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AIG

An Actuarial Analysis of Selected Automobile Warranty Experience as of September 30, 1998

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September 30, 1999

Mr. Jay Morrow
Actuary
American International Underwriters
70 Pine Street-9th Floor
New York, New York 10270

Dear Jay:

We are pleased to submit our report with respect to our actuarial analysis of selected Automobile Warranty experience for AIG as of September 30, 1998.

We estimate the ultimate loss ratio for the terms provided for analysis will be approximately 239%. For extended service contracts (ESCs) on used vehicles this estimate covers contracts written through September 30, 1998 while for new car ESCs our estimates include projections for all contracts to be written on vehicles first put into service on September 30, 1998 or earlier.

To provide a frame of reference, the following is a summary of our estimated ultimate direct losses (net of deductibles) and premiums (net of cancellations) for the terms analyzed:

Ultimate Premium	392,103,007
Ultimate Losses	937,818,897
Loss Ratio	239%

Further details are contained in this report.

If you have any questions regarding the attached material, we will be pleased to answer them for you. We appreciate the opportunity you have given us to be of service to you.

Respectfully submitted,

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Consultant

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SECTION 1: INTRODUCTION

American International Group ("AIG") has retained Milliman & Robertson, Inc. (M&R) to provide an actuarial analysis of a selected portion of their Automobile Warranty Program experience as of September 30, 1998.

PROGRAM – GENERAL

We understand AIG's warranty (or extended service contract) program writes a fairly large number of different ESC terms on both new and used vehicles. We also understand that contracts in the portion of that program we analyzed were administered by one of three administrators, Universal, ISI, and Warrantech.

As is often present in ESC programs, it is possible under certain circumstances to purchase a "new" ESC on a vehicle well after that vehicle is first put into service (the "in service date"). Following usual terminology, we use the term "x months extended eligibility" to denote a new car ESC sold as x months from the vehicle's in-service date. At the request of AIG, we limited our analysis to 39 separate ESC categories; 36 for new car ESCs and 3 for used.

We analyzed used car ESCs for all administrators combined separately for the three terms:

24 months/24,000 miles
36 months/36,000 miles
48 months/48,000 miles

For these contracts, our analysis was on a contract quarter (calendar quarter in which the ESC was written) basis and included contracts written from July 1, 1990 through September 30, 1998.

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We analyzed 36 separate segments for the new ESC experience with all possible combinations of administrator, extended eligibility lag, contract term in time, and contract term in miles in the following categories.

I Administrator

- A Universal
- B ISI & Warrantech

II Extended Eligibility

- A 0 through 6 months
- B 7 through 18 months
- C More than 18 months

III Term in Months

- A 60 months
- B 72 months
- C 84 months

IV Term in Miles

- A 100,000 miles
- B All other

For these 36 segments, AIG supplied data sorted by in-service quarters with in-service dates July 1, 1990 through September 30, 1998. Allocation of our estimates to actual policy quarter, or between contracts already written and those forecast to be written in the future is beyond the scope of this analysis.

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OBJECTIVES

The objectives of this actuarial analysis are the following.

1. An analysis of AIG's own ESC experience to estimate ultimate loss ratios that will be experienced in the terms analyzed. Rather than precise accounting of results by policy quarter for new car ESCs, by agreement with AIG we limited our analysis to in-service quarter for new car ESCs. This analysis can help to identify strength or weaknesses of the program.

2. A review of the resulting loss emergence patterns and a comparison to the loss emergence patterns derived from simulation models developed by M&R.

3. A review of the influence of extended eligibility options on the relative profitability of the various coverage terms.

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SECTION 2: LIMITATIONS & DISTRIBUTION

QUALIFICATIONS AND LIMITATIONS

In performing this analysis we have relied on data and other information provided to us by AIG. We have not audited, verified, or reviewed these data and other information for reasonableness and consistency. Such a review is beyond the scope of our assignment. If the underlying data or information is inaccurate or incomplete, our analysis may likewise be inaccurate or incomplete.

While the following estimated ultimate loss ratios reflect our best professional judgement, arrived at after actuarial analysis of the available data, any study of ultimate losses involves estimates of future contingencies. It is certain that actual future losses and loss adjustment expenses will not develop exactly as expected and may, in fact, vary substantially from our projections. Additionally, our estimates made no provisions for any extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in AIG's historical database or which are not yet quantifiable.

As will be noted in greater detail below, AIG's experience exhibited substantial upward trends, particularly in frequency (the number of claims per contract written). Our final selections consider these trends as well as general automotive conditions. While our selections attempted to strike a balance between these sometimes-contradictory indications, we must caution that the presence of such substantial trends does add to the uncertainty inherent in our forecasts.

In order to control the extent of this analysis, AIG combined experience for terms with mileage limitation other than 100,000 miles. To the extent that the mix of such terms have changed over the experience period of our analysis this combination will affect the applicability of past loss emergence to forecasting future amounts, and thus potentially adds to the uncertainty inherent in our estimates.

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In addition to these considerations, AIG's program is not yet fully mature. For new car terms our approach used the emergence of experience under longer extended eligibility lags (written on cars put into service during earlier quarters) to augment development for shorter extended eligibility lags. Although we believe this approach will provide the best basis for forecasts, it does add to the variability inherent in our estimates.

The causes for the above mentioned inherent uncertainties are numerous. An assumption inherent in many of the calculations and estimates is that the future will tend to resemble the past, as adjusted for expected changes in claim costs. Factors such as future inflation rates, changing in technology, mechanical breakdown trends and claim settlement practices all contribute to the variability of results.

DISTRIBUTION AND USE

This report has been prepared solely for the internal use of the management of AIG. No portion of the report may be provided to any other party without the prior written consent of Milliman & Robertson, Inc. (M&R). No further distribution by any of these parties is authorized. In the event such consent is provided, the report must be provided in its entirety. We recommend that any such party have their own actuary review this report to ensure that the party understands the assumptions and uncertainties inherent in our estimates. This report may not be filed with the SEC or other securities regulatory bodies. All recipients of this report should be aware that the M&R actuaries signing this report are available to answer questions about it.

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SECTION 3: EXECUTIVE SUMMARY

Our main findings and conclusions are presented below. The details of our analyses are described in the following sections of this report including the attached schedules, tables, and exhibits.

1. Ultimate Losses and Loss Ratios

For the major groups we project the following.

	Estimated Net Premium	Estimated Ultimate Losses	Indicated Loss Ratio
All New ISI and Warrantech	167,644,860	589,104,076	351%
All New Universal	53,739,916	128,820,431	240%
All Used	170,718,231	219,894,390	129%
All	392,103,007	937,818,897	239%

We feel that the actual results would tend to be higher than lower. Though the overall loss ratio is in excess of 225% we would not be surprised if the overall loss ratio exceeded 250%.

Obviously, high loss ratios are the result of either losses in excess of expectations, inadequate premium, or a combination of the two. Since a review of AIG's pricing for these contracts is outside the scope of this analysis we do not express an opinion regarding the premium's prospective adequacy. We will thus focus our discussions on our loss projections.

Summary exhibits follow for the following programs. These exhibits (at the end of this report) summarize the programs by ultimate contracts, premium, claims, losses, frequency, pure premium, severity and loss ratio.

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Loss ratios for ISI combined with Warrantech for new cars for extended eligibility options of 0 to 6 months, 7 to 18 months and over 18 months for coverage of the following are shown below.

ISI and Warrantech Combined For new cars for coverage of:	Loss Ratio
60 months and 100,000 miles	
0-6	345%
7-18	390%
18+	436%
All	378%
72 months and 100,000 miles	
0-6	219%
7-18	231%
18+	431%
All	298%
84 months and 100,000 miles	
0-6	251%
7-18	245%
18+	621%
All	481%
60 months all other	
0-6	180%
7-18	212%
18+	247%
All	207%
72 months all other	
0-6	175%
7-18	171%
18+	290%
All	217%
84 months all others	
0-6	188%
7-18	161%
18+	344%
All	265%
ALL ISI and Warrantech	351%

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Loss ratios for Universal for new cars for extended eligibility options of 0 to 6 months, 7 to 18 months and over 18 months for coverage of the following are shown below.

Universal For new cars for coverage of:	Loss Ratio
60 months and 100,000 miles	
0-6	214%
7-18	197%
18+	202%
All	206%
72 months and 100,000 miles	
0-6	198%
7-18	227%
18+	204%
All	209%
84 months and 100,000 miles	
0-6	431%
7-18	411%
18+	355%
All	388%
60 months all other	
0-6	144%
7-18	177%
18+	147%
All	156%
72 months all other	
0-6	176%
7-18	206%
18+	189%
All	189%
84 months all others	
0-6	177%
7-18	125%
18+	146%
All	152%
All Universal	240%

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Loss ratios for Universal and ISI combined with Warrantech for used cars for coverage of the following are shown below.

All Used	Loss Ratio
24 months and 24,000 miles	128%
36 months and 36,000 miles	122%
48 months and 48,000 miles	156%
All Used	129%

The above loss ratios compare our estimates of ultimate losses for all contracts included in AIG's files divided by total premiums written, net of cancellations, but gross of all other expenses. This is how we understand the data provide for our analysis was prepared. In particular, we have included no provision for expenses such as overhead or contingent commissions to the extent that they exist.

As noted above, our new car projections include both loss and premium estimates on contracts that are forecast to be written after September 30, 1998 on vehicles first put into service on that date or before. They implicitly assume continuation of historical writing of extended eligibility contracts and historical rate actions.

As discussed in greater detail later in this report, we used five (5) different forecast methods for each of the 39 separate segments. Especially in the longer terms it was not unusual to see substantial variation among the methods. We attempted to recognize the significant leveraging possible in some of the methods, but the wide range of potential results highlights the uncertainty inherent in these forecasts.

Our loss ratio indications imply substantially worse experience on new car contracts compared to used car contracts. In analyses such as this, it is not unusual to find higher indicated loss ratios in new car portions of a book of business than in corresponding used car contracts. There are several potential reasons for this difference. First, used car contracts tend to be shorter term, in the case of the AIG book no more than 4 years, with a significant portion of the business written for two years or less.

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Therefore, the book will mature much more quickly than a book of new car contracts written over the same period of time, giving managers earlier indications of potential price inadequacy, and consequently more time for corrective measures to be implemented.

In addition, losses on used car contracts tend to be "front loaded," that is, more losses arise earlier in the contract term than later. Hence, emerging experience may appear to be worse than what is actually underlying the book. Even if managers do not react completely to this apparent "bad news," the condition causes more attention to be paid to used car pricing earlier in the life of a program.

This is in contrast to new car coverages that attach after the vehicle manufacture warranty expires. It is not uncommon to see such manufacturer warranties extending for 3 years or 36,000 miles or longer. Thus, new car contracts, tend to be "back loaded," with most of the losses arising in the later years. Consequently, "bad news" may be remain hidden longer, thereby leading to greater potential for pricing inadequacy before corrections are actually made.

As noted above, our analysis indicates generally higher loss ratios for longer-term contracts, conforming to this hypothesis.

Frequency Trends

Given the general improvement in vehicle quality, one would probably not expect increasing frequency (claims per contract). However, we generally found AIG's inherent frequency trends not only positive but also noticeably positive.

It should be noted that in some of the programs the data indicated trends significantly higher than we assumed for our analysis. We caution that if trends similar to those experienced in the recent calendar quarters continue, final results could be substantially higher than those presented here.

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In addition to noticeable frequency trends, we noticed a substantial quarter-to-quarter increase in frequencies between in-service quarter ending June 30, 1995 and that ending September 30, 1995 for all terms administered by ISI and Warrantech. Rather than fitting trends through this jump, we separately considered trends on either side and included the indicated jump in forecast frequencies for later quarters. The results can be seen in the attached detailed exhibits by policy term.

Severity Trends

The industry severity trend based on CPI information for auto repairs has been about 3% - 4%. AIG severity trends are in some cases significantly higher than 4%. In some cases the data indicated trends significantly higher than was assumed in our analysis.

After discussions with AIG personnel, we were unable to discover specific causes for these or the substantial frequency trend indications. When confronted with data deviations so substantially from expected indication, final selections are inherently difficult and subject to substantial variation. Our selections tried to balance AIG's indications with the observed expected patterns.

2. Loss Emergence Patterns

We have developed independent estimates of AIG's loss emergence patterns for each program that is summarized in the summary Exhibit section. Also shown for comparative purposes are emergence patterns based on simulation models developed by M&R for analysis of ESC experience. Generally AIG's emergence seems slower than our simulation indications, particularly in earlier stages of development. We point out, however, that our simulations do not consider extended eligibility, which even in the "0 to 6 month" category will extend the emergence of losses compared to contracts without that feature.

3. Extended Eligibility

For the ISI and Warrantech combined analysis for all term lengths and all mileage, the loss ratios for the over 18 month extended eligibility was significantly higher than the 0 to 6 month and 7 to 18 month options. The analysis of

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the Universal program did not exhibit the same results. The Universal loss ratio did not appear to be correlated with the increase in extended eligibility option. Although there are numerous exceptions, estimated ultimate average losses per contract tend to increase as the period of extended eligibility increases.

Methodology Summary

As indicated above our ultimate loss selections are the result of five different methods applied to data provided by AIG. We intentionally selected a range of methods for use with some more responsive to current indications and others more concerned with long terms trends in the data. Our final selections attempt to balance the strengths and weaknesses of the various methods to arrive at our best estimate of ultimate experience. These methods parallel traditional actuarial forecasting methods, and thus do not provide statistical indications of inherent variability. A review of the variation of results for a particular term should give some indication of the level of that variability, but should be viewed as a lower bound of such uncertainty.

We began our analysis by using standard development factor methods to estimate the ultimate number of contracts (net of cancellations) and ultimate net premium that will be written under this program (by policy quarter for used car terms and by in-service quarter for new car terms).

We also applied development factor methods to estimate ultimate losses by policy (in-service) quarter both in the aggregate, and separately considering policy-to-occurrence and occurrence-to-payment lags.

The remaining three methods considered underlying frequency (claims per contract), severity (losses per claim), and pure premium (losses per contract) trends inherent in AIG's own experience. The benefit of this approach is that its forecasts are not as highly leveraged as those of development factor methods in less mature exposure periods. One method considered trends in pure premiums, the second, separate frequency and severity trends, and the third considered average costs for claims settled at various ages.

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We attempted to balance AIG trend indications with expectations regarding the frequency and cost of automobile repairs in general noted above. Once we selected the trends, we then considered average costs (or claims frequencies) present in the AIG experience to estimate losses yet to occur.

Our final selections were weighted averages of the results of these five projections with weights assigned judgmentally. We have included a more detailed discussion of these methods in Section 4 below.

In many cases, because of the relative immaturity of this program, there was not sufficient data to completely develop losses on some new car contracts for shorter extended eligibility lags. We augmented that development by considering experience for longer lags in the same coverage term and administrator group.

Respectfully submitted,

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