Keefe, Bruyette, & Woods Insurance Conference

Company Participants

- Brian Duperreault, President, Chief Executive Officer & Director
- Meyer Shields, Analyst

MANAGEMENT DISCUSSION SECTION

Meyer Shields {BIO 4281064 <GO>}

Okay. I think we're on. Good morning everyone. With me now we've got Brian Duperreault, CEO of AIG. For those of you who don't know me, significantly less important member of this panel, Meyer Shields, KBW Equity Research.

I want to kick off with the sort of a broad question. And our hope for this session is to have significant interaction with people in the room. So, if you've got a question, we do have a centralized microphone stand. We'll also be taking the microphone around. So, if you've got a question then by all means just signal and we'll get the mic to you to make sure that everyone can hear the question.

Q&A

Q - Meyer Shields {BIO 4281064 <GO>}

But let me start off with the big one and that is, so you've been at AIG for a while now. What's been done? How do you see things panning out? Any surprises over the past year plus?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, yeah, it is. I can't talk about it in days or weeks or months now, it's year, right? So, I've been there a year and three months something like that. And well, I think it's panning out pretty well. I think the biggest indication I think of where we are is the kind of people who've come to the company. And that was one of the things I was probably the most concerned about was could we attract talent back into the company. The company had been losing people.

So, it was a net loser of talent for a number of years. And so would we reverse that trend and boy, I'd tell you we've got - you just got a great team, match them against anybody the people we've been able to put together. So, I think that alone is probably the prime indicator of what's going to happen because you put great people in an situation at AIG where we have an enormous capability, still great - still very, very, very good relationships with our clients and brokers, and so it's - and it's got capabilities second to none. You put great people together with that. So, that's good. So, that's moving well.

I think look at some of the other indicators, the reserves have been relatively stable. So, I think that's another indication of kind of getting to a point of building a base that you can grow from. But it's volatile business and we still suffer from some of that. But we're trying to fix the volatility and the problem with the volatility is if you've got a good book of business and it's volatile, the movement is just, it's the predictability becomes more difficult, right, because you've got big (00:02:45), even if it's good book of business. If it's not a good book of business then you've got and you are taking on large limits, it's even worse, right? We haven't had a lot of great business. So, we have a lot of great businesses. But you look at our underwriting results, they had been very good, and so the volatility just adds to it.

So, we had to dampen that down, get that down, so that there's - you can actually see what's going on because was it, you get 10 large losses was that bad underwriting, was that just the luck of the draw, you wouldn't have seen them in the past because they are reinsured away. So, trying to get that stability back has been an important part of what we're doing. And I think to some degree making purchases that reduce the volatility means you got premium going out the door, if you buy, it's just a loss. It's like when you buy insurance, nothing happens. Did I get ripped off? Well, you bought protection. So, it comes at a cost. So, some of that's flowing through the business. Any surprises like I told you, I was surprised that we were able to get the people. I was surprised at the reaction of the customers, but it was a positive reaction.

Q - Meyer Shields {BIO 4281064 <GO>}

We know who you are?

A - Brian Duperreault {BIO 1645891 <GO>}

You know who I am. So, what I mean by that is, when I first showed up, it was - we have been going through a re-underwriting process and that's been happening, and so we said, we would like - we like this one day, then we say, we don't like it the next day, and actually sometimes we say, look, look, we were wrong about that, we actually do like it, and we're confusing the hell out of the market.

And so, I was concerned that the market would just say, I'll just go find somebody else. But they couldn't or they wouldn't. So, we had - I spent a lot of time with the customers, particularly in the early days, and I was universally, not astounded, but surprised at the positive reaction. They wanted AIG back. They wanted to do business with us. The brokers, who are representing them feel the same way, leaning in, so that was again a very positive surprise.

To name a surprise was the organization structure, which in no sense, and we weren't organized to win. And so, we had to sort that all out and sorting it all out took some time, but it also delayed to some extent getting the talent in because we didn't know where to put them, you got crazy structure. Come in, I did that for a few people like Peter, they come in, I'll sort it out. But we didn't want to make that the mantra. So, we said, look, let's sort out the organizational structure. We say, look, when you come in, this is what you're going to do. This is your - this is the plan. This is your mission, you're out - your place in the sun and so if that was a bit of a surprise, that the organizational structure was as odd as it was. But we sorted that out. So, maybe that's a long-winded answer, but there you go.

Q - Meyer Shields {BIO 4281064 <GO>}

No, that's not we're looking for.

A - Brian Duperreault {BIO 1645891 <GO>}

Okay.

Q - Meyer Shields {BIO 4281064 <GO>}

So, where are we now in terms of having structure reset, having the right people always going to be some sort of attrition or change, but the difference between fixing something that needed to be repaired and just typical...

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah, well, I think its execution now. We were in the execution phase, so structure's right, getting the right people. And I mean, there's still – they are adding. So, you bring good people in and senior levels now, and now that's next level down, next level down, so that's still building. We're still building there. But it's execution, getting our expense levels where they need to be. We've got to do that, that's execution. We got to continue to look at the way we not only take business in, but layoff, so we're still looking at our reinsurance structure because I think there's still some more work to be done there so, but that's execution.

It's getting the rates when you need rates or reducing the limits or finding the right attachment point for this particular risk, all that is work in progress, but we're getting there, that's why I said, I believe we will cross the line. I've said it. Certainly by year-end, we'll be in an underwriting profit position, which is a milestone. It is not the goal, it is a way point. But it is an indication of movement and that's why, put that market down.

Q - Meyer Shields {BIO 4281064 <GO>}

Right? So, there are two comments that came out on the second quarter call that I wanted to dig into a little more. The first is as you said underwriting profit by year end.

A - Brian Duperreault {BIO 1645891 <GO>}

Yes.

Q - Meyer Shields {BIO 4281064 <GO>}

The second is maybe a little caution on loss trends. Now, if you're underwriting profit by the end of the year, underwriting profit by the end of the year, then I think we're fine. But I was hoping you could talk a little bit more about those two aspects of what you're seeing as milestones?

A - Brian Duperreault {BIO 1645891 <GO>}

The aspects being loss trends versus underwriting profit?

Q - Meyer Shields {BIO 4281064 <GO>}

Yeah.

A - Brian Duperreault {BIO 1645891 <GO>}

Well, that's the constant battle in our business, isn't it? You're constantly trying to, I mean, we're predicting the future for heaven's sake, who can do that precisely, right? So, you've got some reasonable expectation of what you think is going to happen loss trends, et cetera. And you've got to keep always – you got to stay on top of it. So, if you take your eye off of that then you lose ground because then you've got to make it up by getting more rate, necessarily than you would have – if you've done it in a steadier way. Anyway, I think Peter did talk about loss trends on the call. And, look, there is certainly, I think he said with the exception of comp, we don't make exceptions to comp anymore, I don't know.

But there is some price movement too, right? So, you've got loss trends. So the question is, are you keeping above the loss trends with our rates, and that's what we were trying to get across is there are some that are little higher than others, and don't ask me about all that stuff. But you have to go by line of business. If it's excess, it's more extreme. You get to be more rate conscious, but you also have to be conscious about where you are attaching because sometimes if you're not attaching high enough, it's like catching a falling knife. There's not enough rate in the world, right? So, you got to keep above it. That's equivalent of a rate, but you're staying above the loss activity. If you stay within the loss activity, your rate requirements are very, very high, right? So, you got to pick your spots. So, there's a lot of ways to construct a portfolio.

But the long story short is we are doing the right thing there, whether it's attachment point or getting rate above loss trend, I think we're confident that we're moving in the right direction. So, that would again give me the reason to say that we'll get the loss ratios to where they need to be, and we also need to get the expense ratios where they need to be. And that's a very important part of getting to a profitable position. If I look at our loss ratios versus our expense ratios, the expense ratios are more out of line with the industry than our loss ratios.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. And I would look at it from a – in sort of a price takers perspective, and that is – that means that that's where you need to have most of the attention done, and I believe it's not going to dramatically change the industry's pricing levels.

A - Brian Duperreault {BIO 1645891 <GO>}

Right.

Q - Meyer Shields {BIO 4281064 <GO>}

So, it's an expense issue, which is something that you focused on, on the second quarter call.

A - Brian Duperreault {BIO 1645891 <GO>}

Right? And it's not a rate – I don't need to get rate. I need to fix the expenses.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay.

A - Brian Duperreault {BIO 1645891 <GO>}

You know what I mean?

Q - Meyer Shields {BIO 4281064 <GO>}

Yeah.

A - Brian Duperreault {BIO 1645891 <GO>}

So, it takes less pressure off. The nicest thing about it from my point of view is I've got more degrees of freedom than maybe my counterparts do because I'm in more extreme positions. Expense ratio is too high. I can work on that. I don't have to get my underwriters to go crazy about price and risk. They can stay in the market and we can still make an improvement, that's what's interesting.

Q - Meyer Shields {BIO 4281064 <GO>}

Right? Again, I want to point out that we're welcoming questions from the floor as much as possible. So, we'll get the mic to Josh (00:11:24).

A - Brian Duperreault {BIO 1645891 <GO>}

Hands are going up.

Q - Meyer Shields {BIO 4281064 <GO>}

Thanks. Brian, I think you're doing a good job with remaking the business for the long term, doing it the right way. I think some investors are frustrated with the perceived lack of progress in terms of getting the combined ratio down. I think you talked about some things that were working against that...

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah.

Q - Meyer Shields {BIO 4281064 <GO>}

...in terms of reducing volatility that cost money, the Swiss Re deal falling off, changing the mix. All those things are sort of headwinds, not necessarily – reduced volatility is a good thing, but it's masking underlying improvement in the loss ratio. Is it possible for you to give us a sense for the magnitude of some of these volatility-reducing efforts? And how much of a headwind that has been and it's sort of offsetting the underlying improvement that you're seeing? And does any of that stuff go away? You're changing your reinsurance. Is this a permanent thing, or can you write smaller risks where you wouldn't need as much reinsurance going forward?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, it looks like smaller risk, well, I wouldn't need as much reinsurance. But that's a whole new segment of business. So, let's see if I can answer this question. Yeah. Can I quantify the actual effect of reducing the volatility in terms of the cost to the company? That's a little bit harder to do. We've given you some indication like the cat program that we've put in place for this year. Last year, we had $4 billion worth of cats, and we had no - basically no recovery, right? So, now I go out and I buy - we go out and buy reinsurance of significance. And I think we said it moved a couple of points in the - a couple of points, right, in the expected levels of cat.

So, that's an indication, right? So, that's a cost-out. If we didn't do it, you would see maybe a couple of points improvement, but you left your company bare to having years where you could take $4 billion out of your book value, which is crazy. So, that's one indication. Some of the others would be proportionally the same, but the book of business wouldn't be as large like the excess of loss program in Europe. That cost is, percentage-wise, a decent piece of the business, but it's not a big - it's kind of loss and rounding error in terms of the whole, but these are pockets of it.

The volatility is interesting. We also have - you look at our investment income, it can be quite volatile, more volatile than I think I've been used to or others. Now, these - all these investments have been good. They've been good book value builders, but they can swing around a little bit.

And then the other thing I'd say about masking or improvement, it depends on the line of business, how soon those improvements show up and you can feel confident in them. Okay, now, I can believe all day long, we're doing the right thing and I do. But I'm not going to wishfully think my loss ratio down until there's clear evidence that it's occurring. So, in casualty business, you have an excess of loss book, the worst one in the world and the best one in the world looks the same. At the end of the first year, you're writing that business. It takes a while.

So, I can go fix it, but we have to say, okay, here's been the trends, here's what we've looked at, the actual - heard the story too many times and they're going to say okay, I hear you, let's see it all play out. If you're right, you're right? So, you're still going to put loss picks up there and reserve levels to be prudent, you have to be, because it's volatile business, right? And you could have - you can do all the right things and have just a year in the extreme, because it's a range, right.

So, you're not going to see the casualty business emerging quickly. It just doesn't happen that way. It's going to take us - let us - let us see how it builds. And it'll bleed out. The difference between say where we are and some of the peers is they've - if they've got a better book of business, they were conservative five years ago that stuff tends to get released. So, you're putting it up this year and releasing it from the back year, and if you do that every time, kind of balances out.

I'm building up. I got nothing to release. So, you're not going to see that until couple of years play out and that's another - I can't - I'm not going to rush, I'm not going to rush that, and I'm not going to - I don't want to be in a position where we got to pick reserves again because we declared victory too soon. But I firmly believe we're doing that, and we'll see if it happens.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. There is a question.

Hi, thanks. Brian, I was hoping you could elaborate a little bit more on the comments about the expense ratio. As far as - maybe give us some examples or some detail of where specifically - you're too high on expenses, is it too many underwriters relative to premium, is it an inefficient claims organization, is it too many middle managers or is it like blocking and tackling, purchasing and real estate type stuff. And if the answer is, it's all of them then maybe you get to highlight the one or two that are the biggest issues?

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah. Well, we've been adding to underwriting. And so, I wouldn't put a finger there. I'm not sure we had an efficient process around the underwriter. So, I don't think we were allowing them to operate properly because we had checkers - check and checkers, but we had a lot of overlay control.

If you have problems with your underwriting, the first thing to fix is the underwriting. You don't fix it by putting people above them to control them. And so we have a lot of that. We had inefficient processes, we still do, where things just have lots of manual intervention and you get to a point where you, yes, you can take 5% off, 10% off. But if you do it across the board, you haven't fixed the problem. So, what we're trying to do now is be much more specific about do you really need this. You can build up, you can justify it in a - the company hasn't been well-run, so we need all these things and you're not addressing the right problem.

So, I wouldn't call the underwriters. That's not a problem. Claims are okay. I'm not sure. And by the way the claims expenses show up in the loss side anyway and we're addressing that. I think we're probably, we do more work with our legal cost, that will show up in a different part of the loss - that will show up in the loss ratio. But it's much more around the administrative process of getting the business on the books, not necessary - and some degree, but not much the decision making around should I write this risk or not. It's all about how it - it's the process around it, and it's been that way for a long, long time. It's been that way for a long, long time. And I said - I have said this in my town halls, it's not my - my legacy will not be, I leave this place kind of the way it was when I left, right? It's going to be - we have to move ourselves into the modern world of how you do business in our industry much more efficient. I hope that helps you.

And by the way, so - so it always involves people, doesn't it? It is lot - expenses tend to be people. And so, we announced our restructuring charge. It takes a while for that to play out, right? It's going to play out for the next several months, and so there's no instant gratification. It's not going to like fall couple of points immediately. It stretches out. But we'll get there before the end of the year.

Q - Meyer Shields {BIO 4281064 <GO>}

Hi, on the Q2 call, you said you are quite pleased. You said you're quite pleased with where reserves were, how much further along are you on the review, and would you say you are still quite pleased?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I think we did 20%, so we're doing the next cadre of them. And I always like to emphasize, it's not like we don't look at the other 80%. If you look - you look at all the reserves every quarter, but there's one that get intense work and you look at the others and if there's something wrong, apparently wrong with part of that 80%, it would have been moved up. So, that's one indication. Work's on-going. Wait till the end of the quarter.

Q - Meyer Shields {BIO 4281064 <GO>}

So, I'm taking that as (00:21:01) from Q2. Is that the right way to think?

A - Brian Duperreault {BIO 1645891 <GO>}

I said I was pleased with the process. I think the way we go about it is the right way. And you're constantly addressing emerging information, some positive, some negative and you blend it all, but I think the process is good. I think there's a conservatism now in place in the reserving process, which I was talking about earlier about not declaring victory too soon. And so, I am not signaling any problem.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thanks.

A - Brian Duperreault {BIO 1645891 <GO>}

Okay.

Q - Meyer Shields {BIO 4281064 <GO>}

I've another one just on regarding S&P. How would you characterize your interactions with them, and if you can speak in terms of runway to achieve results that would maybe cause them to rethink how they look at your credit?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, they are - and I don't think they're unique. But they want to see is an improvement taking place in the portfolio, which - what's the trend, you're getting better, you're getting worse. You never stand still, right? And so, the relationships we have with S&P are all about where are we with that, how are we doing. And I think we have a good relationship. I think they feel good about where we are as a company and the progress, the kind of changes we've made. They love the fact we take volatility out, buy more reinsurance, they're all happy with all that stuff.

Q - Meyer Shields {BIO 4281064 <GO>}

(00:22:44)?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I guess if you – if we start to go backwards, right, if all the changes that we said we were making didn't bear fruit then they wouldn't be happy, right? But you wouldn't be happy and they wouldn't be happy. I don't think they're – they're not going to have something different than you would have in terms of what would make them unhappy.

Q - Meyer Shields {BIO 4281064 <GO>}

Yeah, hi. Thank you. Brian, you said when you arrived the organizational structure made no sense, I believe is what you said earlier. Could you talk about why, what did you see, why did it not make sense? And how have you changed it? Thank you.

A - Brian Duperreault {BIO 1645891 <GO>}

Well, it was you know – one of the things, I'll start with one state and then that is I always say I left an international company with U.S. operations and I came back to a U.S. company with international operations. So, it became much to U.S. centric, and therefore, the international wasn't emphasized very much. We had countries divided between Life and Retirement and Personal – Personal Lines, which was a general insurance book, was over with the life, even though there's no sales compatibility – that's over there.

And so we had countries that we reported up to the Life and Retirement group and other countries who reported up to General Insurance, but it was all General Insurance. Life and Retirement is basically U.S. operation. So, I had – look at – the Personal Lines belongs over here. International should stand on its own two feet. It's a unique thing. We had our large account business. I'll give you another example, so that's one weird thing I found, a large account business.

This is the business that the Fortune 500 companies basically do where they keep a lot of the risk themselves. So, stuff goes and the captives, our retentions, it's done as a package life, I mean, worker's comp, GL/Auto, all come together, there's a lot of credit with it, you are – as an underwriter, there's a lot that's retained and your basic exposure's excess, but it's broad and as a unit. I said okay, who's run – I want to talk to guy running it, but we don't have nobody, we don't have anybody running that. Maybe I'm not speaking English, I want to talk to the guy running the large account business. So – I cannot believe, I don't even know how he did it. So, it would come in, the broker would bring it in, here is the deal. And then we get parceled out like the workers' comp guy would do the workers' comp and auto lady would do the auto, and then it would somehow magically come together. It was not, I mean, I still can't explain it.

I brought these guys that I've known for years that worked with me at - prior AIG and then at ACE and they came back in and we constructed this thing, and it's going to be great. They got a great track record. But sorting that out, I mean, the guy came in, it was like five pages of - you can't believe this. We don't do this and we don't do that. If you don't have a unit, you're not keeping up with your rates. It was - the whole thing was crazy. So, that's just another example. I had to put a whole large account unit back together again.

Lexington; Lexington is a surplus lines company. For you guys that maybe you know the stuff and maybe you don't, but this is where it's not admitted. So, the regular market says, no to this book. This particular risk and then it shows up in the Lexington or other non-admitted companies, and it's pretty quick stuff. You're going to make a quick decision, because it's been hanging around. And the broker - the guy needs us now. This is almost renewal, it's almost expiration date.

So, we had it blended with guys that do normal regular standard business and it would go through this review process and would go up the line and down the line. Well, so, okay, we'll do it three days too late. If it's still around three days later, it's no good. So, we're adversely selecting ourselves. So, you got to put a specialist group in and plus we are upsetting the brokers because surplus lines brokers are very powerful these days, and they don't like the admitted guys and vice versa. And so you better recognize who is bringing you the business and don't stick your finger in their eye by saying well - because they think we are trading against them. So, it's a little crazy. Nobody - how would you organize that way because you don't understand the business? So, anyway, that's three examples, I'll stop boring myself now.

Q - Meyer Shields {BIO 4281064 <GO>}

I think it's less boring. I like the way I wrote this, so I'm going to read this from here.

A - Brian Duperreault {BIO 1645891 <GO>}

Oh, he likes the way he wrote. I can't wait to hear about it.

Q - Meyer Shields {BIO 4281064 <GO>}

We talk about self-graded exams all the time. So superficial hypothesis. You have the right people and underwriting processes in place by year end 2018. So, 2019 risk selection should be as good as anyone else's, which means 2020 underwriting results should be as good as anyone else's. Setting aside what you mentioned before about past year's (00:28:35) other companies, do that make sense? Is that how we can expect things to play out?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, it's a very interesting hypothesis. And how do I argue against that one, it's kind of hard to. But you do mention a very important thing. So, this is accident year paid and put up, right.

Q - Meyer Shields {BIO 4281064 <GO>}

Right.

A - Brian Duperreault {BIO 1645891 <GO>}

Versus calendar year, which is a blend of stuff going in and stuff going out. So, yeah, I would say there where would that not – where would we not match our peers, okay? And it's a little bit like the statement about the reserve releases because I may still feel that our loss picks from a pricing point of view should remain more conservative until we can prove they are not. So, we may still put loss picks out for accident year 2019 that might be above our peers, even though we believe we're matching them just because the track record here is such that you don't want to rush that one too fast.

So your argument's right, but I think in practical circumstances, I said, okay, you can underwrite it, I said, okay, look at I know, Brian, that the results are not good. I know that, but look at this. We've made all these changes. We don't do any of those dumb things anymore. We don't write that bad stuff. I don't have those lousy accounts and you go, okay, that's great. Then the year comes and it's like there's no change because they did something new that was dumb. They didn't do the old dumb thing. They just did something new that was dumb, right?

So now, we're putting really good people in and I trust them. But I'm telling you, it just – you let it play out. You've got to let it play out. That portfolio has – if you are in a changing portfolio structure, right, so you say we had – this is the portfolio of the past, here is the portfolio of the current. Obviously, there are some changes in it, right? So the prediction of it versus that gets a little more complicated because you've got rid of risks and you raised rates and you did these other things, you raised limits. And so I'm just saying, yes, you're right technically in practice maybe (00:31:05) will be a little bit more conservative because we want to have that portfolio play out a little bit more before again we think it's obviously right, but it will be better than the previous years. That's what I am saying, so the loss ratio movements I am seeing are sufficient for me to believe that we'll continue to show better underwriting results over time, so you will get to right to our peer levels where we think we're matching them, give me a little time (00:31:23).

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Fair enough. And as always, there are questions. Please.

Yes, you started out talking about, you want to reduce volatility of the business, but best I understand Validus is a pretty volatile company, so can you comment on how the acquisition will reduce volatility of your business and results, how are you achieving that goal?

A - Brian Duperreault {BIO 1645891 <GO>}

That's good. That's good.

Q - Meyer Shields {BIO 4281064 <GO>}

It's good opportunity to talk about the cat.

A - Brian Duperreault {BIO 1645891 <GO>}

Good opportunity. Well, look, by the way, Validus, they had an underwriting profit last year in the cat. So they reduced volatility. They were using the retro market. They're very good at what they do. Look, I like businesses that have some extreme to them provided you get paid for that, provided you get paid for the extreme. You guys don't like it because it's volatile, but it builds book value over time. So if you have 1 bad year, 10 great years, life is good, right? So Validus has proven, its track record is excellent in being able to play in that game brilliantly, right, where they continue to do to look so. That's why I want them in.

Now, we have other businesses where I was not convinced that we were getting paid for the volatility, you go, like, if you have a large property, right, and you're saying, okay, well, I do $100 million and maybe well I do $500 million, I do $1 billion. The $500 million, extra $500 million, did you get price for that? Did you get value for that? I know you're getting volatility as the pricing there. So at some point, maybe the risk/reward isn't there. And so it's selective attack on the volatility where we don't think we're getting the price for it. That cleared up?

Q - Meyer Shields {BIO 4281064 <GO>}

Well, I'm sort of. I mean, just for me, I don't think the highs of the non-cat years, the ROE was high enough. I mean, I think Validus' highs were 15%, 16%, then we go to years that you break even. Are the highs high enough for return over the cycle given what's going on in reinsurance, but that's an opinion, I guess.

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah. I mean I thought they did a good job in terms of the returns over time. So we're entitled to our own opinion, right.

Q - Meyer Shields {BIO 4281064 <GO>}

I want to jump in on that just really quickly before you go to your question and that is another element that Validus brings to AIG is AlphaCat.

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah.

Q - Meyer Shields {BIO 4281064 <GO>}

Ability to assign different capital to parts of the volatility within AIG. Can you talk about that a little?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I think there is huge potential for the whole ILS market within our portfolio. And I guess somebody else has made the same decision, right?

Q - Meyer Shields {BIO 4281064 <GO>}

It seems like.

A - Brian Duperreault {BIO 1645891 <GO>}

So when you think of an underwriting, underwriting is – at its essence it's looking at this risk and matching it with capital. And this gives us just another capital to use to match it and we're risk originator. So you can kind of leap a little bit ahead into the future to say, there should be ways where we can actually construct business which would be immediately matched with the ILS market. So, that says the cost of capital – you're using it to your advantage because you're saying as underwriters, I can find a cost of capital and match risk with that, cost to capital, match with that; it gives you much more flexibly. So over time, I think this can be quite a useful tool. It does reduce volatility. And I think Validus has done a very, very good job of using their market presence, a piece of business comes in. And for them, it benefits the ILS market than their own. Well, they may – so that's where it will go. So I think it's a good tool and I think you're going to see more of it, not less.

Q - Meyer Shields {BIO 4281064 <GO>}

You mean at AIG or...

A - Brian Duperreault {BIO 1645891 <GO>}

AIG. And I think this other – I think it's indication of others who see the same thing.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. I'm sorry. I got in your way.

No problem. I am wondering how the valuation of your stock impacts at all your thinking in terms of timing of M&A. You've been very clear with the Street that there are things that you – or capabilities you're looking for for AIG. I'm just wondering given where the valuation is today, how that can impact that timing.

A - Brian Duperreault {BIO 1645891 <GO>}

Well, it's a limiting factor. I'd like to have a currency I could use in addition to cash. So it's a limiting factor. It doesn't completely shut me down, depending on what might be there, but you have to recognize it as a limiting factor. We know we bought Validus with cash. I mean there are certain things that we can do that will fill in the portfolio and don't have to be massive because it's usually something large where I'm going to use the stock anyway, right? So it's limiting, but it hasn't stopped us from pursuing acquisitions and we'll see where it goes. I like this – you know the currency gets up, it gives me more degrees of freedom. But it won't stop me from looking.

Q - Meyer Shields {BIO 4281064 <GO>}

We've talked a fair amount so far. I'm sorry, the question here.

A - Brian Duperreault {BIO 1645891 <GO>}

So, question right here.

Q - Meyer Shields {BIO 4281064 <GO>}

Right? He wins.

A - Brian Duperreault {BIO 1645891 <GO>}

He wins. He guessed to ask the question.

Q - Meyer Shields {BIO 4281064 <GO>}

Brian, how do you think about the investment portfolio today? And what is it that you're really looking for to achieve and just what are some of your thoughts about it?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I think you've seen and I didn't initiate this, we reduced the hedge fund components of our investments. And remember, we've got two different animals to deal with here. We've got the life and that's a spread business in many ways, and you got to think about your investments along the lines of what you're taking in and what you're promising and then you get the general insurance, which – investments is an important part of it, but it doesn't turn on investments very much.

In other words, I'm not sure, I get credit for outsized earnings in investments in the general insurance. Everything – the focus is all on combined ratios. And so I have to look at how we do the general insurance a little differently than we do the life. And I'm still looking through that because we do have a volatile investment, it's a good business, don't get me wrong, builds value. So horses for courses, I guess, is the way to put it.

You do want to match your assets and liabilities. In gen, it's a little less important, relatively short duration. So it's a little less important. And so you think about more about stability and consistency and predictability on the general insurance side. Does that answer the question?

Q - Meyer Shields {BIO 4281064 <GO>}

Yeah.

Okay. So we've talked a lot about internal issues. Obviously, one of the levers, one of the aspects of the AIG story is the distribution and I would imagine you've got some goodwill with one in particular. What role do broker relationships play as AIG continues on the path of improvement?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, our book, particularly the commercial book is really driven by brokers. We do have some smaller brokerage business, but predominantly it's larger – into the larger players, and I think having been on the other side, there are – you want to be a market by the way – you want to be a market that they need you, not just you are there as the commodity play, right? So you want to be in a position where they need to go to you that if there is an RFP, two brokers competing against each other and bidding up markets, you want to be one that they're fighting over.

So I got to have AIG because I don't want to be frozen out and not get AIG and have them steal the march. So we're in that position which is interesting. We are a market where the broker really feels they need to be part of us. It's a very interesting business because it's still very, very personal, particularly large account business, very personal. There are relationships. The brokers are obviously not working for me, they are working for the client as they should, but they're also trying to get stuff done and working with somebody that they trust that will not waste their time. There's a certainty to it. They're effective. That's a big deal to a broker because a broker needs to get it done and they just can't like hang their hat on you and then you disappoint them because you stretch it out and then you say no, you said yes, then you say no, you waffle, so this relationship thing, it's a three-way relationship – the client, the broker, us.

Peter Zaffino says, he just – he goes see clients now and he says they like me. When I was working for them, they just treated me one way. Now I'm the carrier, they like me so much more. So it's a very interesting three-way kind of relationship that occurs. We've got great – again, I didn't know if I mentioned this, but the brokers were really surprising again when we're talking about early days of really wanting to weigh in and they need a company that can get it done. If you got a problem, they need a problem solver because anybody can place all the other stuff. It's that problem that they got to solve because they got to solve it, the client is expecting them to get whatever issue we fix. And AIG has been that company for decades and they want that company back and they're doing everything they can to help us.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Just want to see if there are questions in the room.

One aspect of fixing the casualty book, I know your predecessors worked a lot on isolating the 5% of the casualty book that maybe was responsible for the bulk of the reserve development. I wondered if that's the process that's ongoing or if it's something that maybe is not that simple when you're talking about these large accounts that have several product lines while one line might not be profitable, the other lines more than make up for it?

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah, I think there's a little bit of that in that large account book that I mentioned in that product where they have comp GL or auto. They tend to be driven by comp at the end of the day. So how do I answer that? I think the casualty book, and that – it was just as much a property by the way, picking the right guys. It wasn't just casualty. In fact, I think the casualty guys might have been a little better than the property actually fixing the portfolio. But I characterize it this way, okay. This is classic portfolio management. You guys portfolio managers, you're always looking at adding and subtracting, things change, right?

Companies look good one year, they don't look good the next. That's a constant thing in portfolio management. We have the same issue.

I have always believed that the most important thing in the portfolio was the risk itself and less important was the price. You got a market-driven pricing process. You're not just going to beat the market by 10 points. I mean the market gets to a certain price. So the question is, are you putting the right business in the books, particularly where it's volatile. So if you can select businesses that are above average, loss costs are lower, but they're getting average rates, you win, right, and the other way around.

When I looked at what they were doing, I felt that they were spending too much time on the price and not enough time on who they were pricing. And so, that 5% may look good. It could have actually been completely opposite. It had a high price because it deserved an even higher price. And another one could have had a low price, but it was actually priced by the market because it was a good risk and it was sought after. So if you don't put those two together, you can make a lot of mistakes. And I felt we were getting adversely selective.

So portfolio management is portfolio management. It's just what's your philosophy around how to construct it. And I have always felt the risk itself drives it first, first and foremost. You shouldn't write bad business. I don't care what the price is. There is an adage, every risk is writable, it's just a question of price. I don't believe that. I don't believe that at all. There're businesses I don't want on the books. There's not a price in the world that to justify putting them on the books. So we've changed the philosophy.

Q - Meyer Shields {BIO 4281064 <GO>}

It's an interesting development over the course of the year. I'll back up a little bit, we were in Bermuda in May and it seemed like the one really hard line of business at the time was run-off. So we look at AIG because we look at these and you say badaboom, you've got a run-off insurer that now looks like it's going to be competing for business in – if we're right about inflecting loss cost, this should be a really hard line for the next couple of years. How are you thinking about that? What's the opportunity?

A - Brian Duperreault {BIO 1645891 <GO>}

That's interesting. I have to say I have never really sought, call it, legacy here, right, run off as a market opportunity. To me, it was probably the dregs of the past, all isolated. It's hard to say, oh, that looks good, you know.

Q - Meyer Shields {BIO 4281064 <GO>}

(00:46:50)

A - Brian Duperreault {BIO 1645891 <GO>}

Why is it they're in the first place. So, no, my thought process wasn't around, let's get into the legacy business. But we got – we had legacy and we wanted to create a legacy company in Bermuda where we would get really good capital advantages because it's composite company. And it gave us optionality. But I didn't put it up to actually get in the business. What happened was as soon as we announced it, we had all these unsolicited offers to acquire parts of it, right, or all of it and we decided to get together with Carlyle (00:47:36) because I think we have similar philosophies about the business. So we need to stand it up if it's going to actually be in operation and taking new business, it's going to have to be stood up. So it's going to have to have its own processes. They should be separated from the processes of the life and the gen. So we're working on that. So, that's going to take us some time. You saw the announcement.

Once that occurs, let's look at the market then. Is it still a good market? I don't know. If it is, I guess I'd have to consider it as another leg to a stool. If it has - look, I can tell you one thing it's like debt and taxes, legacy is predictable. New business today is the next generation's legacy because it just - this isn't as good as you thought it was. And so there's always legacy being produced in our business, so I do think it has legs in that regard. Do we want to get in that business? I don't know. But it gives us the option.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Want to spend a little bit of time talking about stuff that's working at AIG.

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah, let's do that.

Q - Meyer Shields {BIO 4281064 <GO>}

Personal line, life and retirement. So how do those lines look? How those businesses look?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I think the one thing that really focus on with life and retirement is the diversity of our annuity capabilities. And so there are - if you pick different kinds of annuities, there may be a company larger than us, but no one has the spread of capabilities, which then allows us to be in the one market that actually is favorable and reduce activities in the one that's losing favor where you're just not as comfortable with the pricing.

So, that I think is - and being very conservative and I - these guys are quite conservative. I think it's a very nicely balanced portfolio. And we do have some life, we do have a little bit of international life, but that portfolio of annuities I think is something that needs to be focused on. And we've done a couple of meetings where we bring people in to explain it, because I don't - all of the dialogue is about general insurance and probably should be given that's where the turnaround needs to take place. But it's sort of unfair to them, because they do a great job. So, it's nice to put them in the spotlight.

Q - Meyer Shields {BIO 4281064 <GO>}

We never talk about that that's working. That's one of our...

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah. You never talk about it, right? Kevin never gets a question.

Q - Meyer Shields {BIO 4281064 <GO>}

True that. So, in the same general topic, in Europe, there are a lot of companies that - a lot of insurance companies that are life and non-life. In the U.S., fewer essentially now that Hartford is fully divested. What are the upsides and downsides of having life and non-life?

A - Brian Duperreault {BIO 1645891 <GO>}

I've been in Europe - a product of your education and training, and so it never really was even a question when I joined AIG. We had life and we had non-life, we had international and domestic. And I wouldn't say it was all love and roses, there were some fights between the life and the gen in certain countries, but the benefits of it were very clear. In capital management, diversification, investments, the capabilities that you would have as having life can bleed over into gen, and gen into life. So, you get great capital management. We actually get a great benefit from a tax point of view, too. But more importantly is the capital management that you get in the diversification of earnings.

So, you can do the life and do it badly, I don't think it's more complicated and I got to tell you, I've got a guy, Kevin is just terrific as a leader of the Life and Retirement business. We probably should call it retirement and life, because it's more retirement than life. And by the way, the demographics of the world are definitely in our favor. If you think about your strong suit is retirement, not just here, but all over the world. So, it's business - it's got legs, it's got profitability, it's good balance, good return on its equity, why wouldn't you want to part of the company. But I don't - I never even thought about it.

Q - Meyer Shields {BIO 4281064 <GO>}

Right.

A - Brian Duperreault {BIO 1645891 <GO>}

It's just the way it is. I went to Japan, I ran Japan for a few years, life and gen, and it was beautiful.

Q - Meyer Shields {BIO 4281064 <GO>}

Right? I mean, we didn't see that.

A - Brian Duperreault {BIO 1645891 <GO>}

No, we've been - well, I guess, you still. But I was trying to get life part of ACE when I was there. I think he continues, but I've to try to do that.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. I want to make sure I'm not overlooking any questions in the room.

Given that you have the two sides kind of working differently, some going well, some of them more rehab and idiosyncratic to what it need to do. Kind of going back to question around M&A, how do we think about the next priority for M&A in terms of the different businesses? Do you want to spend more time fixing what needs to be fixed internally versus doing really well, let it stand on its own two legs and continue or grow that more inorganically?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I think you have to think growth and there are times when you grow inorganically and times when you can grow organically, and you have to – I think you got to be able to have the ability in both, right? So, let's just start with that. We're fixing the gen. It is a work-in-progress. It's execution time. I wouldn't do an acquisition that got in the way of that. It could be a great company, but if it creates kind of dislocations, we got to reorganize or we got two of this and two of that, and we only need one and all that. I mean, that I would not do that. So, that kind of limits what I would do. So, a large commercial, I probably wouldn't do it right now, not until we have a solid base.

I don't like financial acquisitions anyway, so I don't want to acquire a company I've got to fix. So, because that's just all it does is suck your resources away from either people doing really well over there and you suck them away, and then they take their eye off the ball on the stuff that was working. So, I hate financial acquisitions. I don't like acquisitions justified on synergies, where you just got to fire a bunch of people to make it worth, it better be more than that to the acquisition story. So, just continuing along these themes, if you look at AIG, we're global, we're in a lot of places, we do a lot of things and yet there's very large pockets of business and then it drops off. So, we are very big in Japan. We've got a large UK operation. We do large commercial in the U.S. We've got a large life operation in the U.S. We don't have life and retirement basically other than a little bit in the UK anywhere else in the world, that's – and I said the demographics globally in our favor.

So, I would look if I could, but it's not easy to find. But if I could, I'd try to diversify the life business and make it a little bit more international. Validus was a good example of businesses that we didn't have and it didn't disrupt the commercial business we win and we win in Lloyd's. We didn't have a reinsurance operation. We didn't have an ILS operation. We didn't have a crop business. And so, I could add those to the general insurance without having any disruption. They stayed as – they stayed in their own place doing their thing. So, those are kind of my rules, if they're better, make you better. Any acquisition better, make you better, and it either makes you better, because you're not doing what they do or they've got better people or they've got better systems. So, they got something better. You can't do – I don't do acquisitions where I got to make them better.

Q - Meyer Shields {BIO 4281064 <GO>}

So, one talking point I made a big deal of early on was that the second person you brought on board after Peter was Serena. Can you give us some insight into what's going on at Blackboard?

A - Brian Duperreault {BIO 1645891 <GO>}

Yeah. Well, the Blackboard is in construction, right? So, we still got the in construction sign on it, but what is the premise. So, the premise is that we can be better users of data and the analytics around it without completely replacing the underwriter, okay. So, there is this thing, the machine is going to do everything. Well, that's not the case, because our business is idiosyncratic. Each risk is a little different. And so, you might think there's some average price, but then you still got a triage. So, underwriters, they're information house, they try to get us much information as they possibly can to make a good decision. So, you're constantly trying to get insight, particularly in how good the company is, are they good managers, are they worried about their own business and they worry about the risk around their own business, then they'll be a better insurance.

So, data is – there's so much data out there that we're not using a lot of the stuff that we could use to make better decisions. And then the second thing is there are still decisions to be made, right? So, you still need underwriters to make the call, but do they need to make the call on 100% of the analysis. So, Blackwood says, no, they probably only need to be in play about 10% of the stuff. So, can we make the underwriter 10x, can we make the underwriter 10 times more efficient? By triaging, by taking all the stuff that comes in and saying, okay, you don't have to worry about this, here's the price, you don't have to worry about that, here's the price, just these would be all be fine. But here is the thing you need to concentrate on. This is what makes this risk different than the others, spend time on it, get it right and the rest of it, don't worry about it.

Whereas the underwriter today will spend time on a lot of things, because you have to, that we could do better for them by giving them the answers and pointing them in the right direction. So, that's Blackwood, and it involves – it's an interesting thing, because it involves a different intake of data, it involves a different relationship with the producer, and it involves a different organization structure within the company to do it right? So, we're working on it, and I believe that it's going to be very successful. Seraina is an extremely good executive. She really is good. And one of the concerns that I had with Seraina, did she really want to do something this experimental, because she has been used to running large organization, she has been in a number of companies and she is very good at that. But she loves this because she loves the innovation side of it. And the other thing is we've got a very good partner in Two Sigma, who's quite an investment company that knows how to use data brilliantly to make good decisions. And I said, okay, I want to take your genius and match it with our genius and can we come up with a real interesting hybrid of an insurance company, that's where we're going. So far so good, that's all I can tell you.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. I'll take it. And before I throw my last question, I just want to see if there is anything in the room. And I intentionally left it for last, because...

A - Brian Duperreault {BIO 1645891 <GO>}

As a last question.

Q - Meyer Shields {BIO 4281064 <GO>}

...it's not a bad question, it's just about pricing. But I don't want it to be seen as the priority.

A - Brian Duperreault {BIO 1645891 <GO>}

Okay.

Q - Meyer Shields {BIO 4281064 <GO>}

So, what do you think of pricing?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I think I talked a little bit about it before. So, we do look at loss trends and our ability to get price against that, and I'd say we're confident right now that we're getting price above trend just about everywhere, but not everywhere, but just about everywhere. And so, that's good. But the second thing is the turnaround in our business is going to be at least as much affected by improvements on our expense ratio as it is about the pricing. So, I'm just not as dependent on the pricing for the turnaround, because we've got further to go than the other guys.

Q - Meyer Shields {BIO 4281064 <GO>}

Right.

A - Brian Duperreault {BIO 1645891 <GO>}

Okay? So, I think it gives you a degree of comfort. But we're pretty confident about where we are price to trend.

A - Meyer Shields {BIO 4281064 <GO>}

Okay. And with that if you all join me in thanking Brian for very informative. Thank you.

A - Brian Duperreault {BIO 1645891 <GO>}

Thank you very much.