

AMERICAN INTERNATIONAL GROUP INC

Form 10-K

February 28, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K**

**(Mark One)**

**☐ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2007**

**or**

**☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-8787**

**American International Group, Inc.  
(Exact name of registrant as specified in its charter)**

**Delaware  
(State or other jurisdiction of  
incorporation or organization)  
70 Pine Street, New York, New York  
(Address of principal executive offices)**

**13-2592361  
(I.R.S. Employer  
Identification No.)  
10270  
(Zip Code)**

**Registrant's telephone number, including area code (212) 770-7000**

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
<b>Common Stock, Par Value \$2.50 Per Share</b>	<b>New York Stock Exchange</b>
<b>5.75% Series A-2 Junior Subordinated Debentures</b>	<b>New York Stock Exchange</b>
<b>4.875% Series A-3 Junior Subordinated Debentures</b>	<b>New York Stock Exchange</b>
<b>6.45% Series A-4 Junior Subordinated Debentures</b>	<b>New York Stock Exchange</b>
<b>7.70% Series A-5 Junior Subordinated Debentures</b>	<b>New York Stock Exchange</b>
<b>NIKKEI 225® Index Market Index Target-Term Securities® due January 5, 2011</b>	<b>American Stock Exchange</b>

**Securities registered pursuant to Section 12(g) of the Act:**

**Title of each class**

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of the registrant computed by reference to the price at which the common equity was last sold as of June 29, 2007 (the last business day of the registrant's most recently completed second fiscal quarter), was approximately \$152,287,000,000.

As of January 31, 2008, there were outstanding 2,522,336,771 shares of Common Stock, \$2.50 par value per share, of the registrant.

**Documents Incorporated by Reference:**

Portions of the registrant's definitive proxy statement filed or to be filed with the Securities and Exchange Commission pursuant to Regulation 14A involving the election of directors at the Annual Meeting of Shareholders of the registrant scheduled to be held on May 14, 2008 are incorporated by reference in Part III of this Form 10-K.

American International Group, Inc. and Subsidiaries  
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\* Except for the information provided in Part I under the heading *Directors and Executive Officers of AIG*, Part III Items 10, 11, 12, 13 and 14 are included in AIG's Definitive Proxy Statement to be used in connection with AIG's Annual Meeting of Shareholders scheduled to be held on May 14, 2008.

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American International Group, Inc. and Subsidiaries

**Part I**

**Item 1.**

**Business**

American International Group, Inc. (AIG), a Delaware corporation, 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. Other significant activities include Financial Services and Asset Management. The principal business units in each of AIG's operating segments are as follows\*:

**General Insurance**

American Home Assurance Company (American Home)

National Union Fire Insurance Company of Pittsburgh, Pa. (National Union)

New Hampshire Insurance Company (New Hampshire)

Lexington Insurance Company (Lexington)

The Hartford Steam Boiler Inspection and Insurance Company (HSB)

Transatlantic Reinsurance Company

United Guaranty Residential Insurance Company

American International Underwriters Overseas, Ltd. (AIUO)

AIU Insurance Company (AIUI)

**Life Insurance & Retirement Services**

**Domestic:**

American General Life Insurance Company (AIG American General)

American General Life and Accident Insurance Company (AGLA)

The United States Life Insurance Company in the City of New York (USLIFE)

The Variable Annuity Life Insurance Company (VALIC)

AIG Annuity Insurance Company (AIG Annuity)

AIG SunAmerica Life Assurance Company (AIG SunAmerica)

**Foreign:**

American Life Insurance Company (ALICO)

AIG Star Life Insurance Co., Ltd. (AIG Star Life)

AIG Edison Life Insurance Company (AIG Edison Life)

American International Assurance Company, Limited, together with American International Assurance Company (Bermuda) Limited (AIA)

American International Reinsurance Company Limited (AIRCO)

Nan Shan Life Insurance Company, Ltd. (Nan Shan)

The Philippine American Life and General Insurance Company (Philamlife)

**Financial Services**

International Lease Finance Corporation (ILFC)

AIG Financial Products Corp. and AIG Trading Group Inc. and their respective subsidiaries (collectively, AIGFP)

American General Finance, Inc. (AGF)

AIG Consumer Finance Group, Inc. (AIGCFG)

Imperial A.I. Credit Companies (A.I. Credit)

**Asset Management**

AIG SunAmerica Asset Management Corp. (SAAMCo)

AIG Global Asset Management Holdings Corp. and its subsidiaries and affiliated companies (collectively, AIG Investments)

AIG Private Bank Ltd. (AIG Private Bank)

AIG Global Real Estate Investment Corp. (AIG Global Real Estate)

At December 31, 2007, AIG and its subsidiaries had approximately 116,000 employees.

AIG's Internet address for its corporate website is [www.aigcorporate.com](http://www.aigcorporate.com). AIG makes available free of charge, through the Investor Information section of AIG's corporate website, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and Proxy Statements on Schedule 14A and amendments to those reports or statements filed or furnished pursuant to Section 13(a), 14(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) as soon as reasonably practicable after such materials are electronically filed with, or furnished to, the Securities and Exchange Commission (SEC). AIG also makes available on its corporate website copies of the charters for its Audit, Nominating and Corporate Governance and Compensation and Management Resources Committees, as well as its Corporate Governance Guidelines (which include Director Independence Standards), Director, Executive Officer and Senior Financial Officer Code of Business Conduct and Ethics, Employee Code of Conduct and Related-Party Transactions Approval Policy. Except for the documents specifically incorporated by reference into this Annual Report on Form 10-K, information contained on AIG's website or that can be accessed through its website is not incorporated by reference into this Annual Report on Form 10-K.

**Throughout this Annual Report on Form 10-K, AIG presents its operations in the way it believes will be most meaningful, as well as most transparent. Certain of the measurements used by AIG management are non-GAAP financial measures under SEC rules and regulations. Statutory underwriting profit (loss) and combined ratios are determined in accordance with accounting principles prescribed by insurance regulatory authorities. For an explanation of why AIG management considers these non-GAAP measures useful to investors, see Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*\*For information on AIG's business segments, see Note 2 to Consolidated Financial Statements.*



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American International Group, Inc. and Subsidiaries

The following table presents the general development of the business of AIG on a consolidated basis, the contributions made to AIG's consolidated revenues and operating income and the assets held, in the periods indicated, by its General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management operations and Other operations. For additional information, see Item 6. Selected Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations and Notes 1 and 2 to Consolidated Financial Statements.

<b>Years Ended December 31,</b> <i>(in millions)</i>	<b>2007</b>	2006 <sup>(a)</sup>	2005 <sup>(a)</sup>	2004 <sup>(a)</sup>	2003 <sup>(a)</sup>
<b>General Insurance operations:</b>					
Gross premiums written	\$ <b>58,798</b>	\$ 56,280	\$ 52,725	\$ 52,046	\$ 46,938
Net premiums written	<b>47,067</b>	44,866	41,872	40,623	35,031
Net premiums earned	<b>45,682</b>	43,451	40,809	38,537	31,306
Net investment income <sup>(b)</sup>	<b>6,132</b>	5,696	4,031	3,196	2,566
Net realized capital gains (losses)	<b>(106)</b>	59	334	228	(39)
Operating income <sup>(b)(c)(d)</sup>	<b>10,526</b>	10,412	2,315	3,177	4,502
Year-end identifiable assets	<b>181,708</b>	167,004	150,667	131,658	117,511
<b>Statutory measures<sup>(e)</sup>:</b>					
Statutory underwriting profit (loss) <sup>(c)(d)</sup>	<b>4,073</b>	4,408	(2,165)	(564)	1,559
Loss ratio	<b>65.6</b>	64.6	81.1	78.8	73.1
Expense ratio	<b>24.7</b>	24.5	23.6	21.5	19.6
Combined ratio <sup>(d)</sup>	<b>90.3</b>	89.1	104.7	100.3	92.7
<b>Life Insurance &amp; Retirement Services operations:</b>					
Premiums and other considerations	<b>33,627</b>	30,766	29,501	28,167	23,568
Net investment income <sup>(b)</sup>	<b>22,341</b>	20,024	18,677	15,654	13,278
Net realized capital gains (losses) <sup>(f)</sup>	<b>(2,398)</b>	88	(158)	45	362
Operating income <sup>(b)(f)</sup>	<b>8,186</b>	10,121	8,965	7,968	6,970
Year-end identifiable assets	<b>615,386</b>	550,957	489,331	457,071	380,126



Gross insurance in force at end of year	<b>2,312,045</b>	2,070,600	1,852,833	1,858,094	1,583,031
<b>Financial Services operations:</b>					
Interest, lease and finance charges <sup>(g)(h)</sup>	<b>(1,209)</b>	7,910	10,523	7,495	6,241
Net realized capital gains (losses)	<b>(100)</b>	(133)	154	(45)	123
Operating income (loss) <sup>(g)(h)</sup>	<b>(9,515)</b>	383	4,424	2,131	1,302
Year-end identifiable assets	<b>203,894</b>	202,485	161,919	161,929	138,613
<b>Asset Management operations:</b>					
Investment income from spread-based products and management, advisory and incentive fees	<b>6,625</b>	4,668	4,500	4,179	3,379
Net realized capital gains (losses)	<b>(1,000)</b>	(125)	82	60	(754)
Operating income	<b>1,164</b>	1,538	1,963	1,947	521
Year-end identifiable assets	<b>77,274</b>	78,275	69,584	68,503	56,047
<b>Other operations:</b>					
Net realized capital gains (losses)	<b>12</b>	217	(71)	(244)	(134)
All other <sup>(i)</sup>	<b>(1,430)</b>	(984)	(2,383)	(134)	(1,254)
<b>Consolidated:</b>					
Total revenues <sup>(j)(k)</sup>	<b>110,064</b>	113,387	108,781	97,823	79,601
Operating income <sup>(b)(j)(k)</sup>	<b>8,943</b>	21,687	15,213	14,845	11,907
Year-end total assets	<b>1,060,505</b>	979,410	853,048	801,007	675,602

(a) Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

(b) In 2006, includes the effect of out of period adjustments related to the accounting for certain interests in unit investment trusts (UCITS). The effect was an increase of \$490 million in both revenues and operating income for General Insurance and an increase of \$240 million and \$169 million in revenues and operating income, respectively, for Life Insurance & Retirement Services.

(c) Includes current year catastrophe-related losses of \$276 million, \$2.89 billion and \$1.05 billion in 2007, 2005 and 2004, respectively. There were no significant catastrophe-related losses in 2006 or 2003.

(d) Operating income was reduced by fourth quarter charges of \$1.8 billion and \$850 million in 2005 and 2004, respectively, resulting from the annual review of General Insurance loss and loss adjustment reserves. In 2006,

*2005 and 2004, changes in estimates for asbestos and environmental reserves were \$198 million, \$873 million and \$850 million, respectively.*

*(e) Calculated on the basis under which the U.S.-domiciled general insurance companies are required to report such measurements to regulatory authorities.*

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## American International Group, Inc. and Subsidiaries

- (f) In 2007, 2006, 2005, 2004 and 2003, includes other-than-temporary impairment charges of \$2.8 billion, \$641 million, \$425 million, \$441 million and \$1.2 billion. See Management's Discussion and Analysis of Financial Condition and Results of Operations – Invested Assets – Other-than-temporary impairments.
- (g) Includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under Statement of Financial Accounting Standards (FAS) No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), including the related foreign exchange gains and losses. In 2007, 2006, 2005, 2004 and 2003, respectively, the effect was \$211 million, \$(1.82) billion, \$2.01 billion, \$(122) million and \$(1.01) billion in both revenues and operating income for Capital Markets. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings. These gains (losses) in 2007 include a \$380 million out of period charge to reverse net gains recognized on transfers of available for sale securities among legal entities consolidated within AIGFP. In 2006, includes an out of period charge of \$223 million related to the remediation of the material weakness in internal control over the accounting for certain derivative transactions under FAS 133. In the first quarter of 2007, AIGFP began applying hedge accounting for certain of its interest rate swaps and foreign currency forward contracts hedging its investments and borrowings.
- (h) In 2007, both revenues and operating income (loss) include an unrealized market valuation loss of \$11.5 billion on AIGFP super senior credit default swap portfolio and an other-than-temporary impairment charge of \$643 million on AIGFP's available for sale investment securities. See Management's Discussion and Analysis of Financial Condition and Results of Operations – Invested Assets – Other-than-temporary impairments.
- (i) In 2005, includes \$1.6 billion of regulatory settlement costs as described under Item 3. Legal Proceedings.
- (j) In 2007, 2006, 2005, 2004 and 2003, includes other-than-temporary impairment charges of \$4.7 billion, \$944 million, \$598 million, \$684 million and \$1.5 billion. Also includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. In 2007, 2006, 2005, 2004 and 2003, respectively, the effect was \$(1.44) billion, \$(1.87) billion, \$2.02 billion, \$385 million and \$(1.50) billion in revenues and \$(1.44) billion, \$(1.87) billion, \$2.02 billion, \$671 million and \$(1.22) billion in operating income. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings.
- (k) Represents income before income taxes, minority interest and cumulative effect of accounting changes.

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### American International Group, Inc. and Subsidiaries

#### **General Insurance Operations**

AIG's General Insurance subsidiaries write substantially all lines of commercial property and casualty insurance and various personal lines both domestically and abroad. Domestic General Insurance operations are comprised of the Domestic Brokerage Group (DBG), Reinsurance, Personal Lines and Mortgage Guaranty.

AIG is diversified both in terms of classes of business and geographic locations. In General Insurance, workers compensation business is the largest class of business written and represented approximately 15 percent of net premiums written for the year ended December 31, 2007. During 2007, 10 percent and 7 percent of the direct General Insurance premiums written (gross premiums less return premiums and cancellations, excluding reinsurance assumed and before deducting reinsurance ceded) were written in California and New York, respectively. No other state or foreign country accounted for more than five percent of such premiums.

The majority of AIG's General Insurance business is in the casualty classes, which tend to involve longer periods of time for the reporting and settling of claims. This may increase the risk and uncertainty with respect to AIG's loss reserve development.

#### **DBG**

AIG's primary Domestic General Insurance division is DBG. DBG's business in the United States and Canada is conducted through American Home, National Union, Lexington, HSB and certain other General Insurance company subsidiaries of AIG. During 2007, DBG accounted for 51 percent of AIG's General Insurance net premiums written.

DBG writes substantially all classes of business insurance, accepting such business mainly from insurance brokers. This provides DBG the opportunity to select specialized markets and retain underwriting control. Any licensed broker is able to submit business to DBG without the traditional agent-company contractual relationship, but such broker usually has no authority to commit DBG to accept a risk.

In addition to writing substantially all classes of business insurance, including large commercial or industrial property insurance, excess liability, inland marine, environmental, workers compensation and excess and umbrella coverages, DBG offers many specialized forms of insurance such as aviation, accident and health, equipment breakdown, directors and officers liability (D&O), difference-in-conditions, kidnap-ransom, export credit and political risk, and various types of professional errors and omissions coverages. Also included in DBG are the operations of AIG Risk Management, which provides insurance and risk management programs for large corporate customers and is a leading provider of customized structured insurance products, and AIG Environmental, which focuses specifically on providing specialty products to clients with environmental exposures. Lexington writes surplus lines for risks on which conventional insurance companies do not readily provide insurance coverage, either because of complexity or because the coverage does not lend itself to conventional contracts. The AIG Worldsource Division introduces and coordinates AIG's products and services to U.S.-based multinational clients and foreign corporations doing business in the U.S.

#### **Reinsurance**

The subsidiaries of Transatlantic Holdings, Inc. (Transatlantic) offer reinsurance on both a treaty and facultative basis to insurers in the United States and abroad. Transatlantic structures programs for a full range of property and casualty products with an emphasis on specialty risk. Transatlantic is a public company owned 59.0 percent by AIG and therefore is included in AIG's consolidated financial statements.

#### **Personal Lines**

AIG's Personal Lines operations provide automobile insurance through aigdirect.com, the newly formed operation resulting from the 2007 combination of AIG Direct and 21st Century Insurance Group (21st Century) operations, and the Agency Auto Division, as well as a broad range of coverages for high net worth individuals through the AIG Private Client Group.

#### **Mortgage Guaranty**

The main business of the subsidiaries of United Guaranty Corporation (UGC) is the issuance of residential mortgage guaranty insurance, both domestically and internationally, that covers the first loss for credit defaults on high loan-to-value conventional first-lien mortgages for the purchase or refinance of one to four family residences. UGC

subsidiaries also write second-lien and private student loan guaranty insurance.

#### **Foreign General Insurance**

AIG's Foreign General Insurance group accepts risks primarily underwritten through American International Underwriters (AIU), a marketing unit consisting of wholly owned agencies and insurance companies. The Foreign General Insurance group also includes business written by AIG's foreign-based insurance subsidiaries. The Foreign General Insurance group uses various marketing methods and multiple distribution channels to write both commercial and consumer lines insurance with certain refinements for local laws, customs and needs. AIU operates in Asia, the Pacific Rim, Europe, the U.K., Africa, the Middle East and Latin America. During 2007, the Foreign General Insurance group accounted for 28 percent of AIG's General Insurance net premiums written.

#### **Discussion and Analysis of Consolidated Net Losses and Loss Expense Reserve Development**

The reserve for net losses and loss expenses represents the accumulation of estimates for reported losses (case basis reserves) and provisions for losses incurred but not reported (IBNR), both reduced by applicable reinsurance recoverable and the discount for future investment income, where permitted. Net losses and loss expenses are charged to income as incurred.

Loss reserves established with respect to foreign business are set and monitored in terms of the currency in which payment is expected to be made. Therefore, no assumption is included for

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changes in currency rates. See also Note 1(ff) to Consolidated Financial Statements.

Management reviews the adequacy of established loss reserves utilizing a number of analytical reserve development techniques. Through the use of these techniques, management is able to monitor the adequacy of AIG's established reserves and determine appropriate assumptions for inflation. Also, analysis of emerging specific development patterns, such as case reserve redundancies or deficiencies and IBNR emergence, allows management to determine any required adjustments.

The Analysis of Consolidated Losses and Loss Expense Reserve Development table presents the development of net losses and loss expense reserves for calendar years 1997 through 2007. Immediately following this table is a second table that presents all data on a basis that excludes asbestos and environmental net losses and loss expense reserve development. The opening reserves held are shown at the top of the table for each year end date. The amount of loss reserve discount included in the opening reserve at each date is shown immediately below the reserves held for each year. The undiscounted reserve at each date is thus the sum of the discount and the reserve held.

The upper half of the table presents the cumulative amounts paid during successive years related to the undiscounted opening loss reserves. For example, in the table that excludes asbestos and environmental losses, with respect to the net losses and loss expense reserve of \$24.83 billion as of December 31, 2000, by the end of 2007 (seven years later) \$33.05 billion had actually been paid in settlement of these net loss reserves. In addition, as reflected in the lower section of the table, the original undiscounted reserve of \$26.12 billion was reestimated to be \$41.21 billion at December 31, 2007. This increase from the original estimate would generally result from a combination of a number of factors, including reserves being settled for larger amounts than originally estimated. The original estimates will also be increased or decreased as more information becomes known about the individual claims and overall claim frequency and severity patterns. The redundancy (deficiency) depicted in the table, for any particular calendar year, presents the aggregate change in estimates over the period of years subsequent to the calendar year reflected at the top of the respective column heading. For example, the redundancy of \$672 million at December 31, 2007 related to December 31, 2006 net losses and loss expense reserves of \$62.72 billion represents the cumulative amount by which reserves in 2006 and prior years have developed favorably during 2007.

The bottom of each table below presents the remaining undiscounted and discounted net loss reserve for each year. For example, in the table that excludes asbestos and environmental losses, for the 2002 year end, the remaining undiscounted reserves held as of December 31, 2007 are \$13.57 billion, with a corresponding discounted net reserve of \$12.57 billion.

The reserves for net losses and loss expenses with respect to Transatlantic and 21st Century are included only in consolidated net losses and loss expenses commencing with the year ended December 31, 1998, the year they were first consolidated in AIG's financial statements. Reserve development for these operations is included only for 1998 and subsequent periods. Thus, the presentation for 1997 and prior year ends is not fully comparable to that for 1998 and subsequent years in the tables below.

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**Analysis of Consolidated Losses and Loss Expense Reserve Development**

The following table presents for each calendar year the losses and loss expense reserves and the development thereof including those with respect to asbestos and environmental claims. See also Management's Discussion and Analysis of Financial Condition and Results of Operations Operating Review General Insurance Operations Reserve for Losses and Loss Expenses.

<i>(in millions)</i>	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	<b>2007</b>
Net Reserves Held	\$20,901	\$25,418	\$25,636	\$25,684	\$26,005	\$29,347	\$36,228	\$47,254	\$57,476	\$62,630	<b>\$69,288</b>
Discount (in Reserves Held)	619	897	1,075	1,287	1,423	1,499	1,516	1,553	2,110	2,264	<b>2,429</b>
Net Reserves Held (Undiscounted)	20,282	26,315	26,711	26,971	27,428	30,846	37,744	48,807	59,586	64,894	<b>71,717</b>
Paid (Cumulative) as of:											
One year later	5,607	7,205	8,266	9,709	11,007	10,775	12,163	14,910	15,326	14,862	
Two years later	9,754	12,382	14,640	17,149	18,091	18,589	21,773	24,377	25,152		
Three years later	12,939	16,599	19,901	21,930	23,881	25,513	28,763	31,296			
Four years later	15,484	20,263	23,074	26,090	28,717	30,757	33,825				
Five years later	17,637	22,303	25,829	29,473	32,685	34,627					
Six years later	18,806	24,114	28,165	32,421	35,656						
Seven years later	19,919	25,770	30,336	34,660							
Eight years	21,089	27,309	31,956								

later

Nine  
years  
later

22,177 28,626

Ten  
years  
later

23,096

(in millions) **1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007**

Net  
Reserves  
Held

(undiscounted) \$ 21,520 \$ 26,315 \$ 26,711 \$ 26,971 \$ 27,428 \$ 30,846 \$ 37,744 \$ 48,807 \$ 59,586 \$ 64,894 **\$ 71,717**

Undiscounted  
Liability

as of:

One  
year  
later

21,563 25,897 26,358 26,979 31,112 32,913 40,931 53,486 59,533 64,238

Two  
years  
later

21,500 25,638 27,023 30,696 33,363 37,583 49,463 55,009 60,126

Three  
years  
later

21,264 26,169 29,994 32,732 37,964 46,179 51,497 56,047

Four  
years  
later

21,485 28,021 31,192 36,210 45,203 48,427 52,964

Five  
years  
later

22,405 28,607 33,910 41,699 47,078 49,855

Six  
years  
later

22,720 30,632 38,087 43,543 48,273

Seven  
years  
later

24,209 33,861 39,597 44,475

Eight  
years  
later

26,747 34,986 40,217

Nine  
years  
later

27,765 35,556

Ten  
years  
later

28,104



Net										
Redundancy/(Deficiency)	(6,541)	(9,241)	(13,506)	(17,504)	(20,845)	(19,009)	(15,220)	(7,240)	(540)	656
Remaining										
Reserves										
(Undiscounted)	6,008	6,930	8,261	9,815	12,617	15,228	19,139	24,751	34,974	49,376
Remaining										
Discount	418	499	591	705	851	1,005	1,155	1,319	1,563	1,937
Remaining										
Reserves	4,590	6,431	7,670	9,110	11,766	14,223	17,984	23,432	33,411	47,439

**The following table presents the gross liability (before discount), reinsurance recoverable and net liability recorded at each year end and the reestimation of these amounts as of December 31, 2007:**

(Millions)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Liability, End of Year	\$ 32,049	\$ 36,973	\$ 37,278	\$ 39,222	\$ 42,629	\$ 48,173	\$ 53,387	\$ 63,431	\$ 79,279	\$ 82,263	\$ 88,100
Reinsurance Recoverable, End of Year	10,529	10,658	10,567	12,251	15,201	17,327	15,643	14,624	19,693	17,369	17,369
Estimated Gross Liability, End of Year	21,520	26,315	26,711	26,971	27,428	30,846	37,744	48,807	59,586	64,894	70,731
Estimated Gross Liability	44,844	54,284	60,212	66,308	70,680	72,234	72,944	74,434	80,941	81,695	88,100
Estimated Reinsurance Recoverable	16,740	18,729	19,995	21,833	22,407	22,379	19,980	18,386	20,816	17,457	17,457
Estimated Net Liability	28,104	35,555	40,217	44,475	48,273	49,855	52,964	56,048	60,125	64,238	70,643
Estimated Net Liability											
Redundancy/(Deficiency)	(12,795)	(17,311)	(22,934)	(27,086)	(28,051)	(24,061)	(19,557)	(11,003)	(1,662)	568	7,457

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American International Group, Inc. and Subsidiaries

**Analysis of Consolidated Losses and Loss Expense Reserve Development Excluding Asbestos and Environmental Losses and Loss Expense Reserve Development**

The following table presents for each calendar year the losses and loss expense reserves and the development thereof excluding those with respect to asbestos and environmental claims. See also Management's Discussion and Analysis of Financial Condition and Results of Operations Operating Review General Insurance Operations Reserve for Losses and Loss Expenses.

<i>(in millions)</i>	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Net Reserves Held	\$ 20,113	\$ 24,554	\$ 24,745	\$ 24,829	\$ 25,286	\$ 28,650	\$ 35,559	\$ 45,742	\$ 55,227	\$ 60,451	\$ 67,597
Discount (in Reserves Held)	619	897	1,075	1,287	1,423	1,499	1,516	1,553	2,110	2,264	2,429
Net Reserves Held (Undiscounted)	20,732	25,451	25,820	26,116	26,709	30,149	37,075	47,295	57,336	62,715	70,026
Paid (Cumulative) as of:											
One year later	5,467	7,084	8,195	9,515	10,861	10,632	11,999	14,718	15,047	14,356	
Two years later	9,500	12,190	14,376	16,808	17,801	18,283	21,419	23,906	24,367		
Three years later	12,618	16,214	19,490	21,447	23,430	25,021	28,129	30,320			
Four years later	14,972	19,732	22,521	25,445	28,080	29,987	32,686				
Five years later	16,983	21,630	25,116	28,643	31,771	33,353					
Six years later	18,014	23,282	27,266	31,315	34,238						
Seven years later	18,972	24,753	29,162	33,051							
	19,960	26,017	30,279								

Eight  
years  
later

Nine  
years  
later

20,779 26,832

Ten  
years  
later

21,202

(in millions) **1997** **1998** **1999** **2000** **2001** **2002** **2003** **2004** **2005** **2006** **2007**

Net Reserves Held (undiscounted) **\$20,732** \$ 25,451 \$ 25,820 \$ 26,116 \$ 26,709 \$ 30,149 \$ 37,075 \$ 47,295 \$ 57,336 \$ 62,715 **\$ 70,026**

Undiscounted Liability as of:

One year later 20,576 24,890 25,437 26,071 30,274 32,129 39,261 51,048 57,077 62,043

Two years later 20,385 24,602 26,053 29,670 32,438 35,803 46,865 52,364 57,653

Three years later 20,120 25,084 28,902 31,619 36,043 43,467 48,691 53,385

Four years later 20,301 26,813 30,014 34,102 42,348 45,510 50,140

Five years later 21,104 27,314 31,738 38,655 44,018 46,925

Six years later 21,336 28,345 34,978 40,294 45,201

Seven years later 21,836 30,636 36,283 41,213

Eight years later 23,441 31,556 36,889

Nine years later 24,261 32,113  
24,588

Ten years later											
Net Redundancy/Deficiency	(3,856)	(6,662)	(11,069)	(15,097)	(18,492)	(16,776)	(13,065)	(6,090)	(317)	672	
Remaining Reserves (undiscounted)	3,086	5,281	6,610	8,162	10,963	13,572	17,454	23,065	33,286	47,687	
Remaining Discount	418	499	591	705	851	1,005	1,155	1,319	1,563	1,937	
Remaining Reserves	2,968	4,782	6,019	7,457	10,112	12,567	16,299	21,746	31,723	45,750	

**The following table presents the gross liability (before discount), reinsurance recoverable and net liability recorded at each year end and the reestimation of these amounts as of December 31, 2007:**

(Millions)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Liability, End of	\$ 29,740	\$ 34,474	\$ 34,666	\$ 36,777	\$ 40,400	\$ 46,036	\$ 51,363	\$ 59,790	\$ 73,808	\$ 77,111	\$ 83,311
Insurance Recoverable, End of Year	9,008	9,023	8,846	10,661	13,691	15,887	14,288	12,495	16,472	14,396	13,396
Liability, End of Year	20,732	25,451	25,820	26,116	26,709	30,149	37,075	47,295	57,336	62,715	70,000
Estimated Gross Liability	35,712	45,467	51,801	58,420	63,320	65,217	66,320	68,100	75,028	76,439	77,111
Estimated Reinsurance Recoverable	11,124	13,354	14,912	17,207	18,119	18,292	16,180	14,715	17,375	14,396	13,396
Estimated Net Liability	24,588	32,113	36,889	41,213	45,201	46,925	50,140	53,385	57,653	62,043	63,715
Estimated Relative Gross Redundancy/(Deficiency)	(5,972)	(10,993)	(17,135)	(21,643)	(22,920)	(19,181)	(14,957)	(8,310)	(1,220)	672	672

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The reserve for losses and loss expenses as reported in AIG's consolidated balance sheet at December 31, 2007 differs from the total reserve reported in the Annual Statements filed with state insurance departments and, where appropriate, with foreign regulatory authorities. The differences at December 31, 2007 relate primarily to reserves for certain foreign operations not required to be reported in the United States for statutory reporting purposes. Further, statutory practices in the United States require reserves to be shown net of applicable reinsurance recoverable.

The reserve for gross losses and loss expenses is prior to reinsurance and represents the accumulation for reported losses and IBNR. Management reviews the adequacy of established gross loss reserves in the manner previously described for net loss reserves.

For further discussion regarding net reserves for losses and loss expenses, see Management's Discussion and Analysis of Financial Condition and Results of Operations — Operating Review — General Insurance Operations — Reserve for Losses and Loss Expenses.

### **Life Insurance & Retirement Services Operations**

AIG's Life Insurance & Retirement Services operations provide insurance, financial and investment-oriented products throughout the world. Insurance-oriented products consist of individual and group life, payout annuities (including structured settlements), endowment and accident and health policies. Retirement savings products consist generally of fixed and variable annuities.

#### **Foreign Life Insurance & Retirement Services**

In its Foreign Life Insurance & Retirement Services businesses, AIG operates principally through ALICO, AIG Star Life, AIG Edison Life, AIA, Nan Shan and Philamlife. ALICO is incorporated in Delaware and all of its business is written outside of the United States. ALICO has operations either directly or through subsidiaries in Europe, including the U.K., Latin America, the Caribbean, the Middle East, South Asia and the Far East, with Japan being the largest territory. ALICO also conducts life insurance business through a joint venture in Brazil. AIA operates primarily in China (including Hong Kong), Singapore, Malaysia, Thailand, Korea, Australia, New Zealand, Vietnam, Indonesia and India. The operations in India are conducted through a joint venture, Tata AIG Life Insurance Company Limited. Nan Shan operates in Taiwan. Philamlife is the largest life insurer in the Philippines. AIG Star Life and AIG Edison Life operate in Japan. Operations in foreign countries comprised 79 percent of Life Insurance & Retirement Services Premiums and other considerations and 76 percent of Life Insurance & Retirement Services operating income in 2007.

The Foreign Life Insurance & Retirement Services companies have over 285,000 full and part-time agents, as well as independent producers, and sell their products largely to indigenous persons in local and foreign currencies. In addition to the agency outlets, these companies also distribute their products through direct marketing channels, such as mass marketing, and through brokers and other distribution outlets, such as financial institutions.

#### **Domestic Life Insurance & Retirement Services**

AIG's principal Domestic Life Insurance & Retirement Services operations include AGLA, AIG American General, AIG Annuity, USLIFE, VALIC and AIG SunAmerica. These companies utilize multiple distribution channels including independent producers, brokerage, career agents and financial institutions to offer life insurance, annuity and accident and health products and services, as well as financial and other investment products. The Domestic Life Insurance & Retirement Services operations comprised 21 percent of total Life Insurance & Retirement Services Premiums and other considerations and 24 percent of Life Insurance & Retirement Services operating income in 2007.

### **Reinsurance**

AIG's General Insurance subsidiaries worldwide operate primarily by underwriting and accepting risks for their direct account and securing reinsurance on that portion of the risk in excess of the limit which they wish to retain. This operating policy differs from that of many insurance companies that will underwrite only up to their net retention limit, thereby requiring the broker or agent to secure commitments from other underwriters for the remainder of the gross risk amount.

Various AIG profit centers, including DBG, AIU and AIG Risk Finance, as well as certain Life Insurance subsidiaries, use AIRCO as a reinsurer for certain of their businesses. In Bermuda, AIRCO discounts reserves attributable to certain classes of business assumed from other AIG subsidiaries.

For a further discussion of reinsurance, see Item 1A. Risk Factors – Reinsurance; Management’s Discussion and Analysis of Financial Condition and Results of Operations – Risk Management – Reinsurance; and Note 5 to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

**Insurance Investment Operations**

A significant portion of AIG's General Insurance and Life Insurance & Retirement Services revenues are derived from AIG's insurance investment operations.

The following table summarizes the investment results of the insurance operations:

Years Ended December 31, (in millions)	Annual Average Cash and Invested Assets			Return on Average Cash and Invested Assets <sup>(b)</sup>	Return on Average Invested Assets <sup>(c)</sup>
	Cash (including short-term investments) <sup>(a)</sup>	Invested Assets <sup>(a)</sup>	Total		
<b>General Insurance:</b>					
<b>2007</b>	<b>\$ 5,874</b>	<b>\$117,050</b>	<b>\$122,924</b>	<b>5.0%</b>	<b>5.2%</b>
2006	3,201	102,231	105,432	5.4	5.6
2005	2,450	86,211	88,661	4.5	4.7
2004	2,012	73,338	75,350	4.2	4.4
2003	1,818	59,855	61,673	4.2	4.3
<b>Life Insurance &amp; Retirement Services:</b>					
<b>2007</b>	<b>\$25,926</b>	<b>\$423,473</b>	<b>\$449,669</b>	<b>5.0%</b>	<b>5.3%</b>
2006	13,698	392,348	406,046	4.9	5.1
2005	11,137	356,839	367,976	5.1	5.2
2004	7,737	309,627	317,364	4.9	5.1
2003	4,680	247,608	252,288	5.3	5.4

(a) Including investment income due and accrued and real estate. Also, includes collateral assets invested under the global securities lending program.

(b) Net investment income divided by the annual average sum of cash and invested assets.

(c) Net investment income divided by the annual average invested assets.

AIG's worldwide insurance investment policy places primary emphasis on investments in government and other high quality, fixed income securities in all of its portfolios and, to a lesser extent, investments in high yield bonds, common stocks, real estate, hedge funds and partnerships, in order to enhance returns on policyholders' funds and generate net investment income. The ability to implement this policy is somewhat limited in certain territories as there may be a lack of adequate long-term investments or investment restrictions may be imposed by the local regulatory authorities.

**Financial Services Operations**

AIG's Financial Services subsidiaries engage in diversified activities including aircraft and equipment leasing, capital markets, consumer finance and insurance premium finance. Together, the Aircraft Leasing, Capital Markets and Consumer Finance operations generate the majority of the revenues produced by the Financial Services operations.

A.I. Credit also contributes to Financial Services income principally by providing insurance premium financing for both AIG's policyholders and those of other insurers.

#### **Aircraft Leasing**

Aircraft Leasing operations represent the operations of ILFC, which generates its revenues primarily from leasing new and used commercial jet aircraft to foreign and domestic airlines. Revenues also result from the remarketing of commercial jets for ILFC's own account, and remarketing and fleet management services for airlines and financial institutions. See also Note 2 to Consolidated Financial Statements.

#### **Capital Markets**

Capital Markets represents the operations of AIGFP, which engages as principal in a wide variety of financial transactions, including standard and customized financial products involving commodities, credit, currencies, energy, equities and rates. The credit products include credit protection written through credit default swaps on super senior risk tranches of diversified pools of loans and debt securities. AIGFP also invests in a diversified portfolio of securities and principal investments and engages in borrowing activities that include issuing standard and structured notes and other securities and entering into guaranteed investment agreements (GIAs).

#### **Consumer Finance**

Consumer Finance operations include AGF as well as AIGCFG. AGF provides a wide variety of consumer finance products, including real estate and non-real estate loans, retail sales finance and credit-related insurance to customers in the United States, the U.K., Puerto Rico and the U.S. Virgin Islands. AGF's finance receivables are primarily sourced through its branches, although many of AGF's real estate loans are sourced through its centralized real estate operations, which include AGF's mortgage banking activities. AIGCFG, through its subsidiaries, is engaged in developing a multi-product consumer finance business with an emphasis on emerging and developing markets.

#### **Asset Management Operations**

AIG's Asset Management operations comprise a wide variety of investment-related services and investment products. These ser-



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### American International Group, Inc. and Subsidiaries

ices and products are offered to individuals, pension funds and institutions globally through AIG's Spread-Based Investment business, Institutional Asset Management, and Brokerage Services and Mutual Funds business. Also included in Asset Management operations are the results of certain SunAmerica sponsored partnership investments.

#### **Spread-Based Investment Business**

AIG's Spread-Based Investment business includes the results of AIG's proprietary spread-based investment operations, the Matched Investment Program (MIP), which was launched in September of 2005 to replace the Guaranteed Investment Contract (GIC) program, which is in runoff. The MIP is an investment strategy that involves investing in various asset classes with financing provided through third parties. This business uses various risk mitigating strategies designed to hedge interest rate and currency risk associated with underlying investments and related liabilities.

#### **Institutional Asset Management**

AIG's Institutional Asset Management business, conducted through AIG Investments, provides an array of investment products and services globally to institutional investors, pension funds, AIG subsidiaries and high net worth investors. These products include traditional equity and fixed income investments, and a wide range of alternative asset classes. These services include investment advisory and subadvisory services, investment monitoring and investment transaction structuring. Within the fixed income and equity asset classes, AIG Investments offers various forms of structured investments aimed at achieving superior returns or capital preservation. Within the alternative asset class, AIG Investments offers hedge and private equity fund-of-funds, direct investments and distressed debt investments.

AIG Global Real Estate provides a wide range of real estate investment and management services for AIG subsidiaries, as well as for third-party institutional investors, high net worth investors and pension funds. Through a strategic network of local real estate ventures, AIG Global Real Estate actively invests in and develops office, industrial, multi-family residential, retail, hotel and resort properties globally.

AIG Private Bank offers banking, trading and investment management services to private clients and institutions globally.

From time to time, AIG Investments acquires alternative investments, primarily consisting of direct controlling equity interests in private enterprises, with the intention of warehousing such investments until the investment or economic benefit thereof is transferred to a fund or other AIG-managed investment product. During the warehousing period, AIG bears the cost and risks associated with carrying these investments and consolidates them on its balance sheet and records the operating results until the investments are transferred, sold or otherwise divested. Changes in market conditions may negatively affect the fair value of these warehoused investments. Market conditions may impede AIG from launching new investment products for which these warehoused assets are being held, which could result in AIG not recovering its investment upon transfer or divestment. In the event that AIG is unable to transfer or otherwise divest its interest in the warehoused investment to third parties, AIG could be required to hold these investments indefinitely. In certain instances, the consolidated warehoused investments are not wholly owned by AIG. In such cases, AIG shares the risk associated with warehousing the asset with the minority interest investors.

#### **Brokerage Services and Mutual Funds**

AIG's Brokerage Services and Mutual Funds business, conducted through AIG Advisor Group, Inc. and AIG SunAmerica Asset Management Corp., provides broker-dealer related services and mutual funds to retail investors, group trusts and corporate accounts through an independent network of financial advisors. AIG Advisor Group, Inc., a subsidiary of AIG Retirement Services, Inc., is comprised of several broker-dealer entities that provide these services to clients primarily in the U.S. marketplace. AIG SunAmerica Asset Management Corp. manages, advises and/or administers retail mutual funds, as well as the underlying assets of variable annuities sold by AIG SunAmerica and VALIC to individuals and groups throughout the United States.

#### **Other Asset Management**

Included in Other Asset Management is income or loss from certain AIG SunAmerica sponsored partnerships and partnership investments. Partnership assets consist of investments in a diversified portfolio of private equity funds, affordable housing partnerships and hedge fund investments.

### **Other Operations**

Certain AIG subsidiaries provide insurance-related services such as adjusting claims and marketing specialized products. Several wholly owned foreign subsidiaries of AIG operating in countries or jurisdictions such as Ireland, Bermuda, Barbados and Gibraltar provide insurance and related administrative and back office services to affiliated and unaffiliated insurance and reinsurance companies, including captive insurance companies unaffiliated with AIG.

AIG has several other subsidiaries that engage in various businesses. Mt. Mansfield Company, Inc. owns and operates the ski slopes, lifts, a school and an inn located in Stowe, Vermont. Also reported in AIG's Other operations are interest expense, expenses of corporate staff not attributable to specific business segments, expenses related to efforts to improve internal controls, corporate initiatives, certain compensation plan expenses and the settlement costs more fully described in Item 3. Legal Proceedings and Note 12(a) to Consolidated Financial Statements.

### **Additional Investments**

AIG's significant investments in partially owned companies (which are accounted for under the equity method) include a 25.4 percent interest in The Fuji Fire and Marine Insurance Co., Ltd., a general insurance company in Japan, a 26.0 percent interest in Tata AIG Life Insurance Company, Ltd. and a 26.0 percent interest

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### American International Group, Inc. and Subsidiaries

in Tata AIG General Insurance Company, Ltd. in India. Substantially all of AIG's equity interest in Allied World Assurance Holdings, Ltd. was sold by AIG in December 2007. For a discussion of AIG's investments in partially owned companies, see Note 1(s) to Consolidated Financial Statements.

### **Locations of Certain Assets**

As of December 31, 2007, approximately 37 percent of the consolidated assets of AIG were located in foreign countries (other than Canada), including \$4.4 billion of cash and securities on deposit with foreign regulatory authorities. Foreign operations and assets held abroad may be adversely affected by political developments in foreign countries, including tax changes, nationalization and changes in regulatory policy, as well as by consequence of hostilities and unrest. The risks of such occurrences and their overall effect upon AIG vary from country to country and cannot easily be predicted. If expropriation or nationalization does occur, AIG's policy is to take all appropriate measures to seek recovery of such assets. Certain of the countries in which AIG's business is conducted have currency restrictions which generally cause a delay in a company's ability to repatriate assets and profits. See also Notes 1 and 2 to Consolidated Financial Statements and Item 1A. Risk Factors - Foreign Operations.

### **Regulation**

AIG's operations around the world are subject to regulation by many different types of regulatory authorities, including insurance, securities, investment advisory, banking and thrift regulators in the United States and abroad. The regulatory environment can have a significant effect on AIG and its business. AIG's operations have become more diverse and consumer-oriented, increasing the scope of regulatory supervision and the possibility of intervention. Although AIG cannot predict the scope or effect of such regulation on its business, AIG expects further regulation of its domestic consumer finance operations as a result of the current disruption of the U.S. residential mortgage market. In addition, the investigations into financial accounting practices that led to two restatements of AIG's consolidated financial statements have heightened regulatory scrutiny of AIG worldwide.

In 1999, AIG became a unitary thrift holding company within the meaning of the Home Owners' Loan Act (HOLA) when the Office of Thrift Supervision (OTS) granted AIG approval to organize AIG Federal Savings Bank. AIG is subject to OTS regulation, examination, supervision and reporting requirements. In addition, the OTS has enforcement authority over AIG and its subsidiaries. Among other things, this permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the financial safety, soundness or stability of AIG's subsidiary savings association, AIG Federal Savings Bank.

Under prior law, a unitary savings and loan holding company, such as AIG, was not restricted as to the types of business in which it could engage, provided that its savings association subsidiary continued to be a qualified thrift lender. The Gramm-Leach-Bliley Act of 1999 (GLBA) provides that no company may acquire control of an OTS regulated institution after May 4, 1999 unless it engages only in the financial activities permitted for financial holding companies under the law or for multiple savings and loan holding companies. The GLBA, however, grandfathered the unrestricted authority for activities with respect to a unitary savings and loan holding company existing prior to May 4, 1999, so long as its savings association subsidiary continues to be a qualified thrift lender under the HOLA. As a unitary savings and loan holding company whose application was pending as of May 4, 1999, AIG is grandfathered under the GLBA and generally is not restricted under existing laws as to the types of business activities in which it may engage, provided that AIG Federal Savings Bank continues to be a qualified thrift lender under the HOLA.

Certain states require registration and periodic reporting by insurance companies that are licensed in such states and are controlled by other corporations. Applicable legislation typically requires periodic disclosure concerning the corporation that controls the registered insurer and the other companies in the holding company system and prior approval of intercorporate services and transfers of assets (including in some instances payment of dividends by the insurance subsidiary) within the holding company system. AIG's subsidiaries are registered under such legislation in those states that have such requirements.

AIG's insurance subsidiaries, in common with other insurers, are subject to regulation and supervision by the states and by other jurisdictions in which they do business. Within the United States, the method of such regulation varies but generally has its source in statutes that delegate regulatory and supervisory powers to an insurance official. The

regulation and supervision relate primarily to approval of policy forms and rates, the standards of solvency that must be met and maintained, including risk-based capital, the licensing of insurers and their agents, the nature of and limitations on investments, restrictions on the size of risks that may be insured under a single policy, deposits of securities for the benefit of policyholders, requirements for acceptability of reinsurers, periodic examinations of the affairs of insurance companies, the form and content of reports of financial condition required to be filed, and reserves for unearned premiums, losses and other purposes. In general, such regulation is for the protection of policyholders rather than the equity owners of these companies.

AIG has taken various steps to enhance the capital positions of the Domestic General Insurance companies. AIG entered into capital maintenance agreements with the Domestic General Insurance companies that set forth procedures through which AIG will provide ongoing capital support. Also, in order to allow the Domestic General Insurance companies to record as an admitted asset at December 31, 2007 certain reinsurance ceded to non-U.S. reinsurers (which has the effect of increasing the statutory surplus of such Domestic General Insurance companies), AIG obtained and entered into reimbursement agreements for approximately \$1.8 billion of letters of credit issued by several commercial banks in favor of certain Domestic General Insurance companies.

In the U.S., Risk-Based Capital (RBC) is designed to measure the adequacy of an insurer's statutory surplus in relation to the risks inherent in its business. Thus, inadequately capitalized general and life insurance companies may be identified. The U.S. RBC formula develops a risk-adjusted target level of statutory

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surplus by applying certain factors to various asset, premium and reserve items. Higher factors are applied to more risky items and lower factors are applied to less risky items. Thus, the target level of statutory surplus varies not only as a result of the insurer's size, but also based on the risk profile of the insurer's operations.

The RBC Model Law provides for four incremental levels of regulatory attention for insurers whose surplus is below the calculated RBC target. These levels of attention range in severity from requiring the insurer to submit a plan for corrective action to placing the insurer under regulatory control.

The statutory surplus of each of AIG's Domestic General Insurance and Life Insurance subsidiaries exceeded their RBC target levels as of December 31, 2007.

To the extent that any of AIG's insurance entities would fall below prescribed levels of statutory surplus, it would be AIG's intention to provide appropriate capital or other types of support to that entity.

A substantial portion of AIG's General Insurance business and a majority of its Life Insurance business is carried on in foreign countries. The degree of regulation and supervision in foreign jurisdictions varies. Generally, AIG, as well as the underwriting companies operating in such jurisdictions, must satisfy local regulatory requirements. Licenses issued by foreign authorities to AIG subsidiaries are subject to modification or revocation by such authorities, and these subsidiaries could be prevented from conducting business in certain of the jurisdictions where they currently operate. In the past, AIG has been allowed to modify its operations to conform with new licensing requirements in most jurisdictions.

In addition to licensing requirements, AIG's foreign operations are also regulated in various jurisdictions with respect to currency, policy language and terms, advertising, amount and type of security deposits, amount and type of reserves, amount and type of capital to be held, amount and type of local investment and the share of profits to be returned to policyholders on participating policies. Some foreign countries regulate rates on various types of policies. Certain countries have established reinsurance institutions, wholly or partially owned by the local government, to which admitted insurers are obligated to cede a portion of their business on terms that may not always allow foreign insurers, including AIG subsidiaries, full compensation. In some countries, regulations governing constitution of technical reserves and remittance balances may hinder remittance of profits and repatriation of assets.

See Management's Discussion and Analysis of Financial Condition and Results of Operations—Capital Resources and Liquidity—Regulation and Supervision and Note 15 to Consolidated Financial Statements.

### **Competition**

AIG's Insurance, Financial Services and Asset Management businesses operate in highly competitive environments, both domestically and overseas. Principal sources of competition are insurance companies, banks, investment banks and other non-bank financial institutions.

The insurance industry in particular is highly competitive. Within the United States, AIG's General Insurance subsidiaries compete with approximately 3,400 other stock companies, specialty insurance organizations, mutual companies and other underwriting organizations. AIG's subsidiaries offering Life Insurance & Retirement Services compete in the United States with approximately 2,100 life insurance companies and other participants in related financial services fields. Overseas, AIG subsidiaries compete for business with foreign insurance operations of the larger U.S. insurers, global insurance groups and local companies in particular areas in which they are active.

### **Directors and Executive Officers of AIG**

All directors of AIG are elected for one-year terms at the annual meeting of shareholders. All executive officers are elected to one-year terms, but serve at the pleasure of the Board of Directors.

Except as hereinafter noted, each of the executive officers has, for more than five years, occupied an executive position with AIG or companies that are now its subsidiaries. Other than the employment contracts between AIG and Messrs. Sullivan and Bensinger, there are no other arrangements or understandings between any executive officer and any other person pursuant to which the executive officer was elected to such position. From January 2000 until joining AIG in May 2004, Dr. Frenkel served as Chairman of Merrill Lynch International, Inc. Prior to joining AIG in September 2006, Ms. Kelly served as Executive Vice President and General Counsel of MCI/WorldCom. Previously, she was Senior Vice President and General Counsel of Sears, Roebuck and Co. from 1999 to 2003. From June 2004

until joining AIG in May 2007, Mr. Kaslow was a managing partner of QuanStar Group, LLC (an advisory services firm), and, from January 2002 until May 2004, Mr. Kaslow was Senior Executive Vice President of Human Resources for Vivendi Universal (an entertainment and telecommunications company).

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American International Group, Inc. and Subsidiaries

**Set forth below is information concerning the directors and executive officers of AIG as of February 28, 2008.**

Name	Title	Age	Served as Director or Officer Since
Stephen F. Bollenbach	Director	65	2008
Marshall A. Cohen	Director	72	1992
Martin S. Feldstein	Director	68	1987
Ellen V. Futter	Director	58	1999
Stephen L. Hammerman	Director	69	2005
Richard C. Holbrooke	Director	66	2001
Fred H. Langhammer	Director	64	2006
George L. Miles, Jr.	Director	66	2005
Morris W. Offit	Director	71	2005
James F. Orr III	Director	64	2006
Virginia M. Rometty	Director	50	2006
Martin J. Sullivan	Director, President and Chief Executive Officer	53	2002
Michael H. Sutton	Director	67	2005
Edmund S. W. Tse	Director, Senior Vice Chairman Life Insurance	70	1996
Robert B. Willumstad	Director and Chairman	62	2006
Frank G. Zarb	Director	73	2001
Jacob A. Frenkel	Vice Chairman Global Economic Strategies	64	2004
Frank G. Wisner	Vice Chairman External Affairs	69	1997
Steven J. Bensinger	Executive Vice President and Chief Financial Officer	53	2002
Anastasia D. Kelly	Executive Vice President, General Counsel and Senior Regulatory and Compliance Officer	58	2006
Rodney O. Martin, Jr.	Executive Vice President Life Insurance	55	2002
Kristian P. Moor	Executive Vice President Domestic General Insurance	48	1998
Win J. Neuger	Executive Vice President and Chief Investment Officer	58	1995
Robert M. Sandler	Executive Vice President Domestic Personal Lines	65	1980
Nicholas C. Walsh	Executive Vice President Foreign General Insurance	57	2005
Jay S. Wintrob	Executive Vice President Retirement Services	50	1999
William N. Dooley	Senior Vice President Financial Services	55	1992
David L. Herzog	Senior Vice President and Comptroller	48	2005
Andrew J. Kaslow	Senior Vice President and Chief Human Resources Officer	57	2007
Robert E. Lewis	Senior Vice President and Chief Risk Officer	56	1993
Brian T. Schreiber	Senior Vice President Strategic Planning	42	2002

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American International Group, Inc. and Subsidiaries

### **Item 1A.**

#### **Risk Factors**

##### **Casualty Insurance Underwriting and Reserves**

**Casualty insurance liabilities are difficult to predict and may exceed the related reserves for losses and loss expenses.** Although AIG annually reviews the adequacy of the established reserve for losses and loss expenses, there can be no assurance that AIG's loss reserves will not develop adversely and have a material effect on AIG's results of operations. Estimation of ultimate net losses, loss expenses and loss reserves is a complex process for long-tail casualty lines of business, which include excess and umbrella liability, D&O, professional liability, medical malpractice, workers compensation, general liability, products liability and related classes, as well as for asbestos and environmental exposures. Generally, actual historical loss development factors are used to project future loss development. However, there can be no assurance that future loss development patterns will be the same as in the past. Moreover, any deviation in loss cost trends or in loss development factors might not be discernible for an extended period of time subsequent to the recording of the initial loss reserve estimates for any accident year. Thus, there is the potential for reserves with respect to a number of years to be significantly affected by changes in loss cost trends or loss development factors that were relied upon in setting the reserves. These changes in loss cost trends or loss development factors could be attributable to changes in inflation or in the judicial environment, or in other social or economic phenomena affecting claims, such as the effects that the recent disruption in the credit markets could have on reported claims under D&O or professional liability coverages. See also Management's Discussion and Analysis of Financial Condition and Results of Operations Operating Review General Insurance Operations Reserve for Losses and Loss Expenses.

##### **Credit Market Environment**

**AIG's businesses may continue to be adversely affected by the current disruption in the global credit markets and repricing of credit risk.** During the second half of 2007, disruption in the global credit markets, coupled with the repricing of credit risk, and the U.S. housing market deterioration created increasingly difficult conditions in the financial markets. These conditions have resulted in greater volatility, less liquidity, widening of credit spreads and a lack of price transparency in certain markets. These conditions continue to adversely affect Mortgage Guaranty's results of operations and the fair value of the AIGFP super senior credit default swap portfolio and contribute to higher levels of finance receivables delinquencies at AGF and to the severe and rapid decline in the fair value of certain investment securities, particularly those backed by U.S. residential mortgage loans. It is difficult to predict how long these conditions will exist and how AIG's markets, products and businesses will continue to be adversely affected. Accordingly, these conditions could adversely affect AIG's consolidated financial condition or results of operations in future periods. In addition, litigation and regulatory or governmental investigations and inquiries have been commenced against AIG related to these events and AIG may become subject to further litigation and regulatory or governmental scrutiny as a result of these events.

##### **Risk Management**

**AIG is exposed to a number of significant risks, and AIG's risk management processes and controls may not be fully effective in mitigating AIG's risk exposures in all market conditions and to all types of risk.** The major risks to which AIG is exposed include: credit risk, market risk, operational risk, liquidity risk and insurance risk. AIG has devoted significant resources to the development and implementation of risk management processes and controls across AIG's operations, including by establishing review and oversight committees to monitor risks, setting limits and identifying risk mitigating strategies and techniques. Nonetheless, these procedures may not be fully effective in mitigating risk exposure in all market conditions, some of which change rapidly and severely. A failure of AIG's risk management processes or the ineffectiveness of AIG's risk mitigating strategies and techniques could adversely affect, perhaps materially, AIG's consolidated results of operations, liquidity or financial condition, result in regulatory action or litigation or damage AIG's reputation. See Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Management.

##### **Liquidity**



**AIG's liquidity could be impaired by an inability to access the capital markets or by unforeseen significant outflows of cash.** This situation may arise due to circumstances that AIG may be unable to control, such as a general market disruption or an operational problem that affects third parties or AIG. In addition, this situation may arise due to circumstances specific to AIG, such as a decline in its credit ratings. AIG depends on dividends, distributions and other payments from its subsidiaries to fund dividend payments and to fund payments on AIG's obligations, including debt obligations. Regulatory and other legal restrictions may limit AIG's ability to transfer funds freely, either to or from its subsidiaries. In particular, many of AIG's subsidiaries, including AIG's insurance subsidiaries, are subject to laws and regulations that authorize regulatory bodies to block or reduce the flow of funds to the parent holding company, or that prohibit such transfers altogether in certain circumstances. These laws and regulations may hinder AIG's ability to access funds that AIG may need to make payments on its obligations. See also Item 1. Business Regulation.

**Some of AIG's investments are relatively illiquid and would be difficult to sell, or to sell at acceptable prices, if AIG required cash in amounts greater than its customary needs.** AIG's investments in certain securities, including certain structured securities, direct private equities, limited partnerships, hedge funds, mortgage loans, flight equipment, finance receivables and real estate are relatively illiquid. These asset classes represented approximately 23 percent of the carrying value of AIG's total cash and invested assets as of December 31, 2007. In addition, the current disruption in the credit markets has affected the liquidity of other AIG portfolios

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## American International Group, Inc. and Subsidiaries

including the residential mortgage-backed securities portfolio. If AIG requires significant amounts of cash on short notice in excess of normal cash requirements or is required to post or return collateral in connection with its investment portfolio, derivative transactions or securities lending activities, then AIG may have difficulty selling these investments or terminating these transactions in a timely manner or may be forced to sell or terminate them for less than what AIG might otherwise have been able to, or both. Although AIGFP has no current intent to do so, if AIGFP sells or closes out its derivative transactions prior to maturity, the effect could be significant to AIG's overall liquidity. **AIG's liquidity may be adversely affected by requirements to post collateral.** Certain of the credit default swaps written by AIGFP contain collateral posting requirements. The amount of collateral required to be posted for most of these transactions is determined based on the value of the security or loan referenced in the documentation for the credit default swap. Continued declines in the values of these referenced securities or loans will increase the amount of collateral AIGFP must post which could impair AIG's liquidity.

See also Management's Discussion and Analysis of Financial Condition and Results of Operations—Capital Resources and Liquidity—Liquidity.

**Investment Concentration**

**Concentration of AIG's investment portfolios in any particular segment of the economy may have adverse effects.** Any concentration of AIG's investment portfolios in any particular industry, group of related industries, asset classes, such as residential mortgage-backed securities and other asset-backed securities, or geographic sector could have an adverse effect on the investment portfolios and consequently on AIG's consolidated results of operations or financial condition. While AIG seeks to mitigate this risk by having a broadly diversified portfolio, events or developments that have a negative effect on any particular industry, asset class, group of related industries or geographic region may have a greater adverse effect on the investment portfolios to the extent that the portfolios are concentrated. Further, AIG's ability to sell assets relating to such particular groups of related assets may be limited if other market participants are seeking to sell at the same time.

**Credit Ratings**

**Ratings actions regarding AIG could adversely affect AIG's business and its consolidated results of operations.**

Following AIG's filing with the SEC on February 11, 2008 of a Current Report on Form 8-K regarding the valuation of AIGFP's super senior credit default swap portfolio and reporting the conclusion by AIG's independent auditors that AIG had a material weakness in internal control over financial reporting and oversight relating to this valuation, the following credit rating actions were taken:

Standard & Poor's, a division of The McGraw-Hill Companies, Inc. (S&P) affirmed its AA- counterparty credit ratings on AIG and its AA+ counterparty credit and financial strength ratings on AIG's core subsidiaries, but revised the rating outlook to negative. In addition, S&P revised its rating outlook on ILFC's corporate credit rating (AA-) to negative. A negative ratings outlook by S&P indicates that a rating may be lowered, but is not necessarily a precursor of a ratings change.

Moody's Investors Service (Moody's) changed its rating outlook for AIG and its subsidiaries that have substantial exposure to the U.S. subprime mortgage market or whose ratings rely on significant explicit or implicit support from AIG to negative. Moody's rates AIG Aa2 and nearly all of its insurance subsidiaries either Aa1 or Aa2. A negative ratings outlook by Moody's indicates that a rating may be lowered, but is not necessarily a precursor of a ratings change.

Fitch Ratings (Fitch) placed AIG's and its subsidiaries' long-term debt ratings (AA), including ILFC (A+) and AGF (A+), on Rating Watch Negative. Rating Watch Negative indicates that a rating has been placed on active rating watch status. Fitch indicated that it expects to resolve the Rating Watch after it reviews AIG's 2007 audited financial statements.

A.M. Best Company (A.M. Best) placed most of its financial strength and issuer credit ratings on AIG's domestic Life Insurance and Retirement Services (A++) and Domestic General Insurance subsidiaries (including Transatlantic) (A+), as well as AIG's issuer credit rating (AA), under review with negative implications. A.M. Best

indicated that following a detailed review of AIG's 2007 audited financial statements and further discussion with AIG management, it will re-evaluate the under review rating status.

Financial strength and credit ratings by the major ratings agencies are an important factor in establishing the competitive position of insurance companies and other financial institutions and affect the availability and cost of borrowings. Financial strength ratings measure an insurance company's ability to meet its obligations to contract holders and policyholders, help to maintain public confidence in a company's products, facilitate marketing of products and enhance a company's competitive position. Credit ratings measure a company's ability to repay its obligations and directly affect the cost and availability to that company of unsecured financing. AIG's ratings have historically provided it with a competitive advantage. However, a ratings downgrade could adversely affect AIG's business and its consolidated results of operations in a number of ways, including:

- increasing AIG's interest expense;
- reducing AIGFP's ability to compete in the structured products and derivatives businesses;
- reducing the competitive advantage of AIG's insurance subsidiaries, which may result in reduced product sales;
- adversely affecting relationships with agents and sales representatives;
- in the case of a downgrade of AGF or ILFC, increasing their interest expense and reducing their ability to compete in their respective businesses; and
- triggering the application of a termination provision in certain of AIG's contracts, principally agreements entered into by AIGFP and assumed reinsurance contracts entered into by Transatlantic.

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### American International Group, Inc. and Subsidiaries

In the event of a downgrade of AIG, AIG would be required to post additional collateral. It is estimated that, as of the close of business on February 14, 2008, based on AIG's outstanding municipal GIAs and financial derivatives transactions as of such date, a further downgrade of AIG's long-term senior debt ratings to Aa3 by Moody's or AA- by S&P would permit counterparties to call for approximately \$1.39 billion of additional collateral. Further, additional downgrades could result in requirements for substantial additional collateral, which could have a material effect on how AIG manages its liquidity. For a further discussion of AIG's credit ratings and the potential effect of posting collateral on AIG's liquidity, see Management's Discussion and Analysis of Financial Condition and Results of Operations Capital Resources and Liquidity Credit Ratings and Liquidity.

#### Catastrophe Exposures

**The occurrence of catastrophic events could adversely affect AIG's consolidated financial condition or results of operations.** The occurrence of events such as hurricanes, earthquakes, pandemic disease, acts of terrorism and other catastrophes could adversely affect AIG's consolidated financial condition or results of operations, including by exposing AIG's businesses to the following:

- widespread claim costs associated with property, workers compensation, mortality and morbidity claims;
- loss resulting from the value of invested assets declining to below the amount required to meet the policy and contract liabilities; and
- loss resulting from actual policy experience emerging adversely in comparison to the assumptions made in the product pricing related to mortality, morbidity, termination and expenses.

#### Reinsurance

**Reinsurance may not be available or affordable.** AIG subsidiaries are major purchasers of reinsurance and utilize reinsurance as part of AIG's overall risk management strategy. Reinsurance is an important risk management tool to manage transaction and insurance line risk retention, and to mitigate losses that may arise from catastrophes. Market conditions beyond AIG's control determine the availability and cost of the reinsurance purchased by AIG subsidiaries. For example, reinsurance may be more difficult to obtain after a year with a large number of major catastrophes. Accordingly, AIG may be forced to incur additional expenses for reinsurance or may be unable to obtain sufficient reinsurance on acceptable terms, in which case AIG would have to accept an increase in exposure risk, reduce the amount of business written by its subsidiaries or seek alternatives.

**Reinsurance subjects AIG to the credit risk of its reinsurers and may not be adequate to protect AIG against losses.** Although reinsurance makes the reinsurer liable to the AIG subsidiary to the extent the risk is ceded subject to the terms and conditions of the reinsurance contracts in place, it does not relieve the AIG subsidiary of the primary liability to its policyholders. Accordingly, AIG bears credit risk with respect to its subsidiaries' reinsurers to the extent not mitigated by collateral or other credit enhancements. A reinsurer's insolvency or inability or refusal to make timely payments under the terms of its agreements with the AIG subsidiaries could have a material adverse effect on AIG's results of operations and liquidity. See also Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Management Reinsurance.

#### Adjustments to Life Insurance & Retirement Services Deferred Policy

##### Acquisition Costs

**Interest rate fluctuations and other events may require AIG subsidiaries to accelerate the amortization of deferred policy acquisition costs (DAC) which could adversely affect AIG's consolidated financial condition or results of operations.** DAC represents the costs that vary with and are related primarily to the acquisition of new and renewal insurance and annuity contracts. When interest rates rise, policy loans and surrenders and withdrawals of life insurance policies and annuity contracts may increase as policyholders seek to buy products with perceived higher returns, requiring AIG subsidiaries to accelerate the amortization of DAC. To the extent such amortization exceeds surrender or other charges earned upon surrender and withdrawals of certain life insurance policies and annuity contracts, AIG's results of operations could be negatively affected.

DAC for both insurance-oriented and investment-oriented products as well as retirement services products is reviewed for recoverability, which involves estimating the future profitability of current business. This review involves significant management judgment. If the actual emergence of future profitability were to be substantially lower than estimated, AIG could be required to accelerate its DAC amortization and such acceleration could adversely affect AIG's results of operations. See also Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates and Notes 1 and 6 to Consolidated Financial Statements.

[Use of Estimates](#)

**If actual experience differs from management's estimates used in the preparation of financial statements, AIG's consolidated results of operations or financial condition could be adversely affected.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the application of accounting policies that often involve a significant degree of judgment. AIG considers that its accounting policies that are most dependent on the application of estimates and assumptions, and therefore viewed as critical accounting estimates, are those described in Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates. These accounting estimates require the use of assumptions, some of which are highly uncertain at the time of estimation. For example, recent market volatility and declines in liquidity have made it more difficult to value certain of AIG's invested assets and the obligations and collateral relating to certain financial instruments issued or held by AIG, such as

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AIGFP's super senior credit default swap portfolio. To the extent actual experience differs from the assumptions used, AIG's consolidated results of operations or financial condition would be directly affected, perhaps materially.

#### **Legal Proceedings**

**Significant legal proceedings may adversely affect AIG's results of operations.** AIG is party to numerous legal proceedings and regulatory or governmental investigations. It is possible that the effect of these unresolved matters could be material to AIG's consolidated results of operations for an individual reporting period. For a discussion of these unresolved matters, see Item 3. Legal Proceedings.

#### **Foreign Operations**

**Foreign operations expose AIG to risks that may affect its operations, liquidity and financial condition.** AIG provides insurance, investment and other financial products and services to both businesses and individuals in more than 130 countries and jurisdictions. A substantial portion of AIG's General Insurance business and a majority of its Life Insurance & Retirement Services business is conducted outside the United States. Operations outside of the United States, particularly those in developing nations, may be affected by regional economic downturns, changes in foreign currency exchange rates, political upheaval, nationalization and other restrictive government actions, which could also affect other AIG operations.

The degree of regulation and supervision in foreign jurisdictions varies. Generally, AIG, as well as its subsidiaries operating in such jurisdictions, must satisfy local regulatory requirements. Licenses issued by foreign authorities to AIG subsidiaries are subject to modification and revocation. Thus, AIG's insurance subsidiaries could be prevented from conducting future business in certain of the jurisdictions where they currently operate. Adverse actions from any single country could adversely affect AIG's results of operations, liquidity and financial condition depending on the magnitude of the event and AIG's net financial exposure at that time in that country.

#### **Regulation**

**AIG is subject to extensive regulation in the jurisdictions in which it conducts its businesses.** AIG's operations around the world are subject to regulation by different types of regulatory authorities, including insurance, securities, investment advisory, banking and thrift regulators in the United States and abroad. AIG's operations have become more diverse and consumer-oriented, increasing the scope of regulatory supervision and the possibility of intervention. In particular, AIG's consumer lending business is subject to a broad array of laws and regulations governing lending practices and permissible loan terms, and AIG would expect increased regulatory oversight relating to this business.

The regulatory environment could have a significant effect on AIG and its businesses. Among other things, AIG could be fined, prohibited from engaging in some of its business activities or subject to limitations or conditions on its business activities. Significant regulatory action against AIG could have material adverse financial effects, cause significant reputational harm or harm business prospects. New laws or regulations or changes in the enforcement of existing laws or regulations applicable to clients may also adversely affect AIG and its businesses.

#### **A Material Weakness**

**A material weakness in internal control over financial reporting and oversight relating to the AIGFP valuation of its super senior credit default swap portfolio could adversely affect the accuracy or timing of future regulatory filings.** AIG's management has concluded that a material weakness relating to the internal control over financial reporting and oversight relating to the fair value valuation of the AIGFP super senior credit default swap portfolio existed as of December 31, 2007. Until remediated, this weakness could adversely affect the accuracy or timing of future filings with the SEC and other regulatory authorities. A discussion of this material weakness and AIG's remediation efforts can be found in Item 9A. Controls and Procedures Management's Report on Internal Control Over Financial Reporting.

#### **Employee Error and Misconduct**

**Employee error and misconduct may be difficult to detect and prevent and may result in significant losses.** Losses may result from, among other things, fraud, errors, failure to document transactions properly or to obtain proper internal authorization or failure to comply with regulatory requirements.

There have been a number of highly publicized cases involving fraud or other misconduct by employees in the financial services industry in recent years, and AIG runs the risk that employee misconduct could occur. It is not always possible to deter or prevent employee misconduct and the controls that AIG has in place to prevent and detect this activity may not be effective in all cases.

#### **Aircraft Suppliers**

**There are limited suppliers of aircraft and engines.** The supply of jet transport aircraft, which ILFC purchases and leases, is dominated by two airframe manufacturers, Boeing and Airbus, and a limited number of engine manufacturers. As a result, ILFC is dependent on the manufacturers' success in remaining financially stable, producing aircraft and related components which meet the airlines' demands, both in type and quantity, and fulfilling their contractual obligations to ILFC. Competition between the manufacturers for market share is intense and may lead to instances of deep discounting for certain aircraft types and could negatively affect ILFC's competitive pricing.

#### **Item 1B.**

##### **Unresolved Staff Comments**

There are no material unresolved written comments that were received from the SEC staff 180 days or more before the end of AIG's fiscal year relating to AIG's periodic or current reports under the Exchange Act.

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### American International Group, Inc. and Subsidiaries

#### **Item 2.**

##### **Properties**

AIG and its subsidiaries operate from approximately 2,100 offices in the United States, 6 offices in Canada and numerous offices in approximately 100 foreign countries. The offices in Greensboro and Winston-Salem, North Carolina; Springfield, Illinois; Amarillo, Ft. Worth, Houston and Lewisville, Texas; Wilmington, Delaware; San Juan, Puerto Rico; Tampa, Florida; Livingston, New Jersey; Evansville, Indiana; Nashville, Tennessee; 70 Pine Street, 72 Wall Street and 175 Water Street in New York, New York; and offices in more than 30 foreign countries and jurisdictions including Bermuda, Chile, Hong Kong, the Philippines, Japan, the U.K., Singapore, Malaysia, Switzerland, Taiwan and Thailand are located in buildings owned by AIG and its subsidiaries. The remainder of the office space utilized by AIG subsidiaries is leased.

#### **Item 3.**

##### **Legal Proceedings**

###### **General**

AIG and its subsidiaries, in common with the insurance industry in general, are subject to litigation, including claims for punitive damages, in the normal course of their business. See also Note 12(a) to Consolidated Financial Statements, as well as the discussion and analysis of Reserve for Losses and Loss Expenses under Operating Review General Insurance Operations in Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Litigation Arising from Operations.** AIG and its subsidiaries, in common with the insurance and financial services industries in general, are subject to litigation, including claims for punitive damages, in the normal course of their business. In AIG's insurance operations, litigation arising from claims settlement activities is generally considered in the establishment of AIG's reserve for losses and loss expenses. However, the potential for increasing jury awards and settlements makes it difficult to assess the ultimate outcome of such litigation.

**Litigation Arising from Insurance Operations – Caremark.** AIG and certain of its subsidiaries have been named defendants in two putative class actions in state court in Alabama that arise out of the 1999 settlement of class and derivative litigation involving Caremark Rx, Inc. (Caremark). The plaintiffs in the second-filed action have intervened in the first-filed action, and the second-filed action has been dismissed. An excess policy issued by a subsidiary of AIG with respect to the 1999 litigation was expressly stated to be without limit of liability. In the current actions, plaintiffs allege that the judge approving the 1999 settlement was misled as to the extent of available insurance coverage and would not have approved the settlement had he known of the existence and/or unlimited nature of the excess policy. They further allege that AIG, its subsidiaries, and Caremark are liable for fraud and suppression for misrepresenting and/or concealing the nature and extent of coverage. In addition, the intervenor-plaintiffs allege that various lawyers and law firms who represented parties in the underlying class and derivative litigation (the Lawyer Defendants) are also liable for fraud and suppression, misrepresentation, and breach of fiduciary duty. The complaints filed by the plaintiffs and the intervenor-plaintiffs request compensatory damages for the 1999 class in the amount of \$3.2 billion, plus punitive damages. AIG and its subsidiaries deny the allegations of fraud and suppression and have asserted that information concerning the excess policy was publicly disclosed months prior to the approval of the settlement. AIG and its subsidiaries further assert that the current claims are barred by the statute of limitations and that plaintiffs' assertions that the statute was tolled cannot stand against the public disclosure of the excess coverage. The plaintiffs and intervenor-plaintiffs, in turn, have asserted that the disclosure was insufficient to inform them of the nature of the coverage and did not start the running of the statute of limitations. On November 26, 2007, the trial court issued an order that dismissed the intervenors' complaint against the Lawyer Defendants and entered a final judgment in favor of the Lawyer Defendants. The intervenors are appealing the dismissal of the Lawyer Defendants and have requested a stay of all trial court proceedings pending the appeal. If the motion to stay is granted, no further proceedings at the trial court level will occur until the appeal is resolved. If the motion to stay is denied, the next step will be to proceed with class discovery so that the trial court can determine, under standards mandated by the Alabama Supreme Court, whether the action should proceed as a class action. AIG cannot reasonably estimate either the



likelihood of its prevailing in these actions or the potential damages in the event liability is determined.

**Litigation Arising from Insurance Operations – Gunderson.** A subsidiary of AIG has been named as a defendant in a putative class action lawsuit in the 14th Judicial District Court for the State of Louisiana (Gunderson). The *Gunderson* complaint alleges failure to comply with certain provisions of the Louisiana Any Willing Provider Act (the Act) relating to discounts taken by defendants on bills submitted by Louisiana medical providers and hospitals that provided treatment or services to workers compensation claimants and seeks monetary penalties and injunctive relief. On July 20, 2006, the court denied defendants' motion for summary judgment and granted plaintiffs' partial motion for summary judgment, holding that the AIG subsidiary was a group purchaser and, therefore, potentially subject to liability under the Act. On November 28, 2006, the court issued an order certifying a class of providers and hospitals. In an unrelated action also arising under the Act, a Louisiana appellate court ruled that the district court lacked jurisdiction to adjudicate the claims at issue. In response, defendants in *Gunderson* filed an exception for lack of subject matter jurisdiction. On January 19, 2007, the court denied the motion, holding that it has jurisdiction over the putative class claims. The AIG subsidiary appealed the class certification and jurisdictional rulings. While the appeal was pending, the AIG subsidiary settled the lawsuit. On January 25, 2008, plaintiffs and the AIG subsidiary agreed to resolve the lawsuit on a class-wide basis for approximately \$29 million. The court has preliminarily approved the settlement and will hold a final approval hearing on May 29, 2008. In the event that the settlement is not finally approved, AIG believes that it has meritorious defenses to

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plaintiffs' claims and expects that the ultimate resolution of this matter will not have a material adverse effect on AIG's consolidated financial condition or results of operations for any period.

**2006 Regulatory Settlements.** In February 2006, AIG reached a resolution of claims and matters under investigation with the United States Department of Justice (DOJ), the Securities and Exchange Commission (SEC), the Office of the New York Attorney General (NYAG) and the New York State Department of Insurance (DOI). AIG recorded an after-tax charge of \$1.15 billion relating to these settlements in the fourth quarter of 2005.

The settlements resolved investigations conducted by the SEC, NYAG and DOI in connection with the accounting, financial reporting and insurance brokerage practices of AIG and its subsidiaries, as well as claims relating to the underpayment of certain workers compensation premium taxes and other assessments. These settlements did not, however, resolve investigations by regulators from other states into insurance brokerage practices related to contingent commissions and other broker-related conduct, such as alleged bid rigging. Nor did the settlements resolve any obligations that AIG may have to state guarantee funds in connection with any of these matters.

As a result of these settlements, AIG made payments or placed amounts in escrow in 2006 totaling approximately \$1.64 billion, \$225 million of which represented fines and penalties. Amounts held in escrow totaling \$347 million, including interest thereon, are included in other assets at December 31, 2007. At that date, approximately \$330 million of the funds were escrowed for settlement of claims resulting from the underpayment by AIG of its residual market assessments for workers compensation. On May 24, 2007, The National Workers Compensation Reinsurance Pool, on behalf of its participant members, filed a lawsuit against AIG with respect to the underpayment of such assessments. On August 6, 2007, the court denied AIG's motion seeking to dismiss or stay the complaint or in the alternative, to transfer to the Southern District of New York. On December 26, 2007, the court denied AIG's motion to dismiss the complaint. AIG filed its answer on January 22, 2008. On February 5, 2008, following agreement of the parties, the court entered an order staying all proceedings through March 3, 2008. In addition, a similar lawsuit filed by the Minnesota Workers Compensation Reinsurance Association and the Minnesota Workers Compensation Insurers Association is pending. On August 6, 2007, AIG moved to dismiss the complaint and that motion is under review. A purported class action was filed in South Carolina Federal Court on January 25, 2008 against AIG and certain of its subsidiaries, on behalf of a class of employers that obtained workers compensation insurance from AIG companies and allegedly paid inflated premiums as a result of AIG's alleged underreporting of workers compensation premiums. AIG cannot currently estimate whether the amount ultimately required to settle these claims will exceed the funds escrowed or otherwise accrued for this purpose.

AIG has settled litigation that was filed by the Minnesota Attorney General with respect to claims by the Minnesota Department of Revenue and the Minnesota Special Compensation Fund.

The National Association of Insurance Commissioners has formed a Market Analysis Working Group directed by the State of Indiana, which has commenced its own investigation into the underreporting of workers compensation premiums. In early 2008, AIG was informed that the Market Analysis Working Group had been disbanded in favor of a multi-state targeted market conduct exam focusing on workers' compensation insurance.

The remaining escrowed funds, which amounted to \$17 million at December 31, 2007, are set aside for settlements for certain specified AIG policyholders. As of February 20, 2008, eligible policyholders entitled to receive approximately \$359 million (or 95 percent) of the excess casualty fund had opted to receive settlement payments in exchange for releasing AIG and its subsidiaries from liability relating to certain insurance brokerage practices. Amounts remaining in the excess casualty fund may be used by AIG to settle claims from other policyholders relating to such practices through February 29, 2008 (originally set for January 31, 2008 and later extended), after which they will be distributed pro rata to participating policyholders.

In addition to the escrowed funds, \$800 million was deposited into a fund under the supervision of the SEC as part of the settlements to be available to resolve claims asserted against AIG by investors, including the shareholder lawsuits described herein.

Also, as part of the settlements, AIG agreed to retain, for a period of three years, an independent consultant to conduct a review that will include, among other things, the adequacy of AIG's internal control over financial reporting,

the policies, procedures and effectiveness of AIG's regulatory, compliance and legal functions and the remediation plan that AIG has implemented as a result of its own internal review.

Other than as described above, at the current time, AIG cannot predict the outcome of the matters described above, or estimate any potential additional costs related to these matters.

#### Private Litigation

*Securities Actions.* Beginning in October 2004, a number of putative securities fraud class action suits were filed against AIG and consolidated as *In re American International Group, Inc. Securities Litigation*. Subsequently, a separate, though similar, securities fraud action was also brought against AIG by certain Florida pension funds. The lead plaintiff in the class action is a group of public retirement systems and pension funds benefiting Ohio state employees, suing on behalf of themselves and all purchasers of AIG's publicly traded securities between October 28, 1999 and April 1, 2005. The named defendants are AIG and a number of present and former AIG officers and directors, as well as C.V. Starr & Co., Inc. (Starr), Starr International Company, Inc. (SICO), General Reinsurance Corporation, and PricewaterhouseCoopers LLP (PwC), among others. The lead plaintiff alleges, among other things, that AIG: (1) concealed that it engaged in anti-competitive conduct through alleged payment of contingent commissions to brokers and participation in illegal bid-rigging; (2) concealed that it used income smoothing products and other techniques to inflate its earnings; (3) concealed that it marketed and sold income smoothing insurance products to other companies; and (4) misled investors about the scope of

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government investigations. In addition, the lead plaintiff alleges that AIG's former Chief Executive Officer manipulated AIG's stock price. The lead plaintiff asserts claims for violations of Sections 11 and 15 of the Securities Act of 1933, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder, Section 20(a) of the Exchange Act, and Section 20A of the Exchange Act. In April 2006, the court denied the defendants' motions to dismiss the second amended class action complaint and the Florida complaint. In December 2006, a third amended class action complaint was filed, which does not differ substantially from the prior complaint. Fact and class discovery is currently ongoing. On February 20, 2008, the lead plaintiff filed a motion for class certification.

*ERISA Action.* Between November 30, 2004 and July 1, 2005, several Employee Retirement Income Security Act of 1974 (ERISA) actions were filed on behalf of purported class of participants and beneficiaries of three pension plans sponsored by AIG or its subsidiaries. A consolidated complaint filed on September 26, 2005 alleges a class period between September 30, 2000 and May 31, 2005 and names as defendants AIG, the members of AIG's Retirement Board and the Administrative Boards of the plans at issue, and four present or former members of AIG's Board of Directors. The factual allegations in the complaint are essentially identical to those in the securities actions described above. The parties have reached an agreement in principle to settle this matter for an amount within AIG's insurance coverage limits.

*Securities Action - Oregon State Court.* On February 27, 2008, The State of Oregon, by and through the Oregon State Treasurer, and the Oregon Public Employee Retirement Board, on behalf of the Oregon Public Employee Retirement Fund, filed a lawsuit against American International Group, Inc. for damages arising out of plaintiffs' purchase of AIG common stock at prices that allegedly were inflated. Plaintiffs allege, among other things, that AIG: (1) made false and misleading statements concerning its accounting for a \$500 million transaction with General Re; (2) concealed that it marketed and misrepresented its control over off-shore entities in order to improve financial results; (3) improperly accounted for underwriting losses as investment losses in connection with transactions involving CAPCO Reinsurance Company, Ltd. and Union Excess; (4) misled investors about the scope of government investigations; and (5) engaged in market manipulation through its then Chairman and CEO Maurice R. Greenberg. The complaint asserts claims for violations of Oregon Securities Law, and seeks compensatory damages in an amount in excess of \$15 million, and prejudgment interest and costs and fees.

*Derivative Actions - Southern District of New York.* On November 20, 2007, two purported shareholder derivative actions were filed in the Southern District of New York naming as defendants the then-current directors of AIG and certain senior officers of AIG and its subsidiaries. Plaintiffs assert claims for breach of fiduciary duty, waste of corporate assets and unjust enrichment, as well as violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Section 20(a) of the Exchange Act, among other things, in connection with AIG's public disclosures regarding its exposure to what the lawsuits describe as the subprime market crisis. The actions were consolidated as *In re American International Group, Inc. 2007 Derivative Litigation*. On February 15, 2008, plaintiffs filed a consolidated amended complaint alleging the same causes of action.

Between October 25, 2004 and July 14, 2005, seven separate derivative actions were filed in the Southern District of New York, five of which were consolidated into a single action. The New York derivative complaint contains nearly the same types of allegations made in the securities fraud and ERISA actions described above. The named defendants include current and former officers and directors of AIG, as well as Marsh & McLennan Companies, Inc. (Marsh), SICO, Starr, ACE Limited and subsidiaries (ACE), General Reinsurance Corporation, PwC, and certain employees or officers of these entity defendants. Plaintiffs assert claims for breach of fiduciary duty, gross mismanagement, waste of corporate assets, unjust enrichment, insider selling, auditor breach of contract, auditor professional negligence and disgorgement from AIG's former Chief Executive Officer and Chief Financial Officer of incentive-based compensation and AIG share proceeds under Section 304 of the Sarbanes-Oxley Act, among others. Plaintiffs seek, among other things, compensatory damages, corporate governance reforms, and a voiding of the election of certain AIG directors. AIG's Board of Directors has appointed a special committee of independent directors (special committee) to review the matters asserted in the operative consolidated derivative complaint. The court has entered an order staying the derivative case in the Southern District of New York pending resolution of the consolidated

derivative action in the Delaware Chancery Court (discussed below). The court also has entered an order that termination of certain named defendants from the Delaware derivative action applies to the New York derivative action without further order of the court. On October 17, 2007, plaintiffs and those AIG officer and director defendants against whom the shareholder plaintiffs in the Delaware action are no longer pursuing claims filed a stipulation providing for all claims in the New York action against such defendants to be dismissed with prejudice. Former directors and officers Maurice R. Greenberg and Howard I. Smith have asked the court to refrain from so ordering this stipulation.

*Derivative Actions Delaware Chancery Court.* From October 2004 to April 2005, AIG shareholders filed five derivative complaints in the Delaware Chancery Court. All of these derivative lawsuits were consolidated into a single action as *In re American International Group, Inc. Consolidated Derivative Litigation*. The amended consolidated complaint named 43 defendants (not including nominal defendant AIG) who, like the New York consolidated derivative litigation, were current and former officers and directors of AIG, as well as other entities and certain of their current and former employees and directors. The factual allegations, legal claims and relief sought in the Delaware action are similar to those alleged in the New York derivative actions, except that shareholder plaintiffs in the Delaware derivative action assert claims only under state law. Earlier in 2007, the Court approved an agreement that AIG be realigned as plaintiff, and, on June 13,

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2007, acting on the direction of the special committee, AIG filed an amended complaint against former directors and officers Maurice R. Greenberg and Howard I. Smith, alleging breach of fiduciary duty and indemnification. Also on June 13, 2007, the special committee filed a motion to terminate the litigation as to certain defendants, while taking no action as to others. Defendants Greenberg and Smith filed answers to AIG's complaint and brought third-party complaints against certain current and former AIG directors and officers, PwC and Regulatory Insurance Services, Inc. On September 28, 2007, AIG and the shareholder plaintiffs filed a combined amended complaint in which AIG continued to assert claims against defendants Greenberg and Smith and took no position as to the claims asserted by the shareholder plaintiffs in the remainder of the combined amended complaint. In that pleading, the shareholder plaintiffs are no longer pursuing claims against certain AIG officers and directors. In November 2007, the shareholder plaintiffs moved to sever their claims to a separate action. AIG joined the motion to the extent that, among other things, the claims against defendants Greenberg and Smith would remain in prosecution in the pending action. In addition, a number of parties, including AIG, filed motions to stay discovery. On February 12, 2008, the court granted AIG's motion to stay discovery pending the resolution of claims against AIG in the New York consolidated securities action. The court also denied plaintiff's motion to sever and directed the parties to coordinate a briefing schedule for the motions to dismiss.

A separate derivative lawsuit was filed in December 2002 in the Delaware Chancery Court against twenty directors and executives of AIG as well as against AIG as a nominal defendant that alleges, among other things, that the directors of AIG breached the fiduciary duties of loyalty and care by approving the payment of commissions to Starr and of rental and service fees to SICO and the executives breached their duty of loyalty by causing AIG to enter into contracts with Starr and SICO and their fiduciary duties by usurping AIG's corporate opportunity. The complaint further alleges that the Starr agencies did not provide any services that AIG was not capable of providing itself, and that the diversion of commissions to these entities was solely for the benefit of Starr's owners. The complaint also alleged that the service fees and rental payments made to SICO and its subsidiaries were improper. Under the terms of a stipulation approved by the Court on February 16, 2006, the claims against the outside independent directors were dismissed with prejudice, while the claims against the other directors were dismissed without prejudice. On October 31, 2005, defendants Greenberg, Matthews, Smith, SICO and Starr filed motions to dismiss the amended complaint. In an opinion dated June 21, 2006, the Court denied defendants' motion to dismiss, except with respect to plaintiff's challenge to payments made to Starr before January 1, 2000. On July 21, 2006, plaintiff filed its second amended complaint, which alleges that, between January 1, 2000 and May 31, 2005, individual defendants breached their duty of loyalty by causing AIG to enter into contracts with Starr and SICO and breached their fiduciary duties by usurping AIG's corporate opportunity. Starr is charged with aiding and abetting breaches of fiduciary duty and unjust enrichment for its acceptance of the fees. SICO is no longer named as a defendant. On April 20, 2007, the individual defendants and Starr filed a motion seeking leave of the Court to assert a cross-claim against AIG and a third-party complaint against PwC and the directors previously dismissed from the action, as well as certain other AIG officers and employees. On June 13, 2007, the Court denied the individual defendants' motion to file a third-party complaint, but granted the proposed cross-claim against AIG. On June 27, 2007, Starr filed its cross-claim against AIG, alleging one count that includes contribution, unjust enrichment and setoff. AIG has filed an answer and moved to dismiss Starr's cross-claim to the extent it seeks affirmative relief, as opposed to a reduction in the judgment amount. On November 15, 2007, the court granted AIG's motion to dismiss the cross-claim by Starr to the extent that it sought affirmative relief from AIG. On November 21, 2007, shareholder plaintiffs submitted a motion for leave to file their Third Amended Complaint in order to add Thomas Tizzio as a defendant. On February 14, 2008, the court granted this motion and allowed Mr. Tizzio until April 2008 to take additional discovery. Document discovery and depositions are otherwise complete.

*Policyholder Actions.* After the NYAG filed its complaint against insurance broker Marsh, policyholders brought multiple federal antitrust and Racketeer Influenced and Corrupt Organizations Act (RICO) class actions in jurisdictions across the nation against insurers and brokers, including AIG and a number of its subsidiaries, alleging that the insurers and brokers engaged in a broad conspiracy to allocate customers, steer business, and rig bids. These

actions, including 24 complaints filed in different federal courts naming AIG or an AIG subsidiary as a defendant, were consolidated by the judicial panel on multi-district litigation and transferred to the United States District Court for the District of New Jersey for coordinated pretrial proceedings. The consolidated actions have proceeded in that court in two parallel actions, *In re Insurance Brokerage Antitrust Litigation* (the *First Commercial Complaint*) and *In re Employee Benefit Insurance Brokerage Antitrust Litigation* (the *First Employee Benefits Complaint*, and, together with the *First Commercial Complaint*, the multi-district litigation).

The plaintiffs in the *First Commercial Complaint* are nineteen corporations, individuals and public entities that contracted with the broker defendants for the provision of insurance brokerage services for a variety of insurance needs. The broker defendants are alleged to have placed insurance coverage on the plaintiffs' behalf with a number of insurance companies named as defendants, including AIG subsidiaries. The *First Commercial Complaint* also named ten brokers and fourteen other insurers as defendants (two of which have since settled). The *First Commercial Complaint* alleges that defendants engaged in a widespread conspiracy to allocate customers through bid-rigging and steering practices. The *First Commercial Complaint* also alleges that the insurer defendants permitted brokers to place business with AIG subsidiaries through wholesale intermediaries affiliated with or owned by those same brokers rather than placing the business with AIG subsidiaries directly. Finally, the *First Commercial Complaint* alleges that the insurer defendants entered into agreements with broker defendants that tied insurance placements to reinsurance placements in order to provide additional

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compensation to each broker. Plaintiffs assert that the defendants violated the Sherman Antitrust Act, RICO, the antitrust laws of 48 states and the District of Columbia, and are liable under common law breach of fiduciary duty and unjust enrichment theories. Plaintiffs seek treble damages plus interest and attorneys' fees as a result of the alleged RICO and Sherman Antitrust Act violations.

The plaintiffs in the *First Employee Benefits Complaint* are nine individual employees and corporate and municipal employers alleging claims on behalf of two separate nationwide purported classes: an employee class and an employer class that acquired insurance products from the defendants from August 26, 1994 to the date of any class certification. The *First Employee Benefits Complaint* names AIG, as well as eleven brokers and five other insurers, as defendants. The activities alleged in the *First Employee Benefits Complaint*, with certain exceptions, track the allegations of contingent commissions, bid-rigging and tying made in the *First Commercial Complaint*.

On October 3, 2006, Judge Hochberg of the District of New Jersey reserved in part and denied in part motions filed by the insurer defendants and broker defendants to dismiss the multi-district litigation. The Court also ordered the plaintiffs in both actions to file supplemental statements of particularity to elaborate on the allegations in their complaints. Plaintiffs filed their supplemental statements on October 25, 2006, and the AIG defendants, along with other insurer and broker defendants in the two consolidated actions, filed renewed motions to dismiss on November 30, 2006. On February 16, 2007, the case was transferred to Judge Garrett E. Brown, Chief Judge of the District of New Jersey. On April 5, 2007, Chief Judge Brown granted the defendants' renewed motions to dismiss the *First Commercial Complaint* and *First Employee Benefits Complaint* with respect to the antitrust and RICO claims. The claims were dismissed without prejudice and the plaintiffs were given 30 days, later extended to 45 days, to file amended complaints. On April 11, 2007, the Court stayed all proceedings, including all discovery, that are part of the multi-district litigation until any renewed motions to dismiss the amended complaints are resolved.

A number of complaints making allegations similar to those in the *First Commercial Complaint* have been filed against AIG and other defendants in state and federal courts around the country. The defendants have thus far been successful in having the federal actions transferred to the District of New Jersey and consolidated into the multi-district litigation. The AIG defendants have also sought to have state court actions making similar allegations stayed pending resolution of the multi-district litigation proceeding. In one state court action pending in Florida, the trial court recently decided not to grant an additional stay, but instead to allow the case to proceed. Defendants filed their motions to dismiss, and on September 24, 2007, the court denied the motions with respect to the state antitrust, RICO, and common law claims and granted the motions with respect to both the Florida insurance bad faith claim against AIG (with prejudice) and the punitive damages claim (without prejudice). Discovery in this action is ongoing.

Plaintiffs filed amended complaints in both *In re Insurance Brokerage Antitrust Litigation* (the *Second Commercial Complaint*) and *In re Employee Benefit Insurance Brokerage Antitrust Litigation* (the *Second Employee Benefits Complaint*) along with revised particularized statements in both actions on May 22, 2007. The allegations in the *Second Commercial Complaint* and the *Second Employee Benefits Complaint* are substantially similar to the allegations in the *First Commercial Complaint* and *First Employee Benefits Complaint*, respectively. The complaints also attempt to add several new parties and delete others; the *Second Commercial Complaint* adds two new plaintiffs and twenty seven new defendants (including three new AIG defendants), and the *Second Employee Benefits Complaint* adds eight new plaintiffs and nine new defendants (including two new AIG defendants). The defendants filed motions to dismiss the amended complaints and to strike the newly added parties. The Court granted (without leave to amend) defendants' motions to dismiss the federal antitrust and RICO claims on August 31, 2007 and September 28, 2007, respectively. The Court declined to exercise supplemental jurisdiction over the state law claims in the *Second Commercial Complaint* and therefore dismissed it in its entirety. On January 14, 2008, the court granted defendants' motion for summary judgment on the ERISA claims in the *Second Employee Benefits Complaint* and subsequently dismissed the remaining state law claims without prejudice, thereby dismissing the *Second Employee Benefits Complaint* in its entirety. On February 12, 2008, plaintiffs filed a notice of appeal to the United States Court of Appeals for the Third Circuit with respect to the dismissal of the *Second Employee Benefits Complaint*. Plaintiffs previously appealed the dismissal of the *Second Commercial Complaint* to the United States Court of Appeals for the



Third Circuit on October 10, 2007. Several similar actions that were consolidated before Chief Judge Brown are still pending in the District Court. Those actions are currently stayed pending a decision by the court on whether they will proceed during the appeal of the dismissal of the Second Commercial Complaint and the Second Employee Benefits Complaint.

On August 24, 2007, the Ohio Attorney General filed a complaint in the Ohio Court of Common Pleas against AIG and a number of its subsidiaries, as well as several other broker and insurer defendants, asserting violation of Ohio's antitrust laws. The complaint, which is similar to the *Second Commercial Complaint*, alleges that AIG and the other broker and insurer defendants conspired to allocate customers, divide markets, and restrain competition in commercial lines of casualty insurance sold through the broker defendant. The complaint seeks treble damages on behalf of Ohio public purchasers of commercial casualty insurance, disgorgement on behalf of both public and private purchasers of commercial casualty insurance, as well as a \$500 per day penalty for each day of conspiratorial conduct. AIG, along with other co-defendants, moved to dismiss the complaint on November 16, 2007. Discovery is stayed in the case pending a ruling on the motion to dismiss or until May 15, 2008, whichever occurs first.

*SICO*. In July, 2005, SICO filed a complaint against AIG in the Southern District of New York, claiming that AIG had refused to provide SICO access to certain artwork and asked the court to order AIG immediately to release the property to SICO. AIG filed

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an answer denying SICO's allegations and setting forth defenses to SICO's claims. In addition, AIG filed counterclaims asserting breach of contract, unjust enrichment, conversion, breach of fiduciary duty, a constructive trust and declaratory judgment, relating to SICO's breach of its commitment to use its AIG shares only for the benefit of AIG and AIG employees. Fact and expert discovery has been concluded and SICO's motion for summary judgment is pending.

*Regulatory Investigations.* Regulators from several states have commenced investigations into insurance brokerage practices related to contingent commissions and other industry wide practices as well as other broker-related conduct, such as alleged bid-rigging. In addition, various federal, state and foreign regulatory and governmental agencies are reviewing certain transactions and practices of AIG and its subsidiaries in connection with industry wide and other inquiries. AIG has cooperated, and will continue to cooperate, in producing documents and other information in response to subpoenas and other requests. On January 29, 2008, AIG reached settlement agreements with nine states and the District of Columbia. The settlement agreements call for AIG to pay a total of \$12.5 million to be allocated among the ten jurisdictions and also require AIG to continue to maintain certain producer compensation disclosure and ongoing compliance initiatives. AIG will also continue to cooperate with these states in their ongoing investigations. AIG has not admitted liability under the settlement agreements and continues to deny the allegations. Nevertheless, AIG agreed to settle in order to avoid the expense and uncertainty of protracted litigation. The settlement agreements, which remain subject to court approvals, were reached with the Attorneys General of the States of Florida, Hawaii, Maryland, Michigan, Oregon, Texas and West Virginia, the Commonwealths of Massachusetts and Pennsylvania, and the District of Columbia, the Florida Department of Financial Services, and the Florida Office of Insurance Regulation. The agreement with the Texas Attorney General also settles allegations of anticompetitive conduct relating to AIG's relationship with Allied World Assurance Company and includes an additional settlement payment of \$500,000 related thereto.

*Wells Notices.* AIG understands that some of its employees have received Wells notices in connection with previously disclosed SEC investigations of certain of AIG's transactions or accounting practices. Under SEC procedures, a Wells notice is an indication that the SEC staff has made a preliminary decision to recommend enforcement action that provides recipients with an opportunity to respond to the SEC staff before a formal recommendation is finalized. It is possible that additional current and former employees could receive similar notices in the future as the regulatory investigations proceed.

**Effect on AIG**

In the opinion of AIG management, AIG's ultimate liability for the unresolved litigation and investigation matters referred to above is not likely to have a material adverse effect on AIG's consolidated financial condition, although it is possible that the effect would be material to AIG's consolidated results of operations for an individual reporting period.

**Item 4.****Submission of Matters to a Vote of Security Holders**

There were no matters submitted to a vote of security holders during the fourth quarter of 2007.

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**Part II****Item 5.****Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

AIG's common stock is listed on the New York Stock Exchange, as well as on the stock exchanges in Paris and Tokyo. The following table presents the high and low closing sales prices and the dividends paid per share of AIG's common stock on the New York Stock Exchange Composite Tape, for each quarter of 2007 and 2006:

	2007			2006		
	High	Low	Dividends Paid	High	Low	Dividends Paid
First quarter	\$72.15	\$66.77	\$0.165	\$70.83	\$65.35	\$0.150
Second quarter	72.65	66.49	0.165	66.54	58.67	0.150
Third quarter	70.44	61.64	0.200	66.48	57.76	0.165
Fourth quarter	70.11	51.33	0.200	72.81	66.30	0.165

The approximate number of holders of common stock as of January 31, 2008, based upon the number of record holders, was 56,500.

Subject to the dividend preference of any of AIG's serial preferred stock that may be outstanding, the holders of shares of common stock are entitled to receive such dividends as may be declared by AIG's Board of Directors from funds legally available therefor.

In February 2007, AIG's Board of Directors adopted a new dividend policy, which took effect with the dividend that was declared in the second quarter of 2007. Under ordinary circumstances, AIG's plan is to increase its common stock dividend by approximately 20 percent annually. The payment of any dividend, however, is at the discretion of AIG's Board of Directors, and the future payment of dividends will depend on various factors, including the performance of AIG's businesses, AIG's consolidated financial condition, results of operations and liquidity and the existence of investment opportunities.

For a discussion of certain restrictions on the payment of dividends to AIG by some of its insurance subsidiaries, see Note 14 to Consolidated Financial Statements.

**The following table summarizes AIG's stock repurchases for the three-month period ended December 31, 2007:**

Period	Total Number of Shares Purchased <sup>(a)(b)</sup>	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs at End of Month <sup>(b)</sup>

October 1 - 31, 2007	13,964,098	\$ 66.12	13,964,098
November 1 - 30, 2007	5,709,067	61.56	5,709,067
December 1 - 31, 2007	1,584,199	55.58	1,584,199
Total	21,257,364	\$ 64.11	21,257,364

(a) *Reflects date of delivery. Does not include 49,583 shares delivered or attested to in satisfaction of the exercise price by holders of AIG employee stock options exercised during the three months ended December 31, 2007 or 23,300 shares purchased by ILFC to satisfy obligations under employee benefit plans.*

(b) *In February 2007, AIG's Board of Directors increased AIG's share repurchase program by authorizing the repurchase of shares with an aggregate purchase price of \$8 billion. In November 2007, AIG's Board of Directors authorized the repurchase of an additional \$8 billion in common stock. A balance of \$10.9 billion remained for purchases under the program as of December 31, 2007, although \$912 million of that amount has been advanced by AIG to purchase shares under the program and an additional \$1 billion was required to be advanced in January 2008 to meet commitments that existed at December 31, 2007.*

AIG does not expect to purchase additional shares under its share repurchase program for the foreseeable future, other than to meet commitments that existed at December 31, 2007.

AIG's table of equity compensation plans previously approved by security holders and equity compensation plans not previously approved by security holders will be included in AIG's Definitive Proxy Statement in connection with its 2008 Annual Meeting of Shareholders, which will be filed with the SEC within 120 days of AIG's fiscal year end.

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**Performance Graph**

The following Performance Graph compares the cumulative total shareholder return on AIG common stock for a five-year period (December 31, 2002 to December 31, 2007) with the cumulative total return of the Standard & Poor's 500 stock index (which includes AIG) and a peer group of companies consisting of nine insurance companies to which AIG compares its business and operations: ACE Limited, Aflac Incorporated, The Chubb Corporation, The Hartford Financial Services Group, Inc., Lincoln National Corporation, MetLife, Inc., Prudential Financial, Inc., The Travelers Companies, Inc. (formerly The St. Paul Travelers Companies, Inc.) and XL Capital Ltd.

**FIVE-YEAR CUMULATIVE TOTAL SHAREHOLDER RETURNS**  
**Value of \$100 Invested on December 31, 2002**

	As of December 31,					
	2002	2003	2004	2005	2006	2007
AIG	\$ 100.00	\$ 115.02	\$ 114.43	\$ 119.98	\$ 127.24	<b>\$ 104.67</b>
S&P 500	100.00	128.68	142.69	149.70	173.34	<b>182.86</b>
Peer Group	100.00	126.10	145.73	179.22	207.37	<b>216.60</b>

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**Item 6.****Selected Financial Data****American International Group, Inc. and Subsidiaries****Selected Consolidated Financial Data**

**The Selected Consolidated Financial Data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and accompanying notes included elsewhere herein.**

**Years Ended December 31,***(in millions, except per share data)*

	<b>2007</b>	2006 <sup>(a)</sup>	2005 <sup>(a)</sup>	2004 <sup>(a)</sup>	2003 <sup>(a)</sup>
<b>Revenues<sup>(b)(c)(d)</sup>:</b>					
Premiums and other considerations	<b>\$ 79,302</b>	\$ 74,213	\$ 70,310	\$ 66,704	\$ 54,874
Net investment income	<b>28,619</b>	26,070	22,584	19,007	16,024
Net realized capital gains (losses)	<b>(3,592)</b>	106	341	44	(442)
Unrealized market valuation losses on AIGFP super senior credit default swap portfolio	<b>(11,472)</b>				
Other income	<b>17,207</b>	12,998	15,546	12,068	9,145
<b>Total revenues</b>	<b>110,064</b>	113,387	108,781	97,823	79,601
<b>Benefits and expenses:</b>					
Incurred policy losses and benefits	<b>66,115</b>	60,287	64,100	58,600	46,362
Insurance acquisition and other operating expenses	<b>35,006</b>	31,413	29,468	24,378	21,332
<b>Total benefits and expenses</b>	<b>101,121</b>	91,700	93,568	82,978	67,694
Income before income taxes, minority interest and cumulative effect of accounting changes <sup>(b)(c)(d)(e)(f)</sup>	<b>8,943</b>	21,687	15,213	14,845	11,907
Income taxes	<b>1,455</b>	6,537	4,258	4,407	3,556
Income before minority interest and cumulative effect of accounting changes	<b>7,488</b>	15,150	10,955	10,438	8,351
Minority interest	<b>(1,288)</b>	(1,136)	(478)	(455)	(252)
Income before cumulative effect of accounting changes	<b>6,200</b>	14,014	10,477	9,983	8,099
Cumulative effect of accounting changes, net of tax		34		(144)	9
<b>Net income</b>	<b>6,200</b>	14,048	10,477	9,839	8,108
<b>Earnings per common share:</b>					
<b>Basic</b>					
Income before cumulative effect of accounting changes	<b>2.40</b>	5.38	4.03	3.83	3.10
Cumulative effect of accounting changes, net of tax		0.01		(0.06)	
<b>Net income</b>	<b>2.40</b>	5.39	4.03	3.77	3.10
<b>Diluted</b>					

Income before cumulative effect of accounting changes	<b>2.39</b>	5.35	3.99	3.79	3.07
Cumulative effect of accounting changes, net of tax		0.01		(0.06)	
Net income	<b>2.39</b>	5.36	3.99	3.73	3.07
Dividends declared per common share	<b>0.77</b>	0.65	0.63	0.29	0.24
Year-end balance sheet data:					
Total assets	<b>1,060,505</b>	979,410	853,048	801,007	675,602
Long-term borrowings <sup>(g)</sup>	<b>162,935</b>	135,316	100,314	86,653	73,881
Commercial paper and extendible commercial notes	<b>13,114</b>	13,363	9,535	10,246	6,468
Total liabilities	<b>964,604</b>	877,542	766,545	721,135	606,180
Shareholders equity	<b>\$ 95,801</b>	\$ 101,677	\$ 86,317	\$ 79,673	\$ 69,230

(a) Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

(b) In 2007, 2006, 2005, 2004 and 2003, includes other-than-temporary impairment charges of \$4.7 billion, \$944 million, \$598 million, \$684 million and \$1.5 billion, respectively. Also includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. In 2007, 2006, 2005, 2004 and 2003, respectively, the effect was \$(1.44) billion, \$(1.87) billion, \$2.02 billion, \$385 million and \$(1.50) billion in revenues and \$(1.44) billion, \$(1.87) billion, \$2.02 billion, \$671 million and \$(1.22) billion in operating income. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings. These gains (losses) in 2007 include a \$380 million out of period charge to reverse net gains recognized on transfers of available for sale securities among legal entities consolidated within AIGFP. The gains (losses) in 2006 include an out of period charge of \$223 million related to the remediation of the material weakness in internal control over the accounting for certain derivative transactions under FAS 133. In the first quarter of 2007, AIG began applying hedge accounting for certain transactions, primarily in its Capital Markets operations. In the second quarter of 2007, AGF and ILFC began applying hedge accounting to most of their derivatives hedging interest rate and foreign exchange risks associated with their floating rate and foreign currency denominated borrowings.

(c) In 2006, includes the effect of out of period adjustments related to the accounting for UCITS. The effect was an increase of \$490 million in both revenues and operating income for General Insurance and an increase of \$240 million and \$169 million in revenues and operating income, respectively, for Life Insurance & Retirement Services.

(d) In 2007, includes an unrealized market valuation loss of \$11.5 billion on AIGFP's super senior credit default swap portfolio and an other-than-temporary impairment charge of \$643 million on AIGFP's available for sale investment securities reported in other income.

(e) Includes current year catastrophe-related losses of \$276 million in 2007, \$3.28 billion in 2005 and \$1.16 billion in 2004. There were no significant catastrophe-related losses in 2006 and 2003.

(f) Reduced by fourth quarter charges of \$1.8 billion and \$850 million in 2005 and 2004, respectively, related to the annual review of General Insurance loss and loss adjustment reserves. In 2006, 2005 and 2004, changes in estimates for asbestos and environmental reserves were \$198 million, \$873 million and \$850 million, respectively.

(g) Includes that portion of long-term debt maturing in less than one year. See also Note 11 to Consolidated Financial Statements.





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American International Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of  
Financial Condition and Results of Operations****Item 7.****Management's Discussion and Analysis of  
Financial Condition and Results of Operations**

Throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations, AIG presents its operations in the way it believes will be most meaningful. Statutory underwriting profit (loss) and combined ratios are presented in accordance with accounting principles prescribed by insurance regulatory authorities because these are standard measures of performance used in the insurance industry and thus allow more meaningful comparisons with AIG's insurance competitors. AIG has also incorporated into this discussion a number of cross-references to additional information included throughout this Annual Report on Form 10-K to assist readers seeking additional information related to a particular subject.

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### **Cautionary Statement Regarding Projections and Other Information About Future Events**

This Annual Report on Form 10-K and other publicly available documents may include, and AIG's officers and representatives may from time to time make, projections concerning financial information and statements concerning future economic performance and events, plans and objectives relating to management, operations, products and services, and assumptions underlying these projections and statements. These projections and statements are not historical facts but instead represent only AIG's belief regarding future events, many of which, by their nature, are inherently uncertain and outside AIG's control. These projections and statements may address, among other things, the status and potential future outcome of the current regulatory and civil proceedings against AIG and their potential effect on AIG's businesses, financial condition, results of operations, cash flows and liquidity, AIG's exposures to subprime mortgages, monoline insurers and the residential real estate market and AIG's strategy for growth, product development, market position, financial results and reserves. It is possible that AIG's actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these projections and statements. Factors that could cause AIG's actual results to differ, possibly materially, from those in the specific projections and statements are discussed throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations and in Item 1A. Risk Factors of this Annual Report on Form 10-K. AIG is not under any obligation (and expressly disclaims any such obligations) to update or alter any projection or other statement, whether written or oral, that may be made from time to time, whether as a result of new information, future events or otherwise.

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American International Group, Inc. and Subsidiaries

### **Management's Discussion and Analysis of Financial Condition and Results of Operations** *Continued*

#### **Overview of Operations and Business Results**

AIG identifies its reportable segments by product or service line, consistent with its management structure. AIG's major product and service groupings are General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management. Through these operating segments, AIG provides insurance, financial and investment products and services to both businesses and individuals in more than 130 countries and jurisdictions. This geographic, product and service diversification is one of AIG's major strengths and sets it apart from its competitors. AIG's Other category consists of items not allocated to AIG's operating segments.

AIG's subsidiaries serve commercial, institutional and individual customers through an extensive property-casualty and life insurance and retirement services network. In the United States, AIG companies are the largest underwriters of commercial and industrial insurance and are among the largest life insurance and retirement services operations as well. AIG's Financial Services businesses include commercial aircraft and equipment leasing, capital markets operations and consumer finance, both in the United States and abroad. AIG also provides asset management services to institutions and individuals. As part of its Spread-Based Investment activities, and to finance its operations, AIG issues various debt instruments in the public and private markets.

AIG's operating performance reflects implementation of various long-term strategies and defined goals in its various operating segments. A primary goal of AIG in managing its General Insurance operations is to achieve an underwriting profit. To achieve this goal, AIG must be disciplined in its risk selection, and premiums must be adequate and terms and conditions appropriate to cover the risks accepted and expenses incurred.

AIG has commenced a realignment to simplify its Foreign General Insurance operations, many of which were historically conducted through branches of U.S. companies. On October 8, 2007, AIU Insurance Company announced the conversion of its existing China branches into AIG General Insurance Company China Limited, the first non-Chinese owned general insurance company established in China. This subsidiary assumed the existing business portfolio, assets and liabilities of the China branches. On October 15, 2007, AIG General Insurance (Taiwan) Co., Ltd. (AIGGI Taiwan) announced the completion of its merger with AIU Insurance Company Taiwan Branch. On December 1, 2007, Landmark Insurance Company Limited, a U.K. subsidiary, assumed all of the insurance liabilities of the U.K. branch of New Hampshire Insurance Company and changed its name to AIG U.K. Ltd. On January 1, 2008, AIU Insurance Company ceased participating in the Domestic General Insurance pooling arrangement. These ongoing simplification efforts are expected to result in better utilization of capital and a lower effective tax rate.

A central focus of AIG operations in recent years has been the development and expansion of distribution channels. In 2007, AIG continued to expand its distribution channels, which now include banks, credit card companies, television-media home shopping, affinity groups, direct response, worksite marketing and e-commerce.

AIG patiently builds relationships in markets around the world where it sees long-term growth opportunities. For example, the fact that AIG has the only wholly owned foreign life insurance operations in China, operating in 19 cities, is the result of relationships developed over nearly 30 years. AIG's more recent extensions of operations into India, Vietnam, Russia and other emerging markets reflect the same growth strategy. Moreover, AIG believes in investing in the economies and infrastructures of these countries and growing with them. When AIG companies enter a new jurisdiction, they typically offer basic protection and savings products. As the economies evolve, AIG's products evolve with them, to more sophisticated and investment-oriented models.

Growth for AIG may be generated internally as well as through acquisitions which both fulfill strategic goals and offer adequate return on capital. In October 2007, AIG expanded its Foreign General Insurance operations in Germany through the acquisition of Württembergische und Badische Versicherungs-AG (WüBA). In January 2007, American General Finance, Inc. (AGF) expanded its operations into the U.K. through the acquisition of Ocean Finance and Mortgages Limited, a finance broker for home owner loans in the U.K.

#### **Outlook**

### **General Trends**

In mid-2007, the U.S. residential mortgage market began to experience serious disruption due to credit quality deterioration in a significant portion of loans originated, particularly to non-prime and subprime borrowers; evolving changes in the regulatory environment; a slower residential housing market; increased cost of borrowings for mortgage participants; and illiquid credit markets.

AIG participates in the U.S. residential mortgage market in several ways: AGF originates principally first-lien mortgage loans and to a lesser extent second-lien mortgage loans to buyers and owners of residential housing; United Guaranty Corporation (UGC) provides first loss mortgage guaranty insurance for high loan-to-value first- and second-lien residential mortgages; AIG insurance and financial services subsidiaries invest in mortgage-backed securities and CDOs, in which the underlying collateral is composed in whole or in part of residential mortgage loans; and AIGFP provides credit protection through credit default swaps on certain super senior tranches of collateralized debt obligations (CDOs), a significant majority of which have AAA underlying or subordinate layers.

Disruption in the U.S. residential mortgage market may also increase claim activity in the financial institution segment of AIG's D&O and professional liability classes of business. However, based on its review of information currently available, AIG believes overall loss activity for the broader D&O and professional liability classes is likely to remain within or near the levels observed during the last several years, which include losses related to stock options backdating as well as to the U.S. residential mortgage market.

The operating results of AIG's consumer finance and mortgage guaranty operations in the United States have been and are likely

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### American International Group, Inc. and Subsidiaries

to continue to be adversely affected by the factors referred to above. The downward cycle in the U.S. housing market is not expected to improve until residential inventories return to a more normal level and the mortgage credit market stabilizes. AIG expects that this downward cycle will continue to adversely affect UGC's operating results for the foreseeable future and will result in a significant operating loss for UGC in 2008. AIG also incurred substantial unrealized market valuation losses in 2007, particularly in the fourth quarter, on AIGFP's super senior credit default swap portfolio and substantial other-than-temporary impairment charges on AIG's Insurance and Financial Services available for sale securities. The results from AIG's operations with exposure to the U.S. residential mortgage market will be highly dependent on future market conditions. Continuing market deterioration will cause AIG to report additional unrealized market valuation losses and impairment charges.

The ongoing effect of the downward cycle in the U.S. housing market on AIG's other operations, investment portfolio and overall consolidated financial condition could be material if the market disruption continues and expands beyond the residential mortgage markets, although AIG seeks to mitigate the risks to its business by disciplined underwriting and active risk management.

Globally, heightened regulatory scrutiny of financial services companies in many jurisdictions has the potential to affect future financial results through higher compliance costs. This is particularly true in the United States, where Federal and state authorities have commenced various investigations of the financial services industry, and in Japan and Southeast Asia, where financial institutions have received remediation orders affecting consumer and policyholder rights.

In certain quarters, AIG's returns from partnerships and other alternative investments were particularly strong, driven by favorable equity market performance and credit conditions. These returns may vary from period to period and AIG believes that the particularly strong performance in certain prior periods is not indicative of the returns to be expected from this asset class in future periods.

AIG has recorded out of period adjustments in the last two years due to the remediation of control deficiencies. As AIG continues its remediation activities, AIG expects to continue to incur expenses related to these activities and to record additional out of period adjustments, although all known errors have been corrected.

### **General Insurance**

The commercial property and casualty insurance industry has historically experienced cycles of price erosion followed by rate strengthening as a result of catastrophes or other significant losses that affect the overall capacity of the industry to provide coverage. As premium rates decline, AIG will generally experience higher current accident year loss ratios, as the written premiums are earned. Despite industry price erosion in commercial lines, AIG expects to continue to identify profitable opportunities and build attractive new general insurance businesses as a result of AIG's broad product line and extensive distribution networks in the United States and abroad.

Workers compensation remains under considerable pricing pressure, as statutory rates continue to decline. Rates for aviation, excess casualty, D&O and certain other lines of insurance also continue to decline due to competitive pressures. Rates for commercial property lines are also declining following another year of relatively low catastrophe losses. Further price erosion is expected in 2008 for the commercial lines; AIG seeks to mitigate the decline by constantly seeking out profitable opportunities across its diverse product lines and distribution networks while maintaining a commitment to underwriting discipline. There can be no assurance that price erosion will not become more widespread or that AIG's profitability will not deteriorate from current levels in major commercial lines.

In Foreign General Insurance, opportunities for growth exist in the consumer lines due to increased demand in emerging markets and the trend toward privatization of health insurance. In commercial lines, the late 2007 acquisition of WüBa enhances AIG's insurance offerings to small and medium sized companies in Europe.

Through operations in Bahrain designed to comply with Islamic law, AIG is tapping into a growing market. Islamic insurance, called Takaful, is an alternative to conventional insurance based on the concept of mutual assistance through pooling of resources.

The Personal Lines automobile marketplace remains challenging with rates declining steadily, increased spending on commissions and advertising and favorable liability frequency trends slowing, while severity in both liability and

physical damage are expected to increase. In addition to the deteriorating underwriting cycle, a generally weakening economy leads to slower growth in automobile insurance exposure units and values. The Personal Lines business is focused on consolidation and improving operational efficiencies to reduce costs, as well as enhancing rating algorithms and creating a new aigdirect.com brand, as a result of the 2007 combination of AIG Direct and 21st Century Insurance Group (21st Century) operations, to support growth. The high net worth market continues to provide opportunities for growth as a result of AIG's innovative products and services specifically designed for that market.

Losses caused by catastrophes can fluctuate widely from year to year, making comparisons of results more difficult. With respect to catastrophe losses, AIG believes that it has taken appropriate steps, such as careful exposure selection and adequate reinsurance coverage, to reduce the effect of possible future losses. The occurrence of one or more catastrophic events of higher than anticipated frequency or severity, such as a terrorist attack, earthquake or hurricane, that causes insured losses, however, could have a material adverse effect on AIG's results of operations, liquidity or financial condition.

#### **Life Insurance & Retirement Services**

Disruption in the U.S. residential mortgage and credit markets had a significant adverse effect on Life Insurance & Retirement Services operating results in 2007 and will continue to be a key factor in 2008 and beyond, especially in the U.S.-based operations. The volatility in operating results will be further magnified by the continuing market shift to variable products with living benefits

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**Management's Discussion and Analysis of  
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and the adoption of FAS No. 157, Fair Value Measurements (FAS 157). Life Insurance & Retirement Services elected the fair value option under FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159), for two products beginning January 1, 2008 - a closed block of single premium variable life business in Japan and an investment-linked life insurance product sold principally in Asia. After adoption on January 1, 2008, subsequent changes in fair value for these products will be reported in operating income. The adoption of FAS 159 for these products is expected to result in a decrease to opening 2008 retained earnings of approximately \$600 million. For a description of these accounting standards, see Note 1 to Consolidated Financial Statements.

Life Insurance & Retirement Services uses various derivative instruments to hedge cash flows related to certain foreign currencies and fixed income related instruments. Although these derivatives are purchased to mitigate the economic effect of movements in foreign exchange rates and interest rates, reported earnings may be volatile due to certain hedges not qualifying for hedge accounting under FAS 133. The change in fair value of derivative instruments is reported in net realized capital gains (losses). Life Insurance & Retirement Services engages in hedging programs that use derivatives and other instruments to hedge the guaranteed living benefits associated with variable products. Nevertheless, short-term market movements will vary from long-term expectations underlying the product pricing assumptions and may cause volatility in reported earnings. The inclusion of risk margins in the valuation of embedded derivatives under FAS 157 will increase earnings volatility as differences emerge between the change in fair value of embedded derivatives and the change in fair value of hedging instruments. As variable products with guaranteed living benefits continue to grow, the reported earnings volatility associated with these programs will likely increase.

Life Insurance & Retirement Services may continue to experience volatility in net realized capital gains (losses) due to other-than-temporary impairment writedowns of the fair value of investments, primarily related to the significant disruption in the residential mortgage and credit markets and foreign currency related losses.

In Japan, given AIG's multi-channel, multi-product strategy, AIG expects its Life Insurance & Retirement Services operations to exceed industry growth in the long term, although downward pressure on earnings growth rates is anticipated due to the difficult market conditions. Market conditions remain challenging as a result of increased competition due to new market entrants, the increasing financial strength of the domestic companies as the economy has recovered, the effect of additional regulatory oversight, changes to the tax deductibility of insurance premiums and the regulatory claims review which has negatively affected consumer perceptions of the industry. While the market shift to variable products with living benefits will constrain fixed annuity sales, AIG is positioned to grow annuity sales overall with its annuity products designed to meet the needs of consumers in a range of market conditions. In addition, AIG expects that the planned integration of AIG Star Life and AIG Edison Life, which is anticipated to be completed in 2009, will provide enhanced distribution opportunities and operational efficiencies pending regulatory approval.

Full deregulation of banks in Japan with respect to insurance product sales became effective in December 2007, and AIG expects that it will be able to leverage its existing bank relationships and innovative product expertise to expand sales of both life and accident and health products in 2008. Deregulation of Japan Post is also expected to provide additional growth opportunities during 2008 and beyond.

Although the Japanese Yen strengthened in the fourth quarter of 2007, historical volatility of Japanese Yen-dollar exchange rates has resulted in higher than normal surrenders, and if that trend returns, an acceleration of the amortization of deferred policy acquisition costs could occur.

Outside of Japan, ALICO continues to execute its strategy of diversifying distribution channels and developing new products. In particular, ALICO's Central and Eastern European operations performed well and demographic and economic conditions in these countries provide excellent opportunities for continued growth.

AIG's operations in China continue to expand, but AIG expects competition in China to remain strong. AIG's success in China will depend on its ability to execute its growth strategy. Key growth strategies in 2008 include expansion of sales and service centers, increased bank distribution and entering into strategic alliances with key

partners. In Southeast Asia, AIG's operations are focused on growing market share and profits in Singapore, Malaysia, Thailand and Hong Kong with products focused on the life savings-oriented consumer along with high net worth consumers through the newly formed Wealth Management Group.

Domestically, AIG plans to continue expansion of its Life Insurance & Retirement Services businesses through direct marketing and independent agent distribution channels. The aging population in the United States provides a growth opportunity for a variety of products, including longevity, guaranteed income and supplemental accident and health products. Certain other demographic groups that have traditionally been underserved provide additional growth opportunities. The Domestic Life Insurance operations showed positive momentum in the second half of 2007 resulting from new products and expanded distribution. Domestic group life/health operations continue to face competitors with greater scale in group benefits.

The fixed annuities business experienced a difficult year as surrenders increased in 2007 due to both an increasing number of policies coming out of their surrender charge period and increased competition from bank deposit products. While surrenders are expected to continue to be higher than normal, the current interest rate environment should provide opportunities for improvements in net flows during 2008. AIG believes that improvement in net flows in the individual variable annuity market will be driven by variable annuity products with living benefits while the group retirement products will continue to experience a shift from group annuities to lower margin mutual fund products.

Since the beginning of 2000, the yield available on Taiwanese 10-year government bonds dropped from approximately 6 percent to less than 3 percent at December 31, 2007. Yields on most

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## American International Group, Inc. and Subsidiaries

other invested assets have correspondingly dropped over the same period. New regulatory capital requirements being developed in Taiwan, combined with growth opportunities in bancassurance and variable annuities with living benefits, may potentially create a need for capital contributions in 2008 and beyond to support local solvency requirements.

**Financial Services**

Within Financial Services, demand for International Lease Finance Corporation (ILFC's) modern, fuel efficient aircraft remains strong, and ILFC plans to increase its fleet by purchasing 73 aircraft in 2008. However, ILFC's margins may be adversely affected by increases in interest rates. AIG Financial Products Corp. and AIG Trading Group Inc. and their respective subsidiaries (collectively, AIGFP) expect opportunities for growth across their product segments, but AIGFP is a transaction-oriented business, and its operating results will depend to a significant extent on actual transaction flow, which is affected by market conditions and other variables outside its control. AIG continues to explore opportunities to expand its Consumer Finance operations into new domestic and foreign markets.

The ongoing disruption in the U.S. residential mortgage and credit markets and the recent downgrades of residential mortgage-backed securities and CDO securities by rating agencies continue to adversely affect the fair value of the super senior credit default swap portfolio written by AIGFP. AIG expects that continuing limitations on the availability of market observable data will affect AIG's determinations of the fair value of these derivatives, including by preventing AIG, for the foreseeable future, from recognizing the beneficial effect of the differential between credit spreads used to price a credit default swap and spreads implied from prices of the CDO bonds referenced by such swap. The fair value of these derivatives is expected to continue to fluctuate, perhaps materially, in response to changing market conditions, and AIG's estimates of the value of AIGFP's super senior credit derivative portfolio at future dates could therefore be materially different from current estimates. AIG continues to believe that the unrealized market valuation losses recorded on the AIGFP super senior credit default swap portfolio are not indicative of the losses AIGFP may realize over time. Under the terms of most of these credit derivatives, losses to AIG would generally result from the credit impairment of the referenced CDO bonds that AIG would acquire in satisfying its swap obligations. Based upon its most current analyses, AIG believes that any credit impairment losses realized over time by AIGFP will not be material to AIG's consolidated financial condition, although it is possible that such realized losses could be material to AIG's consolidated results of operations for an individual reporting period. Except to the extent of any such credit impairment losses, AIG expects the unrealized market valuation losses to reverse over the remaining life of the super senior credit default swap portfolio.

Approximately \$379 billion of the \$527 billion in notional exposure on AIGFP's super senior credit default swap portfolio as of December 31, 2007 were written to facilitate regulatory capital relief for financial institutions primarily in Europe. AIG expects that the majority of these transactions will be terminated within the next 12 to 18 months by AIGFP's counterparties as they implement models compliant with the new Basel II Accord. As of February 26, 2008, \$54 billion in notional exposures have either been terminated or are in the process of being terminated. AIGFP was not required to make any payments as part of these terminations and in certain cases was paid a fee upon termination. In light of this experience to date and after other comprehensive analyses, AIG did not recognize an unrealized market valuation adjustment for this regulatory capital relief portfolio for the year ended December 31, 2007. AIG will continue to assess the valuation of this portfolio and monitor developments in the marketplace. There can be no assurance that AIG will not recognize unrealized market valuation losses from this portfolio in future periods. These transactions contributed approximately \$210 million to AIGFP's revenues in 2007. If AIGFP is not successful in replacing the revenues generated by these transactions, AIGFP's operating results could be materially adversely affected. For additional information on the AIGFP super senior credit default swap portfolio, see Risk Management Segment Risk Management Financial Services Capital Markets Derivative Transactions and Note 8 to Consolidated Financial Statements.

In March 2007, the U.S. Treasury Department published proposed regulations that, had they been adopted in 2007, would have had the effect of limiting the ability of AIG to claim foreign tax credits with respect to certain transactions entered into by AIGFP. AIGFP is no longer a participant in those transactions and therefore, the proposed regulations,

if adopted in their current form in 2008 or subsequent years, would not be expected to have any material effect on AIG's ability to claim foreign tax credits.

Effective January 1, 2008, AIGFP elected to apply the fair value option to all eligible assets and liabilities, other than equity method investments. The adoption of FAS 159 with respect to elections made by AIGFP is currently being evaluated for the effect of recently issued draft guidance by the FASB, anticipated to be issued in final form in early 2008, and its potential effect on AIG's consolidated financial statements.

**Asset Management**

In the Spread-Based Investment business, the Guaranteed Investment Contract (GIC) portfolio continues to run off and was replaced by the Matched Investment Program (MIP). The results from domestic GICs and the MIP have been adversely affected by the ongoing disruption in the credit markets, the weakening U.S. dollar and declining interest rates. The MIP is exposed to credit and market risk in the form of investments in, among other asset classes, U.S. residential mortgage-backed securities, asset-backed securities, commercial mortgage-backed securities and single name corporate credit default swaps entered into by the MIP. In addition, earnings volatility for the MIP may arise from investments in bank loans that are held for future collateralized loan obligations to be managed by AIG Investments. The value of the investments may fluctuate materially from period to period due to market movements, which may result in realized and unrealized net losses. Although it is difficult to estimate future movements in these markets, effective hedges exist to mitigate the effect of

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**Management's Discussion and Analysis of  
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interest rate and foreign currency exchange rate disruptions. Reported results may be volatile due to certain hedges not qualifying for hedge accounting treatment.

In the Institutional Asset Management business, carried interest, computed in accordance with each fund's governing agreement, is based on the investment's performance over the life of each fund. Unrealized carried interest is recognized based on each fund's performance as of the balance sheet date. Future fund performance may negatively affect previously recognized carried interest.

For a description of important factors that may affect the operations and initiatives described above, see Item 1A. Risk Factors.

**Consolidated Results**

**The following table summarizes AIG's consolidated revenues, income before income taxes, minority interest and cumulative effect of accounting changes and net income for the years ended December 31, 2007, 2006 and 2005:**

Years Ended December 31, (in millions)	2007	2006	2005	Percentage Increase/(Decrease)	
				2007 vs. 2006	2006 vs. 2005
Total revenues	\$ <b>110,064</b>	\$ 113,387	\$ 108,781	(3)%	4%
Income before income taxes, minority interest and cumulative effect of accounting changes	\$ <b>8,943</b>	\$ 21,687	\$ 15,213	(59)	43
Net income	\$ <b>6,200</b>	\$ 14,048	\$ 10,477	(56)%	34%

**Effect of Credit Market Events in the Fourth Quarter of 2007**

AIG reported a net loss of \$8.4 billion before tax (\$5.2 billion after tax) in the fourth quarter of 2007 as a result of severe credit market disruption. Contributing to this loss was an \$11.5 billion pre-tax charge for the unrealized market valuation loss on AIGFP's super senior credit default swap portfolio. Net realized capital losses totaled \$2.6 billion before tax in the fourth quarter of 2007, arising primarily from other-than-temporary impairment charges in AIG's investment portfolio, with an additional \$643 million impairment charge related to Financial Services securities available for sale reported in other income. Also contributing to the operating loss for the fourth quarter was an operating loss of \$348 million before tax from Mortgage Guaranty from continued deterioration in the U.S. residential housing market.

**2007 and 2006 Comparison**

AIG's consolidated revenues decreased in 2007 compared to 2006 as growth in Premiums and other considerations and Net investment income in the General Insurance and Life Insurance & Retirement Services segments were more than offset by higher Net realized capital losses compared to 2006 and an unrealized market valuation loss of \$11.5 billion on AIGFP's super senior credit default swap portfolio recorded in other income. Net realized capital losses of \$3.6 billion in 2007 included other-than-temporary impairment charges of the fair value of investments of \$4.1 billion, primarily related to the significant disruption in the residential mortgage and credit markets, and foreign currency related losses of \$500 million. Similarly, AIG recorded in other income, other-than-temporary impairment charges of \$643 million related to its Financial Services securities available for sale reported in other income. Total

other-than-temporary impairment charges in 2006 were \$944 million. See Invested Assets Other-than-temporary impairments herein.

Income before income taxes, minority interest and cumulative effect of accounting changes declined in 2007 due to the losses described above, partially offset by the favorable effects in 2007 of the application of hedge accounting under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133). In 2007, AIGFP applied hedge accounting to certain of its interest rate swaps and foreign currency forward contracts hedging its investments and borrowings. As a result, AIGFP recognized in earnings the change in the fair value of the hedged items attributable to the hedged risks, substantially offsetting the gains and losses on the derivatives designated as hedges. In 2006, AIGFP did not apply hedge accounting to any of its assets and liabilities.

#### **2006 and 2005 Comparison**

The increase in revenues in 2006 compared to 2005 was primarily attributable to the growth in Premiums and other considerations and Net investment income in the General Insurance and Life Insurance & Retirement Services segments. Revenues in the Financial Services segment declined as a result of the effect of hedging activities for AIGFP that did not qualify for hedge accounting treatment under FAS 133, decreasing revenues by \$1.8 billion in 2006 and increasing revenues by \$2.0 billion in 2005.

Income before income taxes, minority interest and cumulative effect of accounting changes increased in 2006 compared to 2005, reflecting higher General Insurance and Life Insurance & Retirement Services operating income. These increases were partially offset by lower Financial Services operating income reflecting the effects of hedging activities that did not qualify for hedge accounting treatment under FAS 133. Results in 2005 reflected the negative effect of \$3.3 billion (pre-tax) in catastrophe-related losses incurred that year. Net income in 2005 also reflected the charges related to regulatory settlements, as described in Item 3. Legal Proceedings, and the fourth quarter

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charge resulting from the annual review of General Insurance loss and loss adjustment reserves.

**Remediation**

Throughout 2007 and 2006, as part of its continuing remediation efforts, AIG recorded out of period adjustments which are detailed below. In addition, certain revisions were made to the Consolidated Statement of Cash Flows.

**2007 Adjustments**

During 2007, out of period adjustments collectively decreased pre-tax operating income by \$372 million (\$399 million after tax). The adjustments were comprised of a charge of \$380 million (\$247 million after tax) to reverse net gains on transfers of investment securities among legal entities consolidated within AIGFP and a corresponding increase to accumulated other comprehensive income (loss); \$156 million of additional income tax expense related to the successful remediation of the material weakness in internal control over income tax accounting; \$142 million (\$92 million after tax) of additional expense related to insurance reserves and DAC in connection with improvements in internal control over financial reporting and consolidation processes; \$42 million (\$29 million after tax) of additional expense, primarily related to other remediation activities; and \$192 million (\$125 million after tax) of net realized capital gains related to foreign exchange.

**2006 Adjustments**

During 2006, out of period adjustments collectively increased pre-tax operating income by \$313 million (\$65 million after tax). The adjustments were comprised of \$773 million (\$428 million after tax) of additional investment income related to the accounting for certain interests in unit investment trusts (UCITS); \$300 million (\$145 million after tax) of charges primarily related to the remediation of the material weakness in internal control over the accounting for certain derivative transactions under FAS 133; \$58 million of additional income tax expense related to the remediation of the material weakness in internal control over income tax accounting; \$85 million (\$55 million after tax) of interest income related to interest earned on deposit contracts; \$61 million (before and after tax) of expenses related to the Starr International Company, Inc. (SICO) Deferred Compensation Profit Participation Plans (SICO Plans); \$59 million (\$38 million after tax) of expenses related to deferred advertising costs; and \$125 million (\$116 million after tax) of additional expense, primarily related to other remediation activities.

Results in 2006 were also negatively affected by a one-time charge relating to the C.V. Starr & Co., Inc. (Starr) tender offer (\$54 million before and after tax) and an additional allowance for losses in AIG Credit Card Company (Taiwan) (\$88 million before and after tax), both of which were recorded in first quarter of 2006.

**Cash Flows**

As part of its ongoing remediation activities, AIG has made certain revisions to the Consolidated Statement of Cash Flows, primarily relating to the effect of reclassifying certain policyholders' account balances, the elimination of certain intercompany balances and revisions related to separate account assets. Accordingly, AIG revised the previous periods presented to conform to the revised presentation. See Note 24 to Consolidated Financial Statements for further information.

**Income Taxes**

The effective tax rate declined from 30.1 percent in 2006 to 16.3 percent in 2007, primarily due to the unrealized market valuation losses on AIGFP's super senior credit default swap portfolio and other-than-temporary impairment charges. These losses, which are taxed at a U.S. tax rate of 35 percent and are included in the calculation of income tax expense, reduced AIG's overall effective tax rate. In addition, other tax benefits, including tax exempt interest and effects of foreign operations are proportionately larger in 2007 than in 2006 due to the decline in pre-tax income in 2007. Furthermore, tax deductions taken in 2007 for SICO compensation plans for which the expense had been recognized in prior years also reduced the effective tax rate in 2007. AIG has now completed its claims for tax refunds attributable to adjustments made for 2004 and prior financial statements. Refund claims for tax years 1991-1996 were filed with the Internal Revenue Service in June 2007. Claims for tax years 1997-2004 will be filed before September 2008.

AIG expects to receive cash tax benefits in 2008 as a result of the unrealized market valuation losses on AIGFP's super senior credit default swap portfolio, whether AIG is in a regular or alternative minimum tax position.



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The following table summarizes the net effect of catastrophe-related losses for the years ended December 31, 2007 and 2005. There were no significant catastrophe-related losses for the year ended December 31, 2006.

<i>(in millions)</i>	2007	2005
Pretax	\$276	\$3,280*
Net of tax and minority interest	\$177	2,109

\* Includes \$312 million in catastrophe-related losses from partially owned companies.

**Segment Results**

The following table summarizes AIG's operations by reporting segment for the years ended December 31, 2007, 2006 and 2005. See also Note 2 to Consolidated Financial Statements.

<i>(in millions)</i>	2007	2006 <sup>(a)</sup>	2005 <sup>(a)</sup>	2007 vs. 2006	Percentage Increase/(Decrease) 2006 vs. 2005
<b>Revenues<sup>(b)</sup>:</b>					
General Insurance <sup>(c)</sup>	\$ 51,708	\$ 49,206	\$ 45,174	5%	9%
Life Insurance & Retirement Services <sup>(c)(d)</sup>	53,570	50,878	48,020	5	6
Financial Services <sup>(e)(f)</sup>	(1,309)	7,777	10,677		(27)
Asset Management	5,625	4,543	4,582	24	(1)
Other	457	483	344	(5)	40
Consolidation and eliminations	13	500	(16)	(97)	
<b>Total</b>	<b>\$110,064</b>	\$113,387	\$108,781	(3)%	4%
<b>Operating Income (loss)<sup>(b)(g)</sup>:</b>					
General Insurance <sup>(c)</sup>	\$ 10,526	\$ 10,412	\$ 2,315	1%	350%
Life Insurance & Retirement Services <sup>(c)(d)</sup>	8,186	10,121	8,965	(19)	13
Financial Services <sup>(e)(f)</sup>	(9,515)	383	4,424		(91)
Asset Management	1,164	1,538	1,963	(24)	(22)
Other <sup>(h)</sup>	(2,140)	(1,435)	(2,765)		
Consolidation and eliminations	722	668	311	8	115
<b>Total</b>	<b>\$ 8,943</b>	\$ 21,687	\$ 15,213	(59)%	43%

- (a) *Certain reclassifications have been made to prior period amounts to conform to the current period presentation.*
- (b) *In 2007, 2006 and 2005, includes other-than-temporary impairment charges of \$4.7 billion, \$944 million and \$598 million, respectively. Also includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. In 2007, 2006, and 2005, respectively, the effect was \$(1.44) billion, \$(1.87) billion and \$2.02 billion in both revenues and operating income. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings. These gains (losses) in 2007 include a \$380 million out of period charge to reverse net gains recognized on transfers of available for sale securities among legal entities consolidated within AIGFP. The gains (losses) in 2006 include an out of period charge of \$223 million related to the remediation of the material weakness in internal control over the accounting for certain derivative transactions under FAS 133.*
- (c) *In 2006, includes the effect of out of period adjustments related to the accounting for UCITS. In 2006, the effect was an increase of \$490 million in both revenues and operating income for General Insurance and an increase of \$240 million and \$169 million in revenues and operating income, respectively, for Life Insurance & Retirement Services.*
- (d) *In 2007, 2006 and 2005, includes other-than-temporary impairment charges of \$2.8 billion, \$641 million and \$425 million, respectively, for Life Insurance & Retirement Services.*
- (e) *Includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. In 2007, 2006 and 2005, respectively, the effect was \$104 million, \$(1.97) billion, and \$2.19 billion in both revenues and operating income. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings. The years ended December 31, 2007 and 2006 include out of period charges of \$380 million and \$223 million, respectively, as discussed in footnote (b). In the first quarter of 2007, AIG began applying hedge accounting for certain transactions, primarily in its Capital Markets operations. In the second quarter of 2007, AGF and ILFC began applying hedge accounting to most of their derivatives hedging interest rate and foreign exchange risks associated with their floating rate and foreign currency denominated borrowings.*
- (f) *In 2007, both revenues and operating income (loss) include an unrealized market valuation loss of \$11.5 billion on AIGFP's super senior credit default swap portfolio and an other-than-temporary impairment charge of \$643 million on AIGFP's available for sale investment securities recorded in other income.*
- (g) *Includes current year catastrophe-related losses of \$276 million in 2007 and \$3.28 billion in 2005. There were no significant catastrophe-related losses in 2006.*
- (h) *In 2005, includes current year catastrophe-related losses from unconsolidated entities of \$312 million.*



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**General Insurance**

AIG's General Insurance operations provide property and casualty products and services throughout the world. Revenues in the General Insurance segment represent net premiums earned, net investment income and net realized capital gains (losses). The increase in General Insurance operating income in 2007 compared to 2006 was driven by strength in the Domestic Brokerage Group (DBG), partially offset by operating losses from the Mortgage Guaranty business and a decrease in Personal Lines operating income.

**Life Insurance & Retirement Services**

AIG's Life Insurance & Retirement Services operations provide insurance, financial and investment-oriented products throughout the world. Revenues in the Life Insurance & Retirement Services operations represent premiums and other considerations, net investment income and net realized capital gains (losses). Foreign operations contributed approximately 76 percent, 68 percent and 59 percent of AIG's Life Insurance & Retirement Services operating income in 2007, 2006 and 2005, respectively.

Life Insurance & Retirement Services operating income declined in 2007 compared to 2006 primarily due to higher net realized capital losses in 2007. In addition, operating income in 2007 was negatively affected by charges related to remediation activity in Asia; an industry wide regulatory claims review in Japan; the effect of Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts (SOP 05-1), which was adopted in 2007; and investment losses where a FAS 115 trading election was made (trading account).

**Financial Services**

AIG's Financial Services subsidiaries engage in diversified activities including aircraft and equipment leasing, capital markets, consumer finance and insurance premium finance. Revenues in the Financial Services segment include interest, realized and unrealized gains and losses, including the unrealized market valuation losses on AIGFP's super senior credit default swap portfolio, lease and finance charges.

Financial Services reported an operating loss in 2007 compared to operating income in 2006, primarily due to an unrealized market valuation loss of \$11.5 billion on AIGFP's super senior credit default swap portfolio, an other-than-temporary impairment charge of \$643 million on AIGFP's investment portfolio of CDOs of asset-backed securities (ABS) and a decline in operating income for AGF. AGF's operating income declined in 2007 compared to 2006 due to reduced residential mortgage origination volume, lower revenues from its mortgage banking activities and increases in the provision for finance receivable losses. In 2007, AGF's mortgage banking operations recorded a pre-tax charge of \$178 million, representing the estimated cost of implementing the Supervisory Agreement entered into with the Office of Thrift Supervision (OTS), which is discussed in the Consumer Finance results of operations section.

Operating income for ILFC increased in 2007 compared to 2006, driven to a large extent by a larger aircraft fleet, higher lease rates and higher utilization.

In 2007, AIGFP began applying hedge accounting under FAS 133 to certain of its interest rate swaps and foreign currency forward contracts that hedge its investments and borrowings and AGF and ILFC began applying hedge accounting to most of their derivatives that hedge floating rate and foreign currency denominated borrowings. Prior to 2007, hedge accounting was not applied to any of AIG's derivatives and related assets and liabilities. Accordingly, revenues and operating income were exposed to volatility resulting from differences in the timing of revenue recognition between the derivatives and the hedged assets and liabilities.

**Asset Management**

AIG's Asset Management operations include institutional and retail asset management, broker-dealer services and spread-based investment businesses. Revenues in the Asset Management segment represent investment income with respect to spread-based products and management, advisory and incentive fees.

Asset Management operating income decreased in 2007 compared to 2006, due to realized capital losses on interest rate and foreign currency hedge positions not qualifying for hedge accounting and other-than-temporary impairment charges on fixed income investments due primarily to disruptions in the U.S. credit markets. These decreases were

partially offset by higher partnership income from the Spread-Based Investment business, increased gains on real estate investments and a gain on the sale of a portion of AIG's investment in Blackstone Group, L.P. in connection with its initial public offering.

#### Capital Resources

At December 31, 2007, AIG had total consolidated shareholders' equity of \$95.8 billion and total consolidated borrowings of \$176.0 billion. At that date, \$67.9 billion of such borrowings were subsidiary borrowings not guaranteed by AIG.

In 2007, AIG issued an aggregate of \$5.6 billion of junior subordinated debentures in five series of securities. Substantially all of the proceeds from these sales, net of expenses, were used to repurchase shares of AIG's common stock. A total of 76,361,209 shares were repurchased during 2007.

In February 2007, AIG's Board of Directors increased AIG's share repurchase program by authorizing the repurchase of shares with an aggregate purchase price of \$8 billion. In November 2007, AIG's Board of Directors authorized the repurchase of an additional \$8 billion in common stock. At February 15, 2008, \$10.25 billion was available for repurchase under the aggregate authorization. AIG did not purchase shares of its common stock under its common stock repurchase authorization during 2006. AIG does not expect to purchase additional shares under its share repurchase program for the foreseeable future, other than pursuant to commitments that existed at December 31, 2007.

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**Management's Discussion and Analysis of  
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AIG manages liquidity at both the subsidiary and parent company levels. At December 31, 2007, AIG's consolidated invested assets, primarily held by its subsidiaries, included \$65.6 billion in cash and short-term investments. Consolidated net cash provided from operating activities in 2007 amounted to \$35.2 billion. At both the subsidiary and parent company level, liquidity management activities are intended to preserve and enhance funding stability, flexibility, and diversity through a wide range of potential operating environments and market conditions. AIG's primary sources of cash flow are dividends and other payments from its regulated and unregulated subsidiaries, as well as issuances of debt securities. Primary uses of cash flow are for debt service, subsidiary funding, shareholder dividend payments and common stock repurchases. As a result of disruption in the credit markets during 2007, AIG took steps to enhance the liquidity of its portfolios, including increasing the liquidity of the collateral in the securities lending program. Management believes that AIG's liquid assets, cash provided by operations and access to the capital markets will enable it to meet its anticipated cash requirements, including the funding of increased dividends under AIG's new dividend policy.

**Critical Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the application of accounting policies that often involve a significant degree of judgment. AIG considers that its accounting policies that are most dependent on the application of estimates and assumptions, and therefore viewed as critical accounting estimates, to be those relating to reserves for losses and loss expenses, future policy benefits for life and accident and health contracts, recoverability of DAC, estimated gross profits for investment-oriented products, fair value measurements of certain financial assets and liabilities, other-than-temporary impairments, the allowance for finance receivable losses and flight equipment recoverability. These accounting estimates require the use of assumptions about matters, some of which are highly uncertain at the time of estimation. To the extent actual experience differs from the assumptions used, AIG's results of operations would be directly affected.

Throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations, AIG's critical accounting estimates are discussed in detail. The major categories for which assumptions are developed and used to establish each critical accounting estimate are highlighted below.

**Reserves for Losses and Loss Expenses (General Insurance):**

*Loss trend factors:* used to establish expected loss ratios for subsequent accident years based on premium rate adequacy and the projected loss ratio with respect to prior accident years.

*Expected loss ratios for the latest accident year:* in this case, accident year 2007 for the year-end 2007 loss reserve analysis. For low-frequency, high-severity classes such as excess casualty, expected loss ratios generally are utilized for at least the three most recent accident years.

*Loss development factors:* used to project the reported losses for each accident year to an ultimate amount.

*Reinsurance recoverable on unpaid losses:* the expected recoveries from reinsurers on losses that have not yet been reported and/or settled.

**Future Policy Benefits for Life and Accident and Health Contracts (Life Insurance & Retirement Services):**

*Interest rates:* which vary by geographical region, year of issuance and products.

*Mortality, morbidity and surrender rates:* based upon actual experience by geographical region modified to allow for variation in policy form, risk classification and distribution channel.

**Deferred Policy Acquisition Costs (Life Insurance & Retirement Services):**

*Recoverability:* based on current and future expected profitability, which is affected by interest rates, foreign exchange rates, mortality experience and policy persistency.

**Deferred Policy Acquisition Costs (General Insurance):**

*Recoverability*: based upon the current terms and profitability of the underlying insurance contracts.

**Estimated Gross Profits (Life Insurance & Retirement Services):**

*Estimated gross profits*: to be realized over the estimated duration of the contracts (investment-oriented products) affect the carrying value of DAC, unearned revenue liability and associated amortization patterns under FAS 97,

Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments (FAS 97); and Sales Inducement Assets under American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts (SOP 03-1). Estimated gross profits include investment income and gains and losses on investments less required interest, actual mortality and other expenses.

**Fair Value Measurements of Financial Instruments:**

AIG measures financial instruments in its trading and available for sale securities portfolios, together with securities sold but not yet purchased, certain hybrid financial instruments, and derivative assets and liabilities at fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The degree of judgment used in measuring the fair value of financial instruments generally correlates with the level of pricing observability. Financial instruments with quoted prices in active markets generally have more pricing observability and less judgment is used in measuring fair value. Conversely, financial instruments traded in other than active markets or that do not have quoted prices have less observability and are measured at fair value using valuation models or other pricing techniques that

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require more judgment. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction and general market conditions.

AIG maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. AIG obtains market price data to value financial instruments whenever such information is available. Market price data generally is obtained from market exchanges or dealer quotations. The types of instruments valued based on market price data include G-7 government and agency securities, equities listed in active markets, investments in publicly traded mutual funds with quoted market prices and listed derivatives.

AIG estimates the fair value of fixed income instruments not traded in active markets by referring to traded securities with similar attributes and using a matrix pricing methodology. This methodology considers such factors as the issuer's industry, the security's rating and tenor, its coupon rate, its position in the capital structure of the issuer, and other relevant factors. The types of fixed income instruments not traded in active markets include non-G-7 government securities, municipal bonds, certain hybrid financial instruments, most investment-grade and high-yield corporate bonds, and most mortgage- and asset-backed products.

AIG initially estimates the fair value of equity instruments not traded in active markets by reference to the transaction price. This valuation is adjusted only when changes to inputs and assumptions are corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity capital markets, and changes in financial ratios or cash flows.

For equity and fixed income instruments that are not traded in active markets or that are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments generally are based on available market evidence. In the absence of such evidence, management's best estimate is used.

AIG obtains the fair value of its investments in limited partnerships and hedge funds from information provided by the general partner or manager of the investments, the financial statements of which generally are audited annually.

Derivative assets and liabilities can be exchange-traded or traded over the counter (OTC). AIG generally values exchange-traded derivatives within portfolios using models that calibrate to market clearing levels and eliminate timing differences between the closing price of the exchange-traded derivatives and their underlying instruments.

OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. When models are used, the selection of a particular model to value an OTC derivative depends on the contractual terms of, and specific risks inherent in, the instrument as well as the availability of pricing information in the market. AIG generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices and rates, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model inputs can generally be verified and model selection does not involve significant management judgment.

Certain OTC derivatives trade in less liquid markets with limited pricing information, and the determination of fair value for these derivatives is inherently more difficult. When AIG does not have corroborating market evidence to support significant model inputs and cannot verify the model to market transactions, transaction price is initially used as the best estimate of fair value. Accordingly, when a pricing model is used to value such an instrument, the model is adjusted so that the model value at inception equals the transaction price. Subsequent to initial recognition, AIG updates valuation inputs when corroborated by evidence such as similar market transactions, third-party pricing services and/or broker or dealer quotations, or other empirical market data. When appropriate, valuations are adjusted for various factors such as liquidity, bid/offer spreads and credit considerations. Such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.

AIGFP employs a modified version of the Binomial Expansion Technique (BET) model to value its super senior credit default swap portfolio, including maturity-shortening puts that allow the holders of the notes issued by certain

multi-sector CDOs to treat the notes as short-term eligible 2a-7 investments under the Investment Company Act of 1940 (2a-7 Puts). The BET model utilizes default probabilities derived from credit spreads implied from market prices for the individual securities included in the underlying collateral pools securing the CDOs, as well as diversity scores, weighted average lives, recovery rates and discount rates. The determination of some of these inputs requires the use of judgment and estimates, particularly in the absence of market observable data. AIGFP also employs a Monte Carlo simulation to assist in quantifying the effect on the valuation of the CDOs of the unique aspects of the CDO's structure such as triggers that divert cash flows to the most senior part of the capital structure. In the final determination of fair value, AIGFP also considers the price estimates for the super senior CDO notes provided by third parties, including counterparties to these transactions, and makes adjustments when deemed necessary. See also Risk Management, Segment Risk Management, Financial Services - Capital Markets Derivative Transactions and Note 8 to Consolidated Financial Statements.

**Other-Than-Temporary Impairments:**

AIG evaluates its investments for impairment such that a security is considered a candidate for other-than-temporary impairment if it meets any of the following criteria:

Trading at a significant (25 percent or more) discount to par, amortized cost (if lower) or cost for an extended period of time (nine consecutive months or longer);

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The occurrence of a discrete credit event resulting in (i) the issuer defaulting on a material outstanding obligation; (ii) the issuer seeking protection from creditors under the bankruptcy laws or any similar laws intended for court supervised reorganization of insolvent enterprises; or (iii) the issuer proposing a voluntary reorganization pursuant to which creditors are asked to exchange their claims for cash or securities having a fair value substantially lower than par value of their claims; or

AIG may not realize a full recovery on its investment, regardless of the occurrence of one of the foregoing events.

The above criteria also consider circumstances of a rapid and severe market valuation decline, such as that experienced in current credit markets, in which AIG could not reasonably assert that the recovery period would be temporary (severity losses).

In light of the recent significant disruption in the U.S. residential mortgage and credit markets, particularly in the fourth quarter, AIG has recognized an other-than-temporary impairment charge (severity loss) of \$2.2 billion (including \$643 million related to AIGFP's available for sale investment securities recorded in other income), primarily from certain residential mortgage-backed securities and other structured securities. Even while retaining their investment grade ratings, such securities were priced at a severe discount to cost. Notwithstanding AIG's intent and ability to hold such securities indefinitely, and despite structures which indicate that a substantial amount of the securities should continue to perform in accordance with their original terms, AIG concluded that it could not reasonably assert that the recovery period would be temporary.

At each balance sheet date, AIG evaluates its securities holdings with unrealized losses. When AIG does not intend to hold such securities until they have recovered their cost basis, AIG records the unrealized loss in income. If a loss is recognized from a sale subsequent to a balance sheet date pursuant to changes in circumstances, the loss is recognized in the period in which the intent to hold the securities to recovery no longer existed.

In periods subsequent to the recognition of an other-than-temporary impairment charge for fixed maturity securities, which is not credit or foreign exchange related, AIG generally accretes into income the discount or amortizes the reduced premium resulting from the reduction in cost basis over the remaining life of the security.

#### **Allowance for Finance Receivable Losses (Financial Services):**

*Historical defaults and delinquency experience:* utilizing factors, such as delinquency ratio, allowance ratio, charge-off ratio, and charge-off coverage.

*Portfolio characteristics:* portfolio composition and consideration of the recent changes to underwriting criteria and portfolio seasoning.

*External factors:* consideration of current economic conditions, including levels of unemployment and personal bankruptcies.

*Migration analysis:* empirical technique measuring historical movement of similar finance receivables through various levels of repayment, delinquency, and loss categories to existing finance receivable pools.

#### **Flight Equipment Recoverability (Financial Services):**

*Expected undiscounted future net cash flows:* based upon current lease rates, projected future lease rates and estimated terminal values of each aircraft based on third-party information.

## **Operating Review**

### **General Insurance Operations**

AIG's General Insurance subsidiaries write substantially all lines of commercial property and casualty insurance and various personal lines both domestically and abroad.

As previously noted, AIG believes it should present and discuss its financial information in a manner most meaningful to its financial statement users. Accordingly, in its General Insurance business, AIG uses certain regulatory measures, where AIG has determined these measurements to be useful and meaningful.

A critical discipline of a successful general insurance business is the objective to produce profit from underwriting activities taking into account costs of capital. AIG views underwriting results to be critical in the overall evaluation of performance.

Statutory underwriting profit is derived by reducing net premiums earned by net losses and loss expenses incurred and net expenses incurred. Statutory accounting generally requires immediate expense recognition and ignores the matching of revenues and expenses as required by GAAP. That is, for statutory purposes, expenses (including acquisition costs) are recognized immediately, not over the same period that the revenues are earned. Thus, statutory expenses exclude changes in DAC.

GAAP provides for the recognition of certain acquisition expenses at the same time revenues are earned, the accounting principle of matching. Therefore, acquisition expenses are deferred and amortized over the period the related net premiums written are earned. DAC is reviewed for recoverability, and such review requires management judgment. The most comparable GAAP measure to statutory underwriting profit is income before income taxes, minority interest and cumulative effect of an accounting change. A table reconciling statutory underwriting profit to income before income taxes, minority interest and cumulative effect of an accounting change is contained in footnote (d) to the following table. See also Critical Accounting Estimates herein and Notes 1 and 6 to Consolidated Financial Statements.

AIG, along with most general insurance companies, uses the loss ratio, the expense ratio and the combined ratio as measures of underwriting performance. The loss ratio is the sum of losses and loss expenses incurred divided by net premiums earned. The expense ratio is statutory underwriting expenses divided by net premiums written. These ratios are relative measurements that describe, for every \$100 of net premiums earned or written, the cost of losses and statutory expenses, respectively. The combined ratio is the sum of the loss ratio and the expense ratio. The combined ratio presents the total cost per \$100 of premium production. A combined ratio below 100 demonstrates underwriting profit; a combined ratio above 100 demonstrates underwriting loss.

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Net premiums written are initially deferred and earned based upon the terms of the underlying policies. The net unearned premium reserve constitutes deferred revenues which are generally earned ratably over the policy period. Thus, the net unearned premium reserve is not fully recognized in income as net premiums earned until the end of the policy period.

The underwriting environment varies from country to country, as does the degree of litigation activity. Regulation, product type and competition have a direct effect on pricing and consequently on profitability as reflected in underwriting profit and statutory general insurance ratios.

**General Insurance Results**

**General Insurance operating income is comprised of statutory underwriting profit (loss), changes in DAC, net investment income and net realized capital gains and losses. Operating income, as well as net premiums written, net premiums earned, net investment income and net realized capital gains (losses) and statutory ratios in 2007, 2006 and 2005 were as follows:**

<i>(in millions, except ratios)</i>	<b>2007</b>	2006	2005	2007 vs. 2006	Percentage Increase/(Decrease) 2006 vs. 2005
<b>Net premiums written:</b>					
Domestic General Insurance					
DBG	<b>\$24,112</b>	\$24,312	\$23,104	(1)%	5%
Transatlantic	<b>3,953</b>	3,633	3,466	9	5
Personal Lines	<b>4,808</b>	4,654	4,653	3	
Mortgage Guaranty	<b>1,143</b>	866	628	32	38
Foreign General Insurance	<b>13,051</b>	11,401	10,021	14	14
<b>Total</b>	<b>\$47,067</b>	\$44,866	\$41,872	5%	7%
<b>Net premiums earned:</b>					
Domestic General Insurance					
DBG	<b>\$23,849</b>	\$23,910	\$22,567	%	6%
Transatlantic	<b>3,903</b>	3,604	3,385	8	6
Personal Lines	<b>4,695</b>	4,645	4,634	1	
Mortgage Guaranty	<b>886</b>	740	533	20	39
Foreign General Insurance	<b>12,349</b>	10,552	9,690	17	9
<b>Total</b>	<b>\$45,682</b>	\$43,451	\$40,809	5%	6%
<b>Net investment income<sup>(a)</sup>:</b>					
Domestic General Insurance					
DBG	<b>\$ 3,879</b>	\$ 3,411	\$ 2,403	14%	42%
Transatlantic	<b>470</b>	435	343	8	27
Personal Lines	<b>231</b>	225	217	3	4
Mortgage Guaranty	<b>158</b>	140	123	13	14
	<b>6</b>	1	1	500	

Intercompany adjustments and eliminations net					
Foreign General Insurance	<b>1,388</b>	1,484	944	(6)	57
<b>Total</b>	<b>\$ 6,132</b>	\$ 5,696	\$ 4,031	8%	41%
Net realized capital gains (losses)	<b>\$ (106)</b>	\$ 59	\$ 334	%	%
Operating income (loss) <sup>(a)(b)</sup> :					
Domestic General Insurance					
DBG	<b>\$ 7,305</b>	\$ 5,845	\$ (820)	25%	%
Transatlantic	<b>661</b>	589	(39)	12	
Personal Lines	<b>67</b>	432	195	(84)	122
Mortgage Guaranty	<b>(637)</b>	328	363		(10)
Foreign General Insurance	<b>3,137</b>	3,228	2,601	(3)	24
Reclassifications and eliminations	<b>(7)</b>	(10)	15		
<b>Total</b>	<b>\$ 10,526</b>	\$ 10,412	\$ 2,315	1%	350%

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<i>(in millions, except ratios)</i>	<b>2007</b>	2006	2005	2007 vs. 2006	Percentage Increase/(Decrease) 2006 vs. 2005
<b>Statutory underwriting profit (loss) <sup>(b)(d)</sup>:</b>					
Domestic General Insurance					
DBG	<b>\$3,404</b>	\$2,322	\$(3,403)	47%	%
Transatlantic	<b>165</b>	129	(434)	28	
Personal Lines	<b>(191)</b>	204	(38)		
Mortgage Guaranty	<b>(849)</b>	188	249		(24)
Foreign General Insurance	<b>1,544</b>	1,565	1,461	(1)	7
<b>Total</b>	<b>\$4,073</b>	\$4,408	\$(2,165)	(8)%	%
<b>Domestic General Insurance<sup>(b)</sup>:</b>					
Loss ratio	<b>71.2</b>	69.6	90.1		
Expense ratio	<b>20.8</b>	21.4	21.0		
<b>Combined ratio</b>	<b>92.0</b>	91.0	111.1		
<b>Foreign General Insurance<sup>(b)</sup>:</b>					
Loss ratio	<b>50.6</b>	48.9	52.0		
Expense ratio <sup>(c)</sup>	<b>34.9</b>	33.6	31.8		
<b>Combined ratio</b>	<b>85.5</b>	82.5	83.8		
<b>Consolidated<sup>(b)</sup>:</b>					
Loss ratio	<b>65.6</b>	64.6	81.1		
Expense ratio	<b>24.7</b>	24.5	23.6		
<b>Combined ratio</b>	<b>90.3</b>	89.1	104.7		

(a) Includes the effect of out-of-period adjustments related to the accounting for UCITS in 2006. For DBG, the effect was an increase of \$66 million, and for Foreign General Insurance, the effect was an increase of \$424 million.

(b) Catastrophe-related losses increased the consolidated General Insurance combined ratio in 2007 and 2005 by 0.60 points and 7.06 points, respectively. There were no significant catastrophe-related losses in 2006. Catastrophe-related losses in 2007 and 2005 by reporting unit were as follows:

<i>(in millions)</i>	2007		2005	
	Insurance Related Losses	Net Reinstatement Premium Cost	Insurance Related Losses	Net Reinstatement Premium Cost
<b>Reporting Unit:</b>				
DBG	<b>\$113</b>	<b>\$ (13)</b>	\$1,811	\$ 136
Transatlantic	<b>11</b>	<b>(1)</b>	463	45
Personal Lines	<b>61</b>	<b>14</b>	112	2
Mortgage Guaranty			10	
Foreign General Insurance	<b>90</b>	<b>1</b>	229	80
<b>Total</b>	<b>\$275</b>	<b>\$ 1</b>	<b>\$2,625</b>	<b>\$ 263</b>

*(c) Includes amortization of advertising costs.*

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(d) Statutory underwriting profit (loss) is a measure that U.S. domiciled insurance companies are required to report to their regulatory authorities. The following table reconciles statutory underwriting profit (loss) to operating income for General Insurance for the years ended December 31, 2007, 2006 and 2005:

(in millions)	Domestic Brokerage Group	Transatlantic	Personal Lines	Mortgage Guaranty	Foreign General Insurance	Reclassifications and Eliminations	Total
<b>2007:</b>							
Statutory underwriting profit (loss)	\$ 3,404	\$ 165	\$ (191)	\$ (849)	\$ 1,544	\$	\$ 4,073
Increase in DAC	97	17	29	57	227		427
Net investment income	3,879	470	231	158	1,388	6	6,132
Net realized capital gains (losses)	(75)	9	(2)	(3)	(22)	(13)	(106)
Operating income (loss)	\$ 7,305	\$ 661	\$ 67	\$ (637)	\$ 3,137	\$ (7)	\$ 10,526
<b>2006:</b>							
Statutory underwriting profit (loss)	\$ 2,322	\$ 129	\$ 204	\$ 188	\$ 1,565	\$	\$ 4,408
Increase in DAC	14	14	2	3	216		249
Net investment income	3,411	435	225	140	1,484	1	5,696
Net realized capital gains (losses)	98	11	1	(3)	(37)	(11)	59
Operating income (loss)	\$ 5,845	\$ 589	\$ 432	\$ 328	\$ 3,228	\$ (10)	\$ 10,412
<b>2005:</b>							
Statutory underwriting profit (loss)	\$ (3,403)	\$ (434)	\$ (38)	\$ 249	\$ 1,461	\$	\$ (2,165)
Increase (decrease) in DAC	(21)	14	19	(8)	111		115
Net investment income	2,403	343	217	123	944	1	4,031
Net realized capital gains (losses)	201	38	(3)	(1)	85	14	334

Operating income								
(loss)	\$ (820)	\$ (39)	\$ 195	\$ 363	\$2,601	\$ 15	\$ 2,315	

**AIG transacts business in most major foreign currencies. The following table summarizes the effect of changes in foreign currency exchange rates on the growth of General Insurance net premiums written for the years ended December 31, 2007 and 2006:**

	2007	2006
Growth in original currency*	3.5%	7.4%
Foreign exchange effect	1.4	(0.2)
Growth as reported in U.S. dollars	4.9%	7.2%

\* Computed using a constant exchange rate for each period.

#### **2007 and 2006 Comparison**

General Insurance operating income increased in 2007 compared to 2006 due to growth in net investment income, partially offset by a decline in underwriting profit and Net realized capital losses. The 2007 combined ratio increased to 90.3, an increase of 1.2 points compared to 2006, primarily due to an increase in the loss ratio of 1.0 points. The loss ratio for accident year 2007 recorded in 2007 was 2.3 points higher than the loss ratio recorded in 2006 for accident year 2006. Increases in Mortgage Guaranty losses accounted for a 2.1 point increase in the 2007 accident year loss ratio. The downward cycle in the U.S. housing market is not expected to improve until residential inventories return to a more normal level, and AIG expects that this downward cycle will continue to adversely affect Mortgage Guaranty's loss ratios for the foreseeable future. The higher accident year loss ratio was partially offset by favorable development on prior years, which reduced incurred losses by \$606 million and \$53 million in 2007 and 2006, respectively. Additional favorable loss development of \$50 million (recognized in consolidation and related to certain asbestos settlements) reduced overall incurred losses.

General Insurance net premiums written increased in 2007 compared to 2006, reflecting growth in Foreign General Insurance from both established and new distribution channels, and the effect of changes in foreign currency exchange rates as well as growth in Mortgage Guaranty, primarily from international business.

General Insurance net investment income increased in 2007 by \$436 million. Interest and dividend income increased \$714 million in 2007 compared to 2006 as fixed maturities and equity securities increased by \$11.6 billion and the average yield increased 10 basis points. Income from partnership investments increased \$159 million in 2007 compared to 2006, primarily due to improved returns on underlying investments and higher levels of invested assets. Investment expenses in 2007 declined \$60 million compared to 2006, primarily due to decreased interest expense on deposit liabilities. These increases to net investment income were partially offset by \$490 million of income from an out of period UCITS adjustment recorded in 2006. Net realized capital losses in 2007 include other-than-temporary impairment charges of \$276 million compared to \$77 million in 2006. See also Capital Resources and Liquidity and Invested Assets herein.

In order to better align financial reporting with the manner in which AIG's chief operating decision makers manage their businesses, commencing in 2007, the foreign aviation business, which was historically reported in DBG, is now reported as part of Foreign General Insurance, and the oil rig and marine businesses, which were historically reported in Foreign General Insurance, are now reported as part of DBG. Prior period amounts have been revised to conform to the current presentation.

#### **2006 and 2005 Comparison**

General Insurance operating income increased in 2006 compared to 2005 due to growth in net premiums, a reduction in both



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catastrophe losses and prior accident year development, and growth in Net investment income. The combined ratio improved to 89.1, a reduction of 15.6 points from 2005, including an improvement in the loss ratio of 16.5 points. The reduction in catastrophe losses represented 6.9 points and the reduction in prior year adverse development represented 11.5 points of the overall reduction. Net premiums written increased \$3.0 billion or 7 percent in 2006 compared to 2005. Domestic General Insurance accounted for \$1.6 billion of the increase as property rates improved and submission activity increased due to the strength of AIG's capacity, commitment to difficult markets and diverse product offerings. Foreign General Insurance contributed \$1.4 billion to the increase in net premiums written. In 2005, Domestic General Insurance net premiums written increased by \$300 million and Foreign General Insurance net premiums written decreased by the same amount as a result of the commutation of the Richmond reinsurance contract. The commutation partially offset the increase in Domestic General Insurance net premiums written in 2006 compared to 2005 and increased Foreign General Insurance net premiums written in 2006 compared to 2005.

In 2006, certain adjustments were made in conjunction with the remediation of the material weakness relating to balance sheet account reconciliations which increased earned premiums by \$189 million and increased other expenses by \$415 million. The combined effect of these adjustments increased the expense ratio by 0.9 points and decreased the loss ratio by 0.3 points.

General Insurance net investment income increased \$1.67 billion in 2006 to \$5.7 billion on higher levels of invested assets, strong cash flows, slightly higher yields and increased partnership income, and included increases from out of period adjustments of \$490 million related to the accounting for certain interests in UCITS, \$43 million related to partnership income and \$85 million related to interest earned on a DBG deposit contract. See also Capital Resources and Liquidity—Liquidity and Invested Assets herein.

**DBG Results****2007 and 2006 Comparison**

DBG's operating income increased in 2007 compared to 2006 primarily due to growth in both net investment income and underwriting profit. The improvement is also reflected in the combined ratio, which declined 4.5 points in 2007 compared to 2006, primarily due to an improvement in the loss ratio of 3.3 points. Catastrophe-related losses increased the 2007 loss ratio by 0.4 points. The loss ratio for accident year 2007 recorded in 2007 was 0.9 points lower than the loss ratio recorded in 2006 for accident year 2006. The loss ratio for accident year 2006 has improved in each quarter since September 30, 2006. As a result, the 2007 accident year loss ratio is 2.8 points higher than the 2006 accident year loss ratio, reflecting reductions in 2006 accident year losses recorded through December 31, 2007. Prior year development reduced incurred losses by \$390 million in 2007 and increased incurred losses by \$175 million in 2006, accounting for 2.4 points of the improvement in the loss ratio.

DBG's net premiums written declined in 2007 compared to 2006 as ceded premiums as a percentage of gross written premiums increased to 24 percent in 2007 compared to 23 percent in 2006, primarily due to additional reinsurance for property risks to manage catastrophe exposures.

DBG's expense ratio decreased to 18.7 in 2007 compared to 19.8 in 2006, primarily due to the 2006 charge related to the remediation of the material weakness in internal control over certain balance sheet reconciliations that accounted for 2.1 points of the decline. The decline was partially offset by increases in operating expenses for marketing initiatives and operations.

DBG's net investment income increased in 2007 compared to 2006, as interest income increased \$384 million in 2007, on growth in the bond portfolio resulting from investment of operating cash flows. Income from partnership investments increased \$159 million in 2007 compared to 2006, primarily due to improved returns on the underlying investments. Other investment income declined \$163 million in 2007 compared to 2006, primarily due to out of period adjustments of \$194 million recorded in 2006. DBG recorded net realized capital losses in 2007 compared to net realized capital gains in 2006 primarily due to other-than-temporary impairment charges of \$213 million in 2007 compared to \$73 million in 2006.



#### 2006 and 2005 Comparison

DBG's operating income was \$5.85 billion in 2006 compared to a loss of \$820 million in 2005, an improvement of \$6.67 billion. The improvement is also reflected in the combined ratio, which declined to 89.9 in 2006 compared to 114.6 in 2005 primarily due to an improvement in the loss ratio of 24.9 points. The reduction in prior year adverse development and the reduction in catastrophe losses and related reinstatement premiums accounted for 20.7 points and 8.3 points, respectively, of the improvement.

DBG's net premiums written increased in 2006 compared to 2005 as property rates improved and submission activity increased due to the strength of AIG's capacity, commitment to difficult markets and diverse product offerings. Net premiums written in 2005 were reduced by \$136 million due to reinstatement premiums related to catastrophes, offset by increases of \$300 million for the Richmond commutation and \$147 million related to an accrual for workers compensation premiums for payroll not yet reported by insured employers. The combined effect of these items reduced the growth rate for net premiums written by 1.3 percent.

The loss ratio in 2006 declined 24.9 points to 70.2. The 2005 loss ratio was negatively affected by catastrophe-related losses of \$1.8 billion and related reinstatement premiums of \$136 million. Adverse development on reserves for loss and loss adjustment expenses declined to \$175 million in 2006 compared to \$4.9 billion in 2005, accounting for 20.7 points of the decrease in the loss ratio.

DBG's expense ratio increased to 19.8 in 2006 compared to 19.5 in 2005, primarily due to an increase in other expenses that amounted to \$498 million in 2006 (including out of period charges of \$356 million) compared to \$372 million in 2005. This increase added 0.4 points to the expense ratio.

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DBG's net investment income increased by \$1.0 billion in 2006 compared to 2005, as interest income increased \$482 million on growth in the bond portfolio resulting from investment of operating cash flows and capital contributions. Partnership income increased from 2005 due to improved performance of the underlying investments, including initial public offering activity. Net investment income in 2006 included increases relating to out of period adjustments of \$109 million for the accounting for UCITS and partnerships and \$85 million related to interest earned on a deposit contract that did not exist in the prior year.

**Transatlantic Results**

2007 and 2006 Comparison

Transatlantic's net premiums written and net premiums earned increased in 2007 compared to 2006 due to increases in both domestic and international operations. The increase in statutory underwriting profit in 2007 compared to 2006 reflects improved underwriting results in Domestic operations. Operating income increased in 2007 compared to 2006 due principally to increased net investment income and improved underwriting results.

2006 and 2005 Comparison

Transatlantic's net premiums written and net premiums earned increased in 2006 compared to 2005 due primarily to increased writings in domestic operations. Operating income increased in 2006 compared to 2005 due largely to lower catastrophe losses and net ceded reinstatement premiums, and increased net investment income.

**Personal Lines Results**

2007 and 2006 Comparison

Personal Lines operating income in 2007 decreased by \$365 million compared to 2006, largely due to an increase in incurred losses from a number of sources, leading to an overall increase in the loss ratio of 6.8 points. Prior year net adverse reserve development contributed 2.5 points of this increase in the loss ratio, as Personal Lines experienced \$7 million in net adverse development (including \$64 million in adverse development from businesses placed in runoff), compared to \$111 million of favorable development in 2006. An additional 1.6 point increase in the loss ratio resulted from \$61 million of losses and \$14 million of reinstatement premiums due to the California wildfires. In addition, an increase in the loss ratio recorded in 2007 for accident year 2007 compared to the loss ratio recorded in 2006 for accident year 2006 of 2.7 points resulted, in part, from an increased frequency of large losses in the Private Client Group and average automobile premiums declining faster than loss trends.

Operating income also declined due to increased expenses. The expense ratio increased 1.1 points in 2007 compared to 2006, primarily due to \$63 million of transaction and integration costs associated with the 2007 acquisition of the minority interest in 21st Century.

Net premiums written increased in 2007 compared to 2006 due to continued growth in the Private Client Group and increased new business production in the aigdirect.com business partially offset by a reduction in the Agency Auto business.

On September 27, 2007, AIG completed its previously announced acquisition of 21st Century, paying \$759 million to acquire the remaining 39.2 percent of the shares of 21st Century that it did not previously own. As a result of the acquisition, the AIG Direct and 21st Century operations have been combined as aigdirect.com.

Under the purchase method of accounting, the assets and liabilities of 21st Century that were acquired were adjusted to their estimated fair values as of the date of the acquisition, and goodwill of \$342 million was recorded. A customer relationship intangible asset, initially valued at \$119 million, was also established.

2006 and 2005 Comparison

Personal Lines operating income increased \$237 million in 2006 compared to 2005 reflecting a reduction in the loss ratio of 5.8 points. Favorable development on prior accident years reduced incurred losses by \$111 million in 2006 compared to an increase of \$14 million in 2005, accounting for 2.7 points of the decrease in the loss ratio. The 2005 catastrophe-related losses of \$112 million added 2.4 points to the loss ratio. The loss ratio for the 2006 accident year improved 0.7 points primarily due to the termination of The Robert Plan relationship effective December 31, 2005 and growth in the Private Client Group. The improvement in the loss ratio was partially offset by an increase in the expense ratio of 0.6 points primarily due to investments in people and technology, national expansion efforts and

lower response rates. Net premiums written were flat in 2006 compared to 2005, with growth in the Private Client Group and Agency Auto divisions offset by termination of The Robert Plan relationship. Growth in the Private Client Group spans multiple products, with a continued penetration of the high net worth market, strong brand promotion and innovative loss prevention programs.

### **Mortgage Guaranty Results**

#### **2007 and 2006 Comparison**

Mortgage Guaranty's operating loss in 2007 was \$637 million compared to operating income of \$328 million in 2006 as the deteriorating U.S. residential housing market adversely affected losses incurred for both the domestic first- and second-lien businesses. Domestic first- and second-lien losses incurred increased 362 percent and 346 percent respectively, compared to 2006, resulting in loss ratios of 122.0 and 357.0, respectively, in 2007. Increases in domestic losses incurred resulted in an overall loss ratio of 168.6 in 2007 compared to 47.2 in 2006. Prior year development reduced incurred losses in 2007 by \$25 million compared to a reduction of \$115 million in 2006, which accounted for 12.7 points of the increase in the loss ratio.

Net premiums written increased in 2007 compared to 2006 primarily due to growth in the international markets, accounting for 19 percent of the increase in net premiums written. In addition

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the increased use of mortgage insurance for credit enhancement as well as better persistency resulted in an increase in domestic first-lien premiums. UGC has taken steps to strengthen its underwriting guidelines and increase rates. It also discontinued new production for certain programs in the second-lien business beginning in the fourth quarter of 2006. However, UGC will continue to receive renewal premiums on that portfolio for the life of the loans, estimated to be three to five years, and will continue to be exposed to possible losses from future defaults.

The expense ratio in 2007 was 21.2, down from 23.4 in 2006 as premium growth offset the effect of increased expenses related to UGC's international expansion and the employment of additional operational resources in the second-lien business.

UGC domestic mortgage risk in force totaled \$29.8 billion as of December 31, 2007 and the 60-day delinquency ratio was 3.7 percent (based on number of policies, consistent with mortgage industry practice) compared to domestic mortgage risk in force of \$24.9 billion and a delinquency ratio of 2.1 percent at December 31, 2006. Approximately 81 percent of the domestic mortgage risk is secured by first-lien, owner-occupied properties.

**2006 and 2005 Comparison**

Mortgage Guaranty operating income declined in 2006 from 2005 due primarily to unfavorable loss experience on third-party originated second-lien business with a credit quality lower than typical for UGC and a softening U.S. housing market. This increased Mortgage Guaranty's consolidated loss ratio in 2006 to 47.2 compared to 26.0 in 2005. The writing of this second-lien coverage, which began in 2005, was discontinued as of year end 2006. Losses in the second-lien business have been mitigated by a policy year aggregate limitation provision that is typically established for each lender.

Net premiums written increased due to growth in the domestic second-lien and international businesses as well as improved persistency in the domestic first-lien business. The expense ratio remained flat as premium growth covered increased expenses related to expansion internationally and continued investment in risk management resources.

**Foreign General Insurance Results****2007 and 2006 Comparison**

Foreign General Insurance operating income decreased in 2007 compared to 2006, due primarily to decreases in Net investment income and statutory underwriting profit. Net investment income in 2006 included income of \$424 million from out of period UCITS adjustments. Statutory underwriting profit decreased due to losses from the June 2007 U.K. floods, an increase in severe but non-catastrophic losses and higher frequency of non-severe losses compared to 2006, partially offset by higher favorable loss development on prior accident years.

Net premiums written increased 14 percent (10 percent in original currency) in 2007 compared to 2006, reflecting growth in commercial and consumer lines driven by new business from both established and new distribution channels, including Central Insurance Co. Ltd. in Taiwan acquired in late 2006. Net premiums written for commercial lines increased due to new business in the U.K. and Europe and decreases in the use of reinsurance, partially offset by declines in premium rates. Growth in consumer lines in Latin America, Asia and Europe also contributed to the increase. Net premiums written for the Lloyd's syndicate Ascot (Ascot) and Aviation declined due to rate decreases and increased market competition.

The 2007 loss ratio increased a total of 1.7 points compared to 2006. Losses of \$90 million from the June 2007 U.K. floods added 0.7 points to the loss ratio and higher severe but non-catastrophic losses and higher loss frequency for personal accident business in Japan and personal lines business in Asia and Latin America added 1.6 points to the loss ratio. Partially offsetting these increases was favorable loss development on prior accident years of \$286 million in 2007 compared to \$183 million in 2006, which decreased the loss ratio by 0.6 points.

The 2007 expense ratio increased 1.3 points compared to 2006. This increase reflected the cost of realigning certain legal entities through which Foreign General Insurance operates and the increased significance of consumer lines of business, which have higher acquisition costs. These factors contributed 0.7 points to the 2007 expense ratio. AIG expects the expense ratio to increase in 2008 due to the continued cost of realigning certain legal entities through

which Foreign General Insurance operates.

Net investment income decreased in 2007 compared to 2006 as the 2006 period included the out of period UCITS adjustments, which more than offset increases resulting from higher interest rates, increased cash flows and mutual fund income. Mutual fund income was \$93 million higher than 2006 reflecting improved performance in the equity markets in 2007. Partnership income was essentially unchanged.

#### 2006 and 2005 Comparison

Foreign General Insurance operating income increased in 2006 compared to 2005 due to out of period UCITS adjustments in 2006, the absence of significant catastrophe-related losses in 2006, rate increases and lower current accident year losses by Ascot on its U.S. book of business and lower asbestos and environmental reserve increases. These increases were partially offset by lower favorable loss development from prior accident years and adverse loss development on the 2005 hurricanes. Statutory underwriting profit increased \$104 million in 2006 compared to 2005. Catastrophes in 2005 resulted in losses of \$229 million and reinstatement premiums of \$80 million.

Net premiums written increased 14 percent (15 percent in original currency) in 2006 compared to 2005, reflecting growth in both commercial and consumer lines driven by new business from both established and new distribution channels, including a wholly owned insurance company in Vietnam and Central Insurance Co., Ltd. in Taiwan. Ascot also contributed to the growth in net premiums written as a result of rate increases on its U.S. business. Consumer lines in Latin America and commercial lines in Europe, including the U.K., also contributed to the increase. Net premiums written in 2005 were reduced by reinstatement premiums related to catastrophes and a portfolio

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transfer of unearned premium reserves to DBG related to the Richmond commutation, accounting for 4 percent of the increase in 2006 compared to 2005.

The loss ratio decreased 3.1 points in 2006 compared to 2005, as the absence of significant catastrophes in 2006 resulted in a decrease in the loss ratio of 2.8 points. The loss ratio also decreased due to rate increases and lower current year losses by Ascot on its U.S. book of business and lower asbestos and environmental reserve increases. These declines were partially offset by lower favorable loss development from prior accident years and adverse development on 2005 hurricanes.

The expense ratio increased 1.8 points in 2006 compared to 2005 due to a \$59 million out of period adjustment for amortization of deferred advertising costs and a premium reduction of \$61 million related to reconciliation remediation activities, in aggregate accounting for 0.7 points of the increase in the expense ratio. The expense ratio also increased due to growth in consumer business lines, which have higher acquisition expenses but historically lower loss ratios.

Net investment income increased \$540 million in 2006 compared to 2005 primarily due to a \$424 million out of period UCITS adjustment.

**Reserve for Losses and Loss Expenses**

**The following table presents the components of the General Insurance gross reserve for losses and loss expenses (loss reserves) as of December 31, 2007 and 2006 by major lines of business on a statutory Annual Statement basis<sup>(a)</sup>:**

<i>(in millions)</i>	2007	2006 <sup>(b)</sup>
Other liability occurrence	\$20,580	\$19,327
Workers compensation	15,568	13,612
Other liability claims made	13,878	12,513
Auto liability	6,068	6,070
International	7,036	6,006
Property	4,274	5,499
Reinsurance	3,127	2,979
Medical malpractice	2,361	2,347
Products liability	2,416	2,239
Accident and health	1,818	1,693
Commercial multiple peril	1,900	1,651
Aircraft	1,623	1,629
Fidelity/surety	1,222	1,148
Mortgage Guaranty/Credit	1,426	567
Other	2,203	2,719
Total	\$85,500	\$79,999

*(a) Presented by lines of business pursuant to statutory reporting requirements as prescribed by the National Association of Insurance Commissioners.*

*(b) Allocations among various lines were revised based on the 2007 presentation.*

AIG's gross reserve for losses and loss expenses represents the accumulation of estimates of ultimate losses, including estimates for incurred but not yet reported reserves (IBNR) and loss expenses. The methods used to

determine loss reserve estimates and to establish the resulting reserves are continually reviewed and updated by management. Any adjustments resulting therefrom are reflected in operating income currently. Because loss reserve estimates are subject to the outcome of future events, changes in estimates are unavoidable given that loss trends vary and time is often required for changes in trends to be recognized and confirmed. Reserve changes that increase previous estimates of ultimate cost are referred to as unfavorable or adverse development or reserve strengthening. Reserve changes that decrease previous estimates of ultimate cost are referred to as favorable development.

Estimates for mortgage guaranty insurance losses and loss adjustment expense reserves are based on notices of mortgage loan delinquencies and estimates of delinquencies that have been incurred but have not been reported by loan servicers, based upon historical reporting trends. Mortgage Guaranty establishes reserves using a percentage of the contractual liability (for each delinquent loan reported) that is based upon past experience regarding certain loan factors such as age of the delinquency, dollar amount of the loan and type of mortgage loan. Because mortgage delinquencies and claims payments are affected primarily by macroeconomic events, such as changes in home price appreciation, interest rates and unemployment, the determination of the ultimate loss cost requires a high degree of judgment. AIG believes it has provided appropriate reserves for currently delinquent loans. Consistent with industry practice, AIG does not establish a reserve for loans that are not currently delinquent, but that may become delinquent in future periods.

At December 31, 2007, General Insurance net loss reserves increased \$6.66 billion from 2006 to \$69.29 billion. The net loss reserves represent loss reserves reduced by reinsurance recoverable, net of an allowance for unrecoverable reinsurance and applicable discount for future investment income.

**The following table classifies the components of the General Insurance net loss reserve by business unit as of December 31, 2007 and 2006:**

<i>(in millions)</i>	<b>2007</b>	2006
DBG <sup>(a)</sup>	<b>\$47,392</b>	\$44,119
Transatlantic	<b>6,900</b>	6,207
Personal Lines <sup>(b)</sup>	<b>2,417</b>	2,440
Mortgage Guaranty	<b>1,339</b>	460
Foreign General Insurance <sup>(c)</sup>	<b>11,240</b>	9,404
 Total Net Loss Reserve	 <b>\$69,288</b>	 \$62,630

*(a) At December 31, 2007 and 2006, respectively, DBG loss reserves include approximately \$3.13 billion and \$3.33 billion (\$3.34 billion and \$3.66 billion, respectively, before discount), related to business written by DBG but ceded to AIRCO and reported in AIRCO's statutory filings. DBG loss reserves also include approximately \$590 million and \$535 million related to business included in AIUO's statutory filings at December 31, 2007 and 2006, respectively.*

*(b) At December 31, 2007 and 2006, respectively, Personal Lines loss reserves include \$894 million and \$861 million related to business ceded to DBG and reported in DBG's statutory filings.*

*(c) At December 31, 2007 and 2006, respectively, Foreign General Insurance loss reserves include approximately \$3.02 billion and \$2.75 billion related to business reported in DBG's statutory filings.*

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The DBG net loss reserve of \$47.4 billion is comprised principally of the business of AIG subsidiaries participating in the American Home Assurance Company (American Home)/ National Union Fire Insurance Company of Pittsburgh, Pa. (National Union) pool (10 companies) and the surplus lines pool (Lexington, AIG Excess Liability Insurance Company and Landmark Insurance Company).

DBG cedes a quota share percentage of its other liability occurrence and products liability occurrence business to AIRCO. The quota share percentage ceded was 15 percent in 2007 and 20 percent in 2006 and covered all business written in these years for these lines by participants in the American Home/ National Union pool. AIRCO's loss reserves relating to these quota share cessions from DBG are recorded on a discounted basis. As of December 31, 2007, AIRCO carried a discount of approximately \$210 million applicable to the \$3.34 billion in undiscounted reserves it assumed from the American Home/ National Union pool via this quota share cession. AIRCO also carries approximately \$540 million in net loss reserves relating to Foreign General Insurance business. These reserves are carried on an undiscounted basis.

The companies participating in the American Home/ National Union pool have maintained a participation in the business written by AIU for decades. As of December 31, 2007, these AIU reserves carried by participants in the American Home/ National Union pool totaled approximately \$3.02 billion. The remaining Foreign General Insurance reserves are carried by AIUO, AIRCO, and other smaller AIG subsidiaries domiciled outside the United States. Statutory filings in the United States by AIG companies reflect all the business written by U.S. domiciled entities only, and therefore exclude business written by AIUO, AIRCO, and all other internationally domiciled subsidiaries. The total reserves carried at December 31, 2007 by AIUO and AIRCO were approximately \$5.16 billion and \$3.67 billion, respectively. AIRCO's \$3.67 billion in total general insurance reserves consist of approximately \$3.13 billion from business assumed from the American Home/ National Union pool and an additional \$540 million relating to Foreign General Insurance business.

**Discounting of Reserves**

At December 31, 2007, AIG's overall General Insurance net loss reserves reflect a loss reserve discount of \$2.43 billion, including tabular and non-tabular calculations. The tabular workers compensation discount is calculated using a 3.5 percent interest rate and the 1979-81 Decennial Mortality Table. The non-tabular workers compensation discount is calculated separately for companies domiciled in New York and Pennsylvania, and follows the statutory regulations for each state. For New York companies, the discount is based on a five percent interest rate and the companies' own payout patterns. For Pennsylvania companies, the statute has specified discount factors for accident years 2001 and prior, which are based on a six percent interest rate and an industry payout pattern. For accident years 2002 and subsequent, the discount is based on the yield of U.S. Treasury securities ranging from one to twenty years and the company's own payout pattern, with the future expected payment for each year using the interest rate associated with the corresponding Treasury security yield for that time period. The discount is comprised of the following: \$794 million tabular discount for workers compensation in DBG; \$1.42 billion non-tabular discount for workers compensation in DBG; and, \$210 million non-tabular discount for other liability occurrence and products liability occurrence in AIRCO. The total undiscounted workers compensation loss reserve carried by DBG is approximately \$13.3 billion as of December 31, 2007. The other liability occurrence and products liability occurrence business in AIRCO that is assumed from DBG is discounted based on the yield of U.S. Treasury securities ranging from one to twenty years and the DBG payout pattern for this business. The undiscounted reserves assumed by AIRCO from DBG totaled approximately \$3.34 billion at December 31, 2007.

**Results of the Reserving Process**

Management believes that the General Insurance net loss reserves are adequate to cover General Insurance net losses and loss expenses as of December 31, 2007. While AIG regularly reviews the adequacy of established loss reserves, there can be no assurance that AIG's ultimate loss reserves will not develop adversely and materially exceed AIG's loss reserves as of December 31, 2007. In the opinion of management, such adverse development and resulting increase in



reserves is not likely to have a material adverse effect on AIG's consolidated financial condition, although it could have a material adverse effect on AIG's consolidated results of operations for an individual reporting period. See also Item 1A. Risk Factors - Casualty Insurance and Underwriting Reserves.

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**The following table presents the reconciliation of net loss reserves for 2007, 2006 and 2005 as follows:**

<i>(in millions)</i>	2007	2006	2005
Net reserve for losses and loss expenses at beginning of year	\$62,630	\$57,476	\$ 47,254
Foreign exchange effect	955	741	(628)
Acquisitions <sup>(a)</sup>	317	55	
Losses and loss expenses incurred:			
Current year	30,261	27,805	28,426
Prior years, other than accretion of discount	(656)	(53)	4,680 <sup>(b)</sup>
Prior years, accretion of discount	327	300	(15)
Losses and loss expenses incurred	29,932	28,052	33,091
Losses and loss expenses paid:			
Current year	9,684	8,368	7,331
Prior years	14,862	15,326	14,910
Losses and loss expenses paid	24,546	23,694	22,241
Net reserve for losses and loss expenses at end of year	\$69,288	\$62,630	\$ 57,476

*(a) Reflects the opening balance with respect to the acquisitions of WüBa and the Central Insurance Co., Ltd. in 2007 and 2006, respectively.*

*(b) Includes fourth quarter charge of \$1.8 billion.*

**The following tables summarize development, (favorable) or unfavorable, of incurred losses and loss expenses for prior years (other than accretion of discount):**

<i>(in millions)</i>	2007	2006	2005
Prior Accident Year Development by Reporting Unit:			
DBG	\$(390)	\$ 175	\$4,878
Personal Lines	7	(111)	14
UGC	(25)	(115)	(103)
Foreign General Insurance	(286)	(183)	(378)
Sub total	(694)	(234)	4,411
Transatlantic	88	181	269
Asbestos settlements*	(50)		
Prior years, other than accretion of discount	\$(656)	\$ (53)	\$4,680

\* Represents the effect of settlements of certain asbestos liabilities.

(in millions)	2007	2006	2005
<b>Prior Accident Year Development by Major Class of Business:</b>			
Excess casualty (DBG)	\$ 73	\$ 102	\$1,191
D&O and related management liability (DBG)	(305)	(20)	1,627
Excess workers compensation (DBG)	(14)	74	983
Reinsurance (Transatlantic)	88	181	269
Asbestos and environmental (primarily DBG)	18	208	930
All other, net	(516)	(598)	(320)
Prior years, other than accretion of discount	\$ (656)	\$ (53)	\$4,680

Accident Year (in millions)	Calendar Year		
	2007	2006	2005
<b>Prior Accident Year Development by Accident Year:</b>			
2006	\$ (1,248)		
2005	(446)	\$ (1,576)	
2004	(428)	(511)	\$ (3,853)
2003	37	(212)	(63)
2002	234	373	1,360
2001	263	29	1,749
2000	321	338	1,323
1999	47	382	944
1998	154	41	605
1997 & Prior	410	1,083	2,615
Prior years, other than accretion of discount	\$ (656)	\$ (53)	\$ 4,680

In determining the loss development from prior accident years, AIG conducts analyses to determine the change in estimated ultimate loss for each accident year for each profit center. For example, if loss emergence for a profit center is different than expected for certain accident years, the actuaries examine the indicated effect such emergence would have on the reserves of that profit center. In some cases, the higher or lower than expected emergence may result in no clear change in the ultimate loss estimate for the accident years in question, and no adjustment would be made to the profit center's reserves for prior accident years. In other cases, the higher or lower than expected emergence may result in a larger change, either favorable or unfavorable, than the difference between the actual and expected loss emergence. Such additional analyses were conducted for each profit center, as appropriate, in 2007 to determine the loss development from prior accident years for 2007. As part of its reserving process, AIG also considers notices of claims received with respect to emerging issues, such as those related to the U.S. mortgage and housing market.

The loss ratios recorded by AIG in 2006 took into account the results of the comprehensive reserve reviews that were completed in the fourth quarter of 2005. AIG's year-end 2005 reserve review reflected careful consideration of the reserve analyses prepared by AIG's internal actuarial staff with the assistance of third-party



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actuaries. In determining the appropriate loss ratios for accident year 2006 for each class of business, AIG gave consideration to the loss ratios resulting from the 2005 reserve analyses as well as all other relevant information including rate changes, expected changes in loss costs, changes in coverage, reinsurance or mix of business, and other factors that may affect the loss ratios.

**2007 Net Loss Development**

In 2007, net loss development from prior accident years was favorable by approximately \$656 million, including approximately \$88 million of adverse development from Transatlantic; and excluding approximately \$327 million from accretion of loss reserve discount. Excluding Transatlantic, as well as accretion of discount, net loss development in 2007 from prior accident years was favorable by approximately \$744 million. The overall favorable development of \$656 million consisted of approximately \$2.12 billion of favorable development from accident years 2004 through 2006, partially offset by approximately \$1.43 billion of adverse development from accident years 2002 and prior and \$37 million of adverse development from accident year 2003. In 2007, most classes of AIG's business continued to experience favorable development for accident years 2004 through 2006. The majority of the adverse development from accident years 2002 and prior was related to development from excess casualty and primary workers compensation business within DBG and from Transatlantic. The development from accident year 2003 was primarily related to adverse development from excess casualty and primary workers compensation business within DBG offset by favorable development from most other classes of business. The overall favorable development of \$656 million includes approximately \$305 million pertaining to the D&O and related management liability classes of business within DBG, consisting of approximately \$335 million of favorable development from accident years 2003 through 2006, partially offset by approximately \$30 million of adverse development from accident years 2002 and prior. The overall favorable development of \$656 million also includes approximately \$300 million of adverse development from primary workers compensation business within DBG. See Volatility of Reserve Estimates and Sensitivity Analyses below.

**2006 Net Loss Development**

In 2006, net loss development from prior accident years was favorable by approximately \$53 million, including approximately \$198 million in net adverse development from asbestos and environmental reserves resulting from the updated ground up analysis of these exposures in the fourth quarter of 2006; approximately \$103 million of adverse development pertaining to the major hurricanes in 2004 and 2005; and \$181 million of adverse development from Transatlantic; and excluding approximately \$300 million from accretion of loss reserve discount. Excluding the fourth quarter asbestos and environmental reserve increase, catastrophes and Transatlantic, as well as accretion of discount, net loss development in 2006 from prior accident years was favorable by approximately \$535 million. The overall favorable development of \$53 million consisted of approximately \$2.30 billion of favorable development from accident years 2003 through 2005, partially offset by approximately \$2.25 billion of adverse development from accident years 2002 and prior. In 2006, most classes of AIG's business continued to experience favorable development for accident years 2003 through 2005. The adverse development from accident years 2002 and prior reflected development from excess casualty, workers compensation, excess workers compensation, and post-1986 environmental liability classes of business, all within DBG, from asbestos reserves within DBG and Foreign General Insurance, and from Transatlantic.

**2005 Net Loss Development**

In 2005, net loss development from prior accident years was adverse by approximately \$4.68 billion, including approximately \$269 million from Transatlantic. This \$4.68 billion adverse development in 2005 was comprised of approximately \$8.60 billion for the 2002 and prior accident years, partially offset by favorable development for accident years 2003 and 2004 for most classes of business, with the notable exception of D&O. The adverse loss development for 2002 and prior accident years was attributable to approximately \$4.0 billion of development from the D&O and related management liability classes of business, excess casualty, and excess workers compensation, and to

approximately \$900 million of adverse development from asbestos and environmental claims. The remaining portion of the adverse development from 2002 and prior accident years included approximately \$520 million related to Transatlantic with the balance spread across many other classes of business. Most classes of business produced favorable development for accident years 2003 and 2004, and adverse development for accident years 2001 and prior.

**Net Loss Development by Class of Business**

The following is a discussion of the primary reasons for the development in 2007, 2006 and 2005 for those classes of business that experienced significant prior accident year developments during the three-year period. See Asbestos and Environmental Reserves below for a further discussion of asbestos and environmental reserves and developments.

*Excess Casualty:* Excess Casualty reserves experienced significant adverse loss development in 2005, but there was only a relatively minor amount of adverse development in 2006 and 2007. The adverse development for all periods shown related principally to accident years 2002 and prior, and resulted from significant loss cost increases due to both frequency and severity of claims. The increase in loss costs resulted primarily from medical inflation, which increased the economic loss component of tort claims, advances in medical care, which extended the life span of severely injured claimants, and larger jury verdicts, which increased the value of severe tort claims. An additional factor affecting AIG's excess casualty experience in recent years has been the accelerated exhaustion of underlying primary policies for homebuilders. This has led to increased construction defect-related claims activity on AIG's excess policies. Many excess casualty policies were written on a multi-year basis in the late

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1990s, which limited AIG's ability to respond to emerging market trends as rapidly as would otherwise be the case. In subsequent years, AIG responded to these emerging trends by increasing rates and implementing numerous policy form and coverage changes. This led to a significant improvement in experience beginning with accident year 2001. In 2007, a significant portion of the adverse development from accident years 2002 and prior also related to other latent exposures, including pharmaceutical and product aggregate-related exposures as well as the construction defect exposures noted above. AIG's exposure to these latent exposures was sharply reduced after 2002 due to significant changes in policy terms and conditions as well as underwriting guidelines.

For the year-end 2005 loss reserve review, AIG's actuaries responded to the continuing adverse development by further increasing the loss development factors applicable to accident years 1999 and subsequent by approximately 5 percent. In addition, to more accurately estimate losses for construction defect-related claims, a separate review was performed by AIG claims staff for accounts with significant exposure to these claims.

For the year-end 2006 loss reserve review, AIG claims staff updated the separate review for accounts with significant exposure to construction defect-related claims in order to assist the actuaries in determining the proper reserve for this exposure. AIG's actuaries determined that no significant changes in the assumptions were required. Prior accident year loss development in 2006 was adverse by approximately \$100 million, a relatively minor amount for this class of business. However, AIG continued to experience adverse development for this class for accident years prior to 2003.

For the year-end 2007 loss reserve review, AIG claims staff updated its review of accounts with significant exposure to construction defect-related claims. AIG's actuaries determined that no significant changes in the assumptions were required. Prior accident year loss developments in 2007 were adverse by approximately \$75 million, a minor amount for this class of business. However, AIG continued to experience adverse development in this class for accident years 2002 and prior, amounting to approximately \$450 million in 2007. In addition, loss reserves developed adversely for accident year 2003 by approximately \$100 million in 2007 for this class. The loss ratio for accident year 2003 remains very favorable for this class and has been relatively stable over the past several years. Favorable developments in 2007 for accident years 2004 through 2006 largely offset the adverse developments from accident years 2003 and prior. A significant portion of the adverse development from accident years 2002 and prior related to the latent exposures described above.

Loss reserves pertaining to the excess casualty class of business are generally included in the other liability occurrence line of business, with a small portion of the excess casualty reserves included in the other liability claims made line of business, as presented in the table above.

*D&O and Related Management Liability Classes of Business:* These classes of business experienced significant adverse development in 2005, but experienced slightly favorable development in 2006 and more significantly favorable development in 2007. The adverse development in 2005 related principally to accident years 2002 and prior. This adverse development resulted from significant loss cost escalation due to a variety of factors, including the following: the increase in frequency and severity of corporate bankruptcies; the increase in frequency of financial statement restatements; the sharp rise in market capitalization of publicly traded companies; and the increase in the number of initial public offerings, which led to an unprecedented number of IPO allocation/laddering suits in 2001. In addition, extensive utilization of multi-year policies during this period limited AIG's ability to respond to emerging trends as rapidly as would otherwise be the case. AIG experienced significant adverse loss development during the period 2002 through 2005 as a result of these issues. AIG responded to this development with rate increases and policy form and coverage changes to better contain future loss costs in this class of business.

For the year-end 2005 loss reserve review, AIG's actuaries responded to the continuing adverse development by further increasing the loss development factor assumptions. The loss development factors applicable to 1997 and subsequent accident years were increased by approximately 4 percent. In addition, AIG's actuaries began to give greater weight to loss development methods for accident years 2002 and 2003, in order to more fully respond to the recent loss experience. AIG's claims staff also conducted a series of ground-up claim projections covering all open claims for this business through accident year 2004. AIG's actuaries benchmarked the loss reserve indications for all

accident years through 2004 to these claim projections.

For the year-end 2006 loss reserve review, AIG's actuaries determined that no significant changes in the assumptions were required. Prior accident year loss development in 2006 was favorable by approximately \$20 million, an insignificant amount for these classes. AIG's actuaries continued to benchmark the loss reserve indications to the ground-up claim projections provided by AIG claims staff for this class of business. For the year-end 2006 loss reserve review, the ground-up claim projections included all accident years through 2005.

For the year-end 2007 loss reserve review, AIG's actuaries determined that no significant changes in the assumptions were required. Prior accident year reserve development in 2007 was favorable by approximately \$305 million, due primarily to favorable development from accident years 2004 and 2005, and to a lesser extent 2003 and 2006. AIG's actuaries continued to benchmark the loss reserve indications to the ground-up claim projections provided by AIG claims staff for this class of business. For the year-end 2007 loss reserve review, the ground-up claim projections included all accident years through 2006, and included stock options backdating-related exposures from accident year 2006. Accident year 2006 reserves developed favorably notwithstanding the effect of claims relating to stock options backdating, which totaled approximately \$300 million. Further, AIG is closely monitoring claims activity in accident year 2007 relating to the U.S. residential mortgage market, consistent with the manner in which claims relating to stock options backdating were monitored



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in 2006, and believes that its reserves as of December 31, 2007 are adequate for its D&O and related management liability classes of business.

Loss reserves pertaining to D&O and related management liability classes of business are included in the other liability claims made line of business, as presented in the table above.

*Excess Workers Compensation:* This class of business experienced significant adverse development in 2005, a relatively minor amount of adverse development in 2006, and a minor amount of favorable development in 2007. The adverse development in 2005 related to 2002 and prior accident years. This adverse development resulted primarily from significant loss cost increases, primarily attributable to rapidly increasing medical inflation and advances in medical care, which increased the cost of covered medical care and extended the life span of severely injured workers. The effect of these factors on excess workers compensation claims experience is leveraged, as frequency is increased by the rising number of claims that reach the excess layers.

In response to the significantly adverse loss development in 2005, an additional study was conducted for the 2005 year-end actuarial reserve analysis for DBG pertaining to the selection of loss development factors for this class of business. Claims for excess workers compensation exhibit an exceptionally long-tail of loss development, running for decades from the date the loss is incurred. Thus, the adequacy of loss reserves for this class is sensitive to the estimated loss development factors, as such factors may be applied to many years of loss experience. In order to better estimate the tail development for this class, AIG claims staff conducted a claim-by-claim projection of the expected ultimate paid loss for each open claim for 1998 and prior accident years as these are the primary years from which the tail factors are derived. The objective of the study was to provide a benchmark against which loss development factors in the tail could be evaluated. The resulting loss development factors utilized by the actuaries in the year-end 2005 study reflected an increase of approximately 18 percent from the factors used in the prior year study without the benefit of the claims benchmark. In addition, the loss cost trend assumption for excess workers compensation was increased from approximately 2.5 percent to 6 percent for the 2005 study.

For the year-end 2006 loss reserve review, AIG claims staff updated the claim-by-claim projection for each open claim for accident years 1999 and prior. These updated claims projections were utilized by the actuaries as a benchmark for loss development factors in the year-end 2006 study. AIG's actuaries determined that no significant changes in the assumptions were required. Prior accident year development in 2006 was adverse by approximately \$70 million, a relatively minor amount for this class.

For the year-end 2007 loss reserve review, AIG claims staff again updated the claim-by-claim projection for each open claim for accident years 2000 and prior. These updated claims projections were utilized by the actuaries as a benchmark for loss development factors in the year-end 2007 study. AIG's actuaries determined that no significant changes in the assumptions were required. Prior accident year development in 2007 was favorable by approximately \$15 million, an insignificant amount for this class.

**Overview of Loss Reserving Process**

The General Insurance loss reserves can generally be categorized into two distinct groups. One group is short-tail classes of business consisting principally of property, personal lines and certain casualty classes. The other group is long-tail casualty classes of business which includes excess and umbrella liability, D&O, professional liability, medical malpractice, workers compensation, general liability, products liability, and related classes.

**Short-Tail Reserves**

For operations writing short-tail coverages, such as property coverages, the process of recording quarterly loss reserves is generally geared toward maintaining an appropriate reserve for the outstanding exposure, rather than determining an expected loss ratio for current business. For example, the IBNR reserve required for a class of property business might be expected to approximate 20 percent of the latest year's earned premiums, and this level of reserve would generally be maintained regardless of the loss ratio emerging in the current quarter. The 20 percent factor would be adjusted to reflect changes in rate levels, loss reporting patterns, known exposure to unreported losses, or

other factors affecting the particular class of business.

#### Long-Tail Reserves

Estimation of ultimate net losses and loss expenses (net losses) for long-tail casualty classes of business is a complex process and depends on a number of factors, including the class and volume of business involved. Experience in the more recent accident years of long-tail casualty classes of business shows limited statistical credibility in reported net losses because a relatively low proportion of net losses would be reported claims and expenses and an even smaller percentage would be net losses paid. Therefore, IBNR would constitute a relatively high proportion of net losses.

AIG's carried net long-tail loss reserves are tested using loss trend factors that AIG considers appropriate for each class of business. A variety of actuarial methods and assumptions is normally employed to estimate net losses for long-tail casualty classes of businesses. These methods ordinarily involve the use of loss trend factors intended to reflect the annual growth in loss costs from one accident year to the next. For the majority of long-tail casualty classes of business, net loss trend factors approximated five percent. Loss trend factors reflect many items including changes in claims handling, exposure and policy forms, current and future estimates of monetary inflation and social inflation and increases in litigation and awards. These factors are periodically reviewed and adjusted, as appropriate, to reflect emerging trends which are based upon past loss experience. Thus, many factors are implicitly considered in estimating the year to year growth in loss costs.

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A number of actuarial assumptions are generally made in the review of reserves for each class of business. For longer tail classes of business, actuarial assumptions generally are made with respect to the following:

Loss trend factors which are used to establish expected loss ratios for subsequent accident years based on the projected loss ratio for prior accident years.

Expected loss ratios for the latest accident year (i.e., accident year 2007 for the year-end 2007 loss reserve analysis) and, in some cases for accident years prior to the latest accident year. The expected loss ratio generally reflects the projected loss ratio from prior accident years, adjusted for the loss trend (see above) and the effect of rate changes and other quantifiable factors on the loss ratio. For low-frequency, high-severity classes such as excess casualty, expected loss ratios generally are used for at least the three most recent accident years.

Loss development factors which are used to project the reported losses for each accident year to an ultimate basis. Generally, the actual loss development factors observed from prior accident years would be used as a basis to determine the loss development factors for the subsequent accident years.

AIG records quarterly changes in loss reserves for each of its many General Insurance classes of business. The overall change in AIG's loss reserves is based on the sum of these classes of business changes. For most long-tail classes of business, the process of recording quarterly loss reserve changes involves determining the estimated current loss ratio for each class of coverage. This loss ratio is multiplied by the current quarter's net earned premium for that class of coverage to determine the current accident quarter's total estimated net incurred loss and loss expense. The change in loss reserves for the quarter for each class is thus the difference between the net incurred loss and loss expense, estimated as described above, and the net paid losses and loss expenses in the quarter. Also any change in estimated ultimate losses from prior accident years, either positive or negative, is reflected in the loss reserve for the current quarter.

### **Details of the Loss Reserving Process**

The process of determining the current loss ratio for each class of business is based on a variety of factors. These include, but are not limited to, the following considerations: prior accident year and policy year loss ratios; rate changes; changes in coverage, reinsurance, or mix of business; and actual and anticipated changes in external factors affecting results, such as trends in loss costs or in the legal and claims environment. The current loss ratio for each class of business reflects input from actuarial, underwriting and claims staff and is intended to represent management's best estimate of the current loss ratio after reflecting all of the factors described above. At the close of each quarter, the assumptions underlying the loss ratios are reviewed to determine if the loss ratios based thereon remain appropriate. This process includes a review of the actual claims experience in the quarter, actual rate changes achieved, actual changes in coverage, reinsurance or mix of business, and changes in certain other factors that may affect the loss ratio. When this review suggests that the initially determined loss ratio is no longer appropriate, the loss ratio for current business is changed to reflect the revised assumptions.

A comprehensive annual loss reserve review is completed in the fourth quarter of each year for each AIG general insurance subsidiary. These reviews are conducted in full detail for each class of business for each subsidiary, and thus consist of hundreds of individual analyses. The purpose of these reviews is to confirm the appropriateness of the reserves carried by each of the individual subsidiaries, and therefore of AIG's overall carried reserves. The reserve analysis for each class of business is performed by the actuarial personnel who are most familiar with that class of business. In completing these detailed actuarial reserve analyses, the actuaries are required to make numerous assumptions, including the selection of loss development factors and loss cost trend factors. They are also required to determine and select the most appropriate actuarial methods to employ for each business class. Additionally, they must determine the appropriate segmentation of data from which the adequacy of the reserves can be most accurately tested. In the course of these detailed reserve reviews a point estimate of the loss reserve is determined. The sum of these point estimates for each class of business for each subsidiary provides an overall actuarial point estimate of the loss reserve for that subsidiary. The ultimate process by which the actual carried reserves are determined considers both the actuarial point estimate and numerous other internal and external factors including a qualitative assessment of

inflation and other economic conditions in the United States and abroad, changes in the legal, regulatory, judicial and social environment, underlying policy pricing, terms and conditions, and claims handling. Loss reserve development can also be affected by commutations of assumed and ceded reinsurance agreements.

#### Actuarial Methods for Major Classes of Business

In testing the reserves for each class of business, a determination is made by AIG's actuaries as to the most appropriate actuarial methods. This determination is based on a variety of factors including the nature of the claims associated with the class of business, such as frequency or severity. Other factors considered include the loss development characteristics associated with the claims, the volume of claim data available for the applicable class, and the applicability of various actuarial methods to the class. In addition to determining the actuarial methods, the actuaries determine the appropriate loss reserve groupings of data. For example, AIG writes a great number of unique subclasses of professional liability. For pricing or other purposes, it is appropriate to evaluate the profitability of each subclass individually. However, for purposes of estimating the loss reserves for professional liability, it is appropriate to combine the subclasses into larger groups. The greater degree of credibility in the claims experience of the larger groups may outweigh the greater degree of homogeneity of the individual subclasses. This determination of data segmentation and actuarial methods is carefully considered for each class of business. The segmentation and actuarial methods chosen are those which together are expected to produce the most accurate estimate of the loss reserves.

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Actuarial methods used by AIG for most long-tail casualty classes of business include loss development methods and expected loss ratio methods, including Bornhuetter Ferguson methods described below. Other methods considered include frequency/severity methods, although these are generally used by AIG more for pricing analysis than for loss reserve analysis. Loss development methods utilize the actual loss development patterns from prior accident years to project the reported losses to an ultimate basis for subsequent accident years. Loss development methods generally are most appropriate for classes of business which exhibit a stable pattern of loss development from one accident year to the next, and for which the components of the classes have similar development characteristics. For example, property exposures would generally not be combined into the same class as casualty exposures, and primary casualty exposures would generally not be combined into the same class as excess casualty exposures. Expected loss ratio methods are generally utilized by AIG where the reported loss data lacks sufficient credibility to utilize loss development methods, such as for new classes of business or for long-tail classes at early stages of loss development.

Expected loss ratio methods rely on the application of an expected loss ratio to the earned premium for the class of business to determine the loss reserves. For example, an expected loss ratio of 70 percent applied to an earned premium base of \$10 million for a class of business would generate an ultimate loss estimate of \$7 million. Subtracting any reported paid losses and loss expense would result in the indicated loss reserve for this class.

Bornhuetter Ferguson methods are expected loss ratio methods for which the expected loss ratio is applied only to the expected unreported portion of the losses. For example, for a long-tail class of business for which only 10 percent of the losses are expected to be reported at the end of the accident year, the expected loss ratio would be applied to the 90 percent of the losses still unreported. The actual reported losses at the end of the accident year would be added to determine the total ultimate loss estimate for the accident year. Subtracting the reported paid losses and loss expenses would result in the indicated loss reserve. In the example above, the expected loss ratio of 70 percent would be multiplied by 90 percent. The result of 63 percent would be applied to the earned premium of \$10 million resulting in an estimated unreported loss of \$6.3 million. Actual reported losses would be added to arrive at the total ultimate losses. If the reported losses were \$1 million, the ultimate loss estimate under the Bornhuetter Ferguson method would be \$7.3 million versus the \$7 million amount under the expected loss ratio method described above. Thus, the

Bornhuetter Ferguson method gives partial credibility to the actual loss experience to date for the class of business. Loss development methods generally give full credibility to the reported loss experience to date. In the example above, loss development methods would typically indicate an ultimate loss estimate of \$10 million, as the reported losses of \$1 million would be estimated to reflect only 10 percent of the ultimate losses.

A key advantage of loss development methods is that they respond quickly to any actual changes in loss costs for the class of business. Therefore, if loss experience is unexpectedly deteriorating or improving, the loss development method gives full credibility to the changing experience. Expected loss ratio methods would be slower to respond to the change, as they would continue to give more weight to the expected loss ratio, until enough evidence emerged for the expected loss ratio to be modified to reflect the changing loss experience. On the other hand, loss development methods have the disadvantage of overreacting to changes in reported losses if in fact the loss experience is not credible. For example, the presence or absence of large losses at the early stages of loss development could cause the loss development method to overreact to the favorable or unfavorable experience by assuming it will continue at later stages of development. In these instances, expected loss ratio methods such as Bornhuetter Ferguson have the advantage of properly recognizing large losses without extrapolating unusual large loss activity onto the unreported portion of the losses for the accident year. AIG's loss reserve reviews for long-tail classes typically utilize a combination of both loss development and expected loss ratio methods. Loss development methods are generally given more weight for accident years and classes of business where the loss experience is highly credible. Expected loss ratio methods are given more weight where the reported loss experience is less credible, or is driven more by large losses. Expected loss ratio methods require sufficient information to determine the appropriate expected loss ratio. This information generally includes the actual loss ratios for prior accident years, and rate changes as well as

underwriting or other changes which would affect the loss ratio. Further, an estimate of the loss cost trend or loss ratio trend is required in order to allow for the effect of inflation and other factors which may increase or otherwise change the loss costs from one accident year to the next.

Frequency/severity methods generally rely on the determination of an ultimate number of claims and an average severity for each claim for each accident year. Multiplying the estimated ultimate number of claims for each accident year by the expected average severity of each claim produces the estimated ultimate loss for the accident year. Frequency/severity methods generally require a sufficient volume of claims in order for the average severity to be predictable. Average severity for subsequent accident years is generally determined by applying an estimated annual loss cost trend to the estimated average claim severity from prior accident years. Frequency/severity methods have the advantage that ultimate claim counts can generally be estimated more quickly and accurately than can ultimate losses. Thus, if the average claim severity can be accurately estimated, these methods can more quickly respond to changes in loss experience than other methods. However, for average severity to be predictable, the class of business must consist of homogeneous types of claims for which loss severity trends from one year to the next are reasonably consistent. Generally these methods work best for high frequency, low severity classes of business such as personal auto. AIG also utilizes these methods in pricing subclasses of professional liability. However, AIG does not generally utilize

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frequency/severity methods to test loss reserves, due to the general nature of AIG's reserves being applicable to lower frequency, higher severity commercial classes of business where average claim severity is volatile.

*Excess Casualty:* AIG generally uses a combination of loss development methods and expected loss ratio methods for excess casualty classes. Expected loss ratio methods are generally utilized for at least the three latest accident years, due to the relatively low credibility of the reported losses. The loss experience is generally reviewed separately for lead umbrella classes and for other excess classes, due to the relatively shorter tail for lead umbrella business.

Automobile-related claims are generally reviewed separately from non-auto claims, due to the shorter tail nature of the automobile related claims. The expected loss ratios utilized for recent accident years are based on the projected ultimate loss ratios of prior years, adjusted for rate changes, estimated loss cost trends and all other changes that can be quantified. The estimated loss cost trend utilized in the year-end 2007 reviews averaged approximately five percent for excess casualty classes. Frequency/severity methods are generally not utilized as the vast majority of reported claims do not result in a claim payment. In addition, the average severity varies significantly from accident year to accident year due to large losses which characterize this class of business, as well as changing proportions of claims which do not result in a claim payment.

*D&O:* AIG generally utilizes a combination of loss development methods and expected loss ratio methods for D&O and related management liability classes of business. Expected loss ratio methods are given more weight in the two most recent accident years, whereas loss development methods are given more weight in more mature accident years. Beginning with the year-end 2005 loss reserve review, AIG's actuaries began to utilize claim projections provided by AIG claims staff as a benchmark for determining the indicated ultimate losses for accident years 2004 and prior. For the year end 2007 loss reserve review, claims projections for accident years 2006 and prior were utilized. In prior years, AIG's actuaries had utilized these claims projections as a benchmark for profitability studies for major classes of D&O and related management liability business. The track record of these claims projections has indicated a very low margin of error, thus providing support for their usage as a benchmark in determining the estimated loss reserve. These classes of business reflect claims made coverage, and losses are characterized by low frequency and high severity. Thus, the claim projections can produce an accurate overall indicator of the ultimate loss exposure for these classes by identifying and estimating all large losses. Frequency/severity methods are generally not utilized for these classes as the overall losses are driven by large losses more than by claim frequency. Severity trends have varied significantly from accident year to accident year.

*Workers Compensation:* AIG generally utilizes loss development methods for all but the most recent accident year. Expected loss ratio methods generally are given significant weight only in the most recent accident year. Workers compensation claims are generally characterized by high frequency, low severity, and relatively consistent loss development from one accident year to the next. AIG is a leading writer of workers compensation, and thus has sufficient volume of claims experience to utilize development methods. AIG does not believe frequency/severity methods are as appropriate, due to significant growth and changes in AIG's workers compensation business over the years. AIG generally segregates California business from other business in evaluating workers compensation reserves. Certain classes of workers compensation, such as construction, are also evaluated separately. Additionally, AIG writes a number of very large accounts which include workers compensation coverage. These accounts are generally priced by AIG actuaries, and to the extent appropriate, the indicated losses based on the pricing analysis may be utilized to record the initial estimated loss reserves for these accounts.

*Excess Workers Compensation:* AIG generally utilizes a combination of loss development methods and expected loss ratio methods. Loss development methods are given the greater weight for mature accident years such as 2001 and prior. Expected loss ratio methods are given the greater weight for the more recent accident years. Excess workers compensation is an extremely long-tail class of business, with loss emergence extending for decades. Therefore there is limited credibility in the reported losses for many of the more recent accident years. Beginning with the year-end 2005 loss reserve review, AIG's actuaries began to utilize claims projections provided by AIG claims staff to help determine the loss development factors for this class of business.

*General Liability:* AIG generally uses a combination of loss development methods and expected loss ratio methods for primary general liability or products liability classes. For certain classes of business with sufficient loss volume, loss development methods may be given significant weight for all but the most recent one or two accident years, whereas for smaller or more volatile classes of business, loss development methods may be given limited weight for the five or more most recent accident years. Expected loss ratio methods would be utilized for the more recent accident years for these classes. The loss experience for primary general liability business is generally reviewed at a level that is believed to provide the most appropriate data for reserve analysis. For example, primary claims made business is generally segregated from business written on an occurrence policy form. Additionally, certain subclasses, such as construction, are generally reviewed separately from business in other subclasses. Due to the fairly long-tail nature of general liability business, and the many subclasses that are reviewed individually, there is less credibility in the reported losses and increased reliance on expected loss ratio methods. AIG's actuaries generally do not utilize frequency/severity methods to test reserves for this business, due to significant changes and growth in AIG's general liability and products liability business over the years.

*Commercial Automobile Liability:* AIG generally utilizes loss development methods for all but the most recent accident year for commercial automobile classes of business. Expected loss ratio methods are generally given significant weight only in the most recent accident year. Frequency/severity methods are generally



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not utilized due to significant changes and growth in this business over the years.

*Healthcare:* AIG generally uses a combination of loss development methods and expected loss ratio methods for healthcare classes of business. The largest component of the healthcare business consists of coverage written for hospitals and other healthcare facilities. Reserves for excess coverage are tested separately from those for primary coverage. For primary coverages, loss development methods are generally given the majority of the weight for all but the latest three accident years, and are given some weight for all years other than the latest accident year. For excess coverages, expected loss methods are generally given all the weight for the latest three accident years, and are also given considerable weight for accident years prior to the latest three years. For other classes of healthcare coverage, an analogous weighting between loss development and expected loss ratio methods is utilized. The weights assigned to each method are those which are believed to result in the best combination of responsiveness and stability.

Frequency/severity methods are sometimes utilized for pricing certain healthcare accounts or business. However, in testing loss reserves the business is generally combined into larger groupings to enhance the credibility of the loss experience. The frequency/severity methods that are applicable in pricing may not be appropriate for reserve testing and thus frequency/severity methods are not generally employed in AIG's healthcare reserve analyses.

*Professional Liability:* AIG generally uses a combination of loss development methods and expected loss ratio methods for professional liability classes of business. Loss development methods are used for the more mature accident years. Greater weight is given to expected loss ratio methods in the more recent accident years. Reserves are tested separately for claims made classes and classes written on occurrence policy forms. Further segmentations are made in a manner believed to provide an appropriate balance between credibility and homogeneity of the data. Frequency/severity methods are used in pricing and profitability analyses for some classes of professional liability; however, for loss reserve testing, the need to enhance credibility generally results in classes that are not sufficiently homogenous to utilize frequency/severity methods.

*Catastrophic Casualty:* AIG utilizes expected loss ratio methods for all accident years for catastrophic casualty business. This class of business consists of casualty or financial lines coverage which attaches in excess of very high attachment points; thus the claims experience is marked by very low frequency and high severity. Because of the limited number of claims, loss development methods are not utilized. The expected loss ratios and loss development assumptions utilized are based upon the results of prior accident years for this business as well as for similar classes of business written above lower attachment points. The business is generally written on a claims made basis. AIG utilizes ground-up claim projections provided by AIG claims staff to assist in developing the appropriate reserve.

*Aviation:* AIG generally uses a combination of loss development methods and expected loss ratio methods for aviation exposures. Aviation claims are not very long-tail in nature; however, they are driven by claim severity. Thus a combination of both development and expected loss ratio methods are used for all but the latest accident year to determine the loss reserves. Expected loss ratio methods are used to determine the loss reserves for the latest accident year. Frequency/severity methods are not employed due to the high severity nature of the claims and different mix of claims from year to year.

*Personal Auto (Domestic):* AIG generally utilizes frequency/severity methods and loss development methods for domestic personal auto classes. For many classes of business, greater reliance is placed on frequency/severity methods as claim counts emerge quickly for personal auto and allow for more immediate analysis of resulting loss trends and comparisons to industry and other diagnostic metrics.

*Fidelity/Surety:* AIG generally uses loss development methods for fidelity exposures for all but the latest accident year. Expected loss ratio methods are also given weight for the more recent accident years, and for the latest accident year they may be given 100 percent weight. For surety exposures, AIG generally uses the same method as for short-tail classes.

*Mortgage Guaranty:* AIG tests mortgage guaranty reserves using loss development methods, supplemented by an internal claim analysis by actuaries and staff who specialize in the mortgage guaranty business. The claim analysis

projects ultimate losses for claims within each of several categories of delinquency based on actual historical experience and is essentially a frequency/severity analysis for each category of delinquency. Additional reserve tests using Bornhuetter Ferguson methods are also employed, as well as tests measuring losses as a percent of risk in force. Reserves are reviewed separately for each class of business to consider the loss development characteristics associated with the claims, the volume of claim data available for the applicable class and the applicability of various actuarial methods to the class.

*Short-Tail Classes:* AIG generally uses either loss development methods or IBNR factor methods to set reserves for short-tail classes such as property coverages. Where a factor is used, it generally represents a percent of earned premium or other exposure measure. The factor is determined based on prior accident year experience. For example, the IBNR for a class of property coverage might be expected to approximate 20 percent of the latest year's earned premium. The factor is continually reevaluated in light of emerging claim experience as well as rate changes or other factors that could affect the adequacy of the IBNR factor being employed.

*International:* Business written by AIG's Foreign General Insurance sub-segment includes both long-tail and short-tail classes of business. For long-tail classes of business, the actuarial methods utilized would be analogous to those described above. However, the majority of business written by Foreign General Insurance is short-tail, high frequency and low severity in nature. For this business, loss development methods are generally employed to

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test the loss reserves. AIG maintains a data base of detailed historical premium and loss transactions in original currency for business written by Foreign General Insurance, thereby allowing AIG actuaries to determine the current reserves without any distortion from changes in exchange rates over time. In testing the Foreign General Insurance reserves, AIG's actuaries segment the data by region, country or class of business as appropriate to determine an optimal balance between homogeneity and credibility.

*Loss Adjustment Expenses:* AIG determines reserves for legal defense and cost containment loss adjustment expenses for each class of business by one or more actuarial methods. The methods generally include development methods analogous to those described for loss development methods. The developments could be based on either the paid loss adjustment expenses or the ratio of paid loss adjustment expenses to paid losses, or both. Other methods include the utilization of expected ultimate ratios of paid loss expense to paid losses, based on actual experience from prior accident years or from similar classes of business. AIG generally determines reserves for adjuster loss adjustment expenses based on calendar year ratios of adjuster expenses paid to losses paid for the particular class of business. AIG generally determines reserves for other unallocated loss adjustment expenses based on the ratio of the calendar year expenses paid to overall losses paid. This determination is generally done for all classes of business combined, and reflects costs of home office claim overhead as a percent of losses paid.

*Catastrophes:* Special analyses are conducted by AIG in response to major catastrophes in order to estimate AIG's gross and net loss and loss expense liability from the events. These analyses may include a combination of approaches, including modeling estimates, ground up claim analysis, loss evaluation reports from on-site field adjusters, and market share estimates.

AIG's loss reserve analyses do not calculate a range of loss reserve estimates. Because a large portion of the loss reserves from AIG's General Insurance business relates to longer-tail casualty classes of business driven by severity rather than frequency of claims, such as excess casualty and D&O, developing a range around loss reserve estimates would not be meaningful. Using the reserving methodologies described above, AIG's actuaries determine their best estimate of the required reserve and advise Management of that amount. AIG then adjusts its aggregate carried reserves as necessary so that the actual carried reserves as of December 31 reflect this best estimate.

**Volatility of Reserve Estimates and Sensitivity Analyses**

As described above, AIG uses numerous assumptions in determining its best estimate of reserves for each class of business. The importance of any specific assumption can vary by both class of business and accident year. If actual experience differs from key assumptions used in establishing reserves, there is potential for significant variation in the development of loss reserves, particularly for long-tail casualty classes of business such as excess casualty, D&O or workers compensation. Set forth below is a sensitivity analysis that estimates the effect on the loss reserve position of using alternative loss trend or loss development factor assumptions rather than those actually used in determining AIG's best estimates in the year-end loss reserve analyses in 2007. The analysis addresses each major class of business for which a material deviation to AIG's overall reserve position is believed reasonably possible, and uses what AIG believes is a reasonably likely range of potential deviation for each class. There can be no assurance, however, that actual reserve development will be consistent with either the original or the adjusted loss trend or loss development factor assumptions, or that other assumptions made in the reserving process will not materially affect reserve development for a particular class of business.

*Excess Casualty:* For the excess casualty class of business, the assumed loss cost trend was approximately five percent. After evaluating the historical loss cost trends from prior accident years since the early 1990s, in AIG's judgment, it is reasonably likely that actual loss cost trends applicable to the year-end 2007 loss reserve review for excess casualty will range from negative five percent to positive 15 percent, or approximately ten percent lower or higher than the assumption actually utilized in the year-end 2007 reserve review. A ten percent change in the assumed loss cost trend for excess casualty would cause approximately a \$2.4 billion increase or a \$1.6 billion decrease in the net loss and loss expense reserve for this class of business. It should be emphasized that the ten percent deviations are not considered the highest possible deviations that might be expected, but rather what is considered by AIG to reflect a reasonably likely range of potential deviation. Actual loss cost trends in the early 1990s were negative for several

years, including amounts below the negative five percent cited above, whereas actual loss cost trends in the late 1990s ran well into the double digits for several years, including amounts greater than the 15 percent cited above. Thus, there can be no assurance that loss trends will not deviate by more than ten percent. The loss cost trend assumption is critical for the excess casualty class of business due the long-tail nature of the claims and therefore is applied across many accident years.

For the excess casualty class of business, the assumed loss development factors are also a key assumption. After evaluating the historical loss development factors from prior accident years since the early 1990s, in AIG's judgment, it is reasonably likely that actual loss development factors will range from approximately 3.5 percent below those actually utilized in the year-end 2007 reserve review to approximately 6.5 percent above those factors actually utilized. If the loss development factor assumptions were changed by 3.5 percent and 6.5 percent, respectively, the net loss reserves for the excess casualty class would decrease by approximately \$600 million under the lower assumptions or increase by approximately \$1.0 billion under the higher assumptions. Generally, actual historical loss development factors are used to project future loss development. However there can be no assurance that future loss development patterns will be the same as in the past, or that they will not deviate by more than the amounts illustrated above. Moreover, as excess casualty is a long-tail class of business, any deviation in loss cost trends or in loss development factors might not be discernible for an extended

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period of time subsequent to the recording of the initial loss reserve estimates for any accident year. Thus, there is the potential for the reserves with respect to a number of accident years to be significantly affected by changes in the loss cost trends or loss development factors that were initially relied upon in setting the reserves. These changes in loss trends or loss development factors could be attributable to changes in inflation or in the judicial environment, or in other social or economic conditions affecting claims. Thus, there is the potential for variations greater than the amounts cited above, either positively or negatively.

*D&O and Related Management Liability Classes of Business:* For D&O and related management liability classes of business, the assumed loss cost trend was approximately four percent. After evaluating the historical loss cost trends from prior accident years since the early 1990s, in AIG's judgment, it is reasonably likely that actual loss cost trends applicable to the year-end 2007 loss reserve review for these classes will range from negative 11 percent to positive 19 percent, or approximately 15 percent lower or higher than the assumption actually utilized in the year-end 2007 reserve review. A 15 percent change in the assumed loss cost trend for these classes would cause approximately a \$550 million increase or a \$500 million decrease in the net loss and loss expense reserves for these classes of business. It should be emphasized that the 15 percent deviations are not considered the highest possible deviations that might be expected, but rather what is considered by AIG to reflect a reasonably likely range of potential deviation. Actual loss cost trends for these classes in the early 1990s were negative for several years, including amounts below the negative 11 percent cited above, whereas actual loss cost trends in the late 1990s ran at nearly 50 percent per year for several years, vastly exceeding the 19 percent figure cited above. Because the D&O class of business has exhibited highly volatile loss trends from one accident year to the next, there is the possibility of an exceptionally high deviation.

For D&O and related management liability classes of business, the assumed loss development factors are also an important assumption but less critical than for excess casualty. Because these classes are written on a claims made basis, the loss reporting and development tail is much shorter than for excess casualty. However, the high severity nature of the claims does create the potential for significant deviations in loss development patterns from one year to the next. After evaluating the historical loss development factors for these classes of business for accident years since the early 1990s, in AIG's judgment, it is reasonably likely that actual loss development factors will range approximately 6 percent lower to 3.5 percent higher than those factors actually utilized in the year-end 2007 loss reserve review for these classes. If the loss development factor assumptions were changed by 6 percent and 3.5 percent, respectively, the net loss reserves for these classes would be estimated to decrease or increase by approximately \$250 million and \$125 million, respectively. As noted above for excess casualty, actual historical loss development factors are generally used to project future loss development. However, there can be no assurance that future loss development patterns will be the same as in the past, or that they will not deviate by more than the 6 percent or 3.5 percent amounts.

*Excess Workers Compensation:* For excess workers compensation business, loss costs were trended at six percent per annum. After reviewing actual industry loss trends for the past ten years, in AIG's judgment, it is reasonably likely that actual loss cost trends applicable to the year-end 2007 loss reserve review for excess workers compensation will range five percent lower or higher than this estimated loss trend. A five percent change in the assumed loss cost trend would cause approximately a \$425 million increase or a \$275 million decrease in the net loss reserves for this business. It should be emphasized that the actual loss cost trend could vary significantly from this assumption, and there can be no assurance that actual loss costs will not deviate, perhaps materially, by greater than five percent.

For excess workers compensation business, the assumed loss development factors are a critical assumption. Excess workers compensation is an extremely long-tail class of business, with a much greater than normal uncertainty as to the appropriate loss development factors for the tail of the loss development. After evaluating the historical loss development factors for prior accident years since the 1980s, in AIG's judgment, it is reasonably likely that actual loss development factors will range approximately 15 percent lower or higher than those factors actually utilized in the year-end 2007 loss reserve review for excess workers compensation. If the loss development factor assumptions were

changed by 15 percent, the net loss reserves for excess workers compensation would increase or decrease by approximately \$600 million. Given the exceptionally long-tail for this class of business, there is the potential for actual deviations in the loss development tail to exceed the deviations assumed, perhaps materially.

*Primary Workers Compensation:* For primary workers compensation, the loss cost trend assumption is not believed to be material with respect to AIG's loss reserves. This is primarily because AIG's actuaries are generally able to use loss development projections for all but the most recent accident year's reserves, so there is limited need to rely on loss cost trend assumptions for primary workers compensation business.

However, for primary workers compensation business the loss development factor assumptions are important. Generally, AIG's actual historical workers compensation loss development factors would be expected to provide a reasonably accurate predictor of future loss development. However, workers compensation is a long-tail class of business, and AIG's business reflects a very significant volume of losses particularly in recent accident years due to growth of the business. After evaluating the actual historical loss developments since the 1980s for this business, in AIG's judgment, it is reasonably likely that actual loss development factors will fall within the range of approximately 3.5 percent below to 8.25 percent above those actually utilized in the year-end 2007 loss reserve review. If the loss development factor assumptions were changed by 3.5 percent and 8.25 percent, respectively, the net loss reserves for workers compensation

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would decrease or increase by approximately \$800 million and \$1.9 billion, respectively. It should be noted that loss emergence in 2006 and 2007 for this class was higher than historical averages, resulting in an increase in loss reserves for prior accident years. During 2007, reserves from prior accident years developed adversely by approximately \$300 million for AIG's primary workers compensation business. AIG relies on longer term averages of historical loss development patterns in setting loss reserves; thus if loss emergence in subsequent years continues at the levels observed in 2006 and 2007 there could be additional adverse development for this class of business that could be more significant than the amount observed in 2007. However, AIG believes it is too soon to ascertain if this increased emergence represents a new trend in the pattern of loss development. For this class of business, there can be no assurance that actual deviations from the expected loss development factors will not exceed the deviations assumed, perhaps materially.

*Other Casualty Classes of Business:* For casualty business other than the classes discussed above, there is generally some potential for deviation in both the loss cost trend and loss development factor assumptions. However, the effect of such deviations is expected to be less material when compared to the effect on the classes cited above.

**Asbestos and Environmental Reserves**

The estimation of loss reserves relating to asbestos and environmental claims on insurance policies written many years ago is subject to greater uncertainty than other types of claims due to inconsistent court decisions as well as judicial interpretations and legislative actions that in some cases have tended to broaden coverage beyond the original intent of such policies and in others have expanded theories of liability. The insurance industry as a whole is engaged in extensive litigation over these coverage and liability issues and is thus confronted with a continuing uncertainty in its efforts to quantify these exposures.

AIG continues to receive claims asserting injuries and damages from toxic waste, hazardous substances, and other environmental pollutants and alleged claims to cover the cleanup costs of hazardous waste dump sites, referred to collectively as environmental claims, and indemnity claims asserting injuries from asbestos.

The vast majority of these asbestos and environmental claims emanate from policies written in 1984 and prior years. Commencing in 1985, standard policies contained an absolute exclusion for pollution-related damage and an absolute asbestos exclusion was also implemented. The current environmental policies that AIG underwrites on a claims-made basis have been excluded from the analysis herein.

The majority of AIG's exposures for asbestos and environmental claims are excess casualty coverages, not primary coverages. Thus, the litigation costs are treated in the same manner as indemnity amounts. That is, litigation expenses are included within the limits of the liability AIG incurs. Individual significant claim liabilities, where future litigation costs are reasonably determinable, are established on a case-by-case basis.

Estimation of asbestos and environmental claims loss reserves is a subjective process and reserves for asbestos and environmental claims cannot be estimated using conventional reserving techniques such as those that rely on historical accident year loss development factors. The methods used to determine asbestos and environmental loss estimates and to establish the resulting reserves are continually reviewed and updated by management.

Significant factors which affect the trends that influence the asbestos and environmental claims estimation process are the court resolutions and judicial interpretations which broaden the intent of the policies and scope of coverage. The current case law can be characterized as still evolving, and there is little likelihood that any firm direction will develop in the near future. Additionally, the exposures for cleanup costs of hazardous waste dump sites involve issues such as allocation of responsibility among potentially responsible parties and the government's refusal to release parties from liability.

Due to this uncertainty, it is not possible to determine the future development of asbestos and environmental claims with the same degree of reliability as with other types of claims. Such future development will be affected by the extent to which courts continue to expand the intent of the policies and the scope of the coverage, as they have in the past, as well as by the changes in Superfund and waste dump site coverage and liability issues. If the asbestos and environmental reserves develop deficiently, such deficiency would have an adverse effect on AIG's future results of operations.

With respect to known asbestos and environmental claims, AIG established over a decade ago specialized toxic tort and environmental claims units, which investigate and adjust all such asbestos and environmental claims. These units evaluate these asbestos and environmental claims utilizing a claim-by-claim approach that involves a detailed review of individual policy terms and exposures. Because each policyholder presents different liability and coverage issues, AIG generally evaluates exposure on a policy-by-policy basis, considering a variety of factors such as known facts, current law, jurisdiction, policy language and other factors that are unique to each policy. Quantitative techniques have to be supplemented by subjective considerations, including management judgment. Each claim is reviewed at least semi-annually utilizing the aforementioned approach and adjusted as necessary to reflect the current information.

In both the specialized and dedicated asbestos and environmental claims units, AIG actively manages and pursues early resolution with respect to these claims in an attempt to mitigate its exposure to the unpredictable development of these claims. AIG attempts to mitigate its known long-tail environmental exposures by utilizing a combination of proactive claim-resolution techniques, including policy buybacks, complete environmental releases, compromise settlements, and, where indicated, litigation.

With respect to asbestos claims handling, AIG's specialized claims staff operates to mitigate losses through proactive handling, supervision and resolution of asbestos cases. Thus, while AIG has resolved all claims with respect to miners and major manufacturers (Tier One), its claims staff continues to operate under the same proactive philosophy to resolve claims involving accounts with products containing asbestos (Tier Two), products



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containing small amounts of asbestos, companies in the distribution process, and parties with remote, ill-defined involvement in asbestos (Tiers Three and Four). Through its commitment to appropriate staffing, training, and management oversight of asbestos cases, AIG seeks to mitigate its exposure to these claims.

To determine the appropriate loss reserve as of December 31, 2007 for its asbestos and environmental exposures, AIG performed a series of top-down and ground-up reserve analyses. In order to ensure it had the most comprehensive analysis possible, AIG engaged a third-party actuary to assist in a review of these exposures, including ground-up estimates for asbestos reserves consistent with the 2005 and 2006 reviews as well as a top-down report year projection for environmental reserves. Prior to 2005, AIG's reserve analyses for asbestos and environmental exposures was focused around a report year projection of aggregate losses for both asbestos and environmental reserves. Additional tests such as market share analyses were also performed. Ground-up analyses take into account policyholder-specific and claim-specific information that has been gathered over many years from a variety of sources. Ground-up studies can thus more accurately assess the exposure to AIG's layers of coverage for each policyholder, and hence for all policyholders in the aggregate, provided a sufficient sample of the policyholders can be modeled in this manner.

In order to ensure its ground-up analysis was comprehensive, AIG staff produced the information required at policy and claim level detail for nearly 1,000 asbestos defendants. This represented over 95 percent of all accounts for which AIG had received any claim notice of any amount pertaining to asbestos exposure. AIG did not set any minimum thresholds, such as amount of case reserve outstanding, or paid losses to date, that would have served to reduce the sample size and hence the comprehensiveness of the ground-up analysis. The results of the ground-up analysis for each significant account were examined by AIG's claims staff for reasonableness, for consistency with policy coverage terms, and any claim settlement terms applicable. Adjustments were incorporated accordingly. The results from the universe of modeled accounts, which as noted above reflects the vast majority of AIG's known exposures, were then utilized to estimate the ultimate losses from accounts or exposures that could not be modeled and to determine an appropriate provision for unreported claims.

AIG conducted a comprehensive analysis of reinsurance recoverability to establish the appropriate asbestos and environmental reserve net of reinsurance. AIG determined the amount of reinsurance that would be ceded to insolvent reinsurers or to commuted reinsurance contracts for both reported claims and for IBNR. These amounts were then deducted from the indicated amount of reinsurance recoverable. The year-end 2007 analysis reflected an update to the comprehensive analysis of reinsurance recoverability that was first completed in 2005 and updated in 2006. All asbestos accounts for which there was a significant change in estimated losses in the 2007 review were analyzed to determine the appropriate reserve net of reinsurance.

AIG also completed a top-down report year projection of its indicated asbestos and environmental loss reserves. These projections consist of a series of tests performed separately for asbestos and for environmental exposures.

For asbestos, these tests project the losses expected to be reported over the next nineteen years, i.e., from 2008 through 2026, based on the actual losses reported through 2007 and the expected future loss emergence for these claims. Three scenarios were tested, with a series of assumptions ranging from more optimistic to more conservative. In the first scenario, all carried asbestos case reserves are assumed to be within ten percent of their ultimate settlement value. The second scenario relies on an actuarial projection of report year development for asbestos claims reported from 1993 to the present to estimate case reserve adequacy as of year-end 2007. The third scenario relies on an actuarial projection of report year claims for asbestos but reflects claims reported from 1989 to the present to estimate case reserve adequacy as of year-end 2007. Based on the results of the prior report years for each of the three scenarios described above, the report year approach then projects forward to the year 2026 the expected future report year losses, based on AIG's estimate of reasonable loss trend assumptions. These calculations are performed on losses gross of reinsurance. The IBNR (including a provision for development of reported claims) on a net basis is based on applying a factor reflecting the expected ratio of net losses to gross losses for future loss emergence.

For environmental claims, an analogous series of frequency/severity tests are produced. Environmental claims from future report years, (i.e., IBNR) are projected out nine years, i.e., through the year 2016.

At year-end 2007, AIG considered a number of factors and recent experience in addition to the results of the respective top-down and ground-up analyses performed for asbestos and environmental reserves. AIG considered the significant uncertainty that remains as to AIG's ultimate liability relating to asbestos and environmental claims. This uncertainty is due to several factors including:

The long latency period between asbestos exposure and disease manifestation and the resulting potential for involvement of multiple policy periods for individual claims;

The increase in the volume of claims by currently unimpaired plaintiffs;

Claims filed under the non-aggregate premises or operations section of general liability policies;

The number of insureds seeking bankruptcy protection and the effect of prepackaged bankruptcies;

Diverging legal interpretations; and

With respect to environmental claims, the difficulty in estimating the allocation of remediation cost among various parties.

After carefully considering the results of the ground-up analysis, which AIG updates on an annual basis, as well as all of the above factors, including the recent report year experience, AIG increased its gross asbestos reserves by \$75 million, all of which was reinsured, resulting in no increase to net reserves. Additionally, during 2007 a reduction in estimated reinsurance recoverable, partially offset by several large favorable asbestos settlements, resulted in a minor amount of adverse incurred loss development.

Based on the environmental top-down report year analysis performed in the fourth quarter of 2007, a minor increase in both gross and net reserves was recognized, resulting in the relatively minor amount of development shown in the table below.

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A summary of reserve activity, including estimates for applicable IBNR, relating to asbestos and environmental claims separately and combined at December 31, 2007, 2006 and 2005 appears in the table below. The vast majority of such claims arise from policies written in 1984 and prior years. The current environmental policies that AIG underwrites on a claims-made basis have been excluded from the table below.

<i>(in millions)</i>	2007		2006		2005	
	Gross	Net	Gross <sup>(e)</sup>	Net	Gross <sup>(e)</sup>	Net
<b>Asbestos:</b>						
Reserve for losses and loss expenses at beginning of year	\$4,523	\$1,889	\$4,501	\$1,840	\$2,622	\$1,060
Losses and loss expenses incurred <sup>(a)</sup>	96	5	572	267	2,206 <sup>(b)</sup>	903 <sup>(b)</sup>
Losses and loss expenses paid <sup>(a)</sup>	(755)	(440)	(550)	(218)	(327)	(123)
Reserve for losses and loss expenses at end of year	\$3,864	\$1,454	\$4,523	\$1,889	\$4,501	\$1,840
<b>Environmental:</b>						
Reserve for losses and loss expenses at beginning of year	\$ 629	\$ 290	\$ 969	\$ 410	\$1,018	\$ 451
Losses and loss expenses incurred <sup>(a)</sup>	10	13	(231)	(59)	47 <sup>(c)</sup>	27 <sup>(c)</sup>
Losses and loss expenses paid <sup>(a)</sup>	(124)	(66)	(109)	(61)	(96)	(68)
Reserve for losses and loss expenses at end of year	\$ 515	\$ 237	\$ 629	\$ 290	\$ 969	\$ 410
<b>Combined:</b>						
Reserve for losses and loss expenses at beginning of year	\$5,152	\$2,179	\$5,470	\$2,250	\$3,640	\$1,511
Losses and loss expenses incurred <sup>(a)</sup>	106	18	341	208	2,253 <sup>(d)</sup>	930 <sup>(d)</sup>
Losses and loss expenses paid <sup>(a)</sup>	(879)	(506)	(659)	(279)	(423)	(191)
Reserve for losses and loss expenses at end of year	\$4,379	\$1,691	\$5,152	\$2,179	\$5,470	\$2,250

- (a) All amounts pertain to policies underwritten in prior years, primarily to policies issued in 1984 and prior.
- (b) Includes increases to gross losses and loss expense reserves of \$2.0 billion and increases to net losses and loss expense reserves of \$843 million for the fourth quarter of 2005.
- (c) Includes increases to gross losses and loss expense reserves of \$56 million and increases to net losses and loss expense reserves of \$30 million for the fourth quarter of 2005.
- (d) Includes increases to gross losses and loss expense reserves of \$2.0 billion and increases to net losses and loss expense reserves of \$873 million for the fourth quarter of 2005.
- (e) Gross amounts were revised from the previous presentation to reflect the inclusion of certain reserves not previously identified as asbestos and environmental related. This revision had no effect on net reserves.

**The gross and net IBNR included in the reserve for losses and loss expenses, relating to asbestos and environmental claims separately and combined, at December 31, 2007, 2006 and 2005 were estimated as follows:**

(in millions)	2007		2006		2005	
	Gross	Net	Gross*	Net	Gross*	Net
Asbestos	\$2,701	\$1,145	\$3,270	\$1,469	\$3,458	\$1,465
Environmental	325	131	378	173	625	266
Combined	\$3,026	\$1,276	\$3,648	\$1,642	\$4,083	\$1,731

\* Gross amounts were revised from the previous presentation to reflect the inclusion of certain reserves not previously identified as asbestos and environmental related. This revision had no effect on net reserves.

**A summary of asbestos and environmental claims count activity for the years ended December 31, 2007, 2006 and 2005 was as follows:**

	2007			2006			2005		
	Asbestos	Environmental	Combined	Asbestos	Environmental	Combined	Asbestos	Environmental	Combined
Claims at beginning of year	6,878	9,442	16,320	7,293	9,873	17,166	7,575	8,216	15,791
Claims during year:									
Opened	656	937	1,593	643	1,383	2,026	854	5,253	6,107
Settled	(150)	(179)	(329)	(150)	(155)	(305)	(67)	(219)	(286)
Dismissed or otherwise resolved	(821)	(2,548)	(3,369)	(908)	(1,659)	(2,567)	(1,069)	(3,377)	(4,446)
Claims at end of year	6,563	7,652	14,215	6,878	9,442	16,320	7,293	9,873	17,166



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## Survival Ratios – Asbestos and Environmental

The table below presents AIG's survival ratios for asbestos and environmental claims at December 31, 2007, 2006 and 2005. The survival ratio is derived by dividing the current carried loss reserve by the average payments for the three most recent calendar years for these claims. Therefore, the survival ratio is a simplistic measure estimating the number of years it would be before the current ending loss reserves for these claims would be paid off using recent year average payments. The December 31, 2007 survival ratio is lower than the ratio at December 31, 2006 because the more recent periods included in the rolling average reflect higher claims payments. In addition, AIG's survival ratio for asbestos claims was negatively affected by the favorable settlements described above, which reduced gross and net asbestos survival ratios at December 31, 2007 by approximately 1.3 years and 2.6 years, respectively. Many factors, such as aggressive settlement procedures, mix of business and level of coverage provided, have a significant effect on the amount of asbestos and environmental reserves and payments and the resultant survival ratio. Moreover, as discussed above, the primary basis for AIG's determination of its reserves is not survival ratios, but instead the ground-up and top-down analysis. Thus, caution should be exercised in attempting to determine reserve adequacy for these claims based simply on this survival ratio.

**AIG's survival ratios for asbestos and environmental claims, separately and combined were based upon a three-year average payment. These ratios for the years ended December 31, 2007, 2006 and 2005 were as follows:**

	Gross*	Net
<b>2007</b>		
Survival ratios:		
Asbestos	7.1	5.6
Environmental	4.7	3.7
Combined	6.7	5.2
<b>2006</b>		
Survival ratios:		
Asbestos	11.8	12.9
Environmental	5.6	4.5
Combined	10.4	10.3
<b>2005</b>		
Survival ratios:		
Asbestos	16.0	19.8
Environmental	7.2	6.2
Combined	13.1	14.2

\* Gross amounts for 2006 and 2005 were revised from the previous presentation to reflect the inclusion of certain reserves not previously identified as asbestos and environmental related. This revision had no effect on net reserves.

Life Insurance &amp; Retirement Services Operations

AIG's Life Insurance & Retirement Services operations offer a wide range of insurance and retirement savings products both domestically and abroad.

AIG's Foreign Life Insurance & Retirement Services operations include insurance and investment-oriented products such as whole and term life, investment linked, universal life and endowments, personal accident and health products, group products including pension, life and health, and fixed and variable annuities. The Foreign Life Insurance & Retirement Services products are sold through independent producers, career agents, financial institutions and direct marketing channels.

AIG's Domestic Life Insurance operations offer a broad range of protection products, such as individual life insurance and group life and health products, including disability income products and payout annuities, which include single premium immediate annuities, structured settlements and terminal funding annuities. The Domestic Life Insurance products are sold through independent producers, career agents and financial institutions and direct marketing channels. Home service operations include an array of life insurance, accident and health and annuity products sold primarily through career agents.

AIG's Domestic Retirement Services operations include group retirement products, individual fixed and variable annuities sold through banks, broker-dealers and exclusive sales representatives, and annuity runoff operations, which include previously acquired closed blocks and other fixed and variable annuities largely sold through distribution relationships that have been discontinued.

In order to better align financial reporting with the manner in which AIG's chief operating decision makers manage their businesses, commencing in 2007, revenues and operating income related to foreign investment-type contracts, which were historically reported as a component of the Asset Management segment, are now reported as part of Foreign Life Insurance & Retirement Services. Prior period amounts have been revised to conform to the current presentation.

AIG's Life Insurance & Retirement Services reports its operations through the following major internal reporting units and legal entities:

#### Foreign Life Insurance & Retirement Services

##### Japan and Other

- American Life Insurance Company (ALICO)
- AIG Star Life Insurance Co., Ltd. (AIG Star Life)
- AIG Edison Life Insurance Company (AIG Edison Life)

##### Asia

- American International Assurance Company, Limited, together with American International Assurance Company (Bermuda) Limited (AIA)
- Nan Shan Life Insurance Company, Ltd. (Nan Shan)
- American International Reinsurance Company Limited (AIRCO)
- The Philippine American Life and General Insurance Company (Philamlife)

#### Domestic Life Insurance

- American General Life Insurance Company (AIG American General)
- The United States Life Insurance Company in the City of New York (USLIFE)

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American General Life and Accident Insurance Company (AGLA)

Domestic Retirement Services

The Variable Annuity Life Insurance Company (VALIC)

AIG Annuity Insurance Company (AIG Annuity)

AIG SunAmerica Life Assurance Company (AIG SunAmerica)

**Life Insurance & Retirement Services Results****Life Insurance & Retirement Services results for 2007, 2006 and 2005 were as follows:**

<i>(in millions)</i>	Premiums and Other Considerations	Net Investment Income	Net Realized Capital Gains (Losses)	Total Revenues	Operating Income
<b>2007</b>					
Foreign Life Insurance & Retirement Services	\$ 26,601	\$ 11,849	\$ (187)	\$ 38,263	\$ 6,197
Domestic Life Insurance	5,836	3,995	(803)	9,028	642
Domestic Retirement Services	1,190	6,497	(1,408)	6,279	1,347
Total	\$ 33,627	\$ 22,341	\$ (2,398)	\$ 53,570	\$ 8,186
<b>2006</b>					
Foreign Life Insurance & Retirement Services*	\$ 24,166	\$ 9,758	\$ 707	\$ 34,631	\$ 6,881
Domestic Life Insurance	5,543	3,778	(215)	9,106	917
Domestic Retirement Services	1,057	6,488	(404)	7,141	2,323
Total	\$ 30,766	\$ 20,024	\$ 88	\$ 50,878	\$ 10,121
<b>2005</b>					
Foreign Life Insurance & Retirement Services	\$ 23,117	\$ 8,718	\$ 84	\$ 31,919	\$ 5,306
Domestic Life Insurance	5,447	3,733	35	9,215	1,495
Domestic Retirement Services	937	6,226	(277)	6,886	2,164
Total	\$ 29,501	\$ 18,677	\$ (158)	\$ 48,020	\$ 8,965

**Percentage****Increase/(Decrease) 2007 vs.****2006:**



Foreign Life Insurance & Retirement Services	10%	21%	%	10%	(10)%
Domestic Life Insurance	5	6		(1)	(30)
Domestic Retirement Services	13			(12)	(42)
Total	9%	12%	%	5%	(19)%

Percentage Increase/(Decrease)  
2006 vs. 2005:

Foreign Life Insurance & Retirement Services	5%	12%	%	8%	30%
Domestic Life Insurance	2	1		(1)	(39)
Domestic Retirement Services	13	4		4	7
Total	4%	7%	%	6%	13%

\* Included an out of period UCITS adjustment which increased net investment income by \$240 million and operating income by \$169 million.

The following table presents the gross insurance in force for Life Insurance & Retirement Services at December 31, 2007, 2006 and 2005:

(in millions)	2007	2006	2005
Foreign*	\$ 1,327,251	\$ 1,162,699	\$ 1,027,682
Domestic	984,794	907,901	825,151
Total	\$ 2,312,045	\$ 2,070,600	\$ 1,852,833

\* Includes increases (decreases) of \$55.1 billion, \$41.5 billion and \$(76.5) billion related to changes in foreign exchange rates at December 31, 2007, 2006 and 2005, respectively.

### 2007 and 2006 Comparison

The severe credit market disruption was a key driver of operating results in 2007 principally due to significant net realized capital losses resulting from other-than-temporary impairment charges of \$2.8 billion and losses on derivative instruments not qualifying for hedge accounting treatment of \$381 million compared to an other-than-temporary impairment charge of \$641 million and gains on derivative instruments of \$268 million in 2006. In addition, net investment income and certain products were negatively affected by the volatile markets. Life Insurance & Retirement Services continued its ongoing project to increase standardization of AIG's actuarial systems and processes throughout the world. Significant progress was made on these initiatives, with only a minimal effect on operating income in this segment. Premiums and other considerations increased in 2007 compared to 2006 despite a very competitive marketplace and a relatively flat yield curve for most of the year.

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Life Insurance & Retirement Services total revenues in 2007 reflect growth in premiums and other considerations compared to 2006 due principally to strong life insurance production in the Foreign Life Insurance & Retirement Services operations, a growing block of U.K. single premium investment-oriented products and higher policyholder charges related to universal life and sales of payout annuities in the Domestic Life Insurance operations. Overall growth in premiums and other considerations was dampened by a continuing shift to interest sensitive products and the suspension of new sales on certain products in Japan resulting from an industry wide review by the tax authorities. Net investment income increased in 2007 compared to 2006 due to higher partnership and mutual fund income as well as higher policyholder investment income and trading gains and losses (together, policyholder trading gains). Policyholder trading gains are offset by a charge to incurred policy losses and benefits expense. Policyholder trading gains increased due to higher levels of assets and generally reflect the trend in equity markets. Policyholder trading gains were \$2.9 billion in 2007 compared to \$2.0 billion in 2006. Net investment income in 2006 included an increase of \$240 million for an out of period adjustment related to the accounting for UCITS.

Operating income in 2007 was significantly adversely affected by net realized capital losses which totaled \$2.4 billion, net of an out-of-period adjustment of \$158 million related to foreign exchange remediation activities, compared to net realized capital gains of \$88 million in 2006. Other factors affecting operating income include trading account losses of \$150 million in the U.K. associated with certain investment-linked products, the adverse effect of \$108 million related to SOP 05-1, which was adopted in 2007, additional claim expense of \$67 million relating to an industry wide regulatory review of claims in Japan (compared to additional claim expense of \$26 million in 2006) and a \$118 million charge related to remediation activities in Asia. Incurred policyholder benefits increased \$36 million in 2007 related to a closed block of Japanese business with guaranteed benefits. Partially offsetting these factors was a \$52 million recovery in 2007 related to the Superior National arbitration. SOP 05-1 generally requires DAC related to group contracts to be amortized over a shorter duration than in prior periods and also requires that DAC be expensed at the time an individual policy is terminated or lapses, even if reinstated shortly thereafter. The effect of SOP 05-1 was most significant to the group products line in the Domestic Life Insurance operations.

Changes in actuarial estimates, including DAC unlockings and refinements to estimates resulting from actuarial valuation system enhancements and conversions, resulted in a net increase to operating income of \$19 million during 2007. However, this net increase resulted from a number of items that had varying effects on the results of operations of certain operating units and lines of business. These adjustments resulted in an increase of \$183 million in operating income for Foreign Life Insurance & Retirement Services and decreases in operating income of \$52 million and \$112 million for Domestic Life Insurance and Domestic Retirement Services, respectively. In addition, the related adjustments significantly affected both acquisition costs and incurred policy losses and benefits in the Consolidated Statement of Income.

Operating income in 2006 included an increase of \$169 million for an out of period adjustment related to the accounting for UCITS and an increase of \$163 million for an out-of-period adjustment related to corrections of par policyholder dividend reserves and allocations between participating and non-participating accounts, both of which were related to remediation efforts. In addition, operating income in 2006 included charges to Domestic Life Insurance operations of \$125 million for the adverse Superior National arbitration ruling, \$66 million related to the exit of the domestic financial institutions credit life business and \$55 million related to other litigation.

**2006 and 2005 Comparison**

Life Insurance & Retirement Services revenues in 2006 increased compared to 2005. Growth in premiums and other considerations was dampened by the effect of foreign exchange, most notably by the weakening Japanese Yen. Net investment income was higher in 2006 compared to 2005 due to higher partnership and mutual fund income, which in 2006 included a positive out-of-period adjustment of \$240 million related to the accounting for UCITS. Operating income grew by \$1.2 billion from 2005, reflecting higher revenues, including net realized capital gains, and out-of-period reductions of policy benefits expense of \$163 million in 2006 resulting from corrections of par

policyholder dividend reserves and allocations between participating and non-participating accounts, both of which were related to remediation efforts. In addition, operating income in 2006 included charges for Domestic Life Insurance of \$125 million for the adverse Superior National arbitration ruling, \$66 million related to the exit of the domestic financial institutions credit life business and \$55 million related to other litigation.

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American International Group, Inc. and Subsidiaries

**Foreign Life Insurance & Retirement Services Results**

**Foreign Life Insurance & Retirement Services results on a sub-product basis for 2007, 2006 and 2005 were as follows:**

<i>(in millions)</i>	Premiums and Other Considerations	Net Investment Income	Net Realized Capital Gains (Losses)	Total Revenues	Operating Income
<b>2007</b>					
Life insurance	\$ 16,630	\$ 7,473	\$ 85	\$24,188	\$ 3,898
Personal accident	6,094	354	(3)	6,445	1,457
Group products	2,979	753	(76)	3,656	263
Individual fixed annuities	438	2,283	(171)	2,550	548
Individual variable annuities	460	986	(22)	1,424	31
Total	\$ 26,601	\$ 11,849	\$ (187)	\$38,263	\$ 6,197
<b>2006</b>					
Life insurance <sup>(a)</sup>	\$ 15,732	\$ 5,937	\$ 574	\$22,243	\$ 4,247
Personal accident	5,518	285	55	5,858	1,459
Group products	2,226	648	47	2,921	450
Individual fixed annuities	400	2,027	31	2,458	580
Individual variable annuities	290	861		1,151	145
Total	\$ 24,166	\$ 9,758	\$ 707	\$34,631	\$ 6,881
<b>2005</b>					
Life insurance	\$ 15,643	\$ 4,884	\$ 94	\$20,621	\$ 3,195
Personal accident	5,002	255	(30)	5,227	1,292
Group products	1,925	613	(9)	2,529	322
Individual fixed annuities	361	1,728	29	2,118	398
Individual variable annuities	186	1,238		1,424	99
Total	\$ 23,117	\$ 8,718	\$ 84	\$31,919	\$ 5,306

**Percentage**

**Increase/(Decrease) 2007 vs.  
2006:**

Life insurance	6%	26%	(85)%	9%	(8)%
Personal accident	10	24		10	
Group products	34	16		25	(42)
Individual fixed annuities	10	13		4	(6)

Individual variable annuities	59	15		24	(79)
Total	10%	21%	%	10%	(10)%
Percentage Increase/(Decrease) 2006 vs. 2005:					
Life insurance	1%	22%	%	8%	33%
Personal accident	10	12		12	13
Group products	16	6		16	40
Individual fixed annuities	11	17	7	16	46
Individual variable annuities	56	(30)		(19)	46
Total	5%	12%	%	8%	30%

(a) Includes the effect of an out of period UCITS adjustment in 2006, which increased net investment income by \$237 million and operating income by \$166 million.

AIG transacts business in most major foreign currencies and therefore premiums and other considerations reported in U.S. dollars vary by volume and from changes in foreign currency translation rates. The following table summarizes the effect of changes in foreign currency exchange rates on the growth of the Foreign Life Insurance & Retirement Services premiums and other considerations for the years ended December 31, 2007 and 2006:

	2007	2006
Growth in original currency*	<b>7.6%</b>	6.5%
Foreign exchange effect	<b>2.5</b>	(2.0)
Growth as reported in U.S. dollars	<b>10.1%</b>	4.5%

\* Computed using a constant exchange rate each period.

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**Japan and Other Results**

Japan and Other results on a sub-product basis for 2007, 2006 and 2005 were as follows:

<i>(in millions)</i>	Premiums and Other Considerations	Net Investment Income	Net Realized Capital Gains (Losses)	Total Revenues	Operating Income
<b>2007</b>					
Life insurance	\$ 4,999	\$ 2,113	\$ (92)	\$ 7,020	\$ 1,193
Personal accident	4,225	204	(1)	4,428	1,071
Group products	2,318	626	1	2,945	250
Individual fixed annuities	386	2,160	(181)	2,365	500
Individual variable annuities	459	980	(21)	1,418	30
<b>Total</b>	<b>\$ 12,387</b>	<b>\$ 6,083</b>	<b>\$ (294)</b>	<b>\$ 18,176</b>	<b>\$ 3,044</b>
<b>2006</b>					
Life insurance <sup>(a)</sup>	\$ 4,783	\$ 1,749	\$ 316	\$ 6,848	\$ 1,731
Personal accident	3,957	162	49	4,168	1,122
Group products	1,740	541	13	2,294	272
Individual fixed annuities	337	1,930	28	2,295	553
Individual variable annuities	289	857		1,146	143
<b>Total</b>	<b>\$ 11,106</b>	<b>\$ 5,239</b>	<b>\$ 406</b>	<b>\$ 16,751</b>	<b>\$ 3,821</b>
<b>2005</b>					
Life insurance	\$ 4,864	\$ 1,828	\$ (52)	\$ 6,640	\$ 1,288
Personal accident	3,788	137	(15)	3,910	1,051
Group products	1,473	535	(34)	1,974	191
Individual fixed annuities	292	1,672	29	1,993	390
Individual variable annuities	186	1,234		1,420	100
<b>Total</b>	<b>\$ 10,603</b>	<b>\$ 5,406</b>	<b>\$ (72)</b>	<b>\$ 15,937</b>	<b>\$ 3,020</b>

**Percentage Increase/(Decrease)  
 2007 vs. 2006:**

Life insurance	5%	21%	%	3%	(31)%
Personal accident	7	26		6	(5)
Group products	33	16	(92)	28	(8)
Individual fixed annuities	15	12		3	(10)
Individual variable annuities	59	14		24	(79)

Total	12%	16%	%	9%	(20)%
Percentage Increase/(Decrease) 2006 vs. 2005:					
Life insurance	(2)%	(4)%	%	3%	34%
Personal accident	4	18		7	7
Group products	18	1		16	42
Individual fixed annuities	15	15	(3)	15	42
Individual variable annuities	55	(31)		(19)	43
Total	5%	(3)%	%	5%	27%

(a) Includes the effect of an out of period UCITS adjustment in 2006, which increased both net investment income and operating income by \$29 million.

#### 2007 and 2006 Comparison

Total revenues for Japan and Other in 2007 increased compared to 2006, primarily due to higher premiums and other considerations and net investment income partially offset by net realized capital losses. Net investment income increased in 2007 compared to 2006 due to higher levels of assets under management and higher policyholder trading gains partially offset by lower partnership and mutual fund income. Operating income decreased in 2007 compared to 2006 due principally to net realized capital losses, a \$187 million charge related to changes in actuarial estimates, trading account losses of \$150 million in the U.K. associated with certain investment-linked products, \$67 million of additional claim expense related to the industry wide regulatory review of claims in Japan and increased incurred policyholder benefits of \$36 million related to a closed block of Japanese business with guaranteed benefits. These decreases were partially offset by the positive effect of foreign exchange rates.

Life insurance premiums and other considerations increased moderately in 2007 compared to 2006. In Japan, single premium sales of U.S. dollar denominated interest sensitive whole life

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products remained strong. First year premium sales declined, however, due to the suspension in April 2007 of increasing term products pending completion of an industry wide review by the National Tax Authority. Although the review was completed with the issue of a draft paper for comment in December 2007, the product remains suspended pending finalization of the report. In Europe, growth in premiums and other considerations was driven by the growing block of U.K. single premium investment-oriented products and the positive effect of foreign exchange rates. The growth in net investment income was due to growth in underlying invested assets and higher partnership income. Life insurance operating income declined in 2007 compared to 2006 due to net realized capital losses, compared to net realized capital gains in 2006. In addition, 2007 operating income was negatively affected by a \$115 million charge related to changes in actuarial estimates, higher incurred policyholder benefits of \$36 million related to a closed block of Japanese business with guaranteed benefits and \$23 million of additional claim expense related to the claims review in Japan. Operating income in 2006 included the effect of an out of period UCITS adjustment, which increased both net investment income and operating income by \$29 million.

Personal accident premiums and other considerations grew modestly as strong growth in Europe was offset by lower growth in Japan, particularly from the direct marketing distribution channel. Net investment income increased in 2007 compared to 2006 primarily due to growth in invested assets. Operating income declined in 2007 compared to 2006 due to a net realized capital loss, a \$42 million charge related to changes in actuarial estimates, \$42 million of additional claim expense related to the claims review in Japan and \$20 million of additional expenses related to SOP 05-1.

Group products premiums and other considerations in 2007 increased significantly compared to 2006 primarily due to the growing credit business in Europe. Net investment income increased in 2007 compared to 2006, primarily due to higher assets under management related to the Brazil pension business. Operating income in 2007 declined compared to 2006 primarily due to \$19 million of additional expenses related to SOP 05-1 and lower net realized capital gains.

Individual fixed annuity deposits improved in 2007 primarily due to sales in the U.K. and were partially offset by declining sales in Japan due to the effect of a weak Japanese Yen for most of the year as well as the market shift to variable annuity products. Assets under management, however, continued to grow. Individual fixed annuities premiums and other considerations growth reflects a shift to front-end load products and higher surrender charges from U.S. dollar products in Japan where a weak Japanese Yen makes it attractive for certain policyholders to lock-in foreign exchange gains in excess of surrender charges. Surrender charges were \$151 million and \$98 million in 2007 and 2006, respectively. Net investment income increased due to higher average investment yields and higher levels of assets under management. Operating income declined in 2007 compared to 2006 due to realized capital losses in 2007 versus realized capital gains in 2006.

Individual variable annuity deposits in 2007 declined compared to 2006 due to the effect of tax law changes in Europe that reduced tax benefits to policyholders, and lower sales in Japan due to increased competition and the introduction of a new law that increased sales compliance and customer suitability requirements. Variable annuity sales in Japan began to improve in the fourth quarter of 2007 as a new product, launched mid-year in 2007, gained acceptance and banks became more comfortable with the new law. The fees generated from the higher levels of assets under management increased premiums and other considerations in 2007 compared to 2006. Net investment income increased due to higher policyholder trading gains in 2007 compared to 2006. Operating income declined in 2007 compared to 2006 primarily due to \$150 million of trading account losses on certain investment-linked products in the U.K. and net realized capital losses.

*2006 and 2005 Comparison*

Total revenues for Japan and Other increased in 2006 compared to 2005. Premiums and other considerations growth rates were dampened by the effect of foreign exchange, most notably by the weakening of the Japanese Yen. Net investment income in 2006 declined compared to 2005 due to lower policyholder trading gains in the individual variable annuity line. Total revenues in 2006 increased compared to 2005 due to realized capital gains relating primarily to derivative instruments for transactions that did not qualify for hedge accounting treatment under



FAS 133. Operating income in 2006 increased compared to 2005 due to growth in the underlying retirement services businesses and realized capital gains of \$406 million. Operating income in 2006 included the effect of an out of period UCITS adjustment which increased net investment income and operating income by \$32 million. Operating income in 2006 was negatively affected by the weakening of the Japanese Yen against the U.S. dollar and the continued runoff of the older, higher margin in-force businesses of AIG Star Life and AIG Edison Life.

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**Asia Results**

Asia results on a sub-product basis for 2007, 2006 and 2005 were as follows:

<i>(in millions)</i>	Premiums and Other Considerations	Net Investment Income	Net Realized Capital Gains (Losses)	Total Revenues	Operating Income (Loss)
<b>2007</b>					
Life insurance	\$ 11,631	\$ 5,360	\$ 177	\$ 17,168	\$ 2,705
Personal accident	1,869	150	(2)	2,017	386
Group products	661	127	(77)	711	13
Individual fixed annuities	52	123	10	185	48
Individual variable annuities	1	6	(1)	6	1
<b>Total</b>	<b>\$ 14,214</b>	<b>\$ 5,766</b>	<b>\$ 107</b>	<b>\$ 20,087</b>	<b>\$ 3,153</b>
<b>2006</b>					
Life insurance <sup>(a)</sup>	\$ 10,949	\$ 4,188	\$ 258	\$ 15,395	\$ 2,516
Personal accident	1,561	123	6	1,690	337
Group products	486	107	34	627	178
Individual fixed annuities	63	97	3	163	27
Individual variable annuities	1	4		5	2
<b>Total</b>	<b>\$ 13,060</b>	<b>\$ 4,519</b>	<b>\$ 301</b>	<b>\$ 17,880</b>	<b>\$ 3,060</b>
<b>2005</b>					
Life insurance	\$ 10,779	\$ 3,056	\$ 146	\$ 13,981	\$ 1,907
Personal accident	1,214	118	(15)	1,317	241
Group products	452	78	25	555	131
Individual fixed annuities	69	56		125	8
Individual variable annuities		4		4	(1)
<b>Total</b>	<b>\$ 12,514</b>	<b>\$ 3,312</b>	<b>\$ 156</b>	<b>\$ 15,982</b>	<b>\$ 2,286</b>

**Percentage**

**Increase/(Decrease) 2007 vs.  
2006:**

Life insurance	6%	28%	(31)%	12%	8%
Personal accident	20	22		19	15
Group products	36	19		13	(93)
Individual fixed annuities	(17)	27	233	13	78

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Individual variable annuities		50		20	(50)
Total	9%	28%	(64)%	12%	3%
Percentage Increase/(Decrease) 2006 vs. 2005:					
Life insurance	2%	37%	77%	10%	32%
Personal accident	29	4		28	40
Group products	8	37	36	13	36
Individual fixed annuities	(9)	73		30	238
Individual variable annuities				25	
Total	4%	36%	93%	12%	34%

(a) Includes the effect of an out of period UCITS adjustment in 2006, which increased net investment income and operating income by \$208 million and \$137 million, respectively.

2007 and 2006 Comparison

Total revenues in Asia in 2007 increased compared to 2006 primarily due to higher premiums and other considerations and net investment income, partially offset by lower net realized capital gains. Premiums and other considerations increased in 2007 compared to 2006, notwithstanding a continued trend toward investment-oriented products where only a portion of policy charges are reported as premiums. Sales of investment-oriented life products have been particularly strong in Hong Kong, Korea and Singapore and more recently in Taiwan. Net investment income grew due to higher policyholder trading gains, higher partnership and unit investment trust income and growth in underlying invested assets. Net realized capital gains in 2007 were lower compared to 2006 due to an increase in other-than-temporary impairment charges and the change in fair value of derivatives that do not qualify for hedge accounting treatment under FAS 133, partially offset by a positive out-of-period adjustment of \$158 million related to foreign exchange remediation activities. Operating income in 2007 increased compared to 2006. Operating income in 2007 included a \$370 million positive effect of changes in actuarial estimates along with higher

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## American International Group, Inc. and Subsidiaries

partnership and UCITS income, partially offset by lower net realized capital gains and a \$118 million charge related to remediation activity. Operating income in 2006 included an increase of \$137 million from an out of period adjustment related to UCITS. In addition, operating income in 2006 included the positive effect of out of period reductions in participating policyholder dividend reserves of \$163 million, primarily as a result of tax remediation adjustments and a correction to expense allocations between participating and non-participating accounts.

Life insurance premiums and other considerations in 2007 reflected a moderate increase compared to 2006, benefiting from improved sales in Thailand and the favorable effect of foreign exchange rates, partially offset by the shift in product mix from traditional life insurance products to investment-oriented products. Net investment income grew in 2007 compared to 2006 due primarily to higher policyholder trading gains, the growth in the underlying invested assets and higher partnership income. Operating income increased in 2007 compared to 2006 due to a \$322 million positive effect of changes in actuarial estimates, partially offset by an \$86 million charge related to remediation activity. Operating income in 2006 included the effect of the out of period UCITS adjustment and reduction in participating policyholder dividend reserves discussed above.

Personal accident revenues grew in 2007 compared to 2006 primarily due to higher premiums and other considerations, particularly in Korea and Taiwan. Operating income reflects the combined effect of premium growth and stable loss ratios and a \$51 million positive effect related to changes in actuarial estimates in 2007.

Group products premiums and other considerations grew in 2007 compared to 2006 due to higher pension management fees and sales. However, operating income declined in 2007 compared to 2006, primarily due to net realized capital losses resulting from other-than-temporary impairment charges, a \$29 million charge related to remediation activity and higher DAC amortization expense.

Individual fixed annuities total revenues grew in 2007 compared to 2006 due primarily to higher net investment income and increased net realized capital gains. Deposits in 2007 declined compared to 2006 due to increased competition and a market shift to variable life products, particularly in Korea.

**2006 and 2005 Comparison**

Revenues for Asia grew in 2006 compared to 2005. Premiums and other considerations in 2006 were negatively affected by the trend towards investment-oriented products as only a portion of the policy charges collected are reported as premiums. Net investment income in 2006 grew compared to 2005 due to higher policyholder trading gains. Net realized capital gains were significantly higher in 2006 compared to 2005 relating primarily to derivative instruments for transactions that do not qualify for hedge accounting treatment under FAS 133. Revenues and operating income in 2006 included increases of \$208 million and \$137 million, respectively, from out of period adjustments related to UCITS. In addition, operating income in 2006 increased due to a \$163 million out of period adjustment related to participating policyholder dividend reserves primarily as a result of tax remediation adjustments and a correction to expense allocations between participating and non-participating accounts.

**Domestic Life Insurance Results**

**Domestic Life Insurance results, presented on a sub-product basis for 2007, 2006 and 2005, were as follows:**

<i>(in millions)</i>	Premiums and Other Considerations	Net Investment Income	Net Realized Capital Gains (Losses)	Total Revenues	Operating Income (Loss)
<b>2007</b>					
Life insurance	\$ 2,352	\$ 1,528	\$ (584)	\$ 3,296	\$ 226
Home service	767	640	(100)	1,307	216
Group life/health	842	200	(16)	1,026	67

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Payout annuities <sup>(a)</sup>	<b>1,820</b>	<b>1,153</b>	<b>(67)</b>	<b>2,906</b>	<b>74</b>
Individual fixed and runoff annuities	<b>55</b>	<b>474</b>	<b>(36)</b>	<b>493</b>	<b>59</b>
<b>Total</b>	<b>\$ 5,836</b>	<b>\$ 3,995</b>	<b>\$ (803)</b>	<b>\$9,028</b>	<b>\$ 642</b>

2006

Life insurance	\$ 2,127	\$ 1,377	\$ (83)	\$3,421	\$ 654
Home service	790	630	(38)	1,382	282
Group life/health	995	213	(8)	1,200	(159)
Payout annuities <sup>(a)</sup>	1,582	1,004	(51)	2,535	76
Individual fixed and runoff annuities	49	554	(35)	568	64
<b>Total</b>	<b>\$ 5,543</b>	<b>\$ 3,778</b>	<b>\$ (215)</b>	<b>\$9,106</b>	<b>\$ 917</b>

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American International Group, Inc. and Subsidiaries  
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<i>(in millions)</i>	Premiums and Other Considerations	Net Investment Income	Net Realized Capital Gains (Losses)	Total Revenues	Operating Income (Loss)
<b>2005</b>					
Life insurance	\$ 2,041	\$ 1,352	\$ 98	\$3,491	\$ 874
Home service	801	605	(2)	1,404	282
Group life/health	1,079	201	(1)	1,279	69
Payout annuities <sup>(a)</sup>	1,473	912	(34)	2,351	128
Individual fixed and runoff annuities	53	663	(26)	690	142
<b>Total</b>	<b>\$ 5,447</b>	<b>\$ 3,733</b>	<b>\$ 35</b>	<b>\$9,215</b>	<b>\$ 1,495</b>

**Percentage  
 Increase/(Decrease) 2007 vs.  
 2006:**

Life insurance	11%	11%	%	(4)%	(65)%
Home service	(3)	2		(5)	(23)
Group life/health	(15)	(6)		(15)	
Payout annuities	15	15		15	(3)
Individual fixed and runoff annuities	12	(14)		(13)	(8)
<b>Total</b>	<b>5%</b>	<b>6%</b>	<b>%</b>	<b>(1)%</b>	<b>(30)%</b>

**Percentage Increase/(Decrease)  
 2006 vs. 2005:**

Life insurance	4%	2%	%	(2)%	(25)%
Home service	(1)	4		(2)	
Group life/health	(8)	6		(6)	
Payout annuities	7	10		8	(41)
Individual fixed and runoff annuities	(8)	(16)		(18)	(55)
<b>Total</b>	<b>2%</b>	<b>1%</b>	<b>%</b>	<b>(1)%</b>	<b>(39)%</b>

(a)

*Premiums and other considerations include structured settlements, single premium immediate annuities and terminal funding annuities.*

#### 2007 and 2006 Comparison

Total Domestic Life Insurance revenues in 2007 decreased compared to 2006 primarily due to higher net realized capital losses, partially offset by higher premiums and other considerations and net investment income. Domestic Life Insurance premiums and other considerations increased in 2007 compared to 2006 primarily due to the growth in life insurance business in force and payout annuity premiums, which were partially offset by a decline in group life/health premiums due to exiting the financial institutions credit life business at the end of 2006. Domestic Life Insurance operating income decreased in 2007 compared to 2006, primarily due to higher net realized capital losses which consisted of losses related to sales of securities, other-than-temporary impairment writedowns of fixed income securities as well as derivative losses. The higher net realized capital losses in 2007 were partially offset by increases in premiums and other considerations and net investment income, and an improvement in group life/health results compared to 2006, which included a \$125 million charge related to the Superior National workers compensation arbitration, a \$66 million loss related to the exit from the financial institutions credit life business and a \$55 million charge related to litigation reserves. Changes in actuarial estimates, including DAC unlockings and refinements in estimates resulting from actuarial valuation system enhancements, resulted in a net decrease in operating income of \$52 million in 2007. Operating income in 2007 was also negatively affected by a \$67 million increase in DAC amortization related to SOP 05-1, which was partially offset by a \$52 million decrease in policy benefits due to additional reinsurance recoveries associated with Superior National.

Life insurance premiums and other considerations increased in 2007 compared to 2006 driven by growth in life insurance business in force and increased policyholder charges related to universal life and whole life products. Net investment income in 2007 compared to 2006 increased due to higher partnership income, higher call and tender income and positive changes from foreign denominated emerging market bonds. Life insurance operating income decreased in 2007 compared to 2006 primarily due to higher net realized capital losses and higher mortality in 2007, although mortality is still within expected ranges. In addition, operating income in 2007 included a \$25 million increase in reserves related to changes in actuarial estimates and an \$11 million increase in DAC amortization related to SOP 05-1.

Home service premiums and other considerations declined in 2007 compared to 2006 as the reduction in premiums in force from normal lapses and maturities exceeded sales growth. Net investment income in 2007 increased slightly compared to 2006 due to higher partnership income and positive changes from foreign denominated emerging market bonds. Home service operating income decreased largely due to higher net realized capital losses and an \$11 million increase in DAC amortization related to SOP 05-1, partially offset by continued improvement in profit margins.

Group life/health premiums and other considerations in 2007 declined compared to 2006, primarily due to the exit from the financial institutions credit life business at the end of 2006 and tightened pricing and underwriting in the group employer product

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lines. Group life/health operating income increased in 2007 compared to 2006. Operating income in 2007 included a \$52 million decrease in policy benefits from additional reinsurance recoveries associated with Superior National, offset by an increase of \$45 million in DAC amortization related to SOP 05-1. The operating loss in 2006 included a \$125 million charge resulting from the loss of the Superior National arbitration, a \$66 million loss related to exiting the financial institutions credit business and a \$25 million charge for litigation reserves.

Payout annuities premiums and other considerations increased in 2007 compared to 2006 reflecting increased sales of structured settlements and terminal funding annuities. Net investment income increased in 2007 reflecting growth in insurance reserves and an increase in call and tender income on fixed income securities. Payout annuities operating income decreased slightly in 2007 as growth in the business was more than offset by higher net realized capital losses and by a \$30 million out of period adjustment to increase group annuity reserves for payout annuities. Operating income in 2006 included a \$24 million increase in reserves as various methodologies and assumptions were enhanced for payout annuity reserves.

Individual fixed and runoff annuities net investment income and operating income decreased in 2007 compared to 2006 reflecting declining insurance reserves. Operating income in 2006 included \$30 million of increased amortization due to DAC unlocking to reflect lower in-force amounts.

## 2006 and 2005 Comparison

Premiums and other considerations for Domestic Life Insurance increased in 2006 compared to 2005 and were primarily driven by growth in the life insurance business in-force and payout annuity premiums, partially offset by declining in-force business in the home service and group life/health lines. Domestic Life Insurance operating income declined in 2006 compared to 2005 due to net realized capital losses and several significant transactions described below in 2006, partially offset by continued growth in life insurance and payout annuity business. Operating income in 2006 included a \$125 million charge resulting from the loss of the Superior National arbitration and a \$66 million loss related to exiting the financial institutions credit business both within the group life/health business. In addition, Domestic Life Insurance operating income was negatively affected by \$55 million in litigation accruals, an increase in reserves of \$24 million related to various methodologies and assumptions which were enhanced in the payout annuity business and a DAC unlocking charge of \$30 million in the individual fixed and runoff annuities line to reflect lower in-force amounts.

**The following table reflects Domestic Life Insurance periodic premium sales by product for 2007, 2006 and 2005:**

<i>(in millions)</i>	<b>2007</b>	2006	2005	2007 vs. 2006	Percentage Increase/(Decrease)
					2006 vs. 2005
<b>Periodic Premium Sales By Product*:</b>					
Universal life	<b>\$230</b>	\$334	\$271	(31)%	23%
Variable universal life	<b>55</b>	56	44	(2)	27
Term life	<b>219</b>	240	229	(9)	5
Whole life/other	<b>9</b>	13	10	(31)	30
Total	<b>\$513</b>	\$643	\$554	(20)%	16%

\* *Periodic premium represents premium from new business expected to be collected over a one-year period.*



2007 and 2006 Comparison

Domestic Life Insurance periodic premium sales declined in 2007 compared to 2006 primarily as a result of the repricing of certain universal life and term products and the tightening of underwriting standards during the second half of 2006. In the second half of 2007, AIG experienced positive sales growth in indexed universal life products and the sale of a large private placement variable universal life case.

2006 and 2005 Comparison

Domestic Life Insurance periodic premium sales increased in 2006 compared to 2005 primarily reflecting growth in the independent distribution platform. During the second half of 2006, certain universal life products were re-priced and underwriting standards were tightened.

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American International Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of  
Financial Condition and Results of Operations** *Continued***Domestic Retirement Services Results****Domestic Retirement Services results, presented on a sub-product basis for 2007, 2006 and 2005 were as follows:**

<i>(in millions)</i>	Premiums and Other Considerations	Net Investment Income	Net Realized Capital Gains (Losses)	Total Revenues	Operating Income
<b>2007</b>					
Group retirement products	\$ 446	\$ 2,280	\$ (451)	2,275	\$ 696
Individual fixed annuities	96	3,664	(829)	2,931	530
Individual variable annuities	627	166	(45)	748	122
Individual annuities runoff*	21	387	(83)	325	(1)
Total	\$ 1,190	\$ 6,497	\$ (1,408)	\$ 6,279	\$ 1,347
<b>2006</b>					
Group retirement products	\$ 386	\$ 2,279	\$ (144)	\$ 2,521	\$ 1,017
Individual fixed annuities	122	3,581	(257)	3,446	1,036
Individual variable annuities	531	202	5	738	193
Individual annuities runoff*	18	426	(8)	436	77
Total	\$ 1,057	\$ 6,488	\$ (404)	\$ 7,141	\$ 2,323
<b>2005</b>					
Group retirement products	\$ 351	\$ 2,233	\$ (67)	\$ 2,517	\$ 1,055
Individual fixed annuities	97	3,346	(214)	3,229	858
Individual variable annuities	467	217	4	688	189
Individual annuities runoff*	22	430		452	62
Total	\$ 937	\$ 6,226	\$ (277)	\$ 6,886	\$ 2,164
<b>Percentage Increase/(Decrease) 2007 vs. 2006:</b>					
Group retirement products	16%	%	%	(10)%	(32)%
Individual fixed annuities	(21)	2		(15)	(49)
Individual variable annuities	18	(18)		1	(37)
Individual annuities runoff	17	(9)		(25)	
Total	13%	%	%	(12)%	(42)%

Percentage Increase/(Decrease)  
2006 vs. 2005:

Group retirement products	10%	2%	%	%	(4)%
Individual fixed annuities	26	7		7	21
Individual variable annuities	14	(7)	25	7	2
Individual annuities runoff	(18)	(1)		(4)	24
Total	13%	4%	%	4%	7%

\* Primarily represents runoff annuity business sold through discontinued distribution relationships.

2007 and 2006 Comparison

Total revenues and operating income for Domestic Retirement Services declined in 2007 compared to 2006 primarily due to increased net realized capital losses. Net realized capital losses for Domestic Retirement Services increased due to higher other-than-temporary impairment charges of \$1.2 billion in 2007 compared to \$368 million in 2006 and sales to reposition assets in certain investment portfolios for both group retirement products and individual fixed annuities, as well as from changes in the value of certain individual variable annuity product guarantees and related hedges associated with living benefit features. Changes in actuarial estimates, including DAC unlockings and refinements to estimates resulting from actuarial valuation system enhancements, resulted in a net decrease to operating income of \$112 million in 2007.

Group retirement products operating income in 2007 decreased compared to 2006 primarily as a result of increased net realized capital losses due to higher other-than-temporary impairment charges and an increase in DAC amortization related to both an increase in surrenders and to policy changes adding guaranteed minimum withdrawal benefit riders to existing contracts. Operating income was also negatively affected in 2007 by an \$18 million adjustment, primarily reflecting changes in actuarial estimates from the conversion to a new valuation system. These were partially offset by higher variable annuity fees which resulted from an increase in separate account assets compared to 2006.

Individual fixed annuities operating income in 2007 decreased compared to 2006 as a result of net realized capital losses due to higher other-than-temporary impairment charges partially offset by increases in partnership income. The decline in operating income also reflected higher DAC amortization and sales inducement costs related to increased surrenders and a \$33 million charge reflecting changes in actuarial estimates from the conver-

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sion to a new valuation system, as well as unlocking future assumptions and experience updates.

Individual variable annuities operating income decreased in 2007 compared to 2006 largely due to an increase in DAC amortization and sales inducement costs related to a \$61 million adjustment reflecting changes in actuarial estimates. Net realized capital losses increased due to changes in the value of certain annuity product guarantees and related hedges associated with living benefit features and higher other-than-temporary impairment charges.

**2006 and 2005 Comparison**

Total Domestic Retirement Services operating income increased in 2006 compared to 2005 principally due to higher partnership and yield enhancement income in the individual fixed annuity product line. Group retirement products total revenues were flat in 2006 as improvements in partnership income and variable annuity fees were offset by increased net realized capital losses. The flat revenues, coupled with higher amortization of deferred acquisition costs related to internal replacements of existing contracts into new contracts, resulted in a decrease in group retirement operating income. Individual variable annuity total revenues increased in 2006, primarily driven by higher variable annuity fees resulting from an increase in assets under management. Partially offsetting these higher fees was an increase in DAC amortization resulting from increased surrender activity in the first half of 2006. In 2006, the individual annuities-runoff operating income increased, even though the underlying reserves decreased due to increased net spreads as a result of higher investment yields partially offset by increased realized capital losses.

**The following table presents the account value roll forward for Domestic Retirement Services by product for 2007 and 2006:**

<i>(in millions)</i>	<b>2007</b>	2006
<b>Group retirement products</b>		
Balance at beginning of year	\$ 64,357	\$ 59,312
Deposits annuities	5,898	5,464
Deposits mutual funds	1,633	1,361
<b>Total Deposits</b>	<b>7,531</b>	6,825
Surrenders and other withdrawals	(6,551)	(6,106)
Death benefits	(262)	(252)
<b>Net inflows (outflows)</b>	<b>718</b>	467
Change in fair value of underlying investments, interest credited, net of fees	3,034	4,578
<b>Balance at end of year</b>	<b>\$ 68,109</b>	\$ 64,357
<b>Individual fixed annuities</b>		
Balance at beginning of year	\$ 52,685	\$ 53,331
Deposits	5,085	5,331
Surrenders and other withdrawals	(7,565)	(6,379)
Death benefits	(1,667)	(1,649)
<b>Net inflows (outflows)</b>	<b>(4,147)</b>	(2,697)
Change in fair value of underlying investments, interest credited, net of fees	1,970	2,051

Balance at end of year	\$ 50,508	\$ 52,685
<b>Individual variable annuities</b>		
Balance at beginning of year	\$ 31,093	\$ 28,267
Deposits	4,472	4,266
Surrenders and other withdrawals	(4,158)	(3,894)
Death benefits	(497)	(486)
Net inflows (outflows)	(183)	(114)
Change in fair value of underlying investments, interest credited, net of fees	2,198	2,940
Balance at end of year	\$ 33,108	\$ 31,093
<b>Total Domestic Retirement Services</b>		
Balance at beginning of year	\$ 148,135	\$ 140,910
Deposits	17,088	16,422
Surrenders and other withdrawals	(18,274)	(16,379)
Death benefits	(2,426)	(2,387)
Net inflows (outflows)	(3,612)	(2,344)
Change in fair value of underlying investments, interest credited, net of fees	7,202	9,569
Balance at end of year, excluding runoff	151,725	148,135
Individual annuities runoff	5,690	6,326
Balance at end of year	\$ 157,415	\$ 154,461
<b>General and separate account reserves and mutual funds</b>		
General account reserve	\$ 88,801	\$ 92,070
Separate account reserve	60,461	55,988
Total general and separate account reserves	149,262	148,058
Group retirement mutual funds	8,153	6,403
<b>Total reserves and mutual funds</b>	<b>\$ 157,415</b>	<b>\$ 154,461</b>

#### 2007 and 2006 Comparison

Domestic Retirement Services deposits increased in 2007 compared to 2006 primarily reflecting higher deposits in group retirement products and individual variable annuities, partially offset by a decrease in individual fixed annuities. Group retirement deposits increased 10 percent in 2007 compared to 2006 as a result of an increased focus on sales management and acquiring outside deposits. Mutual funds deposits increased 20 percent while group annuity deposits increased 8 percent. Over time,

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**Management's Discussion and Analysis of  
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growth in lower margin mutual fund products relative to annuity products will result in a gradual reduction in overall profit margins of this business. Individual fixed annuity sales continued to face increased competition from bank deposit products and money market funds offering very competitive short-term rates in the current yield curve environment, and as a result deposits decreased 5 percent in 2007 compared to 2006. Individual variable annuity deposits increased 5 percent in 2007 compared to 2006 despite the discontinuation of a major bank proprietary product.

Domestic Retirement Services surrenders and other withdrawals increased in 2007 compared to 2006. The increase primarily reflects higher surrenders in both group retirement products and individual fixed annuities. Group retirement surrenders increased as a result of both normal maturing of the business and higher large group surrenders in 2007 compared to 2006. Individual fixed annuity surrenders and withdrawals increased in 2007 due to both an increasing number of policies coming out of their surrender charge period and increased competition from bank deposit products. AIG expects this trend to continue into 2008 as a significant amount of business comes out of its surrender charge period.

**The following table presents Domestic Retirement Services reserves by surrender charge category and surrender rates as of December 31, 2007 and 2006:**

<b>2007</b> <i>(in millions)</i>	Group Retirement Products*	Individual Fixed Annuities	Individual Variable Annuities
No surrender charge	<b>\$49,770</b>	<b>\$11,316</b>	<b>\$13,014</b>
0% - 2%	<b>3,284</b>	<b>3,534</b>	<b>5,381</b>
Greater than 2% - 4%	<b>3,757</b>	<b>7,310</b>	<b>5,133</b>
Greater than 4%	<b>2,280</b>	<b>24,956</b>	<b>9,492</b>
Non-Surrenderable	<b>865</b>	<b>3,392</b>	<b>88</b>
Total Reserves	<b>\$59,956</b>	<b>\$50,508</b>	<b>\$33,108</b>
Surrender rates	<b>9.8%</b>	<b>14.6%</b>	<b>12.8%</b>

<b>2006</b> <i>(in millions)</i>	Group Retirement Products*	Individual Fixed Annuities	Individual Variable Annuities
No surrender charge	\$42,741	\$10,187	\$11,467
0% - 2%	6,921	4,503	4,869
Greater than 2% - 4%	4,573	6,422	4,830
Greater than 4%	2,842	28,109	9,836
Non-Surrenderable	877	3,464	91
Total Reserves	\$57,954	\$52,685	\$31,093

Surrender rates	9.9%	12.0%	13.3%
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\* *Excludes mutual funds of \$8.2 billion and \$6.4 billion in 2007 and 2006, respectively.*

Surrender rates increased for individual fixed annuities, while group retirement surrender rates decreased slightly in 2007 compared to 2006. Although group retirement surrenders increased compared to 2006, the surrender rate decreased slightly as a result of a 6 percent increase in reserves. The increase in the surrender rate for individual fixed annuities continues to be driven by a relatively flat yield curve and the general aging of the in-force block; however, less than 23 percent of the individual fixed annuity reserves as of December 31, 2007 were available for surrender without charge. Individual variable annuities surrender rates were slightly lower in 2007 compared to 2006.

An increase in the level of surrenders in any of these businesses or in the individual fixed annuities runoff block could accelerate the amortization of DAC and negatively affect fee income earned on assets under management.

Higher surrenders in the group retirement and individual fixed annuity blocks, offset somewhat by increased deposits in group retirement, resulted in negative net flows in 2007. The continuation of the current interest rate and competitive environment would prolong this trend.

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**Life Insurance & Retirement Services Net Investment Income and Net Realized Capital Gains (Losses)****The following table summarizes the components of net investment income for the years ended December 31, 2007, 2006 and 2005:**

<i>(in millions)</i>	<b>2007</b>	2006	2005
<b>Foreign Life Insurance &amp; Retirement Services:</b>			
Fixed maturities, including short-term investments	<b>\$ 7,846</b>	\$ 6,820	\$6,059
Equity securities	<b>135</b>	80	51
Interest on mortgage and other loans	<b>466</b>	454	447
Partnership income	<b>128</b>	94	57
Unit investment trusts <sup>(a)</sup>	<b>439</b>	259	4
Other <sup>(b)</sup>	<b>275</b>	301	357
Total investment income before policyholder income and trading gains	<b>9,289</b>	8,008	6,975
Policyholder investment income and trading gains <sup>(c)</sup>	<b>2,899</b>	2,017	2,021
Total investment income	<b>12,188</b>	10,025	8,996
Investment expenses	<b>339</b>	267	278
Net investment income	<b>\$11,849</b>	\$ 9,758	\$8,718
<b>Domestic Life Insurance:</b>			
Fixed maturities, including short-term investments	<b>\$ 3,528</b>	\$ 3,444	\$3,481
Equity securities	<b>(4)</b>	(6)	(3)
Interest on mortgage and other loans	<b>418</b>	349	327
Partnership income excluding Synfuels	<b>123</b>	80	135
Partnership loss Synfuels	<b>(101)</b>	(107)	(143)
Unit investment trusts	<b>3</b>	5	
Other <sup>(b)</sup>	<b>77</b>	67	(4)
Total investment income before policyholder income and trading gains	<b>4,044</b>	3,832	3,793
Policyholder investment income and trading gains <sup>(c)</sup>	<b>4</b>		
Total investment income	<b>4,048</b>	3,832	3,793
Investment expenses	<b>53</b>	54	60
Net investment income	<b>\$ 3,995</b>	\$ 3,778	\$3,733

Domestic Retirement Services:



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Fixed maturities, including short-term investments	<b>\$ 5,376</b>	\$ 5,645	\$5,579
Equity securities	<b>30</b>	38	13
Interest on mortgage and other loans	<b>539</b>	449	401
Partnership income	<b>572</b>	425	224
Other <sup>(b)</sup>	<b>42</b>	(18)	60
Total investment income	<b>6,559</b>	6,539	6,277
Investment expenses	<b>62</b>	51	51
Net investment income	<b>\$ 6,497</b>	\$ 6,488	\$6,226

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<i>(in millions)</i>	<b>2007</b>	2006	2005
<b>Total:</b>			
Fixed maturities, including short-term investments	<b>\$16,750</b>	\$15,909	\$15,119
Equity securities	<b>161</b>	112	61
Interest on mortgage and other loans	<b>1,423</b>	1,252	1,175
Partnership income excluding Synfuels	<b>823</b>	599	416
Partnership loss Synfuels	<b>(101)</b>	(107)	(143)
Unit investment trusts <sup>(a)</sup>	<b>442</b>	264	4
Other <sup>(b)</sup>	<b>394</b>	350	413
<b>Total investment income before policyholder income and trading gains</b>	<b>19,892</b>	18,379	17,045
Policyholder investment income and trading gains <sup>(c)</sup>	<b>2,903</b>	2,017	2,021
<b>Total investment income</b>	<b>22,795</b>	20,396	19,066
Investment expenses	<b>454</b>	372	389
<b>Net investment income<sup>(d)</sup></b>	<b>\$22,341</b>	\$20,024	\$18,677

(a) Includes the effect of an out of period UCITS adjustment in 2006, which increased net investment income by \$240 million and operating income by \$169 million.

(b) Includes real estate income, income on non-partnership invested assets, securities lending and Foreign Life Insurance & Retirement Services equal share of the results of AIG Credit Card Company (Taiwan).

(c) Relates principally to assets held in various trading securities accounts that do not qualify for separate account treatment under SOP 03-1. These amounts are principally offset by an equal change included in incurred policy losses and benefits.

(d) Includes call and tender income.

#### 2007 and 2006 Comparison

Net investment income increased \$2.3 billion, or 12 percent in 2007 compared to 2006 as the invested asset base grew for fixed maturities, equity securities and mortgage and other loans. In addition, yield enhancement activity increased compared to 2006. Net investment income from UCITS in 2006 included a \$240 million out of period increase. Policyholder trading gains increased in 2007 compared to 2006 principally due to an increase in assets under management, partially offset by trading account losses of \$150 million on certain investment-linked products in the U.K. Net investment income for certain operations include investments in structured notes linked to emerging market sovereign debt that incorporates both interest rate risk and currency risk. These investments generated income of \$45 million in 2007 compared to losses of \$8 million in 2006. In addition, period to period comparisons of investment income for some investment activities, particularly partnership income, are affected by yield enhancement activity. See Invested Assets for further information.

AIG generates income tax credits as a result of investing in synthetic fuel production (synfuels) related to the partnership income (loss) shown in the above table and records those benefits separately from segment operating results in its consolidated provision for income taxes. The amounts of those income tax credits were \$84 million, \$127 million and \$203 million for 2007, 2006 and 2005, respectively. These tax credits will no longer be generated after December 31, 2007. Synfuel production has ceased and the investments have been fully written off as of December 31, 2007.

**2006 and 2005 Comparison**

Net investment income increased 7 percent in 2006 compared to 2005 as income from fixed maturities, equity securities and mortgage and other loans income rose as the underlying invested asset base grew. Net investment income in 2006 also included the out of period increase relating to UCITS of \$240 million.

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**The following table summarizes net realized capital gains (losses) for Life Insurance & Retirement Services by major category for the years ended December 31, 2007, 2006 and 2005:**

<i>(in millions)</i>	<b>2007</b>	2006	2005
<b>Foreign Life Insurance &amp; Retirement Services:</b>			
Sales of fixed maturities	<b>\$ (187)</b>	\$(209)	\$ 191
Sales of equity securities	<b>697</b>	459	281
Other:			
Other-than-temporary impairments <sup>(a)</sup>	<b>(1,026)</b>	(81)	(39)
Foreign exchange transactions <sup>(b)</sup>	<b>435</b>	106	40
Derivatives instruments	<b>(135)</b>	276	(599)
Other <sup>(c)</sup>	<b>29</b>	156	210
<b>Total Foreign Life Insurance &amp; Retirement Services</b>	<b>\$ (187)</b>	\$ 707	\$ 84
<b>Domestic Life Insurance:</b>			
Sales of fixed maturities	<b>\$ (114)</b>	\$ (33)	\$ 65
Sales of equity securities	<b>5</b>	17	18
Other:			
Other-than-temporary impairments <sup>(a)</sup>	<b>(585)</b>	(192)	(119)
Foreign exchange transactions	<b>11</b>	(6)	11
Derivatives instruments	<b>(186)</b>	25	65
Other	<b>66</b>	(26)	(5)
<b>Total Domestic Life Insurance</b>	<b>\$ (803)</b>	\$(215)	\$ 35
<b>Domestic Retirement Services:</b>			
Sales of fixed maturities	<b>\$ (192)</b>	\$ 1	\$(106)
Sales of equity securities	<b>29</b>	31	115
Other:			
Other-than-temporary impairments <sup>(a)</sup>	<b>(1,187)</b>	(368)	(267)
Foreign exchange transactions	<b>27</b>	(13)	(7)
Derivatives instruments	<b>(60)</b>	(33)	(12)
Other	<b>(25)</b>	(22)	(7)
<b>Total Domestic Retirement Services</b>	<b>\$ (1,408)</b>	\$(404)	\$(277)
<b>Total:</b>			
Sales of fixed maturities	<b>\$ (493)</b>	\$(241)	\$ 150
Sales of equity securities	<b>731</b>	507	414
Other:			
Other-than-temporary impairments <sup>(a)</sup>	<b>(2,798)</b>	(641)	(425)
Foreign exchange transactions <sup>(b)</sup>	<b>473</b>	87	51
Derivatives instruments	<b>(381)</b>	268	(546)
Other <sup>(c)</sup>	<b>70</b>	108	198

Total	<b>\$(2,398)</b>	\$ 88	\$(158)
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*(a) See Invested Assets Other-than-temporary impairments for additional information.*

*(b) Includes a positive out-of-period adjustment of \$158 million in 2007 related to foreign exchange remediation activities.*

*(c) Includes gains (losses) of \$(16) million, \$88 million and \$109 million in 2007, 2006 and 2005, respectively, allocated to participating policyholders.*

#### 2007 and 2006 Comparison

Net realized capital gains (losses) include normal portfolio transactions as well as derivative gains (losses) for transactions that did not qualify for hedge accounting treatment under FAS 133, foreign exchange gains and losses and other-than-temporary impairments. In 2007, Life Insurance & Retirement Services operations recorded \$2.8 billion of other-than-temporary impairment charges compared to \$641 million in 2006. For Foreign Life Insurance & Retirement Services operations, these losses were related to both the decline in value of U.S. dollar bonds held in Thailand and Singapore, which reflects the depreciation of the U.S. dollar against local currencies, and impairments due, in part, to the recent volatility in the securities markets. Net realized capital losses in the Foreign Life Insurance & Retirement Services operations in 2007 included losses of \$135 million related to derivatives that did not qualify for hedge accounting treatment under FAS 133 compared to a gain of \$276 million in 2006. Derivatives in the Foreign Life Insurance & Retirement Services operations are primarily used to economically hedge cash flows related to U.S. dollar bonds back to the respective currency of the country, principally in Taiwan, Thailand and Singapore. The corresponding foreign exchange gain or loss with respect to the economically hedged bond is deferred in accumulated other

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comprehensive income until the bond is sold or deemed to be other-than-temporarily impaired.

For the Domestic Life Insurance and Domestic Retirement Services operations, the higher net realized capital losses resulted principally from other-than-temporary impairment charges of \$1.8 billion in 2007 compared to \$560 million in 2006 and from the sale of securities in 2007 to reposition assets in certain investment portfolios. Net realized capital losses in the Domestic Life Insurance operations in 2007 included losses of \$186 million related to derivatives that did not qualify for hedge accounting treatment under FAS 133 compared to a gain of \$25 million in 2006. Derivatives in the Domestic Life Insurance operations include affiliated interest rate swaps used to economically hedge cash flows on bonds and option contracts used to economically hedge cash flows on indexed annuity and universal life products. The corresponding gain or loss with respect to the economically hedged bond is deferred in accumulated other comprehensive income until the bond is sold, matures or deemed to be other-than-temporarily impaired. See Invested Assets Valuation of Invested Assets Portfolio Review herein.

2006 and 2005 Comparison

Net realized capital gains (losses) in 2006 improved \$246 million compared to 2005 primarily due to gains on derivative instruments primarily used to economically hedge cash flows that did not qualify for hedge accounting treatment under FAS 133 and related primarily to the Foreign Life Insurance & Retirement Services operations.

**Deferred Policy Acquisition Costs and Sales Inducement Assets**

DAC for Life Insurance & Retirement Services products arises from the deferral of costs that vary with, and are directly related to, the acquisition of new or renewal business. Policy acquisition costs for life insurance products are generally deferred and amortized over the premium paying period in accordance with FAS 60. Policy acquisition costs that relate to universal life and investment-type products are deferred and amortized, with interest in relation to the incidence of estimated gross profits to be realized over the estimated lives of the contracts in accordance with FAS 97. Value of Business Acquired (VOBA) is determined at the time of acquisition and is reported on the consolidated balance sheet with DAC and amortized over the life of the business, similar to DAC. AIG offers sales inducements to contract holders (bonus interest) on certain annuity and investment contracts. Sales inducements are recognized as part of the liability for policyholders contract deposits on the consolidated balance sheet and are amortized over the life of the contract similar to DAC. Total deferred acquisition and sales inducement costs increased \$549 million in 2007 compared to 2006 primarily due to higher production in the Foreign Life Insurance operations partially offset by lower Domestic Life Insurance & Retirement Services sales. Total amortization expense decreased \$328 million compared to 2006. Annualized amortization expense levels in 2007 and 2006 were approximately 10 percent and 13 percent, respectively, of the opening DAC balance. The decline in amortization expense levels relates to changes in actuarial estimates, which is substantially offset by related adjustments to incurred policy losses and benefits.

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The following table summarizes the major components of the changes in DAC/ Value of Business Acquired (VOBA) and Sales Inducement Assets (SIA) for 2007 and 2006:

(in millions)	2007			2006		
	DAC/VOBA	SIA	Total	DAC/VOBA	SIA	Total
<b>Foreign Life Insurance &amp; Retirement Services</b>						
Balance at beginning of year	\$21,153	\$ 404	\$21,557	\$17,638	\$ 192	\$17,830
Acquisition costs deferred	5,640	241	5,881	4,991	112	5,103
Amortization (charged) or credited to operating income:						
Related to net realized capital gains (losses)	117	1	118	5	(3)	2
Related to unlocking future assumptions	(17)	(2)	(19)	102	2	104
All other amortization <sup>(a)</sup>	(1,979)	11	(1,968)	(2,399)	(4)	(2,403)
Change in unrealized gains (losses) on securities	301	16	317	(132)	(6)	(138)
Increase due to foreign exchange	831	10	841	948	13	961
Other <sup>(b)</sup>	129		129		98	98
Balance at end of year <sup>(a)</sup>	\$26,175	\$ 681	\$26,856	\$21,153	\$ 404	\$21,557
<b>Domestic Life Insurance</b>						
Balance at beginning of year	\$ 6,006	\$ 46	\$ 6,052	\$ 5,184	\$ 31	\$ 5,215
Acquisition costs deferred	895	15	910	1,115	18	1,133
Amortization (charged) or credited to operating income:						
Related to net realized capital gains (losses)	13		13	23		23
Related to unlocking future assumptions	6	(1)	5	(42)	(1)	(43)
All other amortization <sup>(a)</sup>	(671)	(7)	(678)	(671)	(2)	(673)
Change in unrealized gains (losses) on securities	162		162	398		398
Increase (decrease) due to foreign exchange	85		85	(1)		(1)
Other <sup>(b)</sup>	(64)		(64)			
Balance at end of year	\$ 6,432	\$ 53	\$ 6,485	\$ 6,006	\$ 46	\$ 6,052
<b>Domestic Retirement Services</b>						
Balance at beginning of year	\$ 5,651	\$ 887	\$ 6,538	\$ 5,284	\$ 871	\$ 6,155
Acquisition costs deferred	741	201	942	717	231	948

Amortization (charged) or credited  
to operating income:

Related to net realized capital gains (losses)	161	41	202	62	19	81
Related to unlocking future assumptions	(7)	(18)	(25)	(3)		(3)
All other amortization <sup>(a)</sup>	(990)	(174)	(1,164)	(789)	(143)	(932)
Change in unrealized gains (losses) on securities	282	54	336	380	(91)	289
Balance at end of year	\$ 5,838	\$ 991	\$ 6,829	\$ 5,651	\$ 887	\$ 6,538

**Total Life Insurance &  
Retirement Services**

Balance at beginning of year	\$32,810	\$1,337	\$34,147	\$28,106	\$1,094	\$29,200
Acquisition costs deferred	7,276	457	7,733	6,823	361	7,184
Amortization (charged) or credited to operating income:						
Related to net realized capital gains (losses)	291	42	333	90	16	106
Related to unlocking future assumptions	(18)	(21)	(39)	57	1	58
All other amortization <sup>(a)</sup>	(3,640)	(170)	(3,810)	(3,859)	(149)	(4,008)
Change in unrealized gains (losses) on securities	745	70	815	646	(97)	549
Increase due to foreign exchange	916	10	926	947	13	960
Other <sup>(b)</sup>	65		65		98	98
Balance at end of year	\$38,445	\$1,725	\$40,170	\$32,810	\$1,337	\$34,147

(a) In 2007, Foreign Life Insurance & Retirement Services includes lower amortization of \$836 million related to changes in actuarial estimates, mostly offset in incurred policy losses and benefits. Domestic Retirement Services includes a higher amortization of \$104 million related to changes in actuarial estimates.

(b) In 2007, includes \$(118) million for the cumulative effect of adoption of SOP 05-1 and \$189 million related to balance sheet reclassifications. In 2006, primarily represents a balance sheet reclassification.

Because AIG operates in various global markets, the estimated gross profits used to amortize DAC, VOBA and sales inducements can be subject to differing market returns and interest rate environments in any single period. The combination of market returns and interest rates may lead to acceleration of amortization in some products and regions and simultaneous deceleration of amortization in other products and regions.

DAC, VOBA and SIA for insurance-oriented, investment-oriented and retirement services products are reviewed for recoverability, which involves estimating the future profitability of current business. This review involves significant management judgment. If actual future profitability is substantially lower than estimated, AIG's DAC, VOBA and SIA may be subject to an impairment charge



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and AIG's results of operations could be significantly affected in such future periods.

**Future Policy Benefit Reserves**

Periodically, the net benefit reserves (policy benefit reserves less DAC) established for Life Insurance & Retirement Services companies are tested to ensure that, including consideration of future expected premium payments, they are adequate to provide for future policyholder benefit obligations. The assumptions used to perform the tests are current best-estimate assumptions as to policyholder mortality, morbidity, terminations, company maintenance expenses and invested asset returns. For long duration traditional business, a lock-in principle applies, whereby the assumptions used to calculate the benefit reserves and DAC are set when a policy is issued and do not change with changes in actual experience. These assumptions include margins for adverse deviation in the event that actual experience might deviate from these assumptions. For business in-force outside of North America, 45 percent of total policyholder benefit liabilities at December 31, 2007 resulted from traditional business where the lock-in principle applies. In most foreign locations, various guarantees are embedded in policies in force that may remain applicable for many decades into the future.

As experience changes over time, the best-estimate assumptions are updated to reflect the observed changes. Because of the long-term nature of many of AIG's liabilities subject to the lock-in principle, small changes in certain of the assumptions may cause large changes in the degree of reserve adequacy. In particular, changes in estimates of future invested asset return assumptions have a large effect on the degree of reserve adequacy.

During 2007, Life Insurance & Retirement Services continued its ongoing project to increase standardization of AIG's actuarial systems and processes throughout the world. In particular, there is an initiative within the Domestic Life Insurance & Retirement Services operations to consolidate the numerous actuarial valuation systems onto common platforms. This initiative began in 2006 and will continue into 2008. In the Foreign Life Insurance operations, actuarial reserves for certain blocks of business have been computed outside of the primary actuarial valuation systems and/or used methodologies that approximate amounts that would have been reported had these blocks of business been included in the primary actuarial valuation systems.

During 2007, Life Insurance & Retirement Services completed various system migrations, implemented more robust models for certain blocks of business and refined its method of approximation on any remaining blocks of business. The majority of these actions occurred in the fourth quarter of 2007 and any resulting changes in actuarial estimates were recorded in the fourth quarter of 2007 results of operations. The above changes in actuarial estimates, including unlockings, resulted in a net increase to operating income of \$19 million during 2007. However, this net increase resulted from a number of items that had varying effects on the results of operations of certain operating units and lines of business. These adjustments resulted in an increase of \$183 million in operating income for Foreign Life Insurance & Retirement Services and decreases in operating income of \$52 million and \$112 million for Domestic Life Insurance and Domestic Retirement Services, respectively. In addition, the related adjustments significantly affected both acquisition costs and incurred policy losses and benefits in the Consolidated Statement of Income due to reclassifications between DAC and future policy benefits reserves.

**Taiwan**

Beginning in 2000, the yield available on Taiwanese 10-year government bonds dropped from approximately 6 percent to 2.6 percent at December 31, 2007. Yields on most other invested assets have correspondingly dropped over the same period. Current sales are focused on products such as:

variable separate account products which do not contain interest rate guarantees, participating products which contain very low implied interest rate guarantees, and accident and health policies and riders.

In developing the reserve adequacy analysis for Nan Shan, several key best estimate assumptions have been made: Observed historical mortality improvement trends have been projected to 2014;

Morbidity, expense and termination rates have been updated to reflect recent experience;

Taiwan government bond rates are expected to remain at current levels for 10 years and gradually increase to best estimate assumptions of a market consensus view of long-term interest rate expectations;

Foreign assets are assumed to comprise 35 percent of invested assets, resulting in a composite long-term investment assumption of approximately 4.9 percent; and

The currently permitted practice of offsetting positive mortality experience with negative interest margins, thus eliminating the need for mortality dividends, will continue.

Future results of the reserve adequacy tests will involve significant management judgment as to mortality, morbidity, expense and termination rates and investment yields. Adverse changes in these assumptions could accelerate DAC amortization and necessitate reserve strengthening.

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**Financial Services Operations**

AIG's Financial Services subsidiaries engage in diversified activities including aircraft and equipment leasing, capital markets, consumer finance and insurance premium finance.

**Financial Services Results**

**Financial Services results were as follows:**

<i>(in millions)</i>	<b>2007</b>	2006	2005	2007 vs. 2006	Percentage Increase/(Decrease) 2006 vs. 2005
<b>Revenues:</b>					
Aircraft Leasing <sup>(a)</sup>	<b>\$ 4,694</b>	\$4,082	\$ 3,668	15%	11%
Capital Markets <sup>(b)</sup>	<b>(9,979)</b>	(186)	3,260		
Consumer Finance <sup>(c)</sup>	<b>3,655</b>	3,587	3,563	2	1
Other, including intercompany adjustments	<b>321</b>	294	186	9	58
<b>Total</b>	<b>\$ (1,309)</b>	\$7,777	\$10,677	%	(27)%
<b>Operating income (loss):</b>					
Aircraft Leasing <sup>(a)</sup>	<b>\$ 873</b>	\$ 578	\$ 769	51%	(25)%
Capital Markets <sup>(b)</sup>	<b>(10,557)</b>	(873)	2,661		
Consumer Finance <sup>(c)</sup>	<b>171</b>	668	922	(74)	(28)
Other, including intercompany adjustments	<b>(2)</b>	10	72		(86)
<b>Total</b>	<b>\$ (9,515)</b>	\$ 383	\$ 4,424	%	(91)%

(a) Both revenues and operating income include gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. In 2007, 2006 and 2005, the effect was \$(37) million, \$(73) million and \$93 million, respectively. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of borrowings. In the second quarter of 2007, ILFC began applying hedge accounting to most of its derivatives hedging interest rate and foreign exchange risks associated with its floating rate and foreign currency denominated borrowings.

(b) Revenues, shown net of interest expense of \$4.6 billion, \$3.2 billion and \$3.0 billion in 2007, 2006 and 2005, respectively, were primarily from hedged financial positions entered into in connection with counterparty transactions. Both revenues and operating income include gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. In 2007, 2006 and 2005, the effect was \$211 million, \$(1.8) billion and \$2.0 billion, respectively. The year ended December 31, 2007 includes a \$380 million out of period charge to reverse net gains recognized on transfers of available for sale securities among legal entities consolidated within AIGFP. The year ended December 31, 2006 includes an out of period charge of \$223 million related to the remediation of the material weakness in internal

*control over the accounting for certain derivative transactions under FAS 133. In the first quarter of 2007, AIGFP began applying hedge accounting for certain of its interest rate swaps and foreign currency forward contracts hedging its investments and borrowings. In 2007, both revenues and operating income (loss) include an unrealized market valuation loss of \$11.5 billion on AIGFP's super senior credit default swap portfolio and an other-than-temporary impairment charge of \$643 million on AIGFP's available for sale investment securities recorded in other income.*

*(c) Both revenues and operating income include gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. In 2007, 2006 and 2005, the effect was \$(20) million, \$(94) million and \$75 million, respectively. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of borrowings. In the second quarter of 2007, AGF began applying hedge accounting to most of its derivatives hedging interest rate and foreign exchange risks associated with its floating rate and foreign currency denominated borrowings. In 2007, includes a pre-tax charge of \$178 million in connection with domestic consumer finance's mortgage banking activities.*

*2007 and 2006 Comparison*

Financial Services reported an operating loss in 2007 compared to operating income in 2006 primarily due to an unrealized market valuation loss of \$11.5 billion on AIGFP's super senior credit default swap portfolio, an other-than-temporary impairment charge on AIGFP's available for sale investment securities recorded in other income, and a decline in operating income for AGF. AGF's operating income declined in 2007 compared to 2006, due to reduced residential mortgage origination volumes, lower revenues from its mortgage banking activities and increases in the provision for finance receivable losses. In 2007, AGF's mortgage banking operations also recorded a pre-tax charge of \$178 million, representing the estimated cost of implementing the Supervisory Agreement entered into with the OTS.

ILFC generated strong operating income growth in 2007 compared to 2006, driven to a large extent by a larger aircraft fleet, higher lease rates and higher utilization.

In 2007, AIGFP began applying hedge accounting under FAS 133 to certain of its interest rate swaps and foreign currency forward contracts that hedge its investments and borrowings and AGF and ILFC began applying hedge accounting to most of their derivatives that hedge floating rate and foreign currency denominated borrowings. Prior to 2007, hedge accounting was not applied to any of AIG's derivatives and related assets and liabilities. Accordingly, revenues and operating income were exposed to volatility resulting from differences in the timing of revenue recognition between the derivatives and the hedged assets and liabilities.

The year ended December 31, 2007 included an out of period charge of \$380 million to reverse net gains recognized on transfers of available for sale securities among legal entities

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consolidated within AIGFP. The year ended December 31, 2006 included out of period charges of \$223 million related to the remediation of the material weakness in internal control over accounting for certain derivative transactions under FAS 133.

In order to better align financial reporting with the manner in which AIG's chief operating decision makers manage their businesses, beginning in 2007, net realized capital gains and losses, including derivative gains and losses and foreign exchange transaction gains and losses for Financial Services entities other than AIGFP, which were historically reported as a component of AIG's Other category, are now reported in Financial Services revenues and operating income. Prior period amounts have been revised to conform to the current presentation.

*2006 and 2005 Comparison*

Financial Services operating income decreased in 2006 compared to 2005, due primarily to the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133.

**Aircraft Leasing**

Aircraft Leasing operations represent the operations of ILFC, which generates its revenues primarily from leasing new and used commercial jet aircraft to foreign and domestic airlines. Revenues also result from the remarketing of commercial aircraft for ILFC's own account, and remarketing and fleet management services for airlines and financial institutions. ILFC finances its aircraft purchases primarily through the issuance of debt instruments. ILFC economically hedges part of its floating rate and substantially all of its foreign currency denominated debt using interest rate and foreign currency derivatives. Starting in the second quarter of 2007, ILFC began applying hedge accounting to most of its derivatives. All of ILFC's derivatives are effective economic hedges; however, since hedge accounting under FAS 133 was not applied prior to April 2, 2007, the benefits of using derivatives to hedge these exposures are not reflected in ILFC's 2006 corporate borrowing rate. The composite borrowing rates at December 31, 2007 and 2006 were 5.16 percent and 5.17 percent, respectively.

ILFC typically contracts to re-lease aircraft before the end of the existing lease term. For aircraft returned before the end of the lease term, ILFC has generally been able to re-lease such aircraft within two to six months of their return. As a lessor, ILFC considers an aircraft idle or off lease when the aircraft is not subject to a signed lease agreement or signed letter of intent. ILFC had no aircraft off lease at December 31, 2007, and all new aircraft scheduled for delivery through 2008 have been leased.

**Aircraft Leasing Results***2007 and 2006 Comparison*

ILFC's operating income increased in 2007 compared to 2006. Rental revenues increased by \$596 million or 15 percent, driven by a larger aircraft fleet and higher lease rates. As of December 31, 2007, 900 aircraft in ILFC's fleet were subject to operating leases compared to 824 aircraft as of December 31, 2006. During 2007, ILFC realized income of \$31 million from the sale of its rights against bankrupt airlines. The increase in revenues was partially offset by reduced flight equipment marketing revenues and increases in depreciation and interest expense. Flight equipment marketing revenues decreased by \$40 million compared to 2006 due to fewer aircraft sales. Depreciation expense increased by \$166 million, or 11 percent, in line with the increase in the size of the aircraft fleet. Interest expense increased by \$176 million, or 12 percent, driven by additional borrowings to fund aircraft purchases and the rising cost of funds. In 2007 and 2006, the losses from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses, were \$37 million and \$73 million, respectively, in both revenues and operating income. During 2006, ILFC recorded charges to income related to a tax settlement in Australia, increased credit reserves and increased lease accruals, all of which totaled \$37 million.

*2006 and 2005 Comparison*

ILFC's operating income decreased in 2006 compared to 2005. Rental revenues increased by \$536 million or 16 percent, driven by a larger aircraft fleet, increased utilization and higher lease rates. During 2006, ILFC's fleet subject to operating leases increased by 78 airplanes to a total of 824. The increase in rental revenues was offset in

part by increases in depreciation expense and interest expense, charges related to bankrupt airlines, as well as the settlement of a tax dispute in Australia related to the restructuring of ownership of aircraft. Depreciation expense increased by \$200 million, or 14 percent, in line with the increase in the size of the aircraft fleet. Interest expense increased by \$317 million, or 28 percent, driven by rising cost of funds, a weaker U.S. dollar against the Euro and the British Pound and additional borrowings funding aircraft purchases. As noted above, ILFC's interest expense did not reflect the benefit of hedging these exposures. In 2006 and 2005, the effect from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses, was a \$73 million loss and a \$93 million gain, respectively, in both revenues and operating income.

### **Capital Markets**

Capital Markets represents the operations of AIGFP, which engages as principal in a wide variety of financial transactions, including standard and customized financial products involving commodities, credit, currencies, energy, equities and rates. The credit products include credit protection written through credit default swaps on super senior risk tranches of diversified pools of loans and debt securities. AIGFP also invests in a diversified portfolio of securities and principal investments and engages in borrowing activities involving the issuance of standard and structured notes and other securities, and entering into guaranteed investment agreements (GIAs).

As Capital Markets is a transaction-oriented operation, current and past revenues and operating results may not provide a basis for predicting future performance. AIG's Capital Markets opera-

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tions derive a significant portion of their revenues from hedged financial positions entered into in connection with counterparty transactions. AIGFP also participates as a dealer in a wide variety of financial derivatives transactions. Revenues and operating income of the Capital Markets operations and the percentage change in these amounts for any given period are significantly affected by the number, size and profitability of transactions entered into during that period relative to those entered into during the prior period. Generally, the realization of transaction revenues as measured by the receipt of funds is not a significant reporting event as the gain or loss on AIGFP's trading transactions is currently reflected in operating income as the fair values change from period to period.

AIGFP's products generally require sophisticated models and significant management assumptions to determine fair values and, particularly during times of market disruption, the absence of observable market data can result in fair values at any given balance sheet date which are not indicative of the ultimate settlement values of the products.

Beginning in 2007, AIGFP applied hedge accounting under FAS 133 to certain of its interest rate swaps and foreign currency forward contracts hedging its investments and borrowings. As a result, AIGFP recognized in earnings the change in the fair value on the hedged items attributable to the hedged risks substantially offsetting the gains and losses on the derivatives designated as hedges. Prior to 2007, AIGFP did not apply hedge accounting under FAS 133 to any of its derivatives or related assets and liabilities. For further information on the effect of FAS 133 on AIGFP's business, see Risk Management Segment Risk Management Financial Services Capital Markets Derivative Transactions and Note 8 to Consolidated Financial Statements.

Effective January 1, 2008, AIGFP elected to apply the fair value option to all eligible assets and liabilities, other than equity method investments. Electing the fair value option will allow AIGFP to more closely align its earnings with the economics of its transactions by recognizing the change in fair value on its derivatives and the offsetting change in fair value of the assets and liabilities being hedged concurrently through earnings. The adoption of FAS 159 with respect to elections made by AIGFP is currently being evaluated for the effect of recently issued draft guidance by the FASB, anticipated to be issued in final form in early 2008, and its potential effect on AIG's consolidated financial statements.

**Capital Markets Results***2007 and 2006 Comparison*

Capital Markets reported an operating loss in 2007 compared to operating income in 2006, primarily due to fourth quarter 2007 unrealized market valuation losses related to AIGFP's super senior credit default swap portfolio principally written on multi-sector CDOs and an other-than-temporary impairment charge on AIGFP's investment portfolio of CDOs of ABS. These losses were partially offset by the effect of applying hedge accounting to certain hedging activities beginning in 2007, as described below, and net unrealized market gains related to certain credit default swaps purchased against the AAA to BBB-rated risk layers on portfolios of reference obligations. AIGFP experienced higher transaction flow in 2007 in its rate and currency products which contributed to its revenues.

The unrealized market valuation losses related to AIGFP's super senior credit default swap portfolio, the preponderance of which relates to credit derivatives written on multi-sector CDO super senior tranches, were as follows:

<i>(in millions)</i>	Three months ended December 31, 2007	Year ended December 31, 2007
Multi-sector CDO	<b>\$10,894</b>	\$11,246
Corporate Debt/CLOs	<b>226</b>	226
<b>Total</b>	<b>\$11,120</b>	\$11,472

Included in AIGFP's net operating loss was a net unrealized market valuation gain of \$401 million on certain credit default swaps and embedded credit derivatives in credit-linked notes in 2007. In these transactions, AIGFP purchased protection at the AAA- to BBB-rated risk layers on portfolios of reference obligations that include multi-sector CDO obligations.

During the fourth quarter of 2007, certain of AIGFP's available for sale investments in super senior and AAA-rated bonds issued by multi-sector CDOs experienced severe declines in their fair value. As a result, AIGFP recorded an other-than-temporary impairment charge in other income of \$643 million. Notwithstanding AIG's intent and ability to hold such securities until they recover in value, and despite structures which indicate that a substantial amount of the securities should continue to perform in accordance with their original terms, AIG concluded that it could not reasonably assert that the recovery period would be temporary. See also Invested Assets - Financial Services Invested Assets and Note 3 to Consolidated Financial Statements.

The change in fair value of AIGFP's credit default swaps that reference CDOs and the decline in fair value of its investments in CDOs were caused by the significant widening in spreads in the fourth quarter on asset-backed securities, principally those related to U.S. residential mortgages, the severe liquidity crisis affecting the structured finance markets and the effects of rating agency downgrades on those securities. AIG continues to believe that these unrealized market valuation losses are not indicative of the losses AIGFP may realize over time on this portfolio. Based upon its most current analyses, AIG believes that any credit impairment losses realized over time by AIGFP will not be material to AIG's consolidated financial condition, although it is possible that such realized losses could be material to AIG's consolidated results of operations for an individual reporting period.

In addition, in 2007 AIGFP recognized a net gain of \$211 million related to hedging activities that did not qualify for hedge accounting treatment under FAS 133, compared to a net loss of \$1.82 billion in 2006.

The year ended December 31, 2007 included an out of period charge of \$380 million to reverse net gains recognized in previous periods on transfers of available for sale securities among legal entities consolidated within AIGFP, and a \$166 million reduction in fair value at March 31, 2007 of certain derivatives that were an integral part of, and economically hedge, the structured transac-



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tions that were potentially affected by the proposed regulations issued by the U.S. Treasury Department discussed above in Overview of Operations and Business Results Outlook. The net loss on AIGFP's derivatives recognized in 2006 included an out of period charge of \$223 million related to the remediation of the material weakness in internal control over accounting for certain derivative transactions under FAS 133. The net loss also reflects the effect of increases in U.S. interest rates and a weakening of the U.S. dollar on derivatives hedging AIGFP's assets and liabilities.

Financial market conditions in 2007 were characterized by increases in global interest rates, widening of credit spreads, higher equity valuations and a slightly weaker U.S. dollar.

The most significant component of Capital Markets operating expenses is compensation, which was approximately \$423 million, \$544 million and \$481 million in 2007, 2006 and 2005, respectively. The amount of compensation was not affected by gains and losses arising from derivatives not qualifying for hedge accounting treatment under FAS 133. In light of the unrealized market valuation loss related to the AIGFP super senior credit default swap portfolio, to retain and motivate the affected AIGFP employees, a special incentive plan relating to 2007 was established. Under this plan, certain AIGFP employees were granted cash awards vesting over two years and payable in 2013. The expense related to these awards will be recognized ratably over the vesting period, beginning in 2008.

AIG elected to early adopt FAS 155, Accounting for Certain Hybrid Financial Instruments (FAS 155) in 2006. AIGFP elected to apply the fair value option permitted by FAS 155 to its structured notes and other financial liabilities containing embedded derivatives outstanding as of January 1, 2006. The cumulative effect of the adoption of FAS 155 on these instruments at January 1, 2006 was a pre-tax loss of \$29 million. AIGFP recognized a loss of \$351 million in 2007 and a loss of \$287 million in 2006 on hybrid financial instruments for which it applied the fair value option under FAS 155. These amounts were largely offset by gains and losses on economic hedge positions also reflected in AIGFP's operating income or loss.

***2006 and 2005 Comparison***

Capital Markets reported an operating loss in 2006 compared to operating income in 2005. Improved results, primarily from increased transaction flow in AIGFP's credit, commodity index, energy and equity products, were more than offset by the loss resulting from the effect of derivatives not qualifying for hedge accounting treatment under FAS 133. This loss was \$1.82 billion in 2006 compared to a gain of \$2.01 billion in 2005, a decrease of \$3.83 billion. A large part of the net loss on AIGFP's derivatives recognized in 2006 was due to the weakening of the U.S. dollar, primarily against the British Pound and Euro, resulting in a decrease in the fair value of the foreign currency derivatives hedging AIGFP's available for sale securities. The majority of the net gain on AIGFP's derivatives in 2005 was due to the strengthening of the U.S. dollar, primarily against the British Pound and Euro, which increased the fair value of the foreign currency derivatives hedging available for sale securities. To a lesser extent, the net gain in 2005 was due to the decrease in long-term U.S. interest rates, which increased the fair value of derivatives hedging AIGFP's assets and liabilities.

Financial market conditions in 2006 were characterized by a general flattening of interest rate yield curves across fixed income markets globally, tightening of credit spreads, higher equity valuations and a weaker U.S. dollar.

**Consumer Finance**

AIG's Consumer Finance operations in North America are principally conducted through AGF. AGF derives a substantial portion of its revenues from finance charges assessed on outstanding real estate loans, secured and unsecured non-real estate loans and retail sales finance receivables and credit-related insurance.

AGF's finance receivables are primarily sourced through its branches, although many of AGF's real estate loans are sourced through its centralized real estate operations, which include AGF's mortgage banking activities. The majority of the real estate loans originated by AGF's mortgage banking subsidiary are originated through broker relationships and are sold to investors on a servicing-released basis. Beginning in July 2003, AGF's mortgage banking subsidiaries originated and sold loans through a services arrangement with AIG Federal Savings Bank (AIG Bank), a federally

chartered thrift and non-subsiary of AGF. The services relationship was terminated in the first quarter of 2006. Since terminating the services relationship with AIG Bank, AGF's mortgage banking subsidiaries have originated these non-conforming real estate loans using their own state licenses.

On June 7, 2007, AIG's domestic consumer finance operations, consisting of AIG Bank, AGF's mortgage banking subsidiary Wilmington Finance, Inc. (WFI) and AGF, entered into a Supervisory Agreement with the OTS. The Supervisory Agreement pertains to certain mortgage loans originated in the name of AIG Bank from July 2003 through early May 2006 pursuant to the services agreement between WFI and AIG Bank, which was terminated in the first quarter of 2006. Pursuant to the terms of the Supervisory Agreement, AIG Bank, WFI and AGF have implemented a financial remediation program whereby certain borrowers may be provided loans on more affordable terms and/or reimbursed for certain fees. Pursuant to the requirements of the Supervisory Agreement, the services of an external consultant have been engaged to monitor, evaluate and periodically report to the OTS on compliance with the remediation program. The Supervisory Agreement will remain in effect until terminated, modified, or suspended in writing by the OTS. Failure to comply with the terms of the Agreement could result in the initiation of formal enforcement action by the OTS. Separately, the domestic consumer finance operations also committed to donate \$15 million over a three-year period to certain not-for-profit organizations to support their efforts to promote financial literacy and credit counseling.

Management's best estimate of the cost of implementing the financial remediation plan contemplated by the Supervisory Agreement, including the \$15 million donation, was \$178 million which was recorded in 2007. The actual cost of implementing the financial remediation plan may differ from this estimate.

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AIG's foreign consumer finance operations are principally conducted through AIG Consumer Finance Group, Inc. (AIGCFG). AIGCFG operates primarily in emerging and developing markets. AIGCFG has operations in Argentina, China, Hong Kong, Mexico, Philippines, Poland, Taiwan and Thailand and began operations in India in 2007 through the acquisition of a majority interest in a sales finance lending operation and the acquisition of a mortgage lending operation. In addition, in 2007, AIGCFG expanded its distribution channels in Thailand by acquiring an 80 percent interest in a company with a network of over 130 branches for secured consumer lending. AIGCFG is continuously exploring expansion opportunities in its existing operations as well as new geographic locations throughout the world.

Certain of the AIGCFG operations are partly or wholly owned by life insurance subsidiaries of AIG. Accordingly, the financial results of those companies are allocated between Financial Services and Life Insurance & Retirement Services according to their ownership percentages. While products vary by market, the businesses generally provide credit cards, unsecured and secured non-real estate loans, term deposits, savings accounts, retail sales finance and real estate loans. AIGCFG originates finance receivables through its branches and direct solicitation. AIGCFG also originates finance receivables indirectly through relationships with retailers, auto dealers, and independent agents.

**Consumer Finance Results***2007 and 2006 Comparison*

Consumer Finance operating income decreased in 2007 compared to 2006. Operating income from the domestic consumer finance operations, which include the operations of AGF and AIG Bank, decreased by \$509 million, or 77 percent, in 2007 compared to 2006. In 2007, domestic results were adversely affected by the weakening housing market and tighter underwriting guidelines, which resulted in lower originations of real estate loans as well as the \$178 million charge discussed above.

AGF's revenues decreased \$95 million or 3 percent during 2007 compared to 2006. Revenues from AGF's mortgage banking activities decreased \$389 million during 2007 compared to 2006, which includes the charges relating to the Supervisory Agreement. The decrease in revenues also reflects a significantly reduced origination volume, lower yields based on market conditions, tighter underwriting guidelines, reduced margins on loans sold and higher warranty reserves, which cover obligations to repurchase loans sold to third-party investors should there be a first payment default or breach of representations and warranties. AGF's revenues in 2007 also included a recovery of \$65 million from a favorable out of court settlement.

AGF's operating income decreased in 2007 compared to 2006, due to reduced residential mortgage origination volumes, lower revenues from its mortgage banking activities and increases in the provision for finance receivable losses. AGF's interest expense increased by \$81 million or seven percent as its borrowing rate increased in 2007 compared to 2006. During 2007, AGF recorded a net loss of \$28 million on its derivatives that did not qualify for hedge accounting under FAS 133, including the related foreign exchange losses, compared to a net loss of \$89 million in 2006. Commencing in the second quarter of 2007, AGF began applying hedge accounting.

AGF's net finance receivables totaled \$25.5 billion at December 31, 2007, an increase of approximately \$1.2 billion compared to December 31, 2006, including \$19.5 billion of real estate secured loans, most of which were underwritten with full income verification. The increase in the net finance receivables resulted in a similar increase in revenues generated from these assets.

Although real estate loan originations declined in 2007, the softening of home price appreciation (reducing the equity customers may be able to extract from their homes by refinancing) contributed to an increase in non-real estate loans of 11 percent at December 31, 2007 compared to December 31, 2006. Retail sales finance receivables also increased 13 percent compared to December 31, 2006 due to increased marketing efforts and customer demand. AGF's centralized real estate operations finance receivables were essentially unchanged while branch business segment finance receivables increased by 8 percent during 2007.

AGF's allowance for finance receivable losses as a percentage of outstanding receivables was 2.36 percent at December 31, 2007 compared to 2.01 percent at December 31, 2006.

Revenues from the foreign consumer finance operations increased by 29 percent in 2007 compared to 2006. Loan growth, particularly in Poland, Thailand and Latin America, was the primary driver of the increased revenues. The

increase in revenues was more than offset by higher expenses associated with branch expansions, acquisition activities and product promotion campaigns. Operating income in 2006 reflects AIGCFG's \$47 million share of the allowance for losses related to industry-wide credit deterioration in the Taiwan credit card market.

*2006 and 2005 Comparison*

Consumer Finance operating income decreased in 2006 compared to 2005. Operating income from domestic consumer finance operations declined by \$193 million, or 23 percent as a result of decreased originations and purchases of real estate loans and margin compression resulting from increased interest rates and flattened yield curves. The foreign operations operating income decreased primarily due to the credit deterioration in the Taiwan credit card market.

Domestically, the U.S. housing market deteriorated throughout 2006 and as a result, the real estate loan portfolio decreased slightly during 2006 due to lower refinancing activity. This lower refinancing activity also caused a significant decrease in originations and whole loan sales in AGF's mortgage banking operation, which resulted in a substantial reduction of revenue and operating income compared to the prior year. However, softening home prices (reducing the equity customers are able to extract from their homes when refinancing) and higher mortgage rates contributed to customers utilizing non-real estate loans, which increased 10 percent compared to 2005. Retail sales finance receivables also increased 23 percent due to increased marketing efforts and customer demand. Higher revenue resulting from portfolio growth was more than offset by higher interest expense. AGF's short-term borrowing rates were 5.14 percent in 2006 compared to

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3.58 percent in 2005. AGF's long-term borrowing rates were 5.05 percent in 2006 compared to 4.41 percent in 2005. During 2006, AGF recorded a net loss of \$89 million on its derivatives that did not qualify for hedge accounting under FAS 133, including the related foreign exchange losses, compared to a net gain of \$69 million in 2005. AGF's net charge-off ratio improved to 0.95 percent in 2006 from 1.19 percent in 2005. The improvement in the net charge-off ratio in 2006 was primarily due to positive economic fundamentals. The U.S. economy continued to expand during the year, and the unemployment rate remained low, which improved the credit quality of AGF's portfolio. AGF's delinquency ratio remained relatively low, although it increased to 2.06 percent at December 31, 2006 from 1.93 percent at December 31, 2005. AGF reduced the hurricane Katrina portion of its allowance for finance receivable losses to \$15 million at December 31, 2006 after the reevaluation of its remaining estimated losses. AGF's allowance ratio was 2.01 percent at December 31, 2006 compared to 2.20 percent at December 31, 2005.

Revenues from the foreign consumer finance operations increased by approximately 13 percent in 2006 compared to 2005. Loan growth, particularly in Poland and Argentina, was the primary driver behind the higher revenues. Higher revenues were more than offset, however, by AIGCFG's \$47 million share of the allowance for losses related to industrywide credit deterioration in the Taiwan credit card market, increased cost of funds, and higher operating expenses in connection with expansion into new markets and distribution channels and new product promotions, resulting in lower operating income in 2006 compared to 2005.

**Asset Management Operations**

AIG's Asset Management operations comprise a wide variety of investment-related services and investment products. Such services and products are offered to individuals, pension funds and institutions (including AIG subsidiaries) globally through AIG's Spread-Based Investment business, Institutional Asset Management and Brokerage Services and Mutual Funds businesses. Also included in Asset Management operations are the results of certain SunAmerica sponsored partnership investments.

The revenues and operating income for this segment are affected by the general conditions in the equity and credit markets. In addition, net realized gains and performance fees are contingent upon various fund closings, maturity levels and market conditions.

**Asset Management Results****Asset Management results were as follows:**

<i>(in millions)</i>	<b>2007</b>	2006	2005	2007 vs. 2006	2006 vs. 2005
					Percentage Increase/ (Decrease)
<b>Revenues:</b>					
Spread-Based Investment business	<b>\$2,023</b>	\$2,713	\$2,973	(25)%	(9)%
Institutional Asset Management*	<b>2,900</b>	1,240	1,026	134	21
Brokerage Services and Mutual Funds	<b>322</b>	293	257	10	14
Other Asset Management	<b>380</b>	297	326	28	(9)
<b>Total</b>	<b>\$5,625</b>	\$4,543	\$4,582	24%	(1)%

Operating income:

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Spread-Based Investment business	\$ (89)	\$ 732	\$1,194	%	(39)%
Institutional Asset Management*	784	438	387	79	13
Brokerage Services and Mutual Funds	100	87	66	15	32
Other Asset Management	369	281	316	31	(11)
Total	\$1,164	\$1,538	\$1,963	(24)%	(22)%

\* Includes the effect of consolidating the revenues and operating loss of warehoused investments totaling \$778 million and \$164 million, respectively, in 2007, a portion of which is offset in minority interest expense.

### 2007 and 2006 Comparison

Asset Management revenues increased in 2007 compared to 2006 primarily due to increased partnership income, management fees, carried interest and the effect of consolidating several warehoused investments. AIG consolidates the operating results of warehoused investments until such time as they are sold or otherwise divested.

Asset Management operating income decreased in 2007 compared to 2006, due to foreign exchange, interest rate and credit-related mark to market losses and other-than-temporary impairment charges on fixed income investments. These other-than-temporary impairment charges were due primarily to changes in market liquidity and spreads. Partially offsetting these decreases were higher partnership income, increased gains on real estate investments and a gain on the sale of a portion of AIG's investment in Blackstone Group, L.P. in connection with its initial public offering.

In order to better align financial reporting with the manner in which AIG's chief operating decision makers manage their businesses, beginning in 2007, net realized capital gains and losses, and foreign exchange transaction gains and losses, which were previously reported as part of AIG's Other category, are now included in Asset Management revenues and operating income. In addition, revenues and operating income related to foreign

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investment-type contracts, which were historically reported as a component of the Spread-Based Investment business, are now reported in the Life Insurance & Retirement Services segment. Also, commencing in 2007, the effect of consolidating managed partnerships and funds, which were historically reported as a component of the Institutional Asset Management business, are now reported in the Consolidation and eliminations category. Prior period amounts have been revised to conform to the current presentation.

**2006 and 2005 Comparison**

Asset Management operating income decreased in 2006 compared to 2005 as a decline in Spread-Based Investment operating income was partially offset by higher Institutional Asset Management operating income.

**Spread-Based Investment Business Results***2007 and 2006 Comparison*

The Spread-Based Investment business reported an operating loss in 2007 compared to operating income in 2006 due to foreign exchange, interest rate and credit-related mark to market losses and other-than-temporary impairment charges on fixed income investments, partially offset by increased partnership income. In 2007, the GIC program incurred foreign exchange losses of \$526 million on foreign-denominated GIC reserves. Partially offsetting these losses were \$269 million of net mark to market gains on derivative positions. These net gains included mark to market gains on foreign exchange derivatives used to economically hedge the effect of foreign exchange rate movements on foreign-denominated GIC reserves and mark to market losses on interest rate hedges that did not qualify for hedge accounting treatment.

The MIP experienced mark to market losses of \$193 million due to interest rate and foreign exchange derivative positions that, while partially effective in hedging interest rate and foreign exchange risk, did not qualify for hedge accounting treatment and an additional \$98 million due to credit default swap losses. The MIP credit default swaps are comprised of single-name high-grade corporate exposures. AIG enters into hedging arrangements to mitigate the effect of changes in currency and interest rates associated with the fixed and floating rate and foreign currency denominated obligations issued under these programs. Some of these hedging relationships qualify for hedge accounting treatment, while others do not. Commencing in the first quarter of 2007, AIG applied hedge accounting to certain derivative transactions related to the MIP. Income or loss from these hedges not qualifying for hedge accounting treatment are classified as net realized capital gains (losses) in AIG's Consolidated Statement of Income. The mark to market losses for 2007 were driven primarily by a decline in short-term interest rates, the decline in the value of the U.S. dollar and widening credit spreads.

Also contributing to the operating loss were other-than-temporary impairment charges on various fixed income investments held in the GIC and MIP portfolios of approximately \$836 million as a result of movements in credit spreads and decreased market liquidity. See Invested Assets - Other-than-temporary impairments. These losses were partially offset by an increase in partnership income associated with the GIC. In addition to other-than-temporary impairments, unrealized losses on fixed income investments were driven by widening credit spreads, partially offset by gains due to falling interest rates. These unrealized losses are recorded in Accumulated other comprehensive income (loss).

During 2007, AIG has issued the equivalent of \$8.1 billion of securities to fund the MIP in the Euromarkets and the U.S. public and private markets compared to \$5.3 billion issued in 2006. At December 31, 2007, total issuances were \$13.4 billion.

**The following table illustrates the anticipated runoff of the domestic GIC portfolio at December 31, 2007:**

<i>(in billions)</i>	Less Than One Year	1-3 Years	3+ <sup>-</sup> -5 Years	Over Five Years	Total
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Domestic GICs	\$ 9.4	\$6.4	\$2.7	\$ 6.8	\$25.3
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### *2006 and 2005 Comparison*

Operating income related to the Spread-Based Investment business declined in 2006 compared to 2005 due primarily to the continued runoff of GIC balances and spread compression related to increases in short-term interest rates. A significant portion of the remaining GIC portfolio consists of floating rate obligations. AIG has entered into hedges to manage against increases in short-term interest rates. AIG believes these hedges are economically effective, but they did not qualify for hedge accounting treatment. The decline in operating income was partially offset by improved partnership income, particularly during the fourth quarter of 2006.

### *Institutional Asset Management Results*

#### *2007 and 2006 Comparison*

Operating income for Institutional Asset Management increased in 2007 compared to 2006 reflecting increased carried interest revenues driven by higher valuations of portfolio investments that are generally associated with improved performance in the equity markets. The increase also reflects a \$398 million gain from the sale of a portion of AIG's investment in Blackstone Group, L.P. in connection with its initial public offering. Also contributing to this increase were higher base management fees driven by higher levels of third-party assets under management. Partially offsetting these increases were the operating losses from warehousing activities. The consolidated warehoused private equity investments are not wholly owned by AIG and thus, a significant portion of the effect of consolidating these operating losses is offset in minority interest, which is not a component of operating income.

AIG's unaffiliated client assets under management, including retail mutual funds and institutional accounts, increased 26 percent to \$94.2 billion at December 31, 2007 compared to December 31, 2006. Additionally, AIG Investments successfully launched several new private equity and real estate funds in 2007, which provide both a base management fee and the opportunity for future incentive fees.



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While unaffiliated client assets under management and the resulting management fees continue to increase, the growth in operating income has trailed the growth in revenues due to the additional costs associated with warehousing activities as well as the costs associated with sales and infrastructure enhancements. The sales and infrastructure enhancements are associated with AIG's planned expansion of marketing and distribution capabilities, combined with technology and operational infrastructure-related improvements.

*2006 and 2005 Comparison*

Operating income related to Institutional Asset Management increased in 2006 compared to 2005, primarily due to realized gains on real estate transactions as well as increased management fees. AIG's unaffiliated client assets under management, including both retail mutual funds and institutional accounts, increased 21 percent from year-end 2005 to \$75 billion, resulting in higher management fee income. Partially offsetting this growth were lower carried interest on private equity investments, and higher expenses related to the planned expansion of marketing and distribution capabilities, combined with technology and operational infrastructure-related enhancements.

*Other Operations*

**The operating loss of AIG's Other category for the years ended December 31, 2007, 2006 and 2005 was as follows:**

<i>(in millions)</i>	<b>2007</b>	2006	2005
<b>Other Operating Income (Loss):</b>			
Equity earnings in partially owned companies	\$ 157	\$ 193	\$ (124)
Interest expense	(1,223)	(859)	(541)
Unallocated corporate expenses*	(560)	(517)	(413)
Compensation expense - SICO Plans	(39)	(108)	(205)
Compensation expense - Starr tender offer		(54)	
Net realized capital gains (losses)	(409)	(37)	269
Regulatory settlement costs			(1,644)
Other miscellaneous, net	(66)	(53)	(107)
<b>Total Other</b>	<b>\$(2,140)</b>	<b>\$(1,435)</b>	<b>\$(2,765)</b>

\* Includes expenses of corporate staff not attributable to specific business segments, expenses related to efforts to improve internal controls, corporate initiatives and certain compensation plan expenses.

**2007 and 2006 Comparison**

The operating loss of AIG's Other category increased in 2007 compared to 2006 reflecting higher interest expense that resulted from increased borrowings, higher unallocated corporate expenses and foreign exchange losses on foreign-denominated debt, a portion of which was economically hedged but did not qualify for hedge accounting treatment under FAS 133. In addition, Net realized capital gains (losses) in 2007 included an other-than-temporary impairment charge of \$144 million related to an investment in a partially owned company and foreign exchange losses of \$221 million on unhedged debt.

The operating loss in 2006 for AIG's Other category included an out of period charge of \$61 million related to the SICO Plans and a one-time charge related to the Starr tender offer of \$54 million. For a further discussion of these items, see Note 19 to Consolidated Financial Statements.

In 2007, no compensation cost was recognized, and compensation cost recognized in 2006 was reversed, with respect to awards under the Partners Plan because the performance threshold was not met. The amounts earned under the AIG Partners Plan will be determined by the Compensation Committee in the first quarter of 2008.

In order to better align financial reporting with the manner in which AIG's chief operating decision makers manage their businesses, beginning in 2007, derivative gains and losses and foreign exchange transaction gains and losses for Asset Management and Financial Services entities (other than AIGFP) are now included in Asset Management and Financial Services revenues and operating income. These amounts were previously reported as part of AIG's Other category. Prior period amounts have been revised to conform to the current presentation.

#### **2006 and 2005 Comparison**

Operating loss for AIG's Other category declined in 2006 compared to 2005, reflecting the regulatory settlement costs of \$1.6 billion in 2005, as described under Item 3. Legal Proceedings, offset by increased interest expense in 2006 as a result of increased borrowings by the parent holding company and realized capital losses of \$37 million. These declines were partially offset by increased equity earnings in certain partially owned companies.

#### **Capital Resources and Liquidity**

At December 31, 2007, AIG had total consolidated shareholders' equity of \$95.8 billion and total consolidated borrowings of \$176.0 billion. At that date, \$67.9 billion of such borrowings were subsidiary borrowings not guaranteed by AIG.

In 2007, AIG issued an aggregate of \$5.6 billion of junior subordinated debentures in five series of securities. Substantially all of the proceeds from these sales, net of expenses, are being used to purchase shares of AIG's common stock. A total of 76,361,209 shares were purchased during 2007.

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## Borrowings

**Total borrowings at December 31, 2007 and 2006 were as follows:**

<i>(in millions)</i>	2007	2006
<b>Borrowings issued by AIG:</b>		
Notes and bonds payable	\$ 14,588	\$ 8,915
Junior subordinated debt	5,809	
Loans and mortgages payable	729	841
MIP matched notes and bonds payable	14,267	5,468
Series AIGFP matched notes and bonds payable	874	72
<b>Total AIG borrowings</b>	<b>36,267</b>	<b>15,296</b>
<b>Borrowings guaranteed by AIG:</b>		
<b>AIGFP</b>		
GIAs	19,908	20,664
Notes and bonds payable	36,676	37,528
Loans and mortgages payable	1,384	
Hybrid financial instrument liabilities <sup>(a)</sup>	7,479	8,856
<b>Total AIGFP borrowings</b>	<b>65,447</b>	<b>67,048</b>
<b>AIG Funding, Inc. commercial paper</b>	<b>4,222</b>	<b>4,821</b>
<b>AIGLH notes and bonds payable</b>	<b>797</b>	<b>797</b>
<b>Liabilities connected to trust preferred stock</b>	<b>1,435</b>	<b>1,440</b>
<b>Total borrowings issued or guaranteed by AIG</b>	<b>108,168</b>	<b>89,402</b>
<b>Borrowings not guaranteed by AIG:</b>		
<b>ILFC</b>		
Commercial paper	4,483	2,747
Junior subordinated debt	999	999
Notes and bonds payable <sup>(b)</sup>	25,737	25,592
<b>Total ILFC borrowings</b>	<b>31,219</b>	<b>29,338</b>
<b>AGF</b>		
Commercial paper and extendible commercial notes	3,801	4,662
Junior subordinated debt	349	
Notes and bonds payable	22,369	19,261
<b>Total AGF borrowings</b>	<b>26,519</b>	<b>23,923</b>

## AIGCFG

Commercial paper	287	227
Loans and mortgages payable	1,839	1,453
<b>Total AIGCFG borrowings</b>	<b>2,126</b>	<b>1,680</b>
AIG Finance Taiwan Limited commercial paper		26
<b>Other subsidiaries</b>	<b>775</b>	<b>672</b>
<b>Borrowings of consolidated investments:</b>		
A.I. Credit <sup>(c)</sup>	321	880
AIG Investments <sup>(d)</sup>	1,636	193
AIG Global Real Estate Investment <sup>(d)</sup>	5,096	2,307
AIG SunAmerica	186	203
ALICO	3	55
<b>Total borrowings of consolidated investments</b>	<b>7,242</b>	<b>3,638</b>
<b>Total borrowings not guaranteed by AIG</b>	<b>67,881</b>	<b>59,277</b>

**Consolidated:**

Total commercial paper and extendible commercial notes	\$ 13,114	\$ 13,363
Total long-term borrowings	162,935	135,316
<b>Total borrowings</b>	<b>\$176,049</b>	<b>\$148,679</b>

(a) Represents structured notes issued by AIGFP that are accounted for using the fair value option.

(b) Includes borrowings under Export Credit Facility of \$2.5 billion and \$2.7 billion at December 31, 2007 and 2006, respectively.

(c) Represents commercial paper issued by a variable interest entity secured by receivables of A.I. Credit.

(d) In 2007, increases in borrowings compared to 2006 were principally attributable to warehousing activities.

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**At December 31, 2007 and 2006, AIG's net borrowings amounted to \$20.3 billion and \$15.4 billion, respectively, as follows:**

<i>(in millions)</i>	2007	2006
AIG's total borrowings	<b>\$176,049</b>	\$148,679
Less:		
Junior subordinated debt	<b>5,809</b>	
Liabilities connected to trust preferred stock	<b>1,435</b>	1,440
MIP matched notes and bonds payable	<b>14,267</b>	5,468
Series AIGFP matched notes and bonds payable	<b>874</b>	72
AIGFP		
GIAs	<b>19,908</b>	20,664
Notes and bonds payable	<b>36,676</b>	37,528
Loans and mortgages payable	<b>1,384</b>	
Hybrid financial instrument liabilities*	<b>7,479</b>	8,856
Borrowings not guaranteed by AIG	<b>67,881</b>	59,277
<b>AIG's net borrowings</b>	<b>\$ 20,336</b>	\$ 15,374

\* Represents structured notes issued by AIGFP that are accounted for at fair value.

**A roll forward of long-term borrowings, excluding borrowings of consolidated investments, for the year ended December 31, 2007 is as follows:**

<i>(in millions)</i>	Balance at December 31, 2006	Issuances	Maturities and Repayments	Effect of Foreign Exchange	Other Changes	Balance at December 31, 2007
<b>AIG</b>						
Notes and bonds payable	\$ 8,915	\$ 5,591	\$ (165)	\$ 122	\$ 125	<b>\$ 14,588</b>
Junior subordinated debt		5,590		218	1	<b>5,809</b>
Loans and mortgages payable	841	600	(724)	12		<b>729</b>
MIP matched notes and bonds payable	5,468	8,092		(4)	711	<b>14,267</b>
Series AIGFP matched notes and bonds payable	72	810	(10)		2	<b>874</b>
<b>AIGFP</b>						
GIAs	20,664	8,830	(10,172)	43	543	<b>19,908</b>
	46,384	50,854	(53,540)	321	136	<b>44,155</b>

Notes and bonds payable and hybrid financial instrument liabilities						
Loans and mortgages payable		1,388	(9)	9	(4)	<b>1,384</b>
AIGLH notes and bonds payable	797					<b>797</b>
Liabilities connected to trust preferred stock	1,440				(5)	<b>1,435</b>
ILFC notes and bonds payable	25,592	3,783	(3,938)	295	5	<b>25,737</b>
ILFC junior subordinated debt	999					<b>999</b>
AGF notes and bonds payable	19,261	7,481	(4,824)	255	196	<b>22,369</b>
AGF junior subordinated debt		349				<b>349</b>
AIGCFG loans and mortgages payable	1,453	3,941	(3,647)	98	(6)	<b>1,839</b>
Other subsidiaries	672	189	(189)	3	100	<b>775</b>
<b>Total</b>	<b>\$132,558</b>	<b>\$97,498</b>	<b>\$ (77,218)</b>	<b>\$ 1,372</b>	<b>\$ 1,804</b>	<b>\$ 156,014</b>

**AIG (Parent Company)**

AIG intends to continue its customary practice of issuing debt securities from time to time to meet its financing needs and those of certain of its subsidiaries for general corporate purposes, as well as for the MIP. As of December 31, 2007, AIG had up to \$17.5 billion of debt securities, preferred stock and other securities, and up to \$12.0 billion of common stock, registered and available for issuance under its universal shelf registration statement.

AIG maintains a medium-term note program under its shelf registration statement. As of December 31, 2007, approximately \$7.3 billion principal amount of senior notes were outstanding under the medium-term note program, of which \$3.2 billion was used for AIG's general corporate purposes, \$873 million was used by AIGFP (referred to as

Series AIGFP in the preceding tables) and \$3.2 billion was used to fund the MIP. The maturity dates of these notes range from 2008 to 2052. To the extent deemed appropriate, AIG may enter into swap transactions to manage its effective borrowing rates with respect to these notes.

AIG also maintains a Euro medium-term note program under which an aggregate nominal amount of up to \$20.0 billion of senior notes may be outstanding at any one time. As of December 31, 2007, the equivalent of \$12.7 billion of notes were outstanding under the program, of which \$9.8 billion were used to fund the MIP and the remainder was used for AIG's general

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corporate purposes. The aggregate amount outstanding includes \$1.1 billion loss resulting from foreign exchange translation into U.S. dollars, of which \$332 million loss relates to notes issued by AIG for general corporate purposes and \$726 million loss relates to notes issued to fund the MIP. AIG has economically hedged the currency exposure arising from its foreign currency denominated notes.

During 2007, AIG issued in Rule 144A offerings an aggregate of \$3.0 billion principal amount of senior notes, of which \$650 million was used to fund the MIP and \$2.3 billion was used for AIG's general corporate purposes.

AIG maintains a shelf registration statement in Japan, providing for the issuance of up to Japanese Yen 300 billion principal amount of senior notes, of which the equivalent of \$450 million was outstanding as of December 31, 2007 and was used for AIG's general corporate purposes. AIG also maintains an Australian dollar debt program under which senior notes with an aggregate principal amount of up to 5 billion Australian dollars may be outstanding at any one time. Although as of December 31, 2007 there were no outstanding notes under the Australian program, AIG intends to use the program opportunistically to fund the MIP or for AIG's general corporate purposes.

During 2007, AIG issued an aggregate of \$5.6 billion of junior subordinated debentures in five series of securities. Substantially all of the proceeds from these sales, net of expenses, are being used to repurchase shares of AIG's common stock. In connection with each series of junior subordinated debentures, AIG entered into a Replacement Capital Covenant (RCC) for the benefit of the holders of AIG's 6.25 percent senior notes due 2036. The RCCs provide that AIG will not repay, redeem, or purchase the applicable series of junior subordinated debentures on or before a specified date, unless AIG has received qualifying proceeds from the sale of replacement capital securities.

In October 2007, AIG borrowed a total of \$500 million on an unsecured basis pursuant to a loan agreement with a third-party bank. The entire amount of the loan remained outstanding at December 31, 2007 and matures in October 2008.

AIG began applying hedge accounting for certain AIG parent transactions in the first quarter of 2007.

**AIGFP**

AIGFP uses the proceeds from the issuance of notes and bonds and GIA borrowings, as well as the issuance of Series AIGFP notes by AIG, to invest in a diversified portfolio of securities and derivative transactions. The borrowings may also be temporarily invested in securities purchased under agreements to resell. AIGFP's notes and bonds include structured debt instruments whose payment terms are linked to one or more financial or other indices (such as an equity index or commodity index or another measure that is not considered to be clearly and closely related to the debt instrument). These notes contain embedded derivatives that otherwise would be required to be accounted for separately under FAS 133. Upon AIG's early adoption of FAS 155, AIGFP elected the fair value option for these notes. The notes that are accounted for using the fair value option are reported separately under hybrid financial instrument liabilities. AIG guarantees the obligations of AIGFP under AIGFP's notes and bonds and GIA borrowings. See Liquidity herein and Note 8 to Consolidated Financial Statements.

AIGFP has a Euro medium-term note program under which an aggregate nominal amount of up to \$20.0 billion of notes may be outstanding at any one time. As of December 31, 2007, \$6.2 billion of notes were outstanding under the program. The notes issued under this program are guaranteed by AIG and are included in AIGFP's notes and bonds payable in the table of total borrowings.

**AIG Funding**

AIG Funding, Inc. (AIG Funding) issues commercial paper that is guaranteed by AIG in order to help fulfill the short-term cash requirements of AIG and its subsidiaries. The issuance of AIG Funding's commercial paper, including the guarantee by AIG, is subject to the approval of AIG's Board of Directors or the Finance Committee of the Board if it exceeds certain pre-approved limits.

As backup for the commercial paper program and for other general corporate purposes, AIG and AIG Funding maintain revolving credit facilities, which, as of December 31, 2007, had an aggregate of \$9.3 billion available to be drawn and which are summarized below under Revolving Credit Facilities.

**ILFC**

ILFC fulfills its short-term cash requirements through operating cash flows and the issuance of commercial paper. The issuance of commercial paper is subject to the approval of ILFC's Board of Directors and is not guaranteed by AIG. ILFC maintains syndicated revolving credit facilities which, as of December 31, 2007, totaled \$6.5 billion and which are summarized below under Revolving Credit Facilities. These facilities are used as back up for ILFC's maturing debt and other obligations.

As a well-known seasoned issuer, ILFC has filed an automatic shelf registration statement with the SEC allowing ILFC immediate access to the U.S. public debt markets. At December 31, 2007, \$4.7 billion of debt securities had been issued under this registration statement and \$5.9 billion had been issued under a prior registration statement. In addition, ILFC has a Euro medium-term note program for \$7.0 billion, under which \$3.8 billion in notes were outstanding at December 31, 2007. Notes issued under the Euro medium-term note program are included in ILFC notes and bonds payable in the preceding table of borrowings. The cumulative foreign exchange adjustment loss for the foreign currency denominated debt resulting from the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133 was \$969 million at December 31, 2007 and \$733 million at December 31, 2006. ILFC has substantially eliminated the currency exposure arising from foreign currency denominated notes by economically hedging the portion of the note exposure not already offset by Euro-denominated operating lease payments.

ILFC had a \$4.3 billion Export Credit Facility for use in connection with the purchase of approximately 75 aircraft delivered through 2001. This facility was guaranteed by various European Export Credit Agencies. The interest rate varies from



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5.75 percent to 5.90 percent on these amortizing ten-year borrowings depending on the delivery date of the aircraft. At December 31, 2007, ILFC had \$664 million outstanding under this facility. The debt is collateralized by a pledge of the shares of a subsidiary of ILFC, which holds title to the aircraft financed under the facility.

In May 2004, ILFC entered into a similarly structured Export Credit Facility for up to a maximum of \$2.6 billion for Airbus aircraft to be delivered through May 31, 2005. The facility was subsequently increased to \$3.6 billion and extended to include aircraft to be delivered through May 31, 2008. The facility becomes available as the various European Export Credit Agencies provide their guarantees for aircraft based on a nine-month forward-looking calendar, and the interest rate is determined through a bid process. At December 31, 2007, ILFC had \$1.9 billion outstanding under this facility. Borrowings with respect to these facilities are included in ILFC's notes and bonds payable in the preceding table of borrowings. The debt is collateralized by a pledge of shares of a subsidiary of ILFC, which holds title to the aircraft financed under the facility.

From time to time, ILFC enters into funded financing agreements. As of December 31, 2007, ILFC had a total of \$1.1 billion outstanding, which has varying maturities through February 2012. The interest rates are LIBOR-based, with spreads ranging from 0.30 percent to 1.625 percent.

The proceeds of ILFC's debt financing are primarily used to purchase flight equipment, including progress payments during the construction phase. The primary sources for the repayment of this debt and the interest expense thereon are the cash flow from operations, proceeds from the sale of flight equipment and the rollover and refinancing of the prior debt. AIG does not guarantee the debt obligations of ILFC. See also Liquidity herein.

**AGF**

AGF fulfills most of its short-term cash borrowing requirements through the issuance of commercial paper. The issuance of commercial paper is subject to the approval of AGF's Board of Directors and is not guaranteed by AIG. AGF maintains committed syndicated revolving credit facilities which, as of December 31, 2007, totaled \$4.8 billion and which are summarized below under Revolving Credit Facilities. The facilities can be used for general corporate purposes and to provide backup for AGF's commercial paper programs.

In January 2007, AGF issued junior subordinated debentures in an aggregate principal amount of \$350 million that mature in January 2067. The debentures underlie a series of trust preferred securities sold by a trust sponsored by AGF in a Rule 144A/Regulation S offering. AGF can redeem the debentures at par beginning in January 2017.

As of December 31, 2007, notes and bonds aggregating \$22.4 billion were outstanding with maturity dates ranging from 2008 to 2031 at interest rates ranging from 1.94 percent to 8.45 percent. To the extent deemed appropriate, AGF may enter into swap transactions to manage its effective borrowing rates with respect to these notes and bonds. As a well-known seasoned issuer, AGF filed an automatic shelf registration statement with the SEC allowing AGF immediate access to the U.S. public debt markets. At December 31, 2007, AGF had remaining corporate authorization to issue up to \$8.1 billion of debt securities under its shelf registration statements.

AGF's funding sources include a medium-term note program, private placement debt, retail note issuances, bank financing and securitizations of finance receivables that AGF accounts for as on-balance-sheet secured financings. In addition, AGF has become an established issuer of long-term debt in the international capital markets.

In addition to debt refinancing activities, proceeds from the collection of finance receivables are used to fund cash needs including the payment of principal and interest on AGF's debt. AIG does not guarantee any of the debt obligations of AGF. See also Liquidity.

**AIGCFG**

AIGCFG has a variety of funding mechanisms for its various markets, including retail and wholesale deposits, short and long-term bank loans, securitizations and intercompany subordinated debt. AIG Credit Card Company (Taiwan), a consumer finance business in Taiwan, and AIG Retail Bank PLC, a full service consumer bank in Thailand, have issued commercial paper for the funding of their respective operations. AIG does not guarantee any borrowings for AIGCFG businesses, including this commercial paper.



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**Revolving Credit Facilities**

AIG, ILFC and AGF maintain committed, unsecured revolving credit facilities listed on the table below in order to support their respective commercial paper programs and for general corporate purposes. AIG, ILFC and AGF expect to replace or extend these credit facilities on or prior to their expiration. Some of the facilities, as noted below, contain a term-out option allowing for the conversion by the borrower of any outstanding loans at expiration into one-year term loans.

As of December 31, 2007 (*in millions*)

Facility	Size	Borrower(s)	Available Amount	Expiration	One-Year Term-Out Option
<b>AIG:</b>					
364-Day Syndicated Facility	\$2,125	AIG/AIG Funding <sup>(a)</sup> AIG Capital Corporation <sup>(a)</sup>	\$2,125	July 2008	Yes
5-Year Syndicated Facility	1,625	AIG/AIG Funding <sup>(a)</sup> AIG Capital Corporation <sup>(a)</sup>	1,625	July 2011	No
364-Day Bilateral Facility <sup>(b)</sup>	3,200	AIG/AIG Funding	210	December 2008	Yes
364-Day Intercompany Facility <sup>(c)</sup>	5,335	AIG	5,335	September 2008	Yes
<b>Total AIG</b>	<b>\$12,285</b>		<b>\$9,295</b>		
<b>ILFC:</b>					
5-Year Syndicated Facility	\$2,500	ILFC	\$2,500	October 2011	No
5-Year Syndicated Facility	2,000	ILFC	2,000	October 2010	No
5-Year Syndicated Facility	2,000	ILFC	2,000	October 2009	No
<b>Total ILFC</b>	<b>\$6,500</b>		<b>\$6,500</b>		
<b>AGF:</b>					
364-Day Syndicated Facility	\$2,625	American General Finance Corporation American General Finance, Inc. <sup>(d)</sup>	\$2,625	July 2008	Yes
5-Year Syndicated Facility	2,125	American General Finance Corporation	2,125	July 2010	No
<b>Total AGF</b>	<b>\$4,750</b>		<b>\$4,750</b>		

(a) *Guaranteed by AIG.*

(b) *This facility can be drawn in the form of loans or letters of credit. All drawn amounts shown above are in the form of letters of credit.*

(c) *Subsidiaries of AIG are the lenders on this facility.*

(d) *American General Finance, Inc. is an eligible borrower for up to \$400 million only.*

### Credit Ratings

The cost and availability of unsecured financing for AIG and its subsidiaries are generally dependent on their short-and long-term debt ratings. The following table presents the credit ratings of AIG and certain of its subsidiaries as of February 15, 2008. In parentheses, following the initial occurrence in the table of each rating, is an indication of that rating's relative rank within the agency's rating categories. That ranking refers only to the generic or major rating category and not to the modifiers appended to the rating by the rating agencies to denote relative position within such generic or major category.

	Short-term Debt			Senior Long-term Debt		
	Moody's	S&P	Fitch	Moody's <sup>(g)</sup>	S&P <sup>(b)</sup>	Fitch <sup>(c)</sup>
AIG	P-1 (1st of 3)	A-1+ (1st of 6)	F1+ (1st of 5)	Aa2 <sup>(e)</sup> (2nd of 9)	AA (2nd of 8) <sup>(f)</sup>	AA (2nd of 9) <sup>(h)</sup>
AIG Financial Products Corp. <sup>(d)</sup>	P-1	A-1+		Aa2 <sup>(e)</sup>	AA <sup>(f)</sup>	
AIG Funding, Inc. <sup>(d)</sup>	P-1	A-1+	F1+			
ILFC	P-1	A-1+	F1 (1st of 5)	A1 (3rd of 9)	AA- (2nd of 8) <sup>(g)</sup>	A+ (3rd of 9) <sup>(h)</sup>
American General Finance Corporation	P-1	A-1 (1st of 6)	F1	A1	A+ (3rd of 8)	A+ <sup>(h)</sup>
American General Finance, Inc.	P-1	A-1	F1			A+ <sup>(h)</sup>

(a) *Moody's Investors Service (Moody's) appends numerical modifiers 1, 2 and 3 to the generic rating categories to show relative position within rating categories.*

(b) *Standard & Poor's, a division of the McGraw-Hill Companies (S&P) ratings may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.*

(c) *Fitch Ratings (Fitch) ratings may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.*

(d) *AIG guarantees all obligations of AIG Financial Products Corp. and AIG Funding, Inc.*

(e) *Negative rating outlook on Senior Unsecured Debt Ratings. A negative outlook by Moody's indicates that a rating may be lowered but is not necessarily a precursor of a ratings change.*

(f) *Negative rating outlook on Counterparty Credit Ratings. A negative outlook by S&P indicates that a rating may be lowered but is not necessarily a precursor of a ratings change.*

(g) *Negative rating outlook on Corporate Credit Rating. A negative outlook by S&P indicates that a rating may be lowered but is not necessarily a precursor of a ratings change.*

*(h) Issuer Default and Senior Unsecured Debt Ratings on Rating Watch Negative. Rating Watch Negative indicates that a rating has been placed on active rating watch status.*

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These credit ratings are current opinions of the rating agencies. As such, they may be changed, suspended or withdrawn at any time by the rating agencies as a result of changes in, or unavailability of, information or based on other circumstances. Ratings may also be withdrawn at AIG management's request. This discussion of ratings is not a complete list of ratings of AIG and its subsidiaries.

Ratings triggers have been defined by one independent rating agency to include clauses or agreements the outcome of which depends upon the level of ratings maintained by one or more rating agencies. Ratings triggers generally relate to events which (i) could result in the termination or limitation of credit availability, or require accelerated repayment, (ii) could result in the termination of business contracts or (iii) could require a company to post collateral for the benefit of counterparties.

AIG believes that any of its own or its subsidiaries' contractual obligations that are subject to ratings triggers or financial covenants relating to ratings triggers would not have a material adverse effect on its financial condition or liquidity. Ratings downgrades could also trigger the application of termination provisions in certain of AIG's contracts, principally agreements entered into by AIGFP and assumed reinsurance contracts entered into by Transatlantic.

It is estimated that, as of the close of business on February 14, 2008, based on AIGFP's outstanding municipal GIAs and financial derivatives transactions as of such date, a downgrade of AIG's long-term senior debt ratings to Aa3 by Moody's or AA by S&P would permit counterparties to call for approximately \$1.39 billion of collateral. Further, additional downgrades could result in requirements for substantial additional collateral, which could have a material effect on how AIGFP manages its liquidity. The actual amount of additional collateral that AIGFP would be required to post to counterparties in the event of such downgrades depends on market conditions, the fair value of the outstanding affected transactions and other factors prevailing at the time of the downgrade. Additional obligations to post collateral would increase the demand on AIGFP's liquidity.

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**Contractual Obligations****Contractual obligations in total, and by remaining maturity at December 31, 2007 were as follows:**

<i>(in millions)</i>	Payments due by Period				
	Total Payments	Less Than One Year	1-3 Years	3+-5 Years	Over Five Years
Borrowings <sup>(a)</sup>	\$ 156,014	\$ 43,891	\$ 32,261	\$26,032	\$ 53,830
Interest payments on borrowings	83,551	5,326	8,899	7,073	62,253
Loss reserves <sup>(b)</sup>	85,500	23,513	26,078	12,397	23,512
Insurance and investment contract liabilities <sup>(c)</sup>	645,583	32,359	42,768	42,282	528,174
GIC liabilities <sup>(d)</sup>	29,797	9,266	8,052	3,458	9,021
Aircraft purchase commitments	20,104	4,174	3,852	2,095	9,983
Operating leases	4,426	747	1,041	693	1,945
Other purchase obligations <sup>(e)</sup>	1,091	1,056	35		
<b>Total<sup>(f)</sup></b>	<b>\$1,026,066</b>	<b>\$120,332</b>	<b>\$122,986</b>	<b>\$94,030</b>	<b>\$688,718</b>

*(a) Excludes commercial paper and borrowings incurred by consolidated investments and includes hybrid financial instrument liabilities recorded at fair value.*

*(b) Represents future loss and loss adjustment expense payments estimated based on historical loss development payment patterns. Due to the significance of the assumptions used, the periodic amounts presented could be materially different from actual required payments.*

*(c) Insurance and investment contract liabilities include various investment-type products with contractually scheduled maturities, including periodic payments of a term certain nature. Insurance and investment contract liabilities also include benefit and claim liabilities, of which a significant portion represents policies and contracts that do not have stated contractual maturity dates and may not result in any future payment obligations. For these policies and contracts (i) AIG is currently not making payments until the occurrence of an insurable event, such as death or disability, (ii) payments are conditional on survivorship, or (iii) payment may occur due to a surrender or other non-scheduled event out of AIG's control. AIG has made significant assumptions to determine the estimated undiscounted cash flows of these contractual policy benefits, which assumptions include mortality, morbidity, future lapse rates, expenses, investment returns and interest crediting rates, offset by expected future deposits and premium on in-force policies. Due to the significance of the assumptions used, the periodic amounts presented could be materially different from actual required payments. The amounts presented in this table are undiscounted and therefore exceed the future policy benefits and policyholder contract deposits included in the balance sheet.*

*(d) Represents guaranteed maturities under GICs.*

*(e) Includes a \$1.0 billion commitment to purchase shares under AIG's share repurchase program which was paid in January 2008 and options to acquire aircraft.*

*(f)*

Does not reflect unrecognized tax benefits of \$1.3 billion, the timing of which is uncertain. However, it is reasonably possible that \$50 million to \$150 million may become payable during 2008. See Note 21 to Consolidated Financial Statements for a discussion on unrecognized tax benefits.

### Off Balance Sheet Arrangements and Commercial Commitments

Off Balance Sheet Arrangements and Commercial Commitments in total, and by remaining maturity at December 31, 2007 were as follows:

(in millions)	Total Amounts Committed	Amount of Commitment Expiration			
		Less Than One Year	1-3 Years	3+-5 Years	Over Five Years
<b>Guarantees:</b>					
Liquidity facilities <sup>(a)</sup>	\$ 2,495	\$ 8	\$ 8	\$1,503	\$ 976
Standby letters of credit	1,713	1,485	42	38	148
Construction guarantees <sup>(b)</sup>	687				687
Guarantees of indebtedness	1,124	106	83	500	435
All other guarantees	767	249	8	35	475
<b>Commitments:</b>					
Investment commitments <sup>(c)</sup>	9,071	3,527	3,604	1,684	256
Commitments to extend credit	1,325	496	591	238	
Letters of credit	1,196	910	6	121	159
Investment protection agreements <sup>(d)</sup>	11,991	3,088	2,094	855	5,954
Maturity shortening puts <sup>(e)</sup>	2,333	1,234	1,099		
Other commercial commitments	1,269	114	111	83	961
<b>Total<sup>(f)</sup></b>	<b>\$ 33,971</b>	<b>\$11,217</b>	<b>\$7,646</b>	<b>\$5,057</b>	<b>\$10,051</b>

(a) Primarily liquidity facilities provided in connection with certain municipal swap transactions and collateralized bond obligations.

(b) Primarily AIG SunAmerica construction guarantees connected to affordable housing investments.

(c) Includes commitments to invest in limited partnerships, private equity, hedge funds and mutual funds and commitments to purchase and develop real estate in the United States and abroad.

(d) Written generally with respect to investments in hedge funds and funds of hedge funds.

(e) Represents obligations under 2a-7 Puts to purchase certain multi-sector CDOs at pre-determined contractual prices.

(f) Excludes commitments with respect to pension plans. The annual pension contribution for 2008 is expected to be approximately \$118 million for U.S. and non-U.S. plans.



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AIG enters into various off-balance-sheet (unconsolidated) arrangements with variable interest entities (VIEs) in the normal course of business. AIG's involvement with VIEs ranges from being a passive investor to designing and structuring, warehousing and managing the collateral of VIEs. AIG engages in transactions with VIEs as part of its investment activities to obtain funding and to facilitate client needs. AIG purchases debt securities (rated and unrated) and equity interests issued by VIEs, makes loans and provides other credit support to VIEs, enters into insurance, reinsurance and derivative transactions and leasing arrangements with VIEs, and acts as the warehouse agent and collateral manager for VIEs.

Under FIN 46(R), AIG consolidates a VIE when it is the primary beneficiary of the entity. The primary beneficiary is the party that either (i) absorbs a majority of the VIE's expected losses; (ii) receives a majority of the VIE's expected residual returns; or (iii) both. For a further discussion of AIG's involvement with VIEs, see Note 7 of Notes to Consolidated Financial Statements.

A significant portion of AIG's overall exposure to VIEs results from AIG Investment's real estate and investment funds.

In certain instances, AIG Investments acts as the collateral manager or general partner of an investment fund, private equity fund or hedge fund. Such entities are typically registered investment companies or qualify for the specialized investment company accounting in accordance with the AICPA Investment Company Audit and Accounting Guide. For investment partnerships, hedge funds and private equity funds, AIG acts as the general partner or manager of the fund and is responsible for carrying out the investment mandate of the VIE. Often, AIG's insurance operations participate in these AIG managed structures as a passive investor in the debt or equity issued by the VIE. Typically, AIG does not provide any guarantees to the investors in the VIE.

**The following table summarizes, by investment activity, AIG's involvement with VIEs. Maximum exposure to loss, as detailed in the table below, is considered to be the notional amount of credit lines, guarantees and other credit support, and liquidity facilities, notional amounts of credit default swaps and certain total return swaps, and the amount invested in the debt or equity issued by the VIEs.**

	Primary Beneficiary		Significant Variable Interest Holder*	
	Total Assets	Total Assets	Total Assets	Maximum Exposure to Loss
(As of December 31,)	2007	2006	2007	2007
<i>(in billions)</i>	2007	2006	2007	2007
Description				
Real estate and investment funds	\$21.7	\$6.1	\$139.0	\$18.5
Tax planning VIEs	0.5	1.4	12.1	6.3
CLOs/ CDOs/ CBOs	0.4		107.8	9.7
Affordable housing partnerships	2.7		0.9	0.9
Other	1.7	1.6	15.3	9.2
<b>Total</b>	<b>\$27.0</b>	<b>\$9.1</b>	<b>\$275.1</b>	<b>\$44.6</b>

\* Includes \$2.4 billion of assets held in an unconsolidated SIV sponsored by AIGFP in 2007. As of December 31, 2007, AIGFP's invested assets included \$1.7 billion of securities purchased under agreements to resell, commercial paper and medium-term and capital notes issued by this entity.

Following is additional information concerning AIG's involvement with collateralized debt obligations and its structured investment vehicle.

### **Collateralized Debt Obligations**

In the normal course of its asset management operations, AIG manages or sponsors CDOs which issue debt and equity interests sold to third party investors. AIG's subsidiaries also invest in the debt and equity securities issued by these CDOs as part of their normal investment activities. AIG also invests in and manages CDOs sponsored by third parties, warehouses assets prior to the establishment of and sale of the warehoused assets to a CDO, enters into derivative contracts with CDOs, including credit default swaps, and acts as an asset manager to CDOs.

Categories of assets owned by these CDOs include residential and commercial mortgage and other asset-backed securities, corporate loans, high-yield and high-grade loans and bonds, and credit default contracts, among other assets, that have ratings ranging from AAA to unrated. AIGFP's portfolio of multi-sector CDOs and, to a lesser extent, certain AIG insurance subsidiaries' direct investments in CDOs, have experienced some downgrades within their asset portfolios. AIG does not expect that it will have to consolidate any of these structures.

These CDOs typically are funded with commercial paper, medium and long-term financing and equity with ratings that range from AAA to unrated. AIG has no obligation to purchase, and has not purchased, any commercial paper issued by these CDOs or provided any support to these CDOs in obtaining financing, and does not intend to do so. However, AIGFP has written the 2a-7 Puts which are included as part of its multi-sector credit default swap portfolio. Under the terms of these securities the holders are permitted or required, in certain circumstances, on a regular basis to tender their securities to the issuers at par. If an issuer's remarketing agent is unable to resell

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the securities so tendered within the maximum interest rate spread range specified in the terms of the securities, AIGFP must purchase the securities at par as long as the securities have not experienced a default. During 2007, AIGFP purchased securities with a principal amount of approximately \$754 million in connection with these obligations. In respect of certain of the 2a-7 Puts, AIGFP has contracted with third parties to provide liquidity for the securities if they are put to AIGFP for up to a three-year period. Such liquidity facilities totaled approximately \$3 billion at December 31, 2007. As of February 26, 2008, AIGFP has not utilized these liquidity facilities. At December 31, 2007, AIGFP had approximately \$6.5 billion of notional exposure on these 2a-7 Puts.

**Structured Investment Vehicle**

AIGFP sponsors one unconsolidated SIV that invests in variable rate, investment-grade debt securities with a weighted average remaining life of four years at December 31, 2007. Assets of the SIV totaled \$2.4 billion at December 31, 2007. Approximately \$31.9 million of these assets have been downgraded one notch from Aa3/AA- to A1/A+ by Moody's and S&P, respectively, since the purchase of these assets by the SIV. The SIV funds its assets by issuing secured financing, commercial paper, and medium-term notes that had a weighted-average remaining life of less than six months at December 31, 2007. The mismatch between the weighted average remaining life of the SIV's assets and liabilities has been removed through the funding support from AIGFP described in the next paragraph. The SIV also issued approximately \$300 million of capital notes originally rated Baa2 and BBB by Moody's and S&P, respectively, and subsequently downgraded in 2007 to B3 and BB- (credit watch negative), respectively, of which AIGFP owns 12 percent.

At December 31, 2007, AIGFP had \$1.7 billion of balance sheet exposure to this SIV representing investments in securities purchased under agreements to resell, commercial paper, and medium-term and capital notes. During the credit market disruptions during the last half of 2007, the SIV experienced difficulty attracting purchasers for its commercial paper and medium-term notes. In January 2008, AIGFP agreed to provide funding support to the SIV, as necessary, to allow the SIV to redeem its commercial paper and medium-term notes as they become due. Moody's affirmed the SIV's senior debt ratings of Aaa. S&P affirmed the SIV's long term issuer credit rating of AAA with a negative outlook and downgraded its capital notes from BB- to CCC- and this rating remains on credit watch negative. AIG does not believe its management of, and current or future investments in, the SIV could have any effect on AIG's debt ratings under any circumstances.

## Shareholders' Equity

**The changes in AIG's consolidated shareholders' equity during 2007 and 2006 follows:**

<i>(in millions)</i>	2007	2006
Beginning of year	\$ 101,677	\$ 86,317
Net income	6,200	14,048
Unrealized appreciation (depreciation) of investments, net of tax	(5,708)	1,735
Cumulative translation adjustment, net of tax	1,185	936
Dividends to shareholders	(1,964)	(1,690)
Payments advanced to purchase shares, net	(912)	
Share purchases	(5,104)	
Other*	427	331
End of year	\$ 95,801	\$ 101,677

\*Reflects the effects of employee stock transactions and cumulative effect of accounting changes.

As indicated in the table above, a significant portion of the 2007 decrease in AIG's consolidated equity during 2007 was the result of share purchases, substantially all of which were funded from the issuance of hybrid debt securities. The effect of these transactions was to replace high cost equity securities (common stock) with cost efficient hybrid securities, a substantial portion of which is treated as equity capital for the purpose of rating agency leverage calculations.

AIG has in the past reinvested most of its unrestricted earnings in its operations and believes such continued reinvestment in the future will be adequate to meet any foreseeable capital needs. However, AIG may choose from time to time to raise additional funds through the issuance of additional securities.

In February 2007, AIG's Board of Directors adopted a new dividend policy, which took effect with the dividend declared in the second quarter of 2007, providing that under ordinary circumstances, AIG's plan will be to increase its common stock dividend by approximately 20 percent annually. The payment of any dividend, however, is at the discretion of AIG's Board of Directors, and the future payment of dividends will depend on various factors, including the performance of AIG's businesses, AIG's consolidated financial position, results of operations and liquidity and the existence of investment opportunities.

#### **Share Repurchases**

From time to time, AIG may buy shares of its common stock for general corporate purposes, including to satisfy its obligations under various employee benefit plans. In February 2007, AIG's Board of Directors increased AIG's share repurchase program by authorizing the purchase of shares with an aggregate purchase price of \$8 billion. In November 2007, AIG's Board of Directors authorized the purchase of an additional \$8 billion in common stock. From March through December 31, 2007, AIG entered into structured share repurchase arrangements providing for the purchase of shares over time with an aggregate purchase price of

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\$7 billion, including a \$1.0 billion commitment entered into in December 2007 but not funded until January 2008.

A total of 76,361,209 shares were purchased during 2007. The portion of the payments advanced by AIG under the structured share repurchase arrangements that had not yet been utilized to repurchase shares at December 31, 2007, amounting to \$912 million, has been recorded as a component of shareholders' equity under the caption, Payments advanced to purchase shares. Purchases have continued subsequent to December 31, 2007, with an additional 12,196,187 shares purchased from January 1 through February 15, 2008. All shares purchased are recorded as treasury stock at cost.

At February 15, 2008, \$10.25 billion was available for purchases under the aggregate authorization. AIG does not expect to purchase additional shares under its share repurchase program for the foreseeable future, other than to meet commitments that existed at December 31, 2007.

**Dividends from Insurance Subsidiaries**

Payments of dividends to AIG by its insurance subsidiaries are subject to certain restrictions imposed by regulatory authorities. With respect to AIG's domestic insurance subsidiaries, the payment of any dividend requires formal notice to the insurance department in which the particular insurance subsidiary is domiciled. Under the laws of many states, an insurer may pay a dividend without prior approval of the insurance regulator when the amount of the dividend is below certain regulatory thresholds. Other foreign jurisdictions, notably Bermuda, Japan, Hong Kong, Taiwan, the U.K., Thailand and Singapore, may restrict the ability of AIG's foreign insurance subsidiaries to pay dividends. Largely as a result of these restrictions, approximately 81 percent of the aggregate equity of AIG's consolidated subsidiaries was restricted from immediate transfer to AIG parent at December 31, 2007. See Regulation and Supervision herein. AIG cannot predict how recent regulatory investigations may affect the ability of its regulated subsidiaries to pay dividends. To AIG's knowledge, no AIG company is currently on any regulatory or similar "watch list" with regard to solvency. See also Liquidity herein, Note 12 to Consolidated Financial Statements and Item 1A. Risk Factors - Liquidity.

**Regulation and Supervision**

AIG's insurance subsidiaries, in common with other insurers, are subject to regulation and supervision by the states and jurisdictions in which they do business. In the United States, the NAIC has developed Risk-Based Capital (RBC) requirements. RBC relates an individual insurance company's statutory surplus to the risk inherent in its overall operations.

AIG's insurance subsidiaries file financial statements prepared in accordance with statutory accounting practices prescribed or permitted by domestic and foreign insurance regulatory authorities. The principal differences between statutory financial statements and financial statements prepared in accordance with U.S. GAAP for domestic companies are that statutory financial statements do not reflect DAC, some bond portfolios may be carried at amortized cost, assets and liabilities are presented net of reinsurance, policyholder liabilities are valued using more conservative assumptions and certain assets are non-admitted.

In connection with the filing of the 2005 statutory financial statements for AIG's Domestic General Insurance companies, AIG agreed with the relevant state insurance regulators on the statutory accounting treatment of various items. The regulatory authorities have also permitted certain of the domestic and foreign insurance subsidiaries to support the carrying value of their investments in certain non-insurance and foreign insurance subsidiaries by utilizing the AIG audited consolidated financial statements to satisfy the requirement that the U.S. GAAP-basis equity of such entities be audited. In addition, the regulatory authorities have permitted the Domestic General Insurance companies to utilize audited financial statements prepared on a basis of accounting other than U.S. GAAP to value investments in joint ventures, limited partnerships and hedge funds. AIG has received similar permitted practices authorizations from insurance regulatory authorities in connection with the 2007 and 2006 statutory financial statements. These permitted practices did not affect the Domestic General Insurance companies' compliance with minimum regulatory capital requirements.

Statutory capital of each company continued to exceed minimum company action level requirements following the adjustments, but AIG nonetheless contributed an additional \$750 million of capital into American Home effective September 30, 2005 and contributed a further \$2.25 billion of capital in February 2006 for a total of approximately \$3 billion of capital into Domestic General Insurance subsidiaries effective December 31, 2005. To enhance their current capital positions, AIG suspended dividends from the DBG companies from the fourth quarter 2005 through 2006, dividend payments resumed in the first quarter of 2007. AIG believes it has the capital resources and liquidity to fund any necessary statutory capital contributions.

As discussed under Item 3. Legal Proceedings, various regulators have commenced investigations into certain insurance business practices. In addition, the OTS and other regulators routinely conduct examinations of AIG and its subsidiaries, including AIG's consumer finance operations. AIG cannot predict the ultimate effect that these investigations and examinations, or any additional regulation arising therefrom, might have on its business. Federal, state or local legislation may affect AIG's ability to operate and expand its various financial services businesses, and changes in the current laws, regulations or interpretations thereof may have a material adverse effect on these businesses.

AIG's U.S. operations are negatively affected under guarantee fund assessment laws which exist in most states. As a result of operating in a state which has guarantee fund assessment laws, a solvent insurance company may be assessed for certain obligations arising from the insolvencies of other insurance companies which operated in that state. AIG generally records these assessments upon notice. Additionally, certain states permit at least a portion of the assessed amount to be used as a credit against a company's future premium tax liabilities. Therefore, the ultimate net assessment cannot reasonably be estimated. The guarantee fund assessments net of credits recognized

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in 2007, 2006 and 2005, respectively, were \$87 million, \$97 million and \$124 million.

AIG is also required to participate in various involuntary pools (principally workers compensation business) which provide insurance coverage for those not able to obtain such coverage in the voluntary markets. This participation is also recorded upon notification, as these amounts cannot reasonably be estimated.

A substantial portion of AIG's General Insurance business and a majority of its Life Insurance & Retirement Services business are conducted in foreign countries. The degree of regulation and supervision in foreign jurisdictions varies. Generally, AIG, as well as the underwriting companies operating in such jurisdictions, must satisfy local regulatory requirements. Licenses issued by foreign authorities to AIG subsidiaries are subject to modification and revocation. Thus, AIG's insurance subsidiaries could be prevented from conducting future business in certain of the jurisdictions where they currently operate. AIG's international operations include operations in various developing nations. Both current and future foreign operations could be adversely affected by unfavorable political developments up to and including nationalization of AIG's operations without compensation. Adverse effects resulting from any one country may affect AIG's results of operations, liquidity and financial condition depending on the magnitude of the event and AIG's net financial exposure at that time in that country.

Foreign insurance operations are individually subject to local solvency margin requirements that require maintenance of adequate capitalization, which AIG complies with by country. In addition, certain foreign locations, notably Japan, have established regulations that can result in guarantee fund assessments. These have not had a material effect on AIG's financial condition or results of operations.

**Liquidity**

AIG manages liquidity at both the subsidiary and parent company levels. At December 31, 2007, AIG's consolidated invested assets included \$65.6 billion in cash and short-term investments. Consolidated net cash provided from operating activities in 2007 amounted to \$35.2 billion. At both the subsidiary and parent company level, liquidity management activities are intended to preserve and enhance funding stability, flexibility, and diversity through a wide range of potential operating environments and market conditions.

As a result of market disruption in the credit markets, AIG took steps to enhance the liquidity of its portfolios. Cash and short-term investments increased in all of AIG's major operating segments. In addition, AIG created an interdisciplinary Liquidity Risk Committee to measure, monitor, control and aggregate liquidity risks across AIG. While this Committee's responsibilities are broad, the Committee's initial focus is on portfolios with shorter-term contractual liabilities, such as securities lending in the United States and retail deposit-like products in the United Kingdom.

Management believes that AIG's liquid assets, cash provided by operations and access to the capital markets will enable it to meet its anticipated cash requirements, including the funding of increased dividends under AIG's current dividend policy. See also Item 1A. Risk Factors—Liquidity and Risk Management herein.

**Insurance Operations**

Insurance operating cash flow is derived from two sources, underwriting operations and investment operations. Cash flow from underwriting operations includes collections of periodic premiums and policyholders' contract deposits, and paid loss recoveries, less reinsurance premiums, losses, benefits, and acquisition and operating expenses. Generally, there is a time lag from when premiums are collected and losses and benefits are paid. Investment cash flow is primarily derived from interest and dividends received and includes realized capital gains net of realized capital losses.

Liquid assets include cash and short-term investments, fixed maturities that are not designated as held to maturity, and publicly traded equity securities. At December 31, 2007 and 2006, AIG's insurance operations had liquid assets of \$476.1 billion and \$428.4 billion, respectively. The portion of liquid assets comprised of cash and short-term investments was \$45.5 billion and \$19.9 billion at December 31, 2007 and 2006, respectively. At December 31, 2007, \$380.9 billion, or 95 percent of the fixed maturity investments that were not designated as held to maturity in AIG's insurance company general account portfolios were rated investment grade. Given the size and liquidity profile of AIG's investment portfolios, AIG believes that deviations from its projected claim experience do not constitute a

significant liquidity risk. AIG's asset/liability management process takes into account the expected maturity of investments and expected benefit payments and policy surrenders as well as the specific nature and risk profile of these liabilities. Historically, there has been no significant variation between the expected maturities of AIG's investments and the payment of claims.

See also Operating Review General Insurance Operations General Insurance Net Investment Income and Life Insurance & Retirement Services Operations Life Insurance & Retirement Services Net Investment Income and Realized Capital Gains (Losses) herein.

#### **General Insurance**

General Insurance operating cash flow is derived from underwriting and investment activities. With respect to General Insurance operations, if paid losses accelerated beyond AIG's ability to fund such paid losses from current operating cash flows, AIG might need to liquidate a portion of its General Insurance investment portfolio and/or arrange for financing. A liquidity strain could result from the occurrence of several significant catastrophic events in a relatively short period of time. Additional strain on liquidity could occur if the investments liquidated to fund such paid losses were sold into a depressed market place and/or reinsurance recoverable on such paid losses became uncollectible or collateral supporting such reinsurance recoverable significantly decreased in value.



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Life Insurance & Retirement Services operating cash flow is derived from underwriting and investment activities. If a substantial portion of the Life Insurance & Retirement Services operations bond portfolio diminished significantly in value and/or defaulted, AIG might need to liquidate other portions of its Life Insurance & Retirement Services investment portfolio and/or arrange financing. Possible events causing such a liquidity strain could include economic collapse of a nation or region in which Life Insurance & Retirement Services operations exist, nationalization, catastrophic terrorist acts, or other economic or political upheaval. In addition, a significant rise in interest rates in a particular region or regions leading to a major increase in policyholder surrenders could also create a liquidity strain.

**Financial Services**

AIG's major Financial Services operating subsidiaries consist of AIGFP, ILFC, AGF and AIGCFG. Sources of funds considered in meeting the liquidity needs of AIGFP's operations include GIAs, issuance of long- and short-term debt, proceeds from maturities, sales of securities available for sale and securities and spot commodities leased or sold under repurchase agreements. ILFC, AGF and AIGCFG utilize the commercial paper markets, bank loans and bank credit facilities as sources of liquidity. ILFC and AGF also fund in the domestic and international capital markets without reliance on any guarantee from AIG. An additional source of liquidity for ILFC is the use of export credit facilities. AIGCFG also uses wholesale and retail bank deposits as sources of funds. On occasion, AIG has provided equity capital to ILFC, AGF and AIGCFG and provides intercompany loans to AIGCFG.

Financial Services liquidity could be impaired by an inability to access the capital markets or by collateral calls. The credit default swaps written by AIGFP on super senior tranches of multi-sector CDOs require, in most cases, physical settlement following an event constituting a failure to pay in respect of the underlying super senior CDO securities. The majority of the other credit default swaps are cash settled, whereby AIGFP would be required upon an event constituting a failure to pay in respect of the underlying super senior CDO securities to make cash payments to the counterparty equal to any actual losses that attach to the super senior risk layer, rather than to purchase the reference obligation. Additionally, certain of the credit default swaps are subject to collateral call provisions. In the case of such swaps written on CDOs, the amount of the collateral to be posted is determined based on the value of the CDO securities referenced in the documentation for the credit default swaps.

**Asset Management**

Asset Management's sources of funds include cash flows from investment management fees, carried interest and returns on various investments. These investments are financed through the issuance of AIG debt in the MIP, the issuance of GICs and funding from AIG. From time to time, AIG Investments utilizes temporary debt funding from AIG primarily to acquire warehoused investments. Subsequent to the initial investment, there are generally no liquidity demands with respect to these warehoused investments. To the extent adverse market conditions prevent AIG Investments from transferring or otherwise divesting these warehoused investments, repayment of the temporary equity funding provided by AIG would be delayed until the investment is transferred or otherwise divested.

AIG Investments incurs expenses associated with cash outflows from the operation of its business, including costs related to portfolio management and related back and middle office costs. In addition, cash is used in association with investment warehousing activities wherein AIG Investments funds and temporarily holds an investment until transferred, sold or otherwise divested.

Cash needs for the Spread-Based Investment business are principally the result of GIC maturities. Significant blocks of the GIC portfolio will mature over the next five years. AIG utilizes asset liability matching to control liquidity risks associated with this business. In addition, AIG believes that its products incorporate certain restrictions which encourage persistency, limiting the magnitude of unforeseen early surrenders in the GIC portfolio.

Liquidity for Asset Management operations can be affected by significant credit or geopolitical events that might cause a delay in fund closings, securitizations or an inability of AIG's clients to fund their capital commitments.

**AIG (Parent Company)**

The liquidity of the parent company is principally derived from its subsidiaries. The primary sources of cash flow are dividends and other payments from its regulated and unregulated subsidiaries, as well as issuance of debt securities. Primary uses of cash flow are for debt service, subsidiary funding, shareholder dividend payments and common stock repurchases. In 2007, AIG parent collected \$4.9 billion in dividends and other payments from subsidiaries (primarily from insurance company subsidiaries), issued \$11.7 billion of debt and retired \$865 million of debt, excluding MIP and Series AIGFP debt. AIG parent also advanced \$6 billion for structured share repurchase arrangements. Excluding MIP and Series AIGFP debt, AIG parent made interest payments totaling \$550 million, made \$5.90 billion in capital contributions to subsidiaries, and paid \$1.93 billion in dividends to shareholders in 2007. In February 2008, AIG contributed approximately \$445 million in the form of forgiveness of Federal income tax recoverables to certain domestic general insurance subsidiaries and \$500 million to certain domestic life insurance subsidiaries, both effective December 31, 2007.

AIG parent funds its short-term working capital needs through commercial paper issued by AIG Funding. As of December 31, 2007, AIG Funding had \$4.2 billion of commercial paper outstanding with an average maturity of 29 days. As additional liquidity, AIG parent and AIG Funding maintain committed revolving credit facilities that, as of December 31, 2007, had an aggregate of \$9.3 billion available to be drawn, and which are summarized above under Revolving Credit Facilities.

At the parent company level, liquidity management activities are conducted in a manner intended to preserve and enhance funding stability, flexibility, and diversity through the full range of

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potential operating environments and market conditions. Assessing liquidity risk involves forecasting of cash inflows and outflows on both a short- and long-term basis. Corporate Treasury is responsible for formulating the parent company's liquidity and contingency planning efforts, as well as for execution of AIG's specific funding activities. Through active liquidity management, AIG seeks to retain stable, reliable and cost-effective funding sources. In addition to current liquidity requirements, factors which affect funding decisions include market conditions, prevailing interest rates and the desired maturity profile of liabilities. The objectives of contingency planning are to ensure maintenance of appropriate liquidity during normal and stressed periods, to measure and project funding requirements during periods of stress, and to manage access to funding sources. Diversification of funding sources is an important element of AIG's liquidity risk management approach.

AIG's liquidity could be impaired by an inability to access the capital markets or by unforeseen significant outflows of cash. This situation may arise due to circumstances that AIG may be unable to control, such as a general market disruption or an operational problem that affects third parties or AIG. Regulatory and other legal restrictions may limit AIG's ability to transfer funds freely, either to or from its subsidiaries. In particular, many of AIG's subsidiaries, including its insurance subsidiaries, are subject to laws and regulations that authorize regulatory bodies to block or reduce the flow of funds to the parent holding company, or that prohibit such transfers altogether in certain circumstances. These laws and regulations may hinder AIG's ability to access funds that it may need to make payments on its obligations. Because of the wide geographic profile of AIG's regulated subsidiaries, management believes that these cash flows represent a diversified source of liquidity for AIG. For a further discussion of the regulatory environment in which AIG subsidiaries operate and other issues affecting AIG's liquidity, see Item 1A. Risk Factors.

**Invested Assets**

The following tables summarize the composition of AIG's invested assets by segment:

<i>(in millions)</i>	General Insurance	Life Insurance & Retirement Services	Financial Services	Asset Management	Other	Total
<b>2007</b>						
Fixed maturities:						
Bonds available for sale, at fair value	\$ 74,057	\$ 294,162	\$ 1,400	\$ 27,753	\$	\$ 397,372
Bonds held to maturity, at amortized cost	21,355	1		225		21,581
Bond trading securities, at fair value		9,948		34		9,982
Equity securities:						
Common stocks available for sale, at fair value	5,599	11,616		609	76	17,900
Common and preferred stocks trading, at fair value	321	21,026		29		21,376
Preferred stocks available for sale, at fair value	1,885	477	8			2,370
Mortgage and other loans receivable, net of allowance	13	24,851	1,365	7,442	56	33,727
Financial services assets:						

Flight equipment primarily under operating leases, net of accumulated depreciation			<b>41,984</b>			<b>41,984</b>
Securities available for sale, at fair value			<b>40,305</b>			<b>40,305</b>
Trading securities, at fair value			<b>4,197</b>			<b>4,197</b>
Spot commodities			<b>238</b>			<b>238</b>
Unrealized gain on swaps, options and forward transactions			<b>17,134</b>		<b>(692)</b>	<b>16,442</b>
Trade receivables			<b>6,467</b>			<b>6,467</b>
Securities purchased under agreements to resell, at contract value			<b>20,950</b>			<b>20,950</b>
Finance receivables, net of allowance	<b>5</b>		<b>31,229</b>			<b>31,234</b>
Securities lending invested collateral, at fair value	<b>5,031</b>	<b>57,471</b>	<b>148</b>	<b>13,012</b>		<b>75,662</b>
Other invested assets	<b>11,895</b>	<b>19,015</b>	<b>3,663</b>	<b>17,261</b>	<b>6,989</b>	<b>58,823</b>
Short-term investments, at cost	<b>7,356</b>	<b>25,236</b>	<b>12,249</b>	<b>4,919</b>	<b>1,591</b>	<b>51,351</b>
<b>Total investments and financial services assets as shown on the balance sheet</b>	<b>127,512</b>	<b>463,808</b>	<b>181,337</b>	<b>71,284</b>	<b>8,020</b>	<b>851,961</b>
Cash	<b>497</b>	<b>1,000</b>	<b>389</b>	<b>269</b>	<b>129</b>	<b>2,284</b>
Investment income due and accrued	<b>1,431</b>	<b>4,728</b>	<b>29</b>	<b>401</b>	<b>(2)</b>	<b>6,587</b>
Real estate, net of accumulated depreciation	<b>349</b>	<b>976</b>	<b>17</b>	<b>89</b>	<b>231</b>	<b>1,662</b>
<b>Total invested assets*</b>	<b>\$ 129,789</b>	<b>\$ 470,512</b>	<b>\$ 181,772</b>	<b>\$ 72,043</b>	<b>\$ 8,378</b>	<b>\$ 862,494</b>

\* At December 31, 2007, approximately 65 percent and 35 percent of invested assets were held in domestic and foreign investments, respectively.

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<i>(in millions)</i>	General Insurance	Life Insurance & Retirement Services	Financial Services	Asset Management	Other	Total
<b>2006</b>						
Fixed maturities:						
Bonds available for sale, at fair value	\$ 67,994	\$288,018	\$ 1,357	\$ 29,500	\$	\$386,869
Bonds held to maturity, at amortized cost	21,437					21,437
Bond trading securities, at fair value	1	10,835				10,836
Equity securities:						
Common stocks available for sale, at fair value	4,245	8,705		226	80	13,256
Common stocks trading, at fair value	350	14,505				14,855
Preferred stocks available for sale, at fair value	1,884	650	5			2,539
Mortgage and other loans receivable, net of allowance	17	21,043	2,398	4,884	76	28,418
Financial services assets:						
Flight equipment primarily under operating leases, net of accumulated depreciation			39,875			39,875
Securities available for sale, at fair value			47,205			47,205
Trading securities, at fair value			5,031			5,031
Spot commodities			220			220
Unrealized gain on swaps, options and forward transactions			19,607		(355)	19,252
Trade receivables			4,317			4,317
Securities purchased under agreements to resell, at contract value			30,291			30,291
Finance receivables, net of allowance			29,573			29,573
Securities lending invested collateral, at fair value	5,376	50,099	76	13,755		69,306

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Other invested assets	9,207	13,962	2,212	13,198	3,532	42,111
Short-term investments, at cost	3,281	15,192	2,807	6,198	5	27,483
<b>Total investments and financial services assets as shown on the balance sheet</b>	<b>113,792</b>	<b>423,009</b>	<b>184,974</b>	<b>67,761</b>	<b>3,338</b>	<b>792,874</b>
Cash	334	740	390	118	8	1,590
Investment income due and accrued	1,363	4,378	23	326	1	6,091
Real estate, net of accumulated depreciation	570	698	17	75	26	1,386
<b>Total invested assets<sup>(a)(b)</sup></b>	<b>\$ 116,059</b>	<b>\$ 428,825</b>	<b>\$ 185,404</b>	<b>\$ 68,280</b>	<b>\$ 3,373</b>	<b>\$ 801,941</b>

(a) Certain reclassifications and format changes have been made to prior period amounts to conform to the current period presentation.

(b) At December 31, 2006, approximately 68 percent and 32 percent of invested assets were held in domestic and foreign investments, respectively.

#### Investment Strategy

AIG's investment strategies are tailored to the specific business needs of each operating unit. The investment objectives are driven by the business model for each of the businesses: General Insurance, Life Insurance, Retirement Services and Asset Management's Spread-Based Investment business. The primary objectives are in terms of preservation of capital, growth of surplus and generation of investment income to support the insurance products. At the local operating unit level, the strategies are based on considerations that include the local market, liability duration and cash flow characteristics, rating agency and regulatory capital considerations, legal investment limitations, tax optimization and diversification. In addition to local risk management considerations, AIG's corporate risk management guidelines impose limitations on concentrations to promote diversification by industry, asset class and geographic sector.

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**The amortized cost or cost and estimated fair value of AIG's available for sale and held to maturity securities at December 31, 2007 and 2006 were as follows:**

(in millions)	December 31, 2007*				December 31, 2006			
	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for sale:*</b>								
U.S. government and government sponsored entities	\$ 7,956	\$ 333	\$ 37	\$ 8,252	\$ 7,667	\$ 221	\$ 140	\$ 7,748
Obligations of states, municipalities and political subdivisions	46,087	927	160	46,854	59,785	1,056	210	60,631
Non-U.S. governments	67,023	3,920	743	70,200	62,860	5,461	437	67,884
Corporate debt	239,822	6,216	4,518	241,520	257,383	7,443	2,536	262,290
Mortgage-backed, asset- backed and collateralized	140,982	1,221	7,703	134,500	104,687	502	362	104,827
<b>Total bonds</b>	<b>\$501,870</b>	<b>\$12,617</b>	<b>\$13,161</b>	<b>\$501,326</b>	<b>\$492,382</b>	<b>\$14,683</b>	<b>\$3,685</b>	<b>\$503,380</b>
Equity securities	15,188	5,545	463	20,270	13,147	2,807	159	15,795
<b>Total</b>	<b>\$517,058</b>	<b>\$18,162</b>	<b>\$13,624</b>	<b>\$521,596</b>	<b>\$505,529</b>	<b>\$17,490</b>	<b>\$3,844</b>	<b>\$519,175</b>
<b>Held to maturity:*</b>								
Bonds Obligations of states, municipalities and political subdivisions	\$ 21,581	\$ 609	\$ 33	\$ 22,157	\$ 21,437	\$ 731	\$ 14	\$ 22,154

\* At December 31, 2007 and 2006, fixed maturities held by AIG that were below investment grade or not rated totaled \$27.0 billion and \$26.6 billion, respectively.

AIG's held to maturity and available for sale fixed maturity investments totaled \$523.5 billion at December 31, 2007, compared to \$525.5 billion at December 31, 2006. At December 31, 2007, approximately 63 percent of the fixed maturities investments were in domestic portfolios. Approximately 53 percent of such domestic securities were rated AAA by one or more of the principal rating agencies. Approximately five percent were below investment grade or not rated. AIG's investment decision process relies primarily on internally generated fundamental analysis and internal risk

ratings. Third party rating services' ratings and opinions provide one source of independent perspectives for consideration in the internal analysis.

A significant portion of the foreign fixed income portfolio is rated by Moody's, S&P or similar foreign rating services. Rating services are not available in all overseas locations. The Credit Risk Committee (CRC) closely reviews the credit quality of the foreign portfolio's non-rated fixed income investments. At December 31, 2007, approximately 19 percent of the foreign fixed income investments were either rated AAA or, on the basis of AIG's internal analysis, were equivalent from a credit standpoint to securities so rated. Approximately five percent were below investment grade or not rated at that date. A large portion (approximately one third) of the foreign fixed income portfolio is sovereign fixed maturity securities supporting the policy liabilities in the country of issuance.

**The credit ratings of AIG's fixed maturity investments, other than those of AIGFP, at December 31, 2007 and 2006 were as follows:**

Rating	2007	2006
AAA	38%	37%
AA	28	26
A	18	20
BBB	11	12
Below investment grade	4	4
Non-rated	1	1
Total	100%	100%



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American International Group, Inc. and Subsidiaries  
**Management's Discussion and Analysis of  
 Financial Condition and Results of Operations** *Continued*

The industry categories of AIG's available for sale corporate debt securities at December 31, 2007 were as follows:

Industry Category	Percentage
Industrials	47%
Financial Institutions	42
Utilities/Other	11
Total*	100%

\* At December 31, 2007 approximately 95% of these investments were rated investment grade.

The amortized cost, gross unrealized gains (losses) and fair value of AIG's investments in mortgage-backed, asset-backed and collateralized securities at December 31, 2007 were as follows:

(in millions)	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>AIG, excluding AIGFP:</b>				
RMBS	\$ 89,851	\$ 433	\$ 5,504	\$ 84,780
CMBS	23,918	237	1,156	22,999
CDO/ ABS	10,844	196	593	10,447
Subtotal, excluding AIGFP	124,613	866	7,253	118,226
Total AIGFP investments in mortgage-backed, asset-backed and collateralized securities	16,369	355	450	16,274
Total	\$ 140,982	\$ 1,221	\$ 7,703	\$ 134,500

### Investments in Residential Mortgage-Backed Securities

As part of its strategy to diversify its investments, AIG invests in various types of securities, including residential mortgage-backed securities (RMBS).

The amortized cost, gross unrealized gains (losses) and estimated fair value of AIG's investments in RMBS securities, other than those of AIGFP, at December 31, 2007 were as follows:

(in millions)	December 31, 2007			Percent
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	

				<b>Fair Value</b>	<b>of Total</b>
<b>Residential mortgage-backed securities:</b>					
U.S. agencies	\$ 14,575	\$ 320	\$ 70	\$ 14,825	17%
Prime non-agency <sup>(a)</sup>	21,552	72	550	21,074	25
Alt-A	25,349	17	1,620	23,746	28
Other housing-related <sup>(b)</sup>	4,301	2	357	3,946	5
Subprime	24,074	22	2,907	21,189	25
<b>Total</b>	<b>\$ 89,851</b>	<b>\$ 433</b>	<b>\$ 5,504</b>	<b>\$ 84,780</b>	<b>100%</b>

(a) Includes foreign and jumbo RMBS-related securities.

(b) Primarily wrapped second-lien.

AIG's operations, other than AIGFP, held investments in RMBS with an estimated fair value of \$84.8 billion at December 31, 2007, or approximately 10 percent of AIG's total invested assets. In addition, AIG's insurance operations held investments with a fair value totaling \$4.0 billion in CDOs, of which \$58 million included some level of subprime exposure. AIG's RMBS investments are predominantly in highly-rated tranches that contain substantial protection features through collateral subordination. At December 31, 2007, approximately 92 percent of these investments were rated AAA, and approximately 6 percent were rated AA by one or more of the principal rating agencies. AIG's investments rated BBB or below totaled \$621 million, or less than 0.1 percent of AIG's total invested assets at December 31, 2007. As of February 25, 2008, \$3.6 billion of AIG's RMBS backed primarily by subprime collateral had been downgraded as a result of rating agency actions since January 1, 2008, and \$6 million of such investments had been upgraded. Subsequent to December 31, 2007, rating agencies have placed on watch for downgrade a majority of 2006 and 2007 vintage AAA-rated subprime RMBS in the market. For AIG, \$9.7 billion was on watch for downgrade.

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**The fair value of AIG's RMBS investments, other than those of AIGFP, at December 31, 2007 by year of vintage and credit rating were as follows:**

<i>(in millions)</i>	Year of Vintage						Total
	Prior	2003	2004	2005	2006	2007	
<b>Rating:</b>							
AAA	\$ 4,053	\$ 6,202	\$ 7,070	\$ 16,011	\$ 25,392	\$ 18,937	\$ 77,665
AA	63	785	555	1,092	2,117	512	5,124
A	46	242	345	480	248	138	1,499
BBB and below		53	74	214	114	37	492
<b>Total</b>	<b>\$ 4,162</b>	<b>\$ 7,282</b>	<b>\$ 8,044</b>	<b>\$ 17,797</b>	<b>\$ 27,871</b>	<b>\$ 19,624</b>	<b>\$ 84,780</b>

**The fair value of AIG's Alt-A investments included in the RMBS investments above, other than those of AIGFP, at December 31, 2007 by year of vintage and credit rating were as follows:**

<i>(in millions)</i>	Year of Vintage						Total
	Prior	2003	2004	2005	2006	2007	
<b>Rating:</b>							
AAA	\$208	\$623	\$ 960	\$4,899	\$9,301	\$6,512	\$22,503
AA	23	199	150	391	117	11	891
A	1	37	51	137	48	6	280
BBB and below		11	19	36	6		72
<b>Total</b>	<b>\$232</b>	<b>\$870</b>	<b>\$1,180</b>	<b>\$5,463</b>	<b>\$9,472</b>	<b>\$6,529</b>	<b>\$23,746</b>

**The fair value of AIG's subprime RMBS investments, other than those of AIGFP, at December 31, 2007 by year of vintage and credit rating were as follows:**

<i>(in millions)</i>	Year of Vintage						Total
	Prior	2003	2004	2005	2006	2007	
<b>Rating:</b>							
AAA	\$127	\$362	\$557	\$5,403	\$7,926	\$4,081	\$18,456
AA	6	35	116	277	1,562	357	2,353
A	10	82	100	120	34	26	372
BBB and below				8			8
<b>Total</b>	<b>\$143</b>	<b>\$479</b>	<b>\$773</b>	<b>\$5,808</b>	<b>\$9,522</b>	<b>\$4,464</b>	<b>\$21,189</b>

AIG's underwriting practices for investing in RMBS, other asset-backed securities and CDOs take into consideration the quality of the originator, the manager, the servicer, security credit ratings, underlying characteristics of the mortgages, borrower characteristics, and the level of credit enhancement in the transaction. AIG's strategy is typically to invest in securities rated AA or better and create diversification across multiple underlying asset classes.

#### General Insurance Invested Assets

In AIG's General Insurance business, the duration of liabilities for long-tail casualty lines is greater than other lines. As differentiated from the Life Insurance & Retirement Services companies, the focus is not on asset-liability matching, but on preservation of capital and growth of surplus.

Fixed income holdings of the Domestic General Insurance companies are comprised primarily of tax-exempt securities, which provide attractive risk-adjusted after-tax returns. These high quality municipal investments have an average rating of AA.

Fixed income assets held in Foreign General Insurance are of high quality and short to intermediate duration, averaging 3.6 years compared to 7.0 years for those in Domestic General Insurance.

While invested assets backing reserves are invested in conventional fixed income securities in Domestic General Insurance, a modest portion of surplus is allocated to large capitalization, high-dividend, public equity strategies and to alternative investments, including private equity and hedge funds. These investments have provided a combination of added diversification and attractive long-term returns.

General Insurance invested assets grew by \$13.7 billion, or 12 percent, during 2007 as bond holdings grew by \$6 billion. Listed equity holdings grew by \$1.3 billion.

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American International Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of  
Financial Condition and Results of Operations** *Continued***Life Insurance & Retirement Services Invested Assets**

With respect to Life Insurance & Retirement Services, AIG uses asset-liability management as a tool worldwide in the life insurance business to influence the composition of the invested assets and appropriate marketing strategies. AIG's objective is to maintain a matched asset-liability structure. However, in certain markets, the absence of long-dated fixed income investment instruments may preclude a matched asset-liability position. In addition, AIG may occasionally determine that it is economically advantageous to be temporarily in an unmatched position. To the extent that AIG has maintained a matched asset-liability structure, the economic effect of interest rate fluctuations is partially mitigated.

AIG's investment strategy for the Life Insurance & Retirement Services segment is to produce cash flows greater than maturing insurance liabilities. AIG actively manages the asset-liability relationship in its foreign operations, even though certain territories lack qualified long-term investments or certain local regulatory authorities may impose investment restrictions. For example, in several Southeast Asian countries, the duration of investments is shorter than the effective maturity of the related policy liabilities. Therefore, there is risk that the reinvestment of the proceeds at the maturity of the initial investments may be at a yield below that of the interest required for the accretion of the policy liabilities. Additionally, there exists a future investment risk associated with certain policies currently in-force which will have premium receipts in the future. That is, the investment of these future premium receipts may be at a yield below that required to meet future policy liabilities.

AIG actively manages the interest rate assumptions and crediting rates used for its new and in force business. Business strategies continue to evolve to maintain profitability of the overall business. In some countries, new products are being introduced with minimal investment guarantees, resulting in a shift toward investment-linked savings products and away from traditional savings products with higher guarantees.

The investment of insurance cash flows and reinvestment of the proceeds of matured securities and coupons requires active management of investment yields while maintaining satisfactory investment quality and liquidity.

AIG may use alternative investments, including equities, real estate and foreign currency denominated fixed income instruments in certain foreign jurisdictions where interest rates remain low and there are limited long-dated bond markets to extend the duration or increase the yield of the investment portfolio to more closely match the requirements of the policyholder liabilities and DAC recoverability. This strategy has been effectively used in Japan and more recently by Nan Shan in Taiwan. In Japan, foreign assets, excluding those matched to foreign liabilities, were approximately 31 percent of statutory assets, which is below the maximum allowable percentage under current local regulation. Foreign assets comprised approximately 33 percent of Nan Shan's invested assets at December 31, 2007, slightly below the maximum allowable percentage under current local regulation. The majority of Nan Shan's in-force policy portfolio is traditional life and endowment insurance products with implicit interest rate guarantees. New business with lower interest rate guarantees are gradually reducing the overall interest requirements, but asset portfolio yields have declined faster due to the prolonged low interest rate environment. As a result, although the investment margins for a large block of in-force policies are negative, the block remains profitable overall because the mortality and expense margins presently exceed the negative investment spread. In response to the low interest rate environment and the volatile exchange rate of the Taiwanese dollar, Nan Shan is emphasizing new products with lower implied guarantees, including participating endowments and investment-linked products. Although the risks of a continued low interest rate environment coupled with a volatile Taiwanese dollar could increase net liabilities and require additional capital to maintain adequate local solvency margins, Nan Shan currently believes it has adequate resources to meet all future policy obligations.

AIG actively manages the asset-liability relationship in its domestic operations. This relationship is more easily managed through the availability of qualified long-term investments.

A number of guaranteed benefits, such as living benefits or guaranteed minimum death benefits, are offered on certain variable life and variable annuity products. AIG manages its exposure resulting from these long-term

guarantees through reinsurance or capital market hedging instruments.

AIG invests in equities for various reasons, including diversifying its overall exposure to interest rate risk. Available for sale bonds and equity securities are subject to declines in fair value. Such declines in fair value are presented in unrealized appreciation or depreciation of investments, net of taxes, as a component of Accumulated other comprehensive income. Declines that are determined to be other-than-temporary are reflected in income in the period in which the intent to hold the securities to recovery no longer exists. See Valuation of Invested Assets herein. Generally, insurance regulations restrict the types of assets in which an insurance company may invest. When permitted by regulatory authorities and when deemed necessary to protect insurance assets, including invested assets, from adverse movements in foreign currency exchange rates, interest rates and equity prices, AIG and its insurance subsidiaries may enter into derivative transactions as end users to hedge their exposures. For a further discussion of AIG's use of derivatives, see Risk Management Credit Risk Management Derivatives herein.

In certain jurisdictions, significant regulatory and/or foreign governmental barriers exist which may not permit the immediate free flow of funds between insurance subsidiaries or from the insurance subsidiaries to AIG parent. For a discussion of these restrictions, see Item 1. Business Regulation.

Life Insurance & Retirement Services invested assets grew by \$41.7 billion, or 10 percent, during 2007 as bond holdings grew by \$5.3 billion, and listed equity holdings grew by \$9.3 billion, or 39 percent.

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## American International Group, Inc. and Subsidiaries

## Financial Services Invested Assets

**Financial Services Securities**

Financial Services securities available for sale of \$40.3 billion at December 31, 2007 is predominantly a diversified portfolio of high-grade fixed income securities where the individual securities have varying degrees of credit risk. At December 31, 2007, the average credit rating of this portfolio was in the AA+ category or the equivalent thereto as determined through rating agencies or internal review. AIGFP has also entered into credit derivative transactions to economically hedge its credit risk associated with \$82 million of these securities. Securities deemed below investment grade at December 31, 2007 totalled \$797 million in fair value, representing two percent of Financial Services securities available for sale. There have been no significant downgrades of these securities through February 15, 2008.

AIGFP's management objective is to minimize interest rate, currency, commodity and equity risks associated with its securities available for sale. When AIGFP purchases a security for its securities available for sale investment portfolio, it simultaneously enters into an offsetting hedge such that the payment terms of the hedging transaction offset the payment terms of the investment security. This achieves the economic result of converting the return on the underlying security to U.S. dollar LIBOR plus or minus a spread based on the underlying profit on each security on the initial trade date. The market risk associated with such hedges is managed on a portfolio basis.

Because hedge accounting treatment was not applied in 2006, the unrealized gains and losses on the derivative transactions with unaffiliated third parties were reflected in operating income. The unrealized gains and losses on the underlying securities available for sale resulting from changes in interest rates and currency rates and commodity and equity prices were included in accumulated other comprehensive income (loss), or in operating income, as appropriate. When a security is sold, the realized gain or loss with respect to this security is included in operating income.

Securities purchased under agreements to resell are treated as collateralized financing transactions. AIGFP takes possession of or obtains a security interest in securities purchased under agreements to resell.

**Capital Markets**

AIGFP uses the proceeds from the issuance of notes and bonds and GIAs to invest in a diversified portfolio of securities, including securities available for sale, and derivative transactions. The funds may also be invested in securities purchased under agreements to resell. The proceeds from the disposal of the aforementioned securities available for sale and securities purchased under agreements to resell are used to fund the maturing GIAs or other AIGFP financings, or to invest in new assets. For a further discussion of AIGFP's borrowings, see Capital Resources and Liquidity Borrowings herein.

Capital Markets derivative transactions are carried at fair value. AIGFP reduces its economic risk exposure through similarly valued offsetting transactions including swaps, trading securities, options, forwards and futures. AIGFP's super senior credit default swaps include structural protection to help minimize risk. For a further discussion on the use of derivatives by Capital Markets, see Operating Review Financial Services Operations Capital Markets and Risk Management Derivatives herein and Note 8 to Consolidated Financial Statements.

AIGFP owns inventories in certain commodities in which it trades, and may reduce the exposure to market risk through the use of swaps, forwards, futures, and option contracts. Physical commodities held in AIGFP's wholly owned broker-dealer subsidiary are recorded at fair value. All other commodities are recorded at the lower of cost or fair value.

Trading securities, at fair value, and securities and spot commodities sold but not yet purchased, at fair value, are marked to fair value daily with the unrealized gain or loss recognized in income. These trading securities are purchased and sold as necessary to meet the risk management and business objectives of Capital Markets operations.

**The gross unrealized gains and gross unrealized losses of Capital Markets operations included in Financial Services assets and liabilities at December 31, 2007 were as follows:**

Gross

Gross

<i>(in millions)</i>	Unrealized Gains	Unrealized Losses
Securities available for sale, at fair value	\$ 939	\$ 777
Unrealized gain/loss on swaps, options and forward transactions*	17,134	22,982

\* *These amounts are also presented as the respective balance sheet amounts.*

#### **ILFC**

The cash used for the purchase of flight equipment is derived primarily from the proceeds of ILFC's debt financings. The primary sources for the repayment of this debt and the related interest expense are ILFC's cash flow from operations, proceeds from the sale of flight equipment and the rollover and refinancing of the prior debt. During 2007, ILFC acquired flight equipment costing \$4.7 billion. For a further discussion of ILFC's borrowings, see Operating Review Financial Services Operations Aircraft Leasing and Capital Resources and Liquidity Borrowings herein.

At December 31, 2007, ILFC had committed to purchase 234 new aircraft deliverable from 2008 through 2017 for an estimated aggregate purchase price of \$20.1 billion. As of February 22, 2008, ILFC has entered into leases for all of the new aircraft to be delivered in 2008, and for 65 of 161 of the new aircraft to be delivered subsequent to 2008. ILFC will be required to find customers for any aircraft currently on order and any aircraft to be ordered, and it must arrange financing for portions of the purchase price of such equipment. ILFC has been successful to date both in placing its new aircraft on lease or under sales contract and obtaining adequate financing, but there can be no assurance that such success will continue in future environments.

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American International Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of  
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Asset Management invested assets are primarily comprised of assets supporting AIG's Spread-Based Investment business, which includes AIG's MIP and domestic GIC programs.

The Spread-Based Investment business strategy is to generate spread income from investments yielding returns greater than AIG's cost of funds. The asset-liability relationship is actively managed. The goal of the MIP investment strategy is to capture a spread between income earned on investments and the funding costs of the program while mitigating interest rate and foreign currency exchange rate risk. The invested assets are predominantly fixed income securities and include U.S. residential mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities. In addition, the MIP sold credit protection by issuing single-name high-grade corporate credit default swaps in 2007.

Asset Management invested assets grew by \$3.8 billion during 2007. The growth in invested assets was primarily attributable to growth in other invested assets and mortgage and other loans receivable partially offset by a decrease in bond holdings, and short-term investments. These increases were primarily driven by continued growth of the MIP and the growth of AIG's Institutional Asset Management business. These increases were partially offset by the decrease in assets associated with the runoff of the domestic GIC program.

**Securities Lending Activities**

AIG's securities lending program is a centrally managed program facilitated by AIG Investments primarily for the benefit of certain of AIG's Insurance companies. Securities are loaned to various financial institutions, primarily major banks and brokerage firms. Cash collateral equal to 102 percent of the fair value of the loaned securities is received. The cash collateral is invested in highly-rated fixed income securities to earn a net spread.

AIG's liability to the borrower for collateral received was \$82.0 billion and the fair value of the collateral reinvested was \$75.7 billion as of December 31, 2007. In addition to the invested collateral, the securities on loan as well as all of the assets of the participating companies are generally available to satisfy the liability for collateral received.

**The composition of the securities lending invested collateral by credit rating at December 31, 2007 was as follows:**

<i>(in millions)</i>	AAA	AA	A	BBB/Not Rated	Short- Term	Total
Corporate debt	\$ 1,191	\$ 9,341	\$ 3,448	\$ 160	\$	\$ 14,140
Mortgage-backed, asset-backed and collateralized	47,180	2,226	22	82		49,510
Cash and short-term investments					12,012	12,012
Total	\$ 48,371	\$ 11,567	\$ 3,470	\$ 242	\$ 12,012	\$ 75,662

**Participation in the securities lending program by reporting unit at December 31, 2007 was as follows:**

	Percent Participation
Domestic Life Insurance and Retirement Services	79%

Foreign Life Insurance	10
Domestic General Insurance	3
Foreign General Insurance	4
Asset Management	4
Total	100.0%

On December 31, 2007, \$11.4 billion (or 13.7 percent) of the liabilities were one-day tenor. These one-day tenor loans do not have a contractual end date but are terminable by either party on demand. The balance of the liabilities contractually mature within three months; however, the maturing loans are frequently renewed and rolled over to extended dates. Collateral held for this program at December 31, 2007 included interest bearing cash equivalents with overnight maturities of \$12.0 billion.

Liquidity in the securities pool is managed based upon historical experience regarding volatility of daily, weekly and biweekly loan balances. Despite the current environment, the program has not experienced a significant decrease in loan balances.

In addition, the invested securities are carried at fair value with unrealized gains and losses recorded in accumulated other comprehensive income (loss) while net realized gains and losses are recorded in earnings. The net unrealized loss on the investments was \$5.0 billion as of December 31, 2007. During 2007, AIG incurred net realized losses of \$1.0 billion on this portfolio, predominantly related to other-than-temporary impairments.

#### Valuation of Invested Assets

##### Traded Securities

The valuation of AIG's investment portfolio involves obtaining a fair value for each security. The source for the fair value is generally from market exchanges or dealer quotations, with the exception of nontraded securities.

##### Nontraded Securities

AIG considers nontraded securities to mean certain fixed income investments, certain structured securities, direct private equities, limited partnerships, and hedge funds.

The aggregate carrying value of AIG's nontraded securities at December 31, 2007 was approximately \$70 billion. The methodology used to estimate fair value of nontraded fixed income investments is by reference to traded securities with similar attributes and using a matrix pricing methodology. This methodology takes into account such factors as the issuer's industry, the security's rating and tenor, its coupon rate, its position in the capital structure of the issuer, and other relevant factors.

For certain structured securities, the carrying value is based on an estimate of the security's future cash flows pursuant to the requirements of Emerging Issues Task Force Issue No. 99-20,

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Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets.

Hedge funds and limited partnerships in which AIG holds in the aggregate less than a five percent interest are carried at fair value.

With respect to hedge funds and limited partnerships in which AIG holds in the aggregate a five percent or greater interest, or less than a five percent interest but where AIG has more than a minor influence over the operations of the investee, AIG accounts for these investments using the equity method.

AIG obtains the fair value of its investments in limited partnerships and hedge funds from information provided by the general partner or manager of these investments, the accounts of which generally are audited on an annual basis.

Each of these investment categories is regularly tested to determine if impairment in value exists. Various valuation techniques are used with respect to each category in this determination.

For a discussion of accounting policies related to changes in fair value of invested assets, see Note 1 to Consolidated Financial Statements.

**Portfolio Review**

*Other-Than-Temporary Impairments*

AIG assesses its ability to hold any fixed maturity security in an unrealized loss position to its recovery, including fixed maturity securities classified as available for sale, at each balance sheet date. The decision to sell any such fixed maturity security classified as available for sale reflects the judgment of AIG's management that the security sold is unlikely to provide, on a relative value basis, as attractive a return in the future as alternative securities entailing comparable risks. With respect to distressed securities, the sale decision reflects management's judgment that the risk-discounted anticipated ultimate recovery is less than the value achievable on sale.

AIG evaluates its investments for impairments in valuation. The determination that a security has incurred an other-than-temporary impairment in value and the amount of any loss recognition requires the judgment of AIG's management and a regular review of its investments. See Note 1(c) to Consolidated Financial Statements for further information on AIG's policy.

Once a security has been identified as other-than-temporarily impaired, the amount of such impairment is determined by reference to that security's contemporaneous fair value and recorded as a charge to earnings.

In light of the recent significant disruption in the U.S. residential mortgage and credit markets, particularly in the fourth quarter, AIG has recognized an other-than-temporary impairment charge (severity loss) of \$2.2 billion (including \$643 million related to AIGFP's available for sale investment securities recorded in other income), primarily with respect to certain residential mortgage-backed securities and other structured securities. Even while retaining their investment grade ratings, such securities were priced at a significant discount to cost. Notwithstanding AIG's intent and ability to hold such securities indefinitely, and despite structures which indicate that a substantial amount of the securities should continue to perform in accordance with original terms, AIG concluded that it could not reasonably assert that the recovery period would be temporary.

As a result of AIG's periodic evaluation of its securities for other-than-temporary impairments in value, AIG recorded other-than-temporary impairment charges of \$4.7 billion (including \$643 million related to AIGFP recorded on other income), \$944 million and \$598 million in 2007, 2006 and 2005, respectively.

In addition to the above severity losses, AIG recorded other-than-temporary impairment charges in 2007, 2006 and 2005 related to:

- securities which AIG does not intend to hold until recovery;
- declines due to foreign exchange;
- issuer-specific credit events;
- certain structured securities impaired under EITF No. 99-20; and
- other impairments, including equity securities and partnership investments.

**Net realized capital gains (losses) for the years ended December 31, 2007, 2006 and 2005 were as follows:**

<i>(in millions)</i>	<b>2007</b>	2006	2005
Sales of fixed maturities	<b>\$ (468)</b>	\$ (382)	\$ 372
Sales of equity securities	<b>1,087</b>	813	643
Sales of real estate and other assets	<b>619</b>	303	88
Other-than-temporary impairments	<b>(4,072)</b>	(944)	(598)
Foreign exchange transactions	<b>(643)</b>	(382)	701
Derivative instruments	<b>(115)</b>	698	(865)
<b>Total</b>	<b>\$ (3,592)</b>	\$ 106	\$ 341
AIGFP other-than-temporary impairments*	<b>\$ (643)</b>	\$	\$

\* Reported as part of other income.

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**Management's Discussion and Analysis of  
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**Other-than-temporary impairment charges for the years ended December 31, 2007, 2006 and 2005 were as follows:**

<i>(in millions)</i>	2007	2006	2005
Impairment type:			
Severity*	\$ 2,200	\$	\$
Lack of intent to hold to recovery	1,054	619	335
Foreign currency declines	500		
Issuer-specific credit events	515	279	257
Adverse projected cash flows on structured securities (EITF 99-20)	446	46	6
<b>Total</b>	<b>\$ 4,715</b>	<b>\$ 944</b>	<b>\$ 598</b>

\* Includes \$643 million related to AIGFP reported in other income.

**Other-than-temporary impairment charges for the year ended December 31, 2007 by Reporting Segment were as follows:**

<i>(in millions)</i>	General Insurance	Life Insurance & Retirement Services	Financial Services	Asset Management	Other	Total
Impairment Type:						
Severity	\$ 71	\$ 1,070	\$ 643	\$ 416	\$	\$ 2,200
Lack of intent to hold to recovery	91	885	7	71		1,054
Foreign currency declines		500				500
Issuer-specific credit events	113	177		69	156	515
Adverse projected cash flows on structured securities	1	166		279		446
<b>Total</b>	<b>\$ 276</b>	<b>\$ 2,798</b>	<b>\$ 650</b>	<b>\$ 835</b>	<b>\$ 156</b>	<b>\$ 4,715</b>

**Other-than-temporary severity-related impairment charges for the year ended December 31, 2007 were as follows:**

Rating:	RMBS	CDO	CMBS	Other Securities	Total
AAA	\$ 168	\$ 621	\$	\$	\$ 789

AA	870	53	6	929
A	66	32	77	175
BBB and below	28		52	80
Nonrated				227
Total	\$ 1,132	\$ 706	\$ 135	\$ 2,200

No other-than-temporary impairment charge with respect to any one single credit was significant to AIG's consolidated financial condition or results of operations, and no individual other-than-temporary impairment charge exceeded two percent of consolidated net income in 2007.

In periods subsequent to the recognition of an other-than-temporary impairment charge for fixed maturity securities, which is not credit or foreign exchange related, AIG generally accretes into income the discount or amortizes the reduced premium resulting from the reduction in cost basis over the remaining life of the security.

#### **Commercial Mortgage Loan Exposure**

At December 31, 2007, AIG had direct commercial mortgage loan exposure of \$17.1 billion, with \$16.3 billion representing U.S. loan exposure. At that date, none of the U.S. loans were in default or delinquent by 90 days or more. The remaining commercial mortgage loans are secured predominantly by properties in Japan. In addition, at December 31, 2007, AIG had approximately \$2.0 billion in residential mortgage loans in jurisdictions outside the United States, primarily backed by properties in Taiwan and Thailand.

At December 31, 2007, AIG owned \$23.9 billion in cost basis of CMBS. Approximately 78 percent of such holdings were rated AAA, approximately 98 percent were rated A or higher, and less than 2 percent were rated BBB or below. At December 31, 2007, all such securities were current in the payment of principal and interest and none had default rates on underlying collateral at levels viewed by AIG as likely to result in the loss of principal or interest.

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There have been disruptions in the commercial mortgage markets in general, and the CMBS market in particular, with credit default swaps indices and quoted prices of securities at levels consistent with a severe correction in lease rates, occupancy and fair value of properties. In addition, spreads in the primary mortgage market have widened significantly. While this capital market stress has not to date been reflected in the performance of commercial mortgage securitization in the form of increased defaults in underlying mortgage pools, pricing of CMBS has been adversely affected by market perceptions that underlying mortgage defaults will increase. As a result, AIG recognized \$135 million of other-than-temporary impairment charges on CMBS trading at a severe discount to cost, despite the absence of any deterioration in performance of the underlying credits, because AIG concluded that it could not reasonably assert that the recovery period was temporary. At this time, AIG anticipates full recovery of principal and interest on the securities to which such other-than-temporary impairment charges were recorded.

**An aging of the pre-tax unrealized losses of fixed maturity and equity securities, distributed as a percentage of cost relative to unrealized loss (the extent by which the fair value is less than amortized cost or cost), including the number of respective items, was as follows at December 31, 2007:**

Aging <sup>(d)</sup> (dollars in millions)	Less than or equal to 20% of Cost <sup>(e)</sup>			Greater than 20% to 50% of Cost <sup>(e)</sup>			Greater than 50% of Cost <sup>(e)</sup>			Total		
	Cost <sup>(a)</sup>	Unrealized Loss	Items	Cost <sup>(a)</sup>	Unrealized Loss	Items	Cost <sup>(a)</sup>	Unrealized Loss	Items	Cost <sup>(a)</sup>	Unrealized Loss <sup>(b)</sup>	Items
<b>Investment grade bonds</b>												
0-6 months	\$ 124,681	\$ 5,099	16,539	\$ 2,588	\$ 681	633	\$	\$	\$	\$ 127,269	\$ 5,780	17,172
7-12 months	53,515	3,078	7,174	3,219	859	1,110				56,734	3,937	8,284
>12 months	63,146	2,966	9,598	699	180	119				63,845	3,146	9,717
<b>Total</b>	<b>\$ 241,342</b>	<b>\$ 11,143</b>	<b>33,311</b>	<b>\$ 6,506</b>	<b>\$ 1,720</b>	<b>1,862</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$ 247,848</b>	<b>\$ 12,863</b>	<b>35,173</b>
<b>Below investment grade bonds</b>												
0-6 months	\$ 5,909	\$ 147	1,611	\$ 68	\$ 18	24	\$	\$	\$	\$ 5,977	\$ 165	1,635
7-12 months	782	45	246	47	8	14				829	53	260
>12 months	1,222	61	204	70	19	9				1,292	80	213
<b>Total</b>	<b>\$ 7,913</b>	<b>\$ 253</b>	<b>2,061</b>	<b>\$ 185</b>	<b>\$ 45</b>	<b>47</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$ 8,098</b>	<b>\$ 298</b>	<b>2,108</b>
<b>Total bonds</b>												
0-6 months	\$ 130,590	\$ 5,246	18,150	\$ 2,656	\$ 699	657	\$	\$	\$	\$ 133,246	\$ 5,945	18,807
7-12 months	54,297	3,123	7,420	3,266	867	1,124				57,563	3,990	8,544
>12 months	64,368	3,027	9,802	769	199	128				65,137	3,226	9,930
<b>Total<sup>(c)</sup></b>	<b>\$ 249,255</b>	<b>\$ 11,396</b>	<b>35,372</b>	<b>\$ 6,691</b>	<b>\$ 1,765</b>	<b>1,909</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$ 255,946</b>	<b>\$ 13,161</b>	<b>37,281</b>

## Equity securities

0-6 months	\$	3,603	\$	297	2,051	\$	262	\$	69	39	\$	\$	\$	3,865	\$	366	2,090
7-12 months		283		33	181		285		64	36				568		97	217
>12 months																	
Total	\$	3,886	\$	330	2,232	\$	547	\$	133	75	\$	\$	\$	4,433	\$	463	2,307

(a) For bonds, represents amortized cost.

(b) The effect on net income of unrealized losses after taxes will be mitigated upon realization because certain realized losses will be charged to participating policyholder accounts, or realization will result in current decreases in the amortization of certain DAC.

(c) Includes securities lending invested collateral.

(d) Represents the number of continuous months that fair value has been less than cost by any amount.

(e) Represents the percentage by which fair value is less than cost at the balance sheet date.

**Unrealized gains and losses**

At December 31, 2007, the fair value of AIG's fixed maturity and equity securities aggregated \$587.1 billion. At December 31, 2007, aggregate pre-tax unrealized gains for fixed maturity and equity securities were \$18.1 billion (\$11.8 billion after tax).

At December 31, 2007, the aggregate pre-tax gross unrealized losses on fixed maturity and equity securities were \$13.6 billion



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(\$8.9 billion after tax). Additional information about these securities is as follows:

These securities were valued, in the aggregate, at approximately 95 percent of their current amortized cost. Less than three percent of these securities were valued at less than 20 percent of their current cost, or amortized cost. Less than four percent of the fixed income securities had issuer credit ratings which were below investment grade.

AIG did not consider these securities in an unrealized loss position to be other-than-temporarily impaired at December 31, 2007, as management has the intent and ability to hold these investments until they recover their cost basis. AIG believes the securities will generally continue to perform in accordance with the original terms, notwithstanding the present price declines.

At December 31, 2007, unrealized losses for fixed maturity securities and equity securities did not reflect any significant industry concentrations.

In 2007, unrealized losses related to investment grade bonds increased \$9.3 billion (\$6.1 billion after tax), reflecting the widening of credit spreads, partially offset by the effects of a decline in risk-free interest rates.

**The amortized cost and fair value of fixed maturity securities available for sale in an unrealized loss position at December 31, 2007, by contractual maturity, is shown below:**

<i>(in millions)</i>	<b>Amortized Cost</b>	<b>Fair Value</b>
Due in one year or less	\$ 9,408	\$ 9,300
Due after one year through five years	36,032	35,267
Due after five years through ten years	54,198	52,394
Due after ten years	56,557	53,578
Mortgage-backed, asset-backed and collateralized	99,751	92,246
<b>Total</b>	<b>\$ 255,946</b>	<b>\$ 242,785</b>

For the year ended December 31, 2007, the pre-tax realized losses incurred with respect to the sale of fixed maturities and equity securities were \$1.3 billion. The aggregate fair value of securities sold was \$38.0 billion, which was approximately 94 percent of amortized cost. The average period of time that securities sold at a loss during 2007 were trading continuously at a price below book value was approximately five months. See Risk Management Investments herein for an additional discussion of investment risks associated with AIG's investment portfolio.

**Risk Management****Overview**

AIG believes that strong risk management practices and a sound internal control environment are fundamental to its continued success and profitable growth. Failure to manage risk properly exposes AIG to significant losses, regulatory issues and a damaged reputation.

The major risks to which AIG is exposed include the following:

*Credit risk* the potential loss arising from an obligor's inability or unwillingness to meet its obligations to AIG.

*Market risk* the potential loss arising from adverse fluctuations in interest rates, foreign currencies, equity and commodity prices, and their levels of volatility.

*Operational risk* the potential loss resulting from inadequate or failed internal processes, people, and systems, or from external events.

*Liquidity risk* the potential inability to meet all payment obligations when they become due.

*General insurance risk* the potential loss resulting from inadequate premiums, insufficient reserves and catastrophic exposures.

*Life insurance risk* the potential loss resulting from experience deviating from expectations for mortality, morbidity and termination rates in the insurance-oriented products and insufficient cash flows to cover contract liabilities in the retirement savings products.

AIG senior management establishes the framework, principles and guidelines for risk management. The primary focus of risk management is to assess the risk of AIG incurring economic losses from the risk categories outlined above. The business executives are responsible for establishing and implementing risk management processes and responding to the individual needs and issues within their business, including risk concentrations within their respective businesses with appropriate oversight by Enterprise Risk Management (ERM).

#### **Corporate Risk Management**

AIG's major risks are addressed at the corporate level through ERM, which is headed by AIG's Chief Risk Officer (CRO). ERM is responsible for assisting AIG's business leaders, executive management and the Board of Directors to identify, assess, quantify, manage and mitigate the risks incurred by AIG. Through the CRO, ERM reports to AIG's Chief Financial Officer, various senior management committees and the Board of Directors through the Finance and Audit Committees.

An important goal of ERM is to ensure that once appropriate governance, authorities, procedures and policies have been established, aggregated risks do not result in inappropriate concentrations. Senior management defines the policies, has established general operating parameters for its global businesses and has established various oversight committees to monitor the risks attendant to its businesses:

The Financial Risk Committee (FRC) oversees AIG's market risk exposures to interest rates, foreign exchange and fair values of shares, partnership interests, real estate and other equity investments and provides strategic direction for AIG's asset-liability management. The FRC meets monthly and acts as a central mechanism for AIG senior management to review comprehensive information on AIG's financial exposures and to exercise broad control over these exposures. There are two subcommittees of the FRC.

The Foreign Exchange Committee monitors trends in foreign exchange rates, reviews AIG's foreign exchange exposures, and provides recommendations on foreign currency asset allocation and remittance hedging.

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The Liquidity Risk Committee is responsible for liquidity policy and implementation at AIG Parent and exercises oversight and control of liquidity policies at each AIG entity. See Capital Resources and Liquidity herein.

The CRC is responsible for the following:

- approving credit risk policies and procedures for use throughout AIG;
- delegating credit authority to business unit credit officers and select business unit managers;
- approving transaction requests and limits for corporate, sovereign and cross-border credit exposures that exceed the delegated authorities;
- establishing and maintaining AIG's risk rating process for corporate, financial and sovereign obligors; and
- conducting regular reviews of credit risk exposures in the portfolios of all credit-incurring business units.

The Derivatives Committee (DC) reviews any proposed derivative transaction or program not otherwise managed by AIGFP. The DC examines, among other things, the nature and purpose of the derivative transaction, its potential credit exposure, if any, and the estimated benefits.

The CSFTC has the authority and responsibility to review and approve any proposed CSFT. A CSFT is any transaction or product that may involve a heightened legal, regulatory, accounting or reputational risk that is developed, marketed or proposed by AIG or a third party. The CSFTC provides guidance to and monitors the activities of transaction review committees (TRCs) which have been established in all major business units. TRCs have the responsibility to identify, review and refer CSFTs to the CSFTC.

### **Credit Risk Management**

AIG devotes considerable resources, expertise and controls to managing its direct and indirect credit exposures, such as investments, deposits, loans, reinsurance recoverables and leases, as well as counterparty risk in derivatives activities, cessions of insurance risk to reinsurers and customers and credit risk assumed through credit derivatives written and financial guarantees. Credit risk is defined as the risk that AIG's customers or counterparties are unable or unwilling to repay their contractual obligations when they become due. Credit risk may also be manifested: (i) through the downgrading of credit ratings of counterparties whose credit instruments AIG may be holding, or, in some cases, insuring, causing the value of the assets to decline or insured risks to rise; and (ii) as cross-border risk where a country (sovereign government risk) or one or more non-sovereign obligors within a country are unable to repay an obligation or are unable to provide foreign exchange to service a credit or equity exposure incurred by another AIG business unit located outside that country.

AIG's credit risks are managed at the corporate level by the Credit Risk Management department (CRM) whose primary role is to support and supplement the work of the CRC. CRM is headed by AIG's Chief Credit Officer (CCO), who reports to AIG's CRO. AIG's CCO is primarily responsible for the development and maintenance of credit risk policies and procedures approved by the CRC. In discharging this function CRM has the following responsibilities:

- Manage the approval process for all requests for credit limits, program limits and transactions.
- Approve delegated credit authorities to CRM credit executives and business unit credit officers.
- Aggregate globally all credit exposure data by counterparty, country and industry and report risk concentrations regularly to the CRC and the Finance Committee of the Board of Directors.
- Administer regular in-depth portfolio credit reviews of all investment, derivative and credit-incurring business units and recommend any corrective actions where required.
- Develop methodologies for quantification and assessment of credit risks, including the establishment and maintenance of AIG's internal risk rating process.
- Approve appropriate credit reserves and methodologies at the business unit and enterprise levels.

AIG closely monitors and controls its company-wide credit risk concentrations and attempts to avoid unwanted or excessive risk accumulations, whether funded or unfunded. To minimize the level of credit risk in certain circumstances, AIG may require third-party guarantees, collateral, such as letters of credit or trust account deposits or reinsurance. These guarantees, letters of credit and reinsurance recoverables are also treated as credit exposure and are added to AIG's risk concentration exposure data.

AIG defines its aggregate credit exposures to a counterparty as the sum of its fixed maturities, loans, finance leases, derivatives (mark to market), deposits (in the case of financial institutions) and the specified credit equivalent exposure to certain insurance products which embody credit risk.

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The following table presents AIG's largest credit exposures at December 31, 2007 as a percentage of total shareholders' equity:

Category	Risk Rating <sup>(a)</sup>	Credit Exposure as a Percentage of Total Shareholders' Equity
<i>Investment Grade:</i>		
10 largest combined	A+ (weighted average) <sup>(b)</sup>	84.8%
Single largest non-sovereign (financial institution)	AA-	8.4
Single largest corporate	AAA	5.4
Single largest sovereign	A	15.7
<i>Non-Investment Grade:</i>		
Single largest sovereign	BB-	1.8
Single largest non-sovereign	B+	0.5

(a) Risk rating is based on external ratings, or equivalent, based on AIG's internal risk rating process.

(b) Six of the ten largest credit exposures are to highly-rated financial institutions and three are to investment-grade rated sovereigns; none is rated lower than BBB+ or its equivalent.

AIG closely controls its aggregate cross-border exposures to avoid excessive concentrations in any one country or regional group of countries. AIG defines its cross-border exposure to include both cross-border credit exposures and its large cross-border investments in its own international subsidiaries. Ten countries had cross-border exposures in excess of 10 percent of total shareholders' equity; seven are AAA-rated and three are AA-rated.

In addition, AIG closely monitors its industry concentrations, the risks of which are often mitigated by the breadth and scope of AIG's international operations.

AIG's single largest industry credit exposure is to the highly-rated global financial institutions sector, accounting for 87 percent of total shareholders' equity at December 31, 2007.

Excluding the U.S. residential and commercial mortgage sectors, AIG's other industry credit concentrations in excess of 10 percent of total shareholders' equity at December 31, 2007 are to the following industries (in descending order by approximate size):

- Electric and water utilities;
- Oil and gas;
- European regional financial institutions;
- Global telecommunications companies;
- Global life insurance carriers;
- U.S.-based regional financial institutions;
- Global securities firms and exchanges; and
- Global reinsurance firms.

AIG participates in the U.S. residential and commercial mortgage markets through AGF, which originates principally first-lien mortgage loans and, to a lesser extent, second-lien mortgage loans to buyers and owners of residential housing; UGC which provides first loss mortgage guaranty insurance for high loan-to-value first- and

second-lien residential mortgages; AIG Investments which invests in mortgage-backed securities and collateralized debt obligations, on behalf of AIG insurance and financial services subsidiaries, in which the underlying collateral comprises residential or commercial mortgage loans; and AIGFP which invests in highly rated tranches of RMBS, CMBS and CDOs and provides credit protection through credit default swaps on certain super senior tranches of CDOs. In addition, AIG Investments invests directly in commercial real estate properties and provides real estate commercial mortgage loans.

Some of AIG's exposures are insured ( wrapped ) by financial guarantor insurance companies, also known as monoline insurers , which at December 31, 2007, provide AIG over \$44 billion (carrying value) in financial support. The monoline insurers include MBIA, Ambac, FGIC, and others and provide support predominantly in the United States. AIG does not rely on the monoline insurance as its principal source of repayment when evaluating securities for purchase. All investment securities are evaluated primarily based on the underlying cash flow generation capacities of the issuer or cash flow characteristics of the security.

Approximately 96 percent of the monoline protection is provided on AIG Investments' fixed maturities exposures, of which municipal securities represent 74 percent of assets insured, substantially all of which had underlying credit ratings of A or higher. AIG considers that the monoline wrap for such securities is of limited support, as the default rate on single A and higher rated municipal bonds has historically been negligible. However, AIG anticipates that the failure of one or more monoline insurers may cause price volatility and other disruption in the municipal bond market, as market participants adjust to the absence of monoline credit support. AIG maintains a credit staff to evaluate its municipal bond holdings, and does not rely on monoline insurers in evaluating securities for its municipal bond portfolios.

Approximately four percent of AIG's monoline insurance supports AIGFP investment exposures.

For the non-municipal assets in the AIG Investments portfolio, at December 31, 2007, AIG owned \$9.5 billion in cost basis or \$8.8 billion in fair value of various types of asset-backed securities wrapped by one or more of the monoline insurers. Based on internal analysis, approximately \$6.7 billion in cost basis represented holdings with underlying ratings estimated at BBB or higher. AIG has generally viewed the monoline credit support on these securities as significant only to tail risk, that is, the risk that as pools of underlying assets amortize, the remaining assets, or tail , may suffer from adverse selection on prepayments or from a lack of adequate risk diversification. While

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these securities initially had underlying investment grade ratings, poor pool performance has in some cases resulted in current ratings of below investment grade. The amount of ultimate loss exposure of these securities to the monoline insurers is a function of the ultimate performance of the collateral pools and cannot be reliably estimated. AIG believes that monoline insurers are currently providing payment support on approximately \$380 million of such securities.

The CRC reviews quarterly concentration reports in all categories listed above as well as credit trends by risk ratings. The CRC may adjust limits to provide reasonable assurance that AIG does not incur excessive levels of credit risk and that AIG's credit risk profile is properly calibrated across business units.

**Market Risk Management**

AIG is exposed to market risks, primarily within its insurance and capital markets businesses. These asset-liability exposures are predominantly structural in nature, and not the result of speculative positioning to take advantage of short-term market opportunities. The Market Risk Management department (MRM), which reports to the CRO, is responsible for control and oversight of market risks in all aspects of AIG's financial services, insurance, and investment activities.

AIG's market exposures arise from the following:

AIG is a globally diversified enterprise with capital deployed in a variety of currencies. Capital deployed in AIG's overseas businesses, when converted into U.S. dollars for financial reporting purposes, constitutes a long foreign currency/short U.S. dollar market exposure on AIG's balance sheet. Similarly, overseas earnings denominated in foreign currency also represent a long foreign currency/short U.S. dollar market exposure on AIG's income statement.

Much of AIG's domestic capital is invested in U.S. fixed income or equity securities, leading to exposures to U.S. yields and equity markets.

Several of AIG's Foreign Life Insurance subsidiaries operate in developing markets where maturities on longer-term life insurance liabilities exceed the maximum maturities of available local currency assets.

As a globally diversified enterprise, AIG is exposed to a variety of foreign currency risks. AIG earns a significant portion of its income from operations conducted in foreign currencies which must be translated into U.S. dollars for consolidated reporting purposes. Consequently, exchange rate fluctuations can cause volatility in AIG's reported earnings. When the U.S. dollar weakens against other currencies, AIG's earnings increase. When the U.S. dollar strengthens against other currencies, AIG's earnings decline.

The sensitivity of AIG's consolidated shareholders' equity to foreign exchange volatility is more complex. AIG has significant capital committed overseas, which rises in value on AIG's consolidated balance sheet when the U.S. dollar weakens. AIG also has significant U.S. dollar asset holdings overseas, which offset the foreign exchange exposure arising from AIG's overseas capital. Similar to the income statement, AIG's overall balance sheet is net long foreign currencies and net short U.S. dollars.

**The table below provides an estimate of the sensitivity of shareholders' equity and net income to 10 percent changes in the value of the U.S. dollar relative to foreign currencies as of December 31, 2007, assuming a tax rate of 35 percent:**

<i>(in millions)</i>	U.S. dollar up 10 percent	U.S. dollar down 10 percent
Shareholders' equity	\$(466)	\$466
Net income	\$(220)	\$220

AIG analyzes market risk using various statistical techniques including Value at Risk (VaR). VaR is a summary statistical measure that uses the estimated volatility and correlation of market factors to calculate the maximum loss that could occur over a defined period of time with a specified level of statistical confidence. VaR measures not only the size of individual exposures but also the interaction between different market exposures, thereby providing a portfolio approach to measuring market risk. Similar VaR methodologies are used to determine capital requirements for market risk within AIG's economic capital framework.

**Insurance, Asset Management and Non-Trading Financial Services VaR**

AIG performs one comprehensive VaR analysis across all of its non-trading businesses, and a separate VaR analysis for its trading business at AIGFP. The comprehensive VaR is categorized by AIG business segment (General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management) and also by market risk factor (interest rate, currency and equity). AIG's market risk VaR calculations include exposures to benchmark Treasury or swap interest rates, but do not include exposures to credit-based factors such as credit spreads. AIG's credit exposures within its invested assets and credit derivative portfolios are discussed in Credit Risk Management - Financial Services herein.

For the insurance segments, assets included are invested assets (excluding direct holdings of real estate) and liabilities included are reserve for losses and loss expenses, reserve for unearned premiums, future policy benefits for life and accident and health insurance contracts and other policyholders' funds. For financial services companies, loans and leases represent the majority of assets represented in the VaR calculation, while bonds and notes issued represent the majority of liabilities.

AIG calculated the VaR with respect to net fair values as of December 31, 2007 and 2006. The VaR number represents the maximum potential loss as of those dates that could be incurred with a 95 percent confidence (i.e., only five percent of historical scenarios show losses greater than the VaR figure) within a one-month holding period. AIG uses the historical simulation methodology that entails repricing all assets and liabilities under explicit changes in market rates within a specific historical time period. AIG uses the most recent three years of historical market information for interest rates, foreign exchange rates, and equity



