

21ST CENTURY INSURANCE GROUP
Form PRER14A
July 23, 2007
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

(Amendment No. 1)

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No. 1)

Filed by the Registrant x
Filed by a Party other than the Registrant o
Check the appropriate box:

x Preliminary Proxy Statement
 o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
 o Definitive Proxy Statement
 o Definitive Additional Materials
 o Soliciting Material Pursuant to §240.14a-12

21st Century Insurance Group

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

o No fee required.
 x Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1)	Title of each class of securities to which transaction applies: 21st Century Insurance Group (the Company) common stock, par value \$0.001 per share (Common Stock)
(2)	Aggregate number of securities to which transaction applies: 41,688,468* * Pursuant to the Agreement and Plan of Merger, dated as of May 15, 2007, among the Company, American International Group, Inc. (AIG), and AIG TW Corp. (Merger Sub), as amended pursuant to Amendment No. 1 to Agreement and Plan of Merger, dated as of June 8, 2007, among the Company, AIG and Merger Sub, providing for the merger of Merger Sub with and into the Company (the Merger), shares of Common Stock (i) owned by AIG, Merger Sub, American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa., New Hampshire Insurance Company or any other direct or indirect wholly owned subsidiary of AIG (except for shares held by any mutual fund advised or managed by any of AIG, Merger Sub or any other direct or indirect wholly owned subsidiary of AIG) at the effective time of the merger will remain outstanding and no consideration will be received therefor and (ii) owned by the Company or any direct or indirect wholly owned subsidiary of the Company (other than shares held on behalf of third parties) at the effective time of the Merger are to be cancelled without any consideration payable therefor. Accordingly, the aggregate number of securities to which the transaction applies excludes the anticipated number of such shares.
(3)	Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined): The proposed maximum aggregate value of the transaction, for purposes only of calculating the filing fee, is \$811,083,026, which is the sum of (a) the product of (i) the 34,657,198 shares of Common Stock that are proposed to be converted into the right to receive the merger consideration, multiplied by (ii) the merger consideration of \$22.00 per share of Common Stock, plus (b) the product of (i) 6,934,391, the number of shares of Common Stock underlying certain options to purchase such shares at a per-share exercise price of less than \$22.00, multiplied by (ii) the amount by which the per-share merger consideration of \$22.00 exceeds the \$15.2953 per share weighted average exercise price of such options, plus (c) the product of (i) 96,879, the number of certain shares of restricted Common Stock multiplied by (ii) the per-share merger

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(4) consideration of \$22.00. The filing fee equals the proposed maximum aggregate value of the transaction multiplied by .0000307.
Proposed maximum aggregate value of transaction: \$811,083,026

(5) Total fee paid: \$24,900.25

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

21ST CENTURY INSURANCE GROUP
6301 OWENSMOUTH AVENUE
WOODLAND HILLS, CALIFORNIA 91367

, 2007

To the stockholders of 21st Century Insurance Group:

You are cordially invited to attend a special meeting of the stockholders of 21st Century Insurance Group (the Company) to be held on , 2007 at 10:00 a.m., local time, at the Warner Center Marriott Hotel, 21850 Oxnard Street, Woodland Hills, California 91367.

At the special meeting, you will be asked to consider and vote upon a proposal to approve a merger agreement among the Company, American International Group, Inc. (AIG), and AIG TW Corp. (Merger Sub).

The merger agreement provides for the merger of Merger Sub with and into the Company, with the Company continuing as the surviving corporation in the merger.

If the merger is completed, each share of Company common stock outstanding at the effective time of the merger (other than any shares held by AIG, Merger Sub, American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa., New Hampshire Insurance Company or any other direct or indirect wholly owned subsidiary of AIG (except for shares held by any mutual fund advised or managed by any of AIG, Merger Sub or any direct or indirect wholly owned subsidiary of AIG), shares owned by the Company or any other direct or indirect wholly owned subsidiary of the Company (except for shares held on behalf of third parties), shares subject to certain Company benefit plans and shares owned by stockholders who have perfected and not withdrawn a demand for appraisal rights under Delaware law) will be cancelled and converted into the right to receive \$22.00 in cash, without interest. As a result of the merger, the Company will be wholly owned by AIG.

To evaluate the proposed acquisition by AIG of all of the outstanding shares of our common stock not already owned by them, our board of directors formed a special committee consisting of John B. De Nault III, Carlene M. Ellis, Dr. R. Scott Foster and Keith W. Renken (the Special Committee). In its evaluation of the merger and the merger agreement, the Special Committee considered the opinion of its financial advisor, Lehman Brothers Inc. (Lehman Brothers), to the effect that, as of the date of the opinion and based on and subject to the assumptions, limitations and qualifications set forth in the opinion, the cash consideration of \$22.00 per share to be offered to stockholders of the Company (other than AIG and its subsidiaries) in the merger was fair, from a financial point of view, to such stockholders. The Lehman Brothers fairness opinion is attached as Annex B to the enclosed proxy statement. Our board of directors, acting on the recommendation of the Special Committee, has unanimously approved a resolution adopting the merger agreement.

Both the Special Committee and our board of directors have determined that the merger and the merger agreement are advisable, substantively and procedurally fair to and in the best interests of our unaffiliated stockholders (by which we mean, for purposes of this proxy statement, stockholders of the Company other than the directors and executive officers of the Company, AIG, Merger Sub, American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company). Therefore, acting on the recommendation of the Special Committee, our board of directors unanimously recommends that you vote FOR the approval of the merger agreement.

The merger cannot occur unless the merger agreement is approved by the affirmative vote of at least a majority of the votes entitled to be cast by the holders of our common stock. AIG has agreed to vote, or cause to be voted, all shares of Company common stock owned by AIG and its subsidiaries (i.e., American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa., New Hampshire Insurance Company), in favor of the proposal to adopt and approve the merger agreement.

Regardless of the number of shares you own, your vote is very important. Whether or not you plan to attend the meeting, please complete, sign, date and return the enclosed proxy card or complete your proxy by following the instructions supplied on the proxy card for voting by telephone or via the Internet (or, if your shares are held in street name by a broker, nominee, fiduciary or other custodian, follow the directions given by the broker, nominee, fiduciary or other custodian regarding how to instruct it to vote your shares). You retain the right to revoke the proxy at any time before it is actually voted by giving notice in writing to the Secretary of the Company, by giving notice in open meeting at the special meeting or by submitting a duly executed proxy bearing a later date. If you have instructed a broker, nominee, fiduciary or other custodian to vote your shares, you must follow directions received from the broker, nominee, fiduciary or other custodian to change or revoke your voting instructions. **The failure to vote will have the same effect as a vote against the merger agreement.** If you do not vote in favor of approval of the merger agreement and you fulfill other procedural requirements which are summarized in the accompanying proxy statement, Delaware law entitles you to a judicial appraisal of the fair value of your shares.

The enclosed proxy statement provides you with detailed information about the proposed merger, the merger agreement and the special meeting. We urge you to read the entire document carefully, including information incorporated by reference and included in annexes.

Michael J. Cassanego
Secretary

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of this transaction or passed upon the merits or fairness of this transaction or the adequacy or accuracy of the disclosure in the enclosed proxy statement. Any representation to the contrary is a criminal offense.

The enclosed proxy statement is dated _____, 2007 and is first being mailed to stockholders on or about _____, 2007.

21ST CENTURY INSURANCE GROUP
6301 OWENSMOUTH AVENUE
WOODLAND HILLS, CALIFORNIA 91367

**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS
TO BE HELD** , 2007

To the stockholders of 21st Century Insurance Group:

We will hold a special meeting of stockholders of 21st Century Insurance Group (the Company) on , 2007 at 10:00 a.m., local time, at the Warner Center Marriott Hotel, 21850 Oxnard Street, Woodland Hills, California 91367. The purpose of the meeting is:

1. to consider and vote upon a proposal to adopt and approve the Agreement and Plan of Merger, dated as of May 15, 2007, among the Company, American International Group, Inc. (AIG), and AIG TW Corp. (Merger Sub), as amended pursuant to Amendment No. 1 to Agreement and Plan of Merger, dated as of June 8, 2007, among the Company, AIG and Merger Sub; and
2. to transact such other business as may properly come before the special meeting or any adjournments or postponements of the special meeting.

We have described the merger agreement and the related merger in the accompanying proxy statement, which you should read in its entirety before voting. A copy of the merger agreement and the amendment thereto are attached as Annex A and Annex D, respectively to the proxy statement. The record date to determine who is entitled to vote at the special meeting is , 2007. Only holders of Company common stock at the close of business on the record date are entitled to notice of, and to vote at, the special meeting.

Your vote is important. To make sure your shares are represented at the special meeting, you should, as soon as possible, complete, sign, date and return the enclosed proxy card or complete your proxy by following the instructions supplied on the proxy card for voting by telephone or via the Internet (or, if your shares are held in street name, by a broker, nominee, fiduciary or other custodian, follow the directions given by the broker, nominee, fiduciary or other custodian regarding how to instruct it to vote your shares). You retain the right to revoke the proxy at any time before it is actually voted by giving notice in writing to the Secretary of the Company, by giving notice in open meeting at the special meeting or by submitting a duly executed proxy bearing a later date. If you have instructed a broker, nominee, fiduciary or other custodian to vote your shares, you must follow directions received from the broker, nominee, fiduciary or other custodian to change or revoke your voting instructions. **The failure to vote will have the same effect as a vote against the merger agreement.** If you do not vote in favor of approval of the merger agreement and you fulfill other procedural requirements which are summarized in the accompanying proxy statement, Delaware law entitles you to a judicial appraisal of the fair value of your shares.

By Order of the Board of Directors,

Michael J. Cassanego
Secretary

Woodland Hills, California
, 2007

Whether or not you plan to attend the special meeting in person, please complete, sign, date and return the enclosed proxy in the accompanying self-addressed postage pre-paid envelope (or, if your shares are held in street name by a broker, nominee, fiduciary or other custodian, follow the directions given by the broker, nominee, fiduciary or other custodian regarding how to instruct it to vote your shares) as soon as possible.

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SUMMARY TERM SHEET

You are being asked to consider and vote upon a proposal to approve the Agreement and Plan of Merger, dated as of May 15, 2007, among 21st Century Insurance Group (the Company), American International Group, Inc. (AIG), and AIG TW Corp. (Merger Sub), as amended pursuant to Amendment No. 1 to Agreement and Plan of Merger, dated as of June 8, 2007, among the Company, AIG and Merger Sub, which is referred to in this proxy statement as the merger agreement. The merger agreement provides for the merger of Merger Sub with and into the Company. The Company would be the surviving corporation in the merger, and, immediately following the merger, AIG and its subsidiaries (including American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company) would have direct or indirect ownership of all of the outstanding capital stock of the Company. This summary term sheet briefly describes the most material terms of the proposed merger and may not contain all of the information that is important to you. The Company urges you to read carefully the entire proxy statement, including the information incorporated by reference and the annexes. You may obtain without charge copies of documents incorporated by reference into this proxy statement by following the instructions under WHERE YOU CAN FIND MORE INFORMATION, beginning on page 110. Each item in this summary term sheet includes a page reference directing you to a more complete description of that item.

Parties Involved in the Proposed Transaction (page 71)

- **21st Century Insurance Group.** Founded in 1958, the Company is a Delaware corporation engaged in the business of providing direct-to-consumer personal auto insurance through its subsidiaries. With \$1.4 billion of revenue in 2006, the Company insures over 1.5 million vehicles in 18 states, including California, Florida, New Jersey, Texas and the Company's newest market, New York. The Company is executing a multi-year geographic expansion strategy. As a result, the Company now operates in markets that total approximately 66% of the U.S. private passenger automobile market. The Company increased the percentage of the U.S. private passenger automobile market in which it operates, up from approximately 18% in 2003. Customers can purchase insurance, service their policy or report a claim at www.21st.com or by phone with our licensed insurance professionals at 1-800-211-SAVE, 24 hours a day, 365 days a year. Service is offered in English and Spanish, both on the phone and on the web. 21st Century Insurance Company, 21st Century Casualty Company and 21st Century Insurance Company of the Southwest, all wholly owned subsidiaries of the Company, are rated A+ by A. M. Best, Fitch Ratings and Standard & Poor's. Since July 27, 1998, AIG and its related entities have owned a controlling equity interest in the Company.
- **American International Group, Inc.** AIG is a holding company which, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and abroad. AIG's primary activities include both general insurance and life insurance & retirement services operations. AIG's subsidiaries serve commercial, institutional and individual customers through an extensive worldwide property-casualty and life insurance network. Other significant activities include financial services and asset management. As a result of the merger, AIG and its subsidiaries (including American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company) will collectively hold 100% ownership of the Company.
- **AIG TW Corp.** Merger Sub, a newly formed Delaware corporation and a wholly owned subsidiary of AIG, has been organized by AIG for the sole purpose of facilitating the merger. Merger Sub's corporate existence will terminate upon consummation of the merger.

The Special Meeting (page 69)

- **Matters to be Considered (page 69).** At the special meeting, stockholders will consider and vote upon a proposal to adopt and approve the merger agreement.
- **Date, Time, Place (page 69).** The special meeting will be held on _____, 2007 at 10:00 a.m., local time, at the Warner Center Marriott Hotel, 21850 Oxnard Street, Woodland Hills, California 91367.
- **Record Date and Quorum (page 69).** The Company has fixed _____, 2007 as the record date for the special meeting. Only holders of record of the Company's common stock as of the close of business on the record date are entitled to notice of, and to vote at, the special meeting and any adjournment or postponement thereof. The presence at the special meeting, in person or by proxy, of the holders of a majority of shares of common stock outstanding on the record date will constitute a quorum, permitting the Company to conduct its business at the special meeting.
- **Required Vote and Voting Rights (pages 70 and 69).** Stockholder adoption and approval of the merger agreement requires the affirmative vote of at least a majority of the votes entitled to be cast at the special meeting. Each share of the Company's common stock is entitled to one vote. AIG has agreed to vote, or cause to be voted, all shares of Company common stock owned by AIG and its subsidiaries, in favor of the proposal to adopt and approve the merger agreement. This agreement by AIG ensures that the merger agreement will be adopted and approved by the holders of a majority of the votes entitled to be cast by the holders of the Company's common stock, as required by Delaware law. A failure to vote your shares of Company common stock or an abstention from voting will have the same effect as a vote against the merger.
- **How Shares are Voted (page 70).** You may vote by attending the special meeting and voting in person by ballot, by completing the enclosed proxy card and then signing, dating and returning it in the self-addressed postage pre-paid envelope provided or by completing your proxy by following the instructions supplied on the proxy card for voting by telephone or via the Internet. Submitting a proxy now will not limit your right to vote at the special meeting if you decide to attend in person. If your shares are held of record in _____ street name, _____ by a broker, nominee, fiduciary or other custodian and you wish to vote in person at the special meeting, you must obtain from the record holder a proxy issued in your name.
- **Revocation of Proxies (page 70).** You may revoke your proxy at any time before it is actually voted by giving notice in writing to the Secretary of the Company, by giving notice in open meeting at the special meeting or by submitting a duly executed proxy bearing a later date. Attendance at the special meeting will not, by itself, revoke a proxy. If you have given voting instructions to a broker, nominee, fiduciary or other custodian that holds your shares in _____ street name, _____ you may revoke those instructions by following the directions given by the broker, nominee, fiduciary or other custodian.

Structure of the Transaction (page 14)

The proposed transaction is a merger of Merger Sub with and into the Company, with the Company continuing as the surviving corporation in the merger.

The Merger. Following the satisfaction or waiver of other conditions to the merger, the following will occur in connection with the merger:

- all shares of the Company's common stock that are held by the Company or any other direct or indirect wholly owned subsidiary of the Company (except for shares held on behalf of third parties) will be cancelled and retired

without any consideration payable therefor;

- all shares of the Company's common stock that are held by AIG, Merger Sub, American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance

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Company of Pittsburgh, Pa., New Hampshire Insurance Company or any other direct or indirect wholly owned subsidiary of AIG (except for shares held by any mutual fund advised or managed by any of AIG, Merger Sub or any other direct or indirect wholly owned subsidiary of AIG) will remain outstanding and receive no consideration therefor;

- each outstanding vested stock option (including those options that will vest on or before the first anniversary of the effective time of the merger) at the effective time of the merger issued under a Company stock option plan will be cancelled and each holder thereof will receive from the Company, on the closing date, an amount in cash equal to the product of (1) the excess, if any, of the per-share merger consideration of \$22.00 over the per-share exercise price of such stock option, multiplied by (2) the number of shares subject to such stock option, less applicable taxes required to be withheld with respect to such payment;
- each stock option that is scheduled to vest following the first anniversary of the effective time will be terminated and, as soon as practicable following the effective time, each holder thereof will receive from AIG restricted stock units with respect to shares of AIG's common stock with a value (as reasonably determined in good faith by AIG) equal to the product of (1) the number of shares subject to such options multiplied by (2) the excess of the per-share merger consideration over the exercise price per share under such Company option;
- each compensatory right of any kind, contingent or accrued, to acquire or receive shares or benefits measured by the value of shares, and each award of any kind consisting of shares that may be held, awarded, outstanding, payable or reserved for issuance under Company stock plans or benefit plans (other than stock options) (the Company Awards) that have vested or will vest on or before the first anniversary of the effective time of the merger will be cancelled and each holder thereof will receive from AIG an amount of cash equal to the product of (1) the number of shares actually or nominally subject to such Company Award immediately prior to the effective time multiplied by (2) the per-share merger consideration of \$22.00, less applicable taxes required to be withheld with respect to such payment;
- each Company Award that is scheduled to vest following the first anniversary of the effective time will be terminated and, as soon as practicable following the effective time, each holder thereof will receive from AIG restricted stock units with respect to shares of AIG's common stock with a value (as reasonably determined in good faith by AIG) equal to the product of (1) the number of shares actually or nominally subject to such Company Awards multiplied by (2) the per-share merger consideration of \$22.00;
- each other share of Company common stock issued and outstanding immediately before the effective time of the merger (other than any share as to which a dissenting stockholder has perfected and not withdrawn appraisal rights under Delaware law) will be converted into the right to receive \$22.00 in cash without interest;
- each share of Merger Sub common stock will be converted into a specified number of shares of common stock of the Company, as the surviving corporation in the merger; and
- each share of Company common stock the holders of which perfect their appraisal rights and strictly follow certain procedures in the manner prescribed by Section 262 of the General Corporation Law of the State of Delaware, or DGCL, will be cancelled and the holders of such shares will be entitled to receive payment of the fair value as determined pursuant to court appraisal proceedings of their shares in cash from the Company, as the surviving corporation of the merger.

Purpose and Reasons for the Merger (page 15)

The Company's purpose in undertaking the merger is to allow its stockholders (other than AIG and its subsidiaries) to realize the value of their investment in the Company in cash at a price that represents a 32.6% premium to the market price of Company common stock before the public announcement of the initial proposal by AIG to acquire 100% ownership of the Company.

AIG's and Merger Sub's purpose for engaging in the merger is to increase AIG's and its subsidiaries' ownership of Company common stock from their current position of approximately 60.7% of the outstanding shares to 100%. Upon completion of the merger, the Company would become a privately held company wholly owned by AIG and its subsidiaries (including American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company).

Certain Effects of the Merger (page 53)

Among other results of the merger, the stockholders of the Company (other than AIG and its subsidiaries, including American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company) will no longer have any interest in, and will no longer be stockholders of, the Company and will not participate in any future earnings or growth of the Company, and AIG will own, directly or indirectly, all of the outstanding shares of the Company. Following the merger, Company common stock will no longer be publicly traded, and the Company will no longer file periodic reports with the Securities and Exchange Commission (SEC).

The Company's Position as to the Fairness of the Merger; Recommendations of the Special Committee and the Board of Directors (page 28)

Because certain members of the Company's board of directors have actual or potential conflicts of interest in evaluating the merger, the board of directors appointed a Special Committee of independent directors, consisting of John B. De Nault III, Carlene M. Ellis, Dr. R. Scott Foster and Keith W. Renken (the Special Committee), to evaluate the merger and the merger agreement and make a recommendation to the board of directors with respect to the merger agreement.

Both the Special Committee and the board of directors of the Company, after careful consideration of numerous factors, have determined that the merger agreement and the merger are advisable, substantively and procedurally fair to and in the best interests of the Company's unaffiliated stockholders (by which we mean, for purposes of this proxy statement, stockholders of the Company other than the directors and executive officers of the Company, AIG, Merger Sub, American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company).

Acting on the recommendation of the Special Committee, the board of directors has unanimously adopted a resolution approving the merger agreement and approved the merger. The board of directors, based in part on the recommendation of the Special Committee, recommends that the Company's stockholders vote for the approval of the merger agreement.

Opinion of Financial Advisor to the Special Committee (page 37)

Lehman Brothers has delivered an opinion to the Special Committee to the effect that, based on and subject to the assumptions, limitations and qualifications set forth in the opinion, as of the date of the opinion, from a financial point of view, the consideration to be offered to the stockholders of the Company (other than AIG and its subsidiaries) in the merger is fair to such stockholders. The full text of Lehman Brothers' written opinion is included in this proxy statement as Annex B. You should read the opinion carefully in its entirety.

As compensation for its services in connection with the merger, the Company agreed to pay Lehman Brothers a retainer of \$200,000 and an opinion fee of \$1 million upon the delivery of Lehman Brothers' opinion. Additional compensation of \$2,800,000 will be payable upon completion of the merger. In addition, the Company has agreed to reimburse Lehman Brothers for reasonable out-of-pocket expenses incurred in connection with the merger and to indemnify Lehman Brothers for certain liabilities that may arise out of its engagement by the Special Committee and the rendering of the Lehman Brothers opinion.

Position of AIG and Merger Sub as to the Fairness of the Merger (page 33)

AIG and Merger Sub believe that the merger is substantively and procedurally fair to the unaffiliated stockholders of the Company. In arriving at their position as to the fairness of the merger, AIG and Merger Sub considered the factors discussed in the section entitled "SPECIAL FACTORS - Position of AIG as to the Fairness of the Merger to the Company's Unaffiliated Stockholders."

Interests of Certain Persons in the Merger (page 55)

In considering the recommendation of the board of directors, you should be aware that certain of the Company's executive officers and directors and AIG and its subsidiaries have interests in the transaction that are different from, or are in addition to, the interests of the Company's unaffiliated stockholders generally. The Special Committee and the board of directors were aware of these potential or actual conflicts of interest and considered them along with other matters when they determined to recommend the merger. These interests, which are discussed in detail in the section entitled "SPECIAL FACTORS - Interests of Certain Persons in the Merger," include the following:

- certain members of the Company's board of directors are affiliated with AIG and have actual or potential conflicts of interest in evaluating the merger;
- Bruce Marlow is the Company's President, Chief Executive Officer and Vice-Chairman, and a member of the board of directors. Upon consummation of the merger, it is anticipated that Mr. Marlow will continue in the position of President of the combined entity of the Company and the profit center of AIG's subsidiaries called AIG Direct. At the request of AIG, Mr. Marlow has entered into a new employment agreement with the Company and AIG, which will be effective upon the consummation of the merger. The employment agreement supersedes both Mr. Marlow's current retention agreement with the Company, as well as the Company's 1998 Executive Severance Plan. Mr. Marlow's employment agreement has a term through December 31, 2009, and provides for an annual base salary of not less than \$950,000 and a target annual bonus of 100% of base salary. In addition, if Mr. Marlow remains employed for one year after the consummation of the merger or is otherwise terminated under certain circumstances within three years, he will receive retention and/or severance payments;
- each member of management and the board of directors who holds a vested stock option (including those that will vest on or before the first anniversary of the effective time of the merger) at the effective time of the merger that was issued under a Company stock option plan will have the right to receive cash in respect of such stock option in an amount equal to the product of (1) the excess, if any, of the per-share merger consideration of \$22.00 over the per-share exercise price of such stock option, multiplied by (2) the number of shares subject to such stock option, less applicable taxes required to be withheld with respect to such payment;
- each member of management and the board of directors who holds a stock option scheduled to vest following the first anniversary of the effective time of the merger shall receive from AIG restricted stock units with respect to shares of AIG's common stock with a value (as reasonably determined in good faith by AIG) equal to the product of (1) the number of shares subject to such option multiplied by (2) the excess, if any, of the per-share merger consideration of \$22.00 over the exercise price per share under such Company option;
- each member of management and the board of directors who holds a vested Company Award (including those that will vest on or before the first anniversary of the effective time of the merger) at the effective time of the merger issued under a Company Award plan will have the right to receive cash in respect of such Company Award in an amount equal to the product of (1) the number of shares actually or nominally subject to such Company Award immediately prior to the effective time multiplied by (2) the per-share merger consideration of \$22.00, less applicable taxes required to be withheld with respect to such payment;

- each member of management and the board of directors who holds a Company Award that is scheduled to vest following the first anniversary of the effective time of the merger shall receive from AIG restricted stock units with respect to shares of AIG's common stock with a value (as reasonably determined in good faith by AIG) equal to the product of (1) the number of shares actually or nominally subject to such Company Awards multiplied by (2) the per-share merger consideration of \$22.00;
- in connection with the merger agreement, the Company has entered into retention and severance agreements with the following officers of the Company: Richard A. Andre; Michael J. Cassanego; Chong Ha; Marlis S. Kerby; Allen Lew; John M. Lorentz; Michael T. Ray; Caren L. Silvestri; Dean E. Stark; Anthony W. Tomich; and Jesus C. Zaragoza. The retention and severance agreements are effective upon the effective time of the merger and provide that, among other things, (i) each executive shall be entitled to receive a cash retention payment if the executive remains employed by the Company on the first anniversary of the effective time of the merger, (ii) if the executive is terminated without cause or terminates his employment for good reason before the third anniversary of the effective time of the merger, the executive will be entitled to receive a cash severance payment, as well as specified health and insurance benefits, and (iii) the executive agrees not to compete with the Company or solicit any Company employees for employment during the period the executive is employed with the Company and for a twelve-month period thereafter;
- the merger agreement provides that the merger shall be treated as a change in control for purposes of the Company's Supplemental Executive Retirement Plan (the SERP) and benefits under the SERP will cease to accrue as of the effective time of the Merger. Participants in the SERP who were actively employed by the Company as of the date of the merger will have the opportunity prior to the effective time of the Merger to make an election to have their benefits under the SERP be paid out to them in cash on January 4, 2008;
- the merger agreement provides that following the merger indemnification and insurance arrangements will be maintained for the persons serving as the Company's directors and officers; and
- each member of the Special Committee received a fee of \$1,500 for each Special Committee meeting attended in connection with the proposed merger. Such fees amounted to up to \$6,000 per meeting and \$237,000 in the aggregate, without regard to whether the Special Committee ultimately recommended approval of the merger agreement or whether the merger is consummated. The members of the Special Committee will also be reimbursed for their reasonable out-of-pocket travel and other expenses in connection with their service on the Special Committee.

No Solicitation of Transactions (page 82)

The merger agreement contains restrictions on the Company's ability to (i) initiate, solicit, knowingly encourage or facilitate any inquiries or the making of any acquisition proposal, (ii) engage in, continue or otherwise participate in any discussions or negotiations regarding, or provide any confidential or non-public information to any person relating to, any acquisition proposal (except solely to provide written notice of the existence of these provisions), or (iii) otherwise knowingly facilitate any effort or attempt to make an acquisition proposal.

The Company may, however, if specified conditions are satisfied and the board of directors or Special Committee, as the case may be, determines in good faith after consultation with outside legal counsel that the failure to take such action would reasonably be expected to result in a violation of the directors' fiduciary duties under applicable law, engage in negotiations or discussions with, and provide information about the Company to, any third party that makes an unsolicited bona fide written acquisition proposal that the board of directors or the Special Committee in good faith determines constitutes a superior proposal or is reasonably likely to result in a superior proposal. The board of directors or Special

Committee may also withhold, withdraw or modify its recommendation of the merger agreement at any time prior to the time the Company requisite vote is obtained if it determines in good faith, after consultation with legal and financial advisors, that the failure to do so would reasonably be expected to result in a violation of the directors' fiduciary duties under applicable laws.

Conditions to Completion of the Merger (page 86)

The obligations of the Company and/or AIG to complete the merger are subject to the satisfaction or waiver of various conditions specified in the merger agreement, including conditions relating to, among other things:

- approval of the merger agreement by the Company's stockholders;
- the absence of any court or governmental entity enacting, issuing, promulgating, enforcing or entering any law that is in effect which restrains, enjoins or otherwise prohibits consummation of the merger;
- obtaining necessary governmental consents and approvals for the transactions contemplated under the merger agreement;
- the absence of any suit, action or proceeding in which a governmental entity is seeking an Adverse Condition (as defined in the merger agreement), or any law deemed applicable to the merger that is reasonably likely to result in an Adverse Condition;
- performance by the parties of their obligations under the merger agreement; and
- the accuracy of the parties' representations and warranties under the merger agreement.

Termination of the Merger Agreement (page 88)

The merger agreement may be terminated at any time and for any reason prior to the effective time of the merger by mutual written consent of the Company (acting through the Special Committee, if then in existence) and AIG. Either the Company (acting through the Special Committee, if then in existence) or AIG may terminate the merger agreement at any time prior to the effective time of the merger if:

- the merger is not consummated by November 30, 2007; *provided, however*, that if the Company or AIG determines that additional time is necessary in order to forestall any action to restrain, enjoin or prohibit the merger by any governmental entity, the termination date may be extended to a date not beyond February 29, 2008;
- there is a failure to obtain approval of the merger agreement by the Company's stockholders at the special meeting;
- the board of directors of the Company (upon the recommendation of the Special Committee, if then in existence) or the Special Committee changes its recommendation of the transaction; or
- any order or other governmental action prohibits the merger.

In addition, the Company (acting through the Special Committee, if then in existence) may terminate the merger agreement at any time prior to the effective time of the merger under specified circumstances relating to:

- a breach of any representation, warranty, covenant or agreement made by AIG in the merger agreement which renders certain conditions to the completion of the merger incapable of being satisfied.

In addition, AIG may terminate the merger agreement at any time prior to the effective time of the merger under specified circumstances relating to:

- a breach of any representation, warranty, covenant or agreement made by the Company in the merger agreement which renders certain conditions to the completion of the merger incapable of being satisfied.

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In the event that the merger agreement is terminated by the Company or AIG as a result of a change in the board of directors or the Special Committee's recommendation of the merger agreement, then the Company is required to pay AIG a termination fee of \$24,300,000 no later than two (2) days after the date of such termination.

Litigation Related to the Merger (page 62)

Edward Bronstein v. 21st Century Insurance Group, et al. and Francis A. Sliwinski v. 21st Century Insurance Group, et al. allege that the Company, its directors and AIG have breached, or will breach, fiduciary duties as a result of AIG's January 24, 2007 merger proposal to acquire the remaining shares of Company stock which AIG does not own. Both actions were filed in the Los Angeles Superior Court in January 2007 and seek class action certification and equitable relief.

On May 23, 2007, a third action, Paul Roberts v. 21st Century Insurance Group, et al. was filed in Los Angeles Superior Court. The Roberts action alleges that the Company, its directors and AIG are breaching fiduciary duties by entering into the merger agreement dated May 15, 2007 and completing the contemplated merger. The Roberts action seeks class certification and equitable relief. The Bronstein, Sliwinski and Roberts actions have been consolidated into a single action captioned In re 21st Century Shareholder Litigation.

The Company believes that each of the actions is without merit.

Federal Income Tax Consequences (page 63)

The receipt of cash in exchange for Company common stock will be a taxable transaction for U.S. federal income tax purposes and may also be taxable under applicable state, local, foreign or other tax laws. In general, United States holders of Company common stock who receive cash in exchange for their shares pursuant to the merger (including any cash received in connection with the exercise of appraisal rights) will recognize gain or loss for U.S. federal income tax purposes equal to the difference, if any, between the holder's adjusted tax basis in the shares and the amount of cash received. If the United States holder holds Company common stock as a capital asset, any gain or loss should generally be a capital gain or loss. If the United States holder has held the shares for more than one (1) year, any gain or loss should generally be a long-term gain or loss. The deductibility of capital losses is subject to limitations. Tax matters are very complex, and the tax consequences of the merger to you will depend on the facts of your own situation. You should consult your tax advisor for a full understanding of the tax consequences of the merger to you, including the federal, state, local and foreign tax consequences of the merger. See SPECIAL FACTORS Federal Income Tax Consequences.

Appraisal Rights (page 65)

If you do not vote in favor of approval of the merger agreement and you fulfill other procedural requirements, Delaware law entitles you to a judicial appraisal of the fair value of your shares. See SPECIAL FACTORS Appraisal Rights.

QUESTIONS AND ANSWERS ABOUT THE MERGER

The following questions and answers, presented for your convenience only, briefly address some commonly asked questions about the merger. You should still carefully read the entire proxy statement, including the information incorporated by reference and the annexes.

Q: Why am I receiving these materials?

A: The board of directors is providing these proxy materials to give you information for use in determining how to vote on the merger agreement in connection with the special meeting.

Q: When and where is the special meeting?

A: The special meeting will be held on _____, 2007 at 10:00 a.m., local time, at the Warner Center Marriott Hotel, 21850 Oxnard Street, Woodland Hills, California 91367.

Q: What am I being asked to vote upon?

A: You are being asked to consider and vote upon a proposal to adopt and approve the merger agreement, pursuant to which Merger Sub will merge with and into the Company, with the Company continuing as the surviving corporation in the merger.

Q: Who can vote on the proposal to adopt and approve the merger agreement?

A: All holders of Company common stock at the close of business on _____, 2007, the record date for the special meeting, may vote in person or by proxy on the proposal to adopt and approve the merger agreement at the special meeting.

Q: What vote is required to approve the merger agreement?

A: Stockholder approval of the merger agreement requires the affirmative vote of at least a majority of the votes entitled to be cast at the special meeting by holders of Company common stock.

Q: What will happen in the merger?

A: Merger Sub will be merged with and into the Company, with the Company continuing as the surviving corporation in the merger. Merger Sub was formed by AIG solely for the purpose of acquiring all of the outstanding shares of Company common stock not already owned by AIG or its subsidiaries. After the merger, the Company will become a wholly owned subsidiary of AIG.

Q: What will I receive in the merger?

A: You will receive \$22.00 in cash, without interest, in exchange for each share of common stock owned by you at the effective time of the merger, unless either (1) you are AIG, Merger Sub or any direct or indirect wholly owned subsidiary of AIG or (2) you vote against approval of the merger agreement and perfect your appraisal rights under Delaware law.

Q: What are the reasons for the merger?

A: The Company's purpose in undertaking the merger is to allow its stockholders (other than AIG and its subsidiaries) to realize the value of their investment in the Company in cash at a price that represents a 32.6%

premium to the market price of Company common stock before the public announcement of the initial proposal by
AIG to acquire 100% ownership of the Company.

AIG's and Merger Sub's purpose for engaging in the merger is to increase AIG's and its subsidiaries' ownership of Company common stock from their current position of approximately 60.7% of the Company's outstanding shares to 100%. Upon completion of the merger, the Company would become a privately held company wholly owned by AIG and its subsidiaries (including American Home

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Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company).

Q: What was the role of the Special Committee?

A: Because certain directors of the Company have actual or potential conflicts of interest in evaluating the merger, the board of directors appointed a Special Committee of independent directors to review and evaluate the proposed merger.

Q: What is the recommendation of the Special Committee?

A: The Special Committee has determined that the merger and the merger agreement are advisable, substantively and procedurally fair to and in the best interests of the Company and its unaffiliated stockholders and recommended to the Company's board of directors that the merger and the merger agreement be approved and adopted. In arriving at its conclusion, the Special Committee considered the opinion of Lehman Brothers, its independent financial advisor, that, as of the date of such opinion and based upon and subject to the limitations, qualifications and assumptions set forth in the opinion, from a financial point of view, the consideration to be offered to the stockholders of the Company (other than AIG and its subsidiaries) in the merger is fair to such stockholders.

Q: What is the recommendation of the board of directors?

A: The board of directors, based in part on the recommendation of the Special Committee, unanimously recommends that the Company's stockholders vote FOR the approval of the merger agreement. Both the Special Committee and the board of directors of the Company, after careful consideration of numerous factors, have determined that the merger agreement and the merger are advisable, substantively and procedurally fair to and in the best interests of the unaffiliated stockholders of the Company. See **SPECIAL FACTORS** Recommendations of the Company, the Special Committee and the Board of Directors; Reasons for Recommending the Approval and Adoption of the Merger Agreement on page 28.

Q: What are the consequences of the merger to present members of management and the board of directors?

A: Immediately following the merger it is expected that the Company's existing members of management will continue as management of the surviving corporation. Like other stockholders, members of management and the board of directors will be entitled to receive \$22.00 per share in cash for each of their shares of Company common stock. The directors of Merger Sub at the effective time of the merger will be the initial directors of the Company, as the surviving corporation, until their successors have been duly elected and qualified or until their earlier death, resignation or removal.

Each member of management and the board of directors who holds a stock option or Company Award at the effective time of the merger that was issued under a Company stock option or benefit plan will have the right to receive a predetermined amount of cash or restricted stock units of AIG's common stock, as applicable, in respect of such stock option or Company Award.

In connection with the merger agreement, the Company and AIG have entered into a new employment agreement with Bruce W. Marlow, the Company's President, Chief Executive Officer and Vice-Chairman, and a member of the board of directors, which will be effective upon the closing of the merger. In addition, the Company has also entered into retention and severance agreements with certain of its executive officers, which will be effective upon the consummation of the merger.

For more information, see **SPECIAL FACTORS** Interests of Certain Persons in the Merger on page 55.

Q: Is the Merger subject to the satisfaction of any conditions?

A: Yes. Before completion of the transactions contemplated by the merger agreement, a number of closing conditions must be satisfied or waived. These conditions are described in this proxy statement in the section entitled **THE MERGER AGREEMENT Conditions to the Merger**. These conditions include, among others, no order being entered which prevents the consummation of the merger; the obtaining of necessary governmental consents and approvals for the transactions contemplated by the merger agreement; the accuracy of the parties' representations and warranties under the merger agreement; and the approval and adoption of the merger agreement and the merger by the stockholders of the Company. If these conditions are not satisfied or waived, the merger will not be completed even if the Company's stockholders vote to adopt the merger agreement.

Q: When do you expect the merger to be completed?

A: We are working toward completing the merger as quickly as possible after the special meeting. We hope to complete the merger during the third quarter of 2007, although there can be no assurance that we will be able to do so.

Q: What are the U.S. federal income tax consequences of the merger to holders of Company common stock (other than AIG and its subsidiaries)?

A: The receipt of cash in exchange for Company common stock will be a taxable transaction for U.S. federal income tax purposes and may also be taxable under applicable state, local, foreign or other tax laws. In general, United States holders of Company common stock who receive cash in exchange for their shares pursuant to the merger (including any cash received in connection with the exercise of appraisal rights) will recognize gain or loss for U.S. federal income tax purposes equal to the difference, if any, between the holder's adjusted tax basis in the shares and the amount of cash received. If the United States holder holds Company common stock as a capital asset, any gain or loss should generally be a capital gain or loss. If the United States holder has held the shares for more than one (1) year, any gain or loss should generally be a long-term gain or loss. The deductibility of capital losses is subject to limitations. Tax matters are very complex, and the tax consequences of the merger to you will depend on the facts of your own situation. You should consult your tax advisor for a full understanding of the tax consequences of the merger to you, including the federal, state, local and foreign tax consequences of the merger. See **SPECIAL FACTORS Federal Income Tax Consequences**.

Q: How do I vote my Company common stock?

A: After carefully reading and considering the information contained in this proxy statement, and whether or not you plan to attend the special meeting in person, please complete, sign, date and return the enclosed proxy in the accompanying self-addressed postage pre-paid envelope or complete your proxy by following the instructions supplied on the proxy card for voting by telephone or via the Internet (or, if your shares are held in "street name" by a broker, nominee, fiduciary or other custodian, follow the directions given by the broker, nominee, fiduciary or other custodian regarding how to instruct it to vote your shares) as soon as possible. For more information on how to vote your shares, see the section entitled **THE SPECIAL MEETING How Shares are Voted; Proxies; Revocation of Proxies** on page 70.

Q: What happens if I do not return a proxy card?

A: If you neither vote at the meeting nor grant your proxy as described in this proxy statement, your shares will not be voted, which will have the effect of voting against the approval of the merger agreement.

Q: May I vote in person?

A: Yes. You may attend the special meeting and vote your shares in person whether or not you sign and return your proxy card. If your shares are held of record in street name by a broker, nominee, fiduciary or other custodian and you wish to vote in person at the special meeting, you must obtain from the record holder a proxy issued in your name.

Q: May I change my vote after I have mailed my signed proxy card?

A: Yes. You may revoke your proxy at any time before it is actually voted by giving notice in writing to the Secretary of the Company, by giving notice in open meeting at the special meeting or by submitting a duly executed proxy bearing a later date. Attendance at the special meeting will not, by itself, revoke a proxy. If you have given voting instructions to a broker, nominee, fiduciary or other custodian that holds your shares in street name, you may revoke those instructions by following the directions given by the broker, nominee, fiduciary or other custodian.

Q: If my shares are held in street name by my broker, will my broker vote my shares for me?

A: Your broker will not be able to vote your shares without instructions from you. You should instruct your broker to vote your shares, following the procedures provided by your broker. Failure to instruct your broker to vote your shares will have the effect of voting against adoption of the merger agreement.

Q: What does it mean if I receive more than one set of materials?

A: This means you own shares of Company common stock that are registered under different names. For example, you may own some shares directly as a stockholder of record and other shares through a broker; or you may own shares through more than one broker. In these situations, you will receive multiple sets of proxy materials. You must complete, sign, date and return all of the proxy cards or follow the instructions for any alternative voting procedure on each of the proxy cards that you receive in order to vote all of the shares you own. Each proxy card you receive comes with its own prepaid return envelope; if you vote by mail, make sure you return each proxy card in the return envelope that accompanies that proxy card.

Q: If the merger is completed, how will I receive the cash for my shares?

A: If the merger is completed, you will be contacted by the bank or trust company designated by AIG to act as paying agent in connection with the merger. The paying agent will provide instructions that will explain how to surrender stock certificates. You will receive cash for your shares from the paying agent after you comply with these instructions. If your shares are held for you in street name by a broker, nominee, custodian or other fiduciary, you will receive instructions from the broker, nominee, custodian or other fiduciary as to how to effect the surrender of your shares and receive cash for those shares.

Q: Should I send in my stock certificates now?

A: No. If the merger is completed, you will receive written instructions for exchanging your Company stock certificates for cash.

Q: What rights do I have to seek appraisal of my shares?

A: The Company's stockholders (other than AIG and its subsidiaries) are entitled to exercise appraisal rights in connection with the merger. If you do not vote in favor of the merger and it is completed, you may seek payment of the fair value of your shares under Delaware law. To do so, however, you must strictly comply with all of the required procedures under Delaware law. See THE MERGER AGREEMENT Appraisal Rights beginning on page 74.

Q: Who can help answer my questions?

A: If you would like additional copies, without charge, of this proxy statement, or if you have questions about the merger agreement or the merger, including the procedures for voting your shares, you may contact us in writing at 21st Century Insurance Group, 6301 Owensmouth Avenue, Woodland Hills, California 91367, or by telephone at (818) 704-3700.

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SPECIAL FACTORS

Structure of the Transaction

The proposed transaction is a merger of Merger Sub with and into the Company, with the Company continuing as the surviving corporation in the merger.

The principal steps that will accomplish the merger are as follows:

The Merger. Following the satisfaction or waiver of other conditions to the merger, the following will occur in connection with the merger:

- all shares of Company common stock that are held by the Company or any other direct or indirect wholly owned subsidiary of the Company (except for shares held on behalf of third parties) will be cancelled and retired without any consideration payable therefor;
- all shares of Company common stock that are held by AIG, Merger Sub, American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa., New Hampshire Insurance Company or any other direct or indirect wholly owned subsidiary of AIG (except for shares held by any mutual fund advised or managed by AIG, Merger Sub or any other direct or indirect wholly owned subsidiary of AIG) will remain outstanding and receive no consideration therefor;
- each outstanding vested stock option (including those options that will vest on or before the first anniversary of the effective time of the merger) at the effective time of the merger issued under a Company stock option plan will be cancelled and each holder thereof will receive from the Company, on the closing date, an amount in cash equal to the product of (1) the excess, if any, of the per-share merger consideration of \$22.00 over the per-share exercise price of such stock option, multiplied by (2) the number of shares subject to such stock option, less applicable taxes required to be withheld with respect to such payment;
- each stock option that is scheduled to vest following the first anniversary of the effective time will be terminated and, as soon as practicable following the effective time, each holder thereof will receive from AIG restricted stock units with respect to shares of AIG's common stock with a value (as reasonably determined in good faith by AIG) equal to (1) the number of shares subject to the Company options multiplied by (2) the excess of the per-share merger consideration over the exercise price per share under such Company option;
- each Company Award that has vested or will vest on or before the first anniversary of the effective time of the merger will be cancelled and each holder thereof will receive from AIG an amount of cash equal to the product of (1) the number of shares actually or nominally subject to such Company Award immediately prior to the effective time multiplied by (2) the per-share merger consideration of \$22.00, less applicable taxes required to be withheld with respect to such payment;
- each Company Award that is scheduled to vest beyond the first anniversary of the effective time will be terminated and, as soon as practicable following the effective time, each holder thereof will receive from AIG restricted stock units with respect to shares of AIG's common stock with a value (as reasonably determined in good faith by AIG) equal to (1) the number of shares actually or nominally subject to such Company Awards multiplied by (2) the per-share merger consideration of \$22.00;
- each other share of Company common stock issued and outstanding immediately before the merger becomes effective (other than any share as to which a dissenting stockholder has perfected and not withdrawn appraisal rights under Delaware law) will be converted into the right to receive \$22.00 in cash without interest;

- each share of Merger Sub common stock will be converted into a specified number of shares of common stock of the Company, as the surviving corporation in the merger; and
- each share of Company common stock the holders of which perfect their appraisal rights and strictly follow certain procedures in the manner prescribed by Section 262 of the General Corporation Law of the State of Delaware, or DGCL, will be cancelled and the holders of such shares will be entitled to receive payment of the fair value as determined pursuant to court appraisal proceedings of their shares in cash from the Company, as the surviving corporation of the merger.

See THE MERGER AGREEMENT. As a result of the merger:

- the stockholders of the Company (other than AIG and its subsidiaries, including American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company) will no longer have any interest in, and will no longer be stockholders of, the Company and will not participate in any future earnings or growth of the Company;
- AIG will own, directly or indirectly, all of the outstanding shares of the Company;
- shares of Company common stock will no longer be listed on the New York Stock Exchange, and price quotations with respect to sales of shares of Company common stock in the public market will no longer be available; and
- the registration of Company common stock under the Securities Exchange Act of 1934, or Exchange Act, will be terminated, and the Company will cease filing reports with the SEC.

Board of Directors of the Company. The board of directors of the Company after the completion of the merger will initially consist of the directors of Merger Sub at the effective time.

For additional details regarding the merger and interests of AIG in the transaction, see SPECIAL FACTORS Interests of Certain Persons in the Merger and THE MERGER AGREEMENT.

Purpose and Reasons for the Merger

Purposes and Reasons for the Merger of the Company

The Company's purpose in undertaking the merger is to allow its stockholders (other than AIG and its subsidiaries) to realize the value of their investment in the Company in cash at a price that represents a 32.6% premium to the market price of Company common stock before the public announcement of the initial proposal by AIG to acquire 100% ownership of the Company.

Purposes and Reasons for the Merger of AIG and Merger Sub

Under the SEC rules governing going private transactions, AIG and Merger Sub are deemed to be engaged in a going private transaction and therefore are required to express their reasons for the merger to the Company's unaffiliated stockholders, as defined in Rule 13e-3 to the Exchange Act. AIG and Merger Sub are making the statements included in this section solely for the purpose of complying with the requirements of Rule 13e-3 and related rules under the Exchange Act.

As part of its ordinary course operations, AIG continuously considers strategic opportunities and alternatives for its portfolio of businesses. As outlined in the amended Schedule 13D that AIG filed with the SEC on January 24, 2007, the proposal AIG made on that date marked a change in AIG's intent with regard to its ownership position in the Company. For AIG and Merger Sub, the primary purpose for the merger is to increase AIG's and its subsidiaries' ownership of the Company common stock from their current position of approximately 60.7% of the outstanding shares to 100%. AIG and Merger Sub will achieve this purpose by way of the merger of Merger Sub with and into the Company, pursuant to which all

of the shares of Company common stock not already owned by AIG and its subsidiaries (including American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company) will be cancelled in exchange for \$22.00 per share in cash, so that the Company can be operated as a wholly owned and privately held company by AIG and its subsidiaries. AIG and Merger Sub believe that structuring the transaction in such manner will enable AIG to acquire all of the outstanding shares of the Company, and at the same time, represents an opportunity for the Company's unaffiliated stockholders to monetize their investment at a full, compelling and fair cash value for their shares. AIG and its subsidiaries (including American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company) will benefit from any future earnings and growth of the Company after the merger, and they will bear the risk of their investment in the Company. The Company's unaffiliated stockholders will not benefit from any future earnings and growth of the Company after the merger, and they will not bear the risk of investment in the Company. For federal income tax consequences of the transaction for the Company's unaffiliated stockholders you should read the "Federal Income Tax Consequences" section of this proxy statement. Early in the process, AIG considered the potential for alternative transactions involving the Company, including a sale of or reduction of its controlling interest in the Company, but prior to making its initial public proposal, AIG dismissed all other alternatives except for the acquisition of the remaining shares of the Company not currently owned by it or by its subsidiaries. Other than with respect to the form of the transaction to be used and the form of the consideration to be used as described under "Special Factors - Background of the Merger," AIG and Merger Sub did not consider other alternatives to acquire the remaining shares of the Company. AIG and Merger Sub believe that structuring the transaction as a merger is preferable to a tender offer structure because a merger allows for a prompt and orderly transfer of ownership of the shares in a single step, without uncertainty as to the probability of acquiring enough shares to execute a back-end short-form merger associated with a tender offer.

AIG knows the Company's business well. AIG believes that by acquiring ownership of all of the outstanding stock of the Company it will have the opportunity to enhance the Company's performance by combining AIG's and the Company's expertise and resources in the personal auto insurance industry. AIG believes that the combination of AIG's and the Company's personal auto insurance businesses will create the scale and sophistication to enable both companies to continue to respond effectively to the marketplace. For instance, since the Company's premium volume is almost the same as AIG Direct's, the premium base over which fixed costs can be spread will effectively double. AIG also anticipates being able to consolidate the IT infrastructure and certain other functions common to each operation. Finally, AIG expects that the total capital allocated to a combined AIG Direct and Company business will be less than the sum of the capital required for the two businesses to operate independently. Due to the challenges associated with combining two businesses in any acquisition, AIG cannot determine the magnitude of these financial benefits, or the time frame in which it expects to generate them. While AIG has not yet developed specific plans or proposals in this regard, AIG has formed a transition team to develop an integration plan that AIG and the Company will implement once the merger is completed. AIG is fully committed to maximizing the long-term business potential and customer servicing capabilities of the combined platform.

In addition, AIG believes that, as a privately held entity, the Company will have the flexibility and ability to devote its efforts and resources and to focus on improving its business without the constraints and distractions caused by the public equity market's valuation of the Company and regulatory burdens imposed by federal securities laws and regulations. AIG and Merger Sub believe that the merger, when completed, would serve the long-term interests of the Company and its policyholders.

Background of the Merger

As a result of the Northridge, California earthquake in January 1994, the Company's financial position was negatively impacted. Therefore, the Company determined that it would be advisable to receive an infusion of capital in exchange for the issuance of additional equity in the Company. In December 1994, AIG and the Company (formerly known as 20th Century Industries) entered into an Investment and Strategic Alliance Agreement whereby AIG acquired beneficial ownership of 40.59% of the Company's common stock through the acquisition of Series A Convertible Preferred Stock and Series A Warrants. Subsequently, in July 1998, through a combination of converting the Series A Preferred Stock, exercising the Series A Warrants, and open market purchases as well as privately negotiated transactions, AIG accumulated beneficial ownership of additional shares of Company common stock resulting in AIG owning a majority of the outstanding shares of Company common stock. Since that time, AIG has beneficially owned a majority of the outstanding shares of Company common stock.

In June 2006, AIG retained Sullivan & Cromwell LLP (S&C) as its legal advisor, to assist it in connection with a possible transaction involving the Company. Also in June 2006, AIG retained Banc of America Securities LLC (BAS) to act as its financial advisor in connection with a possible transaction with the Company. In July 2006, AIG retained J.P. Morgan Securities Inc. (JPMorgan), collectively with BAS AIG's Banking Representatives) to act as its financial advisor in connection with a possible transaction with the Company.

On July 26, 2006, Robert M. Sandler, Chairman of the Company and an Executive Vice President of AIG, as a courtesy, began informing the Company's independent directors of AIG's potential interest in acquiring the outstanding shares of the Company not owned by AIG and its subsidiaries.

On July 27, 2006, Brian T. Schreiber, AIG's Senior Vice President Strategic Planning, contacted Bruce W. Marlow, the Company's President and Chief Executive Officer, regarding AIG's potential interest in acquiring the outstanding shares of Company common stock not owned by AIG and its subsidiaries. Mr. Schreiber sent Mr. Marlow the following letter outlining a preliminary data request to allow AIG to refine its analysis in furtherance of potentially putting forth a valuation proposal with respect to the Company, as well as a confidentiality agreement.

**AMERICAN INTERNATIONAL GROUP, INC.
70 PINE STREET
NEW YORK, NEW YORK 10270**

Brian T. Schreiber
Senior Vice President
Strategic Planning

July 27, 2006

Mr. Bruce Marlow
President and CEO
21st Century Insurance Group
6301 Owensmouth Avenue
11th Floor
Woodland Hills, CA 91367

Dear Bruce:

Per our conversation, I have attached a preliminary information request. The information requested will allow AIG to refine its analysis and, should it decide to proceed, to put forth a valuation proposal in which it has a high degree of confidence. We may request additional confirmatory information once a valuation proposal has been made.

Once the requested information has been provided we also would hope to arrange a limited number of brief conference calls with a smaller number of senior executives to discuss key issues. Bob Sandler, Steve Bensinger and Jeff Hayman may participate in internal AIG discussions in formulating our valuation proposal. We would hope to get back to you with a valuation proposal within two weeks following the conference calls.

I have also attached a proposed confidentiality agreement. I understand that you have or will inform the non-AIG directors that AIG is conducting the information review described above and that all such information would be subject to the terms of the confidentiality agreement.

Please call me after you have reviewed the attached information request and confidentiality agreement so that we can discuss process and any questions you may have.

Very truly yours,
/s/ Brian T. Schreiber

On August 9, 2006, an ad hoc committee of the Company's independent board members, including John B. De Nault III, Carlene M. Ellis, Dr. R. Scott Foster, Phillip L. Isenberg and Keith W. Renken (the ad hoc committee) met at the Los Angeles office of Skadden, Arps, Slate, Meagher & Flom LLP (Skadden Arps) with representatives of the Company's management and Skadden Arps. At the meeting, the ad hoc committee and Skadden Arps discussed the Company's process for evaluating and responding to AIG's potential interest in making a proposal for a transaction, including potentially forming a special committee of independent directors of the Company's board of directors (the Board).

Between August 9, 2006 and August 17, 2006, Skadden Arps and S&C negotiated the terms of the confidentiality agreement.

During the weeks of August 14, 2006 and August 21, 2006, the ad hoc committee, the Company's management and Skadden Arps engaged in pre-interviews with investment banking firms under consideration to provide financial advice to the ad hoc committee and eventually a special committee of the Board.

On August 17, 2006, the ad hoc committee and the Company's management participated in a conference call with Skadden Arps regarding AIG's proposed confidentiality agreement, which was effective as of the same day.

Following the execution of the confidentiality agreement, during late August and early September of 2006, the Company's management responded to AIG's initial data requests by sending summary materials regarding the Company's business to AIG, including financial statements, expansion plans, expense breakdowns, tax information and information relating to legal and regulatory issues and litigation matters affecting the Company. During this time, AIG's Banking Representatives and legal advisors held due diligence calls with Company representatives and advisors to discuss AIG's due diligence questions.

On September 11, 2006, the Company's management provided its projections to AIG.

In mid- to late-September 2006, the ad hoc committee and Skadden Arps held numerous telephonic meetings to discuss AIG's due diligence requests, the Company's financial projections prepared by the Company's management and the process of forming a special committee of the Board. Skadden Arps described the fiduciary duty standards applicable to a transaction in which AIG would purchase all of the outstanding shares not owned by it or its subsidiaries, as well as the independence standards for serving on a special committee formed to evaluate such a transaction.

On October 4, 2006, the Board held a meeting to establish a special committee of independent members of the Board (the Special Committee). The Special Committee was delegated authority to,

among other things, (a) receive, review, evaluate and study the potential transaction with AIG; (b) disclose, or direct the officers of the Company to disclose, to AIG and its representatives subject to appropriate confidentiality arrangements, such confidential information as the Special Committee deems appropriate; (c) negotiate on behalf of the Company the terms and conditions of the potential transaction with AIG; (d) negotiate a definitive agreement, subject to Board approval, with respect to the potential transaction if the Special Committee determines such transaction is fair to and in the best interests of the Company and its stockholders other than AIG; (e) make a recommendation to the Board at the appropriate time as to whether the Special Committee finds that the potential transaction is fair to and in the best interests of the Company and its stockholders other than AIG; (f) select and retain legal counsel to assist the Special Committee and independent financial advisors to assist the Special Committee and the Board; (g) if determined to be in the best interests of the Company, to recommend to the Board establishing severance and retention plans in connection with the potential transaction for the purposes of providing severance protections and retention incentives for selected key employees of the Company; and (h) select and retain such other independent professional advisors. However, the Special Committee was not authorized to solicit or encourage indications of interest from, initiate or engage in discussions or negotiations with, provide any information to, or enter into any arrangement, understanding or agreement with, any third party other than AIG. Notwithstanding, the Special Committee was entitled to consider and review alternative transactions (without taking actions described in the previous sentence) as part of its review and consideration of a potential transaction with AIG. The Special Committee is composed of Mr. John B. De Nault III, Dr. R. Scott Foster, Mr. Keith W. Renken and Ms. Carlene M. Ellis.

After the Board meeting on October 4, 2006, the Special Committee held its first official meeting and elected Mr. De Nault as Chairman. Skadden Arps provided the Special Committee with an additional overview of the directors' fiduciary duties in connection with their role as members of the Special Committee, the independence standards utilized by Delaware courts and the variety of ways a purchase of the minority shares by AIG could proceed. Representatives of potential financial advisors made presentations to the Special Committee regarding their relevant experience. Following the presentations, the Special Committee determined to retain Lehman Brothers as its financial advisor. The Special Committee also determined to retain Skadden Arps as its independent legal counsel.

Between October 4, 2006 and October 20, 2006, Lehman Brothers met with the Company's management and reviewed the financial projections prepared by the Company's management, as well as AIG's due diligence requests. In addition, Lehman Brothers held telephonic meetings with AIG's Banking Representatives, during which AIG's Banking Representatives expressed AIG's desire to obtain additional due diligence materials related to the Company's operations.

On October 20, 2006, the Special Committee held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden Arps. Lehman Brothers provided the Special Committee with an update on AIG's Banking Representatives' detailed and extensive due diligence requests and the Special Committee agreed that the materials could be provided by management unless deemed to be competitively sensitive.

On October 27, 2006, the Special Committee held a telephonic meeting with members of the Company's management, Lehman Brothers and Skadden Arps. The purpose of the meeting was to discuss with the Special Committee various methodologies for valuing the Company. Lehman Brothers discussed and reviewed with the Special Committee preliminary views on valuation based on the financial projections.

In late October and early to mid-November 2006, Lehman Brothers and AIG's Banking Representatives held numerous discussions with respect to AIG's due diligence requests and AIG's view that the assumptions underlying management's financial projections were too optimistic, and Lehman Brothers indicated that even though they had not quantified the expected synergies, which would arise from general and administrative expense savings and technology optimization, such synergies would be, in the Company's view, very significant. During this time, representatives from Skadden Arps and S&C also held discussions with respect to AIG's due diligence requests.

On November 10, 2006, the Special Committee held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden Arps. The Special Committee continued to review management's financial projections with Lehman Brothers and the Company's management. While in executive session without management, the Special Committee determined to recommend restricted stock grants and other retention programs for approximately forty-six (46) non-officer employees of the Company and its subsidiaries and also authorized Skadden Arps to contact S&C to discuss retention issues with respect to the Company's then current management.

On November 15, 2006, the Special Committee (with Dr. Foster absent) held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden Arps. Both Skadden Arps and Lehman Brothers provided the Special Committee with updates on their conversations with S&C and AIG's Banking Representatives, respectively. In addition, the Special Committee also continued to discuss retention issues.

On November 27, 2006, representatives of Lehman Brothers met with AIG's Banking Representatives to further discuss due diligence matters and valuation matters. The investment bankers engaged in lengthy discussions regarding the Company's financial projections. AIG's Banking Representatives reiterated AIG's belief that the assumptions underlying such projections were too optimistic and that there was significant risk that such projections would not be realized. In addition, AIG's Banking Representatives stated that AIG could not definitively estimate the synergies achievable from the transaction based on the information made available to AIG at that time; however, AIG believed that the Company's synergy estimates were too high and that it would take several years after completion of a transaction to fully realize any synergies. AIG's Banking Representatives also informed Lehman Brothers that AIG believed that the Company's stock was then trading at a premium to the Company's inherent value and recent trading prices, and that if a proposal were to be made by AIG, the proposed premium would be determined based on AIG's view of the Company's normalized stock price.

On November 28, 2006, the Special Committee held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden Arps. Upon the advice and input of both Lehman Brothers and Skadden Arps, the Special Committee directed Lehman Brothers to inform AIG's Banking Representatives that AIG either needed to move forward with a proposal, discontinue its consideration of a possible proposal or consider selling its majority stake.

On December 1, 2006, the Special Committee held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden to further discuss its views on valuation. In response to the Special Committee's request, Lehman Brothers prepared materials to be used as a basis for discussion with AIG's Banking Representatives to support a significant premium to the then current market price of \$17.08. The Special Committee determined that a valuation range for the Company in the mid to high 20's should be used in discussions with AIG's Banking Representatives.

During the weeks of December 4, 2006 and December 11, 2006, at the Special Committee's direction, Lehman Brothers met with AIG's Banking Representatives to discuss valuation ranges for the Company. During these meetings, AIG's Banking Representatives shared their views of significantly lower valuation ranges and continued to note that AIG believed that the assumptions underlying the Company's financial projections were overly optimistic.

On December 8, 2006, AIG's Banking Representatives met with Mr. Martin J. Sullivan, the chief executive officer of AIG, and other members of the management of AIG, to update them on the prior discussions with Lehman Brothers and to review a preliminary draft of the financial analysis which was subsequently provided to them on January 16, 2007.

On December 12, 2006, the Special Committee met with representatives from the Company's management, Lehman Brothers and Skadden Arps. Lehman Brothers updated the Special Committee on its conversation with AIG's Banking Representatives, including the AIG's Banking Representative's implied valuation ranges for the Company shares, which were in the high teens, and the fact that AIG's Banking Representatives believed that the Company's stock was then trading in excess of its inherent valuation. Both Lehman Brothers and Skadden Arps informed the Special Committee they had received indications from AIG that the gap between the implied valuation ranges of Lehman Brothers and AIG's Banking Representatives needed to be narrowed or AIG would consider either launching a tender offer or discontinuing consideration of a possible proposal.

During December of 2006 and January of 2007, representatives of the Company, AIG, Skadden Arps and S&C held additional discussions with respect to executive retention issues.

From mid-December of 2006 through mid-January of 2007, representatives of Lehman Brothers continued to have discussions with AIG's Banking Representatives regarding their respective implied valuation ranges. During this period, the discussions did not result in the narrowing of the gap between the respective implied valuation ranges of Lehman Brothers and AIG's Banking Representatives.

On January 16, 2007, AIG's Banking Representatives provided to AIG's management financial analyses regarding a possible transaction with the Company.

On January 17, 2007, representatives of AIG's management provided to the finance committee of the board of directors of AIG an update regarding a possible transaction with the Company. The finance committee authorized Mr. Sullivan to determine whether AIG would make a proposal to acquire the shares of common stock of the Company.

In light of the continuing gap between the respective implied valuation ranges presented on behalf of the Special Committee and those of AIG's Banking Representatives and AIG's views that the assumptions underlying the projections of the Company's management were too optimistic and that the Company's synergy estimates were too high, AIG determined on January 24, 2007 that there was no value in further discussions among the parties' financial advisers at that time, and that AIG would publicly announce a merger proposal and then commence negotiations with the Special Committee and its advisers in the context of such announcement and market reaction thereto. Mr. Sullivan authorized a proposal from AIG to the board of directors of the Company for AIG to acquire all of the outstanding shares of common stock of the Company not owned by AIG or its subsidiaries, at \$19.75 per share. In making this decision, AIG reaffirmed its view that it was interested only in acquiring the publicly held shares of the Company, and had no interest in selling its controlling stake in the Company.

On January 24, 2007, AIG sent the following proposal to the Board:

**AMERICAN INTERNATIONAL GROUP, INC.
70 PINE STREET
NEW YORK, NEW YORK 10270**

Martin J. Sullivan
President and
Chief Executive Officer

January 24, 2007

Board of Directors
21st Century Insurance Group
6301 Owensmouth Avenue
Woodland Hills, California 91367

Dear Board Members:

American International Group, Inc. ("AIG" or "we") is pleased to propose to acquire for cash all of the outstanding shares of common stock, par value \$0.001 (the "Shares"), of 21st Century Insurance Group (the "Company") not owned by AIG and its subsidiaries at a purchase price of \$19.75 per Share.

The proposed per Share price represents a 19.0% premium to today's closing price and a 25.5% premium to the average closing price during the last twelve months. The proposed per Share price also represents a multiple of 19.6x the consensus estimates of the Company's 2007 earnings per share (based on a current First Call estimate of \$1.01 per share).

Through its subsidiaries American Home Assurance Company, Commerce and Industry Insurance Company, National Union Fire Insurance Company of Pittsburgh, Pa. and New Hampshire Insurance Company, AIG is the Company's largest shareholder, owning approximately 61.9% of the outstanding Shares. This proposal would enable the Company's public shareholders to monetize their investment at a full and fair value for their Shares. We therefore are confident that our proposal will be attractive to the Company's public shareholders and that the Company's combination with AIG would serve the best long-term interests of the Company and its policyholders.

The proposed transaction would be effected by means of a merger agreement with the intention for the Company to become a wholly owned subsidiary of AIG. Following completion of the merger, the Company would be able to devote its full energy and resources to building the business.

This proposal is subject to AIG's satisfactory completion of due diligence, satisfaction of regulatory requirements and the approval by a special committee comprised of directors of the Company who are independent of AIG. AIG is interested only in acquiring the publicly held Shares of the Company, and has no interest in selling its controlling stake in the Company. Please be aware that in making this proposal, AIG reserves the right both to withdraw this proposal prior to the execution of a definitive merger agreement and to modify it in any way as a result of negotiations or for any reason at all, including proposing alternative acquisition structures.

Concurrent with sending this proposal to you, AIG is filing an amendment to its Schedule 13D, as required by the Securities Exchange Act of 1934, and plans to issue a press release. In connection with this proposal, AIG has engaged Banc of America Securities LLC and J.P. Morgan Securities Inc. as financial advisors and Sullivan & Cromwell LLP as legal advisor. We are happy to make them available to you to help expedite the transaction.

We look forward to working with you.

Very truly yours,
/s/ Martin J. Sullivan

Concurrent with the delivery of the proposal, AIG issued a press release highlighting the general terms of its proposal and on January 25, 2007, AIG filed an amendment to its Schedule 13D.

On January 25, 2007, the closing price of the common stock of the Company was \$20.93. For the period between January 25 and May 14, inclusively, the volume weighted average price of the common stock of the Company was \$21.06 and the intraday low and high prices for this period ranged between \$20.53 and \$21.86.

On January 25, 2007, the Special Committee held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden Arps. The Special Committee discussed the AIG offer at length. Both Lehman Brothers and Skadden Arps informed the Special Committee of their discussions with S&C and AIG's Banking Representatives, respectively. Management provided the Special Committee with an update with respect to the Company's 2006 fourth quarter results as well as revised projections for the first two quarters of 2007. In light of the information provided by management with respect to the Company's 2006 fourth quarter results and the projections for the first two quarters of 2007, the Special Committee directed management to update the financial projections for the remainder of the projected period.

Following the announcement of AIG's proposal, on January 29, 2007, two putative class action lawsuits were filed by certain of the Company's stockholders against the Company, its directors and AIG in the Delaware Court of Chancery. The complaints generally alleged that the Company's directors and AIG had violated their fiduciary duties owed to the Company's unaffiliated stockholders in connection with AIG's proposal and sought, among other things, to enjoin the AIG proposal or, in the alternative, damages in an unspecified amount and rescission in the event a transaction occurred pursuant to the proposal, as more fully described under the heading entitled "SPECIAL FACTORS Litigation Related to the Merger" beginning on page 62. During the following weeks, representatives of AIG and the Company cooperated in determining how to respond to the lawsuits.

On January 29, 2007, S&C sent additional AIG due diligence request lists to Skadden Arps.

On January 31, 2007, the Special Committee held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden Arps. As requested by the Special Committee, management provided the Special Committee with information regarding 2006 preliminary results and a preliminary revision of its projections for 2007. Skadden Arps discussed alternate transaction structures with the Special Committee. Specifically, the Special Committee discussed the possibility of pursuing a stock-for-stock transaction instead of AIG's proposed cash-for-stock transaction and agreed that a stock-for-stock transaction might be preferable to those minority stockholders who had a low tax basis in the Company's stock and that other stockholders would likely be indifferent to a stock transaction given the liquidity of AIG's stock.

On February 6, 2007, the Special Committee held a telephonic meeting with representatives of the Company's management, Lehman Brothers and Skadden Arps regarding the financial projections. At the meeting, management and Lehman Brothers reviewed with the Special Committee the projections, which included a revision of the Company's 2007 earnings projection from \$1.16 per share to \$0.91 per share and Lehman Brothers' valuation views reflecting such updated projections. The revised projections reflected a decrease in premiums growth rates and higher combined ratios in later years compared to the original projections provided by the Company's management team. Following such review, the Special Committee engaged in a lengthy discussion of potential responses to AIG's proposal and decided to respond to AIG with a counterproposal of \$26.00 per share.

On February 8, 2007, Lehman Brothers met with AIG's Banking Representatives to deliver the Company's \$26.00 per share counterproposal, the Company's revised financial projections and the Company's analysis of cost synergies resulting from the transaction. Subsequently, AIG's Banking Representatives communicated to Lehman Brothers AIG's rejection of the counterproposal. Upon the rejection of the proposal, Lehman Brothers communicated to AIG's Banking Representatives that it expected AIG to indicate some flexibility above AIG's proposed \$19.75 price.

On February 9, 2007, the Special Committee held a telephonic meeting with representatives of the Company's management, Lehman Brothers and Skadden Arps to receive a summary of the previous day's discussions with AIG's Banking Representatives. Lehman Brothers reported that AIG had rejected the \$26.00 per share counterproposal. The Special Committee also discussed providing the Board with an update on the status of negotiations at the next regularly scheduled Board meeting.

On February 13, 2007, Lehman Brothers met with AIG's Banking Representatives, who notified Lehman Brothers that AIG might have some flexibility above its proposed \$19.75 per share price provided its due diligence findings were satisfactory.

On February 20 and February 21, 2007, the Board held its regularly scheduled meetings. At these meetings, Mr. De Nault provided an update with respect to the Special Committee's progress in its negotiations with AIG.

During February and March of 2007, the Company provided due diligence materials to AIG and the respective representatives held telephonic meetings with respect to due diligence questions and issues.

On February 23, 2007, the Special Committee held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden Arps. Skadden Arps provided an update to the Special Committee on a possible stock-for-stock transaction and it was agreed that continuing to pursue a stock-for-stock transaction would be in the best interests of the minority stockholders. In response to a request from AIG, the Special Committee also directed management to set up on-site information technology (IT) meetings and presentations for AIG the following week.

From February 27 to March 1, 2007, on-site IT due diligence meetings with AIG were conducted at the Company's Woodland Hills office.

In late February 2007, representatives of Skadden Arps and S&C had several discussions regarding the structure of a potential stock-for-stock transaction.

On March 2, 2007, the Special Committee held a telephonic meeting with representatives of the Company's management, Lehman Brothers and Skadden Arps. As previously disclosed to the Special Committee, during the meeting's executive session without management and Lehman Brothers present, Mr. De Nault reiterated to the Special Committee that one of the trusts holding shares of Company common stock, of which he is a beneficiary, includes a provision which could result in the shifting of benefits thereunder away from Mr. De Nault if the shares of Company common stock held by the trust were sold for cash. Mr. De Nault informed the Special Committee that the number of shares held in the trust represented approximately 9% of the total number of shares of Company common stock beneficially owned by him, and that he did not believe such amount to be material to his net worth. The Special Committee discussed the issue at length with Skadden Arps without Mr. De Nault present, and determined that it did not constitute a material conflict of interest. In determining that Mr. De Nault did not have a material conflict of interest, the Special Committee considered that Mr. De Nault's shares held in trust are not material to his overall Company holdings or his net worth, as well as his consistent efforts to demand a high valuation for the Company. The Special Committee also determined that Mr. De Nault's input to the Special Committee was valuable and beneficial to the interests of the minority stockholders and that therefore Mr. De Nault should remain a member of the Special Committee. However, to avoid the appearance of the issue being a conflict, the Special Committee resolved that Mr. De Nault would become a non-voting member of the Special Committee, regardless of whether cash or stock was received in a potential transaction with AIG.

On March 5, 2007, the Special Committee held a meeting at Skadden Arps' offices in San Francisco with representatives of the Company's management, Lehman Brothers and Skadden Arps. Skadden Arps provided the Special Committee with an update on potential transaction structures and discussed making the approval of a proposed transaction subject to the approval of a majority of the Company's outstanding shares other than those owned by AIG and its subsidiaries. After hearing from its advisors, the Special

Committee determined that its demands for a significant premium to the current proposal could be somewhat lessened if AIG would consider a stock-for-stock transaction because low tax basis stockholders could achieve a tax-free exchange and all stockholders would have a continuing interest in the combined operations. Accordingly, the Special Committee directed Lehman Brothers to propose a counter-offer of approximately \$24.00 per share, for a stock-for-stock transaction subject to a majority of the minority voting requirement condition.

On March 9, 2007, Lehman Brothers met with AIG's Banking Representatives. Lehman Brothers and AIG's Banking Representatives discussed the status of due diligence and AIG's preliminary findings and observations with respect to these matters. AIG's Banking Representatives also indicated that following a three-day long detailed review of the Company's IT systems on-site, AIG had concluded that it would have to make a significant capital investment and incur significant on-going maintenance costs to integrate its existing platform with the Company's. Accordingly, AIG's Banking Representatives viewed the expected cost savings from the transaction to be less than those anticipated by the Company. In response to the Special Committee's request for AIG to indicate some flexibility in price, AIG's Banking Representatives communicated to Lehman Brothers that the magnitude of AIG's flexibility had been impacted by the evaluation of the Company's recent and projected performance and systems capabilities. AIG's Banking Representatives indicated that they would recommend to AIG increasing AIG's \$19.75 proposal by approximately 5%. In addition, AIG's Banking Representatives informed Lehman Brothers that AIG would not consider a stock transaction.

On March 16, 2007, S&C sent Skadden Arps a draft of AIG's proposed merger agreement. Over the course of the next several weeks, Skadden Arps, the Special Committee and the Company's management had numerous discussions regarding the terms and conditions of the proposed merger agreement.

On March 19, 2007, the Special Committee held a telephonic meeting with representatives of the Company's management, Lehman Brothers and Skadden Arps. Skadden Arps reported to the Special Committee on its conversation with S&C, during which S&C informed Skadden Arps that AIG's unwillingness to consider a stock-for-stock transaction was because such a transaction would be inconsistent with AIG's March 1, 2007 public announcement of its expansion of its share repurchase program. Lehman Brothers reported to the Special Committee on its recent conversation with AIG's Banking Representatives, during which AIG's Banking Representatives informed Lehman Brothers of AIG's view with respect to the expected cost savings from the transaction. Moreover, taking into consideration the softening auto industry market outlook and the Company's recent earnings results, Lehman Brothers advised the Special Committee regarding a potential counter-offer proposal. The Special Committee engaged in a lengthy discussion of the issues and valuations presented and agreed to make to AIG a bifurcated proposal of \$23.00 per share with AIG stock as consideration or \$24.00 per share with cash as consideration, subject to a majority of the minority voting requirement condition and AIG's agreement that the transaction would constitute a change of control for purposes of the Company's SERP.

On March 21, 2007, Lehman Brothers met with AIG's Banking Representatives to communicate the bifurcated proposal by the Special Committee. The bankers discussed the proposal and potential IT synergies, and AIG's Banking Representatives reiterated AIG's refusal to include AIG stock as consideration.

On March 23, 2007, AIG's Banking Representatives again reiterated to Lehman Brothers that AIG was not willing to consider a stock-for-stock transaction and asked Lehman Brothers to confirm that the Company's proposal for a cash transaction was at \$24.00 per share. During the same meeting, Lehman Brothers confirmed the \$24.00 per share price for a cash transaction.

On March 28, 2007, AIG's Banking Representatives shared the results of AIG's IT due diligence with Lehman Brothers.

On March 30, 2007, AIG's Banking Representatives provided a presentation to AIG's management which was an updated version of the presentation made on January 16, 2007.

On April 5, 2007, Lehman Brothers had a telephonic meeting with AIG's Banking Representatives. At this meeting, AIG's Banking Representatives said they were prepared to recommend to AIG that it increase its proposed price to \$21.25 in cash per share, with the merger agreement substantially in the form presented, with no majority of the minority condition and completion of bring-down diligence. AIG's Banking Representatives also said they did not believe AIG had any additional flexibility with regard to the price offered. On April 4, 2007, the closing price of the common stock of the Company was \$20.97.

On April 6, 2007, the Special Committee held a telephonic meeting with representatives of the Company's management, Lehman Brothers and Skadden Arps. Lehman Brothers updated the Special Committee on its discussions with AIG's Banking Representatives. The meeting participants discussed at length the proper response to the aforementioned discussion of a potential proposal by AIG of \$21.25 in cash per share. To assist in preparing a response, the Special Committee asked management for an update on first quarter financial results of the Company for 2007.

On April 10, 2007, the Special Committee held a telephonic meeting with representatives of Lehman Brothers and Skadden Arps. Lehman Brothers updated the Special Committee on numerous conversations they had with AIG's Banking Representatives and recommended that the Special Committee propose to AIG a transaction at \$22.00 in cash per share without a majority of the minority voting requirement condition. The Special Committee engaged in a lengthy discussion of such a potential proposal, focusing on numerous factors, including AIG's and the Company's respective views regarding the synergies achievable from the transaction, the increasingly difficult conditions in the personal lines of the property and casualty business and the Company's recent earnings results. The voting members of the Special Committee indicated that they would be in favor of a transaction at that price. However, Mr. De Nault indicated that he was uncertain whether he could support a \$22.00 per share offer because he was unsure that the offer represented the highest valuation that could be obtained for stockholders.

On April 12, 2007, Lehman Brothers informed AIG's Banking Representatives that the three voting members of the Special Committee would be willing to support a transaction at \$22.00 in cash per share.

On April 16, 2007, the Special Committee held a telephonic meeting with representatives of Lehman Brothers and Skadden Arps. Skadden Arps informed the Special Committee that S&C had indicated that AIG desired to approach Mr. Marlow to negotiate an agreement to retain Mr. Marlow as the chief executive of the surviving corporation in the event a transaction were to be consummated. Mr. De Nault expressed his willingness to support a \$22.00 per share offer if arrangements with respect to the Company's continued payment of dividends were included in the terms of the transaction. Finally, the Special Committee agreed that AIG should not engage in discussions with Mr. Marlow regarding his employment until the parties were closer to reaching an agreement with respect to a transaction.

Throughout the course of the next several weeks, Skadden Arps and S&C had numerous discussions and exchanged drafts of the merger agreement and the accompanying Company Disclosure Letter. During the course of such discussions, S&C notified Skadden Arps that AIG would not proceed with the transaction unless it had certainty with respect to Mr. Marlow's future employment arrangements.

On April 20, 2007, the Special Committee held a telephonic meeting with representatives of Lehman Brothers and Skadden Arps. Skadden Arps updated the Special Committee on negotiations regarding the draft merger agreement. Skadden Arps also informed the Special Committee that AIG was making any transaction contingent upon having certainty with respect to Mr. Marlow's future employment arrangements.

Also on April 20, 2007, Ms. Ellis and Mr. De Nault spoke with Mr. Marlow and provided him with an update on the merger agreement negotiations as well as AIG's desire to reach agreement with Mr. Marlow regarding his future employment arrangements. Ms. Ellis and Mr. De Nault both expressed the Special

Committee's support for Mr. Marlow to engage in discussions with AIG, and the Special Committee subsequently formally requested that Mr. Marlow engage in discussions with AIG.

On April 27, 2007, Messrs. Sullivan, Robert M. Sandler, Executive Vice President Domestic Personal Lines of AIG and Steven J. Bensinger, Executive Vice President and Chief Financial Officer of AIG, met with Mr. Marlow to discuss the terms of Mr. Marlow's continued employment with the Company. During the course of the next few weeks, AIG and its representatives and Mr. Marlow and his representatives held additional discussions and negotiations with respect to the terms of Mr. Marlow's continued employment with the Company following the merger. During this time, AIG and its representatives, and the Company and its representatives also negotiated the assumptions to be used in relation to change in control payouts to the officers of the Company who participated in the Company's SERP.

On May 2, 2007, the Special Committee (with Dr. Foster absent) held a telephonic meeting with representatives of Lehman Brothers and Skadden Arps. Skadden Arps informed the Special Committee as to AIG's requirement that in addition to Mr. Marlow's employment agreement, AIG would require that other officers sign retention agreements and agree to forego any payments under the Company's executive severance plan in exchange for the retention and severance benefits under such retention agreements and the right to elect an early payout of the SERP. Also at the meeting, the Special Committee discussed the current status of the draft merger agreement. The Special Committee felt that AIG's proposed termination fee was too high and directed Skadden Arps to engage in further negotiations on this point. The Special Committee also discussed considering a proposal with respect to the Company's payment of dividends to provide additional value to the Company's minority stockholders.

On May 4, 2007, AIG sent the Company a draft retention and severance agreement for the officers of the Company. During the course of the next few weeks AIG and its representatives, and the Company and its representatives, held additional discussions and negotiations with respect to the retention and severance agreements.

On May 9, 2007, the Special Committee (with Dr. Foster absent) held a telephonic meeting with representatives of Lehman Brothers and Skadden Arps. The Special Committee received updates from its advisors on the status of Mr. Marlow's employment discussions and the arrangements with the Company's other officers and the draft merger agreement. The Special Committee scheduled a meeting to consider the transaction for Monday, May 14, 2007, to be followed by a meeting of the full Board in the event that the Special Committee recommended and approved the merger agreement.

On May 12, 2007, Skadden Arps sent S&C a comprehensive proposal covering the open issues in the merger agreement, including a proposal for a per-share merger consideration of \$22.00 in cash and a requirement for a minimum fixed amount with respect to the Company's ongoing payment of dividends. AIG rejected the proposal with respect to the ongoing payment of dividends and consequently the comprehensive proposal from the Special Committee was withdrawn. Thereafter, Skadden Arps and S&C continued to negotiate on the open issues in the merger agreement.

Over the course of the next day, Skadden Arps and S&C held several telephonic meetings, exchanged drafts of the merger agreement and Company Disclosure Letter, and continued negotiations regarding the final unresolved terms of the merger agreement.

On May 14, 2007, Skadden Arps sent S&C a modified comprehensive proposal, again including a per share merger consideration of \$22.00, but with a modified dividend proposal that would permit the Company to pay a pro rata dividend at closing for the time that accrues between the last record date for ordinary dividends and the closing date. S&C subsequently informed Skadden Arps that AIG found their proposal acceptable.

Later on May 14, 2007, the Special Committee held a telephonic meeting with representatives from the Company's management, Lehman Brothers and Skadden Arps for the purpose of considering recommending the merger agreement for the Board's approval and adoption. Skadden Arps presented the members of the Special Committee with an overview of the final terms of the merger agreement, as well as Mr. Marlow's employment arrangements and the retention and severance agreements with certain other Company officers. Lehman Brothers gave a presentation with respect to the financial aspects of the proposed transaction and delivered its oral opinion, subsequently confirmed in writing, that as of that date and based on and subject to matters stated in such opinion, the proposed consideration was fair, from a financial point of view, to the Company's stockholders (other than AIG and its subsidiaries). After considering the proposed price of \$22.00 per share, the terms of the merger agreement and the various presentations of Lehman Brothers, including Lehman Brothers' oral opinion, the voting members of the Special Committee unanimously approved a recommendation from the Special Committee to the Board that the merger agreement and the merger be approved and adopted and that the Board recommend that the Company's stockholders approve the merger agreement.

Following the Special Committee's determination to recommend approval and adoption of the merger agreement, the Board met to receive the recommendation of the Special Committee. Based on the recommendation of the Special Committee, the Board unanimously approved and adopted the merger, the merger agreement and the transactions contemplated by it.

On the night of May 14, 2007, the Company, AIG and Merger Sub executed the merger agreement, dated May 15, 2007, and on May 15, 2007, each issued press releases announcing the execution of the merger agreement.

On June 8, 2007, the Company, AIG and Merger Sub executed Amendment No. 1 to Agreement and Plan of Merger, dated as of June 8, 2007.

Recommendations of the Company, the Special Committee and the Board of Directors; Reasons for Recommending the Approval and Adoption of the Merger Agreement

Both the Special Committee and the Board of the Company have determined that the merger agreement and the merger are advisable, substantively and procedurally fair to and in the best interests of the unaffiliated stockholders of the Company. The Special Committee (with Mr. De Nault not voting due to his status as a non-voting member of the Special Committee) has unanimously recommended that the board of directors:

- approve and adopt the merger agreement;
- approve the merger; and
- recommend that the stockholders of the Company vote for the approval of the merger agreement.

After considering the recommendation of the Special Committee, the Board approved and adopted the merger agreement, approved the merger and resolved to recommend to the Company's stockholders that they vote for the adoption and approval of the merger agreement.

In reaching their determinations and making their recommendations, both the Special Committee and the Board relied on the Company's management to provide financial information, projections and assumptions (based on the best information available to management at that time), as the starting point for their analyses.

In reaching its determination and making its recommendation, the Special Committee considered factors including:

- the opinion delivered by Lehman Brothers on May 14, 2007 that, as of that date and based on and subject to the assumptions, limitations and qualifications set forth in the opinion, from a financial

point of view, the consideration to be offered to the stockholders of the Company (other than AIG and its subsidiaries) in the merger is fair to such stockholders;

- the fact that the merger consideration of \$22.00 per share in cash to be received by the Company's stockholders (other than AIG and its subsidiaries) represented, at the time of the Special Committee's determination, a 32.6% premium over the closing price of Company common stock on January 24, 2007, the last trading day before the public announcement of AIG's initial proposal to acquire 100% ownership of the Company, and a 39.8% premium to the average closing price for the twelve months prior to January 24, 2007;
- the Special Committee's consideration of the various analyses undertaken by Lehman Brothers, each of which is described below under "SPECIAL FACTORS" Opinion of the Financial Advisor to the Special Committee ;
- the Special Committee's belief, based on the performance of Company common stock immediately following the initial January 24, 2007 announcement of the proposal by AIG to acquire 100% ownership of the Company at a price of \$19.75 per share, absent any other operational announcement and absent a similar increase in the stock prices of the Company's industry peers, that the increase in the market price of Company common stock following that announcement reflected primarily anticipation of a possible acquisition by AIG, rather than a perception of higher intrinsic value for Company common stock;
- the active and direct role of the members of the Special Committee and their representatives in the negotiations with respect to the merger, and the consideration of the transaction by the Special Committee at numerous Special Committee meetings;
- the negotiations that took place between the Special Committee and its representatives, on the one hand, and representatives of AIG, on the other hand, with respect to the increase in the merger consideration from the initial offer at \$19.75 per share to \$22.00 per share and the belief by the members of the Special Committee that \$22.00 per share was the highest price that AIG would agree to pay to the Company's stockholders (other than AIG and its subsidiaries);
- the merger consideration of \$22.00 per share in cash in relation to the then-current market price of Company common stock, the then-current value of the Company in a freely negotiated transaction and the future value of the Company as an independent entity;
- the fact that, to date, no third party has come forward with an alternative transaction proposal;
- the belief that no alternative bidder would be able to consummate an acquisition of the Company due to AIG's position that it is unwilling to sell its shares of Company common stock, which shares represent a controlling interest in connection with any transaction involving the acquisition of the Company;
- the terms of the merger agreement that permit the Company and the Special Committee to explore, under specified circumstances, an unsolicited acquisition proposal and, if the Special Committee determines (i) that an unsolicited acquisition proposal constitutes, or is reasonably likely to constitute a Superior Proposal and (ii) that the failure to take such action would reasonably be expected to result in a failure of the directors' fiduciary duties under applicable law, permit the Board or the Special Committee to withhold, modify or withdraw its recommendation with respect to the merger agreement and the merger;
- the Company's right to terminate the merger agreement in the event that the Board or the Special Committee withholds, modifies or withdraws its recommendation with respect to the merger agreement and the merger subject to the payment of a termination fee; and

- the availability to stockholders who vote against approval of the merger agreement of appraisal rights under Delaware law, which provide stockholders who dispute the fairness of the merger consideration with an opportunity to have a court determine the fair value of their shares.

The Special Committee believes that each of these factors supported its conclusion that the merger is advisable, substantively and procedurally fair to and in the best interests of the Company's unaffiliated stockholders.

In evaluating the merger and related transactions, the Special Committee did not consider:

- the net book value of the Company, because it believed that net book value is not a material indicator of the value of the Company as a going concern but rather is indicative of historical results; or
- the liquidation value of the Company, because the Special Committee considered the Company as a viable, going concern business, and therefore did not consider the liquidation value as a relevant valuation methodology.

In addition, the Special Committee did not establish, and did not consider, a pre-merger going concern value for the equity of the Company and does not believe there is a single method of determining going concern value, although the Special Committee believes the analyses of Lehman Brothers in their totality may be reflective of going concern value.

The Special Committee also considered a variety of risks and other potentially negative factors concerning the merger agreement and the transactions contemplated by it, including the merger. These factors included:

- the fact that, following the merger, the Company's stockholders (other than AIG and its subsidiaries) will no longer participate in any future earnings of the Company or benefit from any increases in the Company's value;
- the fact that, because AIG has agreed to vote, or cause to be voted, approximately 61% of the voting power of Company common stock in favor of approving the merger, the proposed merger does not require the approval of any unaffiliated stockholders;
- the fact that there may be disruptions to the Company's operations following the announcement of the merger;
- the fact that, while the Company expects the merger will be consummated, there can be no assurances that all conditions to the parties' obligations to complete the merger agreement will be satisfied and, as a result, the merger may not be consummated;
- the fact that restrictions on the conduct of the Company's business prior to the consummation of the merger require the Company to conduct its business in the ordinary course, subject to specific limitations, which may delay or prevent the Company from pursuing business opportunities that may arise pending completion of the merger; and
- the fact that, for U.S. federal income tax purposes, the merger consideration will be taxable to the Company's stockholders receiving the merger consideration.

This discussion of the information and factors considered by the Special Committee in reaching its conclusions and recommendation includes all of the material factors considered by the Special Committee, but is not intended to be exhaustive. In view of the wide variety of factors considered by the Special Committee in evaluating the merger agreement and the transactions contemplated by it, including the merger, and the complexity of these matters, the Special Committee did not find it practicable, and did not attempt, to quantify, rank or otherwise assign relative weight to those factors. In addition, different members of the Special Committee may have given different weight to different factors.

The Special Committee believes that sufficient procedural safeguards were and are present to ensure the fairness of the merger and to permit the Special Committee to represent effectively the interests of the Company's unaffiliated stockholders. These procedural safeguards include the following:

- the Special Committee's active and intense negotiations, with the assistance of its advisors, with representatives of AIG regarding the merger consideration and the other terms of the merger and the merger agreement;
- other than their receipt of Board and Special Committee fees, their indemnification and liability insurance rights under the merger agreement and their entitlement to receive cash, in respect of their Company stock options and Company Awards in connection with the merger, members of the Special Committee do not have an interest in the merger different from that of the Company's unaffiliated stockholders;
- the Special Committee retained and received the advice and assistance of Lehman Brothers as its financial advisor and Skadden Arps as its legal advisor, and requested and received from Lehman Brothers an opinion, delivered orally and confirmed in writing on May 14, 2007, with respect to the fairness from a financial point of view of the merger consideration to be offered to the Company's stockholders (other than AIG and its subsidiaries);
- the recognition by the Special Committee that it had no obligation to recommend the approval of the merger proposal or any other transaction;
- the recognition by the Special Committee that the Board could consider and recommend superior proposals; and
- the availability of appraisal rights under Delaware law for the Company's stockholders who oppose the merger.

In light of the procedural safeguards described above, the Special Committee did not consider it necessary to retain an unaffiliated representative to act solely on behalf of the Company's unaffiliated stockholders for purposes of negotiating the terms of the merger agreement or preparing a report concerning the fairness of the merger agreement and the merger.

In reaching its determination that the merger agreement and the merger are advisable, substantively and procedurally fair to and in the best interests of the Company's unaffiliated stockholders, the Board determined that the analysis of the Special Committee was reasonable and expressly adopted the analysis of the Special Committee as to the fairness to the Company's unaffiliated stockholders of the merger consideration of \$22.00 per share. In determining the reasonableness of the Special Committee's analysis and adopting the Special Committee's analysis, the Board considered and relied upon:

- the process the Special Committee conducted in considering the merger;
- the Special Committee's having retained and received advice from its independent legal counsel, Skadden Arps;
- the Special Committee's having retained and received advice from its independent financial advisor, Lehman Brothers;
- the Special Committee's recommendation on May 14, 2007 that the Board determine that the merger agreement and the merger are advisable, substantively and procedurally fair to and in the best interests of the Company's unaffiliated stockholders and approve and adopt the merger agreement and approve the transactions contemplated by the merger agreement, including the merger; and
- the availability of appraisal rights under Delaware law for the Company's stockholders who oppose the merger.

The Board also believes that sufficient procedural safeguards were present to ensure the fairness of the transaction and to permit the Special Committee to represent effectively the interests of the Company's unaffiliated stockholders. The Board reached this conclusion based on, among other things:

- the fact that the Special Committee consisted solely of independent directors who are not affiliated with AIG;
- the selection and retention by the Special Committee of its own financial advisor and legal counsel;
- the fact that the negotiations that had taken place between representatives of AIG, on the one hand, and the Special Committee and its representatives, on the other hand, were structured and conducted so as to preserve the independence of the Special Committee and promote the fairness of the transaction; and
- the fact that the merger agreement and the merger were approved by the members of the Board who are not employees of the Company or affiliated with AIG.

In light of the procedural protections described above, the Board, including each of the non-employee directors, did not consider it necessary either to require a separate affirmative vote of a majority of the Company's stockholders (other than AIG and its subsidiaries) or to retain an unaffiliated representative to act solely on behalf of the Company's unaffiliated stockholders for purposes of negotiating the terms of the merger agreement or preparing a report concerning the fairness of the merger agreement and the merger.

In view of the wide variety of factors considered by the Board in evaluating the merger and the complexity of these matters, the Board did not find it practicable, and did not attempt, to quantify, rank or otherwise assign relative weight to those factors. In addition, different members of the Board may have given different weight to different factors.

Based in part upon the recommendation of the Special Committee, the Board unanimously voted to approve and adopt the merger agreement and resolved to recommend that you vote FOR, the approval of the merger agreement.

If the merger is consummated, members of the Board will be entitled to receive an aggregate of approximately \$67.7 million, consisting of merger consideration and cash in respect of Company stock options and Company Awards, respectively, approximately \$48.2 million of which would be received by members of the Special Committee. See SPECIAL FACTORS Interests of Certain Persons in the Merger.

The Board, based in part on the recommendation of the Special Committee, unanimously recommends that the Company's stockholders vote FOR the approval of the merger agreement. The recommendation of the Board was made after consideration of all the material factors, both positive and negative, as described above.

Position of AIG and Merger Sub as to the Fairness of the Merger to 21st Century's Unaffiliated Stockholders

Under the SEC rules governing going private transactions, AIG and Merger Sub are deemed to be engaged in a going private transaction and therefore are required to express their beliefs as to the substantive and procedural fairness of the merger to the Company's unaffiliated stockholders. AIG and Merger Sub are making the statements included in this section solely for the purposes of complying with the requirements of Rule 13e-3 and related rules under the Exchange Act. AIG's and Merger Sub's views as to fairness of the proposed merger should not be construed as a recommendation to any stockholder of the Company as to how such stockholder should vote on the proposal to adopt and approve the merger agreement.

The Company's unaffiliated stockholders were represented by the Special Committee, which negotiated the terms and conditions of the merger agreement on their behalf, with the assistance of the Special Committee's independent financial and legal advisors. Accordingly, neither AIG nor Merger Sub undertook any independent evaluation of the fairness of the proposed merger or engaged a financial advisor for such purposes. AIG and Merger Sub did not participate in the deliberations of the Special Committee regarding, or receive advice from the Special Committee's legal or financial advisors as to, the substantive and procedural fairness of the proposed merger. AIG and Merger Sub believe, however, that the proposed merger is substantively and procedurally fair to the unaffiliated stockholders of the Company based on the following factors:

- the merger consideration of \$22.00 per share represents a premium of approximately 32.6% to the \$16.59 closing price of Company common stock on the New York Stock Exchange on January 24, 2007, the last trading day before the public announcement of AIG's proposal to acquire the publicly held shares of the Company, a 39.8% premium to the Company's average closing price for the twelve months prior to January 24, 2007 and a 4.8% premium to the \$21.00 closing price of the Company's common stock on the New York Stock Exchange on May 14, 2007, the last trading day before the announcement of the merger agreement;
- the merger will provide consideration to the Company's stockholders entirely in cash, thus eliminating any uncertainty in valuing the merger consideration;
- the fact that there are no non-customary requirements or conditions to the merger and that the merger is not conditioned on any financing being obtained by AIG, thus increasing the likelihood that the merger will be consummated and the consideration to be paid to the Company's stockholders will be paid;
- the merger agreement allows the Board or the Special Committee to withdraw or change its recommendation of the merger agreement, and to terminate the merger agreement in certain circumstances, subject, in certain cases, to a payment by the Company to AIG of \$24.3 million as a termination fee (and given AIG's current 60.7% interest in the Company, AIG will effectively be incurring 60.7% of this fee);
- the fact that the Board established a Special Committee of independent directors, consisting solely of directors who are not officers, employees or controlling stockholders of the Company and are not affiliated with AIG or Merger Sub, to negotiate with AIG and Merger Sub, and to determine if and under what conditions the Company would enter into a merger agreement with AIG;
- the fact that the Special Committee, which was formed on October 4, 2006, was deliberative in its process, analyzing, evaluating and negotiating the terms of the proposed merger and the active and direct role of the members of the Special Committee and their representatives in the negotiations with respect to the merger, and the consideration of the transaction by the Special Committee at numerous Special Committee meetings;

- the fact that neither AIG nor Merger Sub participated in or had any influence on the deliberative process of, or the conclusions reached by, the Special Committee or the negotiating positions of the Special Committee;
- the fact that the Board and Special Committee retained nationally recognized financial and legal advisors, each of which has extensive experience in transactions similar to the proposed merger;
- the \$22.00 per share merger consideration and other terms and conditions of the merger agreement resulted from extensive negotiations between the Special Committee and its advisors and AIG and Merger Sub and their advisors;
- the voting members of the Special Committee unanimously determined that the merger agreement and the merger are advisable, substantively and procedurally fair to, and in the best interests of the Company and its unaffiliated stockholders;
- the Board unanimously determined that the merger agreement and the merger are advisable, substantively and procedurally fair to, and in the best interests of the Company and its unaffiliated stockholders;
- the fact that the Special Committee received an opinion from its financial advisor, to the effect that, as of the date of the opinion and based upon and subject to the factors and assumptions set forth therein, the \$22.00 in cash per share to be received by the holders of Company common stock is fair from a financial point of view to such stockholders, see SPECIAL FACTORS Opinion of the Financial Advisor to the Special Committee ;
- stockholders who do not vote in favor of the merger agreement and who comply with certain procedural requirements will be entitled, upon completion of the merger, to exercise statutory appraisal rights under Delaware law, which allow stockholders to have the fair value of their shares determined by the Delaware Chancery Court and paid to them in cash;
- the merger will provide liquidity, without the brokerage and other costs typically associated with market sales, for the Company's public stockholders whose ability, absent the merger, to sell their shares of Company common stock is adversely affected by the limited trading volume and low public float of the shares.
- that the principal advantage of the Company continuing as a public company would be to allow public stockholders to continue to participate in any growth in the value of the Company's equity, but that, under all of the relevant circumstances and in view of the historical results of operations, financial condition, assets, liabilities, business strategy and prospects of the Company, the nature of the industry in which the Company competes, and trading characteristics of companies with market capitalization similar in size to that of the Company, and in light of the proposed merger consideration of \$22.00 per share, the value to stockholders that would be achieved by continuing as a public company was not likely to be as great as the merger consideration of \$22.00 per share;
- the merger consideration of \$22.00 per share in cash in relation to the then-current market price of Company common stock, the then-current value of the Company in a freely negotiated transaction and the future value of the Company as an independent entity;
- the belief that no alternative bidder would likely be able to consummate an acquisition of the Company due to AIG's position that it is unwilling to sell its shares of Company common stock, which shares represent a controlling interest, in connection with any transaction involving the acquisition of the Company, and that therefore a process to solicit indications of interest from other potential acquirers of the Company was unnecessary and impractical;

- that the Special Committee had no obligation to recommend the approval of the merger proposal or any other transaction; and
- that the Board could consider and recommend superior proposals.

The board of directors and the Special Committee did not (i) retain an unaffiliated representative (other than the Special Committee and its legal and financial advisors) to act solely on behalf of unaffiliated stockholders for purposes of negotiating the terms of the merger agreement, or (ii) structure the transaction to require approval of at least a majority of unaffiliated stockholders. AIG and Merger Sub believe, however, that taking into account the factors listed above, as well as the fact that the agreement between AIG, Merger Sub and the Company resulted from arms-length negotiations between the Special Committee and its advisors and AIG and Merger Sub and their advisors, the absence of these two safeguards did not diminish the fairness of the process undertaken by the Board and the Special Committee. Although AIG's Banking Representatives generally assisted AIG and Merger Sub in connection with the merger and, in particular, performed certain financial analyses relating to the proposed transaction as described under SPECIAL FACTORS Summary of BAS and JPMorgan Presentations to AIG, AIG did not request, and BAS and JPMorgan did not provide (i) any opinion to AIG or any other person in connection with the merger as to the fairness of the merger consideration to AIG, the Company or any other person, or (ii) any other valuation of the Company for the purpose of assessing the fairness of the merger consideration to AIG, the Company or any other person.

AIG and Merger Sub did not consider the liquidation value of the Company because they considered the Company to be a viable, going concern and therefore did not consider liquidation value to be a relevant valuation method. Further, AIG and Merger Sub did not consider net book value, which is an accounting concept, as a factor because they believe that net book value is not a material indicator of the value of the Company as a going concern but rather is indicative of historical costs. AIG and Merger Sub note, however, that the \$22.00 per share cash merger consideration is more than 208% of the Company's net book value as of March 31, 2007. In addition, AIG and Merger Sub did not consider firm offers made by unaffiliated persons during the last two years, as no such offers were made during the last two years. Furthermore, because none of AIG or its subsidiaries including Merger Sub has purchased any Company stock during the last two years (except for any purchases executed by mutual funds that are managed or advised by subsidiaries of AIG on behalf of their clients), AIG or Merger Sub did not consider the prices paid by them in their acquisition of the Company stock under the merger agreement.

The foregoing discussion of the information and factors considered and given weight by AIG and Merger Sub in connection with the fairness of the merger is not intended to be exhaustive but is believed to include all material factors considered by AIG and Merger Sub. AIG and Merger Sub did not find it practicable to, and did not, quantify or otherwise assign relative weights to the individual factors considered in reaching their conclusions as to the fairness of the proposed merger. Rather, the fairness determinations were made after consideration of all of the foregoing factors as a whole.

Financial Projections

In connection with AIG's review of the Company and in the course of the negotiations between the Special Committee and AIG described in SPECIAL FACTORS Background of the Merger, the Company provided AIG with non-public business and financial information. The non-public information included projections of the Company's future operating performance. Such projections also were provided to Lehman Brothers in its capacity as financial advisor to the Special Committee. The information set forth below has been excerpted from the materials provided to AIG and Lehman Brothers, and does not give effect to the transactions contemplated by the merger agreement.

The Company does not, as a matter of course, publicly disclose projections of future revenues or earnings. However, as requested, senior management did provide financial forecasts to AIG, the Special

Committee and its financial advisor, Lehman Brothers. The projections were not prepared with a view to public disclosure and are included in this proxy statement only because such information was made available to AIG in connection with its due diligence investigation of the Company. The projections were not prepared with a view to compliance with the published guidelines of the SEC regarding projections, nor were they prepared in accordance with generally accepted accounting principles or the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of financial projections. The projections included in this proxy statement have not been prepared by, and are not the responsibility of PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, who has neither examined nor compiled the projections, and accordingly, PricewaterhouseCoopers LLP does not express an opinion or any other form of assurance with respect to the projections. The audit report incorporated by reference into this proxy statement related to the Company's historical financial information does not extend to the projections and should not be read to do so. In compiling the projections, the Company's management took into account historical performance, combined with projections regarding development activities. The projections were developed in a manner consistent with management's historical development of budgets and long-range operating projections and were not developed for public disclosure. Although the projections were presented with numerical specificity, the projections reflect numerous assumptions and estimates as to future events made by the Company's management that management believed were reasonable at the time the projections were prepared. Failure to achieve any such assumptions would impact the accuracy of the projections. In addition, factors such as industry performance and general business, economic, regulatory, market and financial conditions, all of which are difficult to predict and beyond the control of management, may cause the projections or the underlying assumptions to be inaccurate. Accordingly, there can be no assurance that the projections will be realized, and actual results may be materially greater or less than those contained in the projections. See FORWARD-LOOKING STATEMENTS on page 69.

The Company does not intend to update or otherwise revise the projections to reflect circumstances existing after the date when made or to reflect the occurrence of future events, even if any or all of the assumptions underlying the projections are shown to be in error. The projections provided by the Company are set forth below:

	Management Projections				
	2007	2008	2009	2010	2011
	(\$ in millions)				
Direct Premiums Written	\$ 1,420.2	\$ 1,633.5	\$ 1,830.0	\$ 2,049.5	\$ 2,295.5
Net Premiums Earned	\$ 1,383.3	\$ 1,582.4	\$ 1,764.5	\$ 1,981.1	\$ 2,219.3
Underwriting Profit	\$ 55.8	\$ 62.8	\$ 87.5	\$ 98.4	\$ 133.7
Investment Income	\$ 67.6	\$ 72.0	\$ 76.7	\$ 82.1	\$ 86.1
Interest Expense	(\$7.0)	(\$5.9)	(\$5.9)	(\$5.9)	(\$5.9)
Provision for Income Taxes	(\$37.7)	(\$43.6)	(\$53.6)	(\$59.1)	(\$72.4)
Net Income	\$ 78.8	\$ 85.3	\$ 104.7	\$ 115.5	\$ 141.5
Earnings Per Share	\$ 0.91	\$ 0.99	\$ 1.21	\$ 1.33	\$ 1.63

The material assumptions made by the Company in developing these projections are as follows:

	Key Management Projections Assumptions				
	2007	2008	2009	2010	2011
Direct Premiums Written Growth (1)	8 %	15 %	12 %	12 %	12 %
Loss and Loss Adjustment Expenses Ratio	73.5 %	75.0 %	74.8 %	75.0 %	75.0 %
Expense Ratio	22.5 %	21.0 %	20.2 %	20.0 %	19.0 %
GAAP Combined Ratio	96.0 %	96.0 %	95.0 %	95.0 %	94.0 %

(1) Expressed as a percentage change over the prior year.

Opinion of the Financial Advisor to the Special Committee

On October 4, 2006, Lehman Brothers was engaged by the Special Committee to act as its financial advisor in connection with a potential acquisition by AIG of the remaining shares of Company common stock not already owned by AIG or its subsidiaries. On May 14, 2007, Lehman Brothers rendered its oral opinion (subsequently confirmed in writing) to the Special Committee that as of such date and, based upon and subject to the matters stated in its opinion, from a financial point of view, the merger consideration to be offered to the stockholders of the Company (other than AIG and its subsidiaries) in the merger was fair to such stockholders.

The full text of Lehman Brothers' written opinion, dated May 14, 2007, is attached as Annex B to this proxy statement. Lehman Brothers provided its opinion for the information and assistance of the Special Committee in connection with its consideration of the merger. Lehman Brothers has not been requested to opine as to, and Lehman Brothers' opinion does not in any manner address, the Company's underlying business decision to proceed with or effect the merger. Lehman Brothers' opinion is not a recommendation as to how any holder of Company common stock should vote with respect to the merger. Stockholders are encouraged to read Lehman Brothers' opinion carefully in its entirety for a description of the assumptions made, procedures followed, factors considered and limitations upon the review undertaken by Lehman Brothers in rendering its opinion. The following is a summary of Lehman Brothers' opinion and the methodology that Lehman Brothers used to render its opinion. This summary is qualified in its entirety by reference to the full text of the opinion.

In connection with rendering the opinion described above, Lehman Brothers reviewed and analyzed, among other things:

- (1) The merger agreement and the specific terms of the proposed merger;
- (2) Publicly available information concerning the Company that it believed to be relevant to its analysis, including the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, Amended Annual Report on Form 10-K/A filed on April 26, 2007 for the fiscal year ended December 31, 2006 and Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2007;
- (3) Financial and operating information with respect to the business, operations and prospects of the Company furnished to Lehman Brothers by the Company, including the financial projections of the Company and estimated cost savings and operating synergies expected to result from the merger (the Expected Synergies), in each case as prepared by the management of the Company;
- (4) Published estimates of independent research analysts with respect to the future financial performance of the Company;
- (5) A trading history of the common stock of the Company from May 10, 2006 to May 10, 2007 and a comparison of such trading history with those of other companies that Lehman Brothers deemed relevant;
- (6) A comparison of the historical financial results and present financial condition of the Company with those of other companies that Lehman Brothers deemed relevant;
- (7) A comparison of the financial terms of the merger transaction with the financial terms of certain other transactions that Lehman Brothers deemed relevant; and
- (8) Public statements made by AIG with respect to its ownership interest in the Company, including the information contained in Schedule 13D/A (including any exhibits thereto) filed by AIG on January 24, 2007. In its proposal to the Board, AIG stated that it was interested only in acquiring the publicly held shares of the Company, and that it had no interest in selling its controlling stake in the Company.

In addition, Lehman Brothers had discussions with the management of the Company concerning its business, operations, assets, liabilities, financial condition and prospects and undertook such other studies, analyses and investigations as Lehman Brothers deemed appropriate.

The Lehman Brothers opinion states that Lehman Brothers assumed and relied upon the accuracy and completeness of the financial and other information used by Lehman Brothers without assuming any responsibility for independent verification of such information and further relied upon the assurances of the management of the Company that they are not aware of any facts or circumstances that would make such information inaccurate or misleading. With respect to the financial projections of the Company, upon advice of the Company, Lehman Brothers assumed that such projections were reasonably prepared on a basis reflecting the best currently available estimates and judgments of the management of the Company as to the future financial performance of the Company. However, for the purpose of Lehman Brothers' analysis, upon discussions with the Company's management such financial projections were adjusted to reflect a more efficient usage of excess capital to align the Company's practice with industry standards and the Company's management has agreed with the appropriateness of the use of, and Lehman Brothers reliance upon, this concept in performing its analysis (see "SPECIAL FACTORS - Financial Projections"). In addition, upon the advice of the Company, Lehman Brothers assumed that the amounts and timing of the expected synergies were reasonable and that the expected synergies would be realized substantially in accordance with such estimates. In arriving at its opinion, Lehman Brothers did not conduct a physical inspection of the properties and facilities of the Company and did not make or obtain any evaluations or appraisals of the respective assets or liabilities of the Company. Furthermore, Lehman Brothers are not actuaries and its services did not include actuarial determinations or evaluations by Lehman Brothers or an attempt to evaluate actuarial assumptions. In that regard, Lehman Brothers made no analyses of, and expressed no opinions as to, the adequacy of insurance reserves of the Company and relied upon information furnished to us by the Company as to the adequacy of such reserves. In addition, the Special Committee did not authorize Lehman Brothers to solicit, and Lehman Brothers did not solicit any indications of interest from any third party with respect to the sale of all or a part of the Company. Lehman Brothers' opinion necessarily is based upon market, economic and other conditions as they existed on, and could be evaluated as of May 14, 2007.

In connection with rendering its opinion, Lehman Brothers performed certain financial, comparative and other analyses as described below. In arriving at its opinion, Lehman Brothers did not ascribe a specific range of value to the Company, but rather made its determination as to the fairness, from a financial point of view, of the merger consideration to be offered to the stockholders of the Company (other than AIG and its subsidiaries) on the basis of financial and comparative analyses. The preparation of a fairness opinion involves various determinations as to the most appropriate and relevant methods of financial and comparative analysis and the application of those methods to the particular circumstances, and therefore, such an opinion is not readily susceptible to summary description. Furthermore, in arriving at its opinion, Lehman Brothers did not attribute any particular weight to any analysis or factor considered by it, but rather made qualitative judgments as to the significance and relevance of each analysis and factor. Accordingly, Lehman Brothers believes that its analyses must be considered as a whole and that considering any portion of such analyses and factors, without considering all analyses and factors as a whole, could create a misleading or incomplete view of the process underlying its opinion. In its analyses, Lehman Brothers made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond the control of the Company. None of the Company, Lehman Brothers or any other person assumes responsibility if future results are materially different from those assumed. Any estimates contained in these analyses were not necessarily indicative of actual values or predictive of future results or values, which may be significantly more or less favorable than as set forth therein. In addition, analyses relating to the value of businesses do not purport to be appraisals or to reflect the prices at which businesses actually may be sold.

The following is a summary of the material financial analyses used by Lehman Brothers in connection with providing its opinion to the Special Committee. **The financial analyses summarized below include information presented in tabular format. The tables alone do not constitute a complete description of the financial analyses. Accordingly, the analyses listed in the tables and described below must be considered as a whole. In order to fully understand the financial analyses used by Lehman Brothers, the tables must be read together with the text of each summary. Considering any portion of such analyses and of the factors considered, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying Lehman Brothers' opinion.**

Comparable Company Analysis:

In order to assess how the public market values shares of similar publicly traded companies, Lehman Brothers reviewed and compared specific financial and market data relating to the Company with selected companies that Lehman Brothers, based on its experience with companies in the personal lines property & casualty insurance industry, deemed the following appropriate as comparables to the Company: The Allstate Corporation, The Progressive Corporation, Safeco Corporation, Mercury General Corporation, The Hanover Insurance Group, The Commerce Group, Inc., State Auto Financial Corporation and Horace Mann Educators Corporation.

The financial information compared included current stock price, market capitalization, price as a percentage of the previous 52 weeks' high and low stock price, estimated earnings per share for 2007 and 2008, GAAP book value as of March 31, 2007, and estimated return on average equity for 2007. The credit statistics compared included the ratio of 2006 net premiums written to surplus and the ratio of long-term debt to book capitalization. In order to arrive at a public market reference range for the Company, Lehman Brothers derived multiples for the comparable companies, including price as a multiple of (i) estimated earnings for 2007 and 2008 in accordance with GAAP and (ii) GAAP book value. The market price information used in such analysis was as of May 10, 2007. The earnings per share estimates used were based on estimates as of May 10, 2007 by Institutional Brokers Estimate System or I/B/E/S (IBES), a data service that monitors and publishes a compilation of earnings estimates regarding companies of interest to institutional investors produced by selected research analysts.

The following table presents the results of the financial analysis described above for the selected companies:

	Price to: 2007E EPS	2008E EPS	Book Value
Allstate	9.2x	9.3x	1.73x
Progressive	12.4x	13.1x	2.48x
SAFECO	10.3x	10.6x	1.67x
Mercury General	13.1x	13.3x	1.75x
Hanover Insurance	11.5x	11.9x	1.20x
Commerce Group	10.8x	12.0x	1.43x
State Auto	10.8x	10.9x	1.41x
Horace Mann	11.3x	11.2x	1.37x

	Price to: 2007E EPS	2008 E EPS	Book Value
Mean	11.2x	11.5x	1.63x
Median	11.1x	11.6x	1.55x
Maximum	13.1x	13.3x	2.48x
Minimum	9.2x	9.3x	1.20x

Lehman Brothers then derived from this the ranges of these multiples deemed most meaningful for this analysis (which were 10.5x-13.1x 2007 estimated earnings and 10.5x-13.3x 2008 estimated earnings, both selected at the top of the ranges, due to the Company's historical trading premium over the selected

comparable companies) and applied these multiples to the Company's estimated 2007 and 2008 earnings of \$0.91 and \$0.99, respectively. In addition, Lehman Brothers also applied a 30% control premium (the premium that Lehman Brothers believed to be the most appropriate in light of the Company's stock price and financial performance and market conditions) to the ranges derived above. These calculations indicated a range of implied per share equity values for the Company of \$14 to \$18. Lehman Brothers noted that the merger consideration of \$22.00 per share was above the range of implied per share equity values for the Company based on the Comparable Company Analysis.

Lehman Brothers selected the comparable companies named above because their businesses and operating profiles are reasonably similar to those of the Company. However, because of the inherent differences between business, operations and prospects of the Company and the businesses, operations and prospects of the comparable companies, Lehman Brothers believed that it was inappropriate to, and therefore did not, rely solely on the quantitative results of the Comparable Company Analysis. Accordingly, Lehman Brothers also made qualitative judgments concerning differences between the financial and operating characteristics and prospects of the Company and the companies included in this analysis that would affect the public trading values of each in order to provide a context in which to consider the results of the quantitative analysis. These qualitative judgments related primarily to the differing sizes, growth prospects, profitability levels and degree of operational risk between the Company and the companies included in the Comparable Company Analysis.

Comparable Transaction Analysis:

Using publicly available information, Lehman Brothers reviewed, analyzed and compared the purchase prices and financial multiples paid in select automobile insurance transactions since 1995 that Lehman Brothers, based on its experience, deemed relevant to arriving at its opinion. Lehman Brothers reviewed the following transactions:

Date Announced	Acquirer	Target
08/25/1995	Berkshire Hathaway, Inc.	GEICO Corporation
03/02/2007	Farmers Group, Inc.	Bristol West Holdings, Inc.
12/04/2006	Elara Holdings, Inc.	Direct General Corp.
07/29/2005	Sentry Insurance Group	Viking Insurance Holdings, Inc.
12/15/2003	Liberte Investors	US Auto Holdings Inc.
06/25/2003	AIG	GE US Auto & Home
05/22/2003	Palisades Group, LLC	High Point Group
03/26/2003	Nationwide Mutual Insurance Co.	Titan Insurance
05/31/2001	Safety Holdings Inc.	Thomas Black Corp.
12/27/1999	Prudential Financial, Inc.	Titan Insurance
07/12/1999	MetLife, Inc.	St. Paul Personal Lines
06/09/1999	The Allstate Corporation	CNA Personal Lines Business
01/11/1999	American Financial Group	Worldwide Insurance Group
01/26/1998	The Allstate Corporation	Pembridge Insurance Co.
10/16/1997	Hartford Financial Services Group	Omni Insurance Group
06/23/1997	General Motors Corp	Integon Corp.

The reasons for and the circumstances surrounding each of the transactions analyzed were diverse and there are inherent differences in the business, operations, financial conditions and prospects of the Company, and the businesses, operations, financial conditions and prospects of the companies included in the Comparable Transaction Analysis. Accordingly, Lehman Brothers believed that a purely quantitative comparable transaction analysis would not be particularly meaningful in the context of the proposed merger. Lehman Brothers believed that the appropriate use of the Comparable Transaction Analysis required qualitative judgments concerning the differences between the characteristics of these transactions and the proposed merger which would affect the acquisition values of the acquired companies and the Company.

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In order to arrive at a valuation range for the Company based on comparable transactions, Lehman Brothers derived multiples for the comparable transactions, including the price paid for the target companies as a multiple of (i) book value of the target companies, (ii) tangible book value of the target companies, (iii) latest twelve months (LTM) net income of the target companies, and (iv) estimated forward earnings for the target companies.

	Price / Book Value	Price / Tangible Book Value	Price / LTM Earnings	Price / Forward Earnings
Mean	2.26x	2.09x	15.9x	19.6x
Median	1.66x	2.24x	14.4x	17.1x

Lehman Brothers also noted that GEICO Corporation was the only true public direct auto franchise that had been acquired in the past twelve years. Moreover, GEICO Corporation was a minority buy-in of a direct auto company with an existing national franchise, and it was bought in at approximately 21.6x LTM earnings and 19.2x forward earnings.

Lehman Brothers selected the price to LTM earnings and price to forward earnings as being the most appropriate multiples and then, based on the GEICO transaction, and then applied these multiples (20.0x 21.6x LTM earnings and 19.2x 20.0x forward earnings) to the Company, by multiplying the low and high end of the ranges described to the Company's LTM and forward earnings of \$1.14 and \$0.91, respectively.

Based on these multiples, the implied per share equity value for the Company from this analysis was \$19-\$23.

Lehman Brothers noted that the merger consideration of \$22.00 per share was within the upper end of the range of the implied share prices of \$19 and \$23 that resulted from the Comparable Transaction Analysis described above.

Minority Squeeze-Out Premiums Paid Analysis:

In order to assess the premium proposed to be paid by AIG in the merger, Lehman Brothers reviewed premiums paid by acquirers in selected minority squeeze-out transactions since 1998 where the acquirer owned at least 50% of the target before the transaction and the acquired entity equity value was at least \$50 million. Lehman Brothers utilized the premiums paid based on Dealogic (a company that designs and develops information systems to address specific needs of the capital markets industry) calculations for the 1 day, 1 week and 1 month prior to the transaction. The following table summarizes the results of such calculations:

	Period Prior to Announcement					
	One Day		One Week		One Month	
Mean Premium	32.7	%	33.9	%	34.7	%
Median Premium	28.4	%	32.0	%	29.3	%
Maximum Premium	140.0	%	109.1	%	162.1	%
Minimum Premium	-11.1	%	-5.8	%	-64.9	%

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Lehman Brothers selected a range based on the mean and median premiums and applied this range to the share price of the Company's common stock for the same periods to calculate the implied per share equity value of the Company as follows:

Implied Price at	Period Prior to Announcement		
	One Day	One Week	One Month
25% premium	\$ 20.74	\$ 20.96	\$ 22.03
30% premium	\$ 21.57	\$ 21.80	\$ 22.91
35% premium	\$22.40	\$22.64	\$23.79

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Based on the above, the implied per share equity value for the Company was \$21 - \$24.

Lehman Brothers noted that the merger consideration of \$22.00 per share was within the range of the implied share prices of \$21 and \$24 that resulted from this analysis.

Discounted Cash Flow Analysis:

In order to estimate the present value of Company common stock, Lehman Brothers modeled a discounted cash flow analysis using the Company's after-tax levered free cash flows for fiscal years 2007 through 2011.

A discounted cash flow is a traditional valuation methodology used to derive a valuation of an asset by calculating the present value of estimated future cash flows of the asset. Present value refers to the current value of future cash flows or amounts and is obtained by discounting those future cash flows or amounts by a discount rate that takes into account macro-economic assumptions and estimates of risk, the opportunity cost of capital, expected returns and other appropriate factors.

Lehman Brothers performed a discounted cash flow analysis for the Company by adding (1) the present value of the Company's projected after-tax levered free cash flows to (2) the present value of the terminal value of the Company. The terminal value refers to the value of all future cash flows from an asset at a particular point in time. Lehman Brothers created three valuation scenarios for the analysis:

- *The Management Case*, based on management's five-year projections;
- *The Industry Growth Case*, based on the combined ratios from the management case, but utilizing an industry average growth rate of 6%;
- *The Extended Case*, based on the management case for the first five years and for years six through ten, based on the combined ratios from the management case but gradually reducing the growth rate to the industry average of 6%.

Discounted cash flow analysis was initially modeled without the inclusion of management's estimates of potential synergies and expense savings that could be realized by AIG. Thereafter, the value of these potential synergies and expense savings that could be realized by AIG were subsequently added to the value of each of the above cases.

To determine terminal value, Lehman Brothers took into account several factors. The Management Case uses a terminal multiple range of 15x to 17x, to reflect the material premium to its peers the Company has historically traded at in the past. The Industry Growth Case and Extended Case use terminal multiples within the peer group range (10x to 12x), albeit at the higher end of such range. This reflects growth rates closer to industry averages in the terminal year and the longer period utilized in the Extended Case places long term growth more in line with peers. Lehman Brothers discounted the levered free cash flow streams and the estimated terminal value to a present value at a range of discount rates. For the Management Case, there is a material increase in anticipated earnings growth over the five year projection period. As a result, Lehman Brothers chose to widen its discount rate range for this case at the low end, by 11% based on cost of capital analysis, and at the high end, 15% to reflect the increased return a buyer might require for the increased risk in achieving the higher growth projections. For both the Industry Growth Case and the Extended Case, Lehman Brothers used a discount rate range of 10% to 12%, reflecting lower volatility and risk associated with utilizing industry averages. The discount rates utilized in this analysis were chosen by Lehman Brothers based on its experience with the personal lines property & casualty insurance industry and also on an analysis of the weighted average cost of capital and cost of equity of the Company and other comparable companies. Lehman Brothers calculated per share equity values by dividing the implied aggregate equity values by the fully diluted shares of the Company. The value of cost savings were calculated separately and 50% and 100% of such cost savings were added to the

discounted cash flow scenarios. The table below shows the range of implied per share equity value for the Company.

Discounted Cash Flow Range

No Synergies	\$ 14 - \$22
50% Synergies	\$ 17 - \$25
100% Synergies	\$ 19 - \$28

Lehman Brothers noted that the merger consideration of \$22.00 per share was at the top of the range of the implied share prices of \$14 and \$22 that resulted from the Discounted Cash Flow Analysis without synergies. Lehman Brothers also noted that the merger consideration of \$22.00 per share was within the upper end of the range of the implied share prices of \$17 and \$25 that resulted from the Discounted Cash Flow Analysis with 50% synergies and within the range of the implied share prices of \$19 and \$28 that resulted from the 100% synergies Discounted Cash Flow.

Analysis at Various Prices:

For illustrative purposes for the consideration of the Special Committee, Lehman Brothers calculated the premium implied by the merger consideration of \$22.00 per share over the market price per share of Company common stock at certain times. Lehman Brothers compared the merger consideration with the following trading prices for Company common stock:

- The closing price of \$16.59 on January 24, 2007 (the last trading day prior to the public announcement of AIG's initial offer);
- The closing price of \$16.77 for the one (1) week prior to January 24, 2007;
- The average closing price of \$16.49 for the one (1) week period prior to January 24, 2007;
- The closing price of \$17.81 for the one (1) month prior to January 24, 2007;
- The average closing price of \$17.06 for the one (1) month period prior to January 24, 2007;
- The \$19.75 initial offer made by AIG in its public announcement on January 24, 2007;
- The 52-week high closing price (prior to the public announcement of AIG's initial offer) of \$17.95; and
- The closing price of \$21.00 on May 14, 2007 (the last trading day prior to the public announcement of AIG's final offer).

Applying the final offer price of \$22.00 per share, the results of Lehman Brothers' calculations are reflected below:

Period Considered:	Premium based on \$22.00 per share
January 24, 2007 Closing Price	32.6 %
1 week ending	31.2 %
1 week average	33.5 %
1 month ending	23.5 %
1 month average	29.0 %
January 24, 2007 AIG Initial Offer Price	11.4 %
52 week high	22.6 %
May 14, 2007	4.8 %

Lehman Brothers noted that the resulting premiums based on the merger consideration of \$22.00 per share were within the range of premiums that resulted from the comparable analyses described above.

For illustrative purposes, Lehman Brothers also calculated the following transaction multiples implied by the merger consideration of \$22.00 per share. Estimates of future results for the Company used by Lehman Brothers in this analysis were based on either Wall Street consensus estimates as provided by IBES, or forecasts prepared by the management of the Company.

- Transaction value as a multiple of historical 2006 earnings per share
- Transaction value as a multiple of estimated 2007 IBES median earnings per share
- Transaction value as a multiple of estimated 2007 management earnings per share
- Transaction value as a multiple of the book value of equity per share at March 31, 2007
- The results of Lehman Brothers' calculations are summarized in the following table:

	Implied multiple based on \$22.00 per share
Price/2006 EPS	19.3x
Price/2007E IBES EPS	23.2x
Price/2007E Management EPS	24.2x
Price/Book	2.08x

General:

The terms of the merger were determined through arms-length negotiations between the Special Committee with its advisors, and AIG and its advisors, and were unanimously approved by the voting members of the Special Committee and the Board. Lehman Brothers' opinion does not address any other aspects of the merger transaction and does not constitute a recommendation to any stockholder as to how to vote or to take any other action with respect to the merger. Lehman Brothers' opinion was one of the many factors taken into consideration by the voting members of the Special Committee in making its unanimous determination to approve the merger agreement. Lehman Brothers' analyses summarized above should not be viewed as determinative of the opinion of the Special Committee with respect to the value of the Company or whether the Special Committee would have been willing to agree to a different price.

Lehman Brothers is an internationally recognized investment banking firm and, as part of its investment banking activities, is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive bids, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes. The Special Committee selected Lehman Brothers because of its expertise, reputation and familiarity with the personal lines property & casualty insurance industry generally and because its investment banking professionals have substantial experience in transactions comparable to the merger.

As compensation for its services in connection with the merger, the Company paid Lehman Brothers a retainer of \$200,000 and an opinion fee of \$1 million upon the delivery of the Lehman Brothers' opinion. Additional compensation of \$2,800,000 will be payable upon completion of the merger. In addition, the Company has agreed to reimburse Lehman Brothers for reasonable out-of-pocket expenses incurred in connection with the merger and to indemnify Lehman Brothers for certain liabilities that may arise out of its engagement by the Special Committee and the rendering of the Lehman Brothers' opinion. Since January 1, 2005, AIG and its affiliates, including the Company, paid Lehman Brothers an aggregate compensation of approximately \$12.2 million. Services rendered include strategic advisory, mergers and acquisitions and capital transactions.

In the ordinary course of its business, Lehman Brothers actively trades in the debt and equity securities and loans, if any, of the Company and AIG for its own account and/or for the accounts of its customers and, accordingly, may at any time hold long or short positions in such securities or loans.

Summary of BAS and JPMorgan Presentations to AIG

In June 2006, AIG retained S&C as its legal advisor, to assist it in connection with a possible transaction involving the Company. Also in June 2006, AIG retained BAS to act as its financial advisor in connection with a possible transaction with the Company. In July 2006, AIG retained JPMorgan to act as its financial advisor in connection with a possible transaction with the Company. AIG selected BAS and JPMorgan to act as financial advisors because they are internationally recognized investment banking firms that are regularly engaged in the valuation of businesses and securities in connection with mergers and acquisitions, negotiated underwritings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes.

On January 16, 2007, BAS and JPMorgan provided a presentation to the management of AIG. On January 17, 2007 AIG's management provided an update to the finance committee of AIG's board of directors regarding a possible transaction with the Company. On March 30, 2007, BAS and JPMorgan provided an updated version of their presentation to the management of AIG.

AIG did not request, and BAS and JPMorgan did not provide, (i) any opinion to AIG or any other person in connection with the merger as to the fairness of the merger consideration to AIG, the Company, the stockholders of the Company or any other person or (ii) any other valuation of the Company for the purpose of assessing the fairness of the merger consideration to AIG, the Company, the stockholders of the Company or any other person. BAS and JPMorgan each have established procedures for rendering a fairness opinion, including review of the fairness opinion and the underlying information, comparisons and analyses by a fairness committee composed of senior investment bankers with relevant expertise. Because BAS and JPMorgan were not requested to render a fairness opinion, it was not necessary to, and they did not, submit the information, comparisons and analyses described below to a fairness committee for review, nor did they follow all of the procedures that they ordinarily follow in connection with rendering a fairness opinion. Had BAS or JPMorgan been requested to provide an opinion or been requested to recommend or provide support for a fair or appropriate valuation of the Company's securities and submitted the information, comparisons and analyses described below to their full fairness opinion process, including review by a fairness committee, the information, comparisons and analyses presented by BAS and JPMorgan following that process may have been different from those described below.

The following summary of the January 16, 2007 and March 30, 2007 presentations is included here to comply with disclosure requirements. The analyses described herein and the order in which they are presented and the results of the analyses do not represent relative importance or weight given to these analyses by BAS, JPMorgan, AIG, its management or the finance committee of AIG's board of directors. The summary of the presentations set forth below is qualified in its entirety by reference to the full text of the presentation materials which are filed as Exhibits to the Company's Schedule 13E-3 dated as of the date hereof and incorporated herein by reference to this document. **Neither the presentation materials nor this summary constitutes a recommendation as to whether any stockholder of the Company should vote in favor of the merger or any other action that any stockholder of the Company should take or refrain from taking in connection with the merger.**

In providing financial advice and preparing financial analysis, BAS and JPMorgan:

- reviewed certain publicly available financial statements and other business and financial information of the Company;
- reviewed certain internal financial statements and other financial and operating data concerning the Company;

- reviewed certain financial forecasts relating to the Company prepared by the Company, including the modifications to those financial forecasts prepared by AIG;
- discussed the Company's past and current operations, financial condition and prospects with senior executives of AIG;
- reviewed the reported prices and trading activity for Company common stock;
- compared the Company's financial performance and the prices and trading activity of Company common stock with that of certain other publicly traded companies that BAS and JPMorgan deemed relevant;
- reviewed the premiums paid in selected cash minority buy-in transactions that BAS and JPMorgan deemed relevant; and
- performed other analyses and considered other factors as BAS and JPMorgan deemed appropriate.

In preparing the presentation materials, BAS and JPMorgan assumed and relied on, without independent verification, the accuracy and completeness of the financial and other information reviewed by it. With respect to the financial forecasts of the Company referenced above, BAS and JPMorgan assumed, at AIG's direction, that such forecasts, as modified by AIG, were reasonably prepared on bases reflecting the best currently available estimates and good faith judgments of the Company's and AIG's management as to the Company's future financial performance before and after giving effect to the sensitivities reflected in such forecasts. Neither BAS nor JPMorgan made any independent valuation or appraisal of the Company's assets or liabilities and neither of them prepared any such valuation or appraisals.

BAS and JPMorgan's presentations were necessarily based on economic, market and other conditions as in effect on, and information made available to them as of, the date of such presentations. Accordingly, although subsequent developments may affect the information contained in the presentations, BAS and JPMorgan did not assume any obligation to update, revise or reaffirm the contents of the presentations.

The following represents a brief summary of the material financial analyses contained in the presentations prepared by BAS and JPMorgan for AIG's management and the finance committee of AIG's board of directors. **The financial analyses summarized below include information presented in tabular format. In order to fully understand the financial analyses performed by BAS and JPMorgan, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses performed by BAS and JPMorgan. Considering the data set forth in the tables below without considering the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of the financial analyses performed by BAS and JPMorgan.**

Discounted Cash Flow Analysis.

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BAS and JPMorgan performed a discounted cash flow analysis of the Company to calculate the present value of the standalone unlevered (i) dividends that the Company could distribute during calendar years 2007 through 2011 and (ii) terminal value based on the net operating income that the Company could generate during calendar year 2012 utilizing two scenarios prepared by AIG and incorporating certain projections for the Company's future performance prepared by the Company, as modified by AIG. The first scenario was used in the preparation of the January 16, 2007 presentation, and we refer to this scenario as the AIG base case. The second scenario was used in the preparation of the March 30, 2007 presentation, and we refer to this scenario as the revised AIG base case. Both the AIG base case and the revised AIG base case assumed that the Company would pay annual dividends equal to (a) the greater of (i) 10% of the policyholder's surplus at the beginning of such year and (ii) 100% of the prior year's net income, plus (b) an additional allowable special dividend of up to \$100 million per year, to the extent the

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aggregate amount of distributions would not exceed an amount that would cause the ratio of net premiums written to statutory surplus to exceed 3.0x. The AIG base case takes into account the Company's projections, provided to BAS and JPMorgan in September 2006, as modified by AIG and the revised AIG base case takes into account the Company's projections, as revised downward by the Company and provided to BAS and JPMorgan in February 2007, as further modified by AIG. The Company's projections are more fully described under SPECIAL FACTORS Financial Projections. BAS and JPMorgan applied multiples ranging from 11.0x to 13.0x to the Company's estimated 2012 GAAP net operating income, then subtracted the Company's current debt from the product of that calculation to arrive at the estimated terminal values. In deriving ranges of multiples and discount rates for purposes of their discounted cash flow analyses, BAS and JPMorgan considered the trading multiples of the selected companies referred to below under Selected Publicly Traded Companies Analysis (in the case of trading multiples) and the weighted average cost of capital of the Company (in the case of discount rate ranges), each a common valuation approach when performing a discounted cash flow analysis. The dividends and terminal values were then discounted to present value using discount rates ranging from 10.0% to 12.0%. The analysis indicated the following implied per share equity value reference ranges for the Company under the AIG base case and AIG revised base case scenarios, without taking into account any synergies anticipated by AIG to result from the merger:

Base C