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12/4/07 DM

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Memorandum

To: / Location:	American International Group, Inc. Domestic Brokerage Group 2000 Audit File
From: / Location:	Andrew Will
Date:	October 15, 2000
Subject:	ADIAL audit strategy

This memorandum serves to document our Actuarially Determined Insurance Assets and Liabilities ("ADIAL") audit strategy for our audits of:

- American International Group's ("AIG") Domestic Brokerage Group ("DBG" or the "Company") on a GAAP basis for inclusion in the 2000 consolidated financial statements of AIG.
- DBG Pool Companies (also referred to as the American Home/National Union Pool) on a statutory basis for stand alone 2000 financial statement regulatory reporting.
- Lexington Pool Companies (also referred to as the Surplus Lines Pool) on a statutory basis for stand alone 2000 financial statement regulatory reporting.
- American International Specialty Lines Insurance Company ("AISLIC") on a statutory basis for 2000 financial statement regulatory reporting.

Reference Attachment A for a list of reporting entities that are part of the DBG and Lexington Pool Companies, respectively.

This document was prepared in conjunction with our overall audit strategy and planning considerations related to our audits of the DBG 2000 GAAP and statutory audits.

The Minnesota statutory regulations require certification by an independent actuary once every three years. The last certification by PwC was performed in 1999; therefore a certification will not be required until 2002.

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Coordination
Our strategy will require the coordination of the following PwC resources: Assurance and Business Advisory Services ("ABAS"), the Actuarial and Insurance Management Solution unit ("AIMS"), Claims Consulting Services ("CCS") and Operational and Systems Risk Management ("OSRM"). ABAS will be responsible for coordinating the overall effort.

Additionally, consistent with our overall audit strategy, we will utilize AIG's Internal Audit Division ("IAD") to execute certain portions of our ADIAL audit strategy. PwC, in accordance with SAS 65, will review work performed by IAD.

Scope
We have identified the following accounts, or components thereof, to be ADIAL:

1. Loss and loss adjustment expenses ("LAE") reserves; both gross and net,
2. Deferred acquisition costs ("DAC") and
3. Premiums receivable.

Loss and LAE reserves; both gross and net
DBG's December 31 loss and LAE reserves are determined on a preliminary basis based on June 30 data and "rolled forward" to December 31 and adjusted as needed. Consequently, PwC's "hard" review (substantive work) will be performed in December/January on June 30 data and a "soft" review (rollforward and analytics) will be performed prior to the issuance of the statutory reports on December 31 data.

Analysis
The following table presents the relative size, based on December 31, 1999 data, of the significant components of the consolidated DBG net reserves.

DBG Pool	93%
Lexington Pool	6%
AISLIC	1%

For AIG internal actuarial purposes, DBG's reserves are analyzed in groups consistent with the above captions.

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The DBG Pool is divided into two distinct segments:

- "Above the line" divisions and
- "Below the line" or division 45.

There are approximately 60 divisions or groups of divisions in the above the line segment. A division or group is comprised of a specific type of business. These divisions include both current and run-off components.

Division 45 is composed of various items, including significant reinsurance agreements (principally the aggregate stop loss) and other corporate transactions. The majority of the items in Division 45 are not analyzed via traditional actuarial methods.

The Lexington Pool is composed of half a dozen divisions, representing specific types of business, plus the aggregate stop loss. National Union is the reinsurer of the Lexington Pool aggregate stop loss.

AISLIC is composed of the non-admitted business written in the DBG Pool divisions. AISLIC has two significant reinsurance agreements: an 80% quota share with National Union and an aggregate stop loss with National Union.

Audit approach

Loss and Premium Processing

ABAS, with the assistance of OSRM and IAD, will document and test the process and controls over loss and premium processing. Our testing will include visiting, on a rotational basis, various claims and underwriting offices. (See claims and underwriting strategies in the Team Asset database.)

Reconciliation of system derived loss and premium data to the AIG Divisional Reserve Packages (as of June 30, 2000)

IAD-EDP, under the supervision of OSRM, will reperform the accumulation of the actuarial triangles.

ABAS, with the assistance of IAD, will reconcile loss and premium data, on a test basis, from the actuarial triangles run by IAD-EDP under the supervision of OSRM, to actuarial triangles in the AIG divisional reserve packages. Each divisional reserve package should include a

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reconciliation of earned premiums and losses by accident/calendar years from the "3201" premium report/"POOCSUM" loss triangles to balances included in the reserve package. Explanations for reconciling amounts should be included in the reserve packages.

Tie-in of AIG Divisional Reserve Packages to Financial Statements
ABAS, for the divisions selected for testing, will agree the reserve amounts from the AIG actuarial department divisional loss reserve studies to the DBG financial statements, via the actuarial net position schedule.

Independent assessment of DBG's reserve need
With the assistance of AIMS, we will independently assess the reserve need for the following entities:

- DBG consolidated (GAAP)
- DBG Pool (statutory)
- Lexington Pool (statutory)
- AISLIC (statutory)

DBG consolidated (GAAP)
As noted above, the most significant component of the DBG consolidated reserves is the DBG Pool reserves (93%). As a result, our review of DBG consolidated reserves will focus on the DBG Pool reserves.

In recent prior years our selection of divisions for review in any given year was guided by the following overarching principles.

- 70% coverage of net reserves for DBG Pool reserves.
  - Review higher risk divisions. Higher risk divisions were divisions that were material to total reserves and consisted of predominantly long tailed lines or complex/unique lines of business, such as Management Liability, General Liability, Workers' Compensation and Risk Finance products.
  - Review lower risk divisions on a triennial rotational basis. Divisions that were not being reviewed in the current year had been reviewed within the last two years.
- Review significant division 45 transactions.

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For 1999, the extent of our review of the DBG Pool reserves and as a result, our review of the DBG consolidated reserves and AIG consolidated domestic general reserves was reduced as compared to recent prior years due to the credit taken for cumulative audit knowledge and experience ("CAKE"), changes in the composition of the DBG Pool reserves and risk of understatement of reserves. In 2000, we plan to carry forward the methodology from last year, utilizing CAKE to reduce the scope of loss reserves reviewed by AIMS. Significant Division 45 transactions will continue to be analyzed separately.

- Organizational structure:
  To maintain independence in the loss reserving process, Frank Douglas, AIG's Chief Property / Casualty Actuary, reports directly to M.R. Greenberg. AIG's actuarial group is significant in size and composed of experienced professionals. PwC has developed a strong professional relationship with Frank Douglas. Frank Douglas perceives value in our independent assessment and as such is open in discussing issues with us.

- Views of rating agencies:
  AM Best, S&P and Moody's all have given AIG their highest rating. AM Best analyses include references to AIG's conservative attitude toward reserves.

- Historical financial data (see Attachment B):
  AIG's historical financial data also evidences AIG's commitment to carrying adequate reserves. For example, the reserve development table (excluding A&E) in AIG's 1999 SEC 10-K filing, which includes all property/casualty operations (foreign general, Transatlantic, 20th Century, Mass Marketing and DBG), indicates that over the last 11 years there were four years with cumulative deficiencies: 1989-1992 with 1990 representing the largest deficiency of $493 MM on initial reserves of $14,539 MM (3%). The reserve development table (including A&E) in AIG's 1999 SEC 10-K filing indicates that over the last 11 years there were 6 years with cumulative deficiencies: 1989-1994 with 1990 representing the largest deficiency of $1,988 MM on initial reserves of $14,699 MM (14%). Additionally, the liability for unpaid claims and claim adjustment expenses footnote in the statutory financial statements for the DBG pool companies indicates that over the last 6 years there was only one year with incurred losses related to prior years: 1993 with $98 MM on prior year reserves of $12,877 MM (1%).

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- Composition of DBG Pool reserves:
  We have identified two significant groups of divisions, AIGRM Non-Excess and AIG Risk Finance, which have limited or no risk in the underlying loss reserves. The total reserves for this group of divisions is $3,191 MM or 22% of total DBG Pool reserves. Further, the division 45 or "below the line" reserves, after adjusting for the internal excess reinsurance related to the National Union Financial Services book, of $879 MM or 6% of total DBG Pool reserves generally are not analyzed by using generally accepted actuarial methods (for example the stop loss provision). As a result of the two previous statements, the total DBG Pool reserves subject to traditional insurance risk, which in turn can be analyzed using generally accepted actuarial methods are $11,546 MM or 80% of total DBG Pool reserves. The two largest groups of divisions subject to traditional insurance risk, National Union Financial Services and American Home Excess, have total reserves of $4,286 MM or 37% of DBG Pool reserves subject to traditional insurance risk or 30% of total DBG Pool reserves.

- Analysis of risk of understatement of reserves (based on 12/31/99 DBG Pool data) (see Attachment B):
  Our overall premise in assessing the risk of understatement of reserves is to consider the magnitude of a difference between DBG's carried reserves and PwC's reserve range that would cause PwC to require AIG or DBG, as appropriate, to record an adjustment to its 2000 financial statements.

  We have calculated our "cushion", the difference that can exist between DBG's carried reserves and our adjusted reserve range before we would require AIG consolidated to record and adjustment to its financial statements, for DBG consolidated. Our cushion is at least $1.2 billion, and may be as much as $1.4 billion, depending upon which accident years may be subject to adverse development. The accident years subject to adverse development are important due to the way in which the stop loss treaties are structured. Additionally, we have calculated our "cushion" for the DBG Pool to be between $1.4 billion and $1.6 billion, based on the same analysis.

We believe the above analysis supports our position to maintain the amount of detailed testing of reserves for the DBG Pool, and as a result, DBG consolidated. As a result, for the DBG Pool we will review significant division 45 items and a limited number of above the line divisions. Our selection of above the line divisions is based on the size of the division, changes in the amount of business in the division, volatility in reserves or exposure to adverse

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development, current business issues and client expectations. We have selected the divisions noted in Attachment C for AIMS detail review.

For the Lexington Pool we will perform testing consistent with prior year. At December 31, 1998 the Lexington Pool was formed between Lexington Insurance Company, Landmark Insurance Company and Starr Excess Liability Insurance Company. In 1998 and prior years, we performed reserves reviews of Lexington and Landmark on a stand-alone basis (Starr Excess was not a DBG company at the time). As a result of the pooling arrangement we will review reserves across all pool participants, consistent with last year.

For AISLIC, we will perform stand-alone testing similar to last year.

Budget:
The comparative budget for AIMS is as follows.

Description	Budget Hrs.	Actual Hrs.	Diff. (Hrs.)	Budget @ STD	Actual @ STD	Diff. $
1999						
AISLIC	25	7.7	(17.3)	12,353	3,804	(8,549)
Lexington Pool	75	76.8	1.8	37,059	37,948	889
DBG Pool	325	426.6	101.6	160,588	210,791	50,203
1999 Total	425	511.1	86.1	210,000	252,543	42,543
2000						
AISLIC	10			5,336		
Lexington Pool	75			40,024		
DBG Pool	385			205,454		
2000 Total	470			250,814		

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Timing:
AIMS will provide clearance on DBG Consolidated, for GAAP purposes, to the ABAS team on January 24, 2001 (ABAS reports to Corporate on January 31, 2001).

AIMS will provide clearance on AISLIC, for statutory purposes, to the ABAS team on March 16, 2001 (in order for AISLIC to comply with a March 31, 2001, ABAS will clear with the client on March 23, 2001).

AIMS will provide clearance on the DBG Pool and the Lexington Pool, for statutory purposes, to the ABAS team on May 18, 2001 (ABAS will clear with the client on May 25, 2001).

Approvals:

Richard Mayock, Partner (ABAS)

Paul O'Connell, Principal (MCS-AIMS)

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Attachment A

DBG Pool

Company	Share of Pool
AIU Insurance Company	1%
American Home Assurance Company	36%
American International Pacific Insurance Company	0%
American International South Insurance Company	0%
Birmingham Fire Insurance Company of PA	5%
Commerce and Industry Insurance Company	10%
Granite State Insurance Company	0%
Illinois National Insurance Company	0%
Insurance Company of the State of Pennsylvania	5%
National Union Fire Ins. Co. of Pittsburgh, PA	38%
New Hampshire Insurance Company	5%
DBG Pool Total:	100%

Lexington Pool

Company	Share of Pool
Lexington Insurance Company	80%
Landmark Insurance Company	2%
Starr Excess Liability Insurance Company, LTD.	18%
Lexington Pool Total:	100%

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Attachment C

List of divisions to be reviewed by AIMS.

Division Name	Division Number	Total Net @ 12/31/99	Total Net @ 12/31/98
DBG Pool			
Financial Services	4/35 - 39/62/69	2,530,255	2,485,330
Excess Casualty	2/8/30/32/81	1,756,051	1,911,698
AIG Risk Finance	79/86	1,514,103	1,210,940
Pollution	57/71/73/77	not reviewed	583,284
AIGRM Misc		611,162	not reviewed
Specialty Workers' Comp	58/13	533,758	618,835
Healthcare	9/29/66/97	82,284	not reviewed
	Total	***7,027,613***	***6,810,087***
	Total DBG Pool	***14,447,523***	***15,122,891***
		48.6%	***45.0%***

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