

## **Personal Lines Agency Business Of Great American Insurance Company**

### **Notes to Financial Statements**

#### **Background and Basis of Presentation**

Great American Insurance Company ("GAI") is an indirect wholly-owned subsidiary of American Financial Group, Inc. Through a reinsurance agreement effective January 1, 2003, GAI transferred its personal lines business written through independent agents (the "Assumed Agency Business") to Infinity Property and Casualty Corporation ("Infinity"). Under the reinsurance agreement, GAI also transferred to Infinity assets (primarily investment securities) with a market value of approximately \$125.3 million.

The accompanying statements have been prepared from the historical accounting records of GAI and present the assets (excluding investments) and liabilities to be transferred, the related underwriting gains and losses and underwriting cash flows attributable to the Assumed Agency Business. The Assumed Agency Business represents a portion of AFG's Personal Lines segment of operations and is not a separate legal entity. Accordingly, this business does not have a separate investment portfolio or equity structure. For these reasons, the financial records necessary for complete financial statements including investments, investment results, and tax provisions do not exist.

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to

make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Changes in circumstances could cause actual results to differ materially from those estimates.

#### **Accounting Policies**

##### ***Deferred Policy Acquisition Costs ("DPAC")***

Policy acquisition costs (principally commissions, premium taxes and other marketing and underwriting expenses) related to the production of new business are deferred and charged against income ratably over the terms of the related policies. The method followed in computing DPAC limits the amount of such costs to their estimated realizable value without any consideration for anticipated investment income.

##### ***Unpaid Losses and Loss Adjustment Expenses***

The net liabilities stated for unpaid claims and for expenses of investigation and adjustment of unpaid claims are based upon (a) the accumulation of case estimates for losses reported prior to the close of the accounting period on direct business written; (b) estimates received from ceding reinsurers and insurance pools and associations; (c) estimates of unreported losses based on past experience; (d) estimates based on experience of expenses for investigating and adjusting claims and (e) the current state of the

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### Notes to Financial Statements *(continued)*

law and coverage litigation. These liabilities are subject to the impact of changes in claim amounts and frequency and other factors. Changes in estimates of the liabilities for losses and loss adjustment expenses are reflected in the Statement of Underwriting Gains and Losses in the period in which determined. In spite of the variability inherent in such estimates, management believes that the liabilities for unpaid losses and loss adjustment expenses are adequate.

#### Premium Recognition

Premiums are earned over the terms of the policies on a pro rata basis. Unearned premiums represent that portion of premiums written which is applicable to the unexpired terms of policies in force.

#### Reinsurance

Effective January 1, 2002, GAI entered into a reinsurance agreement with Inter-Ocean Reinsurance (Ireland) Limited, under which GAI agreed to cede 90% of its automobile physical damage business written through December 2002. This agreement was renewed for 2003 on terms substantially equivalent to those in effect in 2002. Premiums ceded under this agreement were \$78.5 million in 2002.

#### Quarterly Operating Results (Unaudited)

While insurance premiums are recognized on a relatively level basis, claim losses related to adverse weather (snow, hail, hurricanes, tornadoes, etc.) may be seasonal. Quarterly results necessarily rely heavily on estimates and are not necessarily indicative of results for longer periods of time.

The following are quarterly results of operations of the Assumed Agency Business for the two years ended December 31, 2002 (in millions).

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total Year
<b>2002</b>					
Earned premiums	\$39.5	\$41.4	\$ 3.8	\$22.5	\$107.2
Underwriting loss	(2.7)	(1.5)	(4.2)	(1.6)	(10.0)
<b>2001</b>					
Earned premiums	\$35.2	\$37.4	\$39.0	\$38.3	\$149.9
Underwriting loss	(1.2)	(1.4)	(4.7)	(7.4)	(14.7)

#### Insurance Reserves

The following table provides an analysis of changes in the liability for losses and loss adjustment expenses over the past two years on a GAAP basis (in millions):

	Twelve Months Ended December 31,	
	2002	2001
Balance at beginning of period	\$116	\$106
Provision for losses and LAE occurring in the current year	84	118
Net increase in provision for claims of prior years	7	4
Total losses and LAE incurred	91	122
Payments for losses and LAE of:		
Current year	(31)	(62)
Prior years	(50)	(50)
Total payments	(81)	(112)
Balance at end of period	\$126	\$116