Bank of America Merrill Lynch Insurance Conference

Company Participants

- Brian Duperreault, President, Chief Executive Officer & Director
- Unverified Participant

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Next session will be with Brian Duperreault, CEO of AIG. So, Brian rejoined AIG last year after a couple of stints at both building a company and fixing another company. Most of you do know that Brian was CEO of ACE during a tremendous time of growth and expansion for that company and then took over leadership of Marsh & McLennan when that company was, what I would call, rudderless, before Brian joined, following the investigations into contingent commissions. So Brian's vision for AIG is really beginning to take shape and our timing is excellent today. AIG just announced fourth quarter results last week.

Q&A

Q - Unverified Participant

And maybe I'm going to start with a kind of a bigger picture question. I just use the word Brian's vision. So give us a sense, Brian, your vision for the company and maybe the way to think about it would be, you're not where you want to be yet. You've said that. Where are you aiming towards? If in three years you're there...

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah.

Q - Unverified Participant

...describe that company for me?

A - Brian Duperreault {BIO 1645891 <GO>}

That's an (00:01:08) even big, big picture question. I didn't want that one though, okay. Just kidding, I'm a...

(00:01:15)

...what's your vision, (00:01:14) vision. And so if you look, AIG is still a massive organization, it's still an incredible powerhouse. It's a company that the brokers want to see back, it's a company that the clients want to see back, but I tell our people that I'm not here to make it what it was because that's not good enough. It's what it should have been all along, right. So there are many, many good aspects of the company that we want to ensure continue and some things that weren't good and we need to change. But at its fundamentals, I mean, this company is an underwriter, it's a risk taker. It's the go-to company for the large corporations of the world or those who have specific problems or the brokers who need help because they've got something they need to place.

Now we can't do everything, but if we're professional, it gives us an amazing opportunity to differentiate because if you're solving problems, you're - you have a reason to exist. And if you're just a capacity play, you don't and we're not. But I think we lost our way in our ability to do that problem solving, whether it's because we lost some discipline or we lost people or we lost focus, whatever the reason was, but the need is there. The market need is there.

So for us, we need to get back to being basically the underwriting company in the world, the best at what we do. Now that requires people, technology, constantly improving your analysis and your ability to get data and analyze it and all that good stuff, it requires probably the most professional claims group in the world know that (00:03:15) we have that. Well, there was a time when we had it. And there is no reason why we can't reclaim that place; we're not that far away right now. So I would just like to see that, but it - again, not what we were because we didn't do certain things right. Maybe that was the way we siloed and didn't cooperate, et cetera, and so we're going to fix that piece.

Q - Unverified Participant

When you came in, you looked at the operating structure of the company and you kind of determined it didn't make a lot of sense and you've made those changes.

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah.

Q - Unverified Participant

Can you talk about the new structure and what that achieves for the company and what you hope it will achieve for the company?

A - Brian Duperreault {BIO 1645891 <GO>}

Well. First of all, it was a mixed bag because you had personal lines, which is a general insurance effort, capability and it was in with life and retirement, not using life and retirement's balance sheet's capabilities, anything. So there was no synergies there, it didn't make any sense. It really belonged over with commercials. We created general insurance and life and retirement. This isn't like rocket science, pretty basic stuff. So we start with that.

We were, this is - Peter Zaffino in particular and I, overwhelmed about the interest in coming back to the company or joining the company. In other words, there was a whole question about do we have the talent. And by the way, there's great talent in the company, but you always use more and we had a lot of people coming in, saying look, I want to come back, I want to join or I want to return or whatever and we'd have to say, wait a second, hold that thought, our structure doesn't make any sense because I don't know where to put you. I didn't, we didn't, we had a kind of a much more generalist approach to how the company was organized and I'm a believer in specialization, differentiation, unit integrity. I'd like smaller units, not some big thing. I'm not an economy of scales guy. And so we had to redo the structure, particularly in the general insurance side, to create these positions of specialization and capability where you are presenting yourself to the market with something the market needs because you've got expertise in it. We've done that now. That now allows us to go find the people and doing the holes, where we have holes. I think that if you look at the structure and it's been out, and thinking about, so you could see it, I call it maybe 1.0 or 1.5 or something, right. There will be more iterations of that, but the underlying theme of specialization and unit integrity will continue.

Q - Unverified Participant

When a new CEO comes into an insurance company, you get a sense there of the desire to put the past in the past. You did take some reserve charges mostly in the third quarter. Was that what the effort was? Did you make a conscious decision to say, let's be more conservative, let's wall off these reserves and move forward in a clean way?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, what I found was a – and I got this question right from the beginning, and I said the process, I think the process makes sense. I think there is a logic to it. One of the component parts of that is what is your underlying philosophy around the reserves? Are you, do you have a margin of error in them? Do you expect that things can go wrong? Right. And I'm not sure that that existed in the AIG of the past, but the one I showed up in had that philosophy, they believed in that. So, I didn't have to change the approach to how one posts reserves and there is just you have to have some margin of error because it is an estimate and there are swings around that.

So, I think that was good. That was a good start. How one analyzed the business, I think, was fine, is fine. There is, to me, an underlying theory here that isn't just reserving, right. It's making money. So, it's a whole lot easier to put reserves up on business that's actually profitable. Right, because if it's profitable, you know there's a ceiling which is, we're not profitable, right. So you guys, you got moves, you got, it's much more contained.

If you got business that's over the line, how high is up, hard to say. So if you're placing business with very large limits and therefore great volatility, that exacerbates bad results. Then it can get horrific. And so, part of the underlying approach to reserving is effective, so use of reinsurance or reducing your gross lines to dampen volatility. So you don't have the same kind of extreme estimates you got to make. If you've got a – if you got a book that's $50 million of premium, you're putting $100 million limits out and you've got one claim, well, first of all, you're not making the money, any money anymore, is there a second claim lurking out there because if it's $100 million, that's a big chunk of change you got to put up in the reserves. So it makes you crazy trying to estimate these things, if you're an actuary. So dampen the volatility, emphasize selection, get the profitability; that changes the whole way reserves are done too. So we're doing that as well. But I - but I think the process is fine, and I think the underlying approach in terms of conservatism is what I would have hoped to see and I did when I came in.

Q - Unverified Participant

With the reserves, so we've gotten before you joined, we had gotten used to fourth quarter coming around and AIG takes the reserve and it's the U.S. commercial business. You took a sizable charge in the third quarter. There was still an expectation to do some clean-up in the fourth quarter, yet, the company released reserves. My question to you is, did that surprise you when you went through that analysis?

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah. Well so, first of all, I - I say, okay, what's the reserve analysis, what do we have, okay? And I am - once you establish a philosophy that, look, if we want to be conservative, not crazy, but there's got to be some margin of error, where does my role then end? It ends about there, right. I mean I'm not going to say put that reserve up, take that one down. I mean that's - you can't have a process where the CEO is intervening and managing those things, right. So I have to sit back and say, okay, how did you do it, it's much more with the process. What are you guys thinking? Did you - how did you analyze this and what are your conclusions? If they're reasonable, they're reasonable. And so I think the conclusions are reasonable. Did that surprise me? No, because I think you've got reasonable people, making reasonable assumptions that conclusion as a result (00:10:36). So in that sense, no, it didn't surprise me at all.

Q - Unverified Participant

Which is given the trends in that business over the several years?

A - Brian Duperreault {BIO 1645891 <GO>}

True. But at some point, you did your job.

Q - Unverified Participant

Yeah. In the fourth quarter, you did add to the reserves in the commercial business internationally?

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah.

Q - Unverified Participant

But my sense is that business is really quite different than the U.S. business from a tail standpoint. Can you just talk to that?

A - Brian Duperreault {BIO 1645891 <GO>}

Sure, generally speaking, even the longer tail lines aren't as long. So it is a shorter tail, your actions come home to roost (00:11:16) much sooner, good and bad. And you saw that some of that development was in short tail business. So sorting that out, it's a little odd, getting to the profitable position, which is more important to us. I think we still need to do a little bit more work. I think it had some characteristics that were similar, like the larger line example I gave earlier; that was particularly true in Europe, where they were taking very large limits on small premium basis and the ability to get that right is much more difficult with that kind of extreme. So cutting that back, I think we've got, we're in a good - in shape there and you'll see a different reinsurance structure going forward. So I'm very comfortable.

Q - Unverified Participant

Wanted to move on to M&A. When a company like you says, hey, we're interested in M&A, I'm assuming every investment banker in the world will come to you and the question I have is, are you pleased with the opportunities you're seeing and you're seeing everything, anything interesting?

A - Brian Duperreault {BIO 1645891 <GO>}

But by the way, you're absolutely right and it's usually the same companies on page 2, same company on page 4, I get the same, most of the same ideas, maybe I don't like that many new ideas in the world, but the Validus one, nobody brought to me, which is interesting. So it helps to have some of your own ideas too.

Look, I'm not - we're just not out there to buy for buying's sake. I mean, I am trying to fill in the white space, be strategic, but also with companies that I would like to associate with. They're - after you buy them, you got to work with them. And if they're no good, it's a miserable life. So you going to have, you got to pick the right people. And so if you cut through, if you say okay, look, I want this, this, this and this and Validus, by the way, (00:13:14), if I could do more of those, I do them all day long, great people, strategic for us, accretive. It's geographically spread. They are really good at what they do. Well, that ticks all the boxes. If I can find another one like that, I do it on IP.

Q - Unverified Participant

On the Validus deal, so on the fourth quarter call, you seem to suggest, unless I misunderstood it, that the cash on cash returns that you expect in that deal were somewhat below your cost of capital. How do you square that? I mean for most investor standpoint, the question, why did you do the deal then?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I don't - I wouldn't characterize it exactly that way. So let's put it that way. I do think if you look at the cash returns, given tax, et cetera that it's quite, quite beneficial to us. Look at, I mean, an acquisition, if it is strategic, you're probably paying a fair price for it.

Q - Unverified Participant

All right.

A - Brian Duperreault {BIO 1645891 <GO>}

And we paid a fair price, but it's definitely worth the money and long term, it's going to return over and over again because these great people will be deployed to do even more for us. So, I – my first standard is that it is accretive, but is it strategic and are you getting great people? And that pays for itself and all the deals I've ever done, if that was the standard and you guys never asked me another word about it, right.

When I do a deal where it was financially good and not strategic, it just never works out. It just never works out, I hate financial deals, I hate just synergies and if you put two companies together and you squeeze some expenses out and what do you have. You got nothing; you got less expense and probably mediocre outcomes. So that is my standard and it always worked out for me, but this one is even better than the ones I've done before.

Q - Unverified Participant

With Validus, you do pick up what I think is a very good Lloyd's platform. AIG had a Lloyd's business before which they exited. Is this a very different kind of Lloyd's?

A - Brian Duperreault {BIO 1645891 <GO>}

Let me just square that circle now. I mean, I think if you look at some of it, some of the things that have occurred at AIG all go back to the crises and the sales that either were forced upon us or we may have, for other reasons. And in the case of the previous Lloyd's operation, we really didn't own them.

We had a, I think, a minority interest in them. So we were more capital providers and they were – they were out doing – and by the way, they're very good. So by the time I arrived, the decision had been made to sell the remaining interest. So they – I did not have a Lloyd's operation when I walked in the door. And I think the decision that was made was fine. I think they were (00:16:14) Ascot and they're really good people.

But in any case, we didn't have a Lloyd's operation, I think we needed one and this gave us a great way to get a Lloyd's operation in addition to all the other things that I was asked (00:16:27).

Q - Unverified Participant

How do you feel about the reinsurance business? If I look at the reinsurance, well, it's not...

A - Brian Duperreault {BIO 1645891 <GO>}

It's been down in my whole career, it's going down, nobody needs it anymore. But I mean look at it, it's not true. Is it a competitive market, is it more competitive, let's say, it was after Andrew or after Katrina, Rita, et cetera, yeah, it's more competitive, the returns are a little bit less, they're still good.

And I remember I was sitting in Hamilton prior to joining AIG, looking at that market as a participant and understanding what the returns were and the characteristics and I think it's got legs just in general. For us, there's a particular benefit. I mean look, it's only - it's a small percentage of our total; so we get the benefit of capital synergies. They have an ILS capability, which I would - I wanted to have and you can start one from scratch. But things starting from scratch carry a lot of risk and risk (00:17:39) they've got a great track record, billion people in it running it. And for us, that business has its - and that's a variation on reinsurance. But it has - it - probably it has its own runway, maybe a separate runway (00:17:54 to 00:18:04) underwriting is - underwriting is basically the skill set around evaluating a risk, pricing it and placing it somewhere. Most of the time, we place it in our own balance sheet. We will place some of it in the reinsurance market. This is another tool to place it in an ILS market.

So fundamentally, to me, the ILS market is, it's not going away, it's a tool. Its capital return characteristics are different, but that helps you then in your - in your manage of risk, you can find a home for a risk that you couldn't take on yourself, you put it over there because it has a different risk characteristic. And you can originate risk with the sole purpose of putting it in the ILS market; that I think is a future for us. We have to do it, get more of a prediction and a reality, but I think that's got great legs there.

And if you look at reinsurance as a taker of risk, particularly CAT risk, I mean even though we're risk originators, we're not everywhere. So we're not going to take risk in a place we're not in. How do you get a balanced portfolio? With reinsurance, where you can exit large accumulations here, take in accumulations over there (00:19:25) whole portfolio. So it's a management tool for it. And it's got its own return characteristics. So I think look - and it's not just CAT, you know. Reinsurance is a multi-faceted industry. It's not just CAT. Lot of opportunities.

Q - Unverified Participant

You can apply to insurance at some point too.

A - Brian Duperreault {BIO 1645891 <GO>}

That was a long answer. Sorry.

Q - Unverified Participant

That's okay. That was helpful. The life insurance outside the U.S., AIG had been a dominant player there, obviously isn't any longer. You kind of talked about it as a potential place to invest. Is it feasible that you can rebuild that business?

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah, it's feasible, the probabilities are lower than general. It's hard to do greenfield life business. Time that it takes to get the returns is seven years before you're starting to get your returns back. I don't have that patience. No, you guys don't have that patience. So it almost forces one to acquire.

Now we've got great capabilities, our retirement capabilities are, I'd say to everybody, the demographics, they're on our side. I mean we've got, we can help people who are outliving their money find ways to solve that problem and that problem exists everywhere, not just in the United States. So I mean we do have a capability, wouldn't it be nice to deploy it, practically speaking, we'd have to acquire. Can I find one, maybe, but maybe not? So it's - it is a white space, it would be - it would be a strategic initiative. But we are not crazy about it, so if I can't find a way to do it, we've got other places to deploy the capital. That's what's so good about having a diversified portfolio.

Q - Unverified Participant

Just pause for a second, see if there are questions in the audience. If you have a question just raise your hand, we'll get a mic to you. Your answers are very complete, you're satisfying everyone. I want to talk about ceded reinsurance. I guess, one, your philosophy on buying reinsurance, what you've shared in the past, I'd love to hear it again. And then more specifically, what was behind the decision not to renew the Swiss Re quota share contract?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, it helps, if I tell you my philosophy, I think it fits in, right. Well, first of all, reinsurance doesn't solve your gross problem. You've got to make money with your decision making and the business you're taking in. So, reinsurance doesn't make unprofitable business profitable, right. So we're not going to go out to do that. It does help on volatility. So it does improve your predictiveness, right. The things you can do and it helps you tailor where you could take on a piece of business and there are elements of it that you don't like, but there are others who may or you don't have enough of it to make the risk return make any sense in the capital deployment, but there are others who have a lot more of that, they take it from others. So this reinsurance is a way, it's a way of tailoring your risks to fit your standards. It gives you - it takes volatility out, it gives you eyes and ears on your business that are not yours. So these are people independent of you, who come in and say, we've looked at your underwriting, it stinks, and you can't get a place, well, that tells you better go fix the underwriting or they give you insights. So it's - your underwriting is good, but could be better over here, here is the trends we're seeing generally. So there is just market intelligence and specific commentary on your own underwriting capabilities I think are invaluable, invaluable. It can be a capital management thing, you look at, particularly if you're writing new business, you probably want to share that, hedge that risk, don't have it dominate, and you want to balance it out, like in the cap business, it's a volatility question and we're getting to reinsurance to fix the portfolio.

So I wanted to have a balanced portfolio, use reinsurance to balance your portfolio. We have tremendous amount of capital. So it's not, generally speaking, we're not buying it for capital reasons, not at AIG. I've had companies where I had to do it, for capital reasons.

Interesting, just a variation on that. So, but if you get into your portfolios and I talk about unit integrity, those units carry their own capital, we assign it to them. And so they don't think of as a big balance sheet of AIG, they think about the thing they've got and the capital they have, and they're more inclined to protect capital because it's more, it's smaller, more variation on the theme.

So there's a bit of that going on. In the case of Swiss Re, we just looked at our needs, the benefits of the reinsurance, would it make sense, is it a reasonable trade for us? And we just decided that in this particular case, it wasn't.

Q - Unverified Participant

Scott (00:24:50)?

So prior to you re-arriving at the firm, the prior year development would seem to have indicated that more of the underwriting kind of across the organization was being done on a relationship and sort of volume basis with less focus on profitability. Is that a fair statement and if it is a fair statement, are you past that, have you changed that fully to the degree that you'd like to?

A - Brian Duperreault {BIO 1645891 <GO>}

This failure had many fathers (00:25:21), this failure. So some of that was there, there were some other things going on. I will say that when I arrived, there wasn't a mentality around production at any cost. There was a recognition that portfolio management, understanding the construction of your portfolio and doing the right thing and taking the right business, that was all there. I'm not sure that it was completely thought out or deployed correctly, but at least they were in the right direction. What I interjected was to say, look, I want us to do that; that can be wrong, you have to understand your pricing, your overall pricing. So when you think about underwriting, particularly at the levels that we're talking about, commercial underwriting, U.S. large business, all the decisions are discrete. There isn't some average price you get at Walmart. This price is for this risk and this risk is different than any other risk you're going to see this year, because they're all different. And so is that a right price or is it right or wrong?

Well, if nothing happens in that risk, it's a great price. If something happens in that risk, it still might be a great price. So you have the portfolio price build-up of discrete decisions, so where am I going with this? So you're not going to win the game on trying to get a price alone because it's a competitive market, okay. So if you price down, you could ruin your whole portfolio. So the first thing in underwriting has to do with this kind of underwriting is decide is this a risk I want? Do I have a reasonable chance of success with this in my portfolio, is it a bad actor? And a lot of times, you'll find the portfolio isn't rife with bad business, but there is an element that's so bad that it destroys all the good work you did otherwise or another way to put it is, if you can just eliminate some bad decisions, the overall portfolio can actually be quite good even under the worst pricing conditions, so selection, selection, selection; first thought of an underwriter. And so what I - what we're doing now is saying, look, I get back to selectivity, back to having unit integrity and specialization, so I have underwriters who can make that decision, who understand this particular business as well as anybody and they can sort out, this is a good risk and this isn't, okay.

And then you overlay because you still have to tell the underwriter, well, I hear your thought, you're making some great decisions, but your overall pricing is no good. You need a 10% across-the-board increase in this business or we can't write it anymore. And you get that by making a discrete decision one at a time, so maybe you get 12 there and

5 here and maybe you go flat on this one because it's so damn good, you want it out in your portfolio no matter what, right. So it's not an easy game to play, it's very hard, that's why underwriting is so difficult and particularly at the high end, you've got to get the best guys possible with the best tools.

Underwriting is - it's the army, you get 10 people putting one soldier on the battlefield, right, you get 10 support staff (00:28:56), same thing with underwriting, you need actuaries and claims people, administrative type, so everything helps you make this decision. At the end of the day, it's that underwriter. So what - when I say that you are the underwriter, it's - that's the point. I need you and you have to make the decision; I'm going to hold you accountable, but you want to live that life that way, don't you, and they go, yeah, they do. They want to be able to make the decisions or live with the consequences. They'll get the best tools possible, that's been the change happening in the company. I didn't start it, but I'm certainly directing it now.

Q - Unverified Participant

Yeah.

Can you talk about casualty pricing, where we are now and where it needs to be? If it needs to be to a certain level where you can make a reasonable underwriting profit?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I...

Q - Unverified Participant

And how hard would it be to get there?

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah, yeah. Well, if there is any business where your selection matters, right now, it's casualty because there is price going up. I'm not sure it's much better than the loss cost trends and so you're treading water which means - what does that mean, will I get out of it? No, it means it's a lot harder to put your portfolio together because you got - you don't have tailwind, you don't have headwind, you got no wind. And so you have to manage your way through that. So it's a little harder to put the portfolio together. You're probably not in growth mode other than trying to get the price for the risk that you can get. So, I'd say the industry probably needs to do more - certainly needs to do more than what the pricing is now. And for us, that just means, we just have to work a little harder to make money at casualty. There are other lines of business where maybe the pricing is considerably higher. The tailwinds are helping you do your job and you have a little bit more capability of pricing portfolios because you're getting a tailwind, but not the case in casualty. It's not - it's kind of balanced.

Q - Unverified Participant

Roughly speaking, what accident year you think last year would be equal to in past years in regard to casualty pricing?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I think the pricing in casualty has been so-so at best for quite some time. Now, it's improving, but it's – I don't think for an industry, it's acceptable levels of pricing.

Q - Unverified Participant

Other questions in the audience. Probably got time for one more. Let me just touch on personal lines, Brian, which has been a good business for you both in the U.S. and outside the U.S. The company had pulled back from a number of regions where the past management felt they didn't have scale. You kind of said that's white space still, that's something we can expand into. The question is, can you re-enter these markets in a different way where scale is not necessarily the critical thing?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, it's a little easier to do kind of start from scratch businesses in the general insurance business particularly if you've already been in the country or you're in the country because you know it, you know the people, you know the competition. Personal lines though, it's a little harder to do that. I mean in personal lines in the U.S., forget about it, but it's not just the U.S. I mean your ability to make a dent in places around the world much harder because there's a volume question, you've got distribution, you got a feed. So that's a long-winded way of saying, you know, I would probably – I'd be more likely to acquire capabilities for personal lines than to start-up and scratch in most of the places. And for us, we're probably spending more time on the commercial, small commercial, middle commercial market than the personal lines market outside the U.S.

A - Unverified Participant

Let me we wrap it up here, Brian. Fantastic. Great running (00:33:04).

A - Brian Duperreault {BIO 1645891 <GO>}

Thank you. Thank you very much. Appreciate it.

A - Unverified Participant

Thank you very much.