# AIG: Freedom's just another word for nothing left to lose

**Executive summary**

When Brian Duperreault was tempted back into the market after a stellar career to take the top job at AIG, part of the motivation may well have been the legacy defining capstone achievement of turning around the most storied name in insurance.

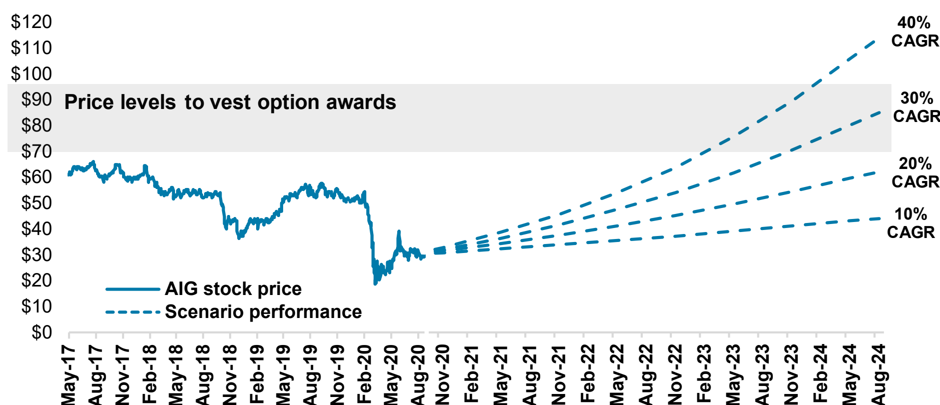
But he and the cadre of top industry talent that followed him were also likely incentivized by the potential for lucrative financial returns available to the management team finally able to turn around this long-flailing institution trading well below peer levels. Indeed, Duperreault and likely successor COO Peter Zaffino both negotiated compensation with a seven-year timeline that would be very rewarding if a turnaround was successful.

Fast forward four years, and the stock is down 51% since new management arrived, and trading at 42% of book value, well below levels when they took over. Despite significant progress on improving the P&C business and building tailwinds in written premiums, it seems unlikely that there is enough time left on their compensation agreements for the improvement to manifest and be rewarded sufficiently by investors. The many false dawns on AIG's P&C turnaround likely make this the mother of all "show me" stories that will take time to convince investors this time is different, and sustainable.

Additionally, the building macro-headwinds in the life business may also complicate the story and introduce unwelcome volatility, complicating the investment profile relative to "cleaner" P&C names benefitting from the same industry tailwinds.

Exhibit: Management long term compensation agreement vesting levels

*Source: Company reports, Inside P&C*




Well, freedom's just another word for nothing left to lose. We'd argue the CEO transition that is now widely expected from Duperreault to Zaffino offers the company the opportunity for more radical thinking, and for more urgency for delivering returns to the owners of the business rather than prioritizing building a "great company" at any cost – return on capital be damned.

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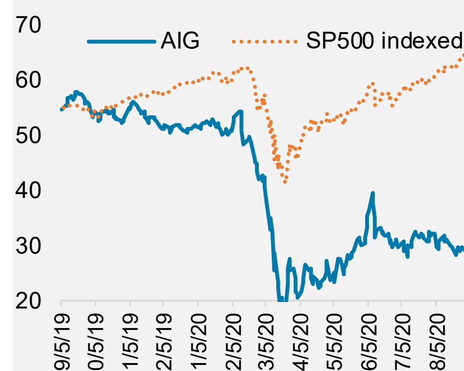
|---|---|
| Market cap ($M) | 25,696.6 |
| Price | 29.4 |
| BVPS | 71.66 |
| Tang. BVPS | 66.07 |
| Price/Book | 0.4 x |
| Price/Tang. Book | 0.5 x |
| 52-week High/Low | 57.89 / 18.78 |
| Dividend Yield | 4.3% |
| ROE | -49.8% |

**1YR Price Peformance**




*Source: SNL, Inside P&C*

Last month, we highlighted the "lost decade" of historic underperformance overseen by the board of AIG in its quest to preserve its stature and rebuild itself into a globally dominant composite insurance group. In our view, if AIG is to avoid another lost decade, it is time for the company to grasp the nettle and face some hard truths. We see three key steps.

**Step 1 – Break up the corporate form and separate life and P&C**

AIG's corporate form as a life and P&C company is no longer a source of strength. The de-risking of its P&C business means it no longer needs the combined balance sheets to support excessive tail-risk taking.

Furthermore, AIG lacks a natural investor constituency who want to express a view on (a) interest rates and macro, and (b) the P&C pricing environment. Its lower market cap means it is no longer a "must own name" that closet indexers will own anyway. Fundamentally, it is too complicated, and too messy for investors who have easier ways to express a similar view in either direction without the AIG baggage, with the company no longer seen as transforming the diversified risks into a stable earnings stream.

There are many potential fundamental barriers to separation – from the value of the DTAs, to capital benefits in rating agency models, to regulatory concerns, to debt constraints. There are also human barriers, from the board's pre-existing opposition dating back to its 2015/16 activist fight, and the potential for an "ex-CEO chairman" should Duperreault transition into the role as expected that could make a strategic pivot awkward. And finally, there are also strong financial incentives to running a bigger company, while we believe you under-estimate ego at your peril in corporate affairs.

Yet we think the combination of a simpler company to manage, an easier way for investors to express a view and compare to peer companies, the potential for component pieces to be acquired and capture a control premium, and the removal of the AIG baggage are all compelling reasons to consider at least some form of break up. At the very least, the company should conduct a strategic review of its options and outline to investors why its current form is the most valuable other than "because that's the way it's always been". We'd also note the company itself has dramatically softened its language around a break up in recent months, leaving much more wriggle room.

**Step 2 – Give up on greatness in P&C and shoot for average**

AIG's leadership since the financial crisis have consistently erred in taking harder decisions related to the P&C business justified by the firm's valuation by the misdiagnosis that the company can be "returned to greatness". The company must accept two points.

(1) That marked to market for fully developed reserves, AIG was never a great company even if it has some great assets, businesses, and has produced some great talent. At its best it was a collection of cleverly packaged financial arbitrages; at its worst it was a collection of unhedged and under-reserved tail-risk bets. (And at its very worst, a collection of "creative" accounting choices).

(2) That AIG's competitive positioning has fundamentally worsened over the decade since the financial crisis by both the emergence of other big balance sheet P&C competitors (Berkshire, Chubb, and specialty tuck-ins to global insurers) and the hollowing out of talent at AIG / better talent recruitment and development at peers.

Even now, with its new operating initiative AIG 200, the company has told investors it is aiming to have the best operating capabilities of its peers within two to three years. Not only is it unlikely AIG could get to where top tier peers are at today within that time frame, it is worth remembering the company is shooting at a moving target. Competitors are also working feverishly to improve – indeed, all with more headroom in margins to invest in the business. There is a reason why persistency of returns in this industry are relatively stable.

We understand the challenge of balancing realism for investors with the need to inspire and motivate internal stakeholders. But the consistent setting of unrealistic goals has been a perennial problem for AIG, which is ultimately de-motivating anyway. With a stock valuation at the very bottom of its peers, AIG should be enthusiastically embracing mediocrity and wholeheartedly outlining a path to average.

Given where we are today, success on even that would be an epic achievement, comparable to other great turnarounds in industry history like Jack Byrne at Geico.

**Step 3 – Re-balance the post-deleveraging capital allocation priorities towards buybacks**

AIG is not in a position to be pursuing a strategy of global growth through M&A. Its lack of stock currency weakens its purchasing power and its below-peer infrastructure limits its ability to be a smart financial buyer through integration synergies. Indeed, integration is a distraction from the multiple pre-existing operating challenges.

On top of this, its valuation at a severe discount to book value should raise the hurdle rate for any investment either in M&A or into the business through growth and/or operating initiatives. After de-leveraging, excess capital should be re-balanced towards buybacks.

Industry insiders often deride "shrinking to greatness" as impossible, and argue that the only path to value creation is to build a good company. That may be the only path to company building, but it is not the only path to value creation for the owners of the business. There is no value for a public company in building a great company at any price regardless of returns to capital.

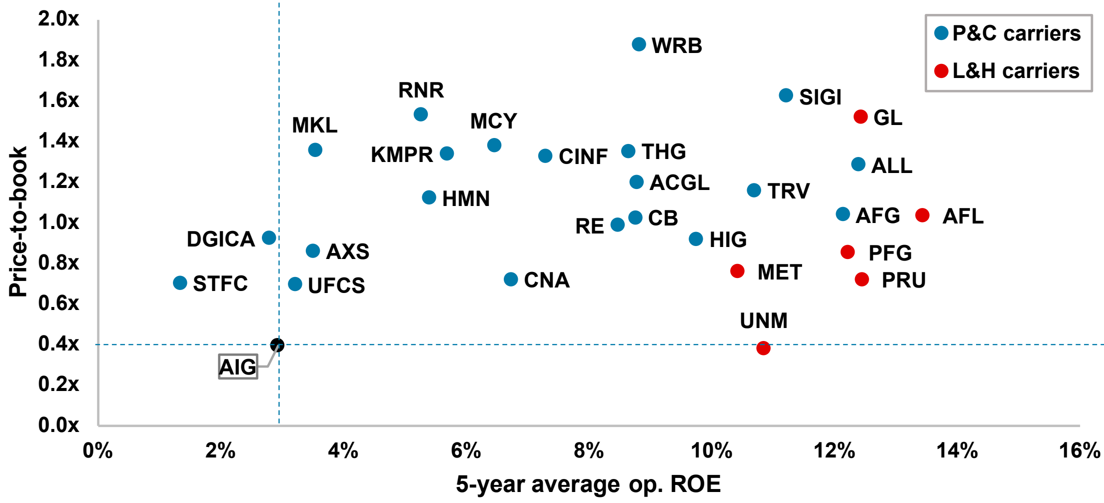
Fundamentally, management needs to accept the reality of the business they run – a competitively weakened company, with few obvious competitive advantages, significant operating challenges, in a low growth, low return industry.

Its strategy from here must reflect this reality – or face another lost decade spent in the pursuit of a glorious return to an illusory past greatness without ever even making it past average on the way.

inside P&C

Exhibit: Price-to-book versus 5-year average op ROE relative to P&C and L&H peers

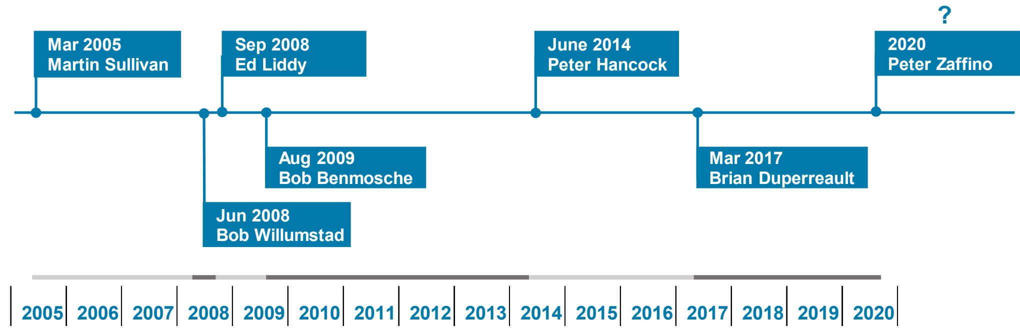
*Source: FactSet*



## Another CEO, another crisis. But will there be another lost decade?

If/when Peter Zaffino becomes the next CEO of AIG as expected, he will be taking charge of a company in crisis. Perhaps the ultimate irony is that this has been true of every AIG CEO since 2005, of which Zaffino would be – unbelievably – the seventh.

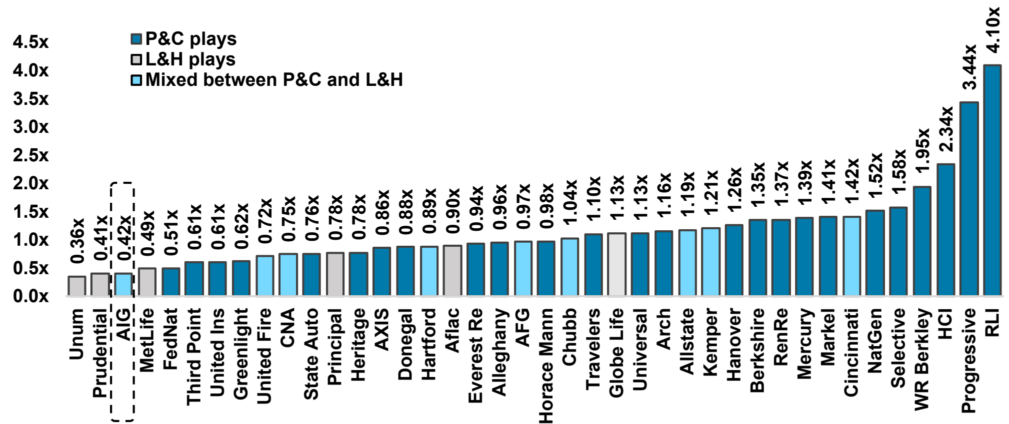
**Exhibit: AIG CEOs timeline**
*Source: Company reports, Inside P&C*




It is easy to lose sight of this crisis, given the sense of calm inevitability, and the apparent slow and orderly pace of transition with a phased handover of responsibility.

But make no mistake about it, AIG faces multiple severe long-term challenges, and an acute near-term crisis centered on a lack of investor confidence. Both are reflected in an abysmal stock valuation.

**Exhibit: Price-to-book for selected P&C and L&H firms**
*Source: SNL*




Arguably, every single one of the past six CEOs in AIG's modern era have under-estimated the scale of the crisis. Current incumbent Brian Duperreault even admitted as much when he said AIG's problems were "deeper and more pervasive" than he appreciated when he took over. Several of the AIG CEO alumni club have paid a very high price for it in terms of their careers, reputation, and legacy (if not with their pocketbooks).

Ultimately, it is likely the legacy of Duperreault's time as AIG's CEO will be judged more fairly when the full evidence of the P&C turnaround actions conducted under his watch have been given time to manifest, likely under his hand-chosen successor. That said, marked to market as things stand, there is certainly a risk that his tenure will not be viewed favorably by investors without a rapid change. (A stock down 50% is another way of saying the shares would need to double just to get back to where they started).

And there are good reasons to think that change might be coming, given that the massive over-hang of the problems in P&C seems better positioned than any point in the last 15 years to abate – with the company completing a truly extraordinary (in every sense of the word) re-underwriting exercise, and enjoying the benefit of industrywide pricing tailwinds.

Even so, there is a certain awkwardness in any transition that would see Duperreault stay involved with the company on the board, for example as chairman, as is widely expected. That is because the fact pattern facing any incoming CEO is different to the one that faced Duperreault when he took over in 2016. When the facts change, you should change your mind.

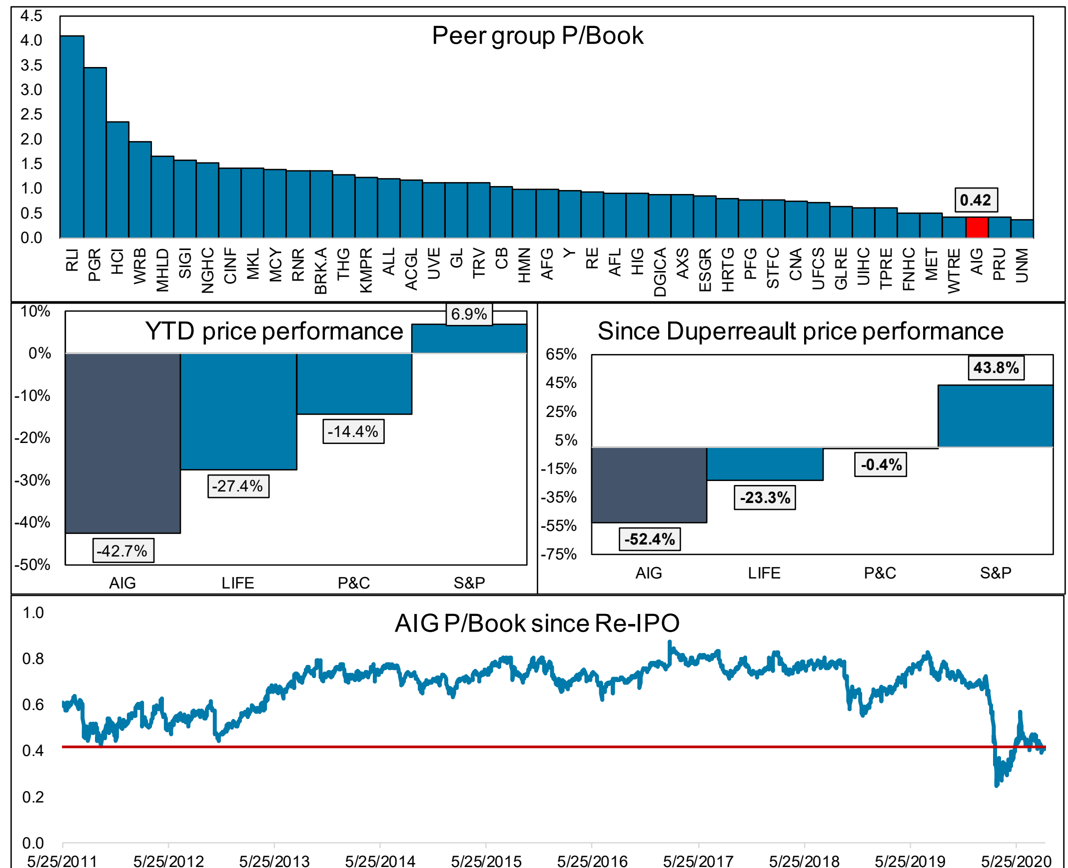
But there is therefore a tension between the "tie yourself to the mast" on strategy and see it through to completion to protect Duperreault's legacy versus any incoming CEO seeing the valuation as evidence of a more radical path forward needed to avoid another lost decade.

If that sounds over-blown, we'd say you underestimate ego in corporate strategy at your peril. Navigating this "awkwardness" would need a deft touch from all stakeholders, especially the independent board members there to represent shareholders.

## The challenges facing an incoming CEO

The near-term and acute crisis facing any incoming CEO at AIG is predominantly one of investor confidence. There is simply no way around the fact that under current management, the company's shares have performed horrifically – a fact they are likely well aware of given they are well aligned with investors.

One can make many arguments as to why, from problems they inherited, from needing more time to see the benefits of their work flow into earnings, to bad luck on the loss environment. But ultimately, those in the top chair get paid the big bucks to deliver results for the owners of the business.




The collapse in investor confidence in AIG can be seen in multiple ways.

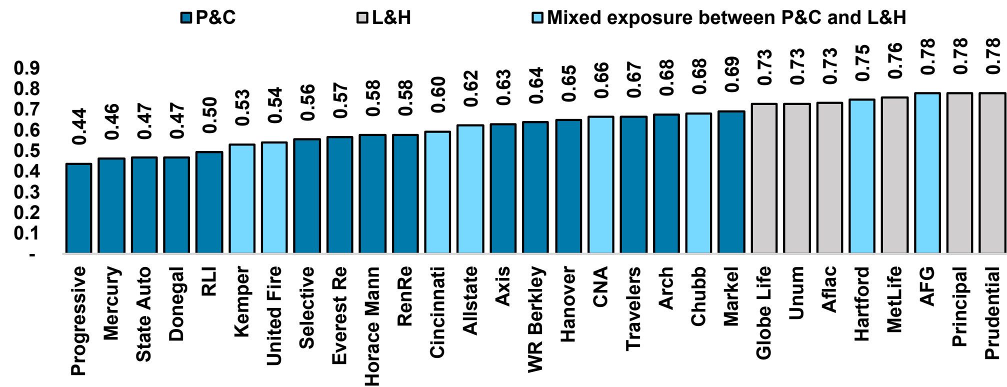
- The shares are down 42.7% YTD, versus +6.9% for the S&P 500, -14.4% for P&C peers, and -27.4% for life peers.
- Since current management took over, the shares are down 52.4%, versus +43.8% for the S&P 500, -0.4% for P&C peers, and -23.3% for life peers.
- The current trading valuation of 42% book value is lower than the stock has traded for 97.3% of the time since its Re-IPO in 2011.
- The valuation is lower than any of its P&C peers, including stressed businesses with existential risks hanging over their entire business model like total return reinsurers.

One of the most notable items of AIG's current stock market problems is that it is trading as if it was a purely life insurance name (see chart below), dragging it into extremely negative sentiment on interest rates and the macro-environment.

Though this intuitively screens as strange, there may be some logic to it. Though AIG's equity is split 52% P&C and 41% life, its earnings over the last three years have been 80% life and 20% P&C (as a % of GI+Life adj. PT income). And even within P&C, 272% of those earnings have been derived from NII rather than less interest-rate sensitive underwriting income.

Exhibit: Correlation of selected P&C and L&H peer stocks with AIG

*Source: FactSet, Inside P&C*




Our assumption here is that algo-driven trading is simply looking at the sources of companies' earnings and re-pricing them based on known and observable inputs. We'd also note that Hartford has been trading more like a life name than a P&C name despite divesting most of its life exposure. This is suggestive of factor and quant driven investing using market betas from the last crisis as a guide to market beta at times of financial market and macro stress.

| **Price to book** | **AIG** |
|---|---|
| Common equity | 65,190 |
| Life equity | 19,513 |
| Average life peer PB | 0.50x |
| Implied life market cap | 9,756.50 |
| Total market cap | 25,696.57 |
| Non-life market cap | 15,940 |
| Non-life common equity | 45,677 |
| Implied Non-life PB | **0.35x** |
| Implied non-life Price per NPW | **~0.65x** |

But another way to think about this is that by judging the business on its sources of earnings, the market is giving very little credit to the latent value in P&C – either through an underwriting turnaround, or through the unlock of book value from a run-off liquidation. This may or may not be a reasonable assumption given AIG's track record and its prior unwillingness to countenance bolder action – but does speak to the potential for a valuation unlock through breaking the P&C unit into something more digestible.

Both of these data points are suggestive that investors are giving very little credit to the company for the improving pricing environment and turnaround actions in P&C that are real but harder to quantify, and weighing more heavily the easily quantifiable market headwinds from the interest rate environment. If management believes in the actions it has taken in P&C, the easiest way to unlock value from them would be to have a clean P&C story where an improving earnings power would force investors to comp its valuation relative to P&C peers.

It also shows the foolhardiness of its M&A strategy that has bought assets like Validus near the top of the cycle at valuations close to 2x tangible and transformed the market's perception of it by putting AIG's name on it to trade at pennies on the dollar.

## The radical alternative path forward

Now, no management team should overreact to short-term volatility in its share price (as AIG's management did to its detriment back in February), but a sustained valuation discount starts to become a signal, not noise.

With the stock trading at a fraction of its net tangible assets, the problem for AIG's management is that it begins to threaten the viability of its stated strategy. Recall, current management has outlined a preference for M&A and growth – and has been willing to execute transactions at a multiple well above their own trading multiples.

But a sustained depressed valuation should at the very least raise the hurdle rate for expected risk-adjusted returns on acquisitions – and for redeployment into the business through organic growth or expense and operating initiatives like AIG 200.

With the change in management and board chair likely, there is an opportunity for a strategic reset.

We see three key areas where any new CEO should consider grasping the nettle and taking radical action: (1) Breaking up its composite corporate form into separate life and P&C companies, (2) Giving up the unrealistic pursuit of greatness in P&C in preference for realistic and achievable targets, and (3) Re-balancing its capital allocation priorities towards buybacks once deleveraging has occurred. We go into detail of each below.

| | |
|---|---|
| **Break-up** | AIG's corporate form as a life and P&C company is no longer a source of strength. Its de-risking of its P&C business means it no longer needs the combined balance sheets to support risk taking.<br><br>AIG lacks a natural investor constituency who want to express a view either on (a) interest rates and macro, and (b) the P&C pricing environment. Its lower market cap means it is no longer a "must own name" that closet indexers will own anyway. |
| **Give up on Greatness** | AIG's leadership since the financial crisis has consistently erred in taking harder decisions related to the P&C business justified by the firm's valuation by the misdiagnosis that the company can be "returned to greatness". Leadership must accept two points.<br><br>(1), That marked to market for fully developed reserves, AIG was never a great company (even if it has some great assets, businesses, and has produced some great talent).<br><br>And (2), that AIG's competitive positioning has fundamentally worsened over the decade since the financial crisis by both the emergence of other big balance sheet P&C competitors (Berkshire, Chubb, and specialty tuck-ins to global insurers) and the hollowing out of talent / better talent recruitment and development at peers. |
| **Capital allocation** | AIG is not in a position to be pursuing a strategy of global growth through M&A. Its weak stock currency weakens its purchasing power and its terrible infrastructure limits its ability to be a smart financial buyer through integration. Indeed, integration is a distraction from the multiple pre-existing operating challenges.<br><br>On top of this, its valuation at a severe discount to book value should raise the hurdle rate for any investment either in M&A or into the business through growth and/or operating initiatives. After de-leveraging, excess capital should be re-balanced towards buybacks. |

However, before we go into the detail, it is worth making some important observations.

First, though we do not know him personally, everything we have seen from Zaffino to date is suggestive of someone willing to make hard decisions and take radical action. If – and it remains an if – he is appointed CEO, he certainly has the profile of someone bold enough to finally grasp the nettle and make decisions that AIG has punted for a decade.

Two data points we would highlight in support of this view of Zaffino as a hard decision maker in his role at P&C are: (1) the unprecedented amount of business shed by the company over the past ~18 months. For context, Validus and Glatefleter brought ~$3.5bn in top line, pricing is up near double digits, but the company's NPW went down $1.3bn in 2019 (inclusive of extra reinsurance purchases). (2) The company has shown a willingness to change its mind on bad bets, with its latest tech-driven vanity project Blackboard shut down and Attune reportedly up for sale. Given that these were both high profile bets by the incoming Duperreault in terms of the future-winning direction he wanted to take the company, both moves seem like a pivot from "hope and growth" to "realism and urgency".

As noted above, the role of the board who has overseen the firm's failed strategy and the potential for an "ex- CEO chairman" remain "personality" issues to navigate.

Finally, we would note that even Duperreault has softened the company's language on a potential break-up in recent months. Recall, prior CEO Peter Hancock's emphatically said "we see tremendous benefits from combining life and P&C activities" and that management and the board thought a break up "did not make financial sense". And among Duperreault's first public comments as CEO were to declare "I did not come here to break up AIG".

This seems to have softened this year when asked about a potential break up on an earnings call in May. Note, though intended as a "no", the statement includes an "at this point", a past tense "were" for reasons they belong together and a "right now" that speaks to a potential for change down the line. That's an awful lot of wriggle room for someone who emphatically "did not come here to break up AIG", and is suggestive of a process behind the scenes to at least look at it.

| **AIG** | *"My job is to continually always think about the structure that we have. Does it make sense? Would it be better in a different structure? And so that thinking continues. I think at this point, we're comfortable with where we are. But my job is to continue to do that. So, we'll continue to keep looking at that. There were reasons why these two belong together, and those are still there. But I'll always think about that. But there's nothing that I would talk about right now. I think we're comfortable with it."*<br><br>- **CEO Brian Duperreault, May 5, 2020** |
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## Part 1 - Recognize the constraints of the corporate form.

AIG's diversified platform has historically been a source of strength – both operationally, and from the perspective of investors.

Operationally, the stable accounting of its life business and large corporate balance sheet historically enabled it to operate as the industry's 500lb gorilla – writing bigger limits, taking more cat and other sources of tail risk, shrugging off risk aggregations (e.g. in its private client business). In short, its larger balance sheet and diversified earnings stream were a fundamental competitive advantage.

From an investment perspective, AIG's non-correlated earnings…combined with let's generously say accounting choices that biased earnings stability…gave the company the earnings profile of a large multi-national financial institution with growing earnings and international exposures. At the peak of the late 1990s stock bubble for tech and international conglomerates, the stock traded at a staggering 6x tangible, which it was able to use to continue its growth through M&A. At its peak, AIG had a market capitalization of $240bn, making it difficult for generalists and closet-index investors not to own.

Both of these advantages are now either less relevant, or entirely reversed.

Operationally, the necessity of the corporate form has lessened as the complexity quotient and tail-risk taking has reduced. One of the great tragedies of AIG over the past decade has been watching successive management team pull a piece of string and not realize how "fixing" one problem would create another problem elsewhere. Examples include:

- Deciding that localized reinsurance by empowered front-line risk takers under-leveraged the firm's position as a major buyer of reinsurance that could be leveraged through a centralized procurement approach. This consultant playbook may have been penny wise, but was pound foolish at a company founded on manuscripted and esoteric coverage that frontline underwriters (potentially) understood and could manage, but the corporate center couldn't possibly.
- Re-underwriting actions for low return business that lowered earned premium and then left less earnings buffer that the heavy reliance on large limit, high concentrated, tail-risk bets had been predicated on

With current management solving for this problem through a wholesale de-risking, making AIG a more normal P&C company with more in-line limits, tail-risk bets, and aggregation – as well as a higher use of reinsurance – the role of the "bigger balance sheet" becomes less clear.

From an investment perspective, AIG lacks a natural investor constituency who want to express a view on (a) interest rates and macro, and (b) the P&C pricing environment. Its lower market cap means it is no longer a "must own name" that closet indexers will own anyway. Fundamentally, it is too complicated, and too messy for investors who have easier ways to express a similar view without the AIG baggage.

Of course, there are multiple barriers to a break up that complicate matters, including:

(a) The company still has $8.6bn of DTA's on its balance sheet, that could be jeopardized by a change in its corporate form. The company previously leant hard on this argument in its battle with the activists in 2015-2016. We'd argue that this is both a manageable constraint the company can optimize should it chose to (e.g. finding ways to accelerate or harvest gains, asset sales, etc), and that at current valuation the upside from a split may well outweigh the lost tax benefits. Unfortunately, this is hard to analyze from the outside without more information

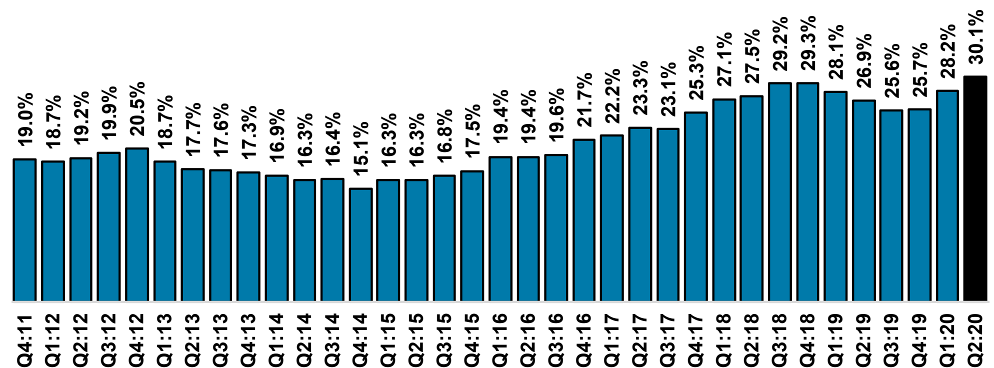
from the company, and its disclosures on these assets have become worse in recent years.

(b) Again in its 2015/2016 activist battle, the company leant heavily on the capital benefits it receives from S&P for its combined corporate form. At that time, it estimated a $5bn benefit. We find this hard to understand, because if true, there is free money sitting on the table for every P&C company to buy a life company and de-capitalize it instantly, and vice versa. The fact that other companies are not consuming this apparent arbitrage is at least *prima facie* evidence that this number is either inflated, or else is gross of other dis-synergies.

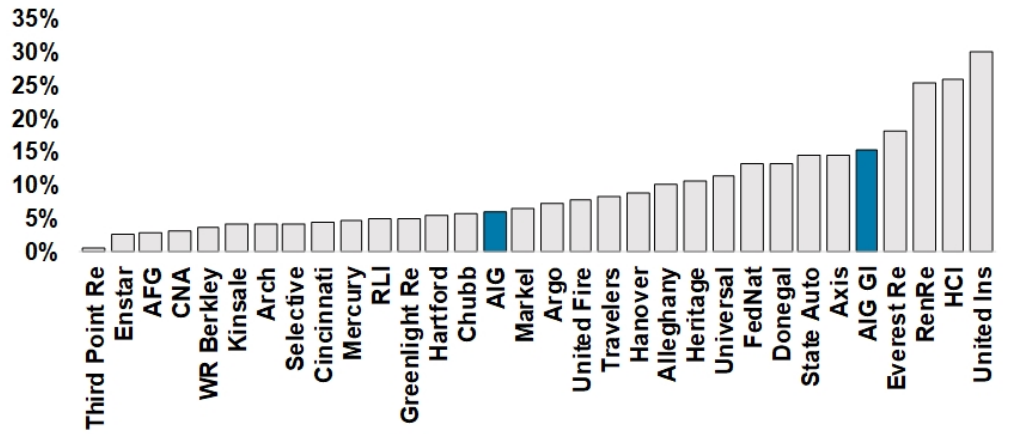
(c) Perhaps most pressing in its current state is issues around its debt burden. The company's debt and preferred to capital stands at 30.6%, the highest level of its modern era. Any change to its corporate form would involve a complicated negotiation with its debtholders around how the debt burden would be allocated, with lenders rightly concerned about any reduction in ability to repay. In short, this would likely require a reasonable amount of deleveraging (something the company needs to do in any case).

Exhibit: AIG financial leverage

*Source: Company reports, Inside P&C*




(d) Finally, AIG has historically benefitted from the fact that the stability of its life earnings (from an accounting perspective) and its large balance sheet have enabled it to take outside tail-risk bets with its P&C business, with large and concentrated cat exposures, large limit strategies across commercial lines, and historically across multiple financial products. Arguably, this is the constraint that was most pressing in 2015/2016 as AIG P&C could not have functioned as a standalone entity without a large balance sheet – for evidence, look at its 2017 losses relative to its P&C balance sheet which makes it screen as a cat reinsurer or Floridian homeowners company.




*Source: SNL, Inside P&C*

## Part 2- Give up on greatness

AIG's leadership since the financial crisis have consistently erred in taking harder decisions related to the P&C business justified by the firm's valuation by the misdiagnosis that the company can be "returned to greatness". The company must accept three points.

**#1 – Admit there is no "return" to greatness.**

There is no return to greatness, because it has never been a great company. At its best, AIG was an ingeniously assembled collection of clever financial arbitrages. At its worst, it was a collection of unhedged positions on tail risks, generating earnings that were the product of systemic under-reserving, and a liberal user of "creative" accounting.

This may sound a petty point but is actually crucial. As we have written before, it is easier to persuade yourself of a long term turnaround plan versus more drastic measures like run-off and liquidations if you think there is a valuable franchise waiting to be rescued. This illusion is part of why successive management teams have been unable to take harder decisions and be seen to have "destroyed" a global franchise. We've also seen internal presentations outlining a "make <insert unit name> great again" approach.

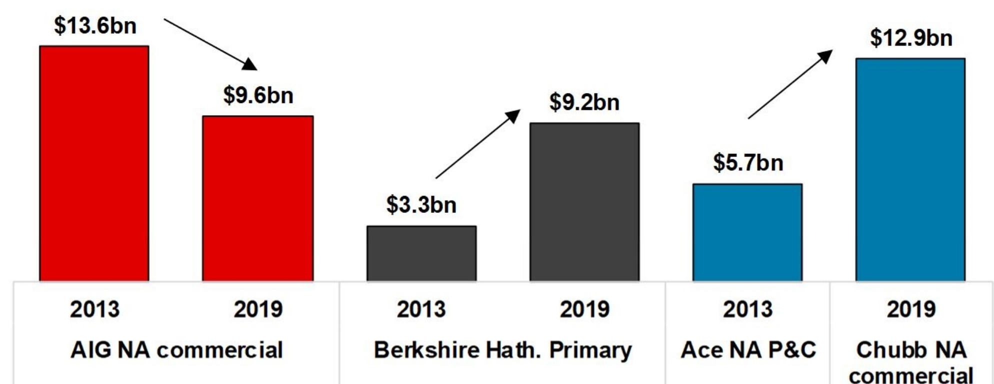
**#2 – Acknowledge the erosion of your competitive position**

AIG's competitive positioning has been severely undermined during its lost decade. In this business, there are essentially only two assets that can differentiate companies: talent and capital.

On talent, AIG was once the undisputed home for top executives, and the talent factory for the entire P&C industry. If the company has rebuilt the quality and depth of its bench at the highest level, it has not come close to reversing the hollowing out and demoralization of the company's broader talent and corporate culture.

On capital, the creation of Berkshire Specialty, the combination of Ace and Chubb, and the tuck in of other specialty companies into large global conglomerates (e.g. Axa-XL) has undermined AIG's edge as the 500lb gorilla able to set its own terms of trade.

**Earned premiums: 2013 vs 2019 for selected carrier segments**




*Source: Company reports*

**#3 – Give up on greatness and set realistic goals**

In spite of – or perhaps because of - the above, management has been unable to avoid the trap of over promising operational improvements, including the pledge to transform AIG P&C into a top tier operating company within two to three years with its AIG 200 strategy.

AIG's management needs to base its strategic planning and stakeholder messaging more firmly in reality if it is going to avoid consistently setting itself up for disappointment (and the demoralization that comes from consistent losses).

For a company trading at 42% of book value to be talking about its ambitions to invest long term in growth, M&A, and operations to have the best capabilities of any peer is borderline delusional. It may be a tough balancing act in terms of motivating internal stakeholders and attracting talent, but the market is telling you that AIG either needs to liquidate itself or commit to a path to something closer to average before it worries about greatness.

Indeed, its consistent tendency to shoot for greatness with expensive moonshot projects like its ill-fated "science office" and Blackboard instead of first prioritizing the pursuit of average likely partly explains why little progress has been made despite so much money spent and so much frenetic corporate activity.

## Part 3 – Pivot capital allocation back towards buybacks

To be frank, at current valuations, AIG should be thinking about selling anything that isn't nailed down and buying back its stock as aggressively as it can. If management truly thinks its core ROE is trending to 10%, it is almost inconceivable that any action management could take like M&A or growth could have comparable risk-adjusted returns on investible time frame than buying back well below intrinsic value.

Exhibit: Book value accretion sensitivity to price-to-book and ROE

*Source: FactSet*

| | | Price-to-book | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | 20% | 40% | 60% | 80% | 100% | 120% | 140% | |
| ROE | 3% | 14.1% | 4.9% | 2.1% | 0.8% | 0.0% | -0.5% | -0.9% | Company trailing 5-year average ROE |
| | 4% | 20.0% | 6.7% | 2.9% | 1.1% | 0.0% | -0.7% | -1.2% | |
| | 5% | 26.7% | 8.6% | 3.6% | 1.3% | 0.0% | -0.9% | -1.5% | |
| | 6% | 34.3% | 10.6% | 4.4% | 1.6% | 0.0% | -1.1% | -1.8% | Company consensus NTM ROE |
| | 7% | 43.1% | 12.7% | 5.3% | 1.9% | 0.0% | -1.2% | -2.1% | |
| | 8% | 53.3% | 15.0% | 6.2% | 2.2% | 0.0% | -1.4% | -2.4% | |
| | 9% | 65.5% | 17.4% | 7.1% | 2.5% | 0.0% | -1.6% | -2.7% | |
| | 10% | 80.0% | 20.0% | 8.0% | 2.9% | 0.0% | -1.8% | -3.1% | 2021 target ROE |

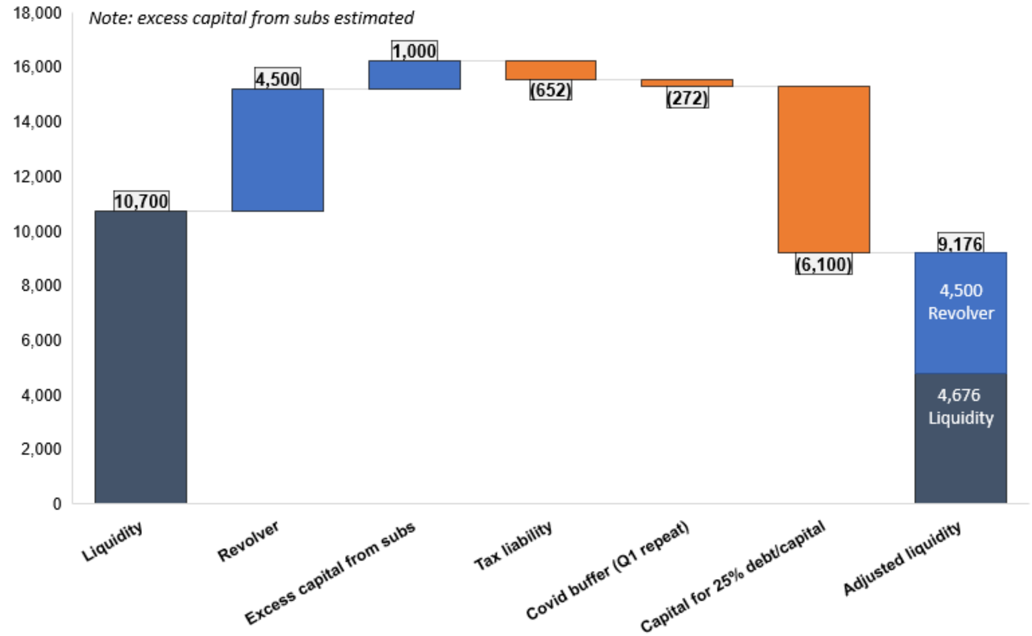
Current AIG valuation (40% column)

One easy push back for the company is to point out that it is currently facing the best market opportunity in P&C it has seen in decades and needs to deploy capital. This is all very well, but we would still argue that a mindset of capital scarcity would be the best path to curing its long-running P&C problems and willingness to write ample business at below adequate returns. Writing new "good business" would need to come at the expense of non-renewing the worst business in the portfolio.

We would however acknowledge that there is no easy path to capital return, given (as noted above) the firm's leverage has reached the highest level of its post crisis era and tipped over 30%. As such, the "excess liquidity" really should be thought of as pre-funded debt reduction, which would reduce liquidity to more normal levels. Therefore, any capital return would essentially come from a combination of earnings and/or asset sales (we favor both).

## Exhibit: AIG adjusted liquidity assumption

*Source: company reports, Inside P&C*




*Note: WAG estimate of excess capital from insurance companies based on disclosed RBC levels. Note, Q2 disclosures suggested more headroom in life in Q2 that at year end that could potentially mean this estimate is understated, though a combination of (a) recent macro volatility that makes assuming your current marks are permanent is probably not prudent, (b) AM Best commentary on life capital adequacy in recent ratings note, and (c) general uncertainty around Covid exposures, make aggressive decapitalization unlikely while financial leverage is high. We'd assume this is not a source of AIG will look to access while uncertainty across its business is elevated, financial leverage is high, and the benefits of its de-risking are yet to be "proven".*

This research report was written by Insider Publishing's Research team which includes Gavin Davis, Gianluca Casapietra, and Dan Lukpanov.

The content of this report includes opinions based on publicly disclosed financials and management commentary.

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