



AMB Credit Report - Business Professional

02350 Lexington Insurance Company

As of October 8, 2008

Company Information

100 Summer Street
Boston, MA 02110

Top Officer: **Shaun E. Kelly**
Top Officer's Title: **President & COO**
Secretary: **Elizabeth M. Tuck**

Telephone: **617-330-1100**
Fax: **N/A**
Web: www.aig.com

A.M.Best Number: **02350**
NAIC Number: **19437**
FEIN Number: **251149494**

History: Lexington Insurance Company began business in 1965.

Licensing: The company is licensed in Delaware. It also operates on a surplus lines or non-admitted basis in the District of Columbia, Puerto Rico, U.S. Virgin Islands, AL, AK, AZ, AR, CA, CO, CT, FL, GA, HI, ID, IL, IN, IA, KS, KY, LA, ME, MD, MA, MI, MN, MS, MO, MT, NE, NV, NH, NJ, NM, NY, NC, ND, OH, OK, OR, PA, RI, SC, SD, TN, TX, UT, VT, VA, WA, WV, WI and WY. It also operates in Great Britain, Puerto Rico, USVI and Bermuda.

Best's Ratings

Financial Strength Ratings
Rating: A pu (Excellent)
Affiliation Code: p (Pooled)
Financial Size Category: XV (\$2 Billion or greater)
Implication: Negative
Action: Downgraded Under Review
Effective Date: 9/15/2008

Issuer Credit Rating
Long-Term: a u
Implication: Negative
Action: Downgraded Under Review
Effective Date: 9/15/2008

Previous FSR Rating Event
A+ p (Superior) 5/28/2008

Security Ratings
No data available

Rating Rationale

The following text is derived from the report of Lexington Insurance Pool.

Under Review Rationale: The rating actions are based on the rapid deterioration of the already existing fragile condition of AIG's financial strength and flexibility. Specifically, AIG's lack of liquidity at the holding company level and management's need to secure funding options are not representative of financial stability and not reflective of AIG's current ratings.

AIG's ratings and under review status will be reviewed as AIG executes its plans to stabilize its financial condition. A.M. Best will need to review the \$20 billion proposed subsidiary asset internal funding mechanism and its impact on the specific subsidiaries.

AIG has been without an approved shelf registration since capital was raised in May of this year. Bank facilities have been utilized with the issuance of commercial paper. The rating actions consider the potential for additional liquidity from unanticipated internal and external sources.

Rating Rationale: The rating is based on the consolidated operating performance of American International Group's Lexington Insurance Pool and applies to the three pool members, led by Lexington Insurance Company (Lexington) and its two affiliates, AIG Excess Liability Insurance Company, Ltd. and Landmark Insurance Company.

The rating reflects Lexington's well-entrenched franchise and distinguished leadership position as the largest and most recognized excess and surplus lines insurance company in the U.S. Sustainable and competitive advantages include freedom of rate and form, deep and broad experienced management, property and casualty product proliferation, diversified distribution, geographic diversification and cross-sell opportunities within AIG's Commercial Insurance Group (formerly Domestic Brokerage Group). In addition to being a global property underwriter, Lexington maintains significant franchises in healthcare, middle market program business, primary and excess liability which is exclusive of the AIG Excess business geared toward Fortune 500 high limit/high net retention excess casualty and financial lines. Overall, Lexington maintains a 10-15 point expense advantage. These positive factors are supported by Lexington's specialized underwriting expertise, its innovative coverage approach and the competitive advantages derived from its affiliation with American International Group, Inc. (AIG)--one of the nation's largest property/casualty insurance organizations. The



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Rating Rationale

negative outlook reflects the uncertainty associated with AIG's recent earnings and capital variability caused by investment concentrations and business segment exposures to the troubled mortgage industry and credit markets.

AIG's property exposures are mainly concentrated within Lexington's excess and surplus lines businesses which have more recently been subject to rate compression beginning in mid-2007. Lexington wrote approximately \$3.6 billion gross and \$1.9 billion net of property premium in 2007. AIG's Commercial Lines Pool provides catastrophe reinsurance protection. Lexington utilizes quota share excess of loss and additional catastrophe protection. Lexington's net appetite varies depending on the primary risk market and catastrophe reinsurance market places. The Lexington franchise provides significant property limits for both natural catastrophe and terrorism exposures including a recently announced appetite for capacity of \$1.5 billion on a global basis. These risks are protected in part by a comprehensive reinsurance program with quality reinsurers. Lexington also manages its portfolio through a dedicated in-house unit that coordinates underwriting activities, provides technology support and monitors field office risk allocations and strict underwriting authority levels. Relative to 2006 aggregate exposure changes in specific catastrophe exposed zonal regions have increased by double digits.

Lexington and its pool members remain integral to AIG's overall corporate strategy and benefit from strong parental support and the utilization of AIG's extensive service, resources, global reach and cross-sell opportunities. As a stand-alone company, Lexington also maintains its commanding position within the E&S market, fostering its own brand name and market reputation among the large national and regional broker communities. However, the pool's success is partially attributable to the close relationship Lexington maintains directly with its insureds.

Partially detracting from these qualitative factors is Lexington's variable statutory underwriting income and moderate level of capitalization particularly compared with similarly rated insurance companies. Earnings in 2006 and 2007 were banner years with \$1.3 billion and \$1.1 billion, respectively, of underwriting income attributable in part to lack of catastrophe losses. The calendar year combined ratio in 2007 was an exceptionally strong 72% supported by approximately three points of reserve redundancy. Capital levels have increased significantly in 2006 and 2007 through the significant earnings and are now more supportive of the rating level. Capital accumulation was constrained in 2007 and will be again in 2008 as a result of the significant dividends upstreamed to AIG. The variable level of capital compared with similarly rated peers has resulted in parental support to be factored into Lexington's rating.

Business Review

The following text is derived from the report of Lexington Insurance Pool.

In addition to being affiliated with American International Group, Inc. (AIG), one of the largest property/casualty organizations in the world, Lexington Insurance Company, together with its pool members, is the largest excess and surplus (E&S) lines insurer in the U.S. Lexington specializes in providing specialty insurance products to large and middle market companies. Within the AIG organization, Lexington is owned 70% by National Union Fire Insurance Company, 20% by The Insurance Company of The State of Pennsylvania and 10% by AIG Casualty Company (formerly Birmingham Fire Insurance Company).

Lexington writes substantially all lines of property/casualty business with an emphasis on U.S. commercial business. The major business segments (based on gross written premium) include property (42%), healthcare (9%), program (16%), casualty (24%), excess casualty (8%) and medical excess (1%). The classes of business include property, medical malpractice, primary and excess liability, directors and officers, errors and omissions, inland marine, and excess and umbrella coverages. Lexington's well-recognized franchise is partially based on the willingness and ability to provide high coverage limits which is well-managed based on extensive use of quota share and excess of loss reinsurance in addition to prudent underwriting and extensive loss control capabilities. Lexington maintains a significant competitive advantage in its low expense ratio. Operations are conducted from 33 physical locations including co-locations with other AIG/Commercial Insurance Group (CIG) operations. Lexington utilizes a low-cost diversified distribution platform including retailers (55%) wholesalers (21%), MGAs (15%) and London brokers (9%). The distribution platform allows a distinct advantage for Lexington management to be close not only to the broker but also close to the insured. Structured products are written but are not considered a significant line of business. However, any of these unique risks that are written are subject to review by the CIG Transaction Review Committee and AIG Complex Structured Financial Transactions Committee.

The majority of AIG's property business is written through the Lexington business segment on a non-admitted basis and is considered a primary property market. The Lexington business segment wrote \$3.9 billion of gross written property premium in 2007. Gross written premium has grown 413% since 2000 while net written premium has increased 775%. Classes of property business written include real estate, general property (including municipality and healthcare), on-shore energy, manufacturing, inland marine, construction (including builders risk and small residential), communications and direct terrorism coverage. Overall, net aggregate commercial exposures increased by significant double digits in 2007 from 2006 while 2008 exposure is expected to remain flat with 2007. Personal lines exposures decreased an average of 20-25% for coastal states and continued exposure reductions are expected in 2008. Lexington provides property per risk capacity of up to \$1.5 billion, the highest capacity layers being added in 2007 and 2008. However, the median policy limit size is \$10 million. California earthquake exposure is generally maintained at less than \$25 million limits. Lexington employs dedicated catastrophe modeling individuals to gather data, edit and model exposures and work in conjunction with a dedicated in-house CIG unit. Lexington's property portfolio is modeled monthly and each risk is modeled prior to quoting. In 2005 through mid-2007 Lexington made rate improvements based on risk characteristics, increased wind and flood deductibles, tightened valuation provisions, and made greater use of sub-limits on service and contingent business interruption. Lexington's stand-alone terrorism exposure capacity is limited to \$250 million per risk and home office approval is required for limits greater than \$25 million. Lexington maintains quota share and excess of loss reinsurance contracts on all layers of its property exposures. Lexington purchases catastrophe protections through AIG including participation in a \$2.75 billion excess of \$1 billion program and a catastrophe aggregate protection of \$300 million excess of \$300 million. Terrorism is protected with an aggregate cover of \$600 million excess of \$1.1



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billion as well as \$150 million excess of \$100 million per location. The terrorism cover is 100% placed (80% with one quality reinsurer).

Note: The commentary above is an excerpt. Please refer to the [Best's Company Report](#) for the complete text.



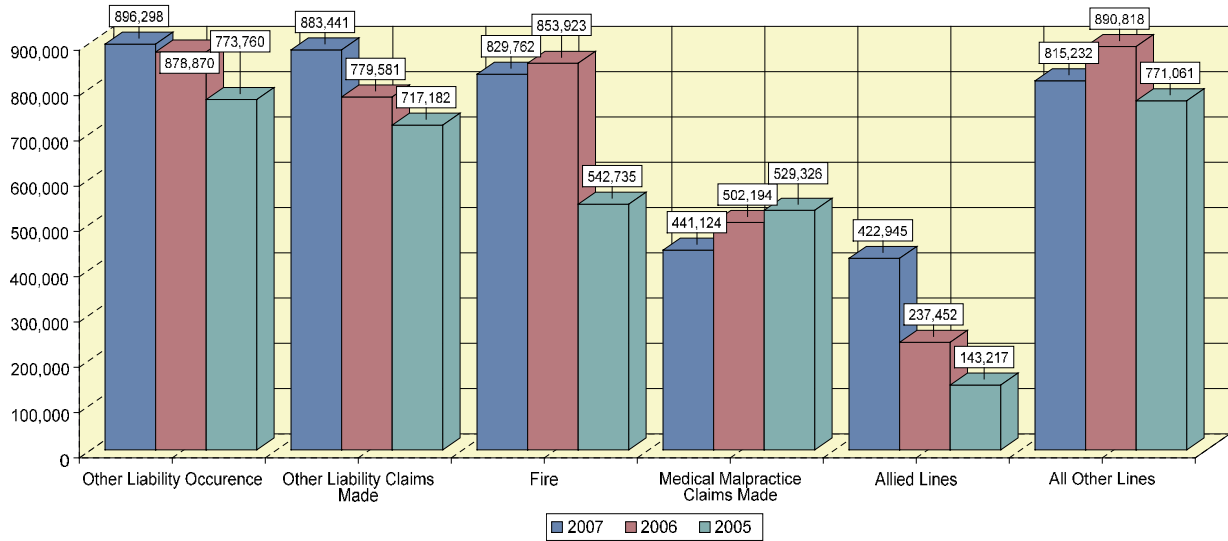
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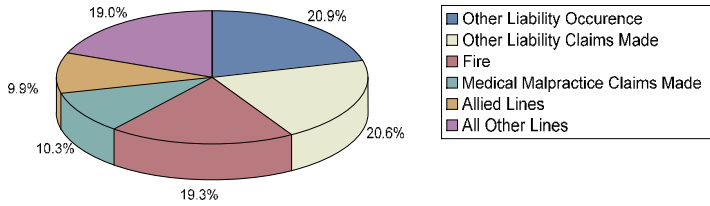
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Top Lines and States of Business (\$000)

3-Year Net Premiums Trend Analysis

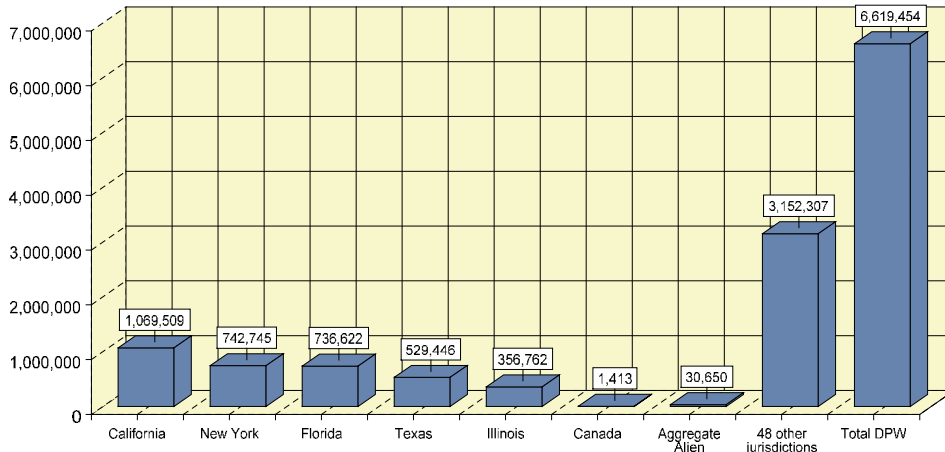


Top Lines of Business (Net Premiums Written)



	2007	2006	2005
Other Liability Occurrence	896,298	876,870	773,760
Other Liability Claims Made	883,441	779,581	717,182
Fire	829,762	853,923	542,735
Medical Malpractice Claims Made	441,124	502,194	529,326
Allied Lines	422,945	237,452	143,217
All Other Lines	815,232	890,818	771,061
Total	4,288,802	4,142,838	3,477,281

Top States of Business (Direct Premiums Written)



	2007
California	1,069,509
New York	742,745
Florida	736,622
Texas	529,446
Illinois	356,762
Canada	1,413
Aggregate Alien	30,650
48 other jurisdictions	3,152,307
Total DPW	6,619,454



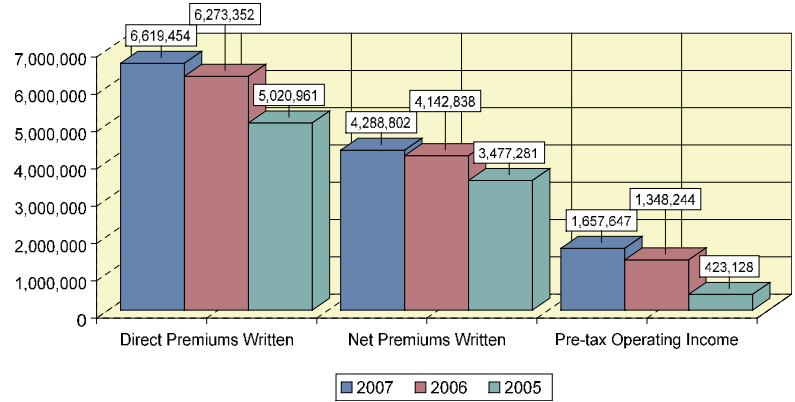
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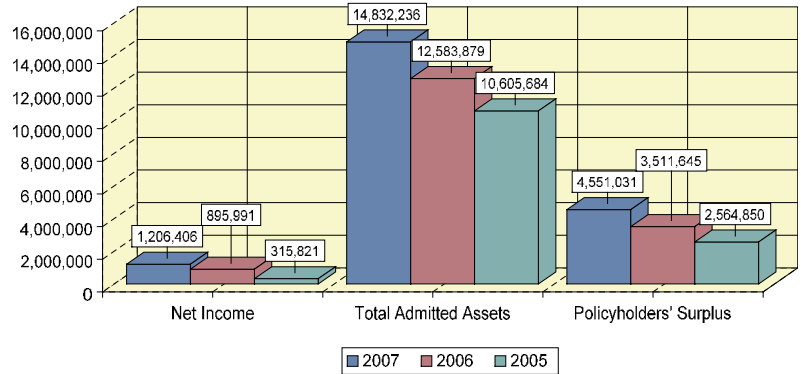
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Key Financial Indicators (\$000)

	Direct Premiums Written	Net Premiums Written	Pre-tax Operating Income
2007	6,619,454	4,288,802	1,657,647
2006	6,273,352	4,142,838	1,348,244
2005	5,020,961	3,477,281	423,128



	Net Income	Total Admitted Assets	Policyholders' Surplus
2007	1,206,406	14,832,236	4,551,031
2006	895,991	12,583,879	3,511,645
2005	315,821	10,605,684	2,564,850



Profitability

	Comb. Ratio	Inv. Yield (%)	Pre-tax ROR (%)
2007	73.1	4.6	41.3
2006	75.4	4.3	35.5
2005	96.6	4.2	13.2

Leverage

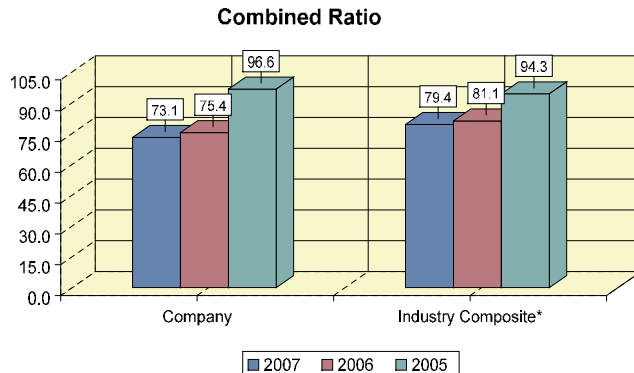
	NA Inv. Leverage	NPW to PHS Net Leverage
2007	36.5	0.9
2006	32.5	1.2
2005	35.3	1.4

Liquidity

	Overall Liq. (%)	Oper. Cash Flow (%)
2007	145.2	182.3
2006	140.0	166.0
2005	133.3	175.4

Combined Ratio

	Company	Industry Composite*
2007	73.1	79.4
2006	75.4	81.1
2005	96.6	94.3



*Industry Composite for this company is Professional Surplus Lines Writers



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Underwriting Experience (\$000)

	Net Underwriting Income	Loss Ratios			Expense Ratios				Comb. Ratio
		Pure Loss	LAE	Loss & LAE	Net Comm.	Other Exp.	Total Exp.	Div. Pol.	
2007	1,040,854	46.9	12.2	59.1	7.5	6.6	14.1	0.0	73.1
2006	890,913	49.5	13.4	62.9	6.3	6.2	12.5	0.0	75.4
2005	69,281	72.4	10.3	82.7	7.9	6.0	13.9	0.0	96.6

	2007	2006	Change Amount	Change %
Direct Premiums Written	6,619,454	6,273,352	346,102	5.5%
Net Premiums Written	4,288,802	4,142,838	145,964	3.5%
Pretax Operating Income	1,657,647	1,348,244	309,403	22.9%
Net Income	1,206,406	895,991	310,415	34.6%
Total Admitted Assets	14,832,236	12,583,879	2,248,357	17.9%
Policyholders' Surplus	4,551,031	3,511,645	1,039,385	29.6%

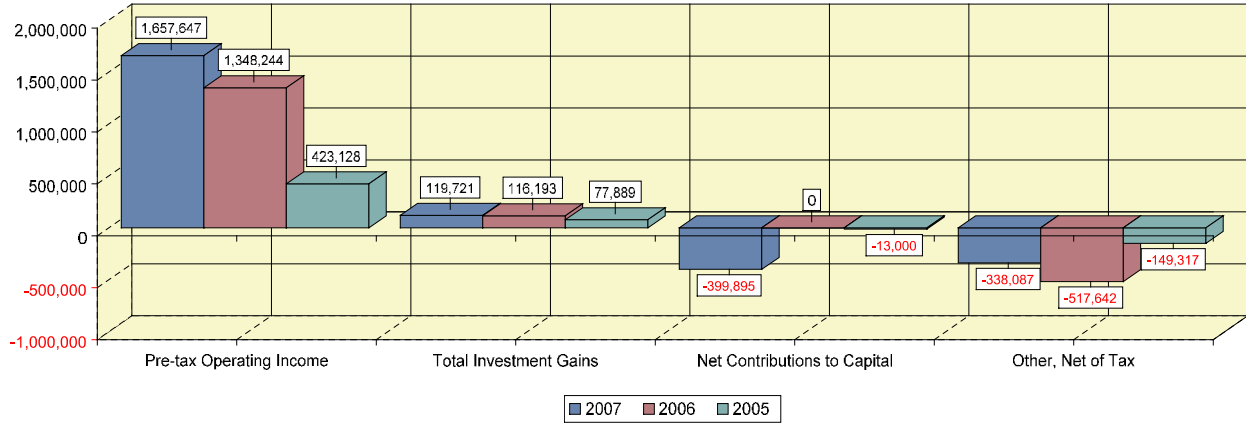


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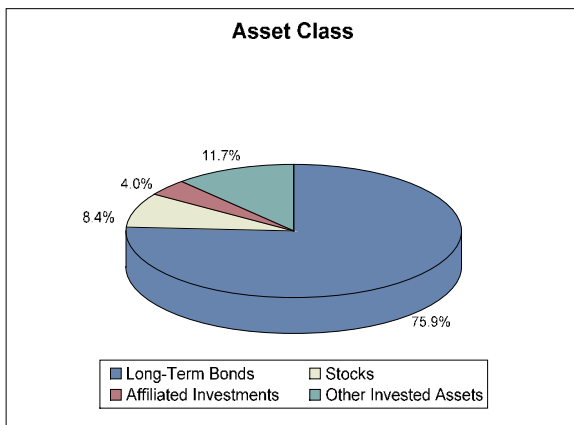
Capital Generation Analysis (\$000)



	Pre-tax Operating Income	Total Investment Gains	Net Contributions to Capital	Other, Net of Tax
2007	1,657,647	119,721	-399,895	-338,087
2006	1,348,244	116,193	0	-517,642
2005	423,128	77,889	-13,000	-149,317
3-Year Total	3,429,019	313,802	-412,895	-1,005,047

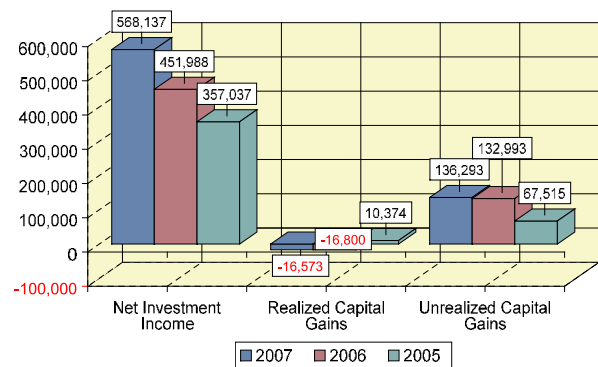
Investment Portfolio Analysis (\$000)

Asset Class	2007
Long-Term Bonds	10,355,034
Stocks	1,148,600
Affiliated Investments	544,245
Other Invested Assets	1,589,630
Total	13,637,509



Investment Income Analysis (\$000)

	Net Investment Income	Realized Capital Gains	Unrealized Capital Gains
2007	568,137	-16,573	136,293
2006	451,988	-16,800	132,993
2005	357,037	10,374	67,515





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Balance Sheet (\$000)

ADMITTED ASSETS		2007
Bonds		10,355,034
Preferred stock		609,356
Common stock		539,243
Cash & short-term invest		321,376
Other non-affil inv asset		1,120,357
Investments in affiliates		544,245
Total invested assets		13,489,612
Premium balances		570,987
Accrued interest		147,896
All other assets		623,741
Total Assets		14,832,236
LIABILITIES & SURPLUS		2007
Loss & LAE reserves		6,942,424
Unearned premiums		2,572,563
Conditional reserve funds		69,547
All other liabilities		696,672
Total Liabilities		10,281,206
Capital & assigned surplus		341,557
Unassigned surplus		4,209,473
Total policyholders' surplus		4,551,031
Total Liabilities & Surplus		14,832,236

Summary of Operations

STATEMENT OF INCOME		2007
Premiums earned		4,015,725
Losses incurred		1,881,576
LAE incurred		490,601
Undrw expenses incurred		602,694
Net underwriting income		1,040,854
Net investment income		568,137
Other income/expense		48,657
Pre-tax oper income		1,657,647
Realized capital gains		-16,573
Income taxes incurred		434,669
Net Income		1,206,406

Note: The most recent data contained in this AMB Credit Report is "Quality Checked" indicating that this financial data was recorded after having cleared A.M. Best Quality Checks.

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