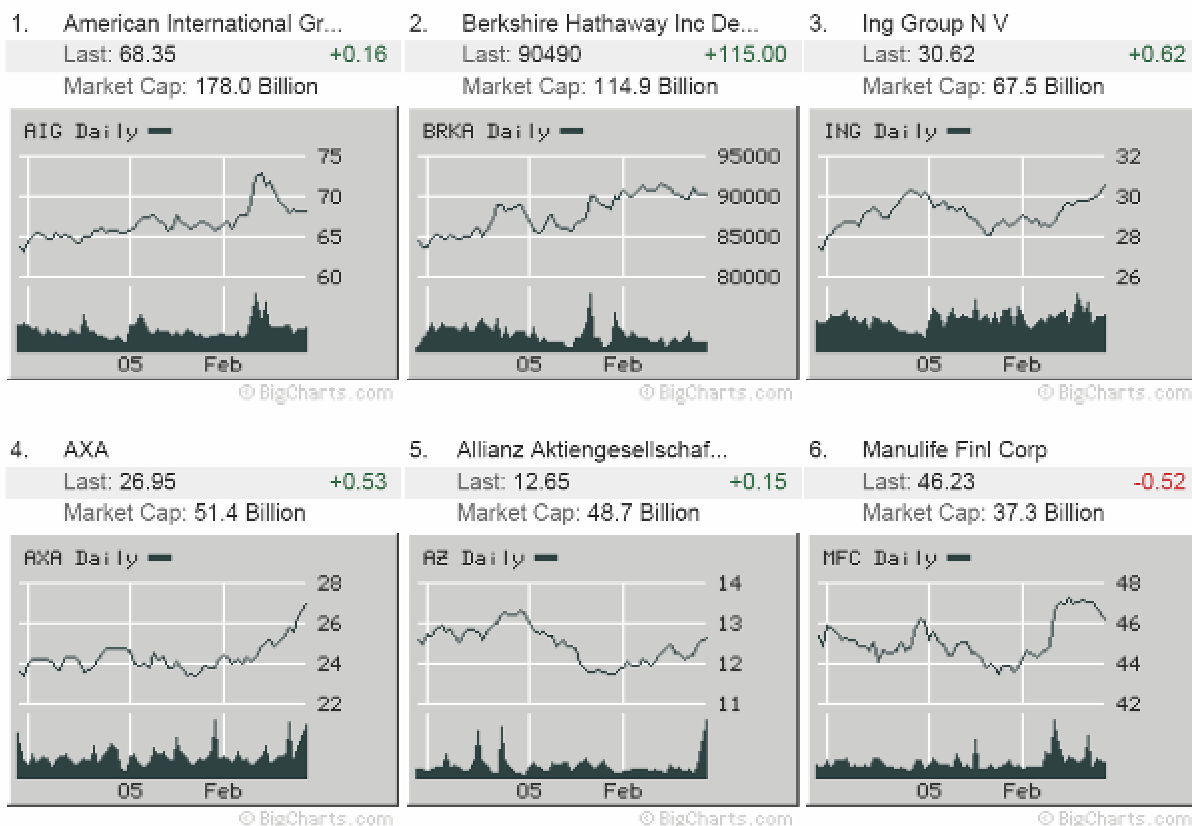
---

# Industry Size

---

- Insurance Industry is typically categorized under
  - Financial Services sector
- Wall Street Journal tracks:
  - 266 Insurance Companies (as of 3/1/05)
  - All of them are classified under:
    - Financials -> Insurance and various sub-categories of Insurance
- Dow Jones Insurance Index: 7 Companies

# Top 6 Insurance by Market Cap February 2005



Source - <http://www.bigcharts.com> & <http://www.wsj.com>

# Leading Writers of P/C Insurance 2003 (\$000)

Rank	Company/Group	Direct premiums written (1)	Market share (percent)
1	State Farm Mutual Group	\$47,226,012	10.5%
2	American International Group	32,366,506	7.2
3	Allstate Insurance Co. Group	23,055,892	5.1
4	Liberty Mutual Group	15,209,080	3.4
5	Travelers Property Casualty Corp. & Affiliates	14,830,949	3.3
6	Farmers Insurance Group	13,731,118	3.0
7	Nationwide Group	13,429,281	3.0
8	Zurich Insurance Co. Group	12,750,912	2.8
9	Progressive Casualty Group	12,191,955	2.7
10	Continental Casualty Group (CNA)	11,462,591	2.5

(1) Before reinsurance transactions, excluding state funds.

Source: NAIC Annual Statement Database, via National Underwriter Insurance Data Services/Highline Data.

# Leading Insurers by Revenues 2003 (\$ 000s)

Rank	Group	Revenues	Assets
1	American International Group	\$81,300	\$677,000
2	Berkshire Hathaway	63,859	180,559
3	State Farm Insurance Cos.	56,065	136,441
4	Allstate	32,149	134,142
5	Hartford Financial Services	18,733	225,853
6	Liberty Mutual Insurance Group	16,914	64,422
7	Nationwide	16,803	147,674
8	Loews (CNA)	15,810	77,881
9	Travelers Property Casualty	15,139	64,872
10	Progressive	11,892	16,282
11	Chubb	11,394	38,361
12	USAA	10,593	41,044
13	St. Paul Cos.	8,958	39,563
14	Fidelity National Financial	7,715	7,312
15	Safeco	7,358	35,845
16	First American Corp.	6,214	4,892
17	American Family Insurance Group	5,895	12,239
18	Erie Insurance Group	4,717	11,860
19	Auto-Owners Insurance	4,211	9,425
20	W.R. Berkley	3,630	9,335

Source: Fortune.,

(\$ millions)





# Demand Factors

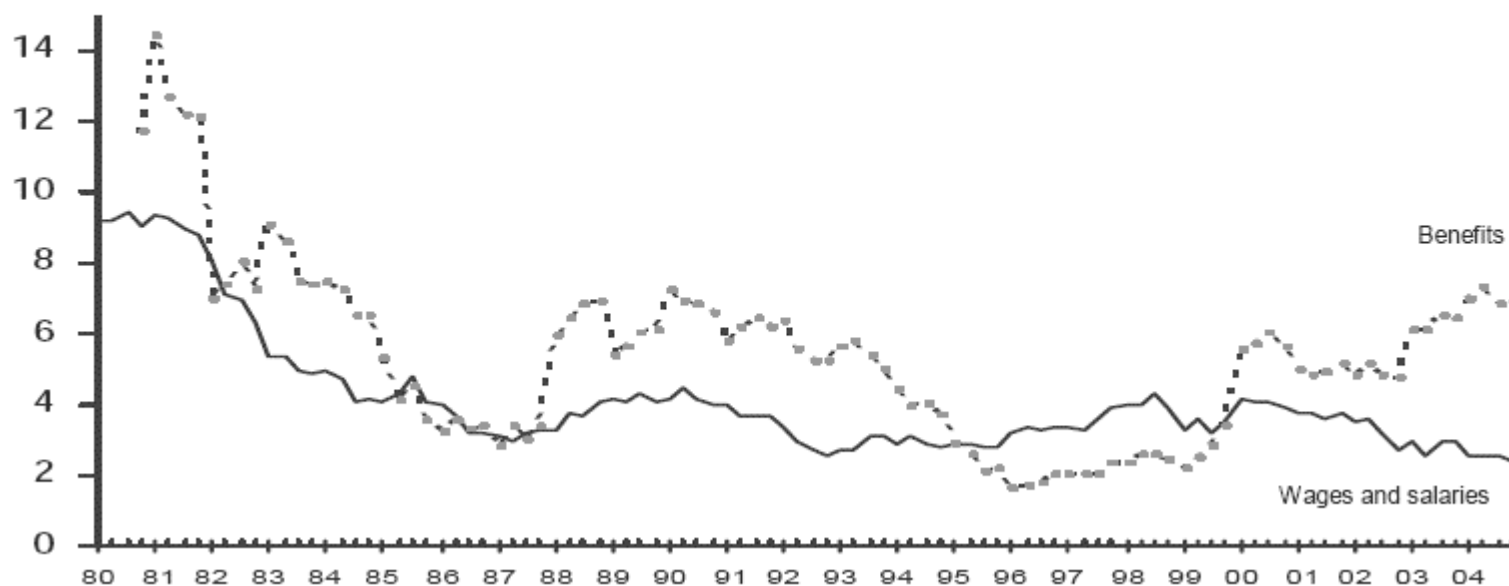
---

- Risk Aversion
  - Most companies & people are Risk Averse!
- Employee Benefits & Worker's Compensation
  - Life, Dental, Vision + Short & Long Term Disability
- Natural Disasters
  - Florida, Gulf-coast: Hurricanes
  - South Asian Tsunami Crisis
  - Fires, Earthquakes, Volcanoes, Floods...
- Man-made
  - Terrorism, 9/11
- Re-insurance

# Demand Factor: Rising Employee Benefits Costs...

Chart A. Changes in wages and salaries and in benefit costs, private industry, 1980-2004

12-month percent change



Source - <http://stats.bls.gov/news.release/pdf/eci.pdf>

# Demand Factors: Weather, Global Warming...

---

# Demand Factors: Hurricane Season!

---

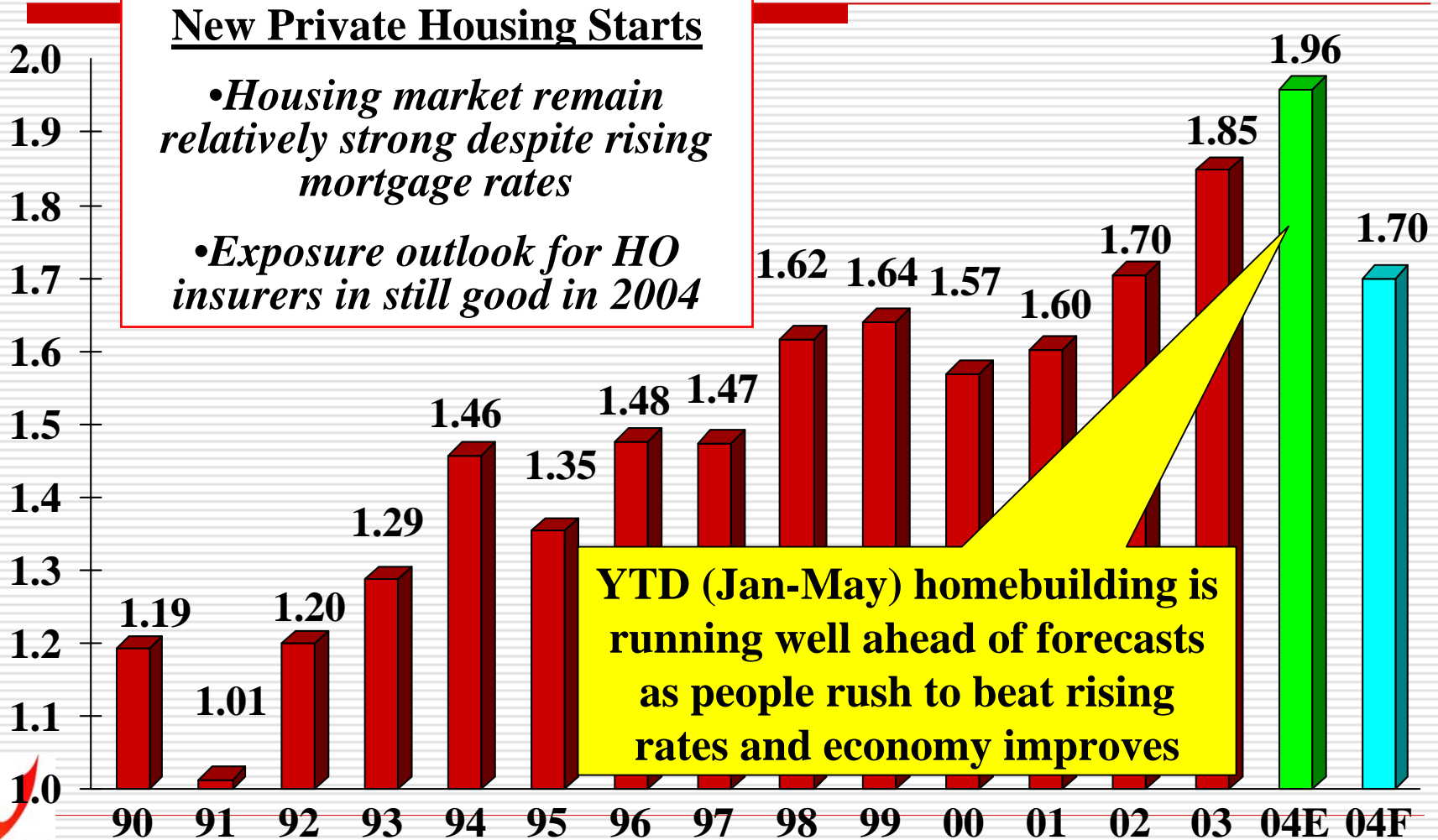
# The Economy & Demand Factors

---

- Low interest rates and strong housing market...
  - Home Owner's Insurance!
- Consumer spending spree & auto discounts...
  - Auto Insurance

# New Private Housing Starts

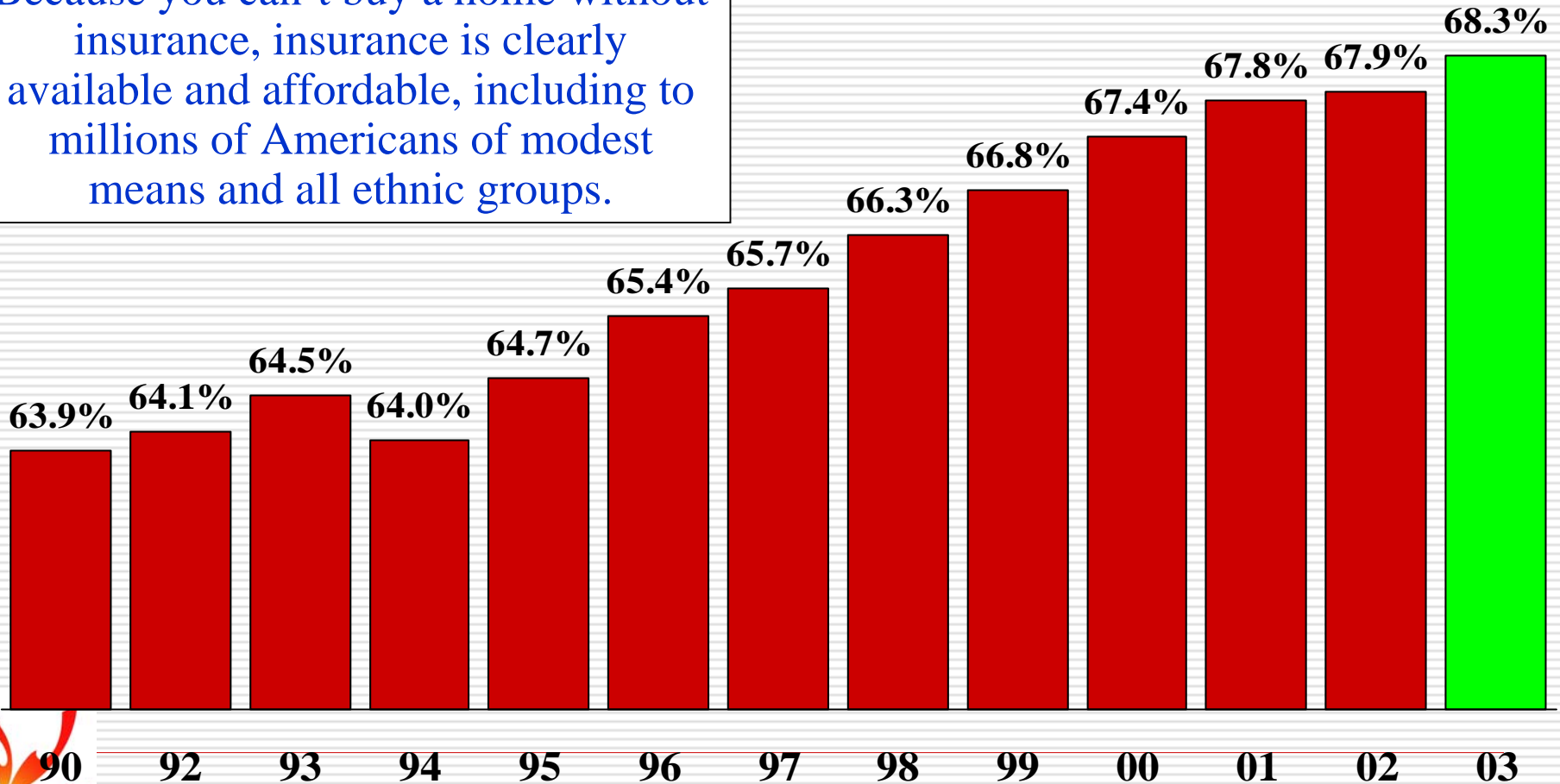
(Millions of Units)



Source: US Department of Commerce; Insurance Information Institute; 2004 estimates based on actual data for Jan-May. Blue Chip Economic Indicators 6/04 for forecast.

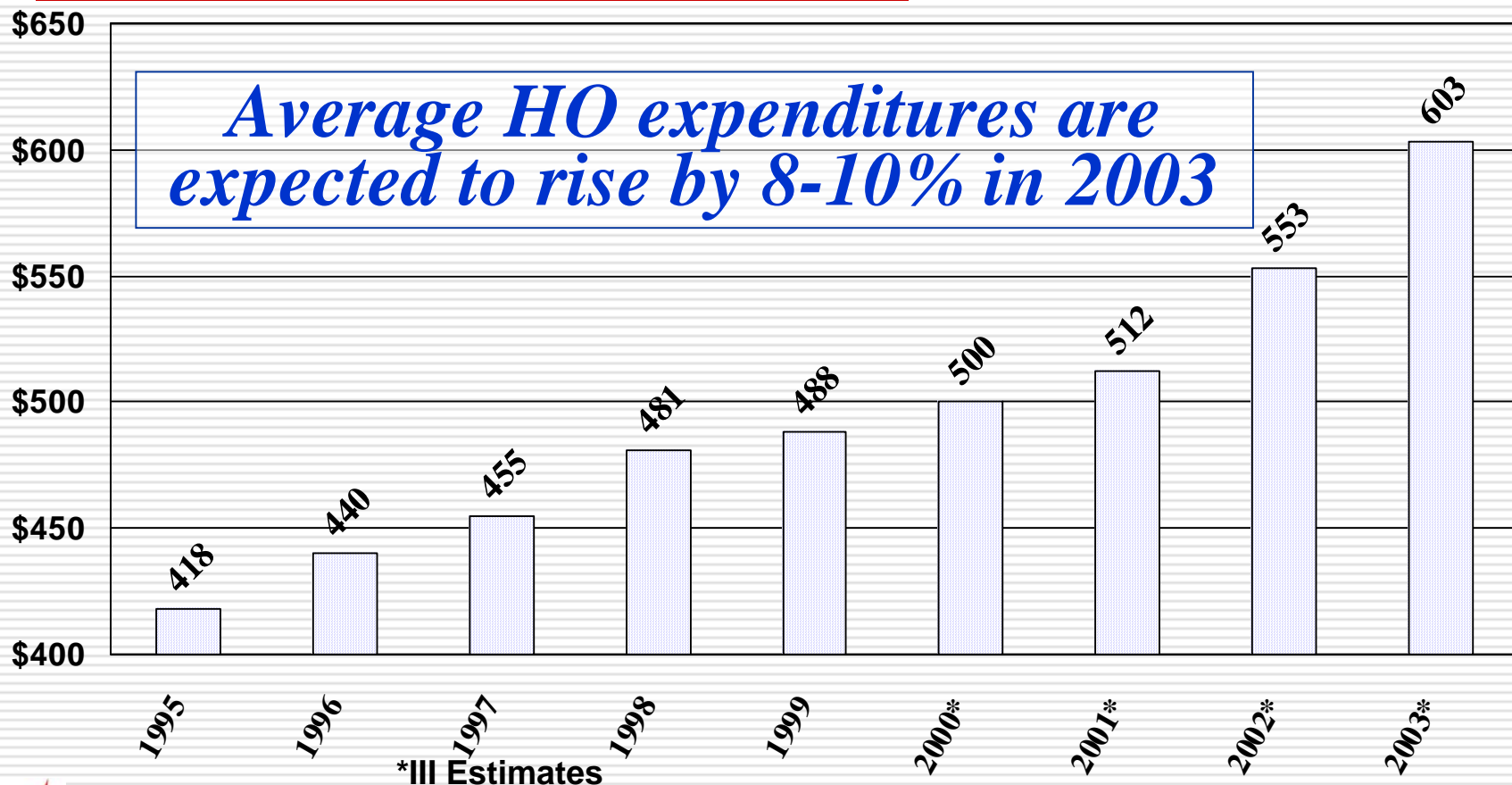
# U.S. Homeownership Rate, **AIG** 1990 to 2003

Homeownership is at a record high. Because you can't buy a home without insurance, insurance is clearly available and affordable, including to millions of Americans of modest means and all ethnic groups.



Source: U.S. Census Bureau

# Average Expenditures on Homeowners Ins.: US

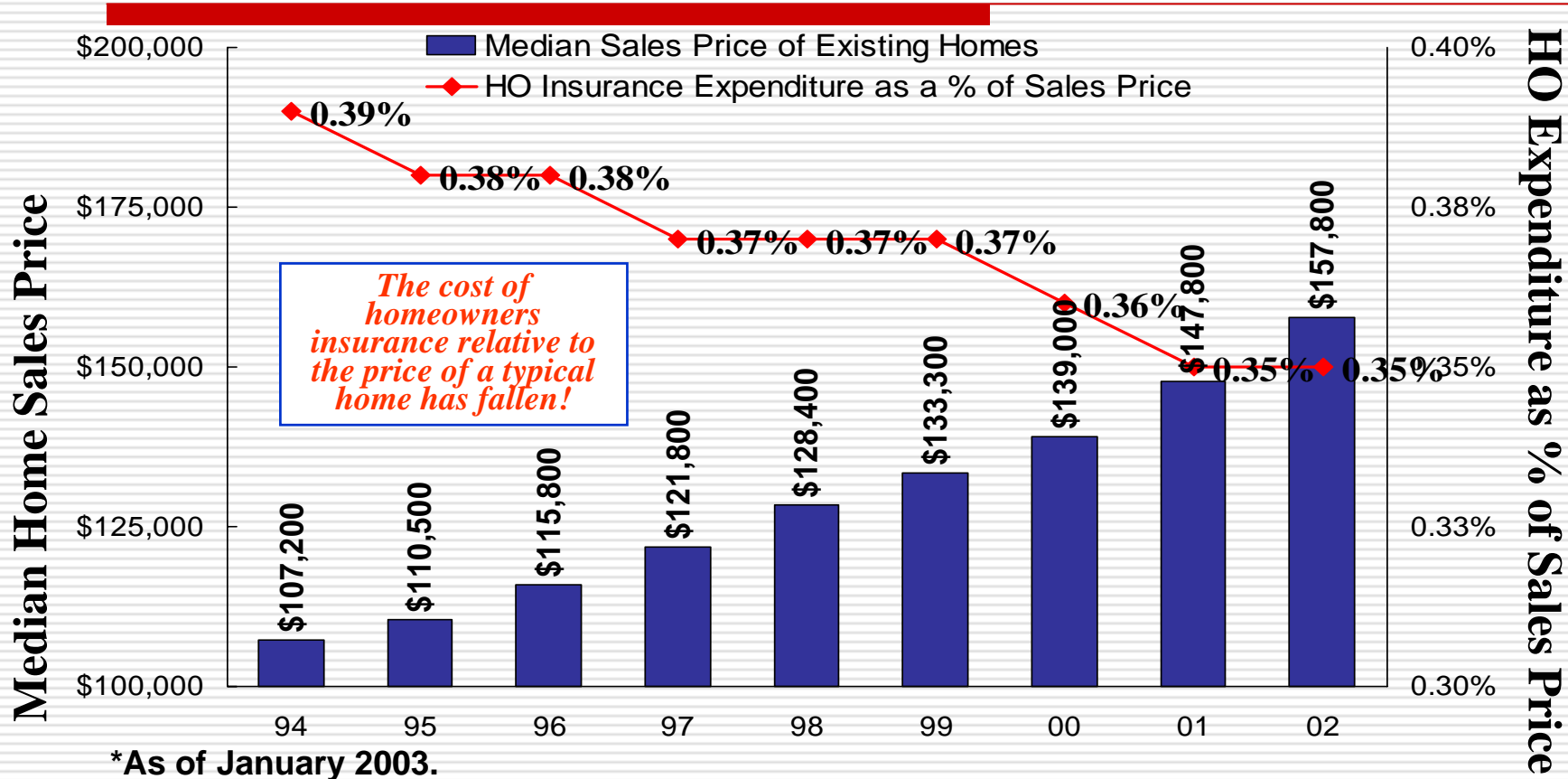


Source: NAIC, Insurance Information Institute





# Homeowners Insurance Expenditure as a % of Median Home Price



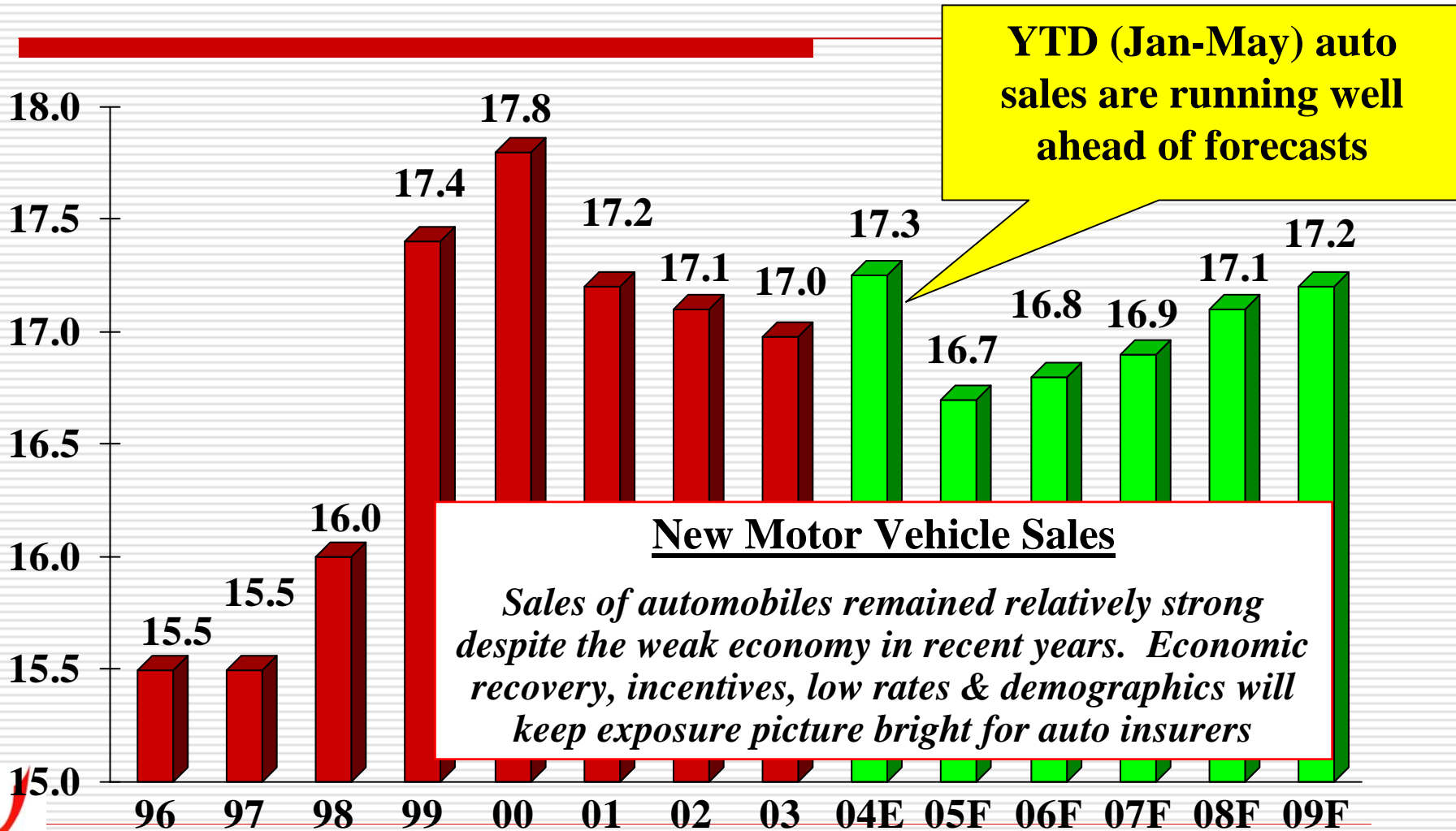
\*As of January 2003.

Source: Insurance Information Institute calculations based on data from National Association of Realtors, NAIC.

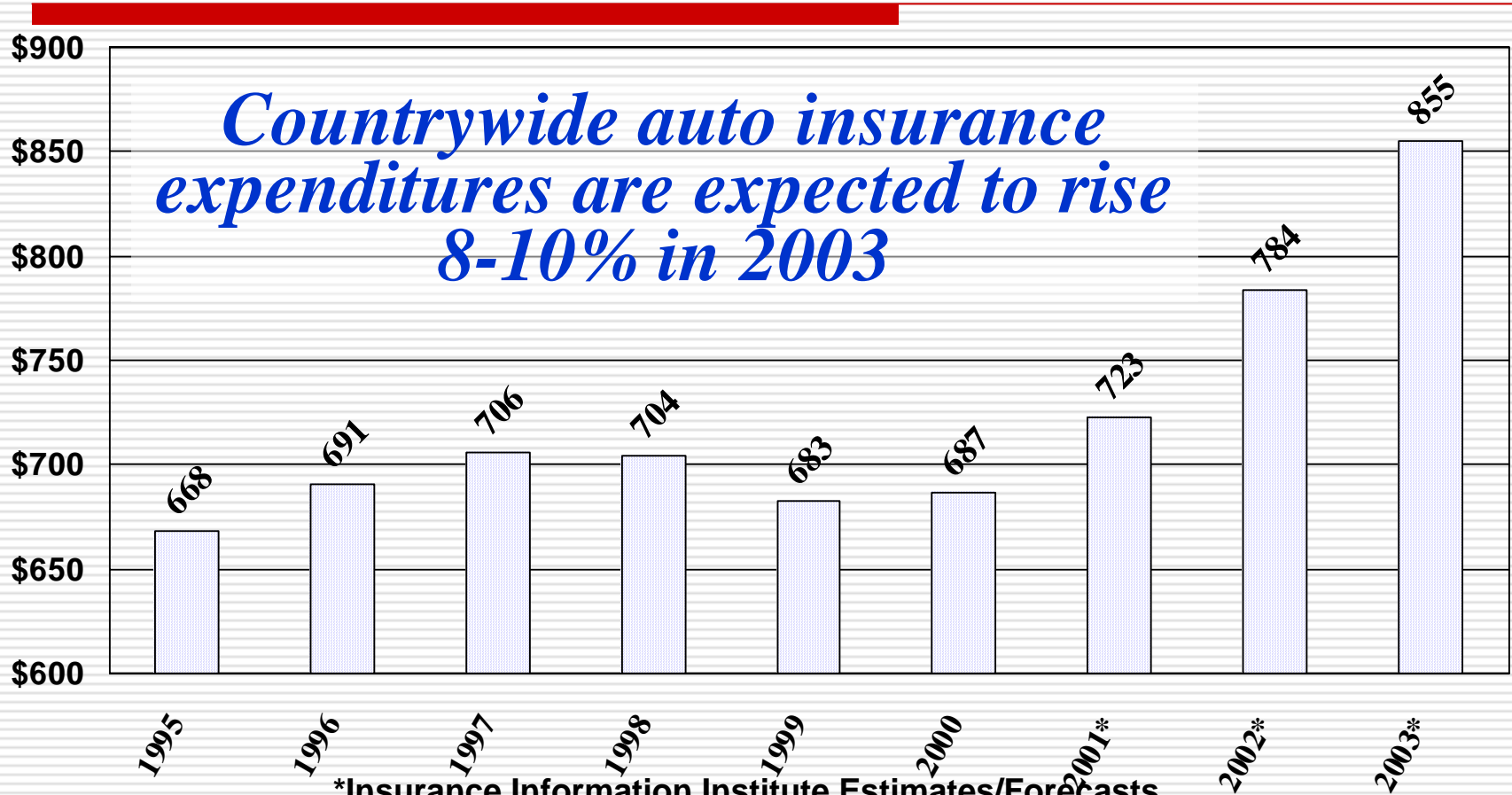


# Motor Vehicle Retail Sales

(Millions of Units)



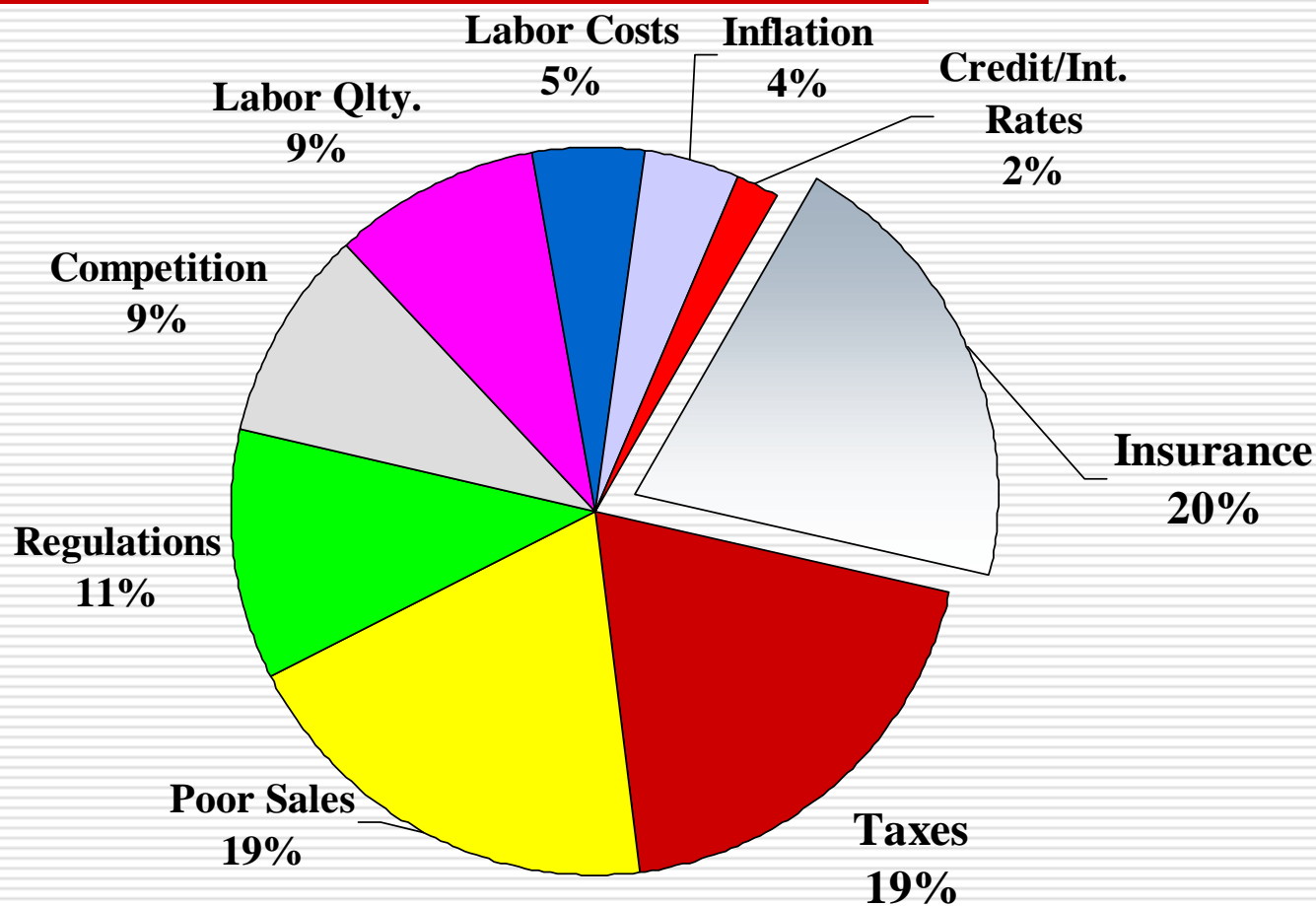
# Average Expenditures on Auto Insurance: US



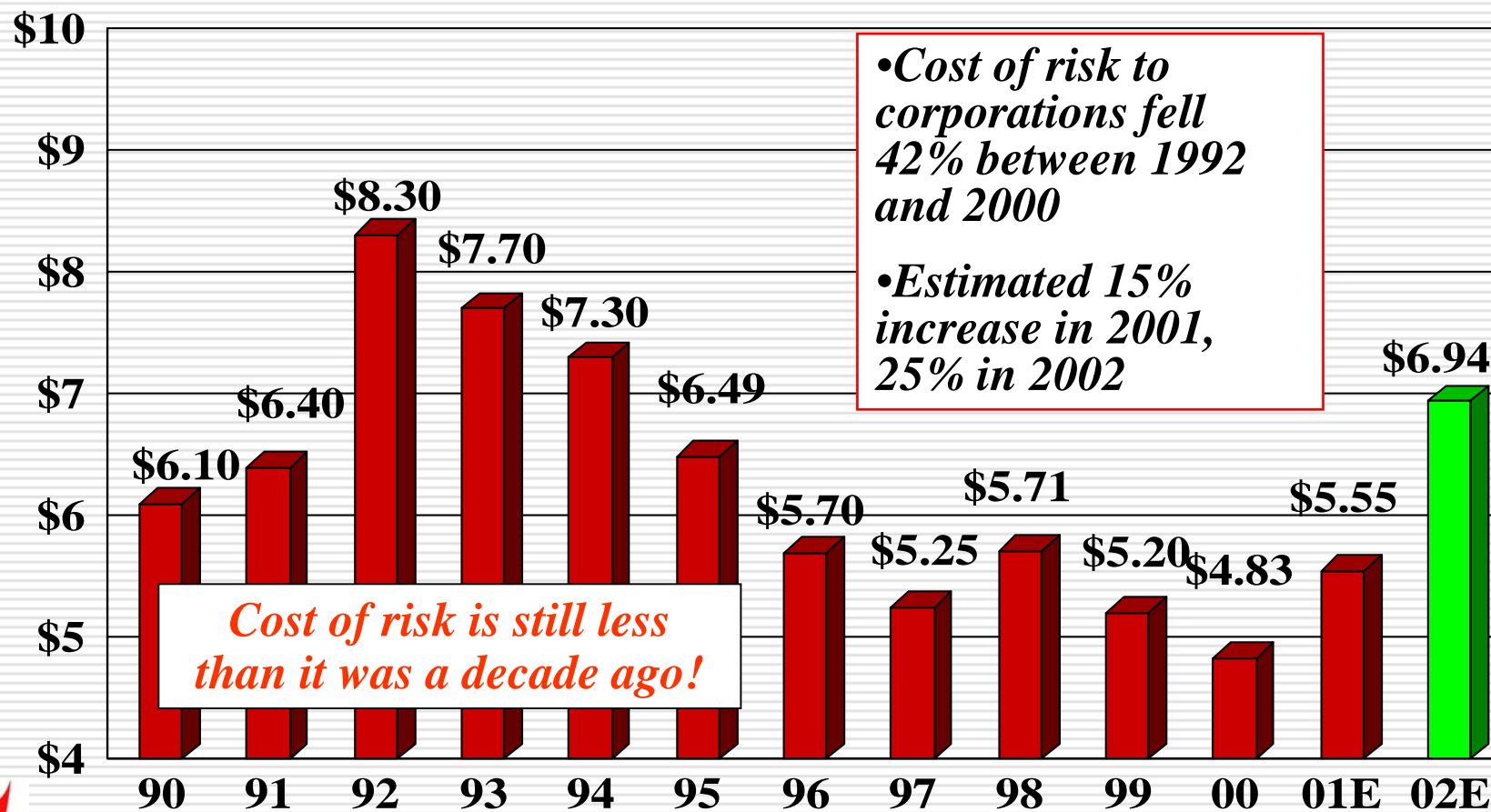
\*Insurance Information Institute Estimates/Forecasts  
 Source: NAIC, Insurance Information Institute



# Insurance is the Biggest Concern of Small Business Owners



# Cost of Risk per \$1,000 of Revenues: 1990-2002E



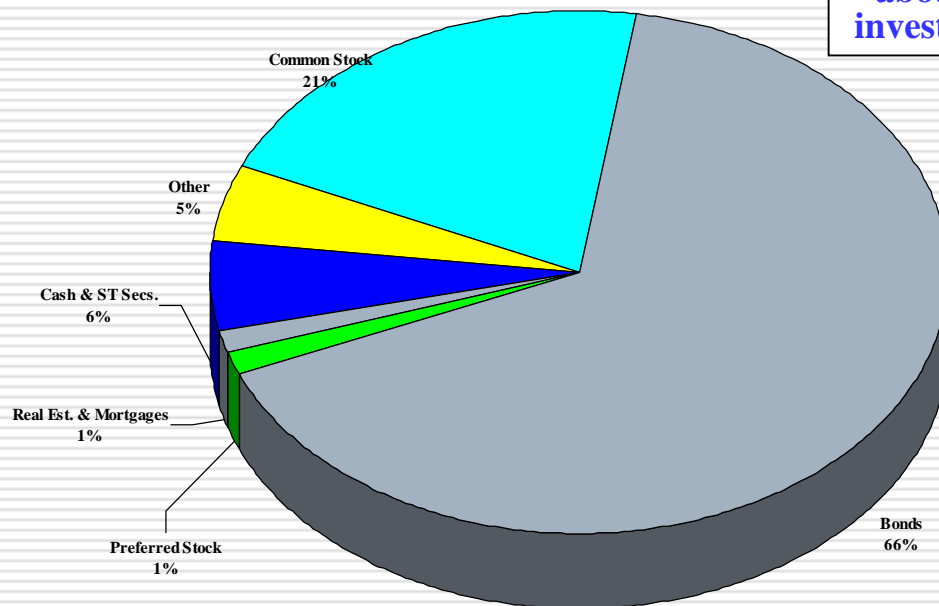
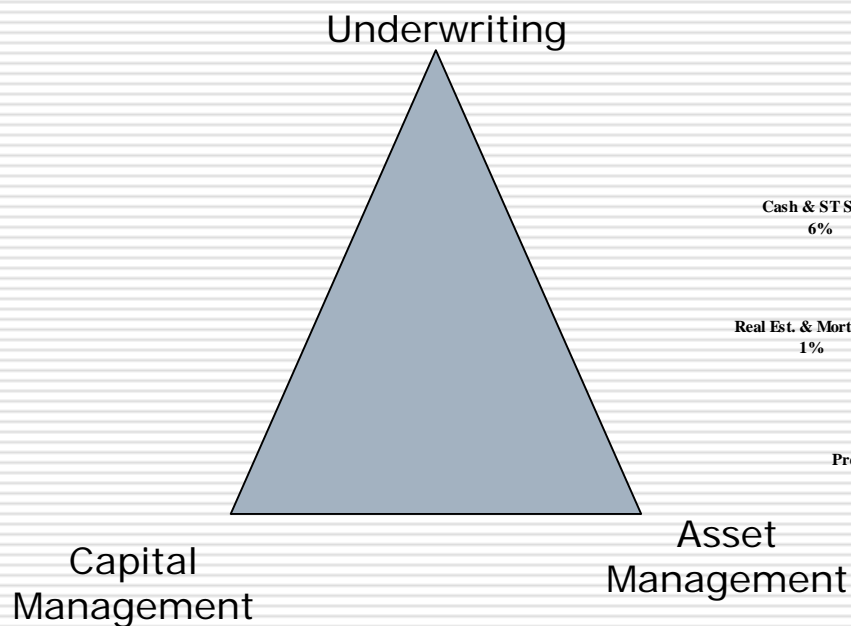
# Insurance Industry: Critical Factors

---

- Risk Assessment & Planning
  - What are the factors for insuring?
  - How to determine premiums?
  - Past is no longer predictive of the future
    - Analyzing & modeling past events is NOT enough
- Claims & Liability Management
  - Spread of Risk
  - Evaluating claims & disbursing funds
- Underwriting, Capital & Asset Management

# Risk Management: 3 Pillars and Allocation of Capital

Common stock accounts for about 1/5 of invested assets



<b><u>Bond Holdings, by Type</u></b>	
Industrial & Misc.	32.5%
Special Revenue	30.5%
Governments	18.0%
States/Terr/Other	15.4%
Public Utilities	3.1%
Parents/Subs/Affiliates	0.5%

Source – Swiss Re & <http://www.iii.org>, A.M. Best

# Comparing GDP to Insurance Industry...

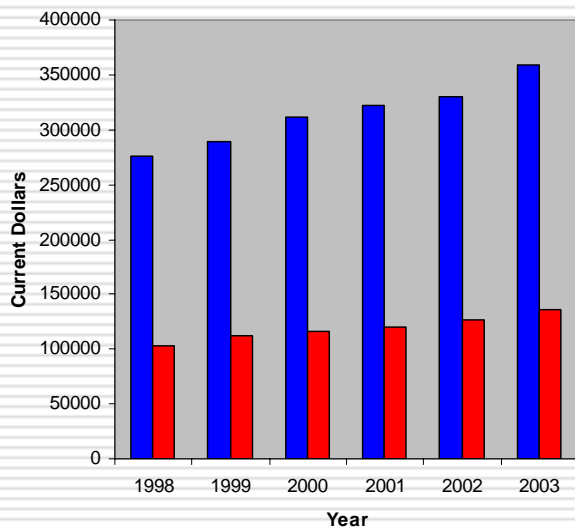
---

- Insurance Services are PART of the Final Goods & Services that make up GDP
  - Hence, it is difficult to compare it to the size of the economy (GDP)
- Next Chart shows
  - GDP by Industrial Sector & the size of the Insurance Sector
  - Source: Bureau of Economic Analysis
    - [gdpbyindustry@bea.gov](http://gdpbyindustry@bea.gov)

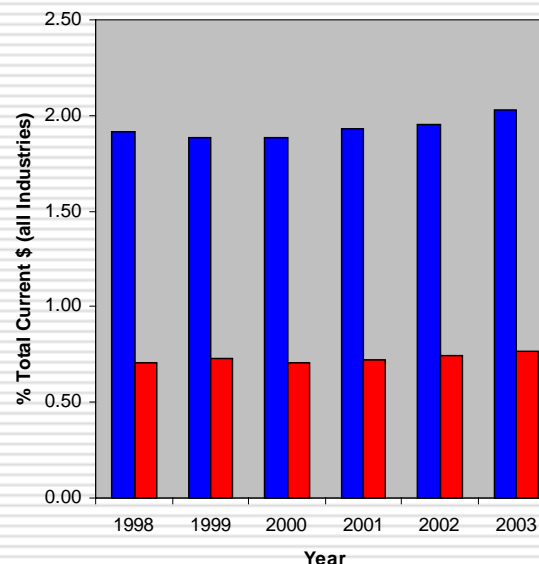


# Size of Industry

■ Insurance  
■ Insurance Agencies, Brokerages & Related



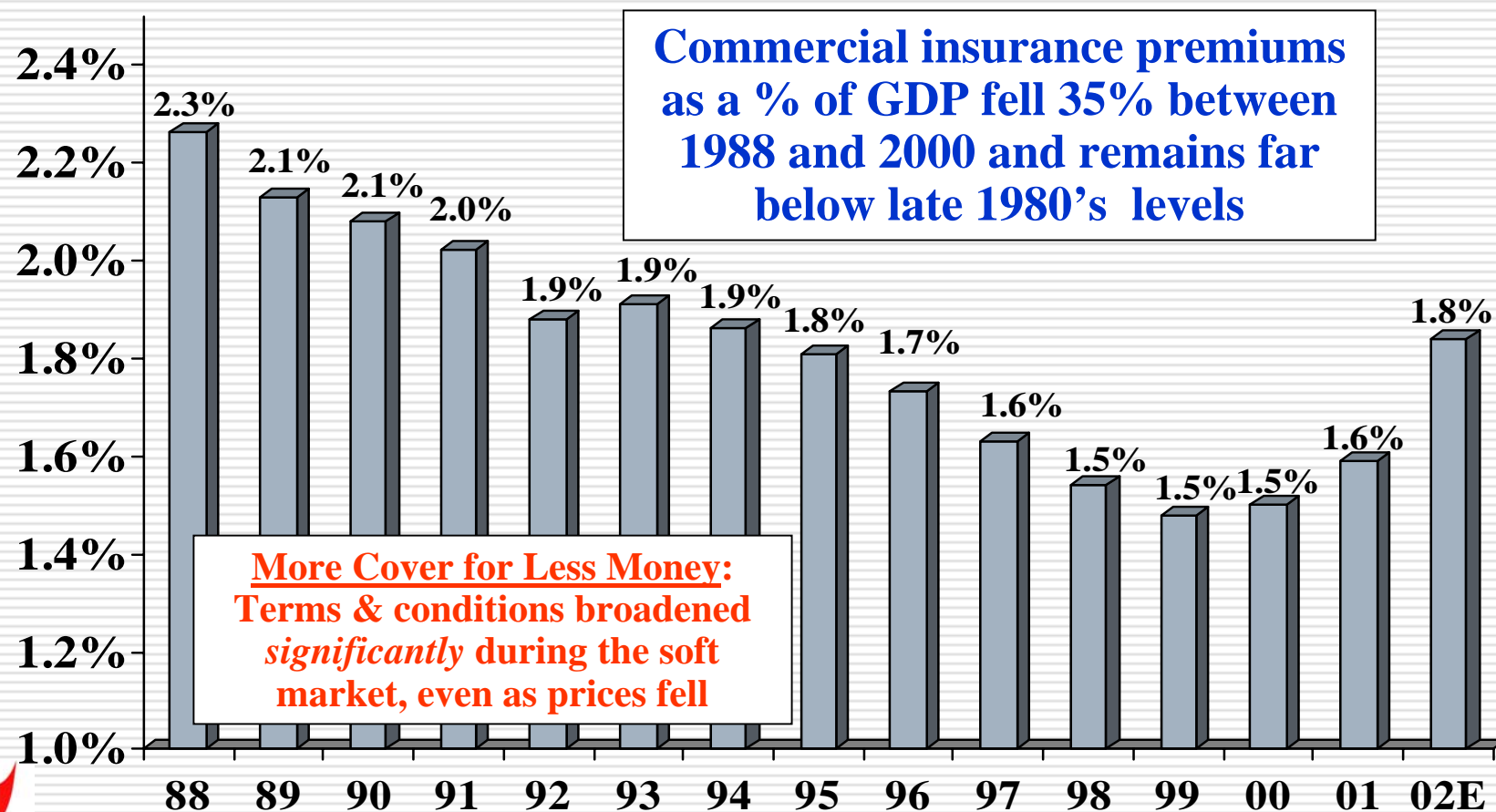
Current Dollars



Percentage of total Industry Current Dollars

IO Code	Description	1998	1999	2000	2001	2002	2003
524100	Insurance carriers (Current \$)	276053	289468	311464	321499	330000	359602
524200	Insurance agencies, brokerages, and related (Current \$)	102474	112098	116539	120010	126356	136143
	Insurance carriers (% of Total)	1.91	1.89	1.88	1.93	1.95	2.03
	Insurance agencies, brokerages, and related (% of Total)	0.71	0.73	0.71	0.72	0.75	0.77
	Total ALL Industries (in Current \$)	14433957	15350018	16526171	16635124	16909522	17696205

# Commercial Lines Net Written Premium as % of GDP



Sources: Insurance Information Institute, calculated from U.S. Bureau of Economic Analysis and A.M. Best data.

# P/C Financial Asset Distribution 1998-2003 (\$ Billions)

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
<b>Total financial assets</b>	<b>\$876.4</b>	<b>\$872.7</b>	<b>\$862.0</b>	<b>\$858.1</b>	<b>\$918.8</b>	<b>\$1,045.0</b>
Checkable deposits and cash	4.0	4.3	3.7	13.1	25.9	34.5
Security RPs (1)	42.7	28.3	38.3	30.2	44.4	52.8
Credit market instruments	521.1	518.2	509.4	518.4	558.3	624.0
U.S. government securities	140.1	136.1	136.2	146.2	174.4	194.7
Treasury	70.4	60.6	52.1	52.0	61.2	68.4
Agency and GSE-backed securities	69.7	75.5	84.1	94.2	113.2	126.3
Municipal securities	208.1	199.0	184.1	173.8	183.0	204.6
Corporate and foreign bonds	171.1	181.1	187.5	196.4	198.9	222.7
Commercial mortgages	2.0	1.9	1.6	1.9	2.0	2.1
Corporate equities	200.1	207.9	194.3	173.9	152.3	182.7
Trade receivables	61.5	63.6	64.6	69.9	74.8	79.3
Miscellaneous assets	47.0	50.6	51.8	52.6	63.1	71.7
(1) RPs are repos (repurchase agreements). Source: Board of Governors of the Federal Reserve System.						

# Employment in Insurance 1994-2003 (000s)

Insurance companies (1)					
Year	<u>Life, health and medical</u>	<u>Property/ casualty</u>	<u>Reinsurers</u>	<u>Insurance agencies, brokerages and related services (2)</u>	<u>Total industry</u>
1994	812.0	568.8	37.7	700.3	2,118.8
1995	807.4	552.0	36.3	712.6	2,108.3
1996	788.0	558.2	35.4	726.4	2,108.0
1997	797.4	566.9	35.1	744.1	2,143.5
1998	816.8	592.0	34.3	766.3	2,209.4
1999	815.3	603.9	33.5	783.4	2,236.1
2000	808.8	591.6	32.3	787.8	2,220.5
2001	807.7	591.3	31.4	803.2	2,233.6
2002	791.1	590.0	31.7	820.4	2,223.2
2003	792.3	606.2	30.6	837.0	2,266.1

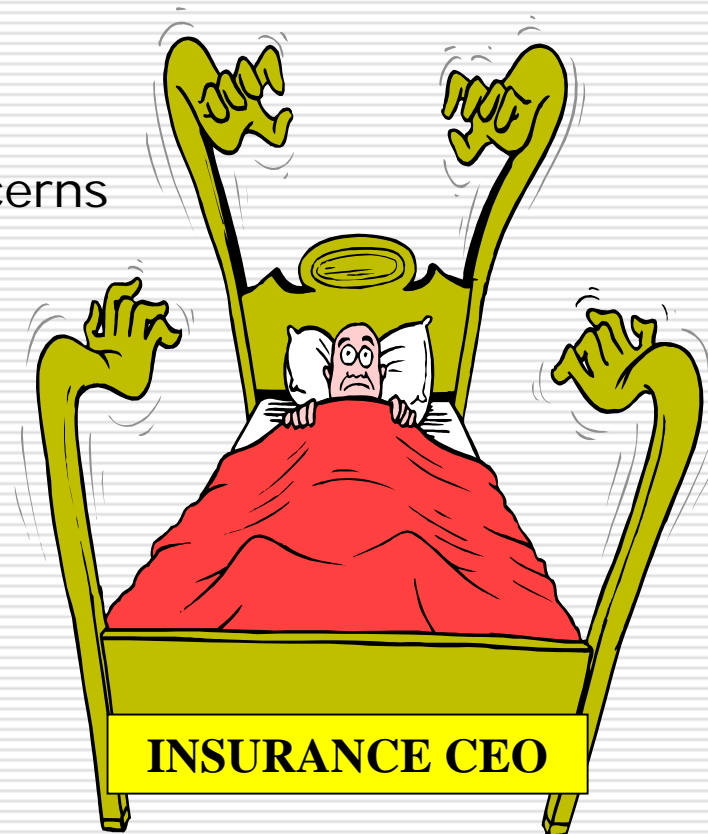
(1) Described by the Bureau of Labor Statistics as “direct insurers.”  
 (2) Includes claims adjusters, third party administrators of insurance funds and other service personnel such as advisory and insurance ratemaking services.

Source: U.S. Department of Labor, Bureau of Labor Statistics.



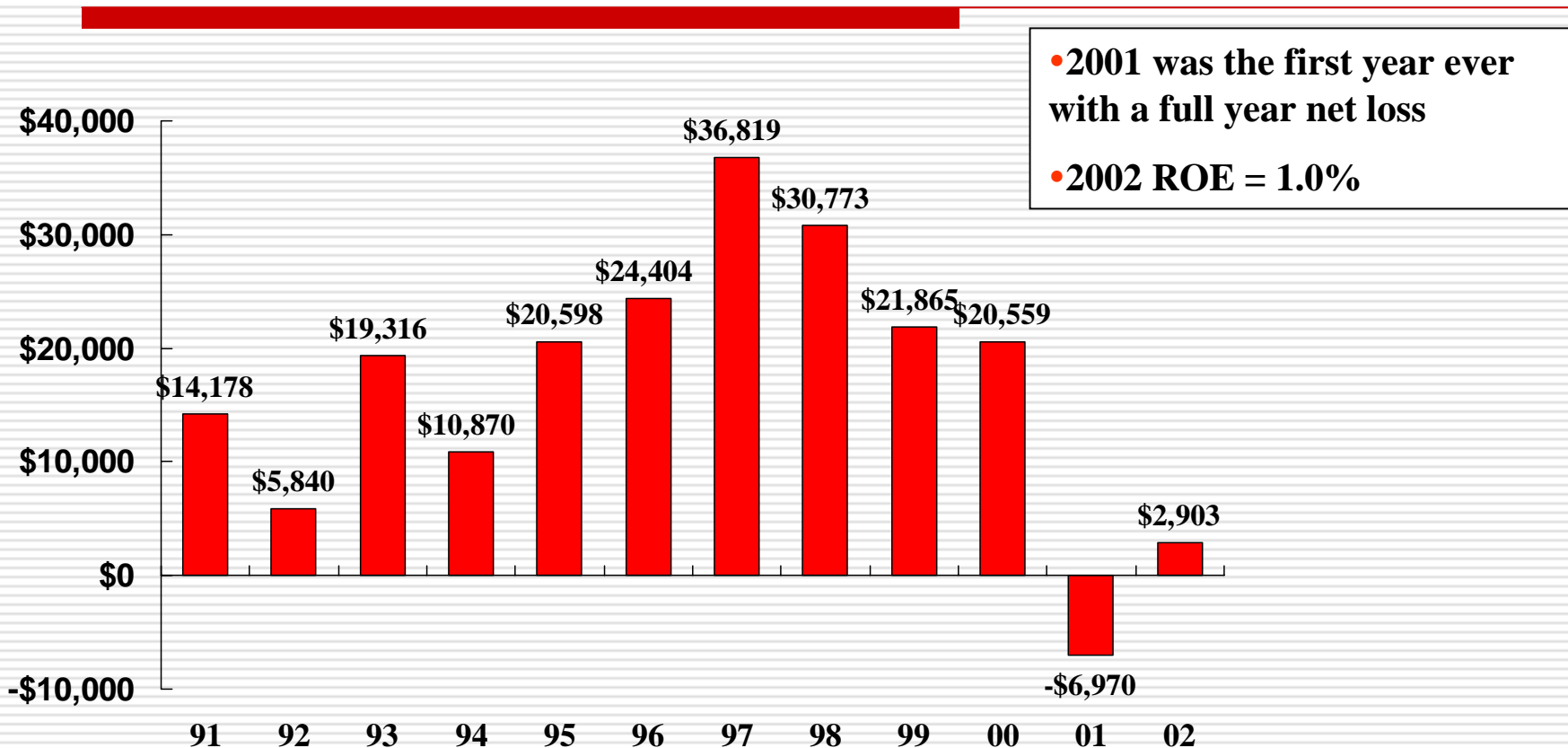
## Leading Causes of CEO Insomnia:

- Profit Woes
- Underwriting Performance
- Reserving Issues
- (In)Solvency Issue & Reinsurance Concerns
- Pricing Discipline
- Scarcity of Capital
- Nightmare on Wall Street
- Abuse of the Civil Justice System



Source – Insurance Information Institute

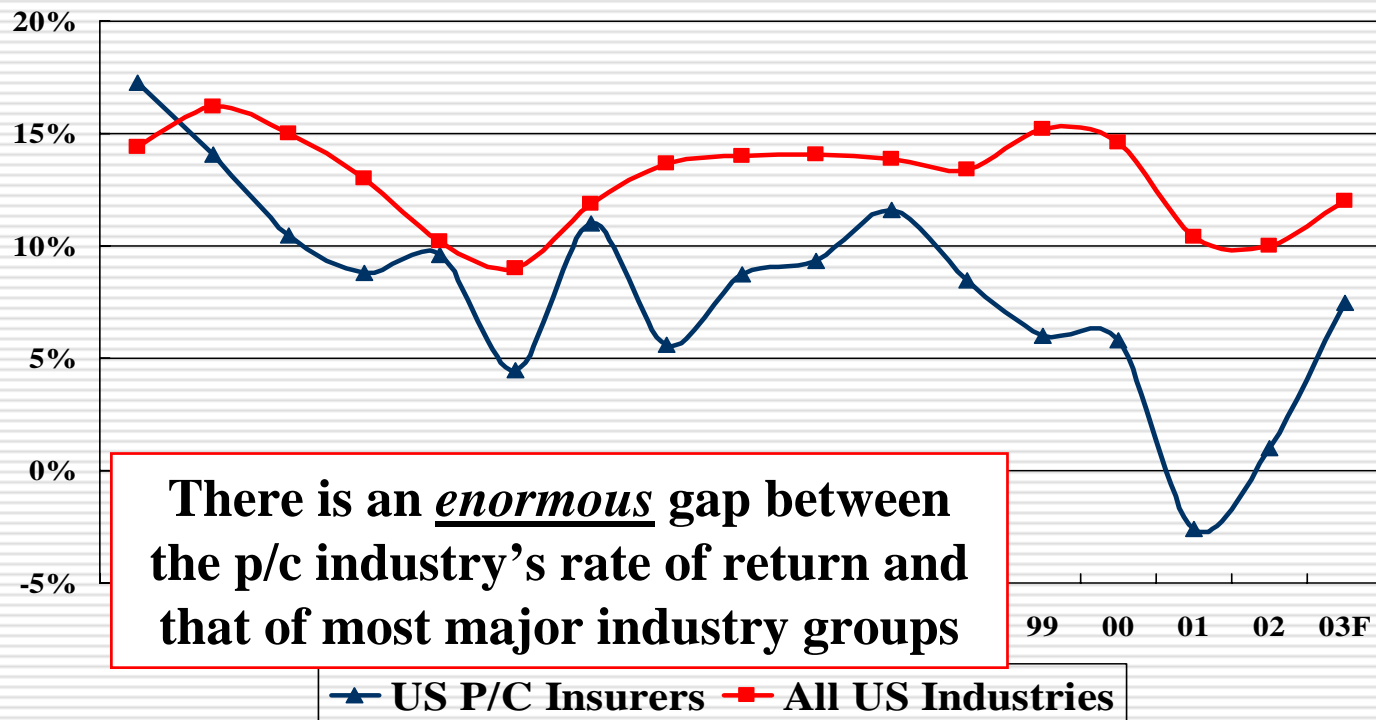
# P/C Net Income After Taxes 1991-2002 (\$ Millions)



Sources: A.M. Best, ISO, Insurance Information Institute.



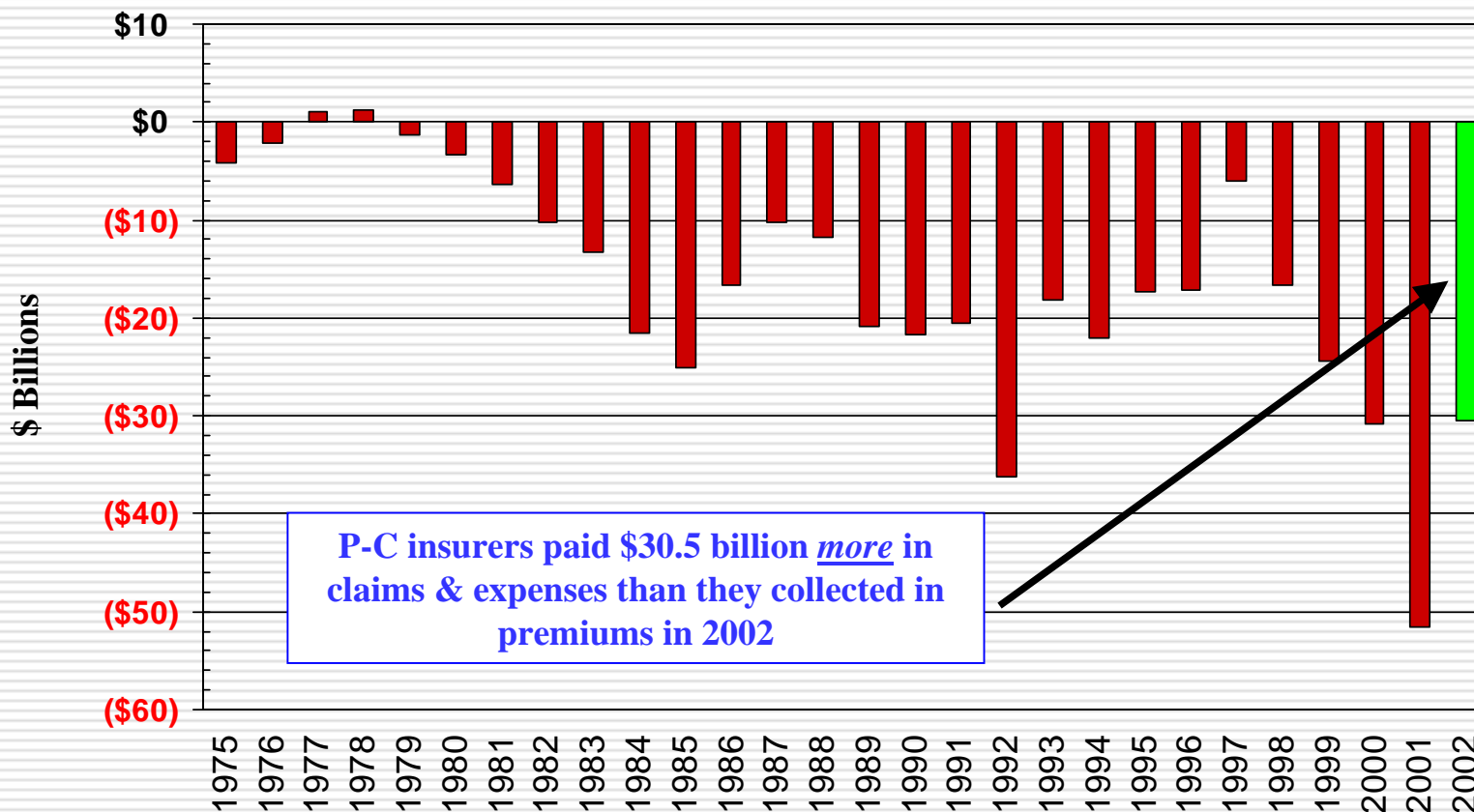
# ROE: P/C vs. All Industries 1987–2003F



Source: Insurance Information Institute; *Fortune*



# Underwriting Gain (Loss) 1975-2002

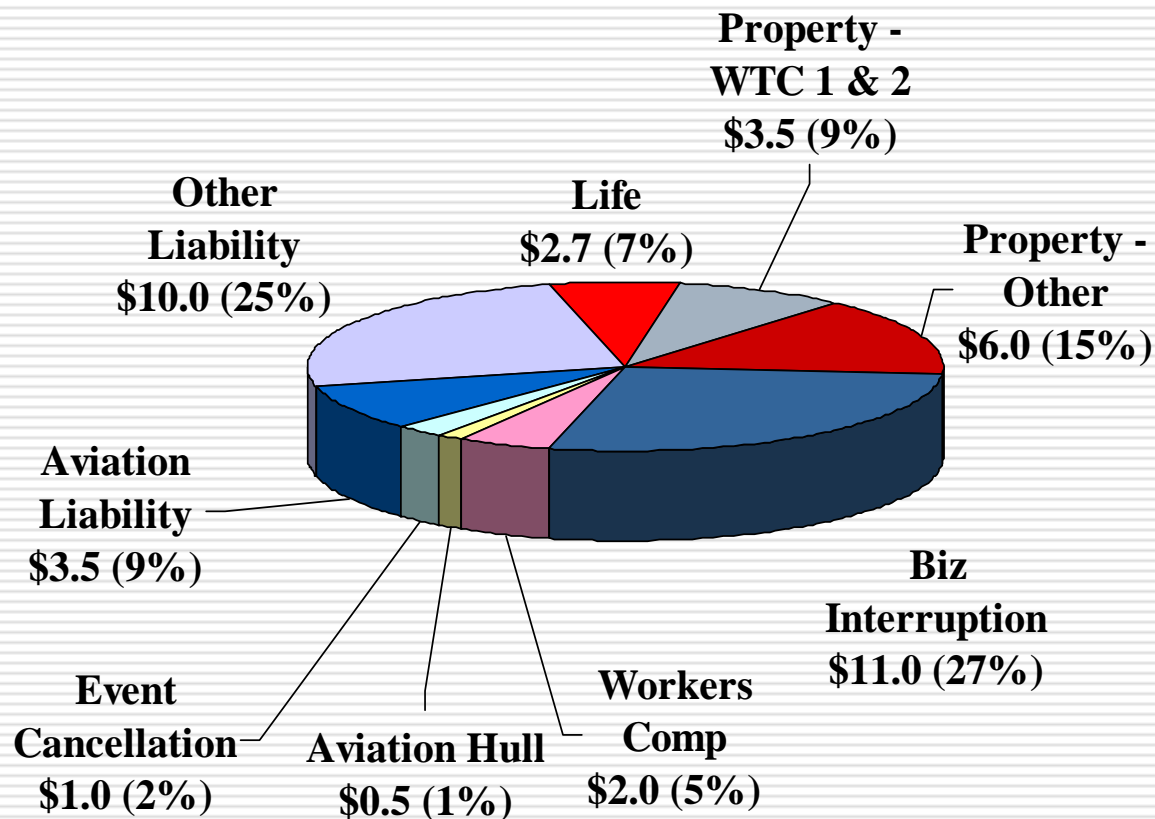


Source: A.M. Best, Insurance Information Institute





# Terrorism: Sept. 11 Industry Loss Estimates (\$ Billions)

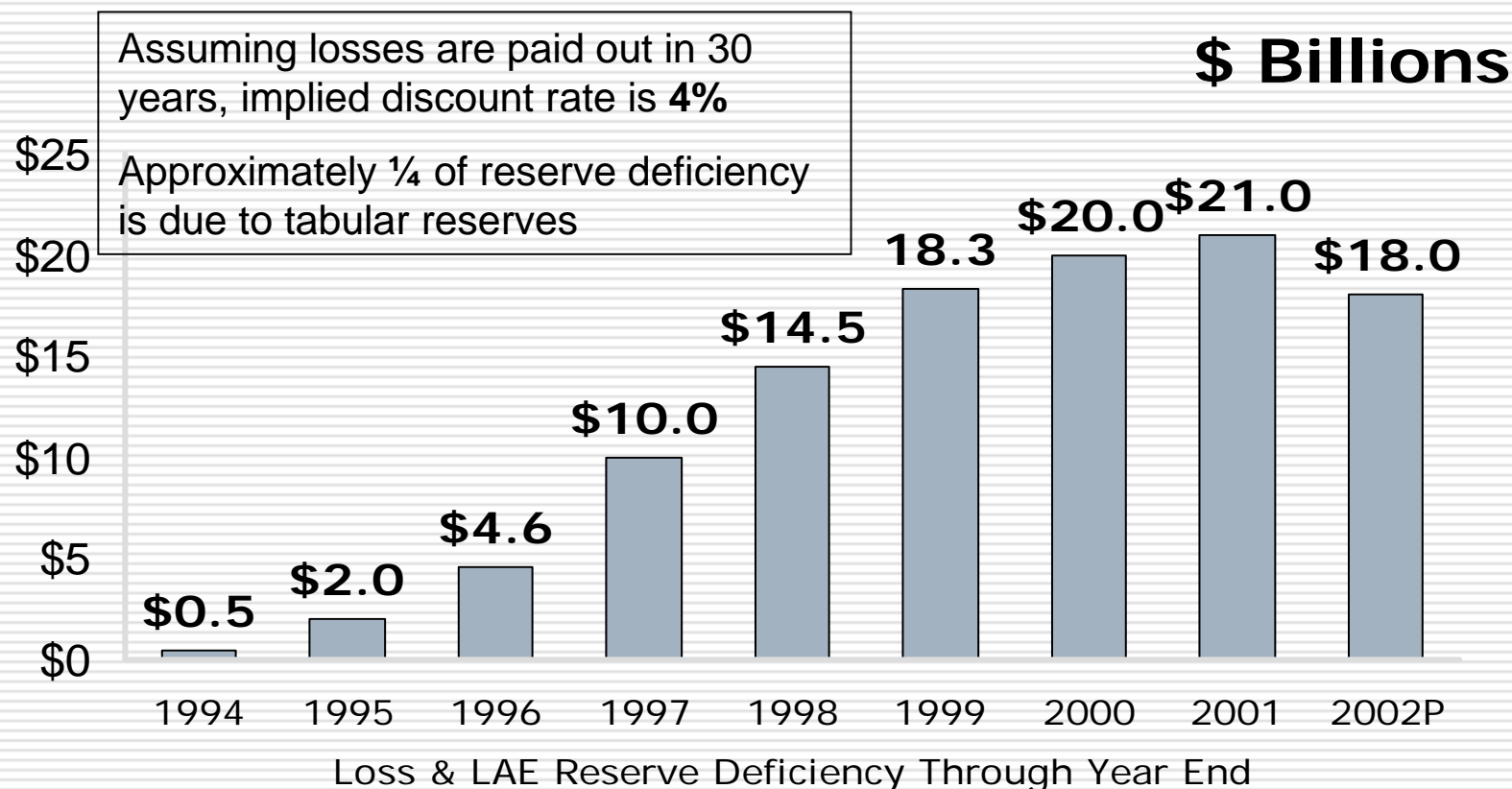


**Consensus Insured Losses Estimate: \$40.2B**

Source: Insurance Information Institute



# WC Reserve Deficiencies Rose Through 2001, Dropped in 2002

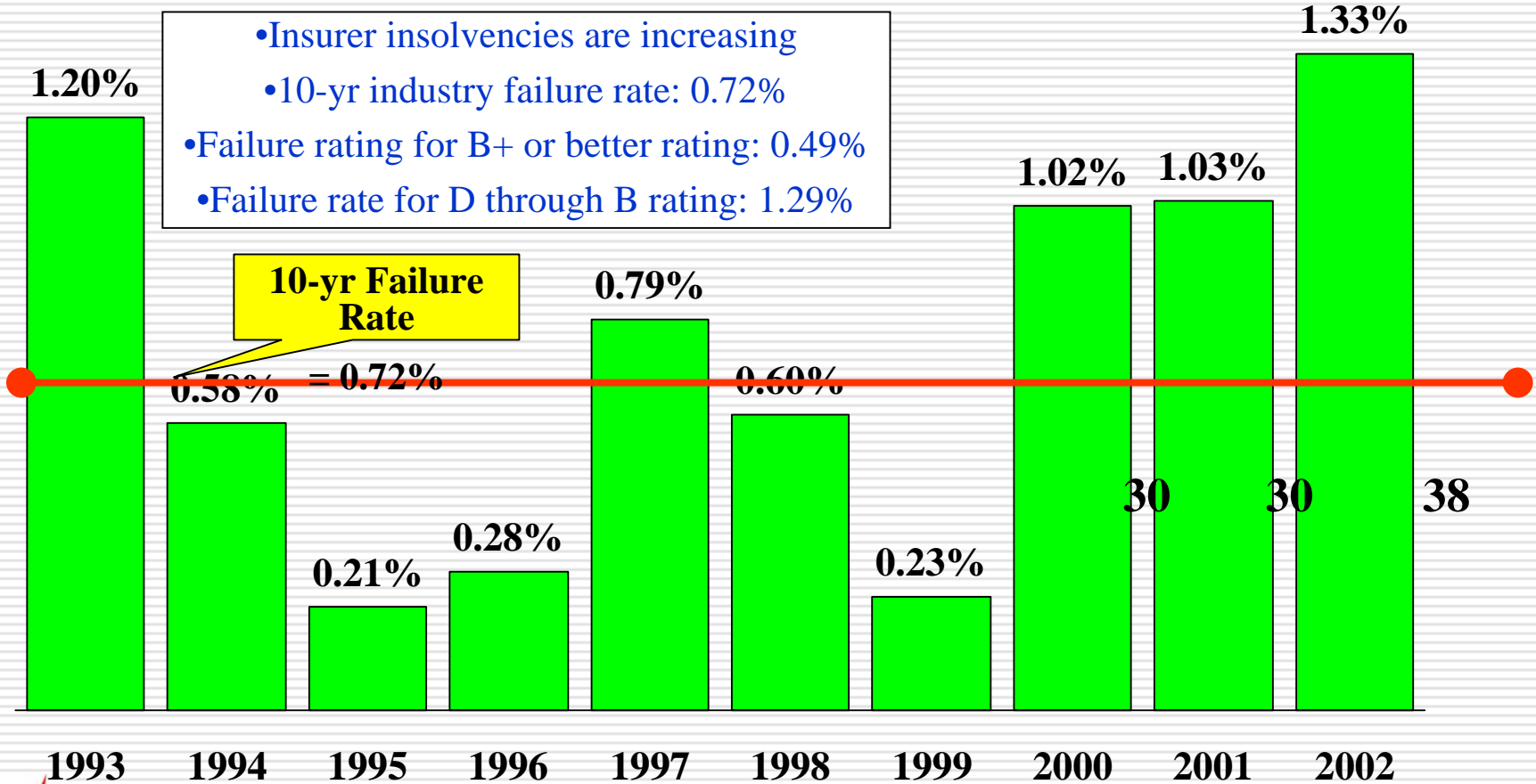


Difference between NCCI estimated ultimate losses and LAE as of 12/31/2002 and reported Schedule P incurred losses and LAE

Source: NCCI



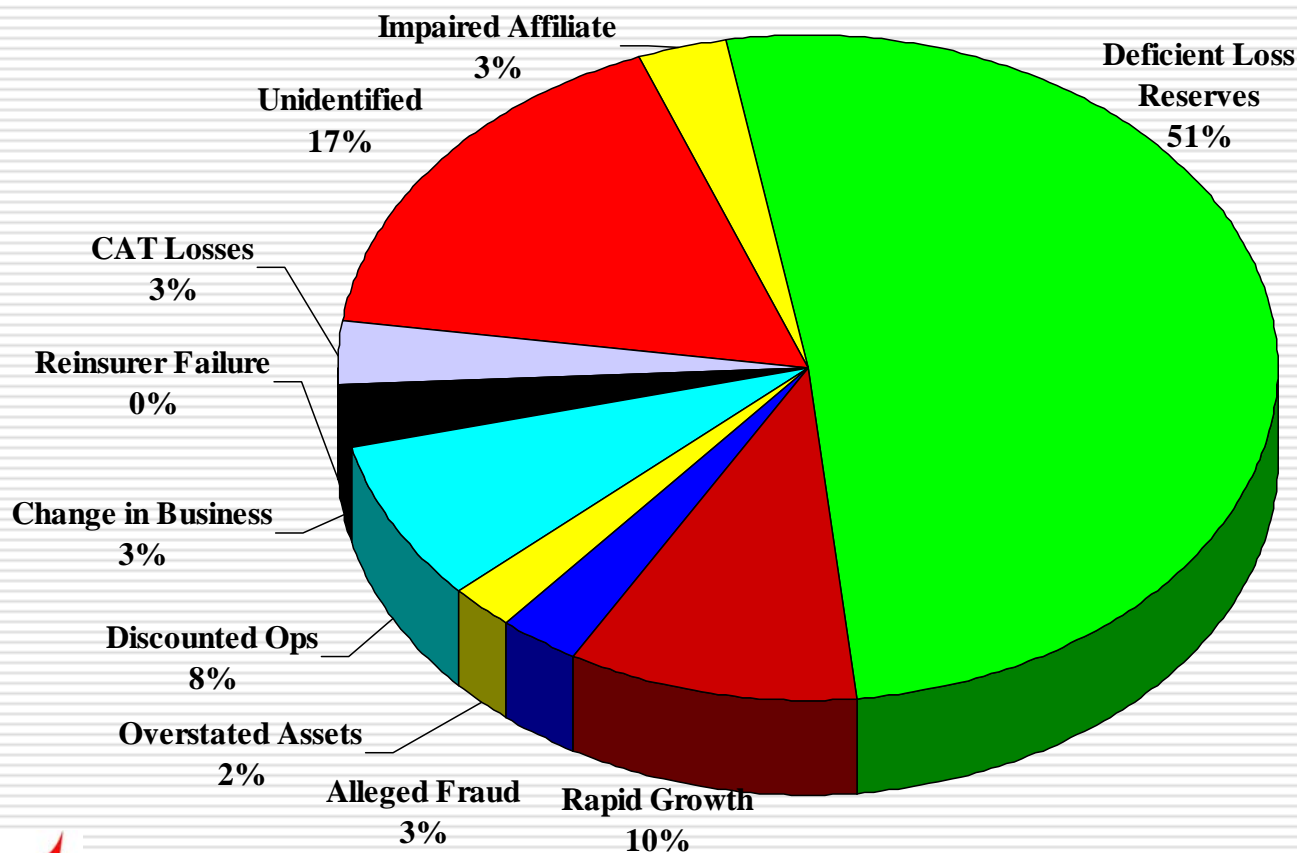
# P/C Company Insolvency Rates, 1993 to 2002



Source: A.M. Best; Insurance Information Institute

# Reason for P/C Insolvencies

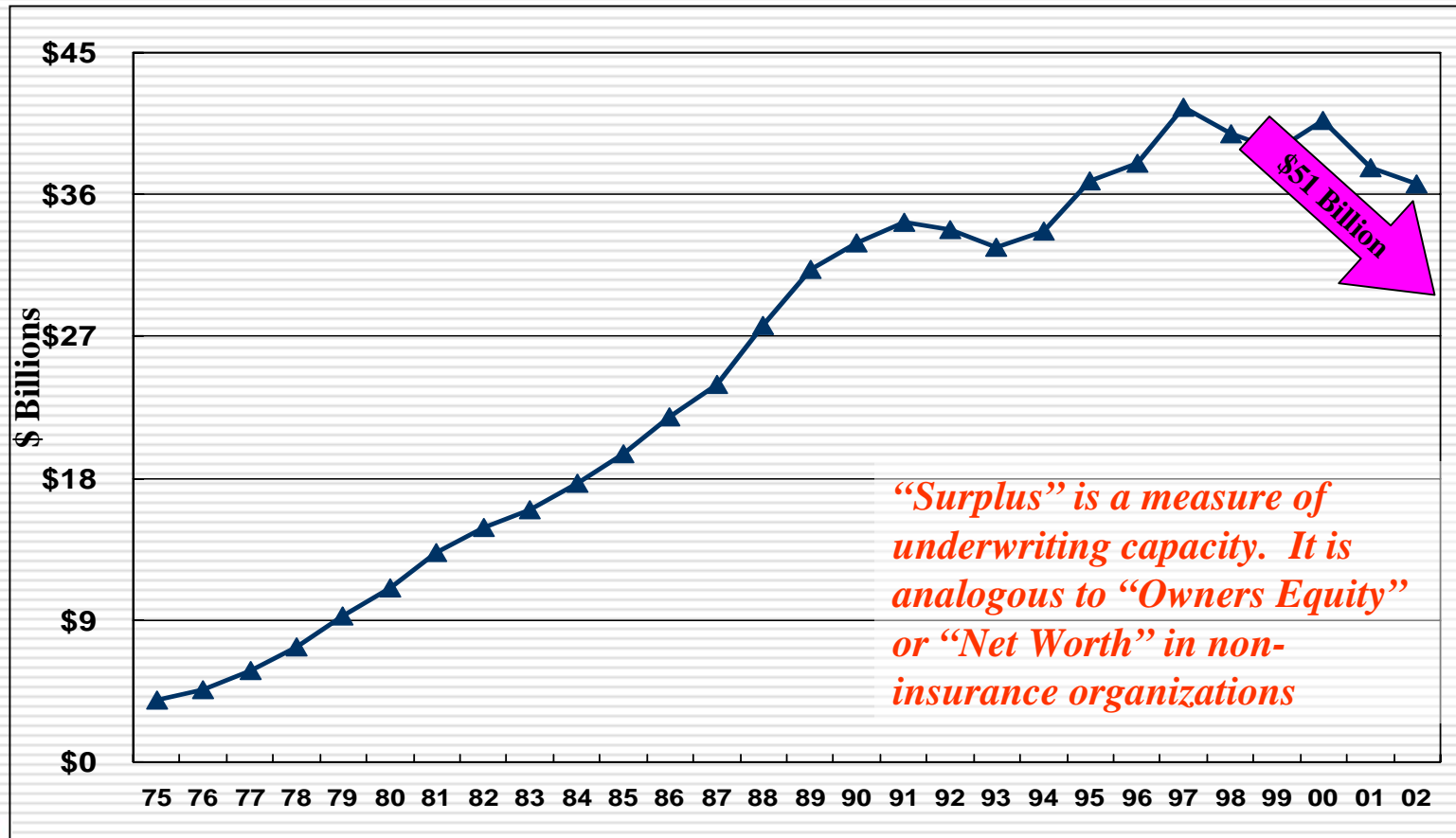
(218 Insolvencies, 1993-2002)



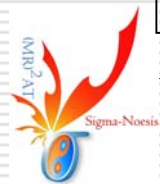
**Reserve deficiencies account for more than half of all p/c insurers insolvencies**



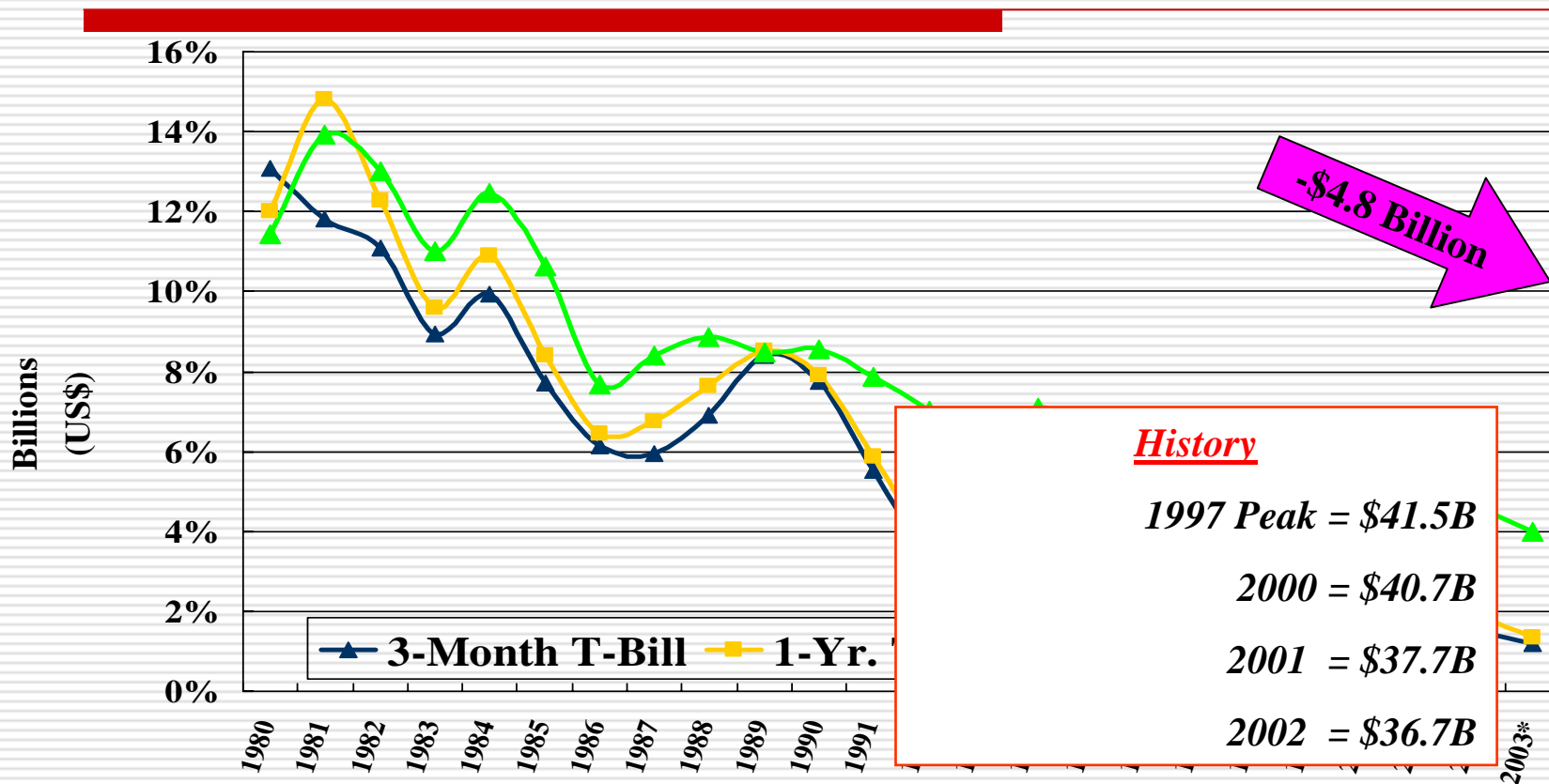
# Policyholder Surplus: 1975-2002



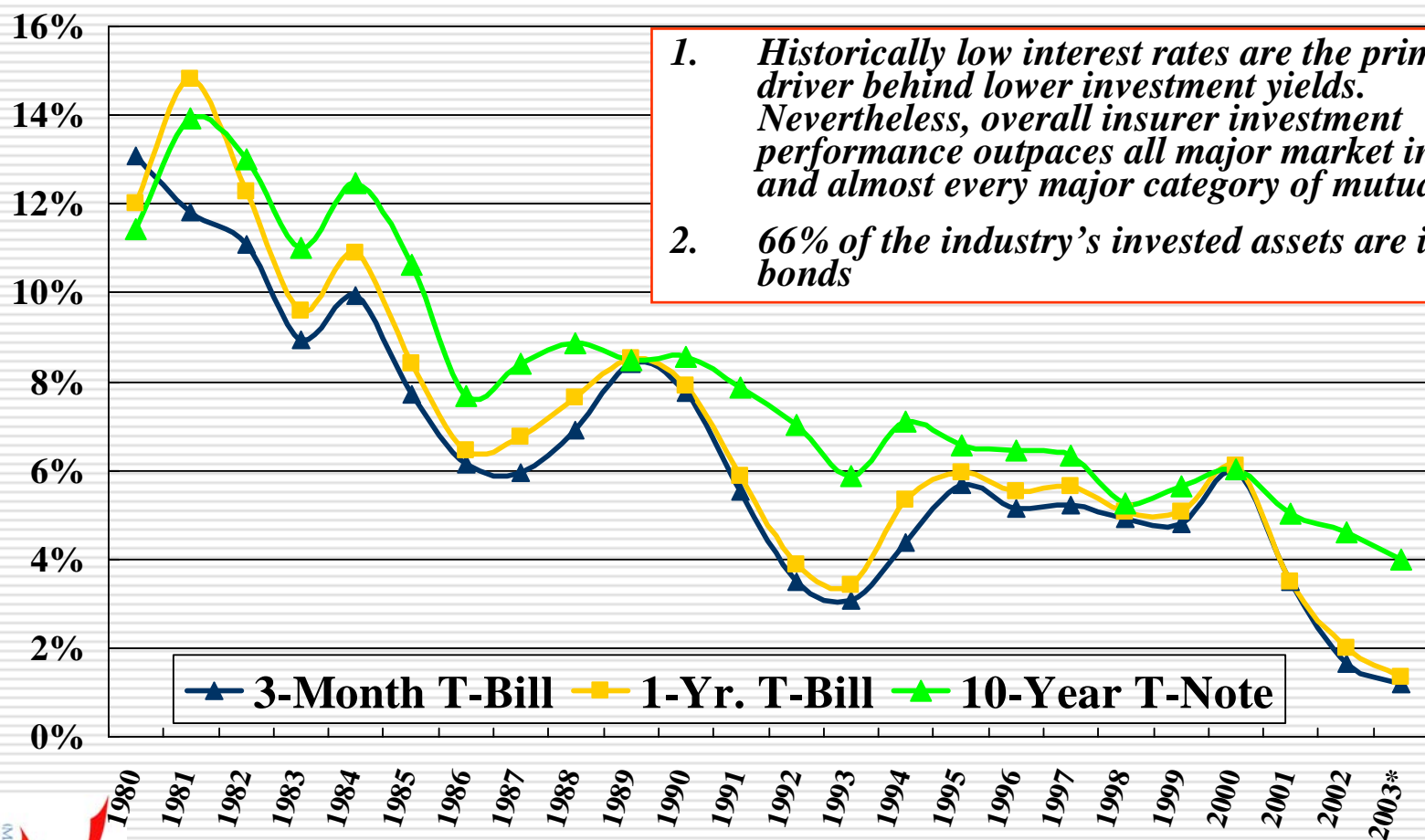
Source: A.M. Best, Insurance Information Institute



# Net Investment Income



# Interest Rates: Lower Than They've Been in Decades



- Historically low interest rates are the primary driver behind lower investment yields. Nevertheless, overall insurer investment performance outpaces all major market indices and almost every major category of mutual fund.*
- 66% of the industry's invested assets are in bonds*

▲ 3-Month T-Bill    ■ 1-Yr. T-Bill    ▲ 10-Year T-Note

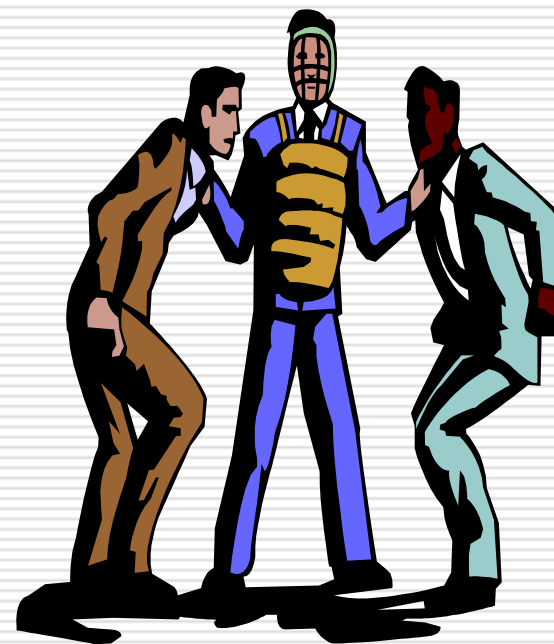
\*As of April 21, 2003.

Source: Board of Governors, Federal Reserve System; Insurance Information Institute



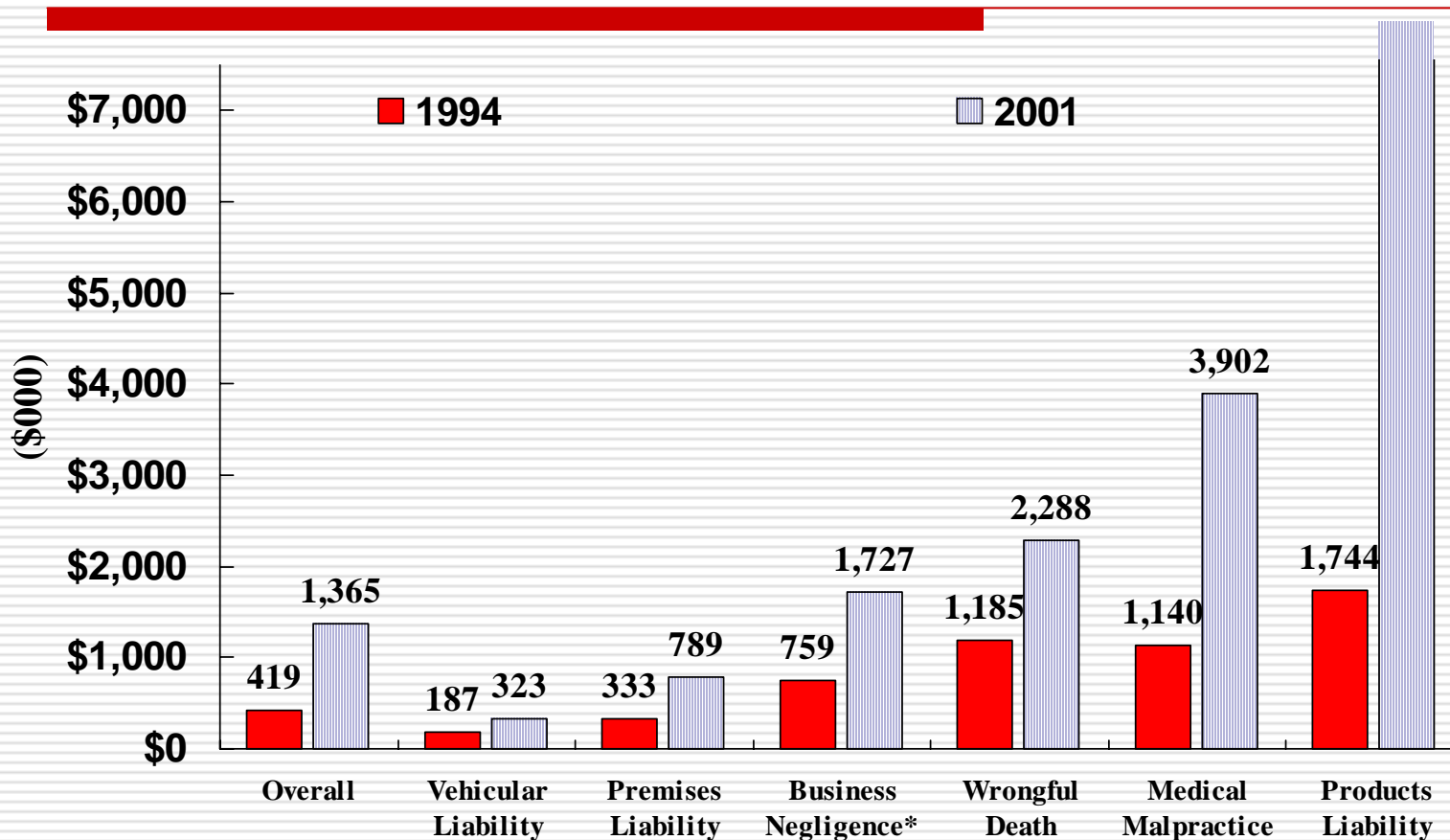
# TORT-ure

- Asbestos
- "Toxic" Mold
- Medical Malpractice
- Construction Defects
- Lead
- Fast/Fattening Foods & Obesity
- Reality TV
- Arsenic Treated Lumber
- Guns
- Genetically Modified Foods (Corn)
- Pharmaceuticals & Medical Devices
- Security exposures (workplace violence, post-9/11 issues)
- Slavery
- What's Next?





# Average Jury Awards 1994 vs. 2001

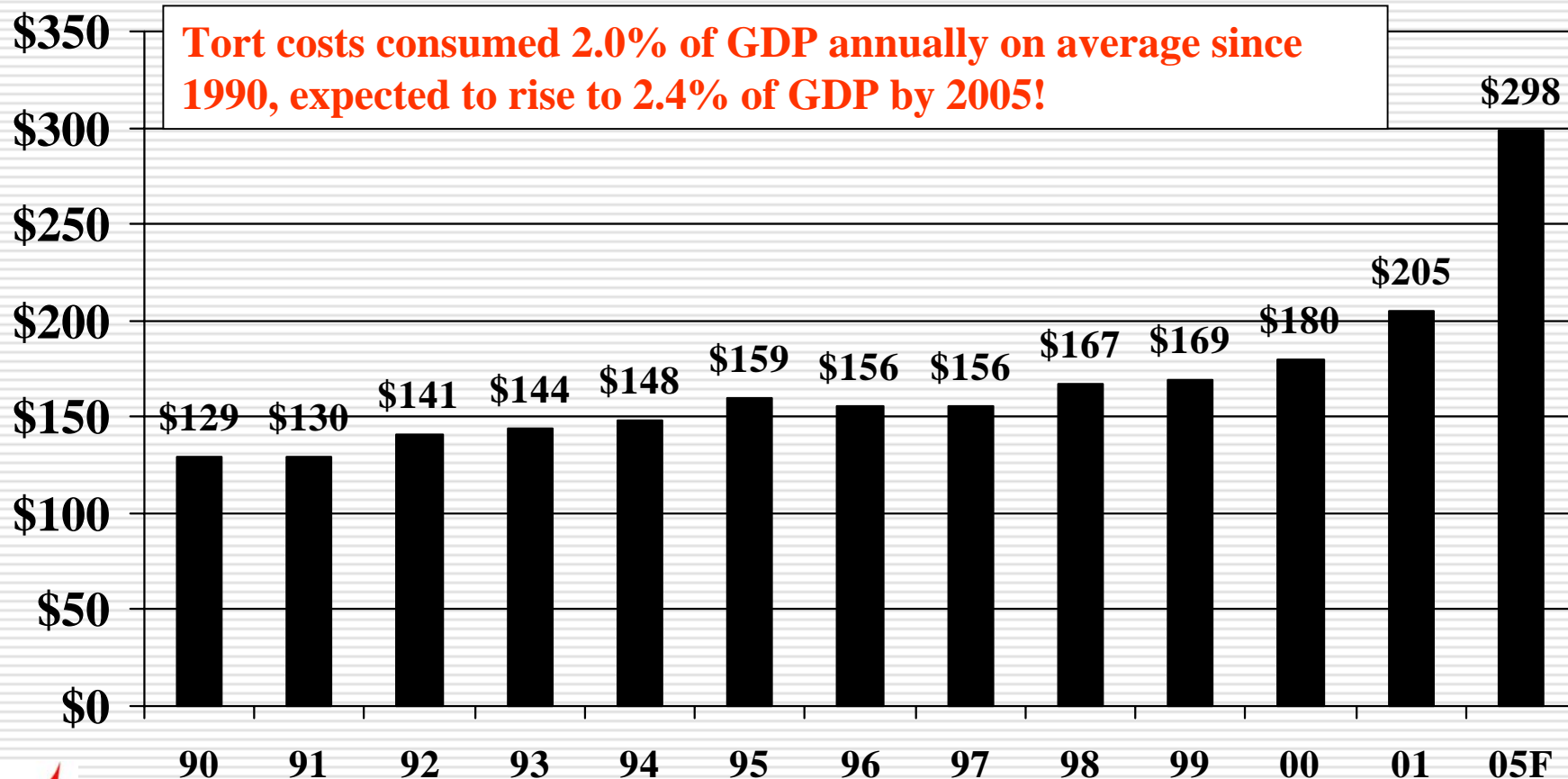


\*Figure is for 2000 (latest available)

Source: Jury Verdict Research; Insurance Information Institute.



# Cost of U.S. Tort System (\$ Billions)



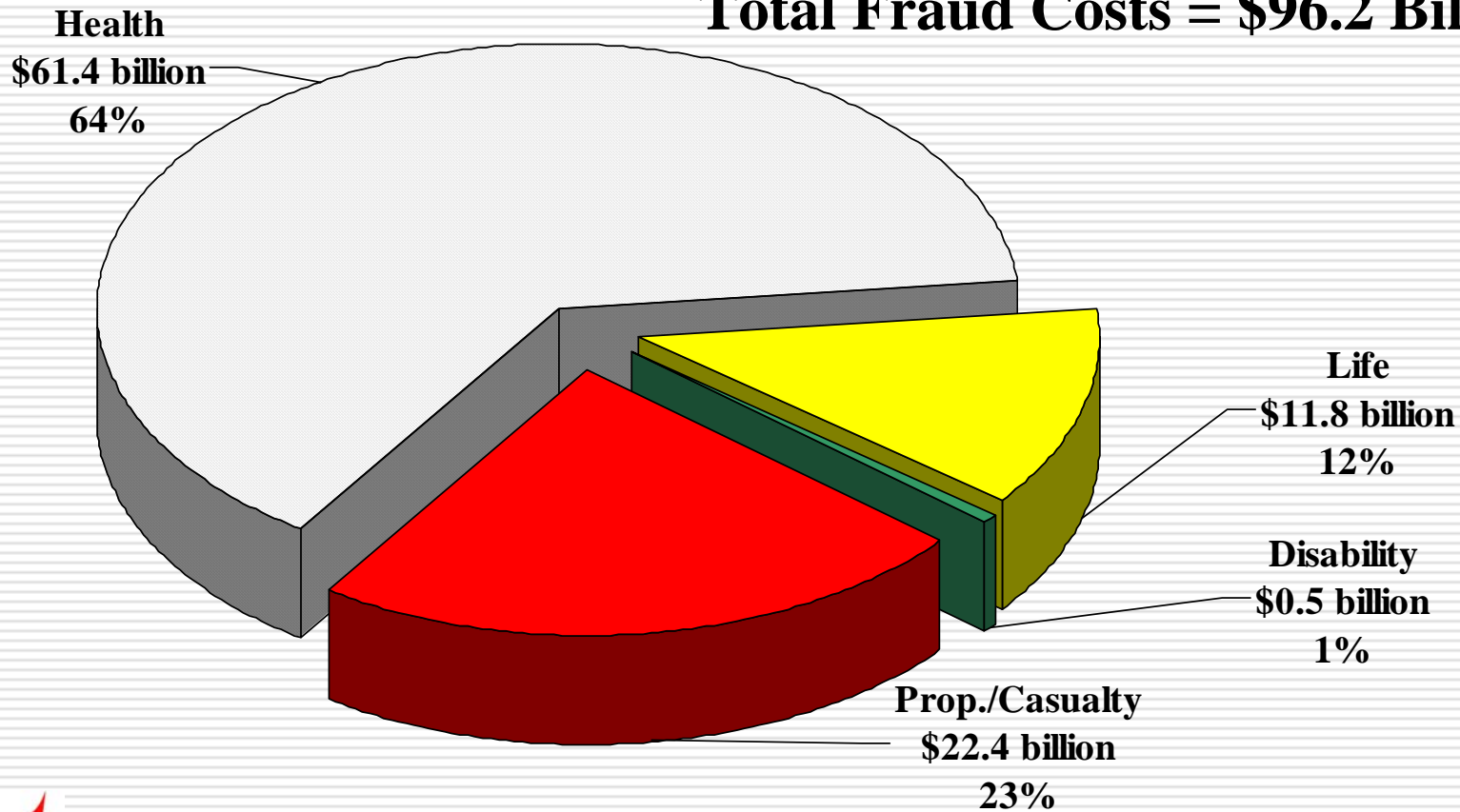
Source: Tillinghast-Towers Perrin. 2005 forecasts from Tillinghast.



# Insurance Fraud in the U.S. Costs Billions!



**Total Fraud Costs = \$96.2 Billion**



Source: Conning & Co.

# Firm Analysis: AIG

---

# Introduction to AIG

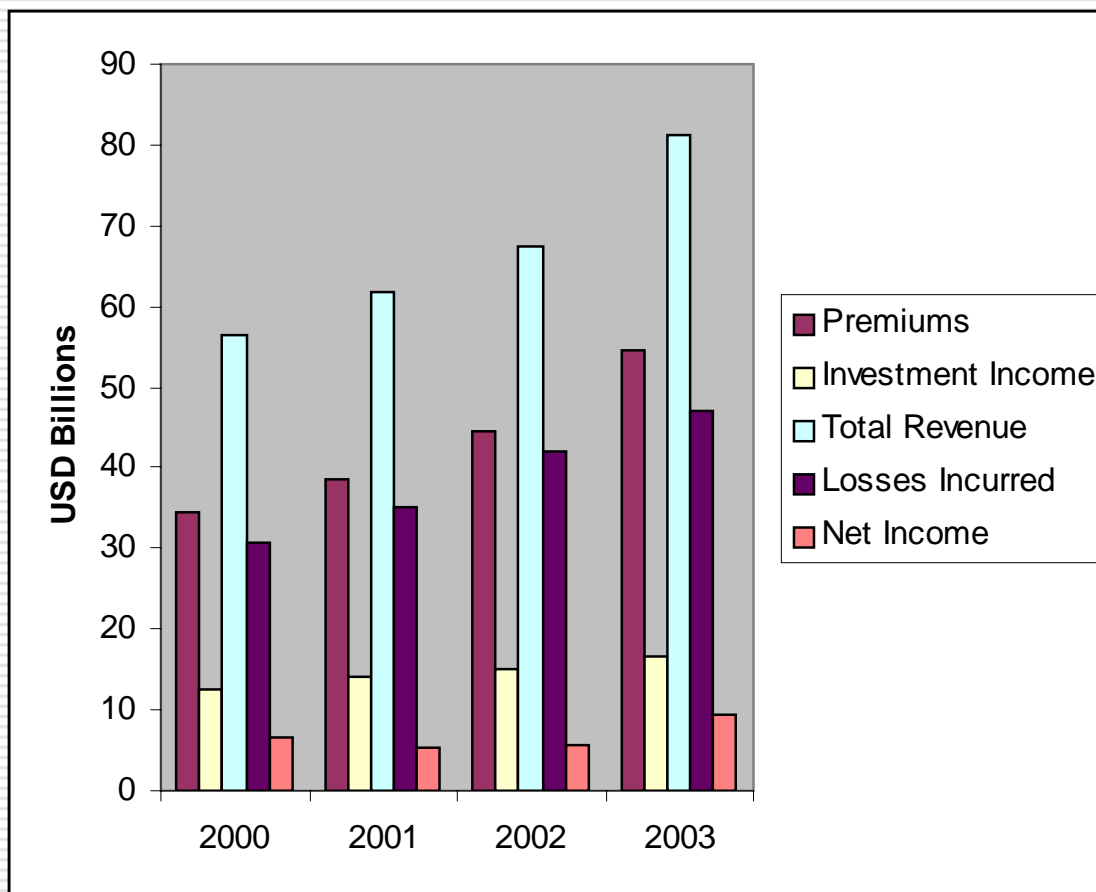
---

# AIG

---

- ❑ International Presence, multiple subsidiary companies
- ❑ Services Commercial, Institutional & Individual Customers
  - Through Worldwide Property-Casualty (P/C) and Life Insurance Networks on any insurer
- ❑ In US – AIG Companies – underwriters of Commercial & Industrial Insurance
- ❑ AIG American General – Life Insurance
- ❑ Other Businesses:
  - Financial Services
    - ❑ Aircraft Leasing, Financial Products, Trading & Market Making
    - ❑ Consumer Finance
  - Retirement Services (AIG SunAmerica)
  - Asset Management (AIG VALIC)

# AIG Performance

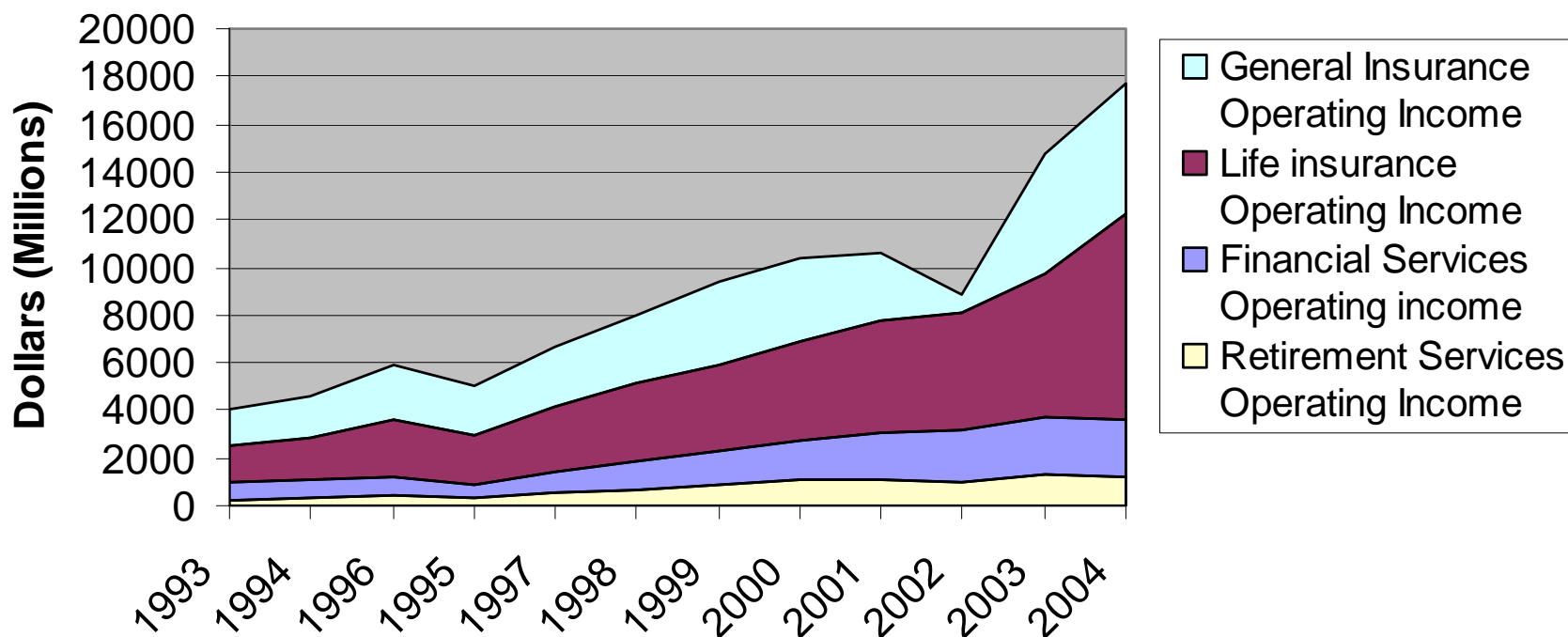


AIG has demonstrated robust growth...



# AIG: 11 Year Performance

## AIG: Operating Income

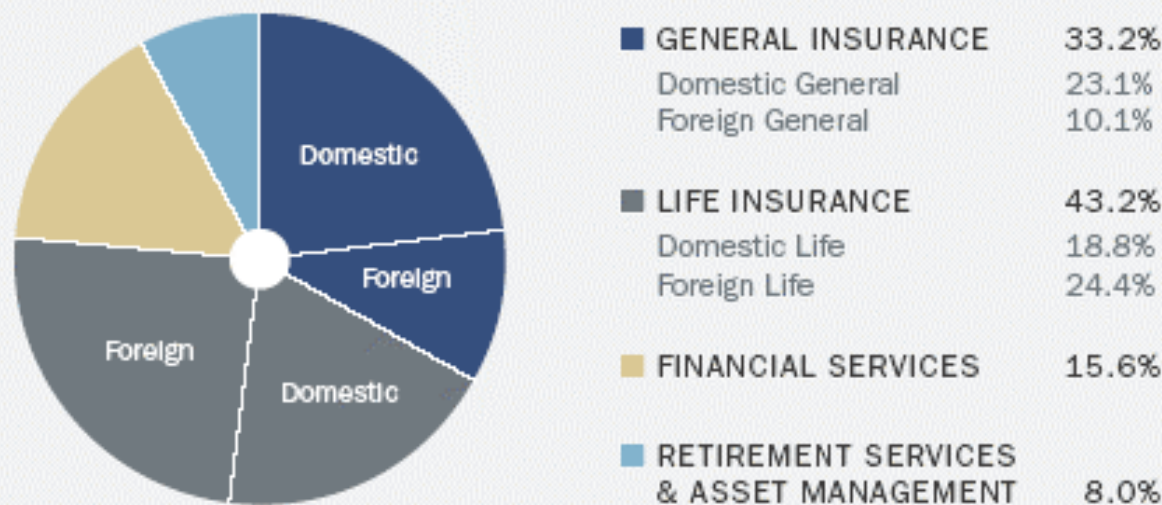


Source – AIG Annual Report



# Operating Income by Segments

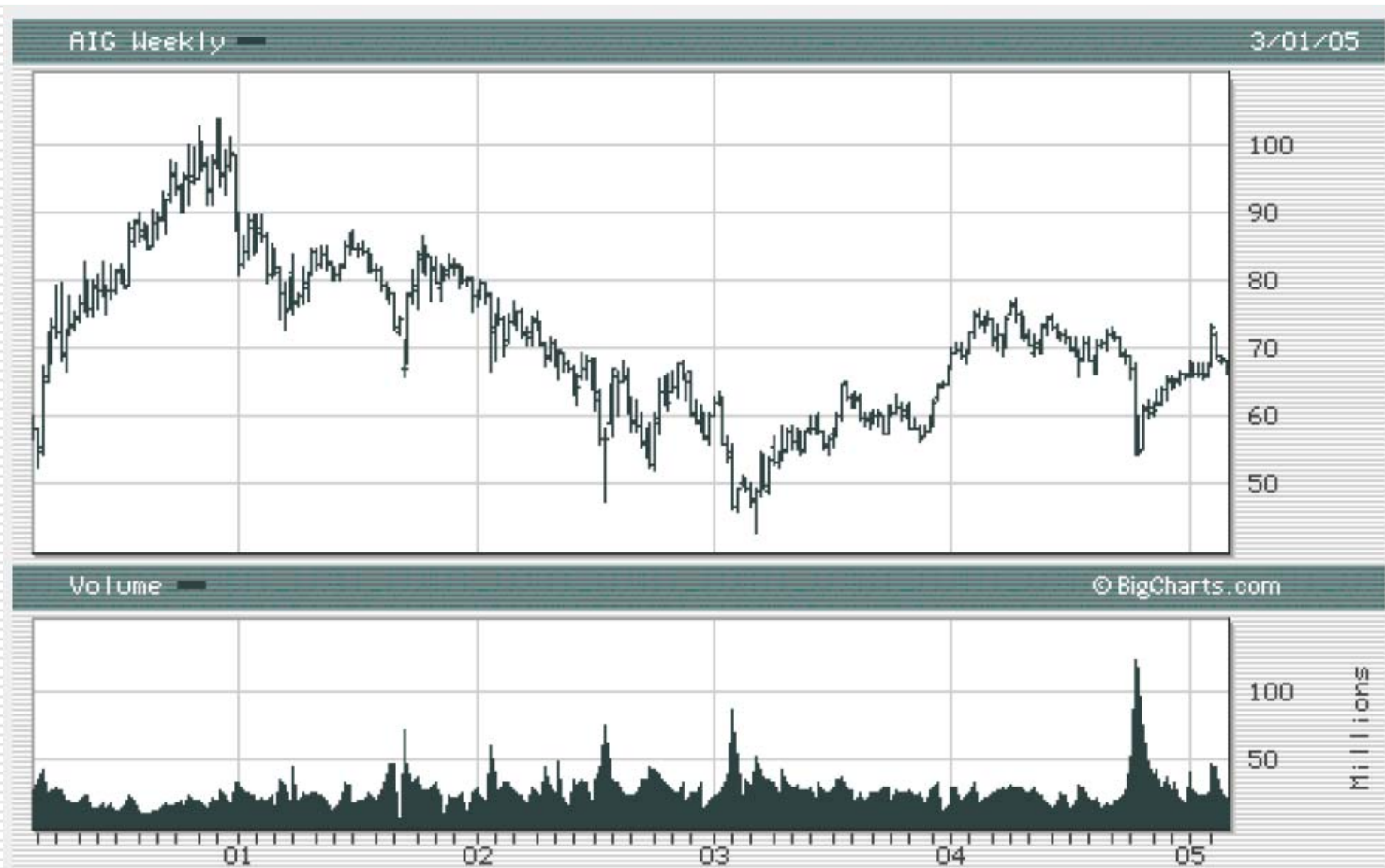
>> 2003 CONSOLIDATED AIG OPERATING INCOME BY MAJOR BUSINESS SEGMENT\*



\* Before realized capital gains (losses), other income (deductions)—net, minority interest, cumulative effect of an accounting change and income taxes.

Source – AIG Annual Report

# AIG 5 Year Stock Performance



# 2003 Assets, Revenue Details

<i>(dollars in millions)</i>	Total	United States and Canada	Other Countries	Percent of Total	
				United States and Canada	Other Countries
<b>General Insurance operations:</b>					
Net premiums earned	\$31,734	\$ 23,269	\$ 8,465	73.3%	26.7%
Underwriting profit	2,220	1,385	835	62.4	37.6
Net investment income	3,022	2,259	763	74.8	25.2
Realized capital gains (losses)	(172)	(40)	(132)	–	–
Operating income	5,070	3,605	1,465	71.1	28.9
Identifiable assets	121,791	87,206	34,585	71.6	28.4
<b>Life Insurance operations:</b>					
GAAP premiums	22,879	5,041	17,838	22.0	78.0
Net investment income	13,640	9,027	4,613	66.2	33.8
Realized capital gains (losses)	(826)	(544)	(282)	–	–
Operating income	6,002	2,420	3,582	40.3	59.7
Identifiable assets	432,633	280,823	151,810	64.9	35.1
<b>Financial Services operations:</b>					
Commissions, transaction and other fees	7,565	3,525	4,040	46.6	53.4
Operating income	2,464	672	1,792	27.3	72.7
Identifiable assets	137,299	121,894	15,405	88.8	11.2
<b>Retirement Services &amp; Asset Management operations:</b>					
Commissions and other fees	3,896	3,209	687	82.4	17.6
Operating income	1,271	1,108	163	87.2	12.8
Identifiable assets	4,254	2,752	1,502	64.7	35.3
<b>Other realized capital gains (losses)</b>	(435)	(431)	(4)	–	–
<b>Income before income taxes, minority interest and cumulative effect of an accounting change</b>	13,908	6,757	7,151	48.6	51.4
<b>Revenues</b>	81,303	45,315	35,988	55.7	44.3
<b>Total assets</b>	678,346	473,571	204,775	69.8	30.2

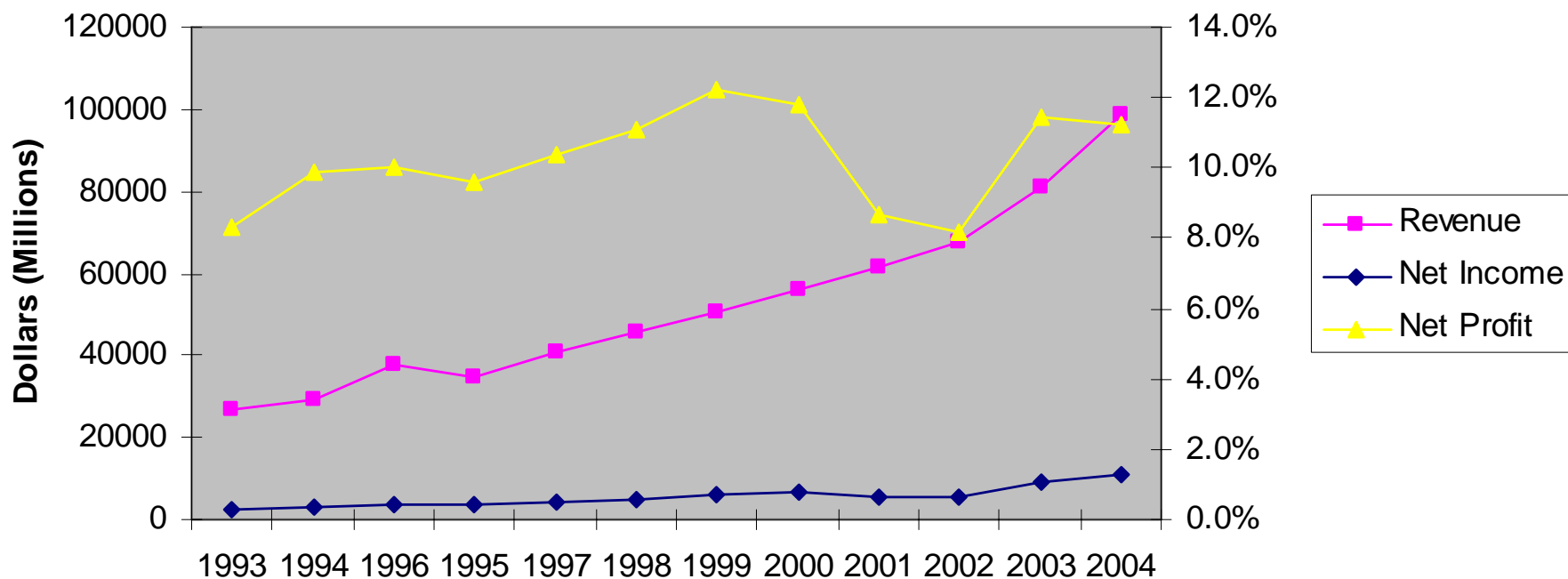
Opportunity to Grow Globally

Source – AIG Annual Report

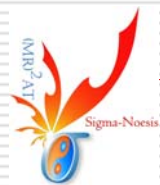


# AIG Performance

## AIG: Revenue & Profits



Source – AIG Annual Report



# AIG vs. Industry

---

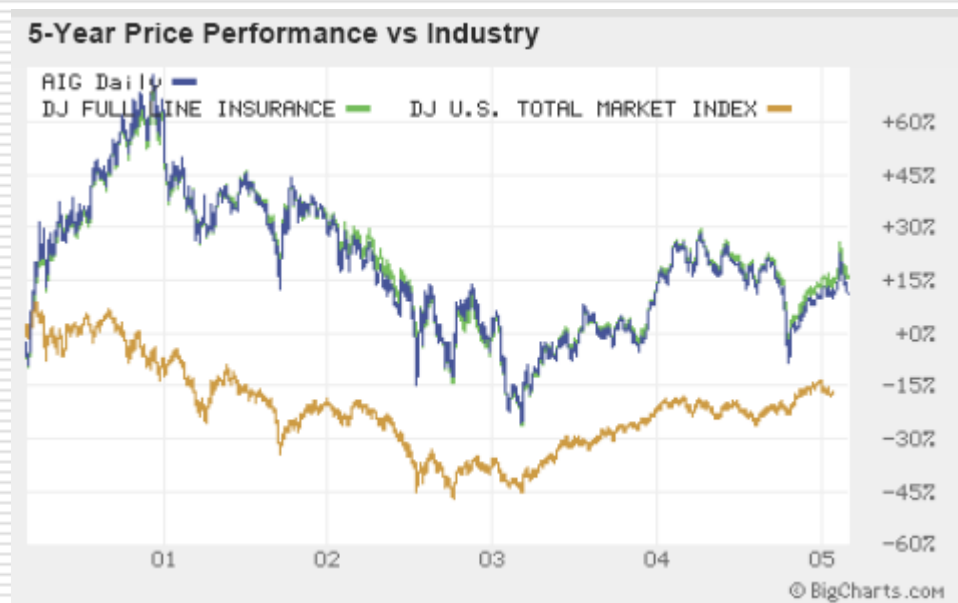
- Dow Jones Insurance Industry Index
  - INF
  - Tracks 7 Companies

Symbol	Company Name
<a href="#">AIG</a>	American International Group, Inc.
<a href="#">AOC</a>	Aon Corporation
<a href="#">CNA</a>	CNA Financial Corp.
<a href="#">HIG</a>	Hartford Finl Svcs Group Inc
<a href="#">HMN</a>	Horace Mann Educators Corporation
<a href="#">SFG</a>	Stancorp Finl Group Inc
<a href="#">UTR</a>	Unitrin Inc

# AIG vs. DJ Insurance Index (INF)



5 Year INF Index



AIG – INF – DJIA

Percentage Change Chart 5 Year

AIG dominates the INF index.



# AIG vs Industry

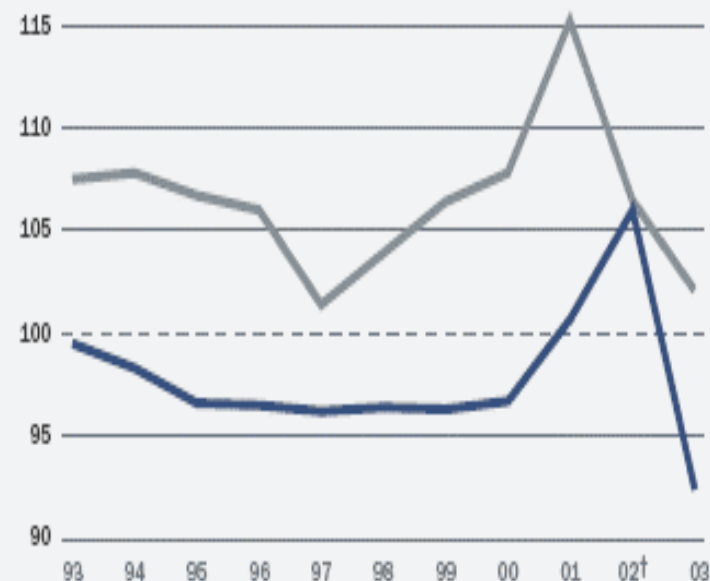
## >> GENERAL INSURANCE COMBINED LOSS AND EXPENSE RATIO

(after dividends to policyholders)

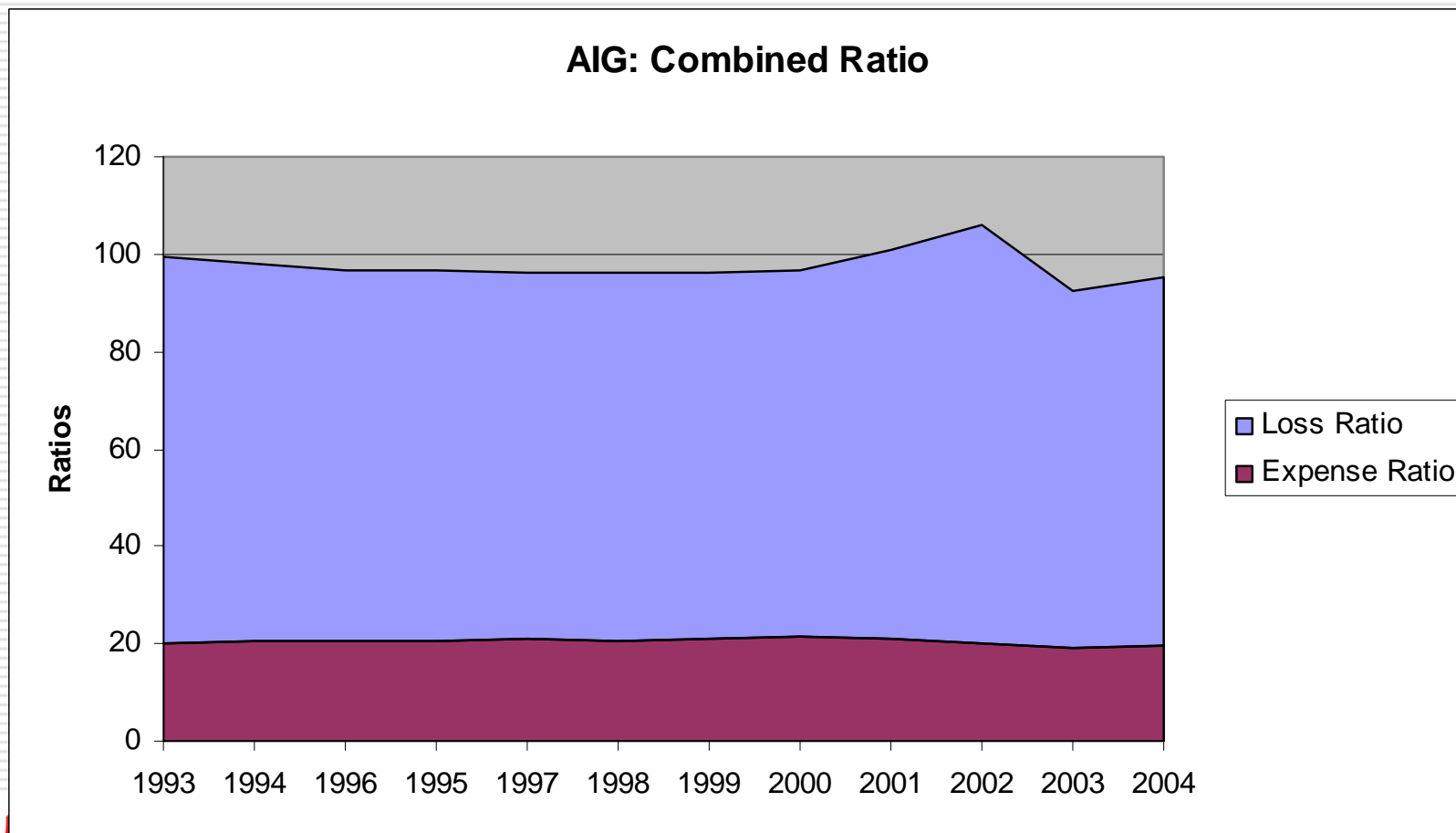
— AIG  
— Industry\*

\* Industry represents U.S. stock companies. 2003 estimated.  
Industry sources: Fox-Pitt, Kelton Inc. and Best's Aggregates & Averages.  
† 2002 AIG combined ratio includes loss reserve charge of \$2.8 billion.

A combined ratio of less than 100 reflects an underwriting profit.



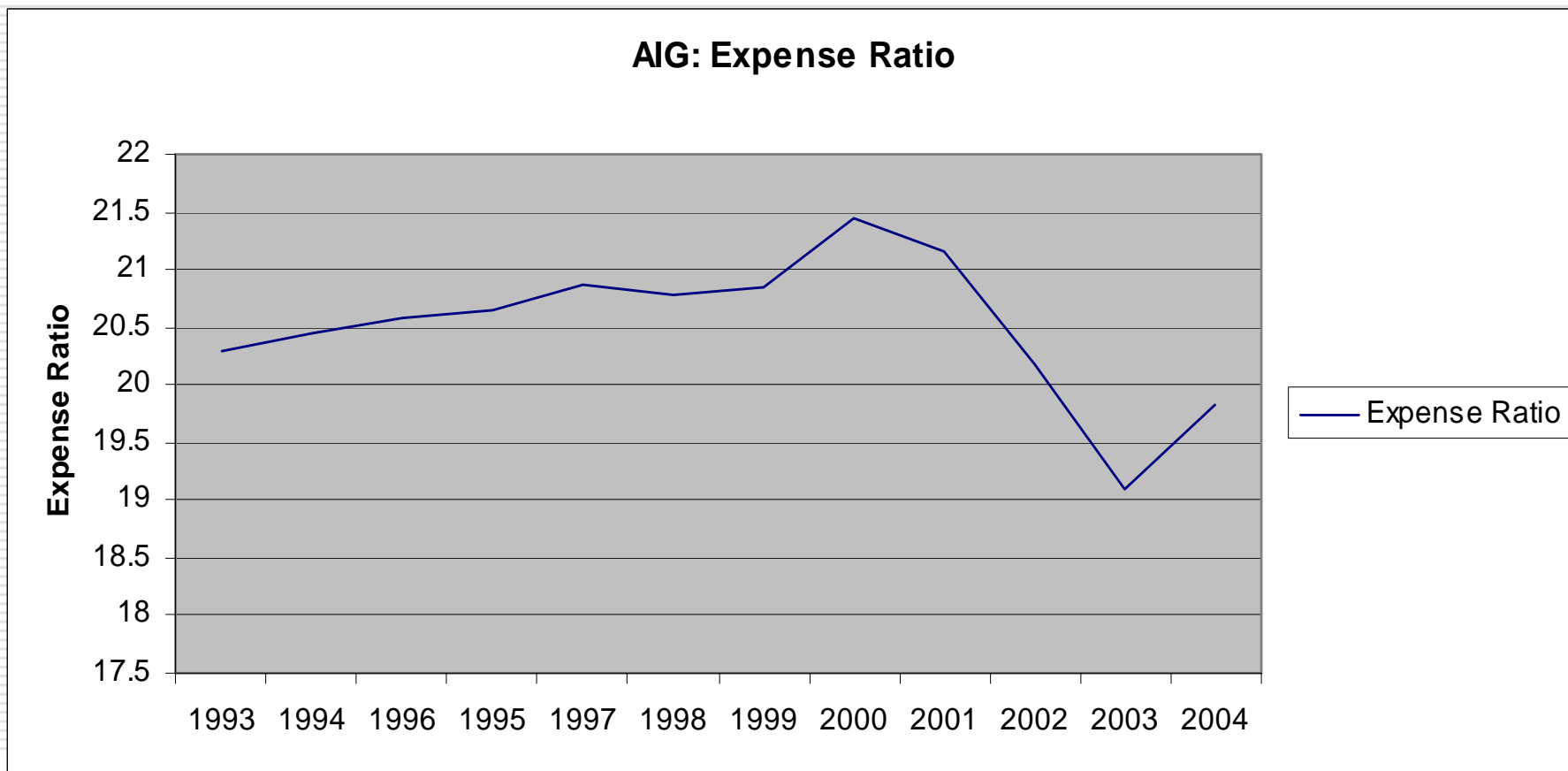
# AIG: Combined Ratio



Source – AIG Annual Report

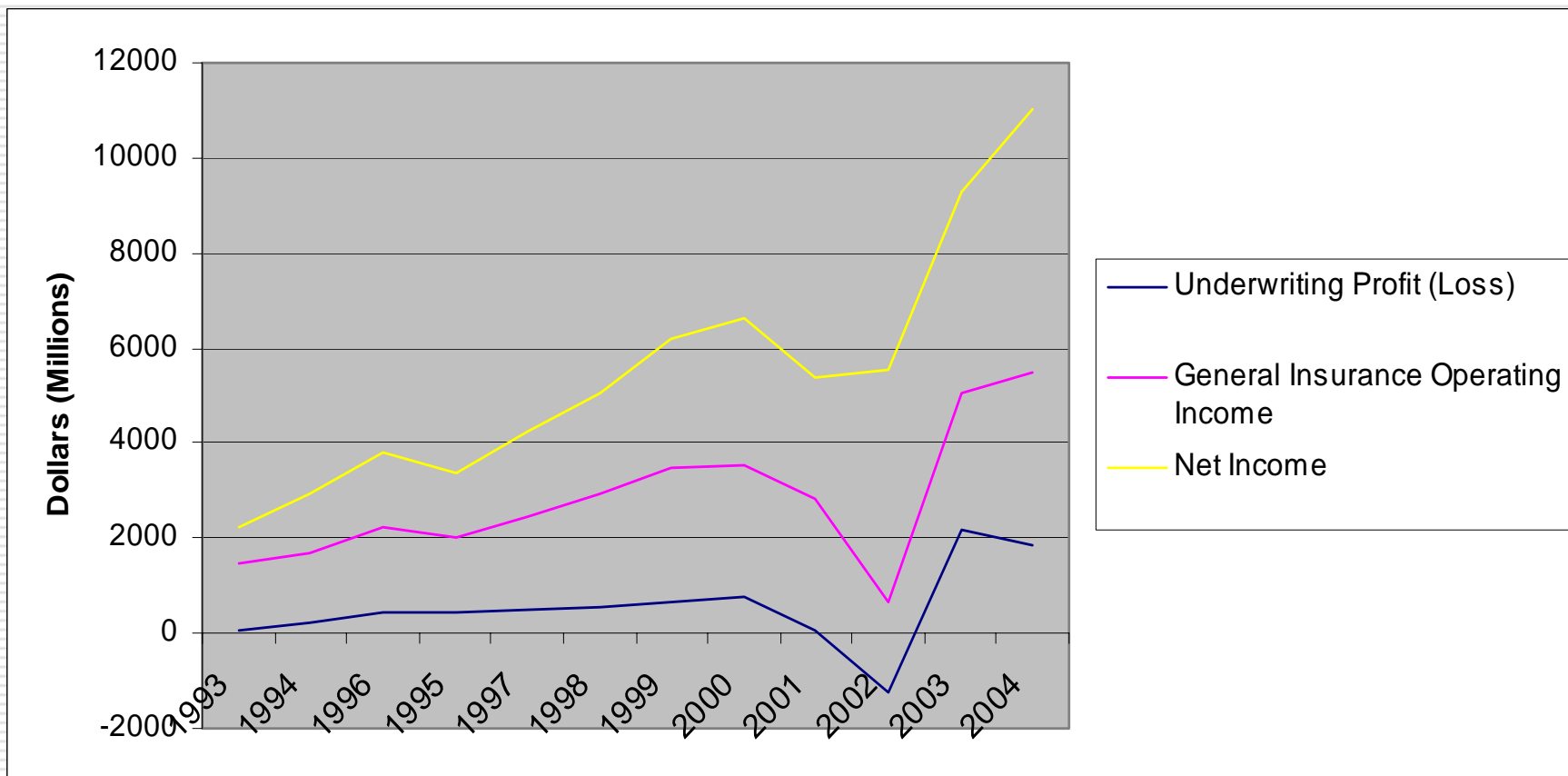


# AIG: Expense Ratio



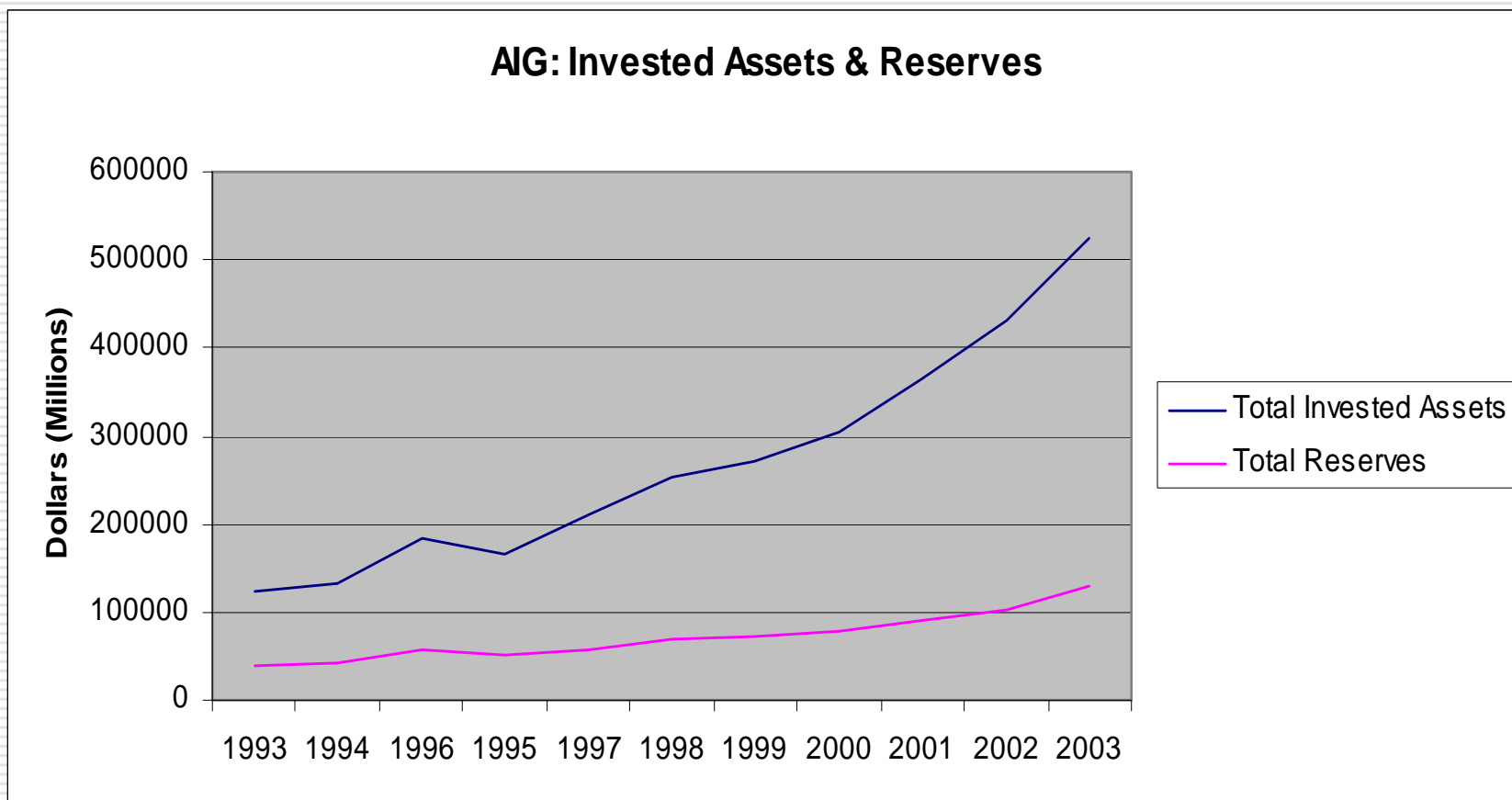
Source – AIG Annual Report

# AIG: Underwriting Affects on Profits



Source – AIG Annual Report

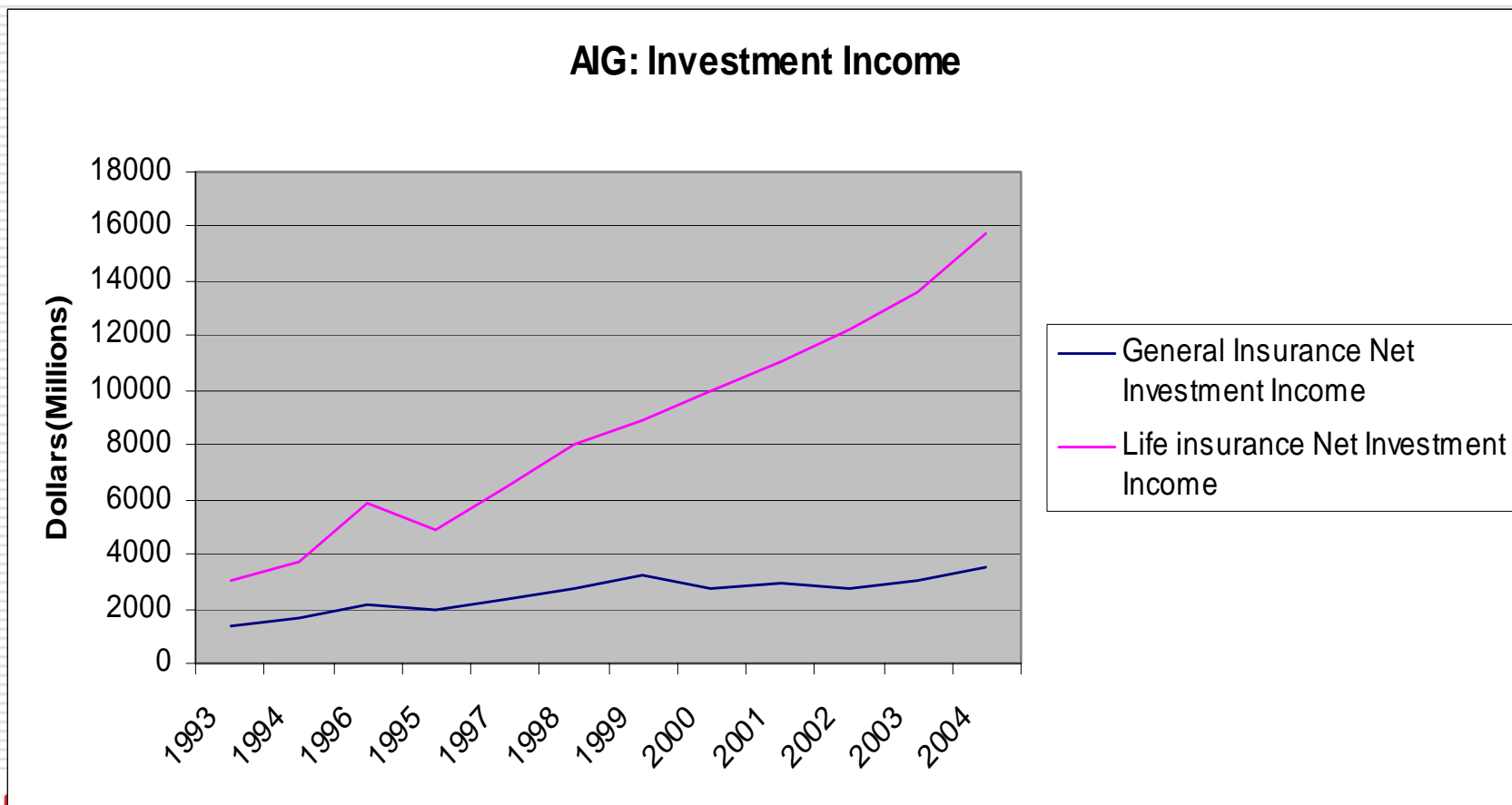
# AIG: Assets & Reserves



Source – AIG Annual Report

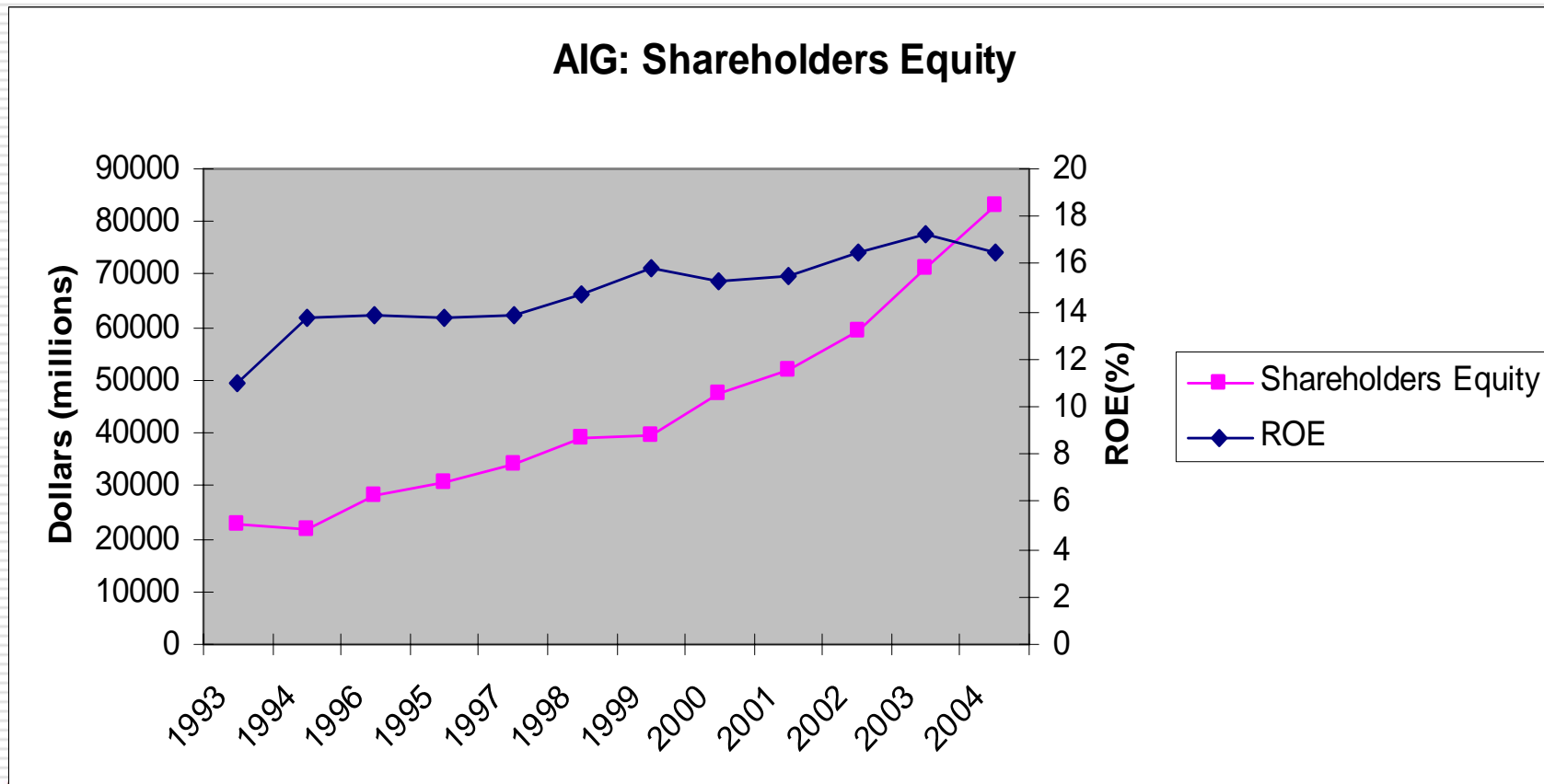


# AIG: Investment Income



Source – AIG Annual Report

# AIG: Return on Equity



Source – AIG Annual Report



# Strengths

---

- Global Presence
  - Founded in 1919 in Shanghai
  - Operations in 130 Countries
  - Market share in individual countries is often very small compared to local competitors
    - Ample opportunity for continued growth
- Most extensive worldwide property-casualty and life insurance networks of any insurer.
  - Agreement with the People's Insurance Company of China (PICC) to develop the market for accident and health products in China
  - Largest foreign life insurer in China
- Underwriting results and tight expense control (combined ratio) have consistently outperformed the industry.
  - Combined Ratio of 92.43
  - Operating efficiency
    - General Insurance expense ratio further improved to 19.10 from 20.19 a year ago.
- World's most profitable insurance organization
- Investments in technology

# Weaknesses

---

- Large complex entity
  - 53 Direct Subsidiaries/204 Total Subsidiaries
- Regulatory Scrutiny/investigations
  - Disclosing less than many regulators would like
  - Lacking tolerance for aggressive regulatory or litigant attacks
- Poor claims-payment reputation
  - Prefers to contest claims and litigate
- A large proportion of business is life insurance,
  - Lacks an Competitive Advantage
  - Depends largely on investment-market performance for earnings.
- Demands excess capital be set aside in low-risk, low return manner
  - Constraints return on capital
- Insurance is commodity-like
  - vulnerable to price-cutting



## Hank Greenberg vs. the Legal System

AIG's CEO is fuming over lawyers' fees, injury awards, and asbestos suits. Saying "you can't have a riskless society," he's seeking change

# AIG Strategy...

- Practices diversification & expansion
  - Example - Financial Services, Aircraft Leasing
    - Helps to protect & cushions from exposure to pure insurance markets

## LIMITED DOWNSIDE

Why is GE so eager to lend a hand? It makes money off the well-collateralized loans and wants to keep as wide a customer base as possible. The Fairfield (Conn.)-based giant owns about 1,300 aircraft, a massive aircraft-engine unit, and has more than \$29 billion in loans and leases to airlines. It's more exposed than rivals like International Lease Finance Corp., a unit of American International Group, which has 88% of its 676-plane fleet leased to airlines outside the U.S. But GE also demands so much collateral and places so many conditions on assistance that analysts believe its downside is

Despite the challenges the airline industry has been facing, aircraft lessor ILFC performed well in a difficult environment. So has Santiago-based LanChile, South America's most profitable airline and a premier ILFC client. Expanding the number of aircraft on lease to existing clients, such as LanChile, is a key ILFC growth strategy. Joe Hermosillo oversees the LanChile account and has worked closely with the air carrier to place seven Boeing 767-300ER aircraft in the LanChile fleet. These aircraft serve routes to Europe and the United States, as well as Ecuador and Peru—destinations that have played an important role in LanChile's growth and success.



# Forecasts, Projections & Recommendations

---

# Improving Critical Drivers...

---

- Use of Technology
  - Risk Assessment
    - Controversies
      - DNA/Genome Analysis for Life & Health Insurance
    - Improved claims-management process
- Improving returns on Asset Management...
- Assessing Weather & Climate Risks...

# Claims Management

---

"Many insurance companies are struggling with replacing large legacy systems that use separate platforms for claims, underwriting, reserves, billing, etc., using outdated technology," says W. Michael Flaharty, principal, claims consulting, at Coopers & Lybrand in New York. "Many of these systems will

# Beyond claims management: Avoiding Worker's Compensation...

---

But the cost of claims is not the only statistic measured by predictive models.

As part of its efforts to create greater claims management efficiencies, AIG Claim Services Inc., a member company of American International Group Inc., based in New York, has begun using a concept it refers to as "data profiling" to track behavioral factors affecting workers' comp claims.

Using a database containing information from the AIGCS customer base, AIG information systems and outside partners, when appropriate, the company analyzes data regarding employees' rate of absenteeism, previous workers' comp or disability claims, likelihood of returning to work, job description, etc. to determine what type of support the employee may need to come back to work.

# Recommendations

---

- Spreading risk between
  - Insureds, Insurers, Re-insurers & the State (Appendix A)
- Global Expansion
  - With Partners
  - AIG is clearly demonstrated its partnership capabilities

# Role of the State (Principle #7)

---

- Any democratic state has the self-imposed constitutional responsibility of ensuring public safety and order. If it is unable to fulfill this duty in its entirety, it must at least contribute to the ensuing costs
- Coverage bottlenecks can be eased by the state as a member of the risk community. This increases the overall capacity available, which in turn facilitates key economic activities, such as granting mortgages.
- Attacks, may only get bigger, the bigger the risk community, the more effectively the economic consequences of the next mega attack will be cushioned

# Forecasts & Projections

## □ Major Concern: Scandals & Probes

### Regulators Probe An AIG Pact With General Re

By IAN MCDONALD  
Staff Reporter of THE WALL STREET JOURNAL  
February 18, 2005; Page B2

Regulators are scrutinizing a deal struck between **American International Group Inc.** and **Berkshire Hathaway Corp.**'s General Reinsurance unit in late 2000 or early 2001 to determine if it was aimed at making the giant insurer's reserves look healthier than they were, according to people familiar with the matter.

### AIG Now Faces An SEC Probe Over Its Books

By THEO FRANCIS and JONATHAN WEIL  
Staff Reporters of THE WALL STREET JOURNAL  
February 15, 2005; Page C1

**American International Group Inc.**, fresh off settlements with the Justice Department and the Securities and Exchange Commission for its role in allegedly helping other companies manipulate their earnings with complicated financial products, is now under scrutiny for its own possible use of such earnings-management techniques.

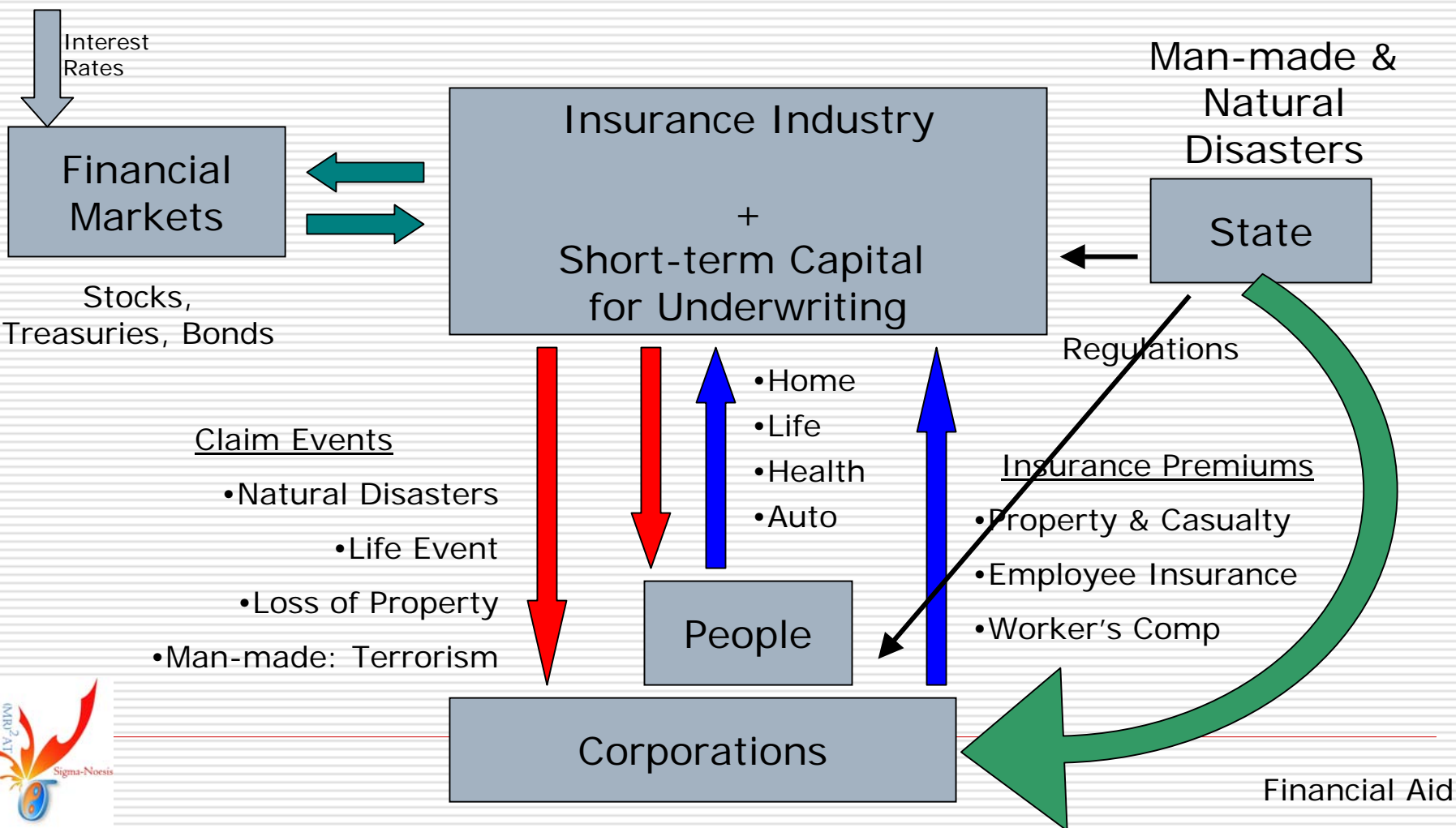
AIG is seriously on the outs with both law enforcement agencies. The trouble seems to have begun on Sept. 21, when the SEC informed AIG that it may bring civil securities-fraud charges against it for allegedly helping PNC Financial Services Group ([PNC](#)) hide underperforming loans in 2001. Eight days later, the Justice Dept. told AIG that it is under criminal investigation for the same deals. Things got noticeably worse on Oct. 4, when both Justice and the SEC warned AIG that it may have misled investors when it issued three press releases that allegedly failed to reveal the full scope of the probes.

# Economic Environment

---



# The Industry Economic Model



# Major Environment Changes: 1996-2000 vs. 2001-2005

---

- GDP measurement changes 2003, to reduce large swings caused by catastrophes such as 9/11
- Rise of Terrorism
- Global Warming, Increased Weather Disasters?
  - Is there something to it?
- Aging Population
  - Health care for elderly, this is a GLOBAL problem
  - Social Security Privatization
- US\$ Devaluation!
- Corporate Governance
  - Accounting & Financial Scandals
    - Fannie Mae, MCI, AIG, Mutual Fund Firms
  - SOX, More accountability
- Declining Interest Rates

# Macro Impact

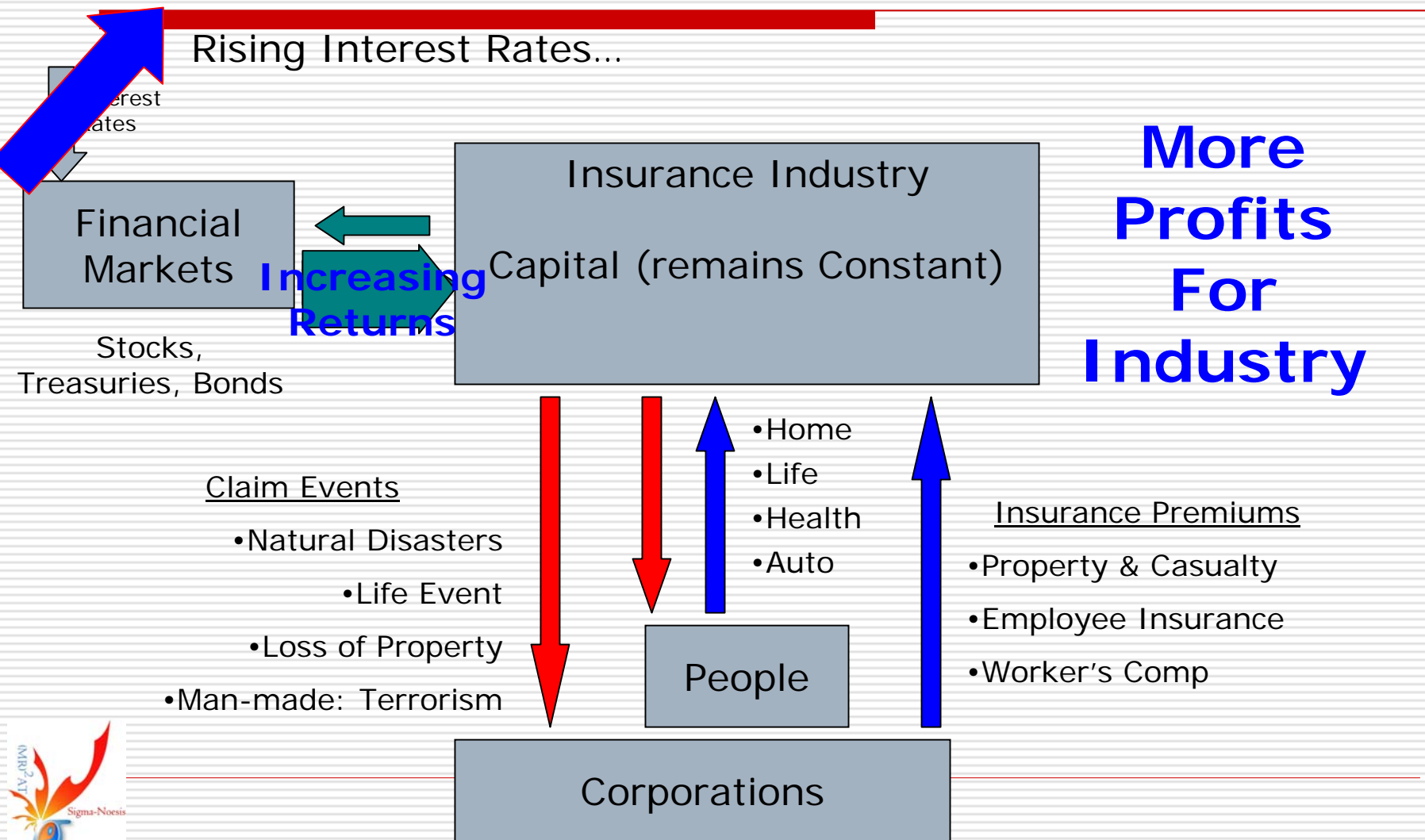
---

# Potential Macro Changes

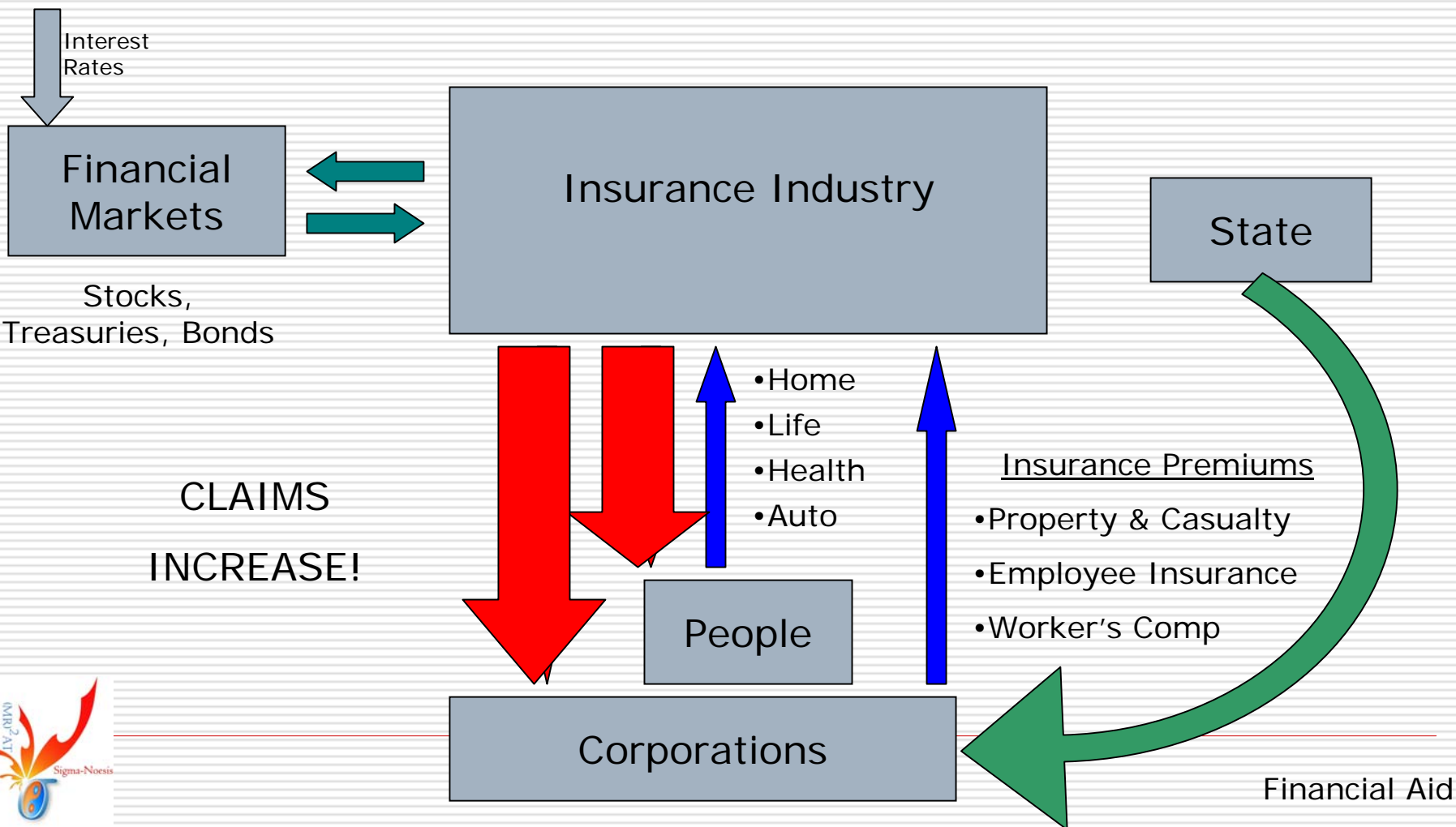
---

- Rising interest rates...
  - Asset Management
  
- Currency Exchange Rates
  - Euro vs. USD
  - China's Currency Devaluation
  
- Catastrophic events...

# Interest Rates & Insurance Model



# Catastrophic event



# Wrap Up

---

# Appendix A

---

The role of the State & Insurance  
Industry



# Country Specific Information

---

- ❑ French Pool GAREAT- started on 1 January 2002, with unlimited state guarantee in excess of the capacity provided by the domestic insurance and international reinsurance markets.
- ❑ Germany's Extremus Versicherungs-AG, started on 1 November 2002, with a government guarantee of €10 billion in excess of €3 billion shared by the German insurance and the international reinsurance community, to expire in 2005.
- ❑ USA: Enactment of the Terrorism Risk Insurance Act (TRIA) on 26 November - a cost-sharing arrangement between the US insurance industry and the federal government for losses related to certified acts of terrorism.
- ❑ Spain: The Consorcio de Compensacion de Seguros (CCS) is a state insurance facility which guarantees cover for "extraordinary" risks such as earthquake, volcanoes, terrorism etc.
- ❑ United Kingdom: Pool Re (insurance companies need to be members)

# Back Up Slides

---

AIG Facts & Figures

# AIG Worldwide

---

# AIG Facts

---

- ❑ 86,000 Employees
- ❑ 50 Million Customers
- ❑ 628,000 Sales Representatives
- ❑ 130 Countries & Jurisdictions

# Source BEA: GDP & Insurance Industry

---

## How are insurance services measured in GDP?

In the 2003 comprehensive revision of the national income and product accounts, BEA adopted a new measure of insurance services. The measure of insurance that is included in GDP is an estimate of the value of the services provided by the insurance company to its policyholders. Insurance companies provide financial protection to policyholders through the pooling of risk, and they provide financial intermediation services through the investment of reserves that are held to help cover extraordinary losses. After accounting for investment income, insurance companies set premiums to cover the expected costs of providing the services, of settling claims, of maintaining reserves against future claims, and of purchasing reinsurance.

Therefore, services of the property-casualty insurance industry are measured as direct premiums earned plus “premium supplements” -- that is, the expected investment income earned from the investment of reserves that are directly attributable to policyholders because of prepayment of premiums or accrual of benefits -- minus normal losses incurred and dividends paid to policyholders. The normal losses are calculated on the basis of historical experience. Because the measurement of insurance services now uses normal losses rather than actual losses, the measure no longer exhibits large swings when disasters take place. Additional information is available from the following articles:

## How is GDP affected by a disaster?

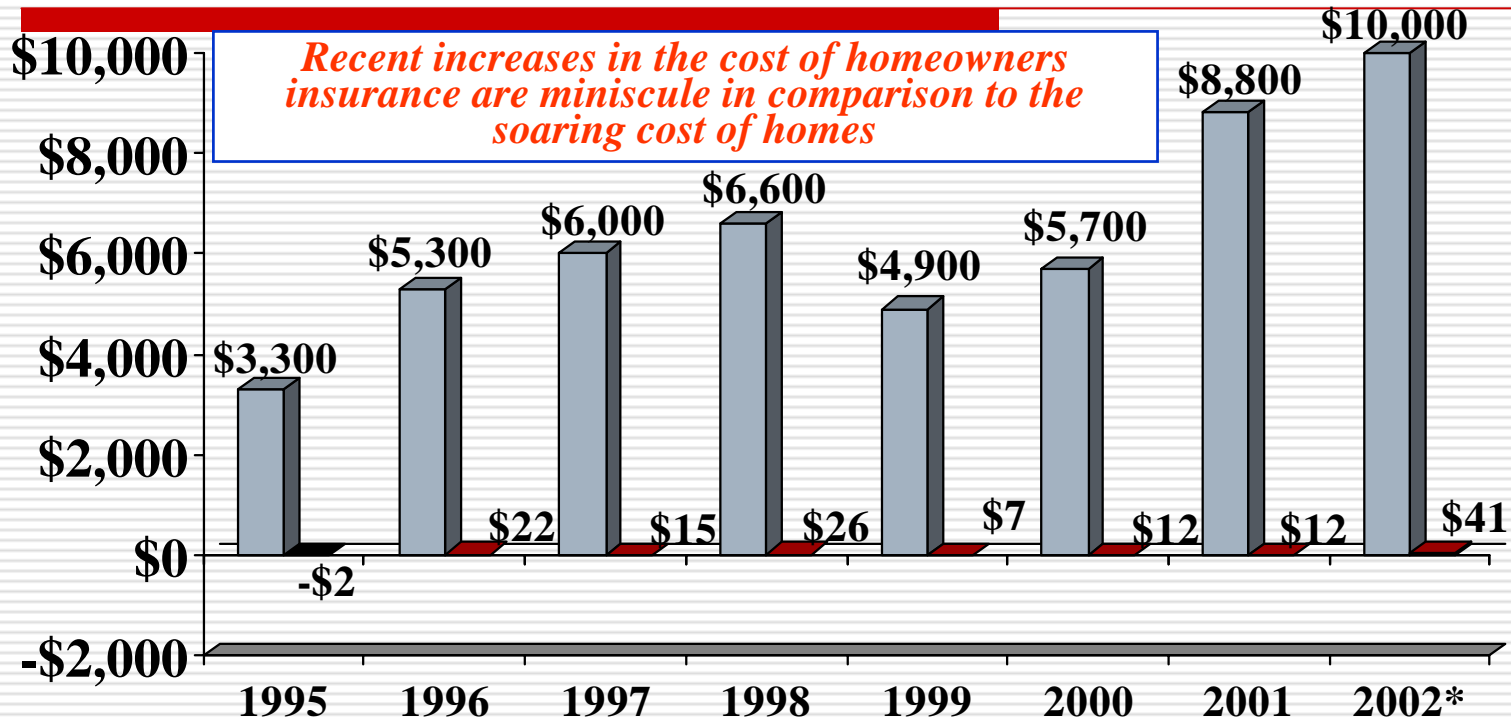
GDP is a measure of the Nation's *current* production of goods and services; as such, it is not directly affected by the loss of property (structures and equipment) produced in previous periods. GDP may be affected indirectly by the actions that consumers, businesses, and governments take in response to disruptions in production or to the loss of property, but these responses are not amenable to precise quantification; moreover, the responses may be spread out over a long period of time. For example: Rebuilding activity, which may occur over many months following a disaster, will typically be reflected in the regular source data used to estimate residential and nonresidential investment. There is no way to disentangle the disaster-related rebuilding from other construction activity.

Tourism and other types of consumer spending may be canceled or postponed in the face of a disaster; whether canceled or merely postponed, the effects will be embedded in the source data that are used to estimate personal consumption expenditures. Again, there is no way to disentangle disaster-related spending from other consumer spending.

As a measure of the Nation's current production of goods and services, GDP includes the value of insurance services produced for policyholders; under a new methodology adopted in the 2003 comprehensive revision, the value of insurance services is not directly affected by the payment of benefits in the wake of a disaster. (See [How are insurance services measured in GDP?](#))



# Change in Cost of Homes vs. Change in Cost of Homeowners Insurance



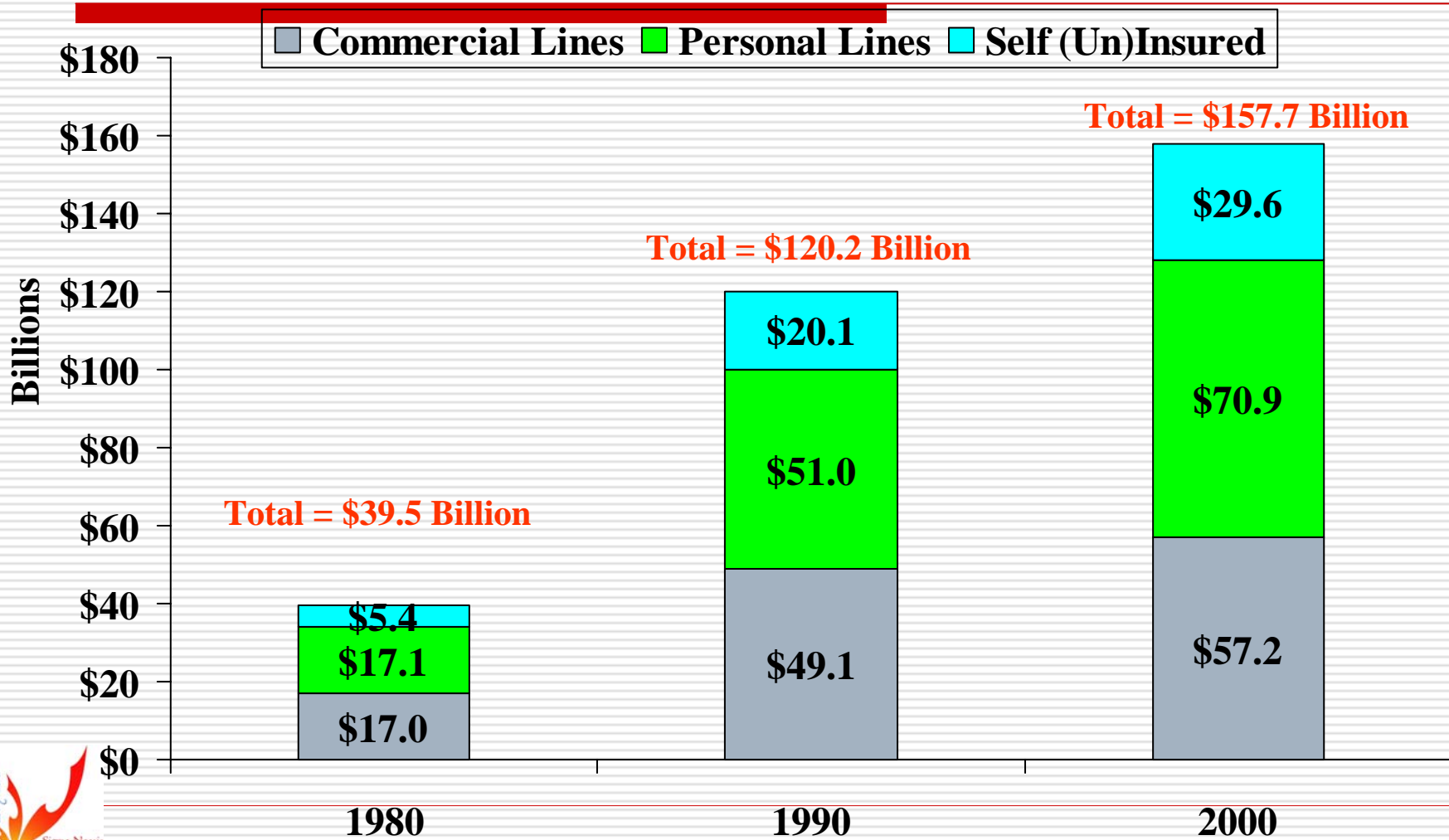
Change in Cost of Median Existing Home  
 Change in Average Homeowners Insurance Expenditure



\*August 2002

Source: Insurance Info. Inst. calculations based on data from Natl. Association of Realtors, NAIC.

# Personal, Commercial & Self (Un) Insured Tort Costs\*

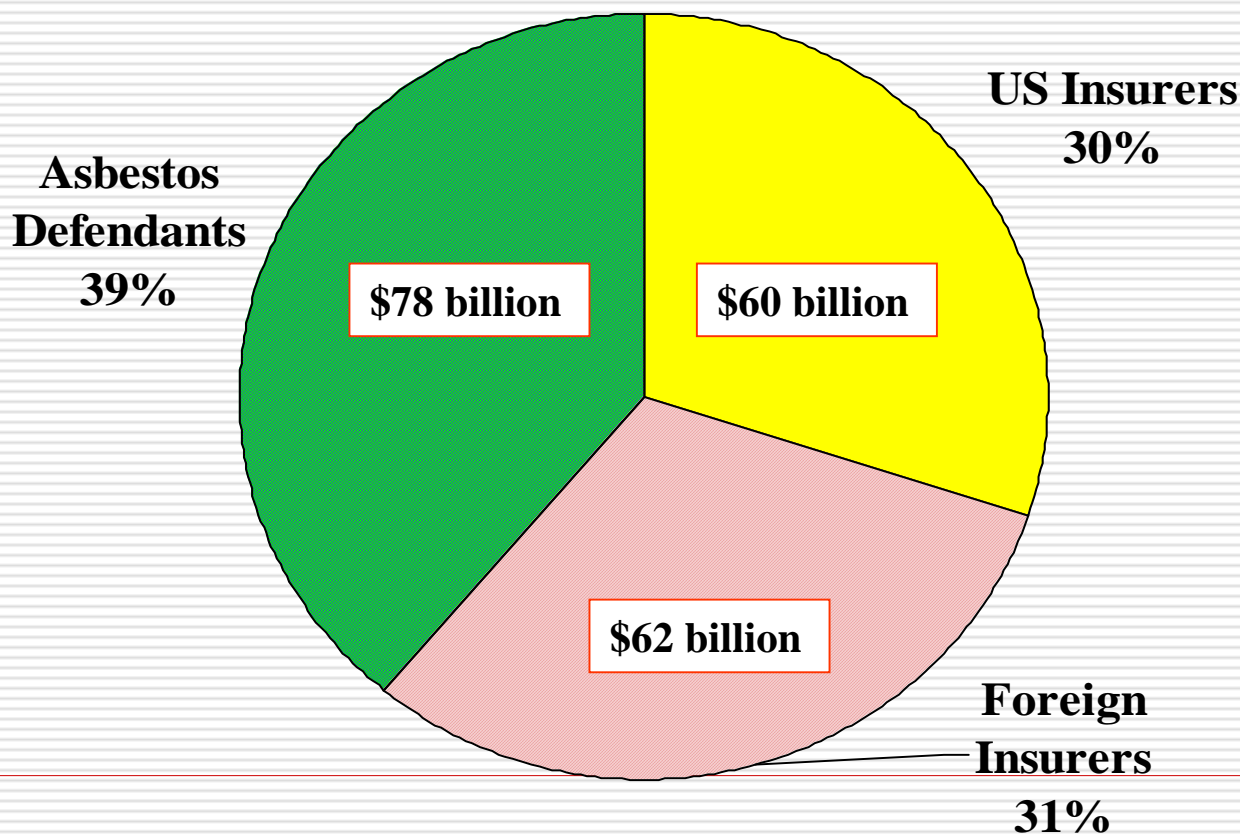


\*Excludes medical malpractice  
 Source: Tillinghast-Towers Perrin



# Who Will Pay for the US Asbestos Mess?

**Estimated Total US Settlements & Expenses = \$200 billion**



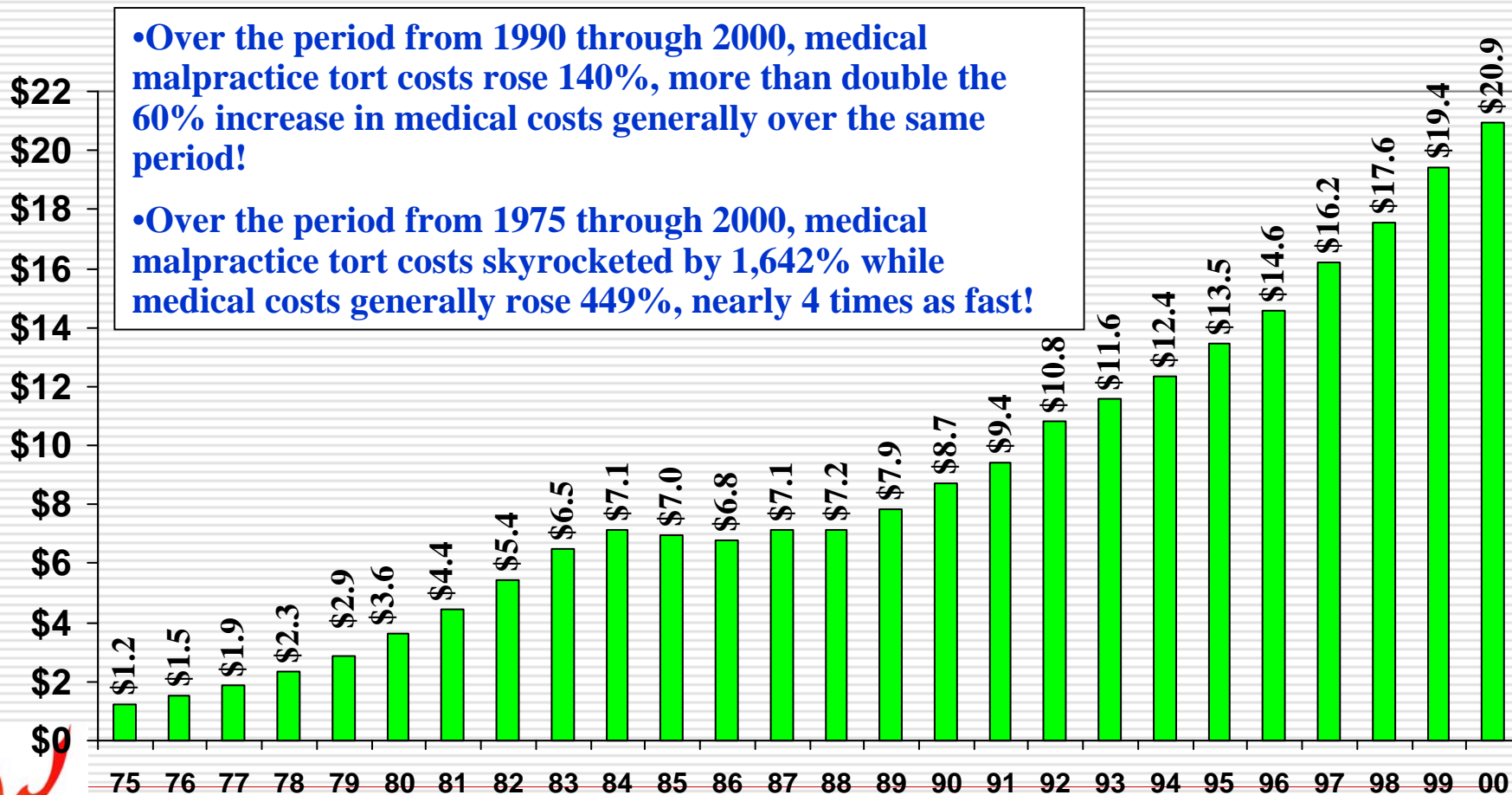
Source: Tillinghast-Towers Perrin; Insurance Information Institute





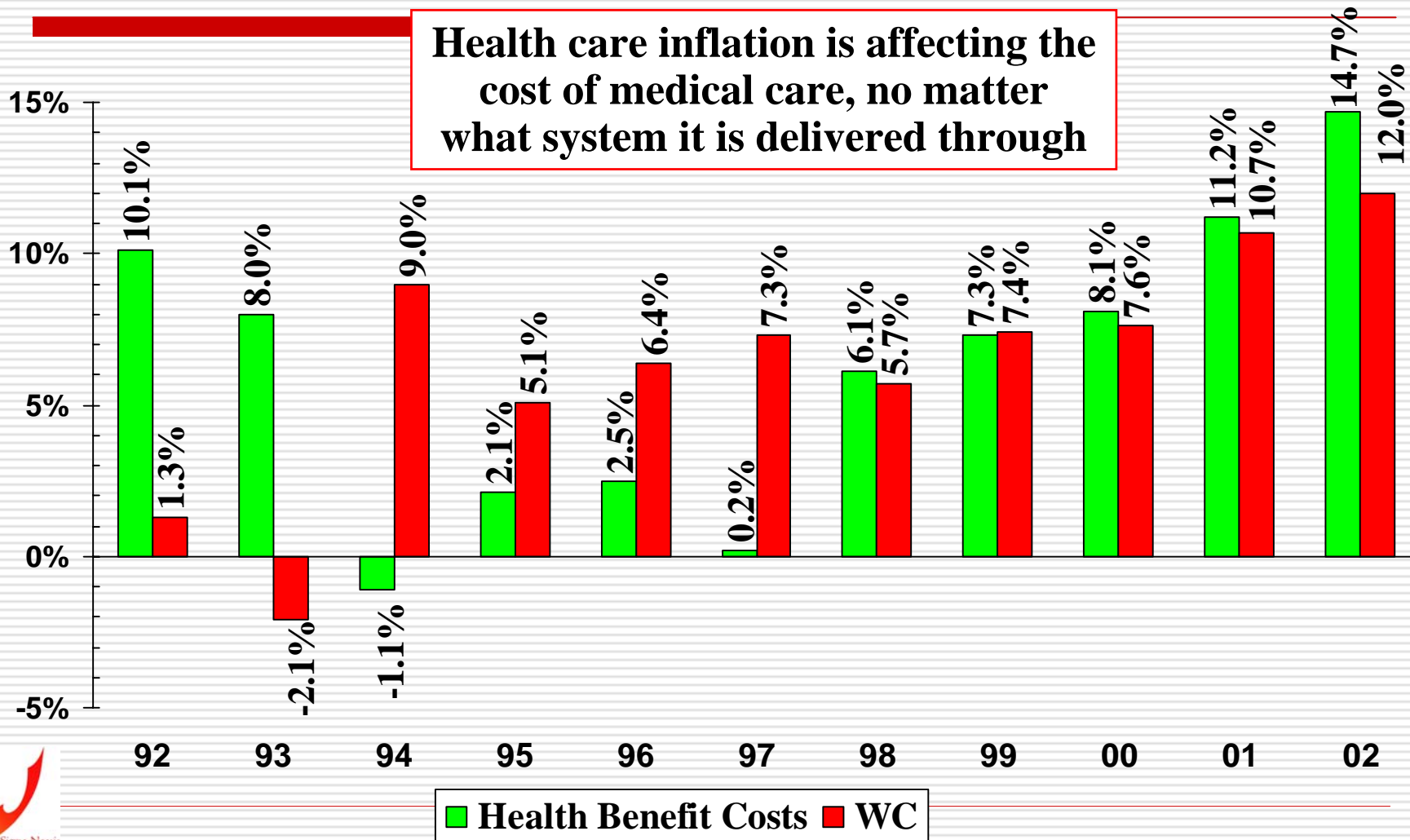
# Medical Malpractice: Tort Cost Growth is Skyrocketing

**\$ Billions**



# Med Claim Costs Rising Sharply

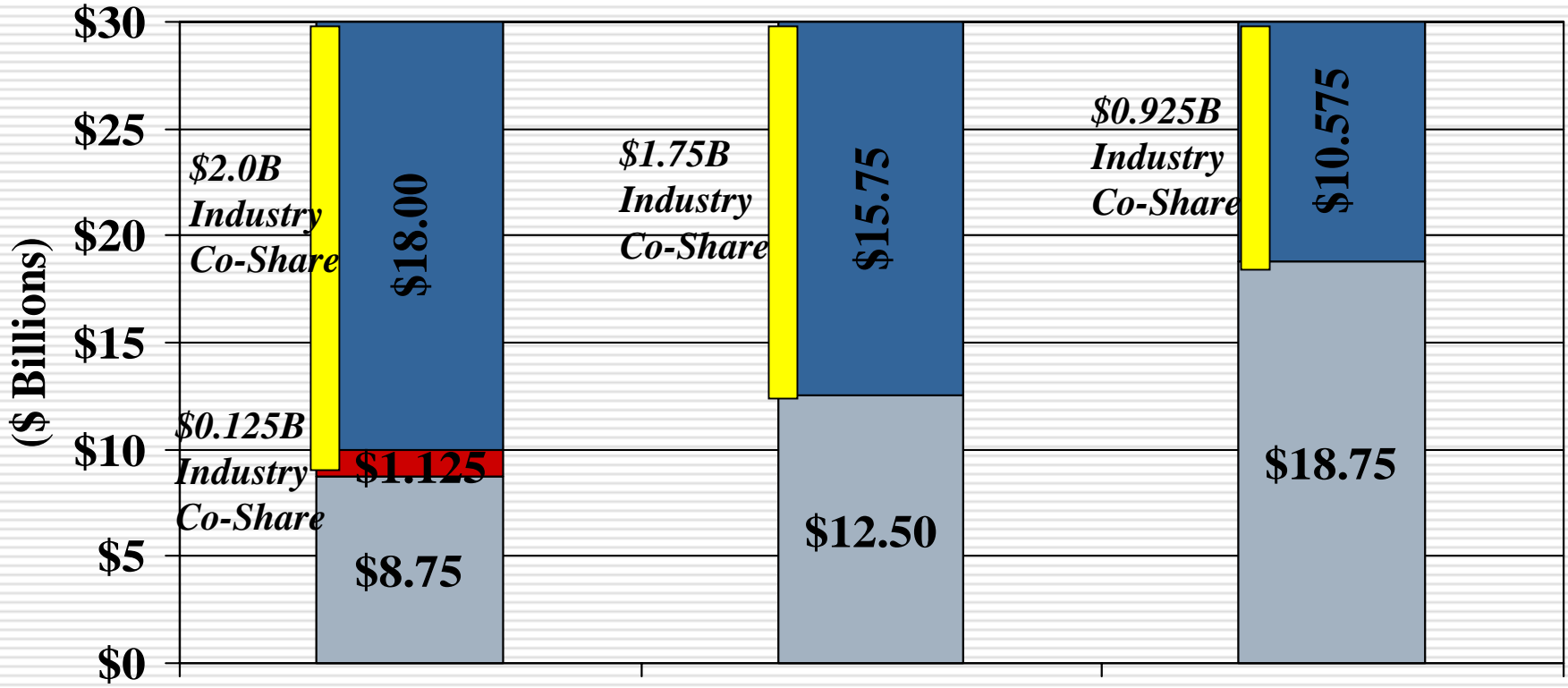
Health care inflation is affecting the cost of medical care, no matter what system it is delivered through



# Industry Losses Under Proposed Federal Backstop Using 9/11 Scenario

(as interpreted on date of enactment, Nov. 26, 2002)

**Total Ind. Loss:** \$10.875B \$14.25B \$19.675B



Industry Retention
  Surcharge Layer
  Co-Reinsurance Layer

Assumes \$30B Commercial Prop & WC Loss, \$125B "At Risk" Commercial DPE



# Sources/Links

---

- ❑ <http://www.aig.com>
- ❑ <http://www.aigcorporate.com>
- ❑ <http://www.businessinsurance.com/cgi-bin/news.pl?newsId=4870>
- ❑ <http://www.wsj.com>
- ❑ <http://www.businessweek.com>
- ❑ <http://www.iii.org>
- ❑ <http://www.bls.gov>
- ❑ <http://www.bea.gov>
- ❑ <http://www.swissre.com>
- ❑ <http://www.bigcharts.com>
- ❑ Principles of Economics, Third Edition, N. Gregory Mankiw, Thomson, South-Western