Deutsche Bank Virtual Global Financial Services Conference

Company Participants

- Mark Lyons, American International Group
- Philip Stefano, Deutsche Bank

Presentation

Philip Stefano {BIO 22473935 <GO>}

Great. Thanks, everyone, for joining our virtual fireside chat with AIG at the Deutsche Bank Global Financial Conference.

I'm Phil Stefano, the insurance analyst here at Deutsche Bank, and we're very excited to have with us early this morning the CFO, Mark Lyons, and deputy CFO and treasurer, Sabra Purtill. At least for the insurance focused [ph] investors, our two esteemed guests likely require little introduction, so I'm just going to provide a brief intro for both.

Mr. Lyons returned to AIG in 2018 after spending the majority of the prior two decades holding various roles with increasing responsibly at Arch Capital Group and Ms. Purtill joined AIG in 2019, previously having been with the Hartford Financial Services Group where she was treasurer and head of IR. So again, thank you both for joining us today.

When we [ph] start with a QA, I'll be doing some questions of my own, but we're also going to leave time for questions from the participants and just quick instructions on that. You can ask a question via the web portal.

There's a box to the left of the slide that you see or you can also e-mail me at Phil.Stefano@DB.com, whichever is easier for you. But first, Mark, I believe that you have a few minutes of prepared remarks, so I will turn it over to you to start us.

Mark Lyons {BIO 6494178 <GO>}

Great. Thank you, Phil, and I appreciate the invite very much. It's always good to get out in front of analysts and investors and this is a great FDA compliant opportunity. So again, thank you.

Thank you for that. So I guess a few summary comments. I'd say first, and we kind of mentioned it on our first quarter call, but AIG entered this COVID whole situation and environment and in a very strong financial position and that continues to be the case.

We enhanced our current liquidity, as you probably saw in the trade press in May, by raising $4.1 billion in the debt capital markets and we now have north of $11 billion of current liquidity at this point in time.

Our subs remain in a very strong position. Both the life and retirement and the general insurance fleet RBC ratios were north of 400% at the end of 2019 and they actually improved between then and 1Q 2020.

I think you guys know that the general insurance story has been one of massive re-underwriting. Peter Zaffino itemizes a lot of those things on the quarterly calls or at least he did in 2019 to give people really a flavor for the kinds of effort that had to be expended and that work continues of course, but it's more the last -- it'll continue, I think, through 2020, but now you've had basically a full renewal of everything and especially in a harder market environment.

So it's, I think, a very -- it bodes very, very well and I think the biggest problem child that general insurance has had has been North American commercial and I think that's where, figuratively speaking, the most surgery and attention has been made. Not that there wasn't attention elsewhere, but I'd say proportionately more there.

The personalized side of the house is really a pretty strong franchise, especially in Japan and with the high net worth business, it's one of the industry leaders in that marketplace. We recently launched Syndicate 2019, as we commented on on the call, in partnership with Lloyd's to really serve that high net worth market which is a -- continues to be a fast-growing and profitable segment.

Life in retirement is a well balanced portfolio. I'm sure we will get into that a bit. It's got a strong breadth of products and distribution channels to really let clients be served, I think, in the right way and as markets change, as pricing conditions change and so forth, there's an array of options for them. Fortitude Re that we've commented on probably since November of 2018 is still on target to close mid year and it's going through the regulatory approval process as we speak.

Our investment portfolio, I think we commented on this probably more fully on the last call, has been really derisked over the last three to four years, really since Doug Dachille got here in late 2015 and I always like to make the analogy that he was faced with similar challenges that general insurance was faced with with a portfolio that needed major rebalancing, major constructive and construction work associated with it and I think that's been evident over time as well and we broke out a lot of information in our financial supplement for investors and analysts and hopefully that's been of value to everyone on this call.

Now, I think just kind of closing where I started is we continue to have a lot of confidence in our balance sheet and the business portfolio as it stands. We'll continue to tinker with it of course, but we feel -- we feel pretty strong about it even with all the uncertainty going on at this time.

We feel we're in a pretty good place to navigate things and this current environment is just that -- the current environment and in three weeks, it could mean something different and there could be different governmental policies coming in and programs and so forth that it's really hard to determine to what extent it buffets up the economy or what it does for overall liquidity, but we still feel that this is an earnings event for AIG, not a capital event and with those intro comments, Phil, I'm happy to kick it back to you and begin the chat.

Questions And Answers

A - Philip Stefano {BIO 22473935 <GO>}

Great. Great. Thanks, Mark. And so one of the questions that we get, especially now that the first quarter earnings is behind us, is trying to parse between the different layers of COVID reserving that people have put out there.

So the question that we're going to begin with asking everyone is to what extent do your COVID first quarter charges represent an ultimate, what's encompassed in them and if you can just talk about the extent to which there may be legal expenses embedded in there. It feels like these are the three kind of primary differences in how people have reported so far.

A - Mark Lyons {BIO 6494178 <GO>}

Okay. Okay. That's a fair question. So I guess there's a lot of subparts there, so let me go through and hit some of them. I think -- I think Peter kind of marched through it, but what we posted, which was $272 million on a net basis, was really a composed of travel exposures, accident and health, contingency, business. Did include property, did include credit and workers comp. We kind of went through I think, but happy to do it again, some of the rationale for some of that.

But to the extent that we could measure it, Phil, it would have contemplated legal expenses and buried in the reserve. The reserves are dominated, as you would expect to be IBNR [ph] reserves, not case reserves.

Now, as things emerge, could legal expenses be a little different than you originally think? I mean, when you look at the papers, and I'm sure everybody's reading the same things, you can have different views coming from different states, you have certain areas trying to get multi-district litigation and DL [ph] litigation and so forth.

So depending on where that goes, it's a different legal spend associated with it, but our reserve's contemplated our best guess at the time. So when you -- I think you said does this represent an ultimate?

So the answer is yes. I guess I have to differentiate how an insurer might look at that and what we're responsible for doing and how the question might be phrased. So I guess first, what's the requirement of any insurer to do it at any point in time?

So at any balance sheet date, you're required to put up your management's best estimate of glossary [ph] service associated with events that have occurred on or before the statement date.

So from that perspective, these are our management's best estimates of the exposures from COVID from claims that occurred 3/31 or prior. It therefore is not an estimate if you think of it like on an underwriting year basis or underwriting years basis, depending how long this lasts, that will be future loss occurrences.

So if there is an event cancellation in September, that's clearly not reflected because it was neither postponed or canceled as of time of the statement date. So hopefully that clarified it.

A - Philip Stefano {BIO 22473935 <GO>}

Yes. No. It does and one of the things that I've been trying to think about is just given the uniqueness of this event and you have a reserving process that you've put in place, to what extent is the reserving process fluid, do you need to start from ground up every quarter or how should we think about what the reserving evolution for COVID could look like as we move forward?

A - Mark Lyons {BIO 6494178 <GO>}

Yes. It's a good question. I think what you'll see -- because I think we talked about kind of a granular, bottom-up approach which involved a lot of different people and functions and then a top-down approach which is more exposure.

So the bottom-up teaches you about where the exposures are and the top-down is more of kind of an exposure rating approach, if you will, or an exposure view. So those two marry themselves.

As time goes on, there's going to be more weight given to the bottom-up than the top-down. I would make the analogy to a reinsurer, right? A lot of -- on a normal catastrophe usually the estimates come out as a function of market share, very top-down and then as the quarters pass, that kind of gets kicked to the curb and it's the actual emergence that dominates and it'll be the same thing here in concept.

A - Philip Stefano {BIO 22473935 <GO>}

Okay. And we had a --

A - Mark Lyons {BIO 6494178 <GO>}

So I think if part of [ph] your question, Phil, was do we have to start from scratch, I'd say it's similar to any other reserve group. So you leverage what you had last time and you look at how things have changed and depending upon what you have, if it's a frequency line or severity line, you can apply different methods of projection. That's all a function of what comes through.

A - Philip Stefano {BIO 22473935 <GO>}

Understood. Understood. And we had -- we had a question come in on the line about COVID. Given that this is -- at least it was described in the opening remarks in earnings event scenario. When you look at stressing the various assumptions that you're making, can you help us understand maybe what the macro circumstances are?

What leads this to be a capital event? How does the evolution of losses change to pivot from being an earnings event we should be comfortable with to a capital event, this may be a bit -- a bit more of a headwind?

A - Mark Lyons {BIO 6494178 <GO>}

Well, as I said, our view is that it is -- with our view of how we've looked at it, it's still an earnings event even with -- I mean -- I mean, I got to back up a bit because as you know, we and others have withdrew guidance because there's only limited visibility. I mean, I don't know about your crystal ball, but mine's very cloudy on 2020, let alone 2021. It's basically opaque on 2021.

So you've got to make assumptions on, for example, where the 10-year is and where that might be over time, what's going on with spreads, what's going on with equity markets and some other aspects you might have, what's going on with other charges that may come through.

So what we did on -- I mean, that's the thing with scenario testing versus probabilistic approaches. You really have to pick a set of dynamics and kind of let that run through. So it would have to be far worse than we've assumed in our -- in our kind of revised view forward, limited visibility view forward for this to become a capital event for AIG.

A - Philip Stefano {BIO 22473935 <GO>}

Got it. And you had mentioned that the guidance was withdrawn. At least for the general insurance, the combined ratio improvement expectation was reiterated. To what extent should we contemplate the potential accident year or attritional losses coming through from COVID and serving as a headwind to that improvement target?

A - Mark Lyons {BIO 6494178 <GO>}

I view that as marginal really at this point. I think there's the possibility of some upward drift and we're talking actually here ex-CAT, Phil, I assume?

A - Philip Stefano {BIO 22473935 <GO>}

Right. Yes.

A - Mark Lyons {BIO 6494178 <GO>}

So yes. Or I assume 2020 ex-CAT [ph]. So yes, there could be some movement, but in AIG's case, because of the kinds of lines affected, it could be driven by our changing mix. I mean, when you have your travel business -- I mean, you know what's going on with travel.

It just fell off a cliff. So the travel volume is off tremendously. That affects loss ratios, it affects acquisition ratios and things of that nature. A&H and other lines are off and they'll rebuild as a function of how the economy rebuilds and what governmental policy lets travel really start to occur again.

So I give the travel example because it's, I think, a good extreme example because many people don't have travel books of how a decrease -- a radical decrease in the volume of the book can actually weight and change your loss ratio overall. Even though every line of business' lost ratio may not have changed appreciably, the weighting may cause some upward pressure.

A - Philip Stefano {BIO 22473935 <GO>}

Got it. And when we think about the the P&C commercial lines, I think in the past you had talked about using a machete to help sculpt the business and maybe you're down to a scalpel at this point. I mean, can you remind us where in the surgery you are with the changes that you're making?

A - Mark Lyons {BIO 6494178 <GO>}

Well, I think if I talk about one that's still a little bigger than a scalpel would have been the Syndicate 2019 on the high net worth business. So that's a -- it's really a strong performer.

The one exposure you have about people in the high net worth segment is they all tend to want to live on the coast, but they don't [ph] all want to live near each other. So you wind up having risk aggregation exposures that you really can't get away from.

But the book of business that AIG has, it's not just auto and homeowners. It's watercraft , it's collections, it's excess liability, there's a -- there's a fine arts, there's a full array, flexible [ph] cars, things of that nature.

So there's a full array of exposures that really do help you overall, but that is, I think, a good recent example of additional portfolio management that welcomes and allows Lloyd's with its innovative structures of bringing in third party capital and arranging it in different ways and it's being complemented with a lot of reinsurance that we have from our third party -- normal third party reinsurance indemnity providers.

So it's a really good spread and it allows the profits to be spread as well, but it should, over time, change AIG's profile to that being a smaller proportion of total and also generate fee income because that will be an MGA structure written through Talbot.

So it will still be written -- the PCG brand will continue, for example, but it will still be written through AIG through Talbot. So we think it's an elegant spread solution that benefits everyone.

A - Philip Stefano {BIO 22473935 <GO>}

Got it. Okay. And switching gears a little bit, we got a couple questions that came in through the line about the seeded [ph] reinsurance program. Was hoping you could just discuss the program generally.

I know there have been several Hansons [ph] over the years which you've detailed on your earnings calls. As we contemplate the structure of the reinsurance program, how should we think about the potential response? At least it feels like the question's geared towards COVID claims on the property versus the casualty side.

A - Mark Lyons {BIO 6494178 <GO>}

Well, we tend to talk about the property more. Happy to do that again, but I think the enhancements -- first off, it's complicated. I could be here for three hours quite frankly, but if I think of the per risk and the CAT, there have been, I think, substantially beneficial tweaks that make the covers more relevant.

So on the per risk side, the attachment points have dropped and there were some AADs, annual aggregate deductables, in some of those and those have been severely lessened.

And because we cut our limits that Peter Zaffino talks about, right? So dramatically, we didn't need some of that extra coverage at the top because our limit's nowhere -- it didn't have that level of size anymore and we had made enormous progress towards eliminating those long term agreements or LTAs, which were the three-year deals that carried a lot of that.

So you've got that benefit there and in the CAT program, you not only have lower attachment points, it's better on the aggregate basis. So it'll attach sooner irrespective of whether it's a large vertical or a collection of aggregate losses over the course of the year and both the per risk and the CAT would have coverage for communicable diseases, for example.

Although, on a go-forward basis, we expect and are already seeing the reinsurance market tighten that and there's generally going to be -- I think as a general rule there'll be [ph] communicable diseases solutions going forward, but all of our reinsurance contracts have strong follow-the-fortune conditions or follow-the-settlement conditions if there are settlements involved. So that would be my summary, Phil.

A - Philip Stefano {BIO 22473935 <GO>}

Okay. And --

A - Mark Lyons {BIO 6494178 <GO>}

Oh, on the property side -- on the casualty side -- sorry. On the casualty side, again, the gross underwriting changes have to drive what you do and I think Peter talked about it last year.

On the casualty side, it was a significant change put in on the growth side by the chief underwriting office, Tom Bolt and his team. So in the past, AIG would compete against itself basically and have different pockets around the world and the brokers knew that and they knew how to exploit the chinks in the armor.

That's no longer happening. So it's more centrally controlled, restrictive ventilation standards between layers where we would operate, whereas in the past, we may have written $200 million with no ventilation in different pockets of the organization and had a huge net on it.

Now there is no more than $100 million that's out and $75 million on new business. There's a 75 X 25 that's 100% seeded and there's a quota share in the first $25 million that's roughly 55% seeded. So let's call that an $11 million net impaired if we had written the whole thing up to $100 million.

So a massively different tail management, number one and number two, it changes your net mix of business which is also favorable to us. So that's how I'd summarize that, Phil.

A - Philip Stefano {BIO 22473935 <GO>}

No, that's great, Mark, and the pricing momentum that we've seen, at least on the primary side, is something that we've been discussing for a while and it feels like the hardness or the firming in reinsurance is a bit of a new phenomenon in the industry. Does it feel like the pricing momentum of reinsurance versus primary, are they materially divergent at this point?

A - Mark Lyons {BIO 6494178 <GO>}

Well, some of the things that we see -- because remember, we have Validus now, right? So we're writing reinsurance assumed [ph], not just dealing with markets on a seeded basis and it's probably worth noting that the amount that Validus rewrites is more than offset the sessions that we do. So on a net-net basis in a harder market like this, we still come out winners from a price game point of view.

So with Japan and Florida whether it's lost affected or not, there was clear indications of real strength of reinsurance pricing going up. So AIG's program, you may recall from Peter, we we still had a 7% spend reduction compared to the prior year, but the rates have -- the rates have gone up, so the reinsurance market that seemed to lag the primary market and the retro market, they were in the middle, that seems to have been corrected.

A - Philip Stefano {BIO 22473935 <GO>}

Got it. Thank you. When we think about -- I guess looking back to the first quarter earnings call, there was -- there was a comment that was made and we had a couple questions come in about the exposure to property and the affirmation of coverage for communicable disease was less than 1% of the total limits on property.

I think people were trying to just get a better understanding for the context in which that was provided and the extent to which the limits could be a headwind as we think about forward earnings potential and maybe you can just clarify or talk around if you have any more clarity in that comment and how we should be thinking about it.

A - Mark Lyons {BIO 6494178 <GO>}

Well, I think -- I think the intent of that was -- to kind of give some relativity, the combination of how often it's offered I guess is a good way of putting it and the sub limits, which are tiny compared.

So it was less than 1%. I think that's what you were referring to, Phil. Less than 1% of the total gross limits in an aggregate sense would be potentially exposed to business interruption if everything went south, including all the things you ask about, coverage, language and legislative efforts and things of that nature.

So I think Peter, in the past, has talked about that depending on whether it's North America or international, it amounts to like $1 million to $1.5 million policy limit gross maybe in North America and less than $1 million internationally.

So if you think of it in context from over the year, there was -- these are astonishing numbers -- $200 billion in limit reductions, gross limits, $200 billion. So if you take the 1%, that's a $2 billion reduction. Assuming they all proportionally had business interruption, that would be a $2 billion reduction in business interruption limit.

So the constant resculpting of the portfolio, and I think Sabra has commented on in the past that if AIG had been struck, if COVID had happened three years ago, would have been a whole different ballgame, but all those efforts that went forth to derisk and restructure the book allowed us to be in this position.

So I would summarize that it's less than 1% of the total limits outstanding, the limits have dropped by $200 billion over the course of a year and that's what puts us in such a great position now.

A - Philip Stefano {BIO 22473935 <GO>}

Understood. Understood. And thinking about Fortitude Re, look, post the sale of Fortitude, are there any parts of AIG that still seem non-core? Or alternatively, is there any area that you see a need to grow inorganically following the sale of Fortitude?

A - Mark Lyons {BIO 6494178 <GO>}

Well, Fortitude dominates, but isn't exclusively what legacy is. There's still some pieces that are probably not worth talking about, but Fortitude still dominates that. So yes, that's considered non-core and that helps the life and retirement be comfortable in saying they don't have legacy exposures, right?

They don't really have the 2000 vintage variable annuity issues, they don't have LTC issues and things like that. To the extent any of that was there, that's over in the Fortitude book and not a -- I'll call it a going concern upon sale.

So I would really say that is still our view of what's non-core. If I -- if I look at L&R between their group, their individual retirement, the life piece and institutional markets which is mostly structures and gifts and pension or [ph] transfer deals and things of that nature, I'd say they're all -- they're all core. Now, the life piece, when we talk about life and retirement, it's dominated by R, not L. So the life piece really is -- compared to others, is probably not proportionately as big as some of our competitors, but I'd say all of it is still core.

And then when I look at GI, it's more -- as Peter would do, we would sit down and look at the portfolio as to what's performing and what's not, what should we grow, what should we coast on, what should we cut back or what should we drop kick?

That's an ongoing -- but that's pruning, right? That's not saying core or non-core. So I think with the exception of legacy, we don't have things that I would really classify as non-core.

A - Philip Stefano {BIO 22473935 <GO>}

Got it. And when you think about the broader AIG portfolio, does it feel like there are things that are missing that would be easier to solve inorganically than organically?

A - Mark Lyons {BIO 6494178 <GO>}

Well, if we didn't have Validus yet, right? I'd say we need a reinsurer, we'd need Lloyd's presence and we need business that we don't heavily crop [ph] and we got all that associated with it.

So I don't think we're in a hurry to flood into the Far East, for example, and that's super competitive at this point. So there might be some areas -- I mean, we used to have a lot in the American presence, for example, and that got cut back.

So I think it's a continual look at the -- at the landscape, Phil. So if some economics within a geographic region improve, then we'll look in that regard. I mean, back to my old company, one of the -- one of the wavy line tenants was to have more of rule of law where you could depend on it.

So whether it's London or England or the U.S. or Australia and some of the others where you had some level of knowledge of how the legal system would work, which is critically important in insurance. So it all goes into the mix.

A - Philip Stefano {BIO 22473935 <GO>}

Okay. And so switching gears a bit, when we have conversations with investors about AIG 200 --