

**Report of the**  
**Multistate Targeted Market Conduct Examination**

for the

**Delaware Department of Insurance**

**Florida Office of Insurance Regulation**

**Indiana Department of Insurance**

**Massachusetts Division of Insurance**

**Minnesota Department of Commerce**

**New York Insurance Department**

**Pennsylvania Insurance Department**

**Rhode Island Division of Insurance**

and

**Other Participating Jurisdictions:** Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Vermont, Washington, West Virginia, Wisconsin and Wyoming

of

**American International Group, Inc.**

**180 Maiden Lane  
New York, New York 10038  
NAIC Group # 0012**

**AIU Insurance Company NAIC #19399  
American Home Assurance Company NAIC #19380  
Chartis Casualty Company NAIC #40258  
Chartis Property Casualty Company NAIC #19402  
Commerce and Industry Insurance Company NAIC #19410  
Granite State Insurance Company NAIC #23809  
Illinois National Insurance Co. NAIC #23817  
Landmark Insurance Company NAIC #35637  
National Union Fire Insurance Company of Pittsburgh, Pa. NAIC #19445  
New Hampshire Insurance Company NAIC #23841  
The Insurance Company of the State of Pennsylvania NAIC #19429**

**December 20, 2010**

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# RACKEMANN SAWYER & BREWSTER

PROFESSIONAL CORPORATION  
COUNSELLORS AT LAW

Established 1886

December 20, 2010

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Dear Commissioners Stewart, McCarty, Robertson, Murphy, Wilson, and Pratter and Superintendents Wrynn and Torti:

Pursuant to the authority granted by 18 DELAWARE CODE, title 18, § 318, FLORIDA STATUTES § 624.316, INDIANA CODE § 27-1-3.1-8, MASSACHUSETTS GENERAL LAWS chapter 175, § 4, MINNESOTA STATUTES § 60A.031, NEW YORK INSURANCE LAW § 309, 40 PENNSYLVANIA STATUTES § 323.3, and RHODE ISLAND GENERAL LAWS § 37-13.1-3 (the "Examination Statutes"), and in accordance with the *NAIC Market Regulation Handbook* ("*Handbook*") and your instructions, a multistate targeted market conduct examination has been conducted of the writing and financial reporting of workers compensation insurance by:

**American International Group, Inc.**  
**and its affiliated companies**  
(collectively, the "Company")

The report of examination is herewith respectfully submitted.

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## **Foreword**

This report on the multistate targeted market conduct examination of the Company is provided pursuant to the *Handbook* and is made by exception. Additional practices, procedures, and files subject to review during the examination were omitted from the report if no improprieties were noted.

The Company was informed on January 28, 2008 that a Multistate Targeted Workers Compensation Market Conduct Examination (the “Examination”) had been called respecting the Company’s writing and financial reporting of workers compensation insurance. The Examination was conducted under the authority of the Examination Statutes. The Lead States in the Examination (as defined in the *Handbook*) are Delaware, Florida, Indiana, Massachusetts, Minnesota, New York, Pennsylvania, and Rhode Island (“Lead States”). The remaining forty-two states and the District of Columbia are Participating States in the Examination (as defined in the *Handbook*) (“Participating States”).

The Examination was called in response to a 2005 investigation by the New York Attorney General (initially relating to other topics) during which concerns relating to the Company’s practices in the writing and reporting of workers compensation insurance arose. The New York Attorney General and Superintendent of Insurance investigated those issues which then gave rise to a number of additional individual state examinations. The Market Analysis Working Group of the National Association of Insurance Commissioners then unanimously endorsed the commencement of this multistate examination.

## **Profile of the Companies**

American International Group, Inc. is the parent company in an insurance holding company system which includes insurance companies and other entities doing business in all the states of the United States, and the District of Columbia. The parent company is a publicly traded company. Workers compensation insurance, general liability insurance, and commercial automobile insurance are among the lines of business that members of the holding company system are authorized to write. The Company operates its U.S. property-casualty insurance business principally through Divisions, and management of these entities is integrated at the holding company level.

The Company wrote relatively little workers compensation insurance in the years prior to 1976. Beginning in the late-1970s the Company established two Divisions (50 and 55) for the purpose of writing workers compensation, general liability, and commercial automobile coverage for large and “jumbo” risks. Administration of these Divisions, originally separate, was merged in the mid-1980s under the management of AIG Risk Management, Inc. (“AIGRM”). By 1996, growth in the AIGRM-managed entities had allowed the Company to expand its market share from a small position in 1976 to being among the very largest writers of workers compensation insurance.

## **Examination Purpose, Scope, Structure, and Results**

The purpose of the Examination was to determine if the Company’s writing and financial reporting of workers compensation insurance was in compliance with applicable law. The Examination’s scope included all U.S. jurisdictions and all periods in which the Company wrote workers compensation insurance.

The Examination benefited greatly from the work undertaken by the previous state examinations conducted by Indiana, Minnesota, and Rhode Island as well as the work of the New York Insurance Department and New York Attorney General. Initially, the Examiners reviewed materials produced by the Company to these previous investigators including “whistleblower” documents, corporate level memoranda and correspondence, premium and loss databases, as well as files for a number of large policyholders that had been requested by individual state examiners. In consideration of these materials, the Examiners determined that a two-track approach would be appropriate and therefore divided the Examination into a Rating and Forms Review and a Premium Reporting Review.

#### The Rating and Forms Review

The Rating and Forms Review examined the Company’s compliance with applicable rating and forms statutes by means of a random sample review. Divisions within the Company historically operated independently so the Examiners treated each Division as a separate population for sampling purposes. Statutes enacted in the majority of states liberalized rating regulation in the early to mid-1990s so, for purposes of the historical Rating and Forms Review, the Examiners limited the population to policy years prior to 1996. Further, the purpose of the review was to generate qualitative conclusions as to the Company’s practices rather than quantifying error rates so statistical credibility was not the controlling factor in determining sample size.

The Examiners randomly selected one hundred “contracts” for review from the two AIGRM-managed Divisions, 50 and 55, about which internal “whistleblowers” had made

allegations.<sup>1</sup> Thereafter, the Examiners also selected a total of fifty additional contracts<sup>2</sup> for review from the Company's largest workers compensation operations not managed by AIGRM for which accessible records presently exist.<sup>3</sup> (The results of review of these fifty accounts were not credible and therefore not included in determining error rates.) Considering the targeted nature of the Examination, the Examiners reviewed the selected contracts against the standards set forth in the *Handbook* for underwriting and rating reviews. See e.g. Standard 1 ("The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the regulated entity's rating plan"); Standard 5 ("All forms, including contracts, riders, endorsement forms and certificates are filed with the insurance department, if applicable"). Within Divisions 50 and 55 the Examiners found a broad pattern of noncompliance with both rating and forms statutes.

General areas of concern include the following:

1. *Use of Unfiled Rating Plans.* The Examiners reviewed many contracts in which the AIGRM-managed entities: rated workers compensation coverage on a "cost plus" model that generated different premiums than would have been produced by filed rating plans; established unfiled 'self-insured retentions' and unfiled deductible plans that generated lower premiums than would have been produced by filed rating plans; and priced portions of workers compensation,

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<sup>1</sup> In AIGRM's parlance, an "account" refers to the overall relationship with the insured across multiple policy years. A "contract" generally refers to all coverage written for an insured in a single policy year and may include multiple policies and lines of business.

<sup>2</sup> Records in those Divisions not managed by AIGRM were organized on a policy basis rather than by "contract". To maintain consistency between samples, the Examiners therefore randomly selected individual policies in these Divisions and requested that the Company produce records for the selected policies and all other policies written by the Company for the relevant insured in the same policy year.

<sup>3</sup> Active operations in certain of the large non-AIGRM-managed Divisions ceased prior to the advent of electronic record keeping. The Company reported that when such records were no longer needed for business purposes they were not retained. The Examiners concluded that this practice was consistent with industry standards and did not raise concerns.

general liability, and commercial automobile coverage on a combined basis in the absence of a filed rating plan providing for such pricing.<sup>4</sup> In the vast majority of cases this lead to policyholders being charged less than provided by the filed rating plan. Over 90% of the contracts where the Company produced records sufficient for the Examiners to draw a conclusion regarding compliance with the rating laws reflected non-compliance.<sup>5</sup>

2. *Use of Unfiled Forms.* While the AIGRM-managed entities generally used filed forms in the writing of workers compensation coverage, in most instances these forms were superseded and ostensibly controlled by unfiled agreements described as, among other things, “Indemnity Agreements”, “Policy & Funding Schedules”, and “Premium Deferral Agreements.” The agreements reviewed altered and were inconsistent with the terms contained in filed forms such that some portion of the “deal” with insureds was contained in these unfiled agreements. Over 90% of those contracts where the Company produced records sufficient for the Examiners to draw a conclusion regarding compliance with the forms laws reflected non-compliance.<sup>6</sup>

3. *Indications of Intentionality.* The materials in policyholder-specific files and in corporate-level documents suggests that the use of unfiled rating plans and unfiled forms was a determined business strategy.

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<sup>4</sup> The Company provided documents to support its position that the use of such programs was widespread in the industry during the relevant time period but that assertion was not tested since it was beyond the bounds of this examination.

<sup>5</sup> A significant number (well beyond the error rate threshold set forth in the *Handbook*) of contracts for which conclusions could be drawn regarding rating compliance also exhibited noncompliance with forms laws.

<sup>6</sup> Of those contracts for which conclusions could be drawn regarding forms compliance, a significant number (well beyond the error rate threshold set forth in the *Handbook*) also demonstrated non-compliance with rating laws.

### The Premium Reporting Review

The Premium Reporting Review examined the accuracy of the Company's internal recording and external reporting of workers compensation premium. In connection with this process, the firm of Merlinos & Associates, Inc. ("Merlinos") was retained as actuarial consultant. With Merlinos' assistance, the Examiners initially reviewed the Company's electronic premium and loss, corporate, and policyholder-specific records and concluded that the AIGRM-managed entities had misreported their workers compensation premium. General areas of concern included the following:

1. *Misreporting of workers compensation premium by line of business.* The AIGRM-managed entities misreported \$2.12 billion of premium collected in respect of workers compensation coverage as general or commercial automobile liability premium. This resulted in the avoidance of premium-based obligations in the workers compensation line of business.
2. *Misreporting of workers compensation premium by state.* Records reviewed by the Examiners show that the Company misreported workers compensation premium by state. This misreporting occurred as a necessary result of misreporting premium by line of business.<sup>7</sup>
3. *Deferred reporting of workers compensation premium.* Frequently, the AIGRM-managed entities deferred recognition and reporting of written premium.
4. *The Company did not remediate known misreporting.* The Company's then chief executive officer and chief financial officer, among other senior managers, received direct written notice of premium misreporting by the AIGRM-managed entities from "whistleblowers".

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<sup>7</sup> The geographical footprint of an insured's premium varies by line of business because general liability premium is often reported to the state of an insured's residence or principle place of business, commercial automobile liability premium is generally reported to the state in which vehicles are garaged, and workers compensation premium is generally reported to the states where workers are employed.

The AIGRM-managed entities continued to misreport premium, and the Company did not correct its prior financial statements.

During the course of this Examination, the AIG holding company suffered significant losses and the United States responded by providing it with substantial financial assistance; consequently, the United States Treasury controls preferred stock with voting and dividend rights to approximately 79.8% of the AIG holding company's common stock. Its Board of Directors and senior management have been changed. In recognition that the United States is now the principal shareholder of the AIG holding company and that taxpayer funds were used to effectuate this arrangement, the insurance regulatory consequences, based on the findings of this Examination, have been significantly moderated.

#### **Plan of Remediation**

The Examiners shared the foregoing results with the Company and sought to reach agreement on methods to correct the Company's premium misreporting. The Examiners determined that efforts to actually re-rate the policies of insurance written would be futile due to the large number of policyholders, the many years involved, the age of the required records, the absence of exposure data, and the range of discretionary underwriting decisions legitimately available during the period. Instead, the focus was placed on an effort to generate a principled, transparent, and reasonable premium reallocation methodology. As a result, the Examiners and the Company have agreed upon a methodology which reallocates approximately \$2.12 billion in premium from the general and commercial automobile liability lines of business to workers compensation for the calendar years 1985 to present. Table 1 below shows the agreed-upon reallocation and the net misreporting of workers compensation premium by the Company in each state.

Table 1

**Premium Reallocation Results**  
**\$2.12 Billion Reallocation**  
(Figures in millions unless otherwise noted)

State	WC Premium	AL/GL Premium	Total
AK	\$ 4.2	\$ (5.0)	\$ (0.8)
AL	\$ 36.0	\$ (32.2)	\$ 3.8
AR	\$ 23.3	\$ (16.0)	\$ 7.4
AZ	\$ 48.1	\$ (45.1)	\$ 3.0
CA	\$ 350.8	\$ (297.3)	\$ 53.5
CO	\$ 21.4	\$ (21.4)	\$ 2.9 k
CT	\$ 23.9	\$ (42.6)	\$ (18.8)
DC	\$ 3.1	\$ (7.1)	\$ (4.1)
DE	\$ 9.1	\$ (13.6)	\$ (4.5)
FL	\$ 102.8	\$ (69.4)	\$ 33.4
GA	\$ 38.6	\$ (31.0)	\$ 7.6
HI	\$ 8.4	\$ (10.9)	\$ (2.5)
IA	\$ 19.3	\$ (12.5)	\$ 6.8
ID	\$ 12.6	\$ (9.9)	\$ 2.7
IL	\$ 84.4	\$ (92.4)	\$ (8.1)
IN	\$ 22.6	\$ (31.0)	\$ (8.4)
KS	\$ 12.6	\$ (14.2)	\$ (1.6)

State	WC Premium	AL/GL Premium	Total
KY	\$ 17.0	\$ (13.6)	\$ 3.4
LA	\$ 51.1	\$ (42.8)	\$ 8.3
MA	\$ 54.7	\$ (67.2)	\$ (12.5)
MD	\$ 45.4	\$ (37.4)	\$ 8.0
ME	\$ 8.8	\$ (8.2)	\$ 0.6
MI	\$ 72.9	\$ (69.4)	\$ 3.5
MN	\$ 26.4	\$ (25.0)	\$ 1.4
MO	\$ 23.3	\$ (42.3)	\$ (19.0)
MS	\$ 13.6	\$ (12.9)	\$ 0.7
MT	\$ 6.8	\$ (4.1)	\$ 2.7
NC	\$ 29.8	\$ (32.1)	\$ (2.2)
ND	\$ -	\$ (1.1)	\$ (1.1)
NE	\$ 7.5	\$ (10.1)	\$ (2.6)
NH	\$ 7.9	\$ (12.5)	\$ (4.7)
NJ	\$ 74.8	\$ (96.5)	\$ (21.7)
NM	\$ 14.2	\$ (14.1)	\$ 0.1
NV	\$ -	\$ (5.7)	\$ (5.7)

State	WC Premium	AL/GL Premium	Total
NY	\$ 174.5	\$ (269.2)	\$ (94.7)
OH	\$ -	\$ (44.8)	\$ (44.8)
OK	\$ 58.5	\$ (48.0)	\$ 10.5
OR	\$ 25.2	\$ (22.3)	\$ 2.9
PA	\$ 172.6	\$ (138.2)	\$ 34.3
RI	\$ 25.4	\$ (13.7)	\$ 11.6
SC	\$ 12.1	\$ (11.5)	\$ 0.6
SD	\$ (3.2)	\$ (2.3)	\$ (5.5)
TN	\$ 28.7	\$ (25.4)	\$ 3.4
TX	\$ 287.3	\$ (187.5)	\$ 99.8
UT	\$ 7.8	\$ (12.0)	\$ (4.2)
VA	\$ 25.6	\$ (32.9)	\$ (7.4)
VT	\$ 10.9	\$ (10.7)	\$ 0.2
WA	\$ -	\$ (14.0)	\$ (14.0)
WI	\$ 20.7	\$ (35.5)	\$ (14.7)
WV	\$ -	\$ (4.5)	\$ (4.5)
WY	\$ -	\$ (2.1)	\$ (2.1)

In connection with the agreed premium reallocation, the Company will file amended financial reports (restated Annual Statement Page 14s) on a consolidated basis with the Lead States and Participating States. It will pay the resulting additional premium taxes and assessments to the affected states (after reflecting actual premium taxes previously paid), together with interest on those premium taxes and assessments, if any. This payment will be approximately \$46.5 million.

Aided by the efforts of the Lead States, the Company is presently seeking to reach agreement with the residual markets and guaranty funds impacted by the misreporting of premium. In addition, the Lead States and the Company have entered into a Regulatory Settlement Agreement (“RSA”) which is attached as Exhibit A.

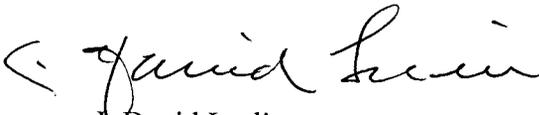
Pursuant to the RSA, the Company will pay a \$100 million fine, which will be allocated among the states as set forth in the table attached to the RSA and will enter into a Compliance Plan, also attached to the RSA, to be monitored by the Lead States.

As set forth in the Compliance Plan attached to the RSA, a Compliance Plan Examination of the Company will be conducted twenty-four months after the final effective date of the RSA based upon a review of the Company's practices during the twelve month's prior to the Compliance Plan Examination in comparison to the Compliance Plan. If the examination reveals that the Company is not in material compliance with the Compliance Plan, a fine of up to \$150 million may be imposed.

**Report Submission**

The report of examination in herewith respectfully submitted,

Sincerely,



J. David Leslie  
Examiner-in-Charge  
*Rackemann, Sawyer & Brewster, P.C.*

Examiners:

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- Ronald S. DUBY, Esq.
- Margaret L. Hayes, Esq.
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### **Acknowledgement**

The assistance of Michael Lamb, a consulting actuary, and examiners from HuffThomas who were retained in the course of the individual state examinations and assisted in the Examination is hereby acknowledged with appreciation.

**Exhibit A**

**Regulatory Settlement Agreement**