Morgan Stanley



Equity Research
North America

United States of America

Insurance - Property & Casualty

# American Int'l Grp

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| STOCK RATING | EQUAL-WEIGHT |
|---|---|
| Price (April 9, 2003) | $53.65 |
| Price Target | NA |
| 52-Week Range | $75.54 - 42.92 |

*Stock ratings are relative to the analyst's industry (or industry team's) coverage universe.*

| GICS SECTOR | FINANCIALS |
|---|---|
| US Strategist Weight | 19.1% |
| S&P 500 Weight | 20.1% |

PLAINTIFF'S EXHIBIT 643

Company Update

April 10, 2003

# *Correction: Thoughts On The Reserve Charge*

- **Recent reserve charge was important**
  We provide perspective on its significance, as well as reviewing it in light of early statutory reserve data.
- **But it's important not to overweight it**
  The charge was financially manageable for AIG--far more so than for competitors. Further development would be manageable as well.
- **Analysis suggests more to come for industry**
  Especially in the D&O area, and for broker reinsurers, we expect reserve additions redux in 2003. Watch out come 2Q and 3Q.
- **Standard reserving methods missed the trend change**
  The industry blew it, in our view, by relying on historical reserving methods during a huge secular shift. And that probably suited many companies just fine.
- **Industry View: In-Line**
  While we believe margins and book value growth should remain healthy for some time, we now view investing in our industry as more of a stock-picking exercise

Δ π EXHIBIT 4
Deponent Schroeder
Date 7/9/08 Rptr. am
WWW.DEPOBOOK.COM

| Fiscal Year Ends (Dec 31) | 2002 | 2003e | 2004e | 2005e |
|---|---|---|---|---|
| EPS ($) | 2.70 | 3.65 | 4.20 | – |
| Prior EPS Ests. ($) | – | – | – | – |
| First Call Consensus ($) | 2.70 | 3.83 | 4.36 | – |
| P/E | 19.9 | 14.7 | 12.8 | – |
| Price/Book | 2.4 | 2.1 | 1.8 | – |
| Yield (%) | 0.3 | 0.4 | 0.4 | – |
| Market Cap ($mn) | 139,951.1 | | | |
| Debt/Cap (12/02) (%) | 42.6 | | | |
| Return on Equity (12/02) (%) | 12.9 | | | |
| Shares Outstanding (mn) | 2,608.6 | | | |

| Q'trly EPS | 2002 actual | 2003e curr | 2003e prior | 2004e curr | 2004e prior |
|---|---|---|---|---|---|
| Q1 | 0.81 | 0.80 | – | – | – |
| Q2 | 0.84 | 0.88 | – | – | – |
| Q3 | 0.85 | 0.94 | – | – | – |
| Q4 | 0.20 | 1.03 | – | – | – |

*e – Morgan Stanley Research estimates*

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# Correction: Thoughts On The Reserve Charge

**Company Description**
*American International Group is the leading U.S.-based international multiline insurance and financial services organization and the largest commercial underwriter in the U.S. AIG has an extensive global presence, particularly in Japan and Asia.*

**Correction:**
In our previous report, we stated that AIG was mainly an excess writer of directors and officers (D&O) coverage, while Chubb was a primary writer. We meant to say that AIG writes mostly primary business, while Chubb is more of an excess writer. We have corrected this reference, and it does not change our analysis.

Also, management stated that the $1.7 billion excess casualty portion of its $2.8 billion charge was ***not***, as we originally thought, comprised mostly of higher workers compensation claims. The company stated that the all or most of the workers' compensation charge is reflected in its $294 million separate charge for that line specifically. We have corrected this reference in our note.

This change affects our analysis. AIG's charge for this line no longer appears as conservative compared to industry estimates of reserve deficiencies, although it still appears within reason relative to our own estimate of the reserve shortfall in the workers' compensation market. In addition, we do not yet have a full set of statutory data to analyze for this line, which would be our preferred method of reaching a conclusion (the method was just a backstop as we await the consolidated Schedule P). We have updated our analysis on pages 8-9 but will reach a more definitive conclusion when the statutory data is available.

**Summary and Investment Conclusion**
In this note we review AIG's fourth quarter reserve charge and consider six questions: We also have a couple of clarifications to our March 31 note, "Sifting Through Massive New Disclosures."

**What does the charge mean to AIG and its peers? Could there be more?** While we were no more thrilled with the charge than anyone else, we believe it is more a reminder of the inherent uncertainty of the property-casualty business than a specific indictment of AIG. One important difference is that the charge was manageable, in a financial sense, for AIG, than for its rivals. Still, it's a reminder that there simply are no exceptions to the rules in this industry. We also believe most of the charge was a catch-up, but there could be more to come for the industry. If so, we think directors & officers (D&O) would be the most likely area, and broker reinsurers would be the most likely candidates, to experience the greatest additional development.

**Should we have seen this coming?** Although there were explanations that seemed reasonable at the time, with hindsight, we believe we should have had more foresight. The numbers tell a story.

**What more do we know about AIG's reserves at this point by reviewing its recent 10k filing and statutory data?** The change in ultimate loss ratios, especially for AY 1999, is notable. If AIG is not done, it has at least made a significant downpayment. We review the details.

**What are the implications of the charge for standard reserving methodology?** To us the key question for the industry is the following. At what point should "traditional" actuarial methods be set aside in favor of judgment? A known weakness of historically-based methods is their delay in capturing significant inflection points in loss trends.

**How are reserving practices changing in this cycle?** In the past, significant reserve shortfalls were deferred and "funded." That game is over. Notably, the companies that can *afford* to play it straight (from a claims and credit rating standpoint) seem to be taking the biggest hits. As such, investors should not just look at reported results, but factor the implications of potentially riskier reserves or more transparent results —into valuations.

**Summary and Overview**
We are maintaining our Equal-weight rating on AIG and remain comfortable with our current earnings estimates. Our estimates for 2003 and 2004 ($3.65 and $4.20 respectively) are below consensus ($3.83 and $4.36) and conservatively below management's guidance of $3.78-$3.92 for 2003. We still view the major issue for the stock as the economy, and have taken what we feel is a conservative view on earnings growth in AIG's more economically sensitive businesses such as asset management, life insurance, and financial services.



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Morgan Stanley's economists appear to be in sync on this issue: Steve Roach reduced his forecast to predict recession last week on a weakened outlook for global growth, and Dick Berner says the US economy has now hit "stall speed," despite the prospect of a tidy end to the Iraq war. While we believe that AIG will increase its commanding financial services presence in the long run, given the 12-18 month time horizon in our rating system, we continue to like the "pure-play" property casualty stocks over the more economically sensitive stocks at this time.

**Impact of SARS = Headline Risk**. AIG faces some short-term issues related to its unique business mix. Among these is SARS, which we think at this point is best described as a headline risk event. The question, in our view, is whether it will be trivial or more important. We simply don't know how large the SARS outbreak may ultimately become, its impact on the global economy, nor do we know how reliable the statistics are, especially from China. But we do not believe SARS should have a meaningful impact on AIG's valuation, unless the unthinkable occurs (not our working assumption).

Of lesser importance, in 1H03 SARS could have a modest effect on AIG's earnings and therefore, lead to stock volatility. This would be due to 1) reduced travel in Asia affecting the personal accident line, often purchased in connection with travel (12% of foreign life premiums); 2) potentially lower sales of all retail financial services products in the region (e.g., life insurance, annuities, credit cards). Foreign life is about a quarter of AIG's operating earnings, with Asia by far the lion's share. Lower sales, on the margin, could reduce the growth rate. We are currently estimating foreign life earnings up 14.6% in 2003.

While a longer-term risk factor is potential distress among Asian airlines, we normally would not expect a shorter-term event such as SARS to affect ILFC's leasing revenues or cause order cancellations.

***Upside Appears in Line With Our Universe.*** AIG is currently trading at 2.4 times book value per share and 2.1 times projected 2003 book value, a higher valuation as compared to the average property casualty insurer in our coverage universe which is currently trading at 1.5 times book value per share. We believe AIG deserves a premium valuation to pure play non-life insurers due to its diverse business mix, financial strength and global reach. We currently expect an operating return on equity of 15-16% for the next two years. However, given the recent kitchen sink charges taken within the industry, we also believe some pure play non-life insurers may be able to finally provide high book value growth and operating returns on equity in the near future, making some of them unusually attractive at current valuations relative to more economically sensitive stocks.

Historically over the past 12 years AIG has traded in a range of 1.9x –2.9x book value. At current valuations, that implies a current stock price range of $43-$65 (or $49-$75 on a one year forward book value basis). Given the current economic outlook, the age of this cycle turn, and investors' general risk aversion, we do not expect valuations above the mid-point of the range right now. For example, the average p/c insurer is now trading at 1.5x times book value—in line with the sector's long-term average—pending evidence of book value growth.

### What Does the Charge Mean to AIG and Peers?

**In general, we believe the charge went a long way toward putting AIG's reserve risk to bed.** The company's accident year 1997-2001 net loss ratios increased by an average of 7 points during calendar year 2002. While we are hesitant to think that AIG can declare victory, intuitively, the magnitude and circumstances of the charge seem likely to put this issue to rest for the time being. We will have a better handle on this question when AIG's consolidated statutory reserves are available in May.

**For many other companies, particularly reinsurers, we remain cautious when contemplating reserve adequacy.** At year-end 2001 we projected the industry's loss reserves to be nearly $120 billion deficient. While the myriad charges this past calendar year helped alleviate the immediate shortfall, we expect that adverse claim development in 2002 has yet to be fully recognized. If the extraordinarily high ceded loss ratios in 2002 annual statements are leading indicators, reinsurers may be particularly susceptible to further adverse reserve development. We will know more after reviewing the 2002 annual statements in more detail.

***Does It Matter If AIG Could Have Reserved Earlier?*** Investors have been focused, for many insurers, on whether companies were tardy in recognizing reserve additions. While we believe it is important to get the financial statements right, from a stock valuation standpoint, the consequences of an innocent mistake are still significant. Intentionally or unintentionally, the industry does not always price and reserve for its high-frequency, known risks, much less the low-frequency or unusual events, such



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as major reversals of inflationary trends. Both affect valuations.

- If the market concludes a company should have recognized losses earlier, the stock reacts sharply.
- If a company could *not* have recognized losses earlier, and was simply mistaken, it still has a major effect, in our view. It is simply a reminder of the inherent volatility of insurance, the difficulty of estimating reserves, and the magnitude of error that can result.

Simply put, we believe investors reacted so strongly to this charge, not just because of its size, but because it was a wake-up call that, inescapably, nonlife insurance is a risky business, even for a company like AIG.

There are two reasons it is important to consider whether the charge could have been recognized earlier.

**First, investors have to consider whether management credibility is eroded beyond the point normally accepted.** That happens rarely, and we don't believe it has occurred at AIG.

We do believe that many, if not most, of the industry's executives fell into the category that Warren Buffett recently described as "Mae West" managers, "I used to be Snow White, but I drifted." That is, otherwise honorable people, faced with impossible demands, slid down a slippery slope. By impossible demands we mean: bad industry economics, continually increasing loss frequency and severity, shareholders insisting on 15% earnings growth and ROEs, analysts requiring companies to meet earnings forecasts with pinpoint precision, and competition that apparently could deal with all of these issues even while underpricing everything in sight.

The tort environment changed dramatically in the late 1990s, but given this impossible environment, how easy would it have been for companies to make the tough call necessary to recognize that in their financial statements? Given the need for tremendous discretion in accounting judgments, is it really surprising that, in an environment of unfavorable secular change and uncertainty, those judgments seem to have worked out in the industry's favor—and by a considerable margin?

Some may take issue with our calling this a "Mae West" situation ... the misjudgments may have been perfectly unintentional. But, without speaking to intentions, in the past four years, virtually all of the industry's misjudgments have been in one direction, amounting to tens of billions of dollars of losses. Shareholders typically have not seen significant stock outperformance despite a prolonged hard market, yet a reading of proxy statements makes it clear that managements' compensation generally has not suffered along with the shareholders.

Nevertheless, we still draw a major distinction between the Mae Wests and "bad people." We've seen plenty of those in insurance, too, but they've fallen in the Willie Sutton category ("That's where the money is"). Most of the companies they ran aren't around anymore.

**This question also bears on whether there is more to come and the charge is a portent for other companies.** We now believe the answer is, maybe and yes. The size of AIG's charge is certainly comforting, but there's of course no absolute assurance there won't ever be more. AIG is not the only company to be playing catch-up. As such, we believe there is a risk of more to come, especially in the excess liability and D&O lines, and for broker reinsurers.

### Reserve Numbers Were a Warning Sign

Should we have seen this coming? Probably, yes. As we discuss later, AIG itself explained, in its form 10-K, that it saw trends emerging but that standard actuarial techniques (Bornheutter Fergusen) masked those emerging trends. We believe that is true for the industry as a whole.

***To some extent, we fault ourselves for not seeing this coming.*** Mathematically, AIG's reserve numbers were indicative for several years; the gap between AIG's always-superior results and the industry's also widened.

Unfortunately, there also were reasonable explanations that led us to conclude everything was OK. In such a soft reinsurance market, we believed AIG's reinsurers were bearing the brunt of market conditions. Also, the company's focus on specialty lines, its market position in primarily retrospectively rated workers' compensation business, its shift toward shorter-tail coverages, and its position as an excess writer all gave us comfort.

***With hindsight, those factors were not enough.*** A good axiom for insurance analysts: "If reserves *look* deficient, assume they *are* deficient." Time after time, in our experience, company managements, in what appears to be complete sincerity, have explained away apparent reserve deficiencies, only to book a huge "reserve strengthening" shortly thereafter. Some of these people have later



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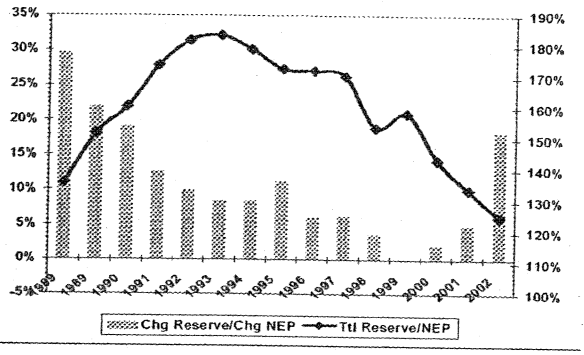
confessed to us their total embarrassment at having to do this. Human nature being what it is, if in doubt, always believe your own eyes.

Exhibit 1, following, shows the change in AIG's earned premiums compared to the change in its reserves from 1989 to 2002. This also shows total reserves versus earned premium. (The blip in 1999 occurred with the consolidation of 21st Century and Transatlantic; we have excluded them from growth rates.) ***The concept behind this graph is simple: as the business grows, the reserves should grow.*** The trend toward lower reserving is pretty unmistakable.

Exhibit 1

**AIG Earned Premiums vs. Change in Net Reserves**




*Source: Company data, Morgan Stanley Research Note: 1998 reserves have been reduced for the consolidation of TRH and TW, or approximately $2.9B.*

***With that said, something new clearly happened at the end of 2002.*** Many companies reported development in workers' compensation in the fourth quarter. The umbrella line, also responsible for part of AIG's charge, is showing unexpectedly high losses for many other companies as well. And the level in D&O severity continues to trend higher than expected. Even a knowledgeable observer who anticipated rising frequency and severity in this line after the IPO "bubble" most likely would not have expected the magnitude of ensuing financial reporting scandals nor the degree of backlash against the accounting and securities industries. In 2003, companies such as HealthSouth continue to surprise with newly discovered problems. And we were (and still are) hearing screams of "shock and awe" from the industry at loss trends in the casualty lines. Those screams are much louder from excess writers like AIG, which are disproportionately affected from such trends.

**First Look at Group Reserves**

We have started to look at AIG's reserves, although hampered somewhat by its huge number of subsidiaries and the fact that consolidated statutory data is not out yet. Nevertheless, we have some observations.

- This was no small tweaking of loss reserves. We provide some perspective.
- The adjustment to excess casualty reserves increased reserve adequacy and seems to lower the odds of more missteps.
- The adjustment to D&O does seem to reflect increased severity. We don't have enough data to know whether development in this line (for AIG or the industry) is "done."
- Asbestos and environmental reserves are improved but still merit attention from analysts.

AIG for the first time disclosed in its 10k filing its 2002 consolidated gross reserves on a statutory basis, as shown in exhibit 2 following. It is currently difficult to make comparisons to prior levels and/or analyze the overall group's reserves. But we will be able to do much more when we receive the consolidated statutory statements which are due to regulators towards the end of May. What we can tell is that other liability "occurrence" and "claims made" collectively represent 44% of AIG's total gross reserves. This does not surprise us as these two lines represented 46% of net statutory reserves as of 12/31/01 and AIG writes a lot of specialty excess of loss coverages.

Exhibit 2

**General Insurance Gross Statutory Reserves**

| *(in millions)* | 12/31/2002 | % Ttl |
|---|---|---|
| Other Liability Occurrence | $14,132 | 27.4% |
| Other Liability Claims Made | $8,559 | 16.6% |
| Workers Compensation | $6,064 | 11.8% |
| Auto Liability | $4,290 | 8.3% |
| International | $2,797 | 5.4% |
| Property | $2,691 | 5.2% |
| Reinsurance | $1,591 | 3.1% |
| Medical Malpractice | $1,560 | 3.0% |
| Aircraft | $1,448 | 2.8% |
| Products Liability | $1,262 | 2.4% |
| Accident & Health | $1,009 | 2.0% |
| Fidelity/Surety | $875 | 1.7% |
| Other | $5,261 | 10.2% |
| Total | $51,539 | |

*Source: Company data, Morgan Stanley Research*



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**Asbestos and Environmental Reserves**

AIG continues to defend its asbestos reserves. From the 10k: "In asbestos, for example, AIG has resolved all claims with respect to miners and product manufacturers (Tier 1), for which payments are completed or reserves are established to cover future payment obligations. Asbestos claims with respect to products containing asbestos (Tier 2) accounts are generally very mature losses, and have been appropriately recognized and reserved by AIG's asbestos claims operation.

"AIG believes that the vast majority of the incoming claims, with respect to products containing small amounts of asbestos and companies in the distribution chain and parties with remote, ill-defined involvement with asbestos (Tier 3 and 4), should not impact its coverage; this is due to a combination of factors, including the increasingly peripheral companies being named in asbestos litigation, smaller limits issued to peripheral defendants, tenuous liability cases against peripheral defendants, attachment points of the excess policies, and the manner in which resolution of these weaker cases would be allocated among all insurers, including non-AIG companies, over a long period of time."

While AIG's survival ratio is mathematically lower in comparison to many other insurers, it appears asbestos may not be as big a financial issue for AIG as for other insurers. At year end, gross asbestos reserves represent 2.2% of book value, and net reserves are approximately 0.6% of book value. A significant increase in those reserves, therefore, would not have the kind of book value effect that similar increases have had on other companies in our universe, nor would we expect the same kind of impact on AIG's ratings.

Paid losses for asbestos have been trending down for the last two years and while claims outstanding for asbestos increased 6%, AIG contends the current claim activity relates primarily to Tier 3 and 4 accounts which would not impact AIG as a high layer excess writer.

We also note that IBNR represents approximately 41% of net A&E reserves, up slightly from previous years. Nonetheless, we continue to believe asbestos always merits attention from analysts, and we will continue to monitor this area.

Exhibit 3

**Asbestos and Environmental Reserves**

| | 2002 | | 2001 | | 2000 | |
|---|---|---|---|---|---|---|
| *(in millions)* | Gross | Net | Gross | Net | Gross | Net |
| **Asbestos:** | | | | | | |
| Reserves, beg. of year | $1,114 | $312 | $1,100 | $338 | $1,093 | $306 |
| Losses and loss expenses incurred* | $395 | $168 | $358 | $92 | $405 | $80 |
| Losses and loss expenses paid* | -$205 | -$80 | -$344 | -$118 | -$398 | -$48 |
| Reserves, end of year | $1,304 | $400 | $1,114 | $312 | $1,100 | $338 |
| **Environmental:** | | | | | | |
| Reserves, beg. of year | $1,115 | $407 | $1,345 | $517 | $1,519 | $585 |
| Losses and loss expenses incurred* | -$140 | -$44 | -$41 | -$34 | -$44 | -$45 |
| Losses and loss expenses paid* | -$143 | -$67 | -$189 | -$76 | -$130 | -$23 |
| Reserves, end of year | $832 | $296 | $1,115 | $407 | $1,345 | $517 |
| **Combined:** | | | | | | |
| Reserves, beg. of year | $2,229 | $719 | $2,445 | $855 | $2,612 | $891 |
| Losses and loss expenses incurred* | $255 | $124 | $317 | $58 | $361 | $35 |
| Losses and loss expenses paid* | -$348 | -$147 | -$533 | -$194 | -$528 | -$71 |
| Reserves, end of year | $2,136 | $696 | $2,229 | $719 | $2,445 | $855 |
| IBNR included in A&E reserves | $1,022 | $283 | $1,038 | $278 | $1,042 | $314 |
| % IBNR | 47.8% | 40.7% | 46.6% | 38.7% | 42.6% | 36.7% |

*Source: Company data, Morgan Stanley Research * All amounts pertain to policies underwritten in prior years*



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Exhibit 4

**Asbestos and Environmental Survival Ratios**

| | Gross | Net |
|---|---|---|
| 2002 Involuntary Surv. Ratios | | |
| Asbestos | 4.1 | 4.9 |
| Environmental | 17.6 | 13.3 |
| Combined | 7.3 | 7.9 |
| 2001 Involuntary Surv. Ratios | | |
| Asbestos | 3.3 | 4.3 |
| Environmental | 18.7 | 16.5 |
| Combined | 6.8 | 8.7 |
| 2000 Involuntary Surv. Ratios | | |
| Asbestos | 3.6 | 6.8 |
| Environmental | 20.0 | 16.9 |
| Combined | 7.6 | 11.5 |

*Source: Company data, Morgan Stanley Research*

### Drilling Down Into the Charge

Now we turn to some of the individual elements of the charge. In it's 10k filing AIG provided additional detail on its $2.8 billion (pretax) net loss reserve charge. The by-line/by-accident year detail provided is typically only found in the annual statements, so we appreciate the company's initiative to make the consolidated information available with the 10-K (and its much easier to understand than the usual 10-K, triangular disclosure that still makes our heads spin). The reserve charge, by accident year and line of business is shown in Exhibit 5 below.

We believe the size of AIG's charge was manageable from a financial perspective (more to follow on this). However, to provide a sense for the magnitude of the charge from a pricing perspective we looked to the annual statements.

The tables following show how AIG's estimate of ultimate losses changed from year-end 2001 to 2002. The magnitude of the change is significant. Specifically, the tables below show the change in ultimate loss estimates (think, cost of goods sold) by accident year for each of the lines that contributed most significantly to the reserve charge. We used the National Union annual statement because it is the lead member of the domestic brokerage group pool and should be proportionately representative of the consolidated loss experience.

Exhibit 5

**4Q02 Charge by Line of Business and Accident Year**

| Line of business (in millions) | Acc. Year | Res. 12/31/01 | Charge | % of Ttl | % Chg. |
|---|---|---|---|---|---|
| **Other Liab. Occur. (a)** | 1997 | $359 | $175 | 6.3% | 48.7% |
| | 1998 | $594 | $352 | 12.6% | 59.3% |
| | 1999 | $766 | $305 | 10.9% | 39.8% |
| | 2000 | $998 | $335 | 12.0% | 33.6% |
| | 2001 | $1,895 | $276 | 9.9% | 14.6% |
| | **Total** | | **$1,443** | **51.5%** | |
| **Other Liab. Clms Mde (b)** | 1997 | $271 | -- | N/A | NM |
| | 1998 | $444 | $135 | 4.8% | 30.4% |
| | 1999 | $371 | $382 | 13.6% | 103.0% |
| | 2000 | $893 | $185 | 6.6% | 20.7% |
| | 2001 | $1,647 | $103 | 3.7% | 6.3% |
| | **Total** | | **$805** | **28.8%** | |
| **Workers' Comp(c)** | 96 & Prior | $1,102 | $144 | 5.1% | 13.1% |
| | 1997 | $206 | $58 | 2.1% | 28.2% |
| | 1998 | $128 | $33 | 1.2% | 25.8% |
| | 1999 | $214 | $29 | 1.0% | 13.6% |
| | 2000 | $548 | -- | N/A | NM |
| | 2001 | $844 | $30 | 1.1% | 3.6% |
| | **Total** | | **$294** | **10.5%** | |
| **Medical Malpractice** | 1997 | $31 | $58 | 2.1% | 187.1% |
| | 1998 | $48 | $35 | 1.3% | 72.9% |
| | 1999 | $70 | $46 | 1.6% | 65.7% |
| | 2000 | $75 | $19 | 0.7% | 25.3% |
| | 2001 | $121 | -- | N/A | NM |
| | **Total** | | **$158** | **5.6%** | |
| **Reinsurance** | 1998 | $126 | $33 | 1.2% | 26.2% |
| | 1999 | $113 | $34 | 1.2% | 30.1% |
| | 2000 | $158 | $33 | 1.2% | 20.9% |
| | **Total** | | **$100** | **3.6%** | **63.3%** |
| | **Total** | | **$2,800** | | |

*Source: Company data, Morgan Stanley Research a) Primarily excess casualty b) Primarily directors and officers c) Primarily excess workers' compensation*

The change in view of the ultimate loss estimates is, in some cases, dramatic. For instance, the Other Liability Occurrence line (excess casualty) saw a *64% increase* in the estimate of ultimate losses on accident year 1999. Although digestible from a financial perspective, this was no small tweaking of loss reserves. This line is the most sensitive to tort costs, and its significance to the total charge sheds light on Mr. Greenberg's comments on tort reform. Without these problems in the long-tailed tort-sensitive lines, AIG's reserve charge would have been *much* smaller.

### National Union Fire; Change in Ultimate Loss Estimates

Exhibit 6

**Other Liability—Occurrence**

| Acc Yr | Ultimate 12/01 | Ultimate 12/02 | % Change |
|---|---|---|---|
| 1997 | 564,949 | 651,359 | 15.3% |
| 1998 | 438,098 | 541,207 | 23.5% |
| 1999 | 194,418 | 318,719 | 63.9% |
| 2000 | 199,530 | 242,729 | 21.7% |
| 2001 | 265,012 | 288,767 | 9.0% |
| Tot Difference | | 380,774 | |

*Source: Company data, Morgan Stanley Research*



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Other lines of business also show large increases; the medical malpractice increase for 1999 is almost as dramatic as other liability, for example.

Exhibit 7

**Other Liability—Claims Made**

| Acc Yr | Ultimate 12/01 | Ultimate 12/02 | % Change |
|---|---|---|---|
| 1997 | 292,111 | 274,287 | -6.1% |
| 1998 | 410,704 | 456,800 | 11.2% |
| 1999 | 347,037 | 489,756 | 41.1% |
| 2000 | 451,098 | 506,718 | 12.3% |
| 2001 | 519,913 | 561,080 | 7.9% |
| Tot Difference | | 267,778 | |

*Source: Company data, Morgan Stanley Research*

Exhibit 8

**Medical Malpractice**

| Acc Yr | Ultimate 12/01 | Ultimate 12/02 | % Change |
|---|---|---|---|
| 1997 | 77,727 | 98,593 | 26.8% |
| 1998 | 63,774 | 77,738 | 21.9% |
| 1999 | 29,224 | 46,948 | 60.6% |
| 2000 | 18,397 | 24,532 | 33.3% |
| 2001 | 16,401 | 14,523 | -11.5% |
| Tot Difference | | 56,811 | |

*Source: Company data, Morgan Stanley Research*

Exhibit 9

**Workers' Compensation**

| Acc Yr | Ultimate 12/01 | Ultimate 12/02 | % Change |
|---|---|---|---|
| 1997 | 526,892 | 546,427 | 3.7% |
| 1998 | 374,069 | 387,531 | 3.6% |
| 1999 | 398,312 | 414,260 | 4.0% |
| 2000 | 481,355 | 471,779 | -2.0% |
| 2001 | 443,046 | 455,459 | 2.8% |
| Tot Difference | | 51,782 | |

*Source: Company data, Morgan Stanley Research*

We think this perspective demonstrates why Mr. Greenberg (along with many other market participants whose opinion we respect) has been so emphatic that long-tailed casualty lines must continue to harden from a rate and form perspective, and puts in perspective his comments on tort reform. With baseball season getting underway, we're thinking the casualty cycle might be only in the 5th inning, rather than the midst of the 7th inning stretch.

***Workers compensation development:*** As shown in Exhibit 5, workers' compensation is only 11% of the charge. According to management, there were no significant additional losses related to workers' compensation recorded in other areas (i.e., other liability). Using other data sources, we can map AIG's charge for reasonableness against the industry.

Exhibit 10

**Top 15 Workers Compensation Insurers in California**

| Company | DPW ($ in 000's) | Mkt Share | % of Ttl DWP |
|---|---|---|---|
| State Comp Ins Fund of CA | $3,638,077 | 42.9% | |
| Zurich/Farmers Group | $402,890 | 4.8% | |
| Kemper Insurance Companies | $331,189 | 3.9% | |
| Liberty Mutual Insurance Cos | $321,213 | 3.8% | |
| American International Grp Inc | $290,822 | 3.4% | 1.0% |
| Everest Re U.S. Group | $237,926 | 2.8% | 12.8% |
| Legion Insurance Group | $229,104 | 2.7% | |
| Great American P&C Ins Group | $221,055 | 2.6% | |
| Zenith National Insurance Grp | $214,912 | 2.5% | |
| Royal & SunAlliance USA | $203,803 | 2.4% | |
| HDI U S Group | $153,332 | 1.8% | |
| Fairfax Financial (US) Group | $153,174 | 1.8% | |
| CNA Insurance Companies | $146,879 | 1.7% | |
| Sierra Insurance Group | $134,836 | 1.6% | |
| Republic Indemnity Co of CA | $131,765 | 1.6% | |
| **Total US PC Industry - CA** | **$8,472,081** | **26.7%** | |
| **Total US PC Industry** | **$31,693,603** | | |

*Source: Company data, Morgan Stanley Research*

**AIG's charge appears within reason relative to our estimate of the reserve shortfall in the workers' compensation market, although it appears a bit light versus other industry measures.** Our conclusions are based on industry estimates of the National Council of Compensation Insurers (NCCI), which has estimated a $21 billion industry reserve deficiency for workers' compensation (excluding state funds including the SCIF – (State Compensation Insurance Fund of California)– the nation's largest workers' compensation insurer, with a 43% share of the huge California market). We also used the California Workers Compensation Insurance Rating Board (CWIRB) estimated reserve deficiency of $12.1 billion in California alone, including the State Fund.

In our recent report, *Workers' Compensation, A Line to Watch,* we suggested that problems had developed in this line and reserve charges were likely. Our own estimate, before recent reserve additions, is that as of 2001 reserves were deficient by $6.2B, not including reserve deficiencies ceded to reinsurers.

In that report, we concluded that the problems essentially relate to rising medical costs and expanded statutory benefits, along with reversal of cost containment efforts in key states, especially California, the nation's largest market.

Exhibit 11, following, compares AIG's workers compensation charge ($294 million) to estimated NCCI and



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WCIRB industry deficiencies, as well as to our estimate. The charge is within a normal range relative to our estimate. AIG booked 4.7% of that number. Our estimate is for US primary insurers only and excludes reinsurers' share and amounts relating to September 11; as such, given AIG's direct market share, we believe this is a reasonable outcome.

Exhibit 11

**Review of AIG vs. Industry: the W/C Charge** *($ in '000s)*

| | | |
|---|---|---|
| AIG Total W/C (DPW) | $1,947,942 | 6.1% of Ind. |
| AIG CA Mrkt Sh (DPW) | $290,822 | 3.4% of CA |
| AIG CA W/C / Ttl AIG W/C | 15% | |
| CA W/C (DPW) | $8,472,081 | 26.7% of Ind. |
| Industry W/C (DPW) | $31,693,603 | |
| WCIRB est CA deficiency | $12,100,000 | |
| NCCI est. deficiency | $21,000,000 | |
| MS W/C Industry estimate | $6,199,428 | |
| AIG W/C | $294,000 | |
| AIG W/C related / NCCI | 1.4% | vs AIG's 6.1% |
| Allocated W/C chrg to CA | $43,893 | |
| Allocated W/C chrg to CA / WCIRB | <1% | vs. AIG CA 3.4% |
| AIG W/C charge / MS W/C industry estimate | 4.7% | vs. AIG share of 6.1% |

*Source: Company data, Morgan Stanley Research AM Best. Note AIG and Industry premiums are based on 2001 statutory data.*

However, the charge appears light relative to AIG's market share as implied by the NCCI's estimated industry deficiency and as implied by the WCIRB (these two sources are calculated on a different basis).

That could suggest that the mix of AIG's workers' compensation book is different than that of the general market (implying a general extrapolation of these industry results to AIG would not be pertinent). It could also mean that the company's historical reserving for this line has been more conservative than the industry and therefore the increase in current reserves was adequate. Individual statutory filings could shed further light on this area. Or finally, it could suggest that the workers' compensation line remains an area to watch.

Notably, while AIG is a leader in the workers' compensation arena (ranking 3rd in the US), we estimate it represents only 9.6% of its total premium volume. As such, even if there were further unfavorable development, we do not believe it would be near the magnitude of the total charge just taken.

**D&O Charge is Significant**

While the most significant portion of the charge related to excess casualty, the size of the D&O charge warrants some attention. In D&O, Exhibits 6 and 7 show that charge was spread over 1998-2001, with accident year 1999 developing particularly adversely.

We believe that D&O has characteristics of both property lines (because of the claims made coverage, claims should be reported or discovered quickly) and casualty (the claims adjustment process can be slowed since litigation is frequently involved). Consequently, we are led to believe that the significant revision in AIG's D&O reserves was more a function of claims misestimation than actuarial reserving shortfalls.

The D&O charge also invites a comparison to AIG's top competitor in this business—Chubb. The exhibit below compares AIG's National Union subsidiary against Chubb's Federal Insurance. The Other Liability Claims Made line is compared since that is where most D&O business resides.



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Exhibit 12

**National Union — Other Liability Claims Made (D&O, E&O, other Professional Liability Coverages)**

| Acc. Year | Direct and Assumed Earned Premiums | Ceded Earned Premiums | Net Earned Premiums | Direct and Assumed Ultimate Loss Ratio | Ceded Ultimate Loss Ratio | Net Ultimate Loss Ratio |
|---|---|---|---|---|---|---|
| 1993 | $546,027 | $165,888 | $380,136 | 39.3% | 13.0% | 50.8% |
| 1994 | $496,655 | $33,692 | $462,963 | 52.5% | 74.3% | 50.9% |
| 1995 | $540,107 | $37,409 | $502,698 | 58.1% | 144.6% | 51.6% |
| 1996 | $601,806 | $42,855 | $558,921 | 58.4% | 224.4% | 45.7% |
| 1997 | $589,482 | $38,492 | $550,990 | 64.5% | 249.7% | 51.5% |
| 1998 | $663,134 | $22,023 | $641,111 | 84.8% | 422.3% | 73.2% |
| 1999 | $595,694 | $69,007 | $526,687 | 109.7% | 207.9% | 96.9% |
| 2000 | $1,022,964 | $193,421 | $829,543 | 74.4% | 124.7% | 62.7% |
| 2001 | $1,094,914 | $233,997 | $860,917 | 80.2% | 128.1% | 67.2% |
| 2002 | $1,449,440 | $305,389 | $1,144,051 | 71.7% | 79.7% | 69.6% |

*Source: Company data, Morgan Stanley Research*

Exhibit 13

**Federal Insurance Company — Other Liability Claims Made (D&O, E&O, other Professional Liability Coverages)**

| Acc. Year | Direct and Assumed Earned Premiums | Ceded Earned Premiums | Net Earned Premiums | Direct and Assumed Ultimate Loss Ratio | Ceded Ultimate Loss Ratio | Net Ultimate Loss Ratio |
|---|---|---|---|---|---|---|
| 1993 | $487,585 | $243,648 | $243,937 | 28.0% | 35.0% | 21.0% |
| 1994 | $521,552 | $233,339 | $288,213 | 54.0% | 52.7% | 55.0% |
| 1995 | $542,634 | $226,815 | $315,819 | 34.5% | 37.7% | 32.2% |
| 1996 | $588,203 | $224,388 | $363,815 | 31.5% | 31.6% | 31.5% |
| 1997 | $641,512 | $173,039 | $468,473 | 57.6% | 55.4% | 58.5% |
| 1998 | $669,373 | $186,729 | $482,644 | 85.7% | 91.9% | 83.3% |
| 1999 | $718,506 | $194,861 | $523,645 | 100.9% | 135.1% | 88.1% |
| 2000 | $1,128,328 | $382,605 | $745,723 | 90.3% | 88.4% | 91.2% |
| 2001 | $1,193,206 | $367,665 | $825,541 | 88.8% | 93.9% | 86.5% |
| 2002 | $1,377,313 | $441,376 | $935,937 | 93.1% | 91.2% | 94.0% |

*Source: Company data, Morgan Stanley Research*

Exhibit 14

**Difference: National Union — Federal: Other Liability Claims Made (D&O, E&O, other Professional Liability Coverages)**

| Acc. Year | Direct and Assumed Earned Premiums | Ceded Earned Premiums | Net Earned Premiums | Direct and Assumed Ultimate Loss Ratio | Ceded Ultimate Loss Ratio | Net Ultimate Loss Ratio |
|---|---|---|---|---|---|---|
| 1993 | $58,442 | -$77,760 | $136,199 | 11.3% | -22.0% | 29.8% |
| 1994 | -$24,897 | -$199,647 | $174,750 | -1.5% | 21.6% | -4.1% |
| 1995 | -$2,527 | -$189,406 | $186,879 | 23.6% | 106.9% | 19.4% |
| 1996 | $13,603 | -$181,533 | $195,106 | 26.9% | 192.8% | 14.2% |
| 1997 | -$52,030 | -$134,547 | $82,517 | 6.9% | 194.3% | -7.0% |
| 1998 | -$6,239 | -$164,706 | $158,467 | -0.9% | 330.4% | -10.1% |
| 1999 | -$122,812 | -$125,854 | $3,042 | 8.8% | 72.8% | 8.8% |
| 2000 | -$105,364 | -$189,184 | $83,820 | -15.9% | 36.3% | -28.5% |
| 2001 | -$98,292 | -$133,668 | $35,376 | -8.6% | 34.2% | -19.3% |
| 2002 | $72,127 | -$135,987 | $208,114 | -21.4% | -11.5% | -24.4% |

*Source: Company data, Morgan Stanley Research*



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**Several observations:**

- The size and trends in the premium levels are remarkably similar, especially considering that AIG writes mostly primary whereas Chubb generally writes in the excess layers above AIG.
- Chubb's net loss reserve ratios are consistently higher than those booked by National Union (the only recent exception being accident year 1999).
- Conversely, AIG's ceded loss ratio is much higher than those shown by Chubb (2002 being the only recent exception). AIG clearly has the capacity to increase its net retention, and with the dramatic hardening of underlying rates and terms, we anticipate AIG will do so rather than going into full 'pay back' mode in its reinsurance program.
- Simplistically, it appears that Chubb is reserved more conservatively than AIG. Looking at the average of the past three years, Chubb's loss ratios are about 25% higher than those booked by AIG. This simplistic conclusion may not be accurate. There are other lines of business included in this segment, the companies are positioned differently in the lines they write (primary vs. excess), and given Chubb's higher reinsurance retentions, it may need more reserves. We are very hesitant to draw a conclusion from this data.

**How Important Is the Charge to AIG?**

The charge was very large as compared to the property casualty operations and reserves. On the other hand, clearly, this was a financially manageable event for AIG, and its shareholders.

The charge was 3.1% of book value. The excess casualty portion alone was 1.9% of book value. Management commented that this was not very large compared to the company's $58 billion of capital. Considered from the perspective of claims-paying ability, that is undoubtedly true. However, based on other measures, the basis for investor concerns is more obvious. Yet we still believe it is important not to overreact. ***A charge of this order of magnitude would be financially disastrous to most companies, representing a catastrophic performance failure. That simply is not true of AIG.***

For example, some companies would lose more than 100% of their capital if they increased reserves by 10%. It is not clear that many of these companies would be able to recapitalize and recover financially from such a blow, whereas for AIG, this was quite a manageable event.

***Still underwriting at a profit.*** Spread back to the prior five years, the charge was 3.6 points on the combined ratio, using total earned premium from 1997-2001. The excess casualty portion alone was 2.2 points. A revision of this magnitude (10% of reserves) would be larger (in point terms) for most companies (because they use reinsurance less extensively and carry more net reserves), and thus would push many further into the range of what may already be unacceptable underwriting performance. In turn, that could have damaging financial and rating consequences. Yet AIG would have written at a 99.4% and a 98.1% combined ratio on average, respectively, during that period (with and without catastrophes) had the losses been recognized earlier. It would be too harsh, we think, to conclude that this is terrible performance during what appears to have been the worst soft market in modern history.

***Impact on book value was not proportional.*** The charge was 10.4% of 3Q02 net reserves. The excess casualty portion represented 6.3% of 3Q02 net reserves. Fortunately, unlike the average insurer, net reserves are only 45% of AIG's shareholders' equity, so the charge sliced less than 5% off of AIG's GAAP book value. Further, post the charge, tangible book value is 90% of reported book value (AIG has $2.33/share of goodwill). A similar swing at some other companies could be crippling from a rating and capital standpoint (the industry average reserves are about 2x capital). While we often talk about the benefits of being large, diversified, and well capitalized in an abstract way, in this situation, they shielded AIG.

***Impact on earnings and ROE is significant.*** The charge was 6.1% of total operating earnings during the entire affected period (3.7% for the excess casualty portion only). That shaved an average of 100 basis points off of AIG's return on equity during that period. As such, the charge is significant, even on a cumulative basis. AIG's earnings (in dollar terms) compounded at almost 18.8% as reported, excluding its September 11th loss. That rate of compounding would not have changed if AIG had recognized the charge ratably over the period, but the perception of the company probably would have been somewhat different based on the lower ROE .



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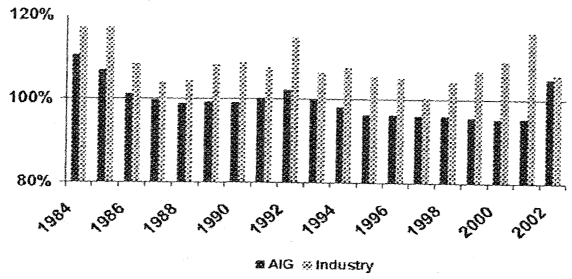
Exhibit 15

**AIG's Combined Ratio vs. Property Casualty Industry**




*Source: Company data, Morgan Stanley Research, AM Best. Note: 2002 Industry combined ratio of 105.9% is a Morgan Stanley estimate.*

***Widening outperformance with hindsight not justified.*** AIG appears to have outperformed the industry's underwriting every year since 1983, beating the industry by an average of 8.7 points (using our 105.9% estimate of the industry's 2002 combined ratio). However, as Exhibit 15 shows, that outperformance widened significantly in the late 1990s and early 2000s. While AIG is known as an excellent underwriter, we might have questioned why the gap would be widening. While simplistic, this is one of the clues that should have suggested to us that a day of reckoning might be coming.

***It was a sizeable day of reckoning.*** The charge represents approximately 7 points on AIG's domestic brokerage business using 1997-2001 earned premiums and 5 points including estimated premiums for 2002. We estimate the charge represented approximately 23% of its net domestic property and casualty reserves (excluding 21st Century and Transatlantic reserves) as of June 30, 2002.

**Implications for Peers**

With the reserve charge reflected in earnings, it is interesting to compare AIG's results and leverage to its peers. Notably, several of the company's larger competitors also have reported very good underwriting results during this period. It is understandable that investors drew inferences about the industry as a whole from AIG's charge. Please note that some of the following companies made acquisitions that may affect comparability from year to year.

We don't necessarily leap to the conclusion that any other company that reported better results will take a charge. Among other things, it may have protected itself with reinsurance, including financial reinsurance. Yet reinsurance (of all types) also carries a future cost when losses are ceded, so investors have learned it is prudent not to wait around for the details when these things occur: they just run. And so, once again, the industry apparently has something to prove.



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Exhibit 16

**AIG 1997—2002 Results vs. Peers**

| | | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | Average |
|---|---|---|---|---|---|---|---|---|
| Combined ratio | AIG | 96.1% | 96.2% | 95.7% | 95.5% | 95.6% | 105.1% | 97.4% |
| Combined ratio | XL | 94.8% | 95.2% | 108.8% | 106.8% | 140.0% | 97.1% | 107.1% |
| Combined ratio | CB | 97.7% | 100.5% | 103.2% | 100.4% | 113.6% | 107.7% | 103.8% |
| Combined ratio | TAP | 105.6% | 104.5% | 102.6% | 101.6% | 109.3% | 124.7% | 108.1% |
| Combined ratio | ACE | 79.4% | 88.0% | 99.5% | 95.5% | 111.6% | 101.7% | 95.9% |
| **Combined ratio** | **Avg** | **94.7%** | **96.9%** | **102.0%** | **100.0%** | **114.0%** | **107.3%** | **102.5%** |
| **Combined ratio** | **Avg. ex AIG** | **94.4%** | **97.0%** | **103.5%** | **101.1%** | **118.6%** | **107.8%** | **103.7%** |
| NWP:S/H Equity | AIG | 39.2% | 37.4% | 40.8% | 36.9% | 38.5% | 47.0% | 40.0% |
| NWP:S/H Equity | XL | 27.6% | 23.6% | 34.1% | 38.0% | 52.8% | 90.6% | 44.4% |
| NWP:S/H Equity | CB | 96.3% | 97.5% | 90.9% | 90.7% | 106.7% | 131.2% | 102.2% |
| NWP:S/H Equity | TAP | 118.8% | 140.4% | 127.5% | 96.0% | 92.1% | 117.8% | 115.5% |
| NWP:S/H Equity | ACE | 28.3% | 23.7% | 56.1% | 90.0% | 97.5% | 123.8% | 69.9% |
| **NWP:S/H Equity** | **Avg** | **62.1%** | **64.5%** | **69.9%** | **70.3%** | **77.5%** | **102.1%** | **74.4%** |
| **NWP:S/H Equity** | **Avg. ex AIG** | **67.8%** | **71.3%** | **77.2%** | **78.7%** | **87.3%** | **115.8%** | **83.0%** |
| Gross Reserves/ S/H Equity | AIG | 97.8% | 98.2% | 96.3% | 85.6% | 85.9% | 91.3% | 92.5% |
| Gross Reserves/ S/H Equity | XL | 124.3% | 87.2% | 96.3% | 101.8% | 217.5% | 201.3% | 138.1% |
| Gross Reserves/ S/H Equity | CB | 172.7% | 183.7% | 182.3% | 170.5% | 237.8% | 250.8% | 199.6% |
| Gross Reserves/ S/H Equity | TAP | 458.8% | 512.7% | 450.4% | 308.7% | 292.5% | 337.9% | 393.5% |
| Gross Reserves/ S/H Equity | ACE | 66.7% | 99.0% | 369.9% | 320.8% | 339.4% | 380.6% | 262.7% |
| **Gross Reserves/ S/H Equity** | **Avg** | **184.1%** | **196.2%** | **239.0%** | **197.5%** | **234.6%** | **252.4%** | **217.3%** |
| **Gross Reserves/ S/H Equity** | **Avg. ex AIG** | **205.6%** | **220.7%** | **274.7%** | **225.4%** | **271.8%** | **292.6%** | **248.5%** |
| Operating return on equity | AIG | 14.4% | 13.6% | 15.6% | 16.2% | 14.9% | 12.9% | 14.6% |
| Operating return on equity | XL | 14.2% | 10.9% | 8.4% | 10.2% | -8.1% | 11.7% | 7.9% |
| Operating return on equity | CB | 12.7% | 11.3% | 9.5% | 10.3% | 1.7% | 3.0% | 8.1% |
| Operating return on equity | TAP | 17.2% | 20.0% | 21.1% | 17.1% | 8.6% | 1.1% | 14.2% |
| Operating return on equity | ACE | 14.6% | 11.4% | 8.0% | 11.4% | -1.6% | 7.8% | 8.6% |
| **Operating return on equity** | **Avg** | **14.6%** | **13.5%** | **12.5%** | **13.1%** | **3.1%** | **7.3%** | **10.7%** |
| **Operating return on equity** | **Avg. ex AIG** | **14.7%** | **13.4%** | **11.8%** | **12.3%** | **0.1%** | **5.9%** | **9.7%** |

*Source: Company data, Morgan Stanley Research*

**Implications for Standard Reserving Methodology**

For some time we have been hearing rumblings in the industry that a contributing factor to companies missing the change in loss trends in the late 1990s—from disinflation to reinflation—in casualty lines was reserving methods. In its 10-k, AIG cited specifically the Bornhuetter-Fergusen reserving method. Under that method, companies reserve for long-tailed lines in which they do not have significant historical data based on long-term trends, with recent experience not heavily weighted. Therefore, pricing assumptions are not unlocked when actual experience deviates from assumptions until there is substantial evidence that the pricing assumptions were incorrect.

***Waiting for the evidence—until it clubs you over the head.*** The insurance industry jokes that the first time an actuary sees a new loss trend it is a "blip," the second time it is "something to be monitored," and only on the third occurrence does it become a trend that is reflected in reserves. What's wrong with that? Nothing, except when a thoughtful study of the macro environment suggests a different conclusion—that trends are changing and they need to be reflected immediately. In casualty lines, inflationary trends began to change in 1998, and swerved sharply upward in 1999.

The industry's reserve additions of 2001 and 2002 appear to be at least partly the result of this "blip, monitor, then reserve" effect on reserves. You could see the change in



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trends in the industry's reserve numbers at the time. AIG also acknowledges this, citing its change in method to now begin weighting recent year's experience more heavily.

> "Actuaries predict the future, not with a crystal ball, but rather by looking out the rear window of a fast moving car. If the car gets to its destination safely everything is fine. If it crashes, its not their fault. Someone else was the driver."
>
> *Leucadia National Corporation, 1998 annual report*

We could argue that the industry, in general, has a lot to answer for in its seemingly blind adherence to historically based actuarial methods. Insurers apparently followed rote procedures in reserving, sometimes at the expense of common sense. You did not have to be a rocket scientist—much less an insurance expert—to recognize that inflationary trends had changed significantly for health care, tort costs and auto repair costs in the late 1990s. The magnitude of these changes may have caught the industry by surprise—especially the excess writers. But the whole conceptual basis of the industry's reserving, based on trended historical results, appears to have been suspect.

We understand that it is important not to overweight what may turn out to be a blip. Our point is that, even to our own uneducated eyes, the change in environment was not a blip.

***We have a sneaking suspicion that, at least in some instances, it was not by chance.*** Surely, some insurers must have recognized the change in inflationary trends before 2002. We certainly heard a lot of companies pointing fingers *at each other* for under-reserving. Those who had a suspicion about their own numbers may well not have understood the *magnitude* of underpricing and the impact on reserving. But we'll bet that more than a few had at least a hint their reserves were off the mark. Traditional reserving methods, however, may have provided a convenient excuse not to deal with the problem.

***One thing is clear, the "blip, monitor, then reserve" method did not work.*** Although it effectively screens out "noise," this method may miss important inflection points and allow underreserving to persist longer than it should in some circumstances.

***And there may be times when that suits the industry just fine.*** If in doubt, all you have to do is think "asbestos"—and we believe our point is proved. This raises the question also of the gatekeepers (auditors and third party actuaries) who are supposed to be skeptical. In general, we fear that they take a checklist approach. If a reserving method is generally accepted as valid, it will not be questioned, even if that defies common sense.

***In the future, however, we wouldn't look for a repeat performance—if only because investors and rating agencies are likely to ask a lot more questions next time.***

**How Are Reserving Practices Changing in This Cycle?**
Historically insurers ended each cycle with deficient reserves (even the biggest and mightiest). The best companies were deficient, while others (and even some of the better companies) with hindsight might be actually insolvent. The key word is hindsight. Historically nonlife insurers "amortized" the reserve deficiency against future rate increases, under-reporting calendar year earnings in the hard market (and beyond). Why isn't that happening in this cycle?

- ***Capital markets efficient; no premium for deferral.*** Old school thinking—that deferring recognition of loss development results in a premium—is disappearing or has already disappeared, in our view. Many more people are focused on "real" economic results in this cycle to help them decide how capital should be allocated.

- ***Different accounting standards create penalty for deferral.*** In the post-Enron, post-WorldCom era, we believe that having an off-balance sheet reservoir of earnings or losses looks at best naïve, and at worst, extremely stupid. Sarbanes-Oxley has put fear into management (with criminal penalties) and auditors, actuaries and other "gatekeepers" remain under pressure to do a better job. Hence, Mr. Greenberg's "You can't run a major company in any industry and think that every quarter is going to be better than the last quarter."

- ***Rating agencies stepping up to the plate.*** The main exception to the rule of booking a loss once it is understood seems to be when doing so carries a severe penalty (e.g., rating downgrade). Here, investors may be dependent on the rating agencies doing their job. Increasingly it appears they are stepping up.

One important lesson of this situation is that no company should be assumed to be different. Until recently, investors, analysts and rating agencies have generally taken the view that, because it has so much more information than we do, and financials are being audited, management's statements about reserves must be given the benefit of the doubt. The



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problem is that managements are only human. Unfortunately, management, actuaries and auditors proved no protection against material reserve deficiencies in recent years. Sometimes, more distance even creates a clearer perspective. In the future, those who are responsible for judging industry reserves (analysts and rating agencies) most likely will no longer be so deferential. S&P's new rating formula, which uses its own judgment about reserves.

**Clarifications to March 31 Note**

We have a couple of clarifications to our recent review of AIG's 10-k, *Sifting Through Massive New Disclosures:*

- We referred to the company's $293 million of hedging losses on derivatives. Management asked us to clarify that effective hedging losses are part of comprehensive income, not net income, and therefore offset gains elsewhere in the financial statements. As such, they also do not affect book value.

- We referred to the company's $14.98 billion of net replacement value of derivatives carried by AIGFP at year end as the only available proxy for the potential exposure to modeled values of derivatives. The amount actually modeled as opposed to based on traded values was not disclosed in the 10-k. Management has subsequently indicated that the vast majority of the derivatives included in that number are valued based on traded market values, not modeled valuations.



**Please see analyst certification and important disclosures starting on page 2.**

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Exhibit 17

## Earnings Model

| ($ in millions, except per share data) | 1998 | 1999 | 2000 | 2001 | 2002E | 2003E | 2004E | 4Q01 | 1Q02 | 2Q02 | 3Q02 | 4Q02E | 1Q03E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Property - Casualty*** | | | | | | | | | | | | | |
| Gross written premium | 20,684.3 | 22,569.4 | 25,049.6 | 29,639.8 | 37,498.8 | 45,974.8 | 55,754.4 | 8,113.8 | 8,976.9 | 8,717.8 | 9,256.2 | 10,548.0 | 11,221.1 |
| change yr/yr | 10.4% | 9.1% | 11.0% | 18.3% | 26.5% | 22.6% | 21.3% | 24.9% | 26.8% | 23.7% | 25.2% | 30.0% | 25.0% |
| Net written premium | 14,586.1 | 16,223.9 | 17,526.3 | 20,100.9 | 27,414.2 | 33,544.1 | 38,100.9 | 5,197.7 | 6,334.3 | 6,782.7 | 7,084.8 | 7,212.5 | 8,480.5 |
| change yr/yr | 8.8% | 11.2% | 8.0% | 14.7% | 36.4% | 22.4% | 13.6% | 15.4% | 30.2% | 34.2% | 42.2% | 38.8% | 33.9% |
| Earned premium | 14,098.0 | 15,543.8 | 17,406.9 | 19,364.9 | 24,269.5 | 30,831.6 | 35,828.0 | 5,055.9 | 5,506.5 | 5,859.2 | 6,195.8 | 6,708.0 | 7,121.8 |
| change yr/yr | 13.5% | 10.3% | 12.0% | 11.2% | 25.3% | 27.0% | 16.2% | 5.6% | 16.6% | 23.6% | 27.9% | 32.7% | 29.3% |
| Paid losses | 10,144.3 | 11,756.7 | 12,987.8 | 14,461.7 | 16,359.4 | 18,981.5 | 24,364.0 | 3,843.8 | 4,016.3 | 3,961.4 | 3,967.2 | 4,414.5 | 4,279.4 |
| Reserve change (related to incurred claims) | 512.4 | (19.2) | 116.6 | 943.9 | 4,454.4 | 4,357.9 | 2,668.5 | 140.9 | 126.8 | 378.0 | 641.1 | 3,308.5 | 1,069.9 |
| Incurred losses | 10,656.7 | 11,737.5 | 13,104.4 | 14,636.6 | 20,813.7 | 23,339.5 | 27,032.5 | 3,984.7 | 4,143.1 | 4,339.4 | 4,608.3 | 7,723.0 | 5,349.3 |
| Other underwriting expenses | 2,910.5 | 3,137.1 | 3,517.5 | 3,871.1 | 4,689.8 | 5,584.9 | 6,525.2 | 955.8 | 1,053.7 | 1,103.6 | 1,196.8 | 1,335.7 | 1,311.4 |
| Pretax underwriting results | 530.7 | 669.2 | 785.0 | 857.2 | (1,234.0) | 1,907.3 | 2,270.3 | 115.4 | 309.7 | 416.2 | 390.7 | (2,350.6) | 461.1 |
| Loss ratio | *75.6%* | *75.5%* | *75.3%* | *75.6%* | *85.8%* | *75.7%* | *75.5%* | *78.8%* | *75.2%* | *74.1%* | *74.4%* | *115.1%* | *75.1%* |
| Expense ratio | *20.6%* | *20.2%* | *20.2%* | *20.0%* | *19.3%* | *18.1%* | *18.2%* | *18.9%* | *19.1%* | *18.8%* | *19.3%* | *19.9%* | *18.4%* |
| Combined ratio | *96.2%* | *95.7%* | *95.5%* | *95.6%* | *105.1%* | *93.8%* | *93.7%* | *97.7%* | *94.4%* | *92.9%* | *93.7%* | *135.0%* | *93.5%* |
| Accident year CR | *98.2%* | *98.2%* | *96.9%* | *93.3%* | *88.3%* | | | | | | | | |
| Net investment income (pretax) | 2,191.8 | 2,516.7 | 2,700.8 | 2,892.6 | 2,759.6 | 3,026.1 | 3,990.1 | 745.4 | 745.4 | 680.0 | 661.0 | 673.2 | 668.5 |
| change yr/yr | 18.3% | 14.8% | 7.3% | 7.1% | -4.6% | 9.7% | 31.9% | 6.1% | 4.1% | -3.8% | -8.7% | -9.7% | -10.3% |
| Corporate pretax income | (437.4) | 62.2 | 172.1 | 3.3 | (129.2) | (135.0) | (80.0) | (52.4) | 6.5 | (49.7) | (25.2) | (60.8) | (40.0) |
| General Insurance | 2,722.6 | 3,185.9 | 3,485.8 | 3,749.9 | 1,525.6 | 4,933.4 | 6,260.4 | 860.8 | 1,055.1 | 1,096.3 | 1,051.7 | (1,677.4) | 1,129.6 |
| Life Insurance | 3,323.5 | 3,758.6 | 4,219.7 | 5,060.2 | 5,982.3 | 6,552.8 | 7,082.6 | 1,321.7 | 1,355.4 | 1,528.4 | 1,516.7 | 1,581.8 | 1,435.4 |
| Financial Services | 1,172.2 | 1,416.9 | 1,665.8 | 1,991.0 | 2,188.7 | 2,317.9 | 2,450.8 | 587.0 | 473.9 | 542.0 | 552.5 | 620.3 | 510.2 |
| Asset Management | 673.4 | 872.8 | 1,108.2 | 1,087.7 | 1,015.9 | 847.4 | 901.8 | 287.2 | 299.7 | 280.2 | 228.2 | 207.8 | 195.4 |
| Other | (437.4) | 62.2 | (143.3) | (2,913.2) | (129.2) | (135.0) | (80.0) | (52.4) | 6.5 | (49.7) | (25.2) | (60.8) | (40.0) |
| Realized Gains (Losses) | 130.029 | 103.078 | -312.73 | -836.34 | -2440.963 | 0 | 0 | -287.1 | -231.8 | -629.5 | -595.6 | -984.1 | 0.0 |
| Total pretax income | 7,584.3 | 9,399.5 | 10,023.4 | 8,139.2 | 8,142.3 | 14,516.4 | 16,615.6 | 2,717.3 | 2,958.7 | 2,767.7 | 2,728.4 | (312.4) | 3,230.6 |
| Taxes | (2,190.5) | (2,832.6) | (2,970.8) | (2,339.1) | (2,328.0) | (4,556.6) | (5,167.4) | (804.0) | (891.8) | (871.8) | (817.4) | 253.1 | (1,017.6) |
| After-tax income | 5,393.8 | 6,566.9 | 7,052.6 | 5,800.0 | 5,814.4 | 9,959.8 | 11,448.1 | 1,913.3 | 2,066.9 | 1,895.9 | 1,910.9 | (59.3) | 2,213.0 |
| Minority Interest, net of tax | 347.8 | 380.6 | 413.7 | 301.0 | 295.5 | 339.8 | 390.8 | 47.4 | 86.6 | 94.7 | 69.7 | 44.5 | 99.6 |
| Cum. Effect Chg. Accting, net of tax | - | - | - | 136.2 | - | - | - | - | - | - | - | - | - |
| Net income | 5,046.0 | 6,186.3 | 6,638.9 | 5,362.8 | 5,518.9 | 9,620.0 | 11,057.4 | 1,865.9 | 1,980.3 | 1,801.2 | 1,841.2 | (103.8) | 2,113.4 |
| change yr/yr | 18.6% | 22.6% | 7.3% | -19.2% | 2.9% | 74.3% | 14.9% | 3.5% | 6.7% | 37.0% | 463.5% | -105.6% | 6.7% |
| Net EPS | $1.92 | $2.34 | $2.52 | $2.02 | $2.10 | $3.65 | $4.20 | $0.70 | $0.75 | $0.68 | $0.70 | ($0.04) | $0.80 |
| Realized gains/losses | $0.02 | $0.02 | ($0.08) | ($0.20) | ($0.61) | $0.00 | $0.00 | ($0.07) | ($0.06) | ($0.16) | ($0.15) | ($0.24) | $0.00 |
| Special Items | $0.00 | $0.00 | ($0.08) | ($0.58) | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 |
| **Operating EPS** | **$1.90** | **$2.32** | **$2.68** | **$2.80** | **$2.70** | **$3.65** | **$4.20** | **$0.77** | **$0.81** | **$0.84** | **$0.85** | **$0.20** | **$0.80** |
| change yr/yr | 18.1% | 22.2% | 15.6% | 4.6% | -3.6% | 35.3% | 14.9% | 9.5% | 12.5% | 10.2% | 55.5% | -73.6% | -0.9% |
| **Fully diluted shares** | **2,633.5** | **2,650.3** | **2,637.8** | **2,649.9** | **2,634.0** | **2,632.5** | **2,634.4** | **2,645.4** | **2,641.0** | **2,639.9** | **2,634.0** | **2,632.5** | **2,632.5** |
| **Shareholders Equity** | **38,994.3** | **39,726.4** | **47,437.6** | **52,150.0** | **58,294.3** | **67,419.9** | **78,744.8** | **52,150.0** | **52,675.0** | **54,963.0** | **58,783.1** | **58,294.3** | **60,284.1** |

*Source: Company data, Morgan Stanley Research*



**Please see analyst certification and important disclosures starting on page 2.**

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Exhibit 18

## Operating Statistics

| ($ in millions, except per share data) | 1998 | 1999 | 2000 | 2001 | 2002E | 2003E | 2004E | 4Q01 | 1Q02 | 2Q02 | 3Q02 | 4Q02E | 1Q03E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Operating/Capital Statistics*** | | | | | | | | | | | | | |
| Dividend | $0.11 | $0.13 | $0.14 | $0.16 | $0.18 | $0.19 | $0.21 | $0.04 | $0.04 | $0.05 | $0.05 | $0.05 | $0.05 |
| Operating Payout ratio | 6.0% | 5.5% | 5.2% | 5.6% | 6.8% | 5.2% | 5.1% | 5.4% | 5.2% | 5.6% | 5.5% | 23.0% | 5.9% |
| Net written premiums: surplus | 118.7% | 121.5% | 125.2% | 142.5% | 174.2% | 184.3% | 179.2% | 147.4% | 176.2% | 191.2% | 207.0% | 183.3% | |
| Net reserves:surplus | 200.3% | 184.2% | 178.2% | 183.6% | 192.8% | 190.7% | 175.8% | 183.6% | 181.0% | 186.0% | 197.5% | 192.8% | |
| Operating ROE | 13.6% | 15.6% | 16.2% | 14.9% | 12.9% | 15.3% | 15.1% | 15.9% | 16.3% | 16.5% | 15.7% | 3.7% | 14.3% |
| Total ROE | 13.8% | 15.7% | 15.2% | 10.8% | 10.0% | 15.3% | 15.1% | 14.5% | 15.1% | 13.4% | 12.9% | -0.7% | 14.3% |
| Debt/Capital | 31.7% | 32.5% | 36.8% | 41.8% | 42.6% | 40.2% | 40.4% | 41.8% | 42.8% | 43.2% | 42.7% | 42.6% | 39.0% |
| Book value per share | $15.08 | $15.25 | $18.09 | $19.94 | $22.38 | $25.88 | $30.12 | $19.94 | $20.16 | $21.05 | $22.53 | $22.38 | $23.15 |
| Operating ROE (Ex. FAS 115) | 13.7% | 15.2% | 15.4% | 14.3% | 12.7% | 15.3% | 15.2% | 15.5% | 15.6% | 15.7% | 15.5% | 3.7% | 14.3% |
| Total ROE (Ex. FAS 115) | 13.8% | 15.3% | 14.5% | 10.3% | 9.9% | 15.3% | 15.2% | 14.1% | 14.5% | 12.8% | 12.7% | -0.7% | 14.3% |
| Debt/Capital (Ex. FAS 115) | 31.7% | 31.4% | 35.7% | 41.0% | 42.7% | 40.2% | 40.4% | 41.0% | 41.5% | 42.3% | 42.8% | 42.7% | 39.0% |
| Book value per share (Ex. FAS 115) | $15.08 | $16.16 | $19.01 | $20.60 | $22.31 | $25.82 | $30.05 | $20.60 | $21.24 | $21.84 | $22.46 | $22.31 | $23.08 |
| ***Reserve Analysis (Net)*** | | | | | | | | | | | | | |
| Beginning reserve balance | 21,171.5 | 24,618.9 | 24,599.7 | 24,951.6 | 25,895.5 | 30,350.0 | 34,707.9 | 25,754.6 | 25,895.5 | 26,022.5 | 26,400.5 | 27,041.6 | 30,350.0 |
| Incurred losses | 10,656.7 | 11,737.5 | 13,104.4 | 15,405.6 | 20,813.7 | 23,339.5 | 27,032.5 | 3,984.7 | 4,143.1 | 4,339.4 | 4,608.3 | 7,723.0 | 5,349.3 |
| Paid losses | (10,144.3) | (11,756.7) | (12,987.8) | (14,461.7) | (16,359.4) | (18,981.5) | (24,364.0) | (3,843.8) | (4,016.3) | (3,961.4) | (3,967.2) | (4,414.5) | (4,279.4) |
| Other changes | 2,935.0 | 0.0 | 235.3 | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Ending net reserve balance | 24,618.9 | 24,599.7 | 24,951.6 | 25,895.5 | 30,350.0 | 34,707.9 | 37,376.5 | 25,895.5 | 26,022.5 | 26,400.5 | 27,041.6 | 30,350.0 | 31,419.9 |
| Paid: incurred | 95.2% | 100.2% | 99.1% | 93.9% | 78.6% | 81.3% | 90.1% | 96.5% | 96.9% | 91.3% | 86.1% | 57.2% | 80.0% |
| Paid: earned | 72.0% | 75.6% | 74.6% | 74.7% | 67.4% | 61.6% | 68.0% | 76.0% | 72.9% | 67.6% | 64.0% | 65.8% | 60.1% |
| Calendar year loss ratio | 75.6% | 75.5% | 75.3% | 75.6% | 85.8% | 75.7% | 75.5% | 78.8% | 75.2% | 74.1% | 74.4% | 115.1% | 75.1% |
| Pts of dev. favorable/ (unfavorable) | 2.0% | 2.5% | 1.4% | -2.3% | -16.8% | | | | | | | | |
| Accident year loss ratio | 77.6% | 78.0% | 76.7% | 73.3% | 69.0% | | | | | | | | |
| Each point = | $0.03 | $0.04 | $0.04 | $0.05 | $0.06 | $0.08 | $0.09 | $0.01 | $0.01 | $0.01 | $0.02 | $0.02 | $0.02 |
| ***Investment Income Analysis - Gen. Insur.*** | | | | | | | | | | | | | |
| Amortized cost investment balance | 36,687.2 | 39,810.1 | 43,037.2 | 40,355.7 | 45,422.3 | 57,398.4 | 74,961.2 | 40,355.7 | 43,358.4 | 42,786.0 | 43,576.3 | 45,422.3 | 43,709.0 |
| change yr/yr | 23.4% | 8.5% | 8.1% | -6.2% | 12.6% | 26.4% | 30.6% | -6.2% | 4.4% | 1.5% | 8.8% | 12.6% | 0.8% |
| Calculated pretax yield | 6.6% | 6.6% | 6.5% | 6.9% | 6.4% | 5.9% | 6.0% | 7.4% | 7.1% | 6.3% | 6.1% | 6.1% | 6.0% |
| Calculated after-tax yield | 5.3% | 5.1% | 5.0% | 5.2% | 4.9% | 4.5% | 4.6% | 5.6% | 5.4% | 4.8% | 4.7% | 4.6% | 4.6% |
| Invested assets at market | 39,858.2 | 39,261.1 | 43,412.2 | 43,158.7 | 53,804.3 | 65,780.4 | 83,343.2 | 43,158.7 | 44,604.4 | 45,904.0 | 51,958.3 | 53,804.3 | 52,091.0 |
| change yr/yr | 20.9% | -1.5% | 10.6% | -0.6% | 24.7% | 22.3% | 26.7% | -0.6% | 2.9% | 5.8% | 17.7% | 24.7% | 16.8% |

*Source: Company data, Morgan Stanley Research*



**Please see analyst certification and important disclosures starting on page 2.**

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Exhibit 19

## Morgan Stanley P-C Insurance Universe Valuations —Part I

| Rating | Company | TKR | Price 4/9/03 | Tgt. Price | Upside Poten. | 52-Week High | 52-Week Low | Div Yld | Shrs (Mil) | Mkt Cap (Mil) | Oper. Earnings Per Shr. 2002A | 2003E | 2004E | P/E Ratio 2002A | 2003E | 2004E | Rel. P/E to S&P 2002A | 2003E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Diversified** | | | | | | | | | | | | | | | | | | |
| E | ACE Ltd. | ACE | $30.89 | N/A | N/A | $44.98 | $22.01 | 2.2% | 262.7 | $8,114 | $1.80 | $3.92 | $4.06 | 17.2 | 7.9 | 7.6 | 93.8% | 46.7% |
| E | AIG | AIG | $53.65 | N/A | N/A | $75.54 | $42.92 | 0.4% | 2,604.5 | $139,737 | $2.70 | $3.65 | $4.20 | 19.9 | 14.7 | 12.8 | 108.6% | 87.0% |
| O | Berkshire Hathaway | BRK.A | $69,300 | $103,000 | 48.6% | $78,500 | $59,600 | 0.0% | 1.5 | $106,352 | $2,546 | $3,415 | $3,836 | 27.2 | 20.3 | 18.1 | 148.8% | 120.1% |
| NR | Cincinnati Financial * | CINF | $36.22 | N/A | N/A | $47.30 | $32.43 | 2.8% | 162.0 | $5,868 | $1.84 | $2.06 | $2.30 | 19.7 | 17.6 | 15.7 | 107.6% | 104.3% |
| O | Hartford Fncl. | HIG | $38.38 | $54 | 40.7% | $70.24 | $31.84 | 2.8% | 255.2 | $9,795 | $4.65 | $4.70 | $5.30 | 8.3 | 8.2 | 7.2 | 45.1% | 48.3% |
| O-V | Travelers PC | TAP'A | $15.02 | $22 | 46.5% | $21.05 | $11.75 | 0.0% | 1,004 | $15,079 | $0.12 | $1.59 | $1.75 | 125 | 9 | 9 | 684.1% | 55.9% |
| E | XL Capital | XL | $74.95 | N/A | N/A | $99.00 | $58.45 | 2.6% | 136.1 | $10,198 | $5.10 | $7.69 | $9.30 | 14.7 | 9.7 | 8.1 | 80.3% | 57.7% |
| **Average** | | | | | | | | **1.5%** | | **$42,163** | | | | **33.2** | **12.6** | **11.2** | **181.2%** | **74.3%** |
| **Specialty** | | | | | | | | | | | | | | | | | | |
| NR | CNA Financial * | CNA | $22.65 | N/A | N/A | $30.99 | $21.21 | 0.0% | 223.5 | $5,065 | $1.78 | $2.65 | $3.28 | 12.7 | 8.6 | 6.9 | 69.5% | 50.6% |
| U | Chubb Corp | CB | $46.19 | N/A | N/A | $78.64 | $41.78 | 3.1% | 171.2 | $7,908 | $1.16 | $3.90 | $5.90 | 39.8 | 11.8 | 7.8 | 217.6% | 70.1% |
| NR | Markel Corp* | MKL | $224.98 | N/A | N/A | $232.00 | $175.00 | 0.0% | 9.8 | $2,205 | $4.44 | $12.01 | $15.71 | 50.7 | 18.7 | 14.3 | 276.9% | 110.9% |
| NR | Philadel. Cons.* | PHLY | $37.64 | N/A | N/A | $48.15 | $26.24 | 0.0% | 21.6 | $814 | $1.73 | $2.67 | $3.14 | 21.8 | 14.1 | 12.0 | 118.9% | 83.6% |
| E | St. Paul Cos | SPC | $33.85 | N/A | N/A | $50.60 | $23.00 | 3.4% | 226.8 | $7,677 | $1.24 | $3.95 | $4.05 | 27.3 | 8.6 | 8.4 | 149.2% | 50.7% |
| O | W.R. Berkley | BER | $42.20 | $44 | 4.3% | $43.61 | $29.90 | 0.9% | 55.2 | $2,330 | $3.04 | $4.30 | $5.00 | 13.9 | 9.8 | 8.4 | 75.9% | 58.2% |
| **Average** | | | | | | | | **1.2%** | | **$4,333** | | | | **27.7** | **11.9** | **9.6** | **151.3%** | **70.7%** |
| **Personal Lines** | | | | | | | | | | | | | | | | | | |
| E | Allstate | ALL | $35.22 | N/A | N/A | $41.95 | $30.05 | 2.6% | 701.1 | $24,693 | $2.92 | $3.20 | $3.60 | 12.1 | 11.0 | 9.8 | 65.9% | 66.2% |
| NR | Mercury General* | MCY | $38.71 | N/A | N/A | $51.15 | $33.50 | 3.4% | 54.3 | $2,101 | $2.05 | $2.64 | $3.02 | 18.9 | 14.7 | 12.8 | 103.2% | 86.8% |
| E | Progressive | PGR | $64.56 | N/A | N/A | $65.63 | $44.75 | 0.2% | 218.0 | $14,074 | $3.22 | $4.14 | $4.19 | 20.0 | 15.6 | N/A | 109.6% | 92.3% |
| O | SAFECO | SAFC | $36.00 | $40 | 11.1% | $38.01 | $24.99 | 2.1% | 138.2 | $4,974 | $2.02 | $2.87 | $3.60 | 17.8 | 12.5 | 10.0 | 97.4% | 74.3% |
| **Average** | | | | | | | | **2.1%** | | **$11,460** | | | | **17.2** | **13.5** | **10.9** | **94.0%** | **79.6%** |
| **Reinsurance** | | | | | | | | | | | | | | | | | | |
| O | Everest Re | RE | $58.67 | $75 | 27.8% | $72.20 | $42.59 | 0.6% | 50.9 | $2,985 | $5.14 | $6.70 | $7.00 | 11.4 | 8.8 | 8.4 | 62.4% | 51.8% |
| O | IPC Holdings | IPCR | $31.07 | $35 | 12.6% | $34.78 | $25.62 | 0.0% | 48.2 | $1,498 | $4.20 | $4.20 | $4.40 | 7.4 | 7.4 | 7.1 | 40.4% | 43.8% |
| E | Max Re Capital** | MXRE | $12.73 | N/A | N/A | $16.15 | $7.50 | 0.6% | 38.0 | $484 | ($0.27) | $0.80 | $1.50 | (47.1) | 15.9 | 8.5 | NM | 94.2% |
| NR | Odyssey Re Hldgs* | ORH | $19.04 | N/A | N/A | $20.25 | $12.87 | 0.5% | 65.1 | $1,240 | $1.28 | $1.69 | $1.96 | 14.9 | 11.3 | 9.7 | 81.3% | 66.6% |
| U | PartnerRe | PRE | $53.36 | N/A | N/A | $57.40 | $38.95 | 2.2% | 52.9 | $2,823 | $3.60 | $5.75 | $5.35 | 14.8 | 9.3 | 10.0 | 81.0% | 54.9% |
| E | Renaissance Re | RNR | $40.75 | N/A | N/A | $44.19 | $30.51 | 1.5% | 69.8 | $2,842 | $5.20 | $5.50 | $6.00 | 7.8 | 7.4 | 6.8 | 42.8% | 43.9% |
| E-V | Montpelier Re | MRH | $29.00 | N/A | N/A | $30.35 | $21.40 | 0.0% | 63.4 | $1,838 | $2.60 | $3.15 | $3.70 | 11.2 | 9.2 | 7.8 | 61.0% | 54.5% |
| NR | Arch Capital Group* | ACGL | $33.95 | N/A | N/A | $35.17 | $22.85 | 0.0% | 54.2 | $1,840 | $1.59 | $2.54 | $3.29 | 21.4 | 13.3 | 10.3 | 116.7% | 79.0% |
| NR | Transatlantic Hldgs* | TRH | $68.10 | N/A | N/A | $89.66 | $60.25 | 0.6% | 52.3 | $3,562 | $3.28 | $5.27 | $6.26 | 20.8 | 12.9 | 10.9 | 113.5% | 76.4% |
| NR | Platinum Underwriters* | PTP | $25.25 | N/A | N/A | $26.79 | $21.29 | 0.0% | 43.0 | $1,086 | $0.15 | $2.02 | $2.94 | 168.3 | 12.5 | 8.6 | NM | 74.1% |
| **Average** | | | | | | | | **0.6%** | | **$2,020** | | | | **23.1** | **10.8** | **8.8** | **74.9%** | **63.9%** |
| **Total Insurance Average** | | | | | | | | **1.2%** | | **$14,340** | | | | **25.8** | **11.9** | **9.9** | **126.1%** | **70.5%** |
| **Total Ins Avg Ex AIG & BRK** | | | | | | | | **1.3%** | | **$5,644** | | | | **26.0** | **11.5** | **9.4** | **125.8%** | **67.8%** |
| **Risk Management** | | | | | | | | | | | | | | | | | | |
| E-V | Aon Corp. | AOC | $22.04 | N/A | N/A | $39.63 | $13.30 | 2.7% | 308.3 | $6,750 | $1.47 | $1.88 | $2.12 | 15.0 | 11.7 | 10.4 | 81.9% | 69.4% |
| U | Arthur J. Gallagher | AJG | $25.67 | N/A | N/A | $37.20 | $21.70 | 2.8% | 88.5 | $2,272 | $1.41 | $1.77 | $2.03 | 18.2 | 14.5 | 12.6 | 99.5% | 85.9% |
| E | Marsh & McLennan | MMC | $45.81 | N/A | N/A | $67.00 | $34.61 | 2.4% | 538.0 | $24,646 | $2.45 | $2.68 | $3.00 | 18.7 | 17.1 | 15.3 | 102.2% | 101.2% |
| E | Willis Group Hldgs | WSH | $28.77 | N/A | N/A | $37.14 | $23.48 | 1.7% | 147.0 | $4,229 | $1.62 | $2.00 | $2.30 | 17.8 | 14.4 | 12.5 | 97.1% | 85.2% |
| **Average** | | | | | | | | **2.4%** | | **$9,474** | | | | **17.4** | **14.4** | **12.7** | **95.2%** | **85.4%** |
| **Financial Guarantors** | | | | | | | | | | | | | | | | | | |
| U | AMBAC Inc. | ABK | $53.29 | N/A | N/A | $71.25 | $43.79 | 0.8% | 109.0 | $5,809 | $4.68 | $5.16 | $5.75 | 11.4 | 10.3 | 9.3 | 62.2% | 61.1% |
| U | MBIA | MBI | $41.06 | N/A | N/A | $57.50 | $34.14 | 1.9% | 145.0 | $5,954 | $4.27 | $4.37 | $4.82 | 9.6 | 9.4 | 8.5 | 52.6% | 55.6% |
| **Average** | | | | | | | | **1.3%** | | **$5,881** | | | | **10.5** | **9.9** | **8.9** | **57.4%** | **58.4%** |
| | **S&P 500** | | **$878.29** | | | **$1,132.94** | **$768.63** | | | | **$48.00** | **$52.00** | **$55.00** | **18.3** | **16.9** | **16.0** | | |

*Source: Company data, Morgan Stanley Research Ratings: O=Overweight, E=Equal Weight, U=Underweight, NR=Not Rated 'A = Actual E = Morgan Stanley Research Estimates NA = Not Available V=Volatile Rating * Stock is not covered by Morgan Stanley Research, all estimated data is First Call consensus figures. ** MXRE data is based on net earnings and not operating earnings*



**Please see analyst certification and important disclosures starting on page 2.**

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Exhibit 20

## Morgan Stanley P-C Insurance Universe Valuations —Part II

| Rating | Company | TKR | Historical Range Hi P/E | Low P/E | Avg P/E | Hi P/B | Low P/B | Avg P/B | Cons. Op. EPS 2003E | 2004E | Book Value Incl. FAS 115 | Excl. FAS 115 | TBVPS | Price to Book Value Incl. FAS | Excl. FAS | TBVPS | 2003E | 2004E | Total ROE 02A Inc FAS | 03E Inc FAS |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Diversified** | | | | | | | | | | | | | | | | | | | | |
| E | ACE Ltd. | ACE | 18.2 | 7.6 | 13.0 | 2.2 | 0.8 | 1.4 | $4.06 | $4.67 | $24.16 | $22.66 | $13.96 | 1.3 | 1.4 | 2.2 | 1.2 | 1.0 | 1.4% | 15.8% |
| E | AIG | AIG | 38.0 | 10.7 | 19.5 | 5.7 | 0.8 | 2.4 | $3.83 | $4.36 | $22.38 | $22.31 | $20.15 | 2.4 | 2.4 | 2.7 | 2.1 | 1.8 | 10.0% | 15.3% |
| O | Berkshire Hathaway | BRK.A | 83.6 | 18.0 | 44.8 | 2.2 | 1.4 | 1.7 | $3.148 | $3.705 | $41,727 | $32,428 | $27,198 | 1.7 | 2.1 | 2.5 | 1.5 | 1.4 | 8.6% | 7.9% |
| NR | Cincinnati Financial * | CINF | 58.5 | 5.1 | 17.0 | 1.8 | 0.7 | 1.2 | $2.06 | $2.30 | $34.65 | $12.10 | $34.65 | 1.0 | 3.0 | 1.0 | NA | NA | N/A | N/A |
| O | Hartford Fncl. | HIG | 17.7 | 11.2 | 14.7 | 2.4 | 1.2 | 1.8 | $4.61 | $5.19 | $42.06 | $37.77 | $35.32 | 0.9 | 1.0 | 1.1 | 0.9 | 0.9 | 10.1% | 4.3% |
| O-V | Travelers PC | TAPB | N/A | N/A | N/A | N/A | N/A | N/A | $1.62 | $1.70 | $10.10 | $9.38 | $7.70 | 1.5 | 1.6 | 2.0 | 1.3 | 1.2 | -0.3% | 14.8% |
| E | XL Capital | XL | 20.4 | 4.5 | 12.4 | 2.4 | 1.1 | 1.5 | $8.04 | $9.34 | $44.48 | $45.23 | $32.33 | 1.7 | 1.7 | 2.3 | 1.5 | 1.3 | 7.5% | 15.2% |
| **Average** | | | **39.4** | **9.5** | **20.2** | **2.8** | **1.0** | **1.7** | | | | | | **1.5** | **1.9** | **2.0** | **1.4** | **1.3** | **6.2%** | **12.2%** |
| **Specialty** | | | | | | | | | | | | | | | | | | | | |
| NR | CNA Financial * | CNA | 238.5 | 3.7 | 29.7 | 2.0 | 0.4 | 1.0 | $2.65 | $3.28 | $38.90 | $37.20 | $38.12 | 0.6 | 0.6 | 0.6 | NA | NA | N/A | N/A |
| U | Chubb Corp | CB | 49.7 | 10.4 | 15.7 | 2.3 | 1.1 | 1.6 | $4.69 | $5.71 | $40.06 | $36.61 | $37.56 | 1.2 | 1.3 | 1.2 | 1.1 | 1.0 | 3.3% | 9.4% |
| NR | Markel Corp* | MKL | 28.5 | 4.9 | 7.7 | 2.8 | 0.7 | 1.7 | $12.01 | $15.71 | $117.89 | $99.67 | $117.85 | 1.9 | 2.3 | 1.9 | NA | NA | N/A | N/A |
| NR | Philadel. Cons.* | PHLY | 21.9 | 7.0 | 15.2 | 2.5 | 1.1 | 1.7 | $2.67 | $3.14 | $21.85 | $21.11 | $20.67 | 1.7 | 1.8 | 1.8 | NA | NA | N/A | N/A |
| E | St. Paul Cos. | SPC | 22.6 | 5.3 | 13.4 | 1.6 | 0.9 | 1.3 | $3.78 | $4.34 | $25.05 | $22.39 | $20.58 | 1.4 | 1.6 | 1.6 | 1.2 | 1.1 | 4.0% | 15.6% |
| O | W.R. Berkley | BER | 31.1 | 11.6 | 17.6 | 1.8 | 0.8 | 1.3 | $4.40 | $5.48 | $24.18 | $22.01 | $23.11 | 1.7 | 1.9 | 1.8 | 1.5 | 1.3 | 15.3% | 17.0% |
| **Average** | | | **65.0** | **7.2** | **16.5** | **2.2** | **0.8** | **1.4** | | | | | | **1.4** | **1.6** | **1.5** | **1.3** | **1.1** | **7.5%** | **14.0%** |
| **Personal Lines** | | | | | | | | | | | | | | | | | | | | |
| E | Allstate | ALL | 39.8 | 8.8 | 13.2 | 2.5 | 1.0 | 1.7 | $3.32 | $3.72 | $24.75 | $22.35 | $24.33 | 1.4 | 1.6 | 1.4 | 1.3 | 1.2 | 6.4% | 12.5% |
| NR | Mercury General* | MCY | 23.9 | 4.3 | 12.0 | 4.7 | 1.0 | 2.1 | $2.06 | $2.65 | $20.21 | $19.44 | $20.08 | 1.9 | 2.0 | 1.9 | NA | NA | N/A | N/A |
| E | Progressive | PGR | 40.1 | 10.4 | 45.2 | 4.8 | 1.6 | 2.8 | $3.84 | $4.01 | $17.28 | $16.50 | $17.28 | 3.7 | 3.9 | 3.7 | 3.2 | 2.9 | 19.0% | 22.6% |
| O | SAFECO | SAFC | 51.0 | 4.3 | 13.2 | 1.4 | 0.6 | 1.1 | $2.66 | $3.20 | $32.07 | $23.52 | $30.70 | 1.1 | 1.5 | 1.2 | 1.1 | 1.0 | 7.5% | 8.7% |
| **Average** | | | **38.7** | **6.9** | **20.9** | **3.4** | **1.1** | **1.9** | | | | | | **2.0** | **2.3** | **2.1** | **1.8** | **1.7** | **11.0%** | **14.6%** |
| **Reinsurance** | | | | | | | | | | | | | | | | | | | | |
| O | Everest Re | RE | 17.6 | 6.4 | 12.6 | 2.1 | 0.8 | 1.3 | $6.92 | $8.00 | $46.55 | $42.20 | $46.55 | 1.3 | 1.4 | 1.3 | 1.1 | 1.0 | 11.3% | 13.0% |
| O | IPC Holdings | IPCR | 12.8 | 5.6 | 8.4 | 1.6 | 0.6 | 1.1 | $4.26 | $4.59 | $26.79 | $25.96 | $26.79 | 1.2 | 1.2 | 1.2 | 1.0 | 0.9 | 13.2% | 14.7% |
| E | Max Re Capital** | MXRE | N/A | N/A | N/A | N/A | N/A | N/A | $0.90 | $1.39 | $15.73 | $14.66 | $15.73 | 0.8 | 0.9 | 0.8 | 0.8 | 0.7 | -1.0% | 5.0% |
| NR | Odyssey Re Hldgs* | ORH | N/A | N/A | N/A | N/A | N/A | N/A | $1.69 | $1.96 | $16.25 | $16.25 | $15.96 | 1.2 | 1.2 | 1.2 | NA | NA | N/A | N/A |
| U | PartnerRe | PRE | 17.6 | 6.4 | 9.4 | 1.7 | 1.0 | 1.3 | $5.99 | $6.88 | $34.89 | $33.21 | $26.69 | 1.5 | 1.6 | 2.0 | 1.4 | 1.2 | 14.0% | 8.2% |
| E | Renaissance Re | RNR | 11.4 | 4.2 | 7.0 | 2.2 | 1.2 | 1.5 | $5.56 | $6.01 | $21.39 | $20.03 | $21.39 | 1.9 | 2.0 | 1.9 | 1.6 | 1.3 | 28.4% | 23.2% |
| E-V | Montpelier Re | MRH | N/A | N/A | N/A | N/A | N/A | N/A | $3.22 | $3.82 | $18.80 | $18.26 | $18.80 | 1.5 | 1.6 | 1.5 | 1.3 | 1.1 | 14.4% | 15.8% |
| NR | Arch Capital Group* | ACGL | N/A | N/A | N/A | N/A | N/A | N/A | $2.54 | $3.29 | $21.20 | $20.58 | $20.16 | 1.6 | 1.6 | 1.7 | NA | NA | N/A | N/A |
| NR | Transatlantic Hldgs* | TRH | 18.4 | 7.0 | 12.2 | 2.3 | 1.0 | 1.6 | $5.27 | $6.26 | $39.01 | $37.13 | $39.01 | 1.7 | 1.8 | 1.7 | NA | NA | N/A | N/A |
| NR | Platinum Underwriters* | PTP | N/A | N/A | N/A | N/A | N/A | N/A | $2.02 | $2.94 | $21.42 | $21.18 | $21.42 | 1.2 | 1.2 | 1.2 | NA | NA | N/A | N/A |
| **Average** | | | **15.6** | **5.9** | **9.9** | **2.0** | **0.9** | **1.4** | | | | | | **1.4** | **1.5** | **1.4** | **1.2** | **1.1** | **13.4%** | **13.3%** |
| **Total Insurance Average** | | | **40.9** | **7.5** | **16.9** | **2.5** | **0.9** | **1.6** | | | | | | **1.5** | **1.7** | **1.7** | **1.4** | **1.2** | **9.6%** | **13.3%** |
| **Total Ins Avg Ex AIG & BRK** | | | **38.8** | **6.8** | **15.2** | **2.4** | **0.9** | **1.5** | | | | | | **1.5** | **1.7** | **1.6** | **1.3** | **1.2** | **9.7%** | **13.5%** |
| **Risk Management** | | | | | | | | | | | | | | | | | | | | |
| E-V | Aon Corp. | AOC | 32.5 | 6.6 | 15.5 | 4.3 | 1.1 | 1.9 | $1.97 | $2.29 | $12.73 | $15.85 | NM | 1.7 | 1.4 | NM | 1.6 | 1.5 | 12.6% | 14.9% |
| U | Arthur J. Gallagher | AJG | 32.6 | 8.6 | 15.6 | 8.7 | 2.3 | 4.1 | $1.83 | $2.16 | $5.96 | $5.96 | NM | 4.3 | 4.3 | NM | 3.4 | 2.9 | 31.1% | 27.2% |
| E | Marsh & McLennan | MMC | 33.2 | 8.5 | 16.1 | 8.9 | 1.8 | 4.4 | $2.74 | $3.11 | $9.33 | $10.17 | NM | 4.9 | 4.5 | NM | 4.5 | 4.2 | 26.6% | 28.5% |
| E | Willis Group Hldgs | WSH | N/A | N/A | N/A | N/A | N/A | N/A | $2.04 | $2.38 | $5.78 | $6.67 | NM | 5.0 | 4.3 | NM | 4.2 | 3.4 | 27.2% | 27.5% |
| **Average** | | | **32.8** | **7.9** | **15.7** | **7.3** | **1.7** | **3.5** | | | | | | **4.0** | **3.6** | **NM** | **3.4** | **3.0** | **24.4%** | **24.5%** |
| **Financial Guarantors** | | | | | | | | | | | | | | | | | | | | |
| U | AMBAC Inc. | ABK | 17.9 | 7.0 | 11.2 | 2.4 | 0.9 | 1.5 | $5.22 | $5.84 | $24.20 | $31.19 | NM | 1.6 | 1.7 | NM | 1.4 | 1.2 | 13.1% | 14.5% |
| U | MBIA | MBI | 17.7 | 5.3 | 11.0 | 2.3 | 0.7 | 1.4 | $4.45 | $4.86 | $37.95 | $34.21 | NM | 1.1 | 1.2 | NM | 1.0 | 0.9 | 11.3% | 11.1% |
| **Average** | | | **17.8** | **6.2** | **11.1** | **2.4** | **0.8** | **1.4** | | | | | | **1.3** | **1.5** | **NM** | **1.2** | **1.1** | **12.2%** | **12.8%** |

*Source: Company data, Morgan Stanley Research Ratings: O=Overweight, E=Equal Weight, U=Underweight, NR=Not Rated 'A = Actual E = Morgan Stanley Research Estimates NA = Not Available V= Volatile Rating * Stock is not covered by Morgan Stanley Research, all estimated data is First Call consensus figures. ** MXRE data is based on net earnings and not operating earnings*



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## Analyst Certification

The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report: Alice Schroeder.

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In the next 3 months, Morgan Stanley expects to receive or intends to seek compensation for investment banking services from American Int'l Grp.

The research analysts, strategists, or research associates principally responsible for the preparation of this research report have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors, firm revenues and overall investment banking revenues.

### Global Stock Ratings Distribution

*(as of Mar 31, 2003)*

| | Coverage Universe | | Investment Banking Clients (IBC) | | |
|---|---|---|---|---|---|
| Stock Rating Category | Count | % of Total | Count | % of Total IBC | % of Rating Category |
| **Overweight** | 593 | 32% | 237 | 39% | 40% |
| **Equal-weight** | 861 | 47% | 270 | 44% | 31% |
| **Underweight** | 395 | 21% | 108 | 18% | 27% |
| **Total** | 1,849 | | 615 | | |

*Data include common stock and ADRs currently assigned ratings. For disclosure purposes (in accordance with NASD and NYSE requirements), we note that Overweight, our most positive stock rating, most closely corresponds to a buy recommendation; Equal-weight and Underweight most closely correspond to neutral and sell recommendations, respectively. However, Overweight, Equal-weight, and Underweight are not the equivalent of buy, neutral, and sell but represent recommended relative weightings (see definitions below). An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.*

### Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stocks's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V). We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months. Ratings prior to March 18, 2002: SB=Strong Buy; OP=Outperform; N=Neutral; UP=Underperform. For definitions, please go to www.morganstanley.com/companycharts.

### Analyst Industry Views

Attractive (A). The analyst expects the performance of his or her industry coverage universe to be attractive vs. the relevant broad market benchmark over the next 12-18 months.

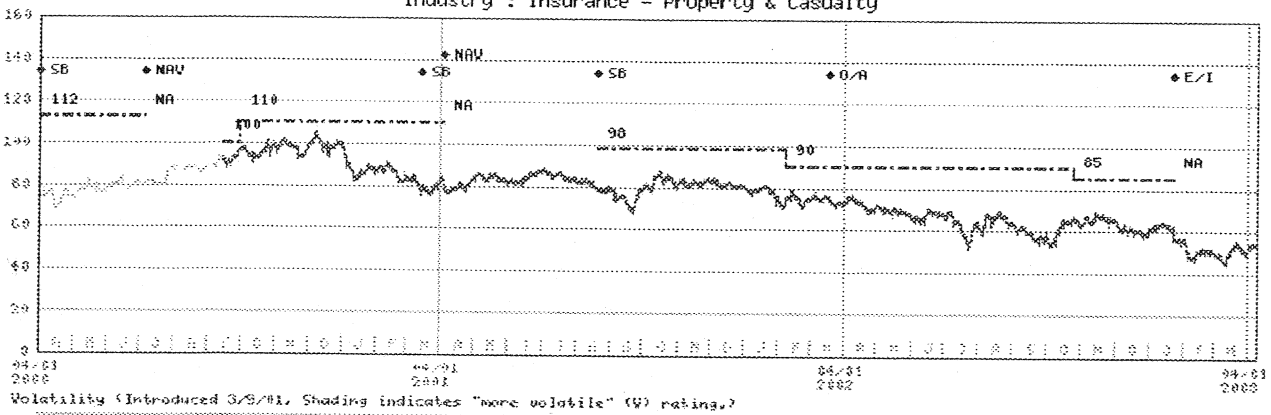
In-Line (I). The analyst expects the performance of his or her industry coverage universe to be in line with the relevant broad market benchmark over the next 12-18 months.

Cautious (C). The analyst views the performance of his or her industry coverage universe with caution vs. the relevant broad market benchmark over the next 12-18 months.

*Stock price charts and rating histories for companies discussed in this report are available at www.morganstanley.com/companycharts. You may also request this information by writing to Morgan Stanley at 1585 Broadway, 14th Floor (Attention: Research Disclosures), New York, NY, 10036 USA.*

## Stock Price, Price Target and Rating History (See Rating Definitions)

American Int'l Grp (AIG.N) - As of 4/7/03 in USD
Industry : Insurance - Property & Casualty




Volatility (Introduced 3/9/01, Shading indicates "more volatile" (V) rating.)

Stock Rating History: 2/28/00 : SB; 7/6/00 : NAV; 3/14/01 : SB; 4/4/01 : NAV; 8/21/01 : SB; 3/18/02 : O/A; 1/24/03 : E/I

Price Target History: 2/28/00 : 112; 7/6/00 : NA; 9/14/00 : 100; 9/29/00 : 110; 4/4/01 : NA; 8/21/01 : 98; 2/8/02 : 90; 10/25/02 : 85; 1/24/03 : NA

Source: Morgan Stanley Research  Date Format : MM/DD/YY  Price Target ---  No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) ---- Stock Price (Covered by Current Analyst) ****
Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) +
Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAV)
Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAV)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

## Other Important Disclosures

For a discussion, if applicable, of the valuation methods used to determine the price targets included in this summary and the risks related to achieving these targets, please refer to the latest relevant published research on these stocks. Research is available through your sales representative or on Client Link at www.morganstanley.com and other electronic systems.

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**Additional information on recommended securities is available on request.**

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## INDUSTRY COVERAGE: INSURANCE - PROPERTY & CASUALTY

| Company | Ticker | Rating | as of | Price at 4/4/03 |
|---|---|---|---|---|
| ACE Limited | ACE.N | E | 7/31/02 | $31.71 |
| Allstate Corporation | ALL.N | E | 1/24/03 | $35.16 |
| AMBAC Inc. | ABK.N | U | 3/18/02 | $54.30 |
| American Int'l Grp | AIG.N | E | 1/24/03 | $53.66 |
| Aon Corporation | AOC.N | E | 3/18/02 | $21.61 |
| Arthur J. Gallagher & Co. | AJG.N | U | 3/18/02 | $25.86 |
| Berkshire Hathaway Inc. | BRKa.N | O | 3/18/02 | $69,200.00 |
| Everest Re Group, Ltd. | RE.N | O | 1/24/03 | $59.64 |
| IPC Holdings, Ltd. | IPCR.O | O | 7/24/02 | $31.28 |
| Marsh & McLennan | MMC.N | E | 1/24/03 | $44.90 |
| Max Re Capital Limited | MXRE.O | E | 1/24/03 | $12.58 |
| MBIA | MBI.N | U | 1/24/03 | $41.05 |
| Montpelier Re Holdings, Ltd. | MRH.N | E | 11/20/02 | $27.91 |
| PartnerRe Ltd. | PRE.N | U | 1/24/03 | $53.28 |
| RenaissanceRe Holdings Ltd. | RNR.N | E | 3/18/02 | $41.05 |
| SAFECO Corporation | SAFC.O | O | 7/23/02 | $36.21 |
| St. Paul Companies, Inc. | SPC.N | E | 5/24/02 | $33.85 |
| The Chubb Corporation | CB.N | U | 5/24/02 | $45.99 |
| The Progressive Corporation | PGR.N | E | 1/24/03 | $63.82 |
| Travelers Property Casualty | TAPa.N | O | 1/24/03 | $14.55 |
| W.R. Berkley Corp. | BER.N | O | 3/18/02 | $42.60 |
| Willis Group Holdings | WSH.N | E | 3/18/02 | $28.15 |
| XL Capital Ltd. | XL.N | E | 1/24/03 | $75.17 |

*Stock ratings are subject to change. Please see latest research for each company.*

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