

November 11, 2019

AIG: THE PATH FORWARD

With the re-underwriting in full swing, expenses and capital allocation questions now loom over AIG's operating turnaround...

We have previously written about AIG's [Three Step Master plan](#). However, in truth, this is really more of a model for understanding management's tactics around managing the expectations of its many internal and external stakeholders rather than its actual strategy.

More fundamentally, the three things AIG has needed to do to become a normal company again has been clear since the company exited government ownership close to a decade ago. (1) Fix the loss ratio, (2) fix the expense ratio and (3) fix capital efficiency.

First, the good news. Progress fixing the loss ratio has been astonishingly bold.

As we detail below, the company's re-underwriting efforts continued to accelerate in Q3. It should be obvious to everyone by now that AIG's underwriting actions are a [once in a generation event](#).

Importantly, much of the reported underlying loss ratio improvement to date has been due to M&A-driven mix-shift. With pricing actions still accelerating and likely to continue to build on a written basis through at least early next year, the impact on an earned basis is very much still to come.

Perhaps even more importantly, disclosures on limit reductions tell an extraordinary story of de-risking from [excess](#) business. As we explain below, we expect this to be a multi-year tailwind due to the slow recognition in actuarial accounting (excess biz is fixed by attaching out, not by pricing, which takes time to prove out and be recognized).

However, the other two legs remain less clear, with unacknowledged trade-offs looming on expenses and capital management.

On [expenses](#), clearly the opportunity is huge. AIG consistently enjoyed a cost advantage in its multi-decade era of dominance due to its colossal scale advantage (and, in hindsight, short-sighted decisions to defer investments in technology and integrating its global platform to sustain its runaway valuation).

Expenses continued to improve in Q3 (GI G&A ratio down 1.7pts), with reinsurance, shared-service efforts by prior management, and the opportunities from the merger of its Japanese legal entities (closed April 2017) likely providing plenty of fertile ground to harvest gains. And on top of this, management has begun to make vague noises around a [new expense initiative](#) dubbed "AIG 200" – [details below](#).

Now, management has not quantified its expected savings from AIG 200, nor the investment expenses necessary to achieve them. However, CEO Brian Duperreault has a couple of times hinted towards a P&C expense improvement needed of [around 5pts](#) to close the gap to peers.

Yet, Duperreault has also recently said he also expects the same initiative to help the company to reach "operating excellence" and for the company to have the best operating capabilities of its peers. [Within two to three years](#).

It is worth noting that each of these targets on their own would represent a heroic achievement. Doing them both simultaneously within two to three years would be astonishing.

Indeed, Duperreault's language around this hints more towards a sequencing that first sees investment in capabilities, with the expense

INSIDE P&C RESEARCH

Gavin Davis, Director of Research
gavin.davis@insidepandc.com
(212) 224 3328

James Thaler, CFA, Senior Analyst
james.thaler@insidepandc.com
(212) 224 3336

Dan Lukpanov, CFA, Research Analyst
dan.lukpanov@insidepandc.com
(212) 224 3326

Gianluca Casapietra, Research Analyst
gianluca.casapietra@insidepandc.com
(212) 224 3495

AIG, Key Statistics

Market Cap (\$mn)	48,639
Share price	55.9
MTD	5.6%
YTD	41.9%
1-YR	27.6%
3-YR	(11.5)%
Div Yield	2.3%
Price / Earnings	27.8 x
Price / Book	0.7 x
Price / Tangible Book	0.9 x

Source: S&P Global, Inside P&C

savings more likely coming later, but this is just our interpretation. [Details below.](#)

Third, capital efficiency has improved, but re-deployment will be a challenge.

Increased capital efficiency is perhaps the area where the company has made most progress over the past few years, even if its prior aggressive buyback plan has subsequently been criticized by new management. [Details below.](#)

However, [capital allocation](#) is job #1 for any CEO. With holding company liquidity back over \$7bn (and growing) and financial leverage down ~3pts since year-end at 26% total debt-to cap, capital will need to be re-deployed or else become a significant drag on ROE goals.

In Q3, the company did not repurchase any stock, blaming this on the somewhat antiquated notion that it is imprudent to buyback stock during peak cat risk seasons, something done habitually at high quality peers with well-established capital management programs.

What seems clear is the company's priorities are not oriented around capital return in the near term, with management consistently signaling a preference to improve financial flexibility, reduce leverage, and [reinvest in the business.](#)

However, the company's capital allocation preference here is also likely to bump up against real world constraints in the form of inflated asset prices for insurance businesses.

Recall, management's own estimate for its return on investment for Validus was in the high single digits. It's a fairly simple truism that it will be hard to deliver on a target double digit ROE so-long as capital is redeployed at below target rates over a sustained period. Doubly so given management's stated preference to eschew synergy-driven deals and focus instead on strategic and capabilities driven deals (likely with at least some unacknowledged capital synergies).

Now, AIG's management has made astonishing progress to date, and deserves all the accolades it is receiving for meeting its problems head on.

It is not being hyperbolic to say that, given its historic role in poisoning the well, the conversion of AIG into a rational competitor may be the most important secular change in P&C for a generation.

Even so, whatever the tailwinds are building in P&C, the path forward for the [operating](#) turnaround will only get harder from here, especially if P&C tailwinds begin to be partially offset by emerging risks in life and retirement (e.g. compression risk, market risk etc).

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AIG: THE PATH FORWARD FROM HERE

The path to fixing AIG has been clear since the company exited government ownership close to a decade ago.

Put simply, the firm has been facing three fundamental problems.

- (1) The loss ratio has been too high, driven by a combination of elevated attritional losses, outsized catastrophe losses, and prior year development.
- (2) The expense ratio has been persistently tracking at 500bps or higher than most comparable peers.
- (3) The firm has a persistent capital problem, and has struggled to reduce its capital requirements due to its legacy of outsized volatility.

Despite the obviousness of all three to all concerned, the company has made little to no progress to date in its reported results on anything other than capital efficiency.

The path forward for AIG

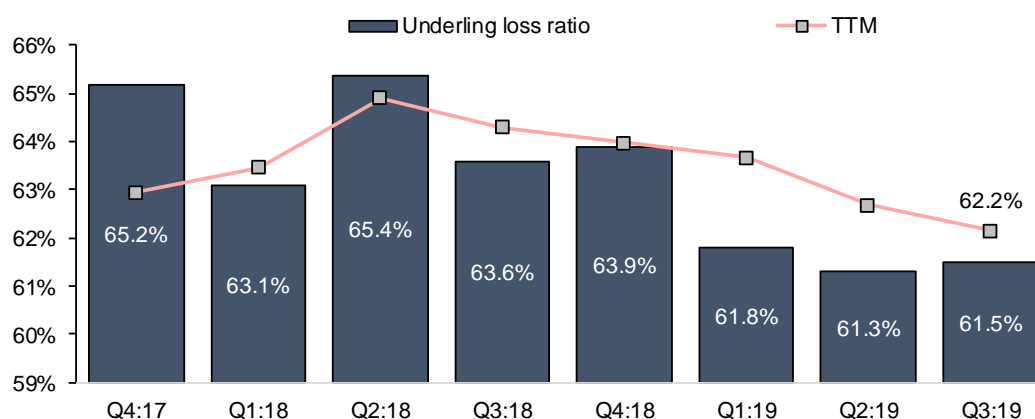
First, the good news. By now it should be clear to everyone that the steps taken to re-underwrite the P&C portfolio are nothing short of extraordinary – a once in a generation event. For background see: [AIG's 'misery without end' must end](#) and [Inside the battle to save AIG](#).

In Q3, the ex-cat accident year loss ratio improved 2.1pts to 61.5%, driven by International. The improvement was held back by the North America Commercial operations which improved only 0.3pts. However, this included a 1pt drag from a crop true-up and 2.5pts from higher losses in inland marine, aviation, and energy, suggesting some underlying improvement elsewhere from mix-shift and underwriting actions.

Of course, it is important to remember that, as we explained in [AIG: The three-step master plan](#), most of the progress to date has come from mix-shift through acquisitions rather than due to actions on the legacy business = lower loss ratio business in Validus, Talbot, and Glatfelter mixing in while drastically cutting higher loss ratio casualty business.

EXHIBIT: AIG GI UNDERLYING LOSS RATIO

Source: Company reports, Inside P&C



Underwriting actions accelerated in Q3

However, looking beyond the immediate mix-driven improvement, there are plenty of reasons to be optimistic about continued improvement from here.

Similar to prior quarters, management provided some selective disclosure on some key segments of the market to give an illustration of competitive dynamics.

Though there should always be some scepticism around selectively disclosed metrics, the numbers highlighted by management were simply staggering (see graphic below).

EXHIBIT: RATE COMMENTARY

Source: S&P Global, Inside P&C

AIG GI (Ex-Validus and Glatfelter)	<ul style="list-style-type: none"> o Q3 GI rate, ex-Validus & Glatfelter, high single to low double digits o NA commercial rates up low double digits, high single-digits in Q2 o Int. commercial rates up low to mid-single digits across all geographies
Lexington	<ul style="list-style-type: none"> o Casualty submission volume up 62%, total limits reduced by 58%, rates up 31% o Property submission volume up 47%, total limits down 74% o Overall proportion of excess policies from 11% in 2018 to 25% YTD (property) o Property deductibles up 18%, rate up 15%
NA Retail Property	<ul style="list-style-type: none"> o Continued to reduce aggregates and exposure to certain classes o Reduced total gross limits by over \$20bn or 37%, down \$80bn or 49% YTD o NA retail property rate in high teens, mid-20s excl impact of LT agreements o Average deductible increased by 27% in Q3; 30% YTD o Expect to see rate increases through the remainder of the year and into 2020
D&O	<ul style="list-style-type: none"> o Commercial D&O rate increases exceeding 30% o Public D&O rate increases exceeding 35% o Primary comm'l D&O aggregate limits down by over 40% in Q3, 30% in Q2 o Primary comm'l D&O policies (limits > \$10mn in lead layers) down 40%

And importantly, the company's underwriting actions on a written basis appeared to have accelerated in Q3. For example.

- o **Casualty** pricing in Lexington was up only 6% in Q4:18, 8% in Q1, 20% in Q2, and 31% in Q3.
- o In **D&O**, pricing was up 9% in Q4:18, 11% in Q1, 17% in Q2, and 28% in Q3.

As such, we expect increases on written premiums to continue to build margin tailwinds at least into early 2020 (recall GI CEO Peter Zaffino said in September that the firm's remediation "isn't fully done" and there will likely be more "work done" in 2020 that will lead to some lines shrinking further).

Looking beyond pricing...

Note, despite receiving much less attention by most external observers, the re-underwriting actions are likely to have a larger impact on underwriting results over time than pure pricing.

Based on the disclosure the company has given around limit reductions versus premium reductions, it seems reasonably clear that much of the focus has been around the excess book. And there are two important things to consider.

- o First, however trite this sounds, excess books are not cured by price action, but by not having losses.
- o Second, because of the way actuarial accounting works, the benefit of actions taken to "attach out" of losses are likely to take years to show

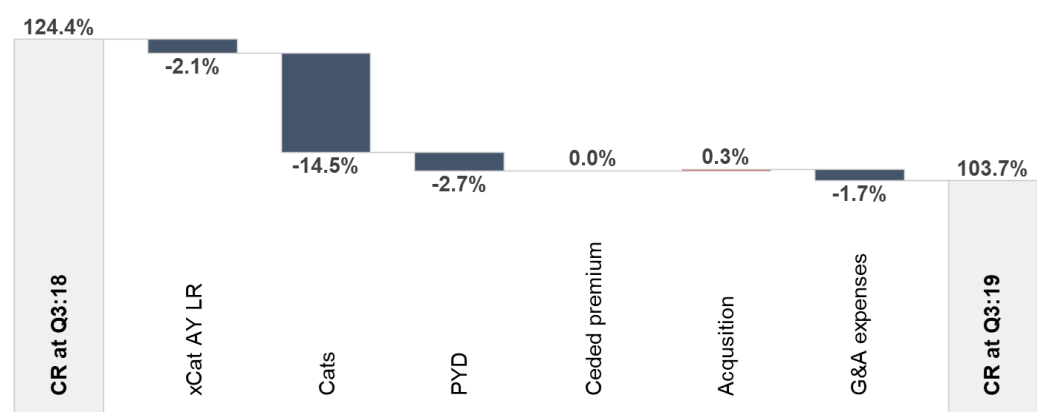
through to the extent the data is considered credible to be bleed into loss picks.

For all the cynicism around earnings management – and we have never been accused of a lack of cynicism - this is one fundamental reason the old aphorisms around serial correlation - that “good years get better and bad years gets worse” holds true. But we’d add that management is hardly incentivized to drop much to the bottom line so long as it is able to leverage the weak trailing results into better economic terms.

Quantifying the impact of these multiple moving pieces – the mix shift, the pricing action, the dramatic deductible increases, and the apparent radical decline in excess business – is near impossible from the outside. But the direction of travel and long duration of tailwinds seem likely, absent an even more dramatic loss cost environment.

EXHIBIT: AIG Q3 COMBINED RATIO YOY CHANGE ATTRIBUTION

Source: Company reports, Inside P&C

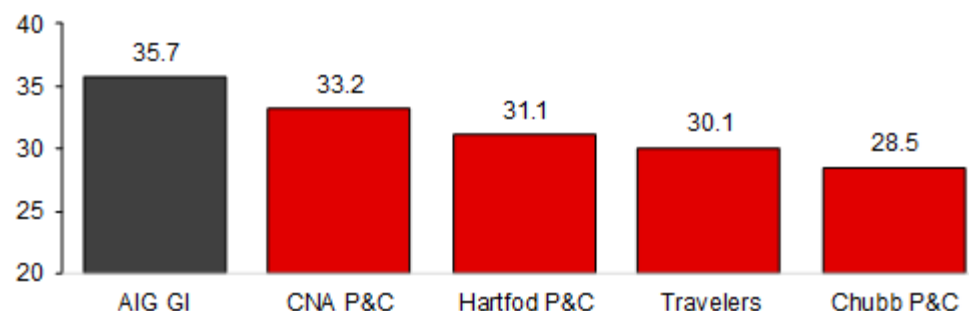


EXPENSE RATIO: OPERATING EXCELLENCE IN 2-3 YEARS OR 500BPS OF ER IMPROVEMENT. SOMETHING'S GOT TO GIVE...

On expenses, clearly the opportunity is huge. AIG consistently enjoyed a cost advantage in its multi-decade era of dominance due to its colossal scale advantage (and, in hindsight, short-sighted decisions to defer investments in technology, infrastructure, and integrating its global platform to sustain its runaway valuation). However, since the crisis, it has lagged most peers by ~500bps or more.

EXHIBIT: LARGE CAP COMMERCIAL EXPENSE RATIOS

Source: Company reports, Inside P&C



Expenses continued to improve in Q3 (GI G&A ratio down 1.7pts), with reinsurance, shared-service efforts by prior management, and the opportunities from the merger of its Japanese legal entities (closed April 2017) likely providing plenty of fertile ground to harvest gains. And on top of this, management has begun to make vague noises around a new expense initiative dubbed "AIG 200".

However, AIG has been reluctant to spell out what this means exactly beyond a plan to have a plan, this quarter referring to *"transformational change to our infrastructure and underwriting operations as well as developing a new data architecture, all of which will be designed to achieve best-in-class operations that deliver value through scale and simplification"*. And not adding much else.

Recall, the company has not quantified its expected expense savings, nor the investment expenses necessary to achieve them. However, CEO Brian Duperreault has a couple of times hinted towards a P&C expense improvement needed of around 5pts to close the gap to peers.

Even so, Duperreault has also recently said he also expects the company to reach "operating excellence" and for the company to have the best operating capabilities of its peers within two to three years.

Our view is: something's got to give.

Background on AIG 200

Recall, AIG first unveiled its new expense and operational transformation initiative with scant details on its Q2 call. At this time management explained the title was a reference to improving the operating platform for the next 100 years of the business following the (hotly disputed) 100-year anniversary.

Though scant details were given, management suggested the expense ratio improvement would be "much more than 200bps" with at least 500bps of expense improvement needed on the GI expense ratio. The project is also expected to be a "three year plus" program.

"If you look at the GI expense ratio, in particular. To pick a number, it's at least 500 basis points too high, in my mind. And how are you ever going to get that down? We have to transform the company. We have to do it fundamentally. It's going to take us some time, but it's the next great step and to me, it's as important as anything we've been doing to date in this company."

- CEO Brian Duperreault, Q2 conference call

This was followed up by some incremental information around the project's focus at public appearances by Duperreault and AIG group COO and General Insurance CEO Peter Zaffino at investor conferences in September.

Zaffino in particular provided some modest new details around the areas of focus, and some examples of the project work currently underway. He also acknowledged the effort would require some cost cutting.

"While the primary purpose is not about cost cutting, we do expect our work will ultimately lead to a reduced expense base over time and more importantly an improved experience for our distribution partners, client policyholders and colleagues."

- AIG COO Peter Zaffino, KBW conference September 2019

Here is a summary of what we know. The initiative has four key pillars: (1) achieving underwriting excellence, (2) modernizing operating infrastructure, (3) enhancing user and customer experience, and (4), becoming a more unified company.

The first pillar on underwriting improvements has already seen a lot of publically disclosed actions – including improving underwriting talent, changing its appetite around both gross and net limits, restructuring its risk appetite around complex risks, reducing concentrations in high net worth homeowners, and the deployment of “ventilation” of layers through a program rather than one large stretch. See [AIG's misery without end must end](#) for background.

AIG 200: Four Pillars to improve operating performance	
#1	Achieving underwriting excellence
#2	Modernizing operating infrastructure
#3	Enhancing user and customer experience
#4	Becoming a more unified company

As such, though technology and digitization may aid continued improvement in underwriting, it is likely the expense portion of the initiatives will be focussed on the other three around operating infrastructure, technology and user experience, and leveraging the firm's vast scale.

Zaffino said it was too early to quantify both the size of the expected financial investment required to make the operational improvements and the likely long term financial impact.

However, he outlined several examples of projects being undertaken. See below.

AIG 200: Two specific areas highlighted	
Japan transformation	<ul style="list-style-type: none"> ○ Next step following integration of Consumer and SME entities in 2018. ○ AIG is looking to improve the strategic positioning of the business by “transforming it into a next generation digital insurance company”. ○ The new model is expected to reduce paper-intensive manual processes with automation and digitization.
Shared services	<ul style="list-style-type: none"> ○ Identified as a “significant opportunity and priority for AIG 200”. ○ Progress to date has not been fully realized due to siloed approach. ○ The current “5-function, 5-business model approach will be transformed into a single fully-integrated “multi-functional digital end-to-end” process operation. ○ Changes will deliver value “through scale and simplification”.

Recall, a pivot to shared services was a key initiative of prior management under CEO Peter Hancock, who had unveiled plans to move almost 9k employees to 11 shared service locations globally by the end of 2015.

The new strategy appears a continuation of this work to fully integrate the shared services into a single function, and fully exploit AIG’s massive global scale that has never been fully leveraged due to its history as a company haphazardly assembled through expansive M&A in a pre-digital era with a partly-decentralized operating philosophy.

The unacknowledged trade-offs: Investing in operating excellence Vs. cutting costs.

As noted above, the company has not quantified its expected expense savings, nor the investment expenses necessary to achieve them. However, CEO Brian Duperreault has a couple of times hinted towards a P&C expense improvement needed of **around 5pts** to close the gap to peers.

Even so, Duperreault has also recently said he also expects the company to reach “operating excellence” and for the company to have the best operating capabilities of its peers **within two to three years**.

It is worth noting that either of these goals on their own – a 5pt expense improvement or reaching top tier operating excellence - would represent an enormously bold target.

In terms of operating excellence, AIG’s historical underinvestment in its operating platform is legend.

Suffice it to say it would be a heroic achievement if management was able to drag the company back towards average among its peers in terms of operating excellence within three to five years – let alone top of the pack within two.

Of course, the company has multiple stakeholders to manager, including its executives and employees who undoubtedly want to feel part of an ambitious, aspirational, and winning organization.

To that end, some of management's language is undoubtedly around re-shaping perceptions of the company – both internally and externally – as a globally competitive and aspirational firm instead of a walking punchline for poor risk management and a synonym for corporate failure.

The expense ratio improvement goal is equally problematic.

On the one hand, this should be an achievable goal. AIG has substantial scale advantages over most peers, and has been investing aggressively in consolidating and improving its back office systems since its accounting scandal in 2005.

Though much derided for other reasons, the firm's prior management put it on a path towards improved expense efficiency with investments into shared services and integrated claims systems that they were never able to fully see to maturity. To some extent, current management may be able to harvest some of these gains while still investing in other needed improvements.

That said, the very fact the firm's operating technology "problem" is now more than a decade old should serve as a warning that this will be no walk in the park, and management should be careful about declaring victory before it's even finalized its plans by its own admission.

Similarly, top tier operating excellence is a moving target. One of the reasons there is such a persistent performance gap in P&C is that top tier firms are able to use their excess margin gap to peers to continually invest in the franchise and sustain their competitive advantages in technology and capabilities without making challenging investment trade-offs or disappointing investors on the bottom line.

Even more importantly - If each of these targets on their own would represent a heroic achievement, doing them simultaneously within two to three years would be utterly astonishing.

Indeed, Duperreault's language around this hints more towards a sequencing that first sees investment in capabilities, with the expense savings more likely coming later, but this is just our interpretation. For example, at a recent investor conference, he said:

"Anybody can cut a bunch of costs out and then you have this immediate improvement in your bottom line, but it's not sustainable. And so the difference here is this a long-term project to ensure that it is sustainable... So that requires true investment, creating efficiencies and processes." - **CEO Brian Duperreault, Barclays Financial Conference, September 2019**

Of course, this "invest in the franchise first" fits better with the company's other actions to date, with management constantly re-iterating it is eschewing easy fixes and preferring a long term strategic approach. And recall, management joined the firm in 2017 with 7-year options, explicitly incentivizing this approach.

But there is a risk the company's bullish language in recent months is elevating near-term expectations among the investment community – especially on the back of the firm's recent underwriting improvement that has given credibility to the turnaround plan.

However, the simple truth of the matter is that the first leg of the operating turnaround – the loss ratio – is the most powerful and immediate lever a management team has to pull. And management has done an excellent job pulling this lever to date, and is rightly getting a lot of credit for it.

But cutting expenses in a sustainable way is just harder to do if you're not willing to sacrifice the franchise for a near term gain (typically done by someone looking to ultimately sell their way out of their systems problem = not possible for AIG due to size).

Over time the company will undoubtedly provide more details on the quantum, timing, and sequencing of its expected investment needs and expense savings.

But in the near term, given the momentum around the AIG turnaround story in 2019 to date, there is substantial risk of near-term expectations getting a little ahead of themselves. Despite the significant progress to date, the next step in the operating turnaround is simply harder than the first.

CAPITAL MANAGEMENT: THE \$7BN AND GROWING QUESTION

Capital efficiency is perhaps the area where the company has made most progress over the past few years, even if its prior aggressive buyback plan has subsequently been criticized by new management. For example:

- Since 2016 the company has reduced its life RBC's from a well-above target ~500% in 2015 to below 400% in 2018 (somewhat below its target range under prior management).
- Similarly, AIG's capital intensity in a post-SIFI era looks less conservative, with assets to equity (ex-separate accounts) of 6-7x making it look more like the hybrid Life & PC company it is rather than being less aggressively leveraged than some of its short-tail P&C peers as was the case through most of its post-crisis life under prior management.
- We have previously highlighted recent actions the firm has taken to continue to remove capital intensive tail-risk from its own balance sheet, including its attempts to de-consolidate DSA Re, and shifting HNW "cat" risk to Lloyd's, as well documented steps around both its gross and net underwriting strategies.

EXHIBIT: ASSETS/EQUITY (EX SEPARATE ACC.) FOR P&C & LIFE

Source: S&P Global, Inside P&C

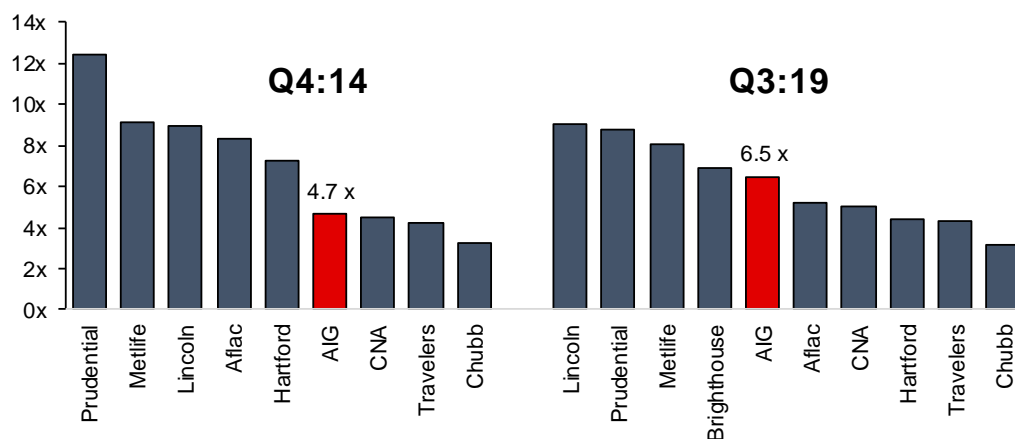
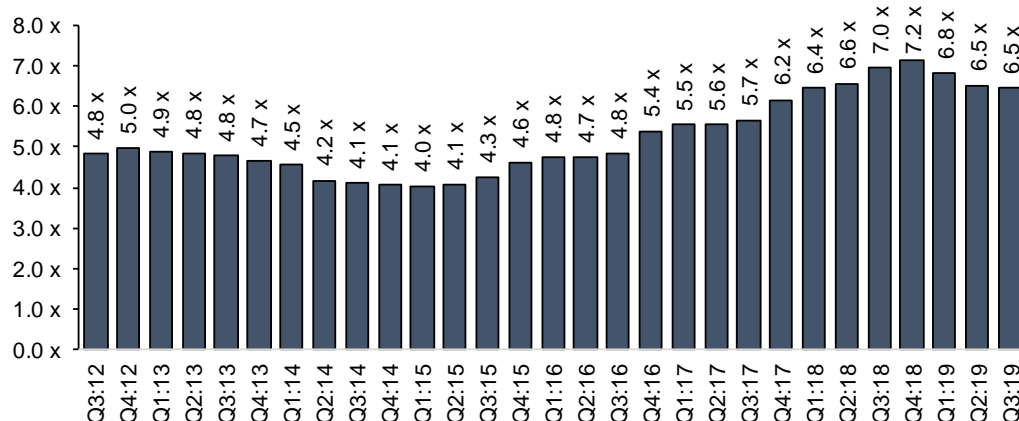


EXHIBIT: AIG'S ASSETS/EQUITY (EX SEPARATE ACC.)

Source: S&P Global, Inside P&C



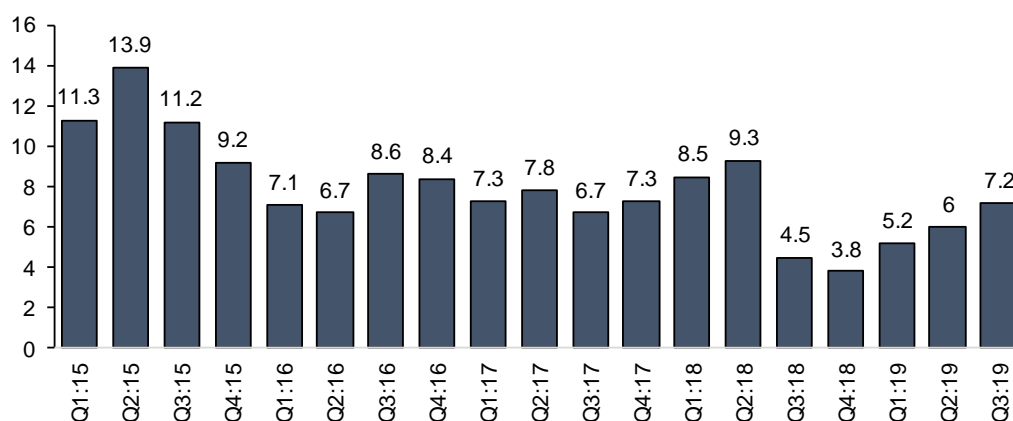
Of course, there is something of an irony in the fact that current management has been so critical of the “risky” return of capital under prior management. After all, asset intensity appears to have been most impacted by the deployment of liquidity to buy Validus shares rather than AIG shares previously. (Of course, we’re being flippant as part of the critique relates to returning so much capital while simultaneously taking more risk in large net P&C underwriting limits).

Even so, capital allocation is becoming a more pressing concern.

Capital allocation is job #1 for any CEO, and with holding company liquidity back over \$7bn and financial leverage down ~3pts since year-end at 26% total debt-to-cap, capital will need to be re-deployed or else become a significant drag on ROE goals.

EXHIBIT: AIG PARENT LIQUIDITY (\$BILLIONS)

Source: Company reports, Inside P&C



In Q3, the company did not repurchase any stock, blaming this on the somewhat antiquated notion that it is imprudent to buyback stock during peak cat risk seasons, something done habitually at high quality peers with well-established capital management programs.

What seems more clear is the company’s capital priorities are not oriented around capital return in the near term, with management consistently signaling a preference to improve financial flexibility, reduce leverage, and reinvest in the business.

However, the company’s capital allocation preference here is also likely to bump up against real world constraints in the form of inflated asset prices for insurance businesses.

Recall, management’s own estimate for its return on investment for Validus was in the high single digits. It’s a fairly simple truism that it will be hard to deliver on a target double digit ROE so-long as capital is redeployed at below target rates over a sustained period. Doubly so given management’s stated preference to eschew synergy-driven deal and focus instead on strategic and capabilities driven deal (likely with at least some unacknowledged capital synergies).

Perhaps most challenging will be its stated intent to grow in small and middle markets. As we have previously written, it’s not entirely clear it has any particular competitive advantage either in underwriting or distribution away from its historic core in large and complex risk (apart from a few “moon shot” projects

it rarely discusses). Additionally, its target markets are already overcrowded, highly competitive, and evolving to benefit those with the best technology not the biggest balance sheet or line sizes.

These conditions typically lead to very expensive M&A, or else increased risk of growth through price competition and/or adverse selection driven growth. Successfully pursuing this strategic goal while require a deft touch indeed.

Note, as the charts below show, AIG's capital return plan that was among the most aggressive of its peers just a few short years ago is now lagging other similar companies. **AIG's pre-existing scale, historically weak operating infrastructure, foot print in competitive mature industries, and inflated asset values make both inorganic and organic growth challenging.**

EXHIBIT: BUYBACKS AS % OF EQUITY

Source: S&P Global, Inside P&C

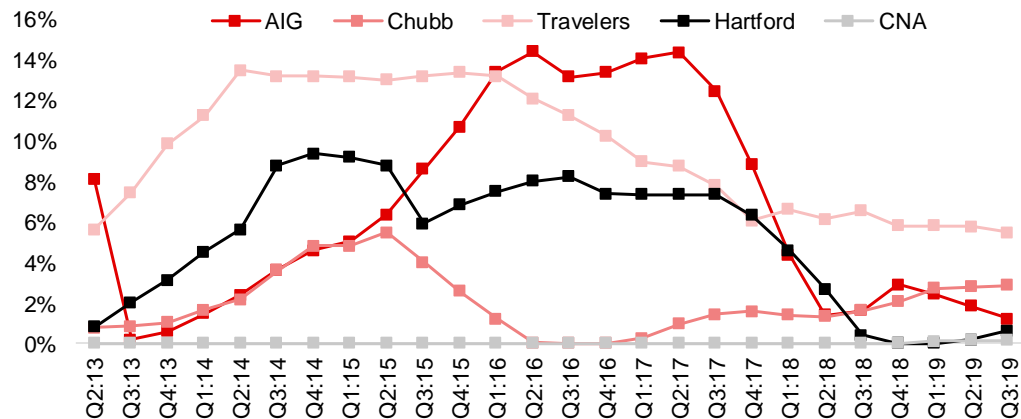
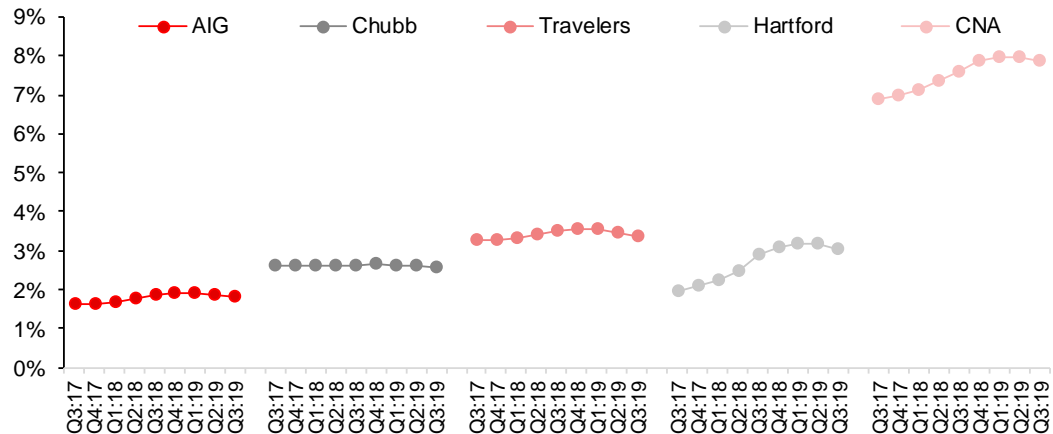


EXHIBIT: DIVIDENDS DECLARED AS A % OF COMMON EQUITY (TTM)

Source: Company reports, Inside P&C



AIG Q3 EARNING SUMMARY: NII AND UNDERWRITING DRIVE IMPROVEMENT

AIG missed analyst estimates, posting a materially lower \$0.56/sh in operating EPS versus consensus estimates of \$1.09 (according to SNL). The miss was driven by higher cat losses and a review of actuarial estimates in the life and retirement business that led to a reserve charge.

Adjusted after-tax income came in at \$505M, supported by \$646M in after-tax earnings from Life and Retirement. The result compares with a \$301M loss recorded in the year-prior quarter.

EXHIBIT: AIG EARNINGS SUMMARY

Source: Company reports, Inside P&C

(\$mn)	American International Group (AIG)					
Period:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	VAR
Operating EPS.	\$ (0.34)	\$ (0.63)	\$ 1.58	\$ 1.43	\$ 0.56	-267.7%
GWP	8,668	7,699	10,195	8,654	8,583	(1.0%)
NWP	6,835	6,424	6,033	6,581	6,648	(2.7%)
NEP	7,081	7,171	6,713	6,694	6,659	(6.0%)
U/W gain	(1,726)	(1,071)	179	147	(249)	(85.6%)
NII	901	349	1,089	833	756	(16.1%)
Cats	(22.0%)	(11.2%)	(2.7%)	(2.5%)	(7.6%)	14.4pts
PPD	(2.9%)	(5.2%)	0.9%	0.9%	(0.1%)	2.8pts
AY ex-cat LR	63.4%	64.0%	61.7%	61.3%	58.7%	(4.8)pts
Loss ratio	88.6%	80.1%	63.1%	63.0%	69.3%	(19.3)pts
Expense ratio	35.7%	34.8%	34.3%	34.8%	34.4%	(1.4)pts
Combined ratio	124.4%	114.9%	97.3%	97.8%	103.7%	(20.6)pts

Profitability overall remained low, with adjusted **ROE** hitting **4.1%** for the quarter and **8.6% year-to-date**. Recall, AIG has set out a goal to generate a sustained 10% ROE by 2021. In total, net investment income for the quarter arrived at \$3.4B, essentially flat with the year-prior quarter. Capital gains had a meaningful impact on the company's result, as AIG generated pre-tax net capital gains of \$929M in the quarter vs. year-ago losses of \$511M.

By segment, General Insurance generated \$507M in adjusted pre-tax income, comprised of an underwriting loss of \$249M and investment income of \$756M. The underwriting loss was driven primarily by catastrophe losses totalling \$497M, including **\$254M** from Typhoon Faxai and **\$135M** from Hurricane Dorian. These losses added 7.5pts to the combined ratio, which reached 103.7% for the quarter. In total, AIG reported \$1.1B net fewer cat losses compared with the year-prior quarter.

On the underwriting side, the company improved its attritional combined ratio by 350bps, with 210bps of improvement coming from AIG's attritional loss ratio and 140bps of improvement coming from the company's expense ratio. The company attributed the decrease the adjusted accident year loss ratio to changes in business mix, strong results from Glatfelter, improved loss performance from a number of lines, and changes in reinsurance. AIG attributed the improvement in the expense ratio to "better expense discipline".

NWP in all lines lower except Special Risk

All-in, gross written premium was down 1% at \$8.6bn and net written premium (NWP) was down 2.7 percent due to increased reinsurance purchases.

The decrease was driven by lower international volumes, partly due to FX. By line of business, the firm reported significant reductions of volume in property, accident & health, liability and financial lines (see table below). Personal lines were slightly down. To partially offset, net underwriting volume in special risks was up 35.1%, likely driven by the impact of acquisitions.

Key data points by geography:

- **North America:** NWP was +7.6% to \$3.4bn, partially due to meaningful rate increases across many lines of business, partially offset by “underwriting actions to strengthen the portfolio” = the massive re-underwriting in large and complex risk and other underperforming lines that has moved the market. Note the level of price increases, and acquired revenues, mean the level of churned business is significant.
- **International:** NWP was -11.6% on a reported basis or -10.6% on a constant dollar basis. The firm attributed this to re-underwriting actions, partially offset by the impact of acquired premiums = the opposite of North America.

Key data points by line of business include:

- Property was down 14.2% to \$773mn.
- Specialty risks grew premiums 35.1% to \$1.2bn.
- Liability down 12% to \$1.1bn.
- Financial lines down 5.5% to \$967mn.
- Total personal down 6.4% to \$2.6bn, driven by 13.4% decline in A&H.

EXHIBIT: AIG PREMIUMS WRITTEN BY PRODUCT LINE

Source: Company reports, Inside P&C

(\$mn)	AIG NWP by product line					
Period:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	VAR
General Insurance						
Property	901	691	299	1,004	773	(14.2%)
Special Risks	911	970	1,481	1,012	1,231	35.1%
Liability	1,204	1,006	997	910	1,060	(12.0%)
Financial Lines	1,023	1,054	1,001	954	967	(5.5%)
Total Commercial	4,039	3,721	3,778	3,880	4,031	(0.2%)
Personal Lines	1,537	1,441	1,057	1,574	1,527	(0.7%)
Accident & Health	1,259	1,262	1,198	1,127	1,090	(13.4%)
Total Personal	2,796	2,703	2,255	2,701	2,617	(6.4%)
GI NWP	6,835	6,424	6,033	6,581	6,648	(2.7%)

NA Commercial Lines sees a big improvement

The North American Commercial lines business was a big driver of YoY improvement, with a 20.1pt improvement in the combined ratio due to reductions in high loss ratio businesses, strong results from Glatfelter, “improved rate adequacy” and other factors. Crop losses from flooding in Midwest added 100bps to the combined ratio. Inland marine, aviation and energy added 250bps on the combined ratio. Key data points include:

- The accident year loss ratio improved 0.4pts to 75.1%.
- Catastrophes contributed 6.4pts, down 15.2pts YoY.
- PPD removed 1.4pts from combined, 2.1pts more than in 2018.
- Expense ratio improved 2.5pts to 24.1%.
- Combined ratio down 20.1pts to 105.1%.

EXHIBIT: AIG NA COMMERCIAL LINES PERFORMANCE

Source: Company reports, Inside P&C

(\$mn)	AIG, North America commercial					
Period:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	VAR
NWP	2,229	2,161	1,998	2,364	2,502	12.2%
NEP	2,425	2,594	2,375	2,457	2,435	0.4%
UW gain	(609)	(541)	54	(36)	(123)	(79.8%)
Cats	21.6%	9.7%	5.2%	5.4%	6.4%	(15.2)pts
PPD	0.7%	13.1%	(2.5%)	(2.9%)	(1.4%)	(2.1)pts
AY ex-cat LR	75.5%	72.0%	69.1%	72.4%	75.1%	(0.4)pts
Loss ratio	98.5%	93.6%	70.7%	74.8%	80.9%	(17.6)pts
Expense ratio	26.6%	27.3%	27.0%	26.7%	24.1%	(2.5)pts
Combined ratio	125.1%	120.9%	97.7%	101.5%	105.1%	(20.1)pts

International Commercial benefits from below-trend loss activity in Specialty and Talbot

The international commercial lines combined ratio improved 19pts to 104.1%, driven by lower catastrophe losses amounting to 8.1pts, a 12.4pt improvement YoY. The underlying loss ratio improved 5.6pts to 57.6%, benefitting from severe and attritional losses falling below historical levels. Also, the lower losses reflected the re-underwriting actions. Key data points include:

- Accident year loss ratio improved 5.6pts to 57.6%
- Cats added 8.1pts to the combined, an improvement of 12.4pts YoY.
- PPD added 2.2pts to the combined, down 1.6pts YoY.
- Expense ratio worsened 0.6pts to 36.2%.
- Combined ratio improved 19pts to 104.1%.

(\$mn)	AIG, International commercial					
Period:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	VAR
NWP	1,810	1,561	1,780	1,516	1,528	(15.6%)
NEP	1,826	1,852	1,684	1,574	1,578	(13.6%)
UW gain	(423)	(251)	68	51	(65)	(84.6%)
Cats	20.6%	7.2%	1.0%	0.3%	8.1%	(12.4)pts
PPD	3.7%	4.0%	2.4%	(0.4%)	2.2%	(1.6)pts
AY ex-cat LR	63.3%	69.3%	59.6%	61.6%	57.6%	(5.6)pts
Loss ratio	87.6%	80.5%	63.0%	61.5%	67.9%	(19.6)pts
Expense ratio	35.6%	33.1%	33.0%	35.3%	36.2%	0.6pts
Combined ratio	123.2%	113.6%	96.0%	96.8%	104.1%	(19.0)pts

NA Personal

The North American personal lines combined ratio improved 35.6pts to 107.5%, driven by a 20.7pt improvement in catastrophes and 14pts of improvement in unfavorable development.

Key data points include:

- Accident year loss ratio improved 1pt to 52.2%.
- Catastrophes added 9pts to the combined, down 20.7pts YoY.
- PPD added 2.9pts to the combined, down 14pts YoY.
- Expense ratio flat at roughly 43.4%.
- Combined ratio improved 35.6pts to 107.5% YoY.

EXHIBIT: AIG NA PERSONAL LINES RESULTS

Source: Company reports, Inside P&C

(\$mn)	AIG, North America personal					
Period:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	VAR
NWP	935	783	580	943	902	(3.5%)
NEP	877	834	778	845	823	(6.2%)
U/W gain	(378)	(330)	(65)	31	(62)	(83.6%)
Cats	29.6%	49.8%	5.1%	3.9%	9.0%	(20.7)pts
PPD	16.9%	0.0%	1.3%	2.4%	2.9%	(14.0)pts
AY ex-cat LR	53.2%	48.2%	59.0%	46.7%	52.2%	(1.0)pts
Loss ratio	99.8%	98.0%	65.4%	53.0%	64.2%	(35.6)pts
Expense ratio	43.3%	41.6%	42.9%	43.3%	43.4%	0.0pts
Combined ratio	143.1%	139.6%	108.4%	96.3%	107.5%	(35.6)pts

International Personal Lines improve on lower cats and Japan auto

International personal lines saw a reduction in premium volumes, with a 7.8% decline in NWP. The subsegment's combined ratio improved by 16.2pts to 99.9% YoY. Driving the improvement were lower cat losses and continued favorable trend in Japan personal auto. Key data points include:

- Accident year loss ratio improved 3.1pts to 50.3%.
- 8.2pts of catastrophes, down 12.3pts YoY
- PPD deteriorated 0.4pts to roughly 1.1pts of favorable development.
- Expense ratio improved 1.3pts to 42.5%
- Combined ratio improved 16.2pts to 99.9%.

EXHIBIT: AIG INTERNATIONAL PERSONAL LINES RESULTS

Source: Company reports, Inside P&C

(\$mn)	AIG, International personal					
Period:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	VAR
NWP	1,861	1,919	1,675	1,758	1,716	(7.8%)
NEP	1,953	1,891	1,876	1,818	1,823	(6.7%)
U/W gain	(316)	51	122	101	1	(100.3%)
Cats	20.5%	0.2%	0.0%	0.0%	8.2%	(12.3)pts
PPD	(1.5%)	(2.0%)	(2.8%)	0.1%	(1.1%)	0.4pts
AY ex-cat LR	53.4%	55.2%	55.2%	52.8%	50.3%	(3.1)pts
Loss ratio	72.4%	53.4%	52.4%	52.9%	57.4%	(14.9)pts
Expense ratio	43.8%	43.9%	41.1%	41.6%	42.5%	(1.3)pts
Combined ratio	116.2%	97.3%	93.5%	94.4%	99.9%	(16.2)pts

This research report was written by Insider Publishing's Research team which includes Gavin Davis, James Thaler, Gianluca Casapietra, and Dan Lukpanov.

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