

Non-Life Insurance: AIG Reserves Deficient, But Industry Flush? Won't Turn Market, But AIG May Yet Lose Share

Target Price Change in Bold

Ticker	Rating	CUR	11/27/2009 Closing Price	Target Price	YTD Rel. Perf.	EPS			P/E			Yield
						2008A	2009E	2010E	2008A	2009E	2010E	
AIG	U	USD	33.30	12.00	-11.9%	-398.26	-15.55	6.80	NM	NM	4.9	NA
<i>OLD</i>				20.00								
HIG	O	USD	23.72	36.00	20.0%	2.80	0.95	3.65	8.5	25.0	6.5	0.9%
TRV	M	USD	51.65	54.00	-5.1%	5.27	5.70	6.70	9.8	9.1	7.7	2.6%
ALL	M	USD	28.27	34.00	-28.3%	3.09	3.10	3.95	9.1	9.1	7.2	2.8%
PGR	O	USD	16.61	21.00	-6.8%	1.29	1.50	1.70	12.9	11.1	9.8	NA
CB	M	USD	49.54	57.00	-19.3%	5.58	5.95	5.60	8.9	8.3	8.8	2.8%
CNA	M	USD	22.91	25.00	15.8%	1.92	3.40	2.60	11.9	6.7	8.8	NA
ACE	M	USD	48.18	59.00	-24.4%	7.72	8.60	8.30	6.2	5.6	5.8	NA
SPX			1087.27			65.47	60.96	76.85	16.6	17.8	14.1	2.3%

O – Outperform, M – Market-Perform, U – Underperform, N – Not Rated

Highlights

- We conducted a segmented industry loss reserve analysis to see if it revealed any possible competitive issues that could emerge in the coming years. The main result is a letdown for the possibility of near-term pricing improvement. Every company subgroup—large publics, mutuals, reinsurance & international, and small privates—shows strong and relatively comparable loss reserve adequacy to the other segments. This means that no subgroup is more likely than another to outlast the soft market.
 - In particular, average industry reserve adequacy of about 8 points of 2008 earned premium (\$26bn dollar adequacy) ranged 4-14% across 4 industry subgroups we looked at. For the large US public companies in our coverage (excluding AIG), the average adequacy is about 11 points, concentrated in commercial lines and specialty businesses.
- But we did reveal a very unexpected result that could have major ramifications in coming year. It appears that AIG's loss reserves are significantly deficient again, much sooner that we would have forecast 2 years ago.
 - Our estimate is about \$11bn deficient, +/- a \$4bn standard deviation and equal to about 24 points of total 2008 earned premium (35 points for US only). This equals about \$10 per fully diluted share after-tax. The majority of the deficiency (\$10bn) is concentrated in 3 long-tailed casualty lines: Work Comp (\$1.8bn), General Liability (\$5.6bn), and Professional Liability (\$2.6bn).
 - Because this result was so unexpected to us, we conducted numerous independent reasonableness checks on the AIG analysis. In each case, looking at paid/incurred ratios, implied real price adequacy, and empirical loss development factors, it appears at a minimum that AIG's results are worse than its other large peers, and directionally worse than its booked reserves.
 - These results give some credence to long-held views that AIG simply has always been a more aggressive competitor. There is even some support to the idea that discipline was lost after former CEO "Hank" Greenberg left the company. But a more solid analytical reason that may explain the

recent deterioration is that AIG's reinsurance usage has been cut nearly in half since the late 1990s, from 43% cessions in 1999 to 22% in 2008. This fact supports both the idea that AIG's underwriters never adjusted to the greater need for more "net line" underwriting, as well as the possibility that AIG's reserves will have a "thicker" tail without so much reinsurance usage.

Investment Conclusion

We cut our AIG target price to \$12 from \$20 to reflect the reserve deficiency. There is now 64% potential downside to our target from AIG's most recent close. We continue to rate AIG Underperform.

The results of this study were a big surprise to us. The original purpose of the analysis is rather anti-climatic, as current loss reserve adequacy seems rather evenly distributed by company subgroup, which suggests that the industry could continue competing with itself for quite some time. This lends support to our view that a balance sheet driven hard market, of the type seen in 1985 and 2001, is likely 2-3 years off.

The potential implications of this result for AIG are quite significant. If our analysis is even directionally correct, it implies that AIG shareholders and the Federal Government face considerably more uncertainty than they may have anticipated. At a minimum, if these results are reasonable, AIG would likely have to take some kind of reserve charge before it could sell or IPO its Chartis unit, which would probably greatly increase the difficulty of implementing such a deal in the first place. There is also the possibility for even greater Government scrutiny and penalties, although we have no insight as to what this might be at this point.

But this may also lead to a result that was widely anticipated earlier this year but for the wrong reason, namely continued loss of AIG market share. It was viewed by many that AIG's weakened state would compel clients and brokers to want to move business. We were skeptical of this view because we felt that clients would instead stay put and wait for the uncertainty to pass before making a major decision. So far, our view is what appears to be playing out. But now, with this loss reserve result, we have a more analytical case to make that AIG may face client flight in the future, driven by fear over its potentially weakened claims-paying ability. That factor seems much more likely to matter to risk managers than what is happening in AIG's Financial Products unit. It is very difficult to determine if and when any reserving problems will be manifest in AIG's results, and so if and when competitors will be able to capitalize. But at this point, we now think it is more likely that companies like TRV, CB, ACE, and even CNA will eventually be able to capitalize on the likely uncertainty this will create in AIG's client base.

Details

We published our first total US industry loss reserve study for 2008 back on September 16. Given the current lack of any sign of a pricing cycle in the offing, we decided that decomposing the industry into subgroups of companies might be useful before proceeding on to the individual company analyses. This interim analysis might shed some light on the competitive environment in terms of which types of companies might have better balance sheets.

The results of this study were a big surprise to us. The original purpose of the analysis is rather anti-climatic: as we shall show, current loss reserve adequacy seems rather evenly distributed by company subgroup, which suggests that the industry could continue competing with itself for quite some time. This lends support to our view that a balance sheet driven hard market, of the type seen in 1985 and 2001, is likely 2-3 years off.

But there was one very important exception to this result. When analyzing the subgroup of public companies (all of our US coverage), the original analysis showed almost no reserve adequacy in total, which made no sense. The largest company in this subgroup is AIG, and we decided to look at AIG first, and go to each company one by one to find the problem. We did not need to go any further: AIG appears to have very deficient loss reserves, on the order of about \$11bn pre-tax. Upon removing AIG, the remaining

public company subgroup appears to have very redundant loss reserves, as we expected. So what was a diagnostic operation has arguably turned into the most important part of this note.

Therefore, we have broken this note into 2 main sections. Part 1 is fairly compact, and provides details about the overall analysis and conclusions. Part 2 provides more details on the AIG results alone, and in particular undertakes a rigorous set of diagnostic tests to validate the result.

The potential implications of this result for AIG are quite significant. If our analysis is even directionally correct, it implies that AIG shareholders and the Federal Government face considerably more uncertainty than they may have anticipated: recall that AIG's insurance units were not generally considered to be part of its problems. In fact, early in AIG's downfall, borrowing surplus from AIG's insurance units was considered a possibility for saving the holding company. At a minimum, if these results are reasonable, AIG would likely have to take some kind of reserve charge before it could sell or IPO its Chartis unit, which would probably greatly increase the difficulty of implementing such a deal in the first place. There is also the possibility for even greater Government scrutiny and penalties, although we have no insight as to what this might be at this point.

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Part 1: Subgroup Analysis of US Industry Loss Reserves Show Few Chinks Across Business Types

The main purpose of this note was to break up total US industry statutory loss reserves into some conceptual business subgroups. We first did an analysis like this back in 2002, to gain insight into which types of companies were in the worst shape after the toll taken in the late 1990s soft market. At that time, reinsurers and smaller companies seemed to have borne the brunt of the damage. But we don't see that this time: reserve adequacy is much more evenly distributed across the subgroups, with the exception of AIG.

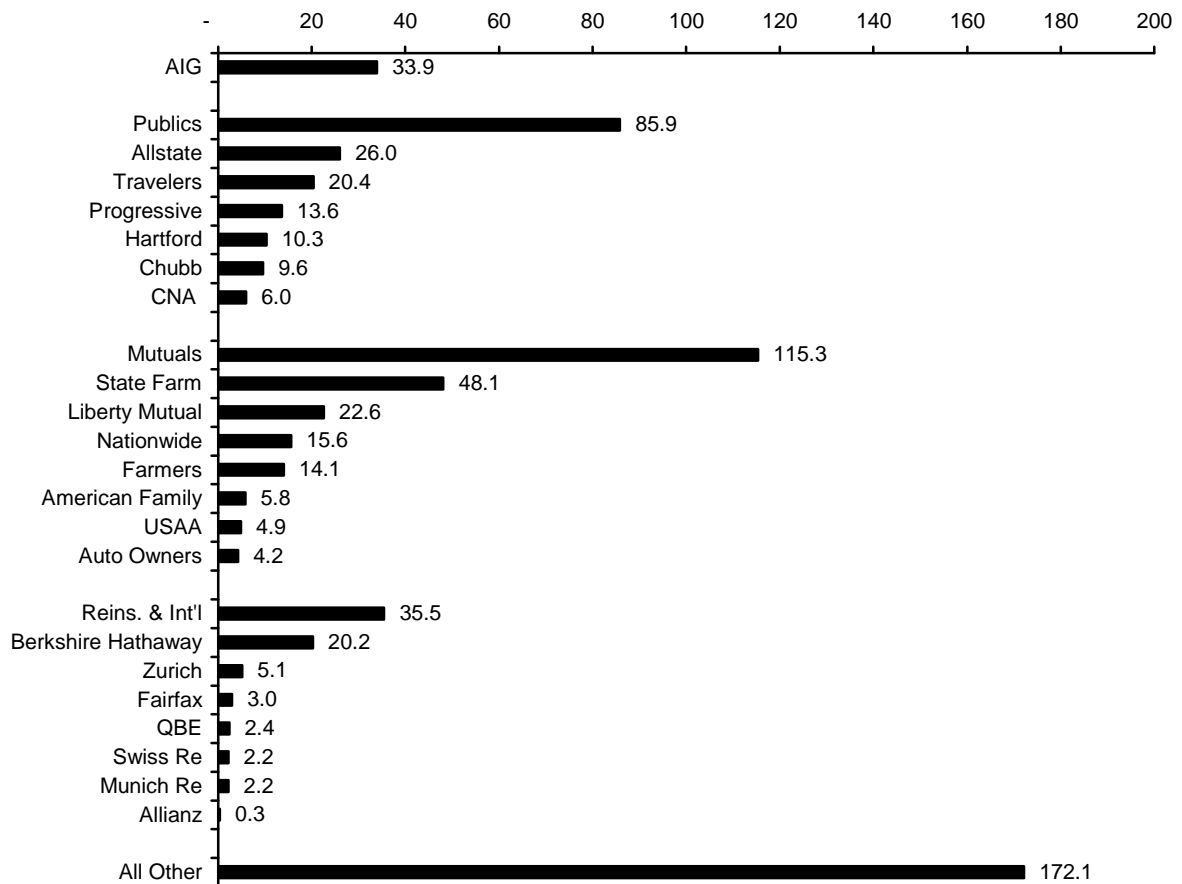
Exhibit 1 shows how we define the subgroups for analysis purposes. There are 4 subgroups we derived from the US statutory data:

- *Publics*, which are defined as the large public companies that make up our US insurance coverage;
- *Mutuals*, consisting of the 7 largest US mutual insurers;
- *Reinsurance & International* (abbreviated *R&I*), comprising the largest US subsidiaries of predominantly international or reinsurance companies; and
- *All Other*, by definition consisting of the rest of the industry, which is dominated by medium and small private stock companies.

Exhibit 1 shows not only the companies making up the subgroups, but shows 2008 earned premium volume to get an idea of which companies dominate the results. Keep in mind that this data is *only* US statutory

data, meaning that any non-US business will not be included. So in particular, the R&I subgroup is not a complete analysis of all of the business for the companies in question.

Exhibit 1
Distribution of 2008 Statutory Earned Premium by Analysis Subgroups and Components



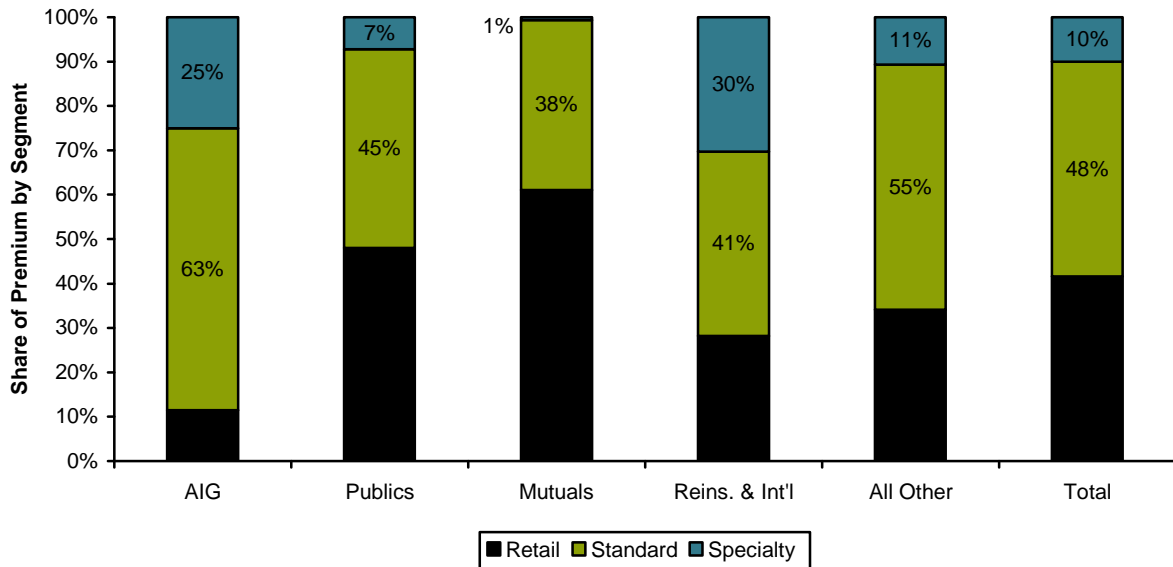
Source: Highline Data, SNL, Bernstein Analysis

When we do loss reserve work, we always work at the most detailed level available, namely the line of business segments as defined in the Annual Statement Schedule P. But for analysis like this, it is rather unwieldy, and frankly not necessary, to look at every line of business result. Thus, we have summarized results to a level of 3 major business segments:

- *Retail*, consisting of personal lines and small business insurance;
- *Standard*, consisting of basic commercial lines like property, liability, and work comp; and
- *Specialty*, consisting of more difficult lines like medial malpractice, other professional liability, and excess-of-loss reinsurance.

When we later look at AIG specifically, we will concentrate on 3 Schedule P lines that dominate its deficiency: Work Comp (Sch. P Part D), General Liability (Sch. P Part H), and Professional Liability (Sch. P Part HC). Parts D and H dominate the Standard segment, while Part HC is a major component of the Specialty segment (Medical Malpractice, Parts F and FC, are the other major component, and are very redundant but are not major factors for the companies in our coverage).

Exhibit 2
Share of 2008 Earned Premium by Business Segment Within Analysis Subgroup



Source: Highline Data, SNL, Bernstein Analysis

Exhibit 2 shows the 2008 earned premium distribution by major segment within each of the company subgroups. The basic premium split is 60/40 commercial/retail, with more Retail business in the Publics and Mutuels subgroups owing to the presence of large personal lines writers (e.g. Allstate and State Farm). Keep in mind, however, that the majority of the loss reserve redundancy is concentrated in commercials, owing to the longer-tailed nature of this business.

Exhibit 3 is a high level summary of the major conclusions. We show both our estimate of total loss reserve adequacy as of year-end 2008 by subgroup, as well as this figure stated as a percentage of 2008 earned premium. We find this latter statistic more useful in that it represents the way most analysts and investors think about loss reserve adequacy, namely as points of potential future favorable or adverse loss ratio development.

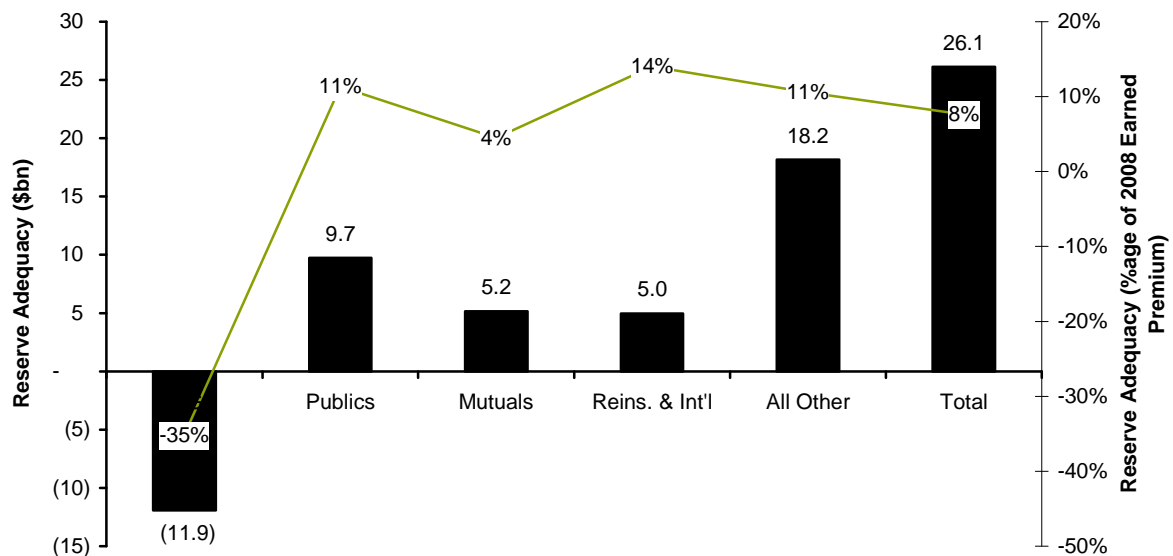
In total, loss reserves appeared to be \$26 billion redundant, equal to about 8 points of loss ratio. But for the Publics and All Other, this percentage was 11%, and was 14% for the R&I subgroup. The Mutual subgroup is much weaker at 4%, but this is because of its high concentration of personal lines business; as we shall see, commercial reserve adequacy is fairly comparable across subgroups. In contrast, AIG appears to be nearly \$12 billion deficient on its US statutory book, or about 35% points of 2008 earned premium.

We should point out 3 facts about this analysis with respect to our last on September 16. First, the normal way we would have derived the All Other group is to subtract the other 3 subgroup analyses from our last industry analysis. But because of the AIG discovery, we did much more cross-checking, and part of that was to project the All Other subgroup from the ground up. As a result, the total "bottom up" redundancy estimate of \$26 billion is lower than the "top down" estimate of \$34 billion¹ we got in September. The difference of \$8 billion seems quite large, but it is less than 2 points of total 2008 loss ratio, and the total

¹ Specifically, we got a total estimate of \$28 billion, consisting of \$34 billion from loss and allocated loss expenses, and (\$6 billion) from unallocated loss expenses. For the current analysis, we are excluding unallocated expenses.

standard deviation of the estimate is about \$10 billion. We attempted to reconcile between "top down" and "bottom up", but this is as close as we could get. Each approach has some merit—the "top down" has more diversification benefits, while the "bottom up" may capture more line of business differences—so the unknowable "real" answer probably lies somewhere in the middle. We are likely to reconcile these approaches as we further finalize the analysis, but for the purpose of this note, we use the lower "bottom up" estimate. This is not likely to change the overall conclusion we would draw.

Exhibit 3
Estimated Year-End 2008 Loss Reserve Adequacy by Subgroup, in Billions of \$s and as %age of 2008 Earned Premium

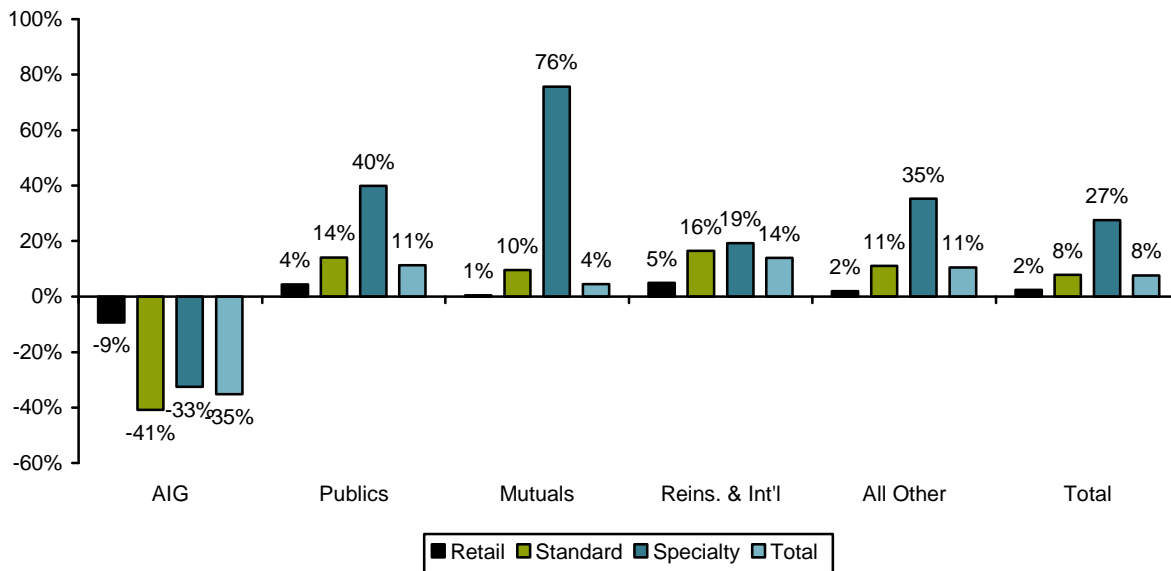


Source: Highline Data, SNL, Bernstein Analysis

Second, we decided to exclude all Financial and Mortgage Guaranty date from the analysis. The last 3 years (2006-08) appear very contaminated from the credit crisis, and there is no good way to forecast these years using historical data. Thus, we are implicitly treating these lines as "adequate". This only impacts AIG and the All Other subgroup (and of course the total).

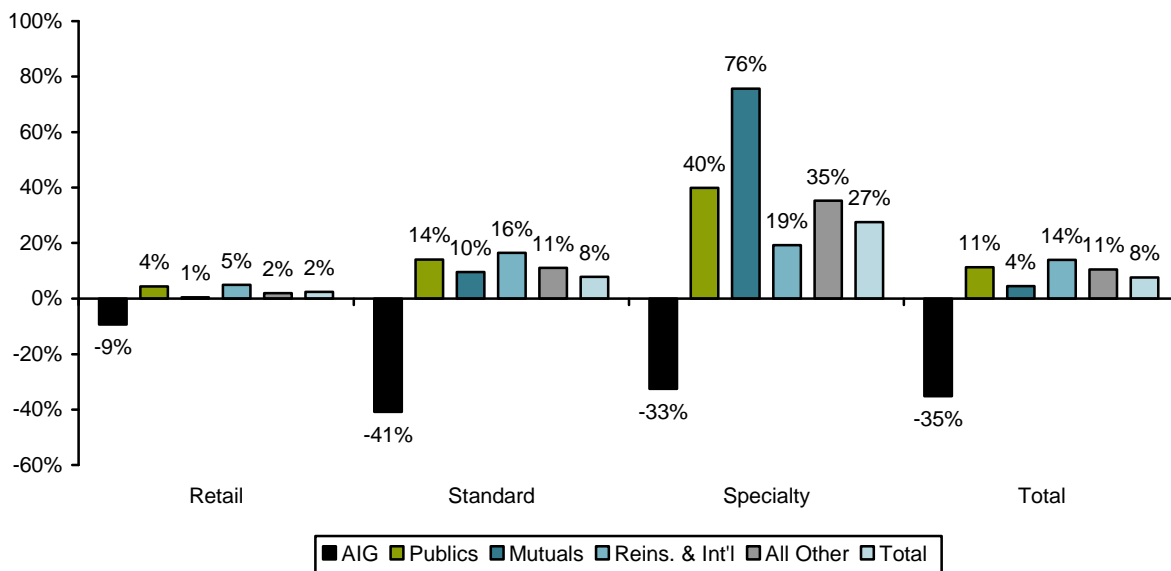
Finally, AIG has a large amount of non-US business which needs to be analyzed to get an idea of total loss reserve adequacy. We have a method to do this (we use the 10K reserve data, subtract US paid loss data, and can get a non-US paid loss triangle), and the non-US piece has an estimated reserve redundancy of about \$1 billion. Thus, our total estimate of AIG's reserve deficiency is about \$11 billion, with a total standard deviation of the estimate of about \$4 billion. This is a very large standard deviation, but notice that AIG *still* appears to be deficient even with 2 standard deviations per our estimate. We will discuss AIG in even more detail in Part 2 of this note. For now, consider that after a 35% US income tax rate, \$11bn of pre-tax deficiency equals about \$7 billion, equal to about \$10 per fully diluted share. This is nearly 1/3rd of AIG's current market value of \$33.30.

Exhibit 4
Estimated Year-End 2008 Loss Reserve Adequacy as %age of 2008 Earned Premium, by Subgroup and Business Segment



Source: Highline Data, SNL, Bernstein Analysis

Exhibit 5
Estimated Year-End 2008 Loss Reserve Adequacy as %age of 2008 Earned Premium, by Business Segment and Subgroup

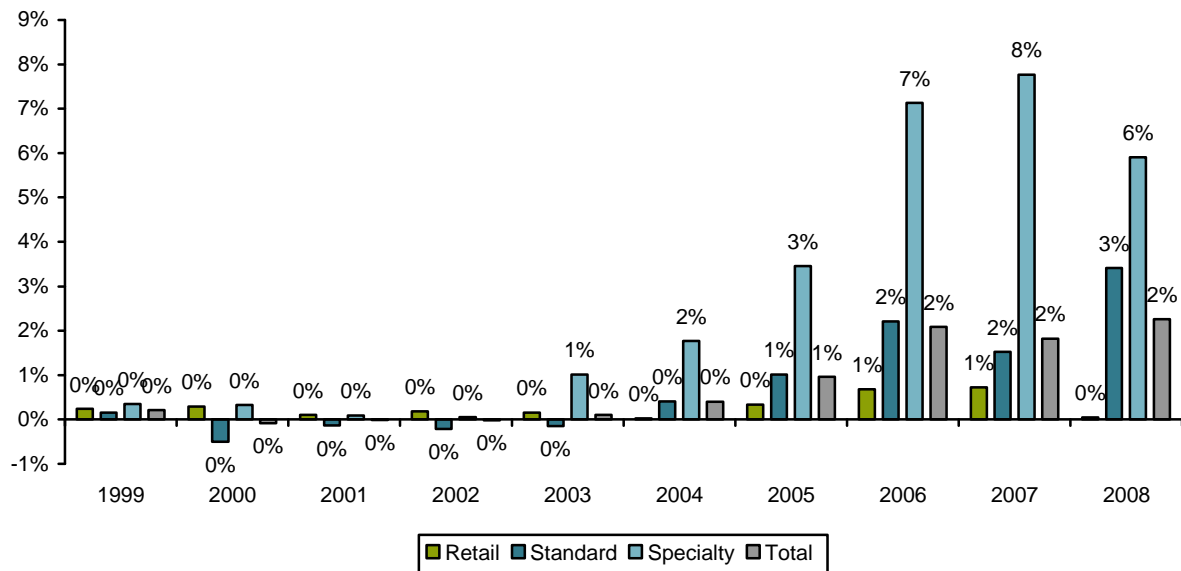


Source: Highline Data, SNL, Bernstein Analysis

Exhibits 4 & 5 break the adequacy estimates into the major business segment level of detail. We show adequacy as a percentage of 2008 earned premium. The exhibits show the same data, but with different cross-tabulation. Exhibit 4 groups the data by company subgroup, allowing segment comparisons within subgroup, which Exhibit 5 groups by major segment, allowing comparisons across subgroups. Exhibit 5 in particular shows that the levels of adequacy within a business segment is fairly consistent. For example, excluding AIG, Retail adequacy ranges 1-5 points, while Standard ranges 8-16 points. The range for Specialty is much wider at 19-76 points, but this is likely owing to difference in mixes of business. For example, the 76 point redundancy for Specialty business in Mutuals is dominated by legacy medical malpractice reserves (i.e. low current writings).

In Exhibit 6, we show the distribution of adequacy for the industry in total, split by accident year and major segments. As one would expect, adequacy is dominated in the more recent 2005-08 accident years. This exhibit by subgroup largely shows the same result, so we excluded them to reduce clutter. Two exceptions were AIG, which we do show next in Exhibit 7, and RIR, which has a much more even (but volatile) distribution of adequacy across the years, even older accident years. This is plausible because of the large concentration of excess reinsurance in the R&I subgroup. Excess reinsurance is very long-tailed, and so there could be uncertainty lasting for longer than it might in most other lines of business.

Exhibit 6
Distribution of year-End 2008 Reserve Adequacy by Accident Year, Total US Industry by Business Segment, as %age of Earned Premium



Source: Highline Data, SNL, Bernstein Analysis

At some future date, we will likely publish more of the line of business details in Black Book form, but for this note we have tried to focus on the key data from which we can draw the strongest conclusions. As noted previously, the results of this subgroup analysis are something of a letdown, but that still produces an important conclusion. With loss reserve adequacy as evenly spread as it appears to be, it will likely take 2-3 years of additional reserve releases before reserves are deficient enough to produce a large pricing cycle.

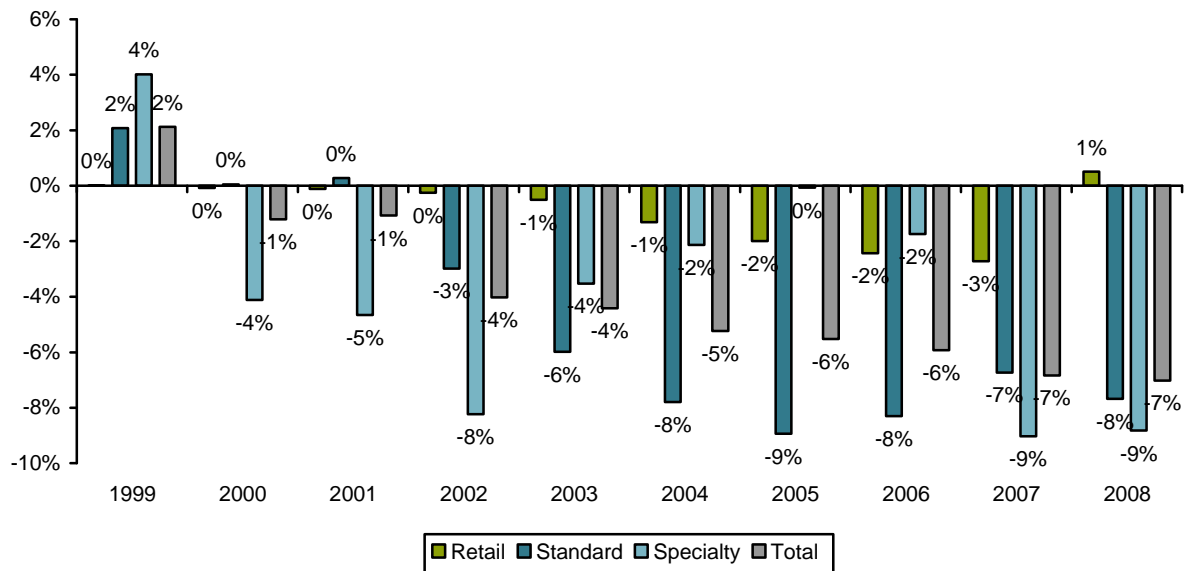
Part 2: Testing Our AIG Result for Reasonableness

Because the AIG finding is so unexpected, we think it is necessary to provide supporting information so that investors can weigh the results for themselves. In this section, we provide a number of standard and

U.S. Insurance/Nonlife

novel tests that allow investors to compare AIG's relative reserve adequacy against other benchmarks. To show the magnitude of the potential problem, Exhibit 7 shows the distribution of deficiency across accident years and major segment. AIG shows nearly the opposite behavior that we would expect, namely that more recent years are getting *worse*, not better, in contrast to every other subgroup we analyzed. Average deficiency for 2005-08 is estimated at about 6-7 points of loss ratio in each year. Thus, not only do we need to test our results carefully, but if possible, we need to figure out why AIG's results are so at odds with the rest of the industry.

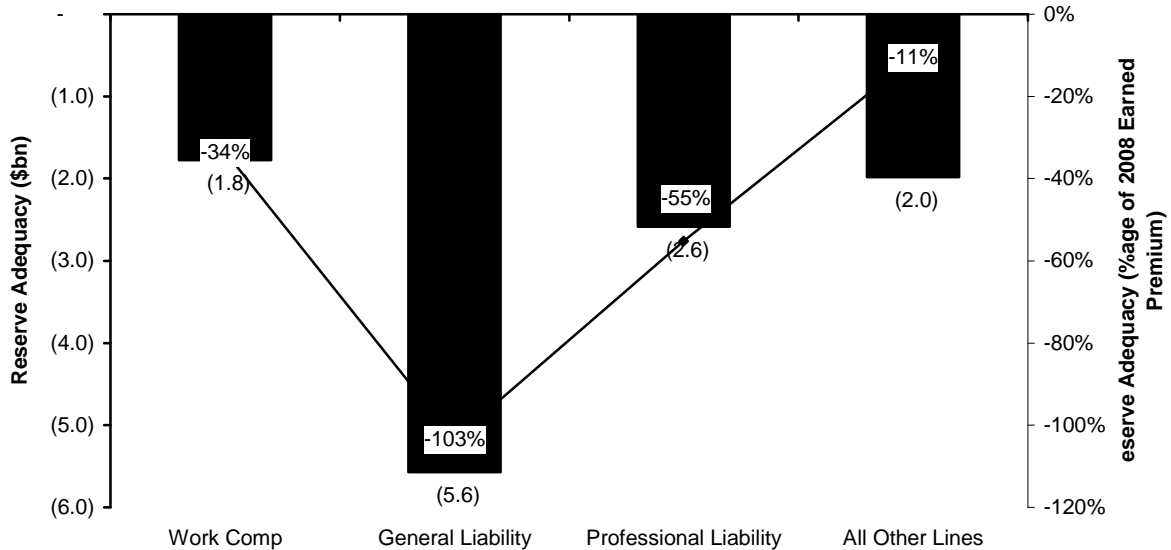
Exhibit 7
Distribution of year-End 2008 Reserve Adequacy by Accident Year, AIG Statutory by Business Segment, as %age of Earned Premium



Source: Highline Data, SNL, Bernstein Analysis

We should point out that the statistical methodology we use for all of our analyses is designed to be as comparable as possible across lines of business and companies. However, we don't think providing pages and pages of loss triangles is going to be very helpful to the average investor. Fortunately, there are only a few lines of business, namely the long-tailed casualty lines, that are driving most of the deficiency, as shown below in Exhibit 8. \$10bn of the \$12 billion total deficiency estimate is concentrated in 3 lines: Work Comp (\$1.8bn), General Liability (\$5.6bn), and Professional Liability (\$2.6bn).

Exhibit 8
AIG Estimate Reserve Adequacy for Selected Long-Tailed Lines of Business, Year-End 2008



Source: Highline Data, SNL, Bernstein Analysis

Further, the relative tests we are going to show here are more meaningful when one has a full *absolute* ground-up analysis to serve as a basis. It is when one only looks at relative analysis (e.g. the paid/incurred test we will look at next) that we have no good frame of reference. So in some ways, the best proof we have is that AIG's results are so very different from our 4 other comparable analyses. Performing these simpler diagnostics merely adds more confidence to the core result.

Before we begin the detailed tests, here is an executive summary of the results to come:

- There is plenty of empirical support for the idea that AIG's reserves are, at the very least, less conservatively reserved (paid/incurred test) and have lower price adequacy (real price adequacy test) versus its comparable public company rivals.
- There is also good evidence that AIG is not booking its results consistent with its historical development patterns (LDF test), whereas our estimates appear more in line with AIG's own data. While AIG certainly has access to better data than we do, our analysis seems to be more consistent with the publicly available data.
- These results give some credence to long-held views that AIG simply has always been a more aggressive competitor. There is even some support to the idea that discipline was lost after former CEO "Hank" Greenberg left the company. But a more solid analytical reason that may explain the recent deterioration is that AIG's reinsurance usage has been cut nearly in half since the late 1990s, from 43% cessions in 1999 to 22% in 2008. This fact supports both the idea that AIG's underwriters never adjusted to the greater need for more "net line" underwriting, as well as the possibility that AIG's reserves will have a "thicker" tail without so much reinsurance usage.

A word of warning seems appropriate here. Loss reserving is a difficult subject. It uses unfamiliar terminology and complex methodologies. It entails considerable uncertainty of outcome. Normally, we target our research at an "intermediate" level of understanding; that is, we don't assume that you are a loss reserving expert, but we do assume that you are familiar with the procedure, understand why it is important,

and know what terms like *loss triangle*, *paid/incurred ratio*, and *loss development factor* mean. However, we also understand that anything connected to AIG may reach a wider audience than it did a few years ago. Therefore, we have tried to provide more explanation and examples that we typically would. But even this additional detail is *not* sufficient to make one an expert in loss reserving. Thus, we would caution anyone not familiar with loss reserving techniques to be very careful in drawing strong conclusions from anything they read here.

Test 1—Paid/Incurred Ratios: So-called *paid/incurred* ratios are probably the most used loss reserve test on Wall Street. If an investor or analyst is going to do anything at all to examine loss reserve adequacy, *paid/incurred* analysis may be the only thing they look at. It is a *relative* test in that it does not provide an objective self-supporting estimate of reserve adequacy. But in conjunction with such a ground-up analysis, as we have, *paid/incurred* ratios can quickly reveal relative adequacy differences in an intuitive manner.

The basic idea behind *paid/incurred* ratios is grounded in the core framework of all loss reserve analysis. The two main sources of raw loss data are *paid* and *reported* losses, which are pretty much what the names say they are. The goal is to use historical *paid* and *reported* data to extrapolate future *paid* and *reported* losses. To do this, the data are organized into *loss triangles*. In one dimension (usually the vertical axis), the losses are grouped by *accident year* or *incurred year* (same definition), which is the year a claim occurred. This grouping corresponds to *earned premium*, and indeed this is how accountants match up premiums and losses for earnings recognition.

Along the horizontal axis, the losses are grouped by *development age*. This concept is key: development age is nothing more than the amount of time that has passed since a loss was incurred. Many lines of business, like general liability and workers' compensation, take a long time to report and pay out from the initial incurred date, and these classes are called *long-tailed* as a result. The main assumption of nearly all loss reserving methods is that comparable blocks of business will develop "the same" no matter when they were written. More precisely, the rate at which losses were reported and paid in the past should be comparable to how they will report and pay out in the future. Thus, if we can figure out those rates of growth, we can estimate future loss reserve need.

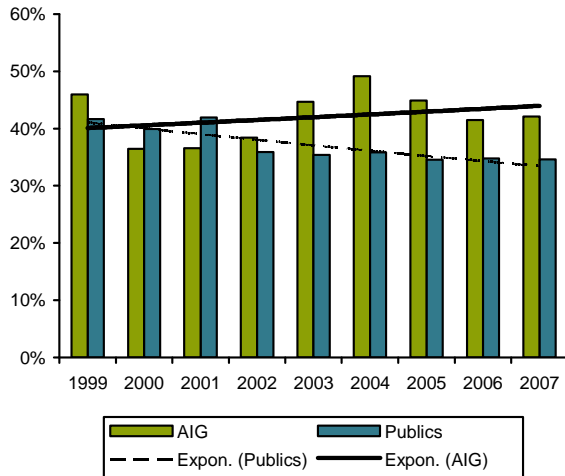
Thus, if you are presented with a company's *paid loss triangle* and its estimates ultimate incurred losses by accident year (we will call these *ultimates* for short), you can try to "reverse engineer" whether or not these *ultimates* are reasonable. Since the rate of *paid loss* growth is a guide to how one ought to forecast future losses, we could construct ratios estimating that rate of growth for a comparable development age. Specifically, we could fix a development age, say 24 months after the start of the incurred date, and construct the ratio of *paid loss* to incurred (estimates ultimate) loss by accident year. This ratio is precisely what is meant by a *paid/incurred ratio*.

The test is to look at how the *paid/incurred* ratio changes over time. All else equal, a rising *paid/incurred* ratio is assumed to indicate *deteriorating* reserve adequacy across time. The argument is that *paid loss* development stays consistent over time (within some reasonable range), so that any noticeable trend is likely to be occurring through the company's selected *ultimates*. This test is among the most objective, in that it involves no estimates on the part of the analyst, merely a computation. But as we noted, *paid/incurred* ratios only provide a *relative* test of adequacy, not an absolute estimate. Given that we *have* an absolute estimate from our statistical model (which we will discuss in some additional detail when we get to Test 2), doing *paid/incurred* analysis allows us to see if our results seem consistent with that analysis.

The next 4 exhibits, Exhibits 9-12, show *paid/incurred* ratios at Age 24 months for accident years 1999-2007 (2008 has to be excluded because it is only 12 months old at year-end 2008). We show a comparison of AIG's ratios to those of the Publics subgroup, AIG's US competitor set. As noted above, we will focus on the 3 long-tailed lines where most of the deficiency is located. We also have an exhibit for all lines in total, but actually we would not expect this exhibit to be as useful. It is usually not a good idea to look at

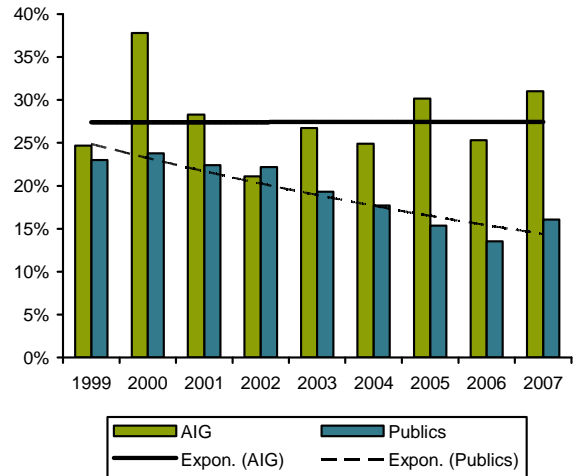
total company results when doing any kind of reserve work. All reserving methods use the idea that reported and paid losses have a pattern of development that is consistent over time. When you start mixing lines with different development patterns, you are asking for trouble. In fact, AIG's total paid/incurred ratios do NOT indicate a problem, whereas all the individual line of business exhibits do suggest a problem.

Exhibit 9
Paid/Incurred Ratio Test, Workers' Comp (Sch. P Part D), AIG vs. Publics, Accident Years 1999-2007 at 24 Months



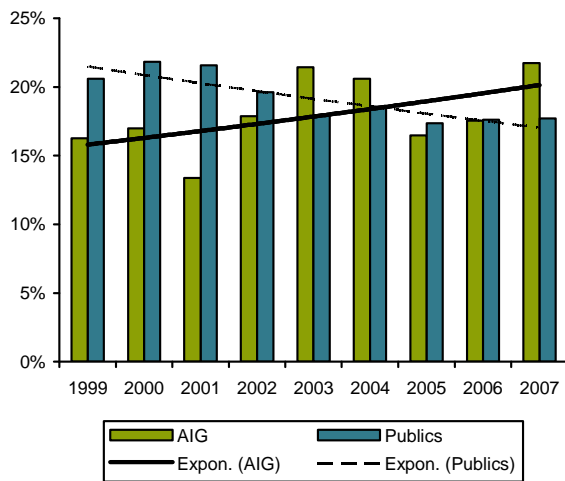
Source: Highline Data, SNL, Bernstein Analysis

Exhibit 10
Paid/Incurred Ratio Test, General Liability (Sch. P Part H), AIG vs. Publics, Accident Years 1999-2007 at 24 Months



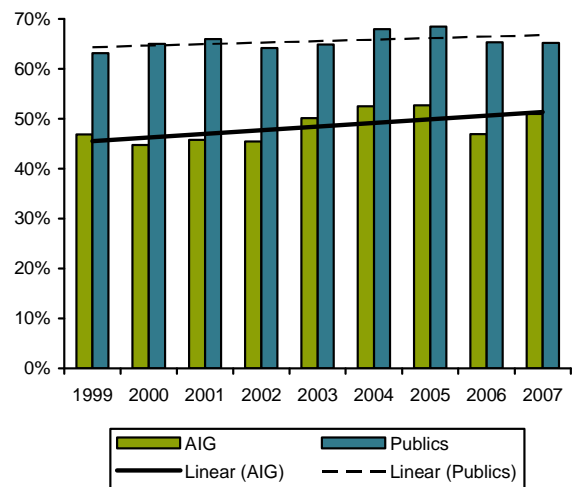
Source: Highline Data, SNL, Bernstein Analysis

Exhibit 11
Paid/Incurred Ratio Test, Professional Liability (Sch. P Part HC), AIG vs. Publics, Accident Years 1999-2007 at 24 Months



Source: Highline Data, SNL, Bernstein Analysis

Exhibit 12
Paid/Incurred Ratio Test, Total All Lines (Sch. P Summary), AIG vs. Publics, Accident Years 1999-2007 at 24 Months



Source: Highline Data, SNL, Bernstein Analysis

We have added a trend line to each series, not to measure a precise trend, but to show the general direction of either deterioration (rising trend) or improvement (falling trend). For each of the 3 casualty lines, AIG is certainly deteriorating relative to competitors, and is at least not improving. Professional Liability seems to show outright deterioration, whereas Work Comp and General Liability are less certain. But again, *relative* to the Publics subgroup, it seems rather clear that AIG's paid/incurred ratios are worsening. But we do NOT see this in Exhibit 12 for the total company. This shows the potential hazards one faces when using heterogeneous data like that for the total company.

Test 2—Real Price Adequacy: Since beginning our coverage of non-life insurance at Bernstein, we have used a statistical model to forecast loss reserves which differs from more traditional actuarial methods (although increasingly, actuaries are adopting more statistical methods similar to ours). Most basic actuarial approaches extend the paid/incurred ratio by measuring the growth rate of reported and paid losses across development ages, and summarize these growth rates in the form of *loss development factors*, which we will discuss more in Test 3. In contrast, our method starts by looking at the incremental reported and paid losses in each age for each accident year. For additional statistical efficacy, as well as making the results easier to use, we actually use incremental loss *ratios*, taking each loss increment as a ratio of premium for the given accident year.

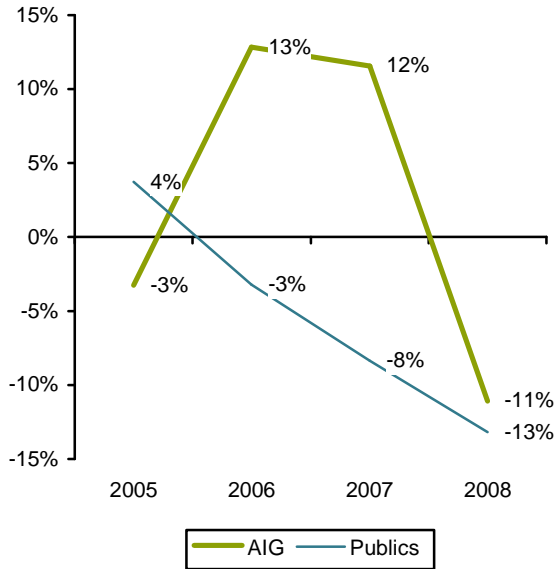
But using incremental loss ratios introduces a problem that has to be addressed. There is no reason to think that premiums across the years reflect the same *price levels*, or that losses reflect the same level of *loss trend*. When actuaries use historical premiums and losses to set future rates, they address this problem through a process called *on-leveling*. This means that older premiums have all subsequent price changes applied to them, and older losses are trended forward to the current estimated trend level. Once the data are on-leveled, we can treat all the loss ratios as being a reasonable estimate of the *current* loss ratio.

Now we obviously don't have access to company price changes or loss trend assumptions. We don't even have such data in a useable format for the industry. Nonetheless, the data itself allows us to estimate a reasonable amount of needed on-leveling. For example, actual industry data show that all the incremental paid and reported loss ratios for the soft market years of 1999-2001 are higher than for the strong post-cycle years of 2004-06, comparing across the available development ages (we have more ages for older years). Thus, our statistical model estimates the optimal amount by which we should adjust the *premiums only*, in order to minimize the variance of the incremental loss ratios at each development age. We do this simultaneously for both reported and paid incremental losses. Now because we are adjusting only the premiums, the adjustment includes both a provision for price changes *and* loss trend. There is no way to separate out the effects using only data available from Schedule P. Thus, when we first developed this model, we coined the term *real price change* to mean the difference between price change and loss trend. Thus, the premium adjustments in our model reflect estimates of *real* price change.

While this approach definitely requires an estimate, it is not an estimate of forecasting. It is an estimate of how much the price and loss levels vary across years using simple relationships that the empirical loss ratios ought to have. So our estimated real price changes are not completely objective, like the paid/incurred ratios, but they are close.

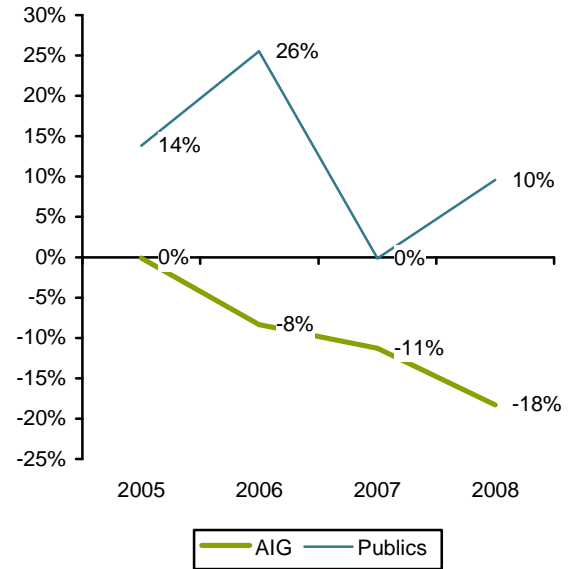
In the next 4 exhibits, Exhibits 13-16, we show the same lines and comparison of AIG vs. the Publics subgroup. The test in this case is the cumulative estimate real price change since 2004, so for years 2005-08. Price level, loss trend, and reserve adequacy are intimately related. All else equal, we would expect deteriorating real price adequacy to suggest more of a potential problem with reserve adequacy.

Exhibit 13
Cumulative Real Price Adequacy, Workers' Comp (Sch. P Part D), AIG vs. Publics, Accident Years 2005-2008



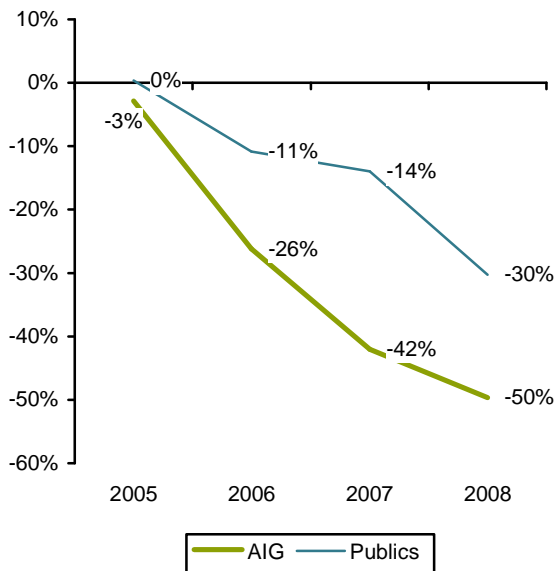
Source: Highline Data, SNL, Bernstein Analysis

Exhibit 14
Cumulative Real Price Adequacy, General Liability (Sch. P Part H), AIG vs. Publics, Accident Years 2005-2008



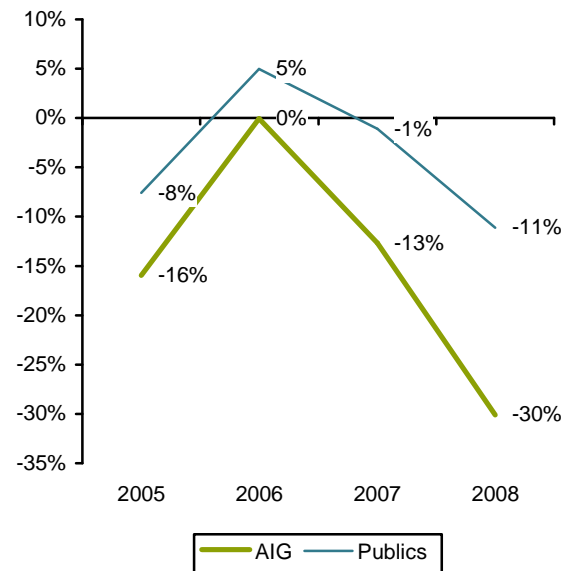
Source: Highline Data, SNL, Bernstein Analysis

Exhibit 15
Cumulative Real Price Adequacy, Professional Liability (Sch. P Part HC), AIG vs. Publics, Accident Years 2005-2008



Source: Highline Data, SNL, Bernstein Analysis

Exhibit 16
Cumulative Real Price Adequacy, Total All Lines (Sch. P Summary), AIG vs. Publics, Accident Years 2005-2008



Source: Highline Data, SNL, Bernstein Analysis

U.S. Insurance/Nonlife

While both AIG and the Publics show deteriorating real price adequacy for all the tests, AIG is worse for every test except Work Comp. This seems driven by one very favorable real price increment in 2006 for AIG, followed by a large decline in 2008 that undid nearly all the 2006 gain. Note that our method usually does not provide any insight into the reason for the real price changes, and there is always some statistical error in any method like this. But once again, we are looking for the weight of evidence. The fact that total AIG real price adequacy appears to be 30% lower at the end of 2008 vs. 2004, compared to only an 11% decline for its competitor set, suggests that AIG probably has more questionable loss reserve adequacy.

Test 3—Implied Loss Development Factors: For our final test, we construct the data used in more standard actuarial analysis, and use this to compare the rates of reported and paid loss development in AIG's historical results to the implied growth rates in both AIG's booked ultimates and our statistically-derived ultimates. Because this requires assembling much more data, we elected to show the results only for General Liability (Part H) and the company in total. Remember that we said that using total company data to project results is potentially very misleading, and our estimates are all ground up by line. But as we will show, our estimate appear more consistent to AIG's empirical data than does AIG's estimates of ultimates.

Exhibit 17

AIG Paid Loss Development Factors (LDFs), Total All Lines, with Comparison of Formulaic, AIG Implied, and SCB Implied LDFs

Year	Age 1:2	Age 2:3	Age 3:4	Age 4:5	Age 5:6	Age 6:7	Age 7:8	Age 8:9	Age 9:10	Age 10:Ult
1999	1.773	1.293	1.166	1.099	1.059	1.048	1.050	1.017	1.030	
2000	1.813	1.302	1.153	1.097	1.076	1.065	1.051	1.032		
2001	1.865	1.283	1.161	1.114	1.074	1.055	1.042			
2002	1.798	1.300	1.198	1.102	1.058	1.067				
2003	1.816	1.271	1.140	1.081	1.094					
2004	1.888	1.229	1.142	1.099						
2005	1.795	1.226	1.166							
2006	1.776	1.332								
2007	1.981									
Incremental	Age 1:2	Age 2:3	Age 3:4	Age 4:5	Age 5:6	Age 6:7	Age 7:8	Age 8:9	Age 9:10	Age 10:Ult
Formulaic	1.839	1.276	1.160	1.098	1.072	1.059	1.048	1.025	1.030	
AIG	1.957	1.227	1.204	1.076	1.060	1.026	1.018	1.022	1.034	1.056
SCB	1.924	1.260	1.169	1.100	1.073	1.059	1.050	1.024	1.033	1.061
Cumulative	Age 1:Ult	Age 2:Ult	Age 3:Ult	Age 4:Ult	Age 5:Ult	Age 6:Ult	Age 7:Ult	Age 8:Ult	Age 9:Ult	Age 10:Ult
Formulaic	3.964	2.155	1.689	1.456	1.325	1.236	1.167	1.114	1.087	1.056
AIG	3.839	1.962	1.599	1.328	1.234	1.164	1.135	1.116	1.092	1.056
SCB	4.175	2.170	1.723	1.474	1.340	1.249	1.180	1.123	1.097	1.061

	Age 1:5	Age 5:Ult
AIG	3.110	1.234
SCB	3.115	1.340
Difference	0.1%	8.6%

Source: Highline Data, SNL, Bernstein Analysis

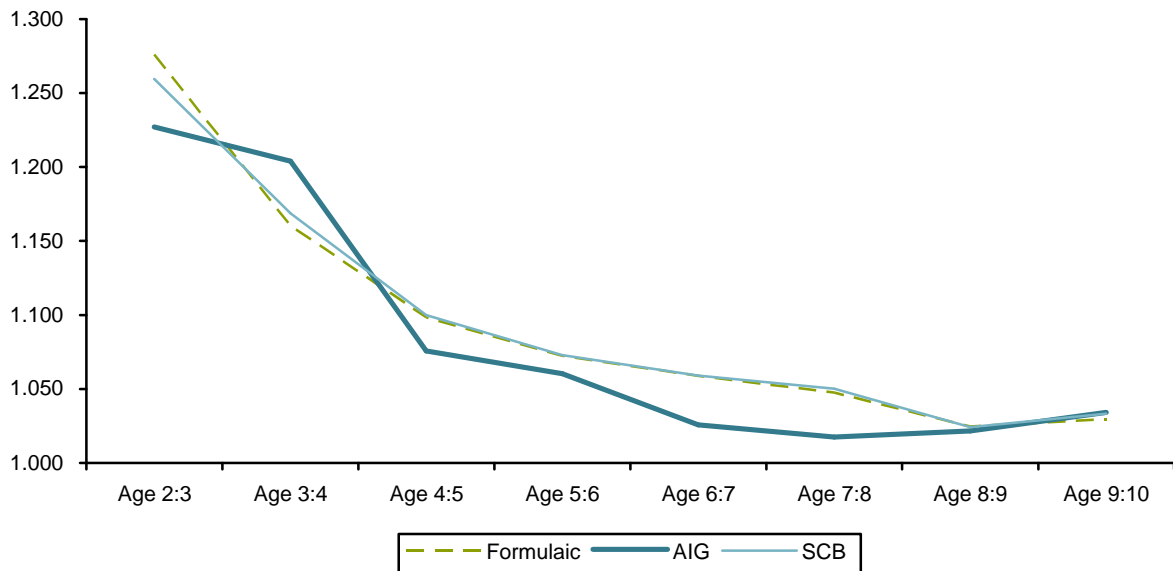
Exhibit 17 shows the paid loss development factors (LDFs) for all of AIG's lines of business in total. The LDFs are arranged by accident year in the vertical direction and development age in the horizontal direction. The label Age 1:2 (read "age 1 to 2") is simple the ratio of the cumulative paid losses at Age 2 (2 years later) over the level at Age 1 (end of the initial year). The most basic actuarial technique is to take the average of the LDFs for a given age and use this estimate for the LDF of a less developed year at that age. We call this estimate the Formulaic estimate in the exhibit. For example, the Formulaic paid LDF for Age 1:2 is 1.839. Thus, if we had the Age 1 paid losses for 2008, we could multiple them by 1.839, and this would give us an estimate of what the 2008 losses might look like at Age 2 (i.e. the end of 2009).

In the exhibit, we have the raw incremental LDFs in the section labeled Incremental. The next section, labeled Cumulative, multiplies the LDF backwards to obtain so called *age-to-ultimate* factors. It is these

factors that produce the actual estimate of ultimate. For example, the Formulaic factor at Age 5:Ult is 1.325. This is the product of the LDFs Age 5:6, 6:7, 7:8, 8:9, 9:10, and 10:Ult. Note that the 10:Ult factor, often called the *tail factor*, cannot be estimated from the triangle data. Most companies have additional data they can use to estimate the tail. Our model uses the most mature company estimates to estimate our tail.

In each section, after the Formulaic estimate, we have estimates labeled AIG and SCB. These estimate the LDFs that would be required to reproduce AIG or our estimates of ultimate, respectively. We can now see how the LDFs compare. We have boxed some AIG estimates (Ages 5:6 to 7:8) where the LDFs appear rather low versus either Formulaic or us. At the very bottom, we show Age 1:5 and Age 5:Ult factors, essentially the "beginning" and "end" of the pattern. This shows quite succinctly that it is in the tail, Age 5:Ult, where AIG differs the most from us.

Exhibit 18
Comparison of Total All Lines Paid Incremental LDFs, Formulaic vs. AIG Implied vs. SBC Implied



Source: Highline Data, SNL, Bernstein Analysis

This is very apparent if the incremental LDFs are graphed, as we do in Exhibit 18. We drop the Age 1:2 factor because it is much larger than the others and obscures the detail. As is very apparent, our LDFs are much closer to the Formulaic pattern than is AIG's implied pattern. In particular, the tail looks much thinner for Ages 5-8. In effect, this thinner tail is driving all of the overall difference.

Exhibit 19

AIG Reported Loss Development Factors (LDFs), Total All Lines, with Comparison of Formulaic, AIG Implied, and SCB Implied LDFs

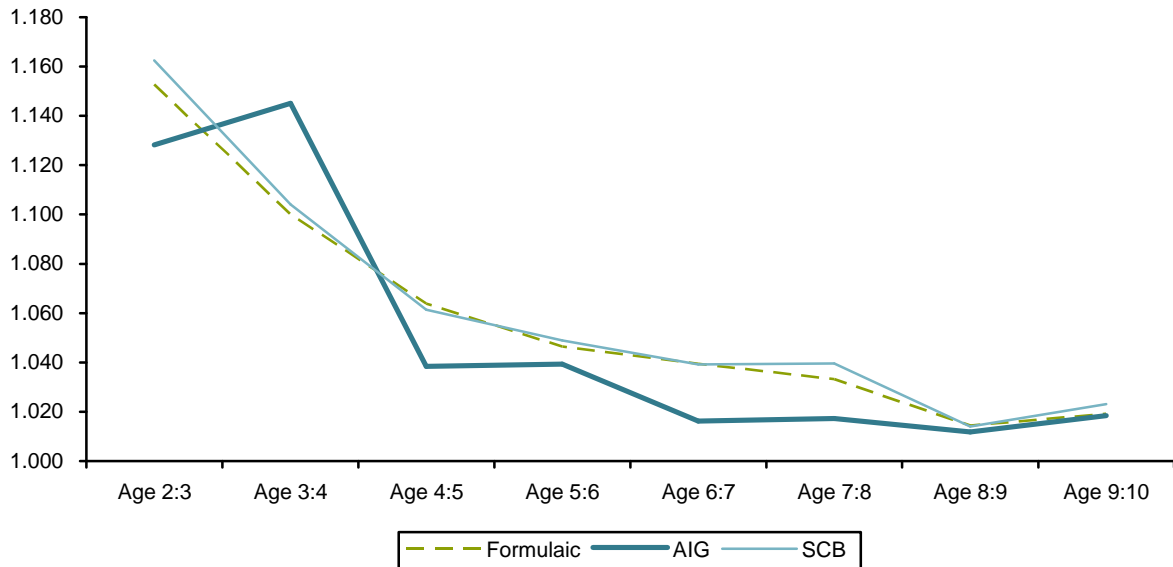
Year	Age 1:2	Age 2:3	Age 3:4	Age 4:5	Age 5:6	Age 6:7	Age 7:8	Age 8:9	Age 9:10	Age 10:Ult
1999	1.381	1.156	1.123	1.068	1.051	1.036	1.037	1.008	1.019	
2000	1.357	1.185	1.115	1.082	1.058	1.043	1.041	1.021		
2001	1.317	1.175	1.129	1.073	1.043	1.038	1.023			
2002	1.413	1.200	1.114	1.062	1.028	1.041				
2003	1.329	1.127	1.084	1.050	1.054					
2004	1.302	1.138	1.072	1.056						
2005	1.322	1.106	1.086							
2006	1.385	1.171								
2007	1.497									
Incremental	Age 1:2	Age 2:3	Age 3:4	Age 4:5	Age 5:6	Age 6:7	Age 7:8	Age 8:9	Age 9:10	Age 10:Ult
Formulaic	1.370	1.153	1.100	1.064	1.046	1.039	1.033	1.014	1.019	
AIG	1.358	1.128	1.145	1.038	1.039	1.016	1.017	1.012	1.018	1.020
SCB	1.360	1.162	1.104	1.061	1.049	1.039	1.040	1.014	1.023	1.027
Cumulative	Age 1:Ult	Age 2:Ult	Age 3:Ult	Age 4:Ult	Age 5:Ult	Age 6:Ult	Age 7:Ult	Age 8:Ult	Age 9:Ult	Age 10:Ult
Formulaic	2.190	1.599	1.387	1.261	1.185	1.133	1.090	1.055	1.040	1.020
AIG	2.057	1.515	1.343	1.173	1.129	1.087	1.069	1.051	1.039	1.020
SCB	2.237	1.645	1.415	1.282	1.208	1.151	1.108	1.066	1.051	1.027

	Age 1:5	Age 5:Ult
AIG	1.822	1.129
SCB	1.853	1.208
Difference	1.7%	6.9%

Source: Highline Data, SNL, Bernstein Analysis

We see basically the same result looking at total company reported losses in Exhibit 19. We see the same thin tail problem for Ages 5-8, which clearly shows up in the graph in Exhibit 20. And once again, our estimates are very consistent with the Formulaic method, despite the fact that our estimates are ground up and using a different model.

Exhibit 20
Comparison of Total All Lines Incremental Reported LDFs, Formulaic vs. AIG Implied vs. SCB Implied



Source: Highline Data, SNL, Bernstein Analysis

In the next 4 exhibits, we do the same analysis for the General Liability line (Part H), which we identified as the biggest source of AIG's potential deficiency.

Exhibit 21
AIG Paid Loss Development Factors (LDFs), General Liability (Sch. P Part H), with Comparison of Formulaic, AIG Implied, and SCB Implied LDFs

Year	Age 1:2	Age 2:3	Age 3:4	Age 4:5	Age 5:6	Age 6:7	Age 7:8	Age 8:9	Age 9:10	Age 10:Ult
1999	2.272	1.859	1.175	1.339	1.050	1.075	1.075	1.018	1.035	
2000	2.585	1.184	1.300	1.167	1.006	1.060	1.181	1.016		
2001	2.569	1.319	1.348	1.215	1.145	1.178	1.024			
2002	1.548	1.682	1.532	1.180	1.060	1.215				
2003	2.079	1.595	1.246	1.143	1.336					
2004	1.591	1.438	1.424	1.382						
2005	1.388	1.207	1.543							
2006	1.709	1.833								
2007	2.073									
Incremental	Age 1:2	Age 2:3	Age 3:4	Age 4:5	Age 5:6	Age 6:7	Age 7:8	Age 8:9	Age 9:10	Age 10:Ult
Formulaic	1.888	1.522	1.360	1.241	1.117	1.134	1.086	1.017	1.035	
AIG	1.997	1.495	1.210	1.254	1.152	1.020	1.019	1.031	1.062	1.084
SCB	2.003	1.486	1.316	1.246	1.203	1.149	1.082	1.038	1.022	1.108
Cumulative	Age 1:Ult	Age 2:Ult	Age 3:Ult	Age 4:Ult	Age 5:Ult	Age 6:Ult	Age 7:Ult	Age 8:Ult	Age 9:Ult	Age 10:Ult
Formulaic	7.607	4.029	2.646	1.946	1.568	1.404	1.238	1.141	1.122	1.084
AIG	6.430	3.220	2.154	1.780	1.419	1.233	1.209	1.186	1.151	1.084
SCB	8.573	4.281	2.881	2.188	1.756	1.460	1.270	1.174	1.132	1.108
				Age 1:5	Age 5:Ult					
AIG				4.530	1.419					
SCB				4.882	1.756					
Difference				7.8%	23.7%					

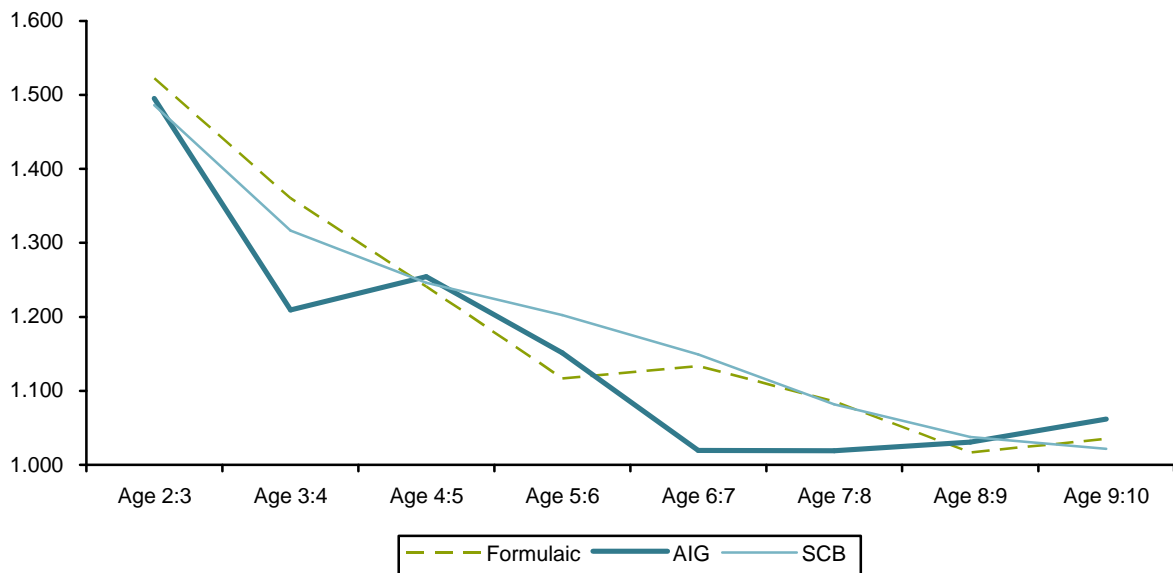
Source: Highline Data, SNL, Bernstein Analysis

U.S. Insurance/Nonlife

For Part H, the 3 patterns are not as similar, but the basic problems remain. AIG still seems to have a thin tail problem for Ages 6-7, as well as for the Age 3:4 factor. This shows up very clearly in the graph in Exhibit 22, where AIG's factors are much lower than either Formulaic or us. But our factors do appear somewhat higher than the Formulaic, particularly at Age 5:6 and Age 8:9. So one might level the criticism that our method is too conservative. In fact, it is starting to be understood that statistical methods like our perform better than standard LDF models, and our historical back-testing supports this. But we do want to highlight the point that our estimates are clearly the most conservative versus either AIG's selected ultimates or its empirical loss data.

Exhibit 22

Comparison of General Liability Incremental Paid LDFs, Formulaic vs. AIG Implied vs. SBC Implied



Source: Highline Data, SNL, Bernstein Analysis

We see the same results when looking at the reported loss data for Part H in Exhibits 23 and 24. If anything, the differences are even bigger, with AIG's implied factors looking much smaller, and ours even larger versus the Formulaic.

Exhibit 23

AIG Reported Loss Development Factors (LDFs), General Liability (Sch. P Part H), with Comparison of Formulaic, AIG Implied, and SCB Implied LDFs

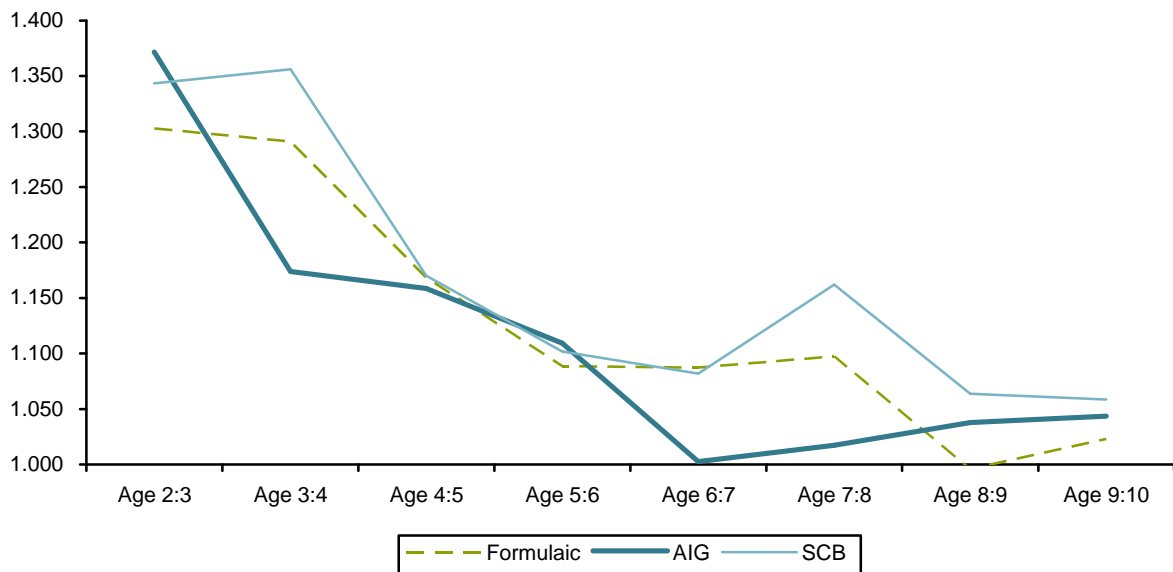
Year	Age 1:2	Age 2:3	Age 3:4	Age 4:5	Age 5:6	Age 6:7	Age 7:8	Age 8:9	Age 9:10	Age 10:Ult
1999	2.389	1.312	1.195	1.295	1.050	1.021	1.105	0.989	1.023	
2000	2.058	1.009	1.332	1.158	0.942	1.019	1.201	1.006		
2001	1.848	1.391	1.276	1.056	1.161	1.145	1.009			
2002	1.598	1.475	1.233	1.148	1.039	1.163				
2003	1.725	1.101	1.320	1.076	1.264					
2004	1.004	1.537	1.281	1.252						
2005	1.471	1.152	1.414							
2006	1.984	1.450								
2007	2.220									
Incremental	Age 1:2	Age 2:3	Age 3:4	Age 4:5	Age 5:6	Age 6:7	Age 7:8	Age 8:9	Age 9:10	Age 10:Ult
Formulaic	1.772	1.303	1.291	1.168	1.089	1.087	1.098	0.996	1.023	
AIG	2.081	1.372	1.174	1.159	1.109	1.003	1.017	1.038	1.044	1.055
SCB	2.026	1.343	1.356	1.170	1.102	1.082	1.162	1.064	1.059	0.994
Cumulative	Age 1:Ult	Age 2:Ult	Age 3:Ult	Age 4:Ult	Age 5:Ult	Age 6:Ult	Age 7:Ult	Age 8:Ult	Age 9:Ult	Age 10:Ult
Formulaic	4.863	2.744	2.106	1.631	1.396	1.282	1.179	1.075	1.079	1.055
AIG	5.021	2.413	1.759	1.498	1.293	1.165	1.162	1.143	1.101	1.055
SCB	6.695	3.304	2.460	1.814	1.550	1.407	1.300	1.119	1.052	0.994

	Age 1:5	Age 5:Ult
AIG	3.884	1.293
SCB	4.319	1.550
Difference	11.2%	19.9%

Source: Highline Data, SNL, Bernstein Analysis

Exhibit 24

Comparison of General Liability Incremental Reported LDFs, Formulaic vs. AIG Implied vs. SBC Implied



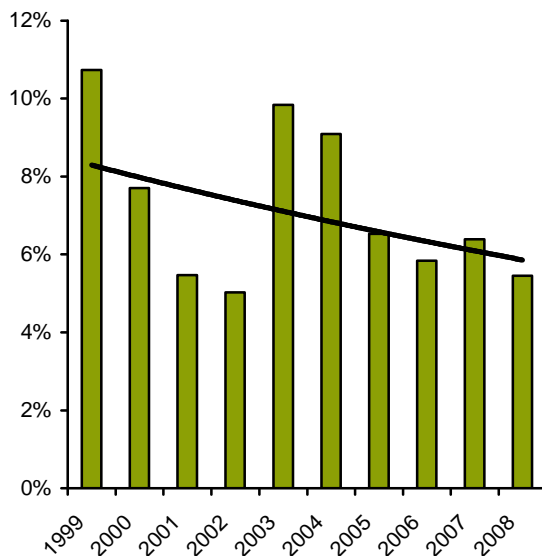
Source: Highline Data, SNL, Bernstein Analysis

We have now completed 3 sets of rigorous tests designed to substantiate the results of ground-up statistical analysis of AIG's loss reserve adequacy. Yet we are still left with the question of *why*. Even after all of this work, we are still astonished that the number is so large (which is why we went to these extra lengths). All of our work has shown that the ups and downs of the pricing cycle tend to have similar effect on all players. So we did expect AIG's reserve adequacy to be worse than its peers (we had that result back at year-end 2006), but not outright deficient, let alone to this degree. It seems like something unusual must be going on.

These results give some credence to long-held market views that AIG simply has always been a more aggressive competitor. Other companies and brokers have complained about this for years. There is even some support to the idea that discipline was lost after former CEO "Hank" Greenberg left the company. Certainly Greenberg has made this suggestion himself with respect to the debacle in Financial Products, a comment we have always taken rather skeptically. Nonetheless, we certainly cannot dismiss these possibilities out of hand unless we have an alternative reason.

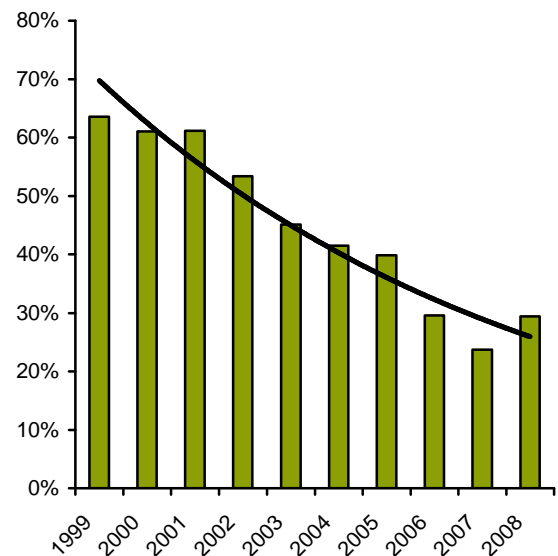
It turns out that a more solid analytical reason does present itself. The recent deterioration in both price and loss reserve adequacy may be a function of the fact that AIG's reinsurance usage has been cut nearly in half since the late 1990s, from 43% cessions in 1999 to 22% in 2008. In Exhibits 25-28, we construct ratios of ceded to gross earned premium by accident year, for the 3 liability lines we have been testing, as well as in total. In every case, AIG exhibits some level of decline in ceded premium relative to gross. The relationship is more volatile for Work Comp and Professional Liability, but is rock-solid for General Liability and for the company in total.

Exhibit 25
AIG Ceded/Gross Ratios, Workers' Comp (Sch. P Part D),
Accident Years 1999-2008



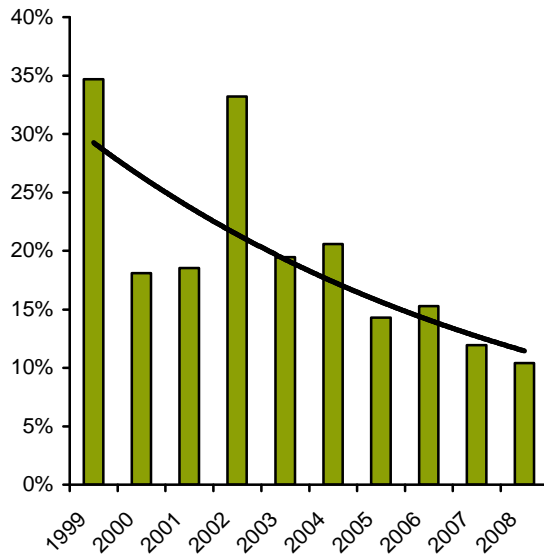
Source: Highline Data, SNL, Bernstein Analysis

Exhibit 26
AIG Ceded/Gross Ratios, General Liability (Sch. P Part
H), Accident Years 1999-2008



Source: Highline Data, SNL, Bernstein Analysis

Exhibit 27
AIG Ceded/Gross Ratios, Professional Liability (Sch. P Part HC), Accident Years 1999-2008



Source: Highline Data, SNL, Bernstein Analysis

Exhibit 28
AIG Ceded/Gross Ratios, Total All Lines (Sch. P Summary), Accident Years 1999-2008



Source: Highline Data, SNL, Bernstein Analysis

This fact supports both the idea that AIG's underwriters never adjusted to the greater need for more "net line" underwriting, as well as the possibility that AIG's reserves will have a "thicker" tail without so much reinsurance usage. In the 1990s, AIG was a very skillful buyer of reinsurance, and routinely had better results net of reinsurance than gross. In such a situation, underwriters may get used to writing business that only works with large reinsurance support.

The lower reinsurance usage also makes it a reasonable question as to the thinner development tail implicit in AIG's ultimates is appropriate. A reasonable criticism that AIG or anyone else could level against our analysis is that AIG's older business is not nearly as much like its current business. Therefore, the thicker tail we see in the older years is not appropriate to use for current business. We are well aware of such problems in our reserve work. But in the case of AIG, the large reduction in reinsurance would tend to thicken the tail, as more large losses get into the tail. There is no easy way for external analysts like us to estimate the impact of this, but given the actuarial training of 2 of Bernstein's analysts, we are certainly aware of these effects from the days when we worked in companies.

So these tests all seem to at least support the possibility that AIG's reserve adequacy is material worse than it is booking and versus its peers. There is still further work we can do in the future to refine these estimates and tests, but so far this is the most cross-checking and supplemental testing we have ever done for a reserve analysis. Despite the unexpected results, this analysis makes us rather more confident that we are at least directionally correct.

Disclosure Appendix

Valuation Methodology

Our target prices are a weighted average of intrinsic value (DCF) and a 12-month forward multiple of price/book, except for AIG. Our target price for AIG is a scenario-weighted summary of a Downside scenario of \$0 (60% weight; case where Government pulls support), a Base scenario of \$25 (30% weight; book value less reserve deficiency), and an Upside scenario of \$43 (10% weight; upside to asset sales and valuations, but now reflecting our reserve deficiency estimate). The assumptions for the rest of our coverage are summarized in Exhibit 29, and AIG's assumptions are in Exhibits 30-32.

Exhibit 29

Valuation Assumptions

	<i>Diversified</i>			<i>Personal lines</i>		<i>Commercial lines</i>		ACE
	AIG	HIG	TRV	ALL	PGR	CB	CNA	
Current Price As Per 11/27/2009	\$ 33.30	\$ 23.72	\$ 51.65	\$ 28.27	\$ 16.61	\$ 49.54	\$ 22.91	\$ 48.18
Target Price	12.00	36.00	54.00	34.00	21.00	57.00	25.00	59.00
Upside (Downside)	-64%	52%	5%	20%	26%	15%	9%	22%
Components Of Target Price:								
Intrinsic Value		\$ 40.95	\$ 67.05	\$ 40.40	\$ 21.50	\$ 64.45	\$ 31.90	\$ 71.70
12-Month Multiple Value		33.73	49.68	31.29	20.26	54.27	22.88	54.38
Weight For Intrinsic Value		25%	25%	25%	25%	25%	25%	25%
Intrinsic Value:		\$ 40.95	\$ 67.05	\$ 40.40	\$ 21.50	\$ 64.45	\$ 31.90	\$ 71.70
Long-Term ROE		12%	13%	13%	25%	13%	9%	15%
Long-Term Growth		7%	7%	4%	8%	6%	6%	10%
Real Options/Intrinsic		2%	1%	5%	18%	2%	0%	6%
Intrinsic/Normal Earnings		10.9	14.7	11.6	15.9	15.3	17.8	11.6
Intrinsic/Embedded Book		1.1	1.1	1.2	2.3	1.1	0.9	1.2
Multiple Standard:		P/B	P/B	P/B	P/B	P/B	P/B	P/B
Multiple Denominator In 12 Months:		37.47	52.30	34.76	9.65	49.34	38.13	60.42
Multiple Target:		0.90	0.95	0.90	2.10	1.10	0.60	0.90
Average		1.45	1.25	1.45	2.95	1.55	0.80	1.30
Std. Deviation		0.35	0.35	0.30	0.65	0.30	0.35	0.30
Current Multiple		0.68	1.01	0.88	2.04	1.09	0.65	0.86

Source: Company Reports, Bernstein Analysis

Exhibit 30
AIG Summary Valuation

Scenario	Per Share	Weight
Downside	\$ -	60%
Base	\$24.95	30%
Upside	\$ 43.34	10%
Total	\$ 11.82	100%
<i>Tangible:</i>	<i>\$3.01 (Memo)</i>	

Downside = No end value
 Base = Year-end book value
 Upside = Midpoint of range of asset sale/upside scenarios

Source: Company Reports, Bernstein Analysis

Exhibit 31
AIG Base Scenario Assumptions

Q2 Book Value:	\$58.0 bn
Q3 Net Income:	\$0.5 bn
Q3 AOCI Change:	\$11.5 bn
Back Out Preferreds:	(\$44.8) bn
Q3 Other Items:	\$2.7 bn
Q3 Book Value:	\$27.9 bn
Common Share:	\$5.4 bn
Per share:	\$40.00
Intangibles:	
Prepaid commitment fee:	\$ 13.0 bn
Goodwill and other:	\$ 5.8 bn
Est. reserve deficiency	\$ 7.0 bn
Q3 Tangible Book Value:	\$2.1 bn
Common Share:	\$0.4 bn
Per share:	\$3.01
Estimated Year-End**:	\$17.4 bn
20.1% Share:	\$3.4 bn
Per share:	\$24.95

** Q4E \$5bn charge on pre-paid commitment fee and other losses, no intangibles excluded, but reserve deficiency estimate included.

Source: Company Reports, Bernstein Analysis

Exhibit 32
AIG Upside Scenario Assumptions

Sources of Upside	Description	"Base" \$bn	Upside Potential	
			Percent	\$bn
CDS Book	Upside from Maiden Lane III share	\$11.7	0% - 50%	\$ - - \$ 5.9
Other Investments	Upside from current marks in insurance cos.	\$40.0	0% - 50%	\$ - - \$ 20.0
Estimated Reserve Deficiency		(\$7.0)	-50% - 50%	\$ (3.0) - \$ 3.0
Operating Units, Non-Insurance	Franchise or sale value (price/book -1)	\$14.5	-67% - 10%	(\$9.7) - \$1.5
<i>ILFC</i>	<i>0.6-1.2x book</i>	\$8.0	-40% - 20%	\$ (3.2) - \$ 1.6
<i>Capital Markets</i>	<i>0.0x book</i>	\$1.5	-100% - -100%	\$ (1.5) - \$ (1.5)
<i>Consumer Finance</i>	<i>0.0-0.2x book</i>	\$2.0	-100% - -80%	\$ (2.0) - \$ (1.6)
<i>Asset Management</i>	<i>0.0-2.0x book</i>	\$3.0	-100% - 100%	\$ (3.0) - \$ 3.0
Operating Units, Insurance	Franchise or sale value (price/book -1)	\$92.0	-17% - 25%	(\$15.3) - \$23.3
<i>Non-Life Domestic</i>	<i>0.8-1.2x book</i>	\$26.0	-20% - 20%	\$ (5.2) - \$ 5.2
<i>Non-Life Foreign</i>	<i>0.8-1.4x book</i>	\$9.0	-20% - 40%	\$ (1.8) - \$ 3.6
<i>Life Domestic</i>	<i>0.8-1.2x book</i>	\$26.0	-20% - 20%	\$ (5.2) - \$ 5.2
<i>Life Foreign</i>	<i>0.9-1.3x book</i>	\$31.0	-10% - 30%	\$ (3.1) - \$ 9.3
Grand Total	All sources of upside from "base" book value	\$ 158.2	-18% - 34%	\$ (28.0) - \$ 53.7
Plus Base Book Value	Estimated 2009 Year-End	\$ 17.4	-61% - 408%	\$ (10.6) - \$ 71.1
Per Share	135 million shares (post reverse split)			\$ (78.75) \$527.94
Share to Common Holders	Assumption of Government Support			\$ (15.20) \$101.88
Midpoint Selected Upside Value				\$ 43.34
	Estimated Standard Deviation (assuming min/max valuation ranges are 5/95% percentiles):			~ \$ 42.00

Source: Company Reports, Bernstein Analysis

Risks

There are numerous sources of potential uncertainty in any loss reserve analysis. Also, we must always assume that companies have better data than we do. Therefore, our analysis could be inaccurate in many different ways. In particular, AIG may not be as deficient as we estimate, or may be deficient at all. In this case, it would be more difficult for competitors to make headway on trying to take some of AIG's market share.

Conversely, if our company subgroup analysis happens to be too optimistic, then reserve deficiencies and thus market hardening may occur faster than we currently expect. Some insurance executives think current reserve adequacy is already much worse than we think. Thus, our cautious stance on commercial insurers may be inappropriate, particularly with the stocks so uniformly cheap.

Finally, our view is that a large AIG reserve deficiency coupled with large redundancies elsewhere will not harden the market. But this is debatable, and in the short-term, investors might take a more relative positive bet on AIG's nearest competitors. In particular, this could be much better for the stocks of TRV, CB, CNA, and ACE in the short run than we expect.

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12-Month Rating History as of 11/28/2009

Ticker Rating Changes

ACE	M (RC) 01/06/09	O (RC) 06/16/04	
AIG	U (RC) 09/01/09	M (RC) 01/06/09	O (IC) 05/31/00
ALL	M (RC) 01/06/09	O (RC) 03/27/08	
CB	M (RC) 05/21/09	U (RC) 01/06/09	O (RC) 11/16/07
CNA	M (RC) 01/06/09	O (RC) 11/16/07	
HIG	O (RC) 03/27/08		
PGR	O (RC) 12/06/06		
TRV	M (RC) 01/06/09	O (RC) 11/16/07	

Rating Guide: O - Outperform, M - Market-Perform, U - Underperform, N - Not Rated
Rating Actions: IC - Initiated Coverage, DC - Dropped Coverage, RC - Rating Change

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