AMERICAN INTERNATIONAL GROUP INC
Form 10-K
March 01, 2007

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

Form 10-K

(Mark One)

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the fiscal year ended December 31, 2006

or

o	**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	**13-2592361**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
70 Pine Street, New York, New York	**10270**
(Address of principal executive offices)	**(Zip Code)**

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

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

Title of each class	**Name of each exchange on which registered**
Common Stock, Par Value $2.50 Per Share	**New York Stock Exchange, Inc.**

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 o No þ

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 o No þ

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 þ No o

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. o

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

Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer o

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

Yes o No þ

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 30, 2006 (the last business day of the registrant s most recently completed second fiscal quarter), was approximately $130,207,300,000.

As of January 31, 2007, there were outstanding 2,601,583,676 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 16, 2007 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 16, 2007.*

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 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)

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)

SunAmerica Life Insurance Company (SunAmerica Life)

AIG SunAmerica Life Assurance Company

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

Asset Management

AIG SunAmerica Asset Management Corp. (SAAMCo)

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

At December 31, 2006, AIG and its subsidiaries had approximately 106,000 employees.

AIG s Internet address for its corporate website is *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 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 of Notes to Consolidated Financial Statements.*

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 realized capital gains (losses). 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 of Notes to Consolidated Financial Statements.

Years Ended December 31, *(in millions)*	**2006**	2005	2004	2003	2002
General Insurance operations:					
Gross premiums written	**$ 56,280**	$ 52,725	$ 52,046	$ 46,938	$ 36,678
Net premiums written	**44,866**	41,872	40,623	35,031	26,718
Net premiums earned	**43,451**	40,809	38,537	31,306	23,595
Net investment income[(a)]	**5,696**	4,031	3,196	2,566	2,350
Realized capital gains (losses)	**59**	334	228	(39)	(345)
Operating income[(a)(b)(c)(d)]	**10,412**	2,315	3,177	4,502	923
Identifiable assets	**167,004**	150,667	131,658	117,511	105,891
Statutory measures[(e)]:					
Statutory underwriting profit (loss)[(b)(c)(d)]	**4,408**	(2,165)	(564)	1,559	(1,843)
Loss ratio	**64.6**	81.1	78.8	73.1	83.1
Expense ratio	**24.5**	23.6	21.5	19.6	21.8
Combined ratio[(d)]	**89.1**	104.7	100.3	92.7	104.9
Life Insurance & Retirement Services operations:					
GAAP premiums	**30,636**	29,400	28,088	23,496	20,694
Net investment income[(a)]	**19,439**	18,134	15,269	12,942	11,243
Realized capital gains (losses) [(f)]	**88**	(158)	45	362	(295)
Operating income[(a)]	**10,032**	8,904	7,925	6,929	5,258
Identifiable assets	**534,977**	480,622	447,841	372,126	289,914
Insurance in-force at end of year[(g)]	**2,070,600**	1,852,833	1,858,094	1,583,031	1,298,592
Financial Services operations:					

Interest, lease and finance charges[(h)]	**8,010**	10,525	7,495	6,242	6,822
Operating income[(h)]	**524**	4,276	2,180	1,182	2,125
Identifiable assets	**206,845**	166,488	165,995	141,667	128,104
Asset Management operations:					
Net investment income from spread-based products and advisory and management fees	**5,814**	5,325	4,714	3,651	3,467
Operating income	**2,346**	2,253	2,125	1,316	1,125
Identifiable assets	**97,913**	81,080	80,075	64,047	53,732
Other operations:					
Realized capital gains (losses)	**(41)**	165	(229)	(765)	(1,013)
All other[(i)]	**(1,586)**	(2,700)	(333)	(1,257)	(610)
Revenues[(j)(k)]	**113,194**	108,905	97,666	79,421	66,171
Total operating income[(a)(j)(l)]	**21,687**	15,213	14,845	11,907	7,808
Total assets	**979,414**	853,051	801,007	675,602	561,131

(a) *Includes the effect of out of period adjustments related to the accounting for certain interests in unit investment trusts and other mutual funds (unit investment trusts). For 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.*

(b) *Includes current year catastrophe-related losses of $2.89 billion and $1.05 billion in 2005 and 2004, respectively. There were no significant catastrophe-related losses in 2006.*

(c) *Includes additional losses incurred and net reinstatement premiums related to prior year catastrophes of $199 million and $277 million in 2006 and 2005, respectively.*

(d) *Operating income was reduced by fourth quarter charges of $1.8 billion, $850 million and $2.1 billion for 2005, 2004 and 2002, 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 insurance companies are required to report such measurements to regulatory authorities.*

(f) Includes the effect of hedging activities that did not qualify for hedge accounting treatment under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133) and the application of Statement of Financial Accounting Standards No. 52, Foreign Currency Translation (FAS 52). For 2006, 2005, 2004, 2003 and 2002, respectively, the amounts included are $355 million, $(495) million, $(140) million, $78 million and $(91) million.

(g) 2005 includes the effect of the non-renewal of a single large group life case of $36 billion. Also, the foreign in-force is translated to U.S. dollars at the appropriate balance sheet exchange rate in each period.

(h) Includes the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For 2006, 2005, 2004, 2003 and 2002, respectively, the effect was $(1.82) billion, $2.01 billion, $(122) million, $(1.01) billion and $220 million in both revenues and operating income for Capital Markets. These amounts result primarily from interest rate and foreign currency derivatives that are economically hedging available for sale securities and borrowings. For 2004, 2003 and 2002, respectively, the effect was $(27) million, $49 million and $20 million in operating income for Aircraft Leasing. In 2006 and 2005, Aircraft Leasing derivative gains and losses were reported as part of AIG s Other category, and were not reported in Aircraft Leasing operating income.

(i) Includes $1.6 billion of regulatory settlement costs in 2005 as described under Item 3. Legal Proceedings.

(j) Includes the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For 2006, 2005, 2004, 2003 and 2002, respectively, the effect was $(1.86) billion, $2.02 billion, $385 million, $(1.50) billion and $(216) million in revenues and $(1.86) billion, $2.02 billion, $671 million, $(1.22) billion and $(58) million in operating income. These amounts result primarily from interest rate and foreign currency derivatives that are hedging available for sale securities and borrowings.

(k) Represents the sum of General Insurance net premiums earned, Life Insurance & Retirement Services GAAP premiums, net investment income, Financial Services interest, lease and finance charges, Asset Management net investment income from spread-based products and advisory and management fees, and realized capital gains (losses).

(l) Represents income before income taxes, minority interest and cumulative effect of accounting changes.

American International Group, Inc. and Subsidiaries

General Insurance Operations

AIG s General Insurance subsidiaries are multiple line companies writing 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, 2006. During 2006, 8 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 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 2006, DBG accounted for 54 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. The AIG Risk Management operation provides insurance and risk management programs for large corporate customers. The AIG Risk Finance operation is a leading provider of customized structured insurance products. Also included in DBG are the operations of AIG Environmental, which focuses specifically on providing specialty products to clients with environmental exposures. Lexington writes surplus lines for risks 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.

Certain of the products of the DBG companies include funding components or have been structured so that little or no insurance risk is actually transferred. Funds received in connection with these products are recorded as deposits and included in other liabilities, rather than premiums and incurred losses.

Reinsurance

The subsidiaries of Transatlantic Holdings, Inc. (Transatlantic) offer reinsurance on both a treaty and facultative basis to insurers in the U.S. 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 59.2 percent by AIG and therefore is included in AIG s consolidated financial statements.

Personal Lines

AIG s Personal Lines operations provide automobile insurance through AIG Direct, a mass marketing operation, the Agency Auto Division and 21st Century Insurance Group (21st Century), as well as a broad range of coverages for high net-worth individuals through the AIG Private Client Group. 21st Century is a public company owned 61.9 percent by AIG and therefore is included in AIG s consolidated financial statements. During the first quarter of 2007, AIG offered to acquire the outstanding shares of 21st Century not already owned by AIG and its subsidiaries.

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, on 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, including the U.K., Africa, the Middle East and Latin America. During 2006, the Foreign General Insurance group accounted for 25 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. 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 respective local or functional currency. Therefore, no assumption is included for changes in currency rates. See also Note 1(b) of Notes to Consolidated Financial Statements.

Management reviews the adequacy of established loss reserves through the utilization of 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 1996 through 2006. 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 $24.75 billion as of December 31, 1999, by the end of 2006 (seven years later) $29.16 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 $25.82 billion was reestimated to be $36.28 billion at December 31, 2006. 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 $259 million at December 31, 2006 related to December 31, 2005 net losses and loss expense reserves of $57.34 billion represents the cumulative amount by which reserves for 2005 and prior years have developed favorably during 2006.

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 2001 year end, the remaining undiscounted reserves held as of December 31, 2006 are $12.25 billion, with a corresponding discounted net reserve of $11.35 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.

American International Group, Inc. and Subsidiaries

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.

(in millions)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	**2006**
Net Reserves Held	$20,496	$20,901	$25,418	$25,636	$25,684	$26,005	$29,347	$36,228	$47,254	$57,476	**$62,630**
Discount (in Reserves Held)	393	619	897	1,075	1,287	1,423	1,499	1,516	1,553	2,110	**2,264**
Net Reserves Held (Undiscounted)	20,889	21,520	26,315	26,711	26,971	27,428	30,846	37,744	48,807	59,586	**64,894**
Paid (Cumulative) as of:											
One year later	5,712	5,607	7,205	8,266	9,709	11,007	10,775	12,163	14,910	15,326	
Two years later	9,244	9,754	12,382	14,640	17,149	18,091	18,589	21,773	24,377		
Three years later	11,943	12,939	16,599	19,901	21,930	23,881	25,513	28,763			
Four years later	14,152	15,484	20,263	23,074	26,090	28,717	30,757				
Five years later	16,077	17,637	22,303	25,829	29,473	32,685					
Six years later	17,551	18,806	24,114	28,165	32,421						
Seven years later	18,415	19,919	25,770	30,336							
Eight years later	19,200	21,089	27,309								

Nine years later	20,105	22,177
Ten years later	20,972	

(in millions)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	**2006**
Net Reserves Held (undiscounted)	$20,889	$21,520	$26,315	$ 26,711	$ 26,971	$ 27,428	$ 30,846	$ 37,744	$48,807	$59,586	**$64,894**
Undiscounted Liability as of:											
One year later	20,795	21,563	25,897	26,358	26,979	31,112	32,913	40,931	53,486	59,533	
Two years later	20,877	21,500	25,638	27,023	30,696	33,363	37,583	49,463	55,009		
Three years later	20,994	21,264	26,169	29,994	32,732	37,964	46,179	51,497			
Four years later	20,776	21,485	28,021	31,192	36,210	45,203	48,427				
Five years later	20,917	22,405	28,607	33,910	41,699	47,078					
Six years later	21,469	22,720	30,632	38,087	43,543						
Seven years later	21,671	24,209	33,861	39,597							
Eight years later	22,986	26,747	34,986								
Nine years later	25,264	27,765									
Ten years later	26,091										
	(5,202)	(6,245)	(8,671)	(12,886)	(16,572)	(19,650)	(17,581)	(13,753)	(6,202)	53	

Net Redundancy/(Deficiency)										
Remaining Reserves (Undiscounted)	5,119	5,588	7,677	9,261	11,122	14,393	17,670	22,734	30,632	44,207
Remaining Discount	360	427	517	623	748	894	1,079	1,265	1,484	1,809
Remaining Reserves	4,759	5,161	7,160	8,638	10,374	13,499	16,591	21,469	29,148	42,398

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, 2006.

(in millions)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	**2006**
Gross Liability, End of Year	$32,605	$ 32,049	$ 36,973	$ 37,278	$ 39,222	$ 42,629	$ 48,173	$ 53,387	$63,431	$79,279	**$82,263**
Reinsurance Recoverable, End of Year	11,716	10,529	10,658	10,567	12,251	15,201	17,327	15,643	14,624	19,693	**17,369**
Net Liability, End of Year	20,889	21,520	26,315	26,711	26,971	27,428	30,846	37,744	48,807	59,586	**64,894**
Reestimated Gross Liability	41,685	43,993	53,004	58,320	63,768	67,554	68,657	69,007	70,895	78,946	
Reestimated Reinsurance Recoverable	15,594	16,227	18,018	18,723	20,224	20,476	20,229	17,511	15,886	19,413	
Reestimated Net Liability	26,091	27,766	34,986	39,597	43,544	47,078	48,428	51,496	55,009	59,533	
Cumulative Gross Redundancy/ (Deficiency)	(9,080)	(11,944)	(16,031)	(21,042)	(24,546)	(24,925)	(20,484)	(15,620)	(7,464)	333	

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.

(in millions)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	**2006**
Net Reserves Held	$19,753	$20,113	$24,554	$24,745	$24,829	$25,286	$28,650	$35,559	$45,742	$55,227	**$60,451**
Discount (in Reserves Held)	393	619	897	1,075	1,287	1,423	1,499	1,516	1,553	2,110	**2,264**
Net Reserves Held (Undiscounted)	20,146	20,732	25,451	25,820	26,116	26,709	30,149	37,075	47,295	57,336	**62,715**
Paid (Cumulative) as of:											
One year later	5,603	5,467	7,084	8,195	9,515	10,861	10,632	11,999	14,718	15,047	
Two years later	8,996	9,500	12,190	14,376	16,808	17,801	18,283	21,419	23,906		
Three years later	11,582	12,618	16,214	19,490	21,447	23,430	25,021	28,129			
Four years later	13,724	14,972	19,732	22,521	25,445	28,080	29,987				
Five years later	15,460	16,983	21,630	25,116	28,643	31,771					
Six years later	16,792	18,014	23,282	27,266	31,315						
Seven years later	17,519	18,972	24,753	29,162							
Eight years	18,149	19,960	26,017								

later		
Nine years later	18,873	20,779
Ten years later	19,471	

(in millions)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	**2006**
Net Reserves Held (undiscounted)	$20,146	$20,732	$25,451	$ 25,820	$ 26,116	$ 26,709	$ 30,149	$ 37,075	$47,295	$57,336	**$62,715**
Undiscounted Liability as of:											
One year later	19,904	20,576	24,890	25,437	26,071	30,274	32,129	39,261	51,048	57,077	
Two years later	19,788	20,385	24,602	26,053	29,670	32,438	35,803	46,865	52,364		
Three years later	19,777	20,120	25,084	28,902	31,619	36,043	43,467	48,691			
Four years later	19,530	20,301	26,813	30,014	34,102	42,348	45,510				
Five years later	19,633	21,104	27,314	31,738	38,655	44,018					
Six years later	20,070	21,336	28,345	34,978	40,294						
Seven years later	20,188	21,836	30,636	36,283							
Eight years later	20,515	23,441	31,556								
Nine years later	21,858	24,261									
Ten years later	22,486										

Net Redundancy/(Deficiency)	(2,140)	(3,529)	(6,105)	(10,463)	(14,178)	(17,309)	(15,361)	(11,616)	(5,069)	259
Remaining Reserves (undiscounted)	3,015	3,482	5,539	7,121	8,979	12,247	15,523	20,562	28,458	42,030
Remaining Discount	360	427	517	623	748	894	1,079	1,265	1,484	1,809
Remaining Reserves	2,655	3,055	5,022	6,498	8,231	11,353	14,444	19,297	26,974	40,221

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, 2006.

illions)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2
s Liability, End of	$30,302	$29,740	$34,474	$ 34,666	$ 36,777	$ 40,400	$ 46,036	$ 51,363	$59,897	$73,912	**$77**
surance Recoverable, of Year	10,156	9,008	9,023	8,846	10,661	13,691	15,887	14,288	12,602	16,576	**14**
Liability, End of Year	20,146	20,732	25,451	25,820	26,116	26,709	30,149	37,075	47,295	57,336	**62**
timated Gross lity	32,186	34,940	44,281	50,004	55,974	60,289	61,735	62,488	64,772	73,241	
timated Reinsurance verable	9,699	10,679	12,725	13,722	15,680	16,270	16,225	13,797	12,409	16,164	
timated Net Liability	22,487	24,261	31,556	36,282	40,294	44,019	45,510	48,691	52,363	57,077	
ulative Gross ndancy/(Deficiency)	(1,884)	(5,200)	(9,807)	(15,338)	(19,197)	(19,889)	(15,699)	(11,125)	(4,875)	671	

American International Group, Inc. and Subsidiaries

The reserve for losses and loss expenses as reported in AIG s consolidated balance sheet at December 31, 2006 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, 2006 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 subsidiaries offer a wide range of insurance and retirement savings products both domestically and abroad. 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.

There was no significant adverse effect on AIG s Life Insurance & Retirement Services results of operations from economic conditions in any one state, country or geographic region for the year ended December 31, 2006.

Foreign Life Insurance & Retirement Services

In its Life Insurance & Retirement Services businesses, AIG operates overseas principally through ALICO, AIG Star Life, AIG Edison Life, AIA, AIRCO, 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. 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 78 percent of Life Insurance & Retirement Services GAAP premiums and 68 percent of Life Insurance & Retirement Services operating income in 2006.

The Foreign Life Insurance & Retirement Services companies have over 270,000 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.

Life insurance products such as whole life and endowment continue to be significant in the overseas companies, especially in Southeast Asia, while a mixture of life insurance, accident and health and retirement services products are sold in Japan.

AIG also has subsidiary operations in Canada, Egypt, Mexico, Poland, Switzerland, Russia and Puerto Rico, and conducts life insurance business through a joint venture in Brazil and in certain countries in Central and South America.

Domestic Life Insurance & Retirement Services

AIG s principal domestic Life Insurance & Retirement Services operations include AGLA, AIG American General, AIG Annuity, USLIFE, VALIC and SunAmerica Life. These companies utilize multiple distribution channels including independent producers, brokerage, career agents and banks 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 22 percent of total Life Insurance & Retirement Services GAAP premiums and 32 percent of Life Insurance & Retirement Services operating income in 2006.

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, AIG Reinsurance Advisors, Inc. and AIG Risk Finance, as well as certain Foreign Life subsidiaries, use AIRCO as a reinsurer for certain of their businesses, and AIRCO also receives premiums from offshore captives of AIG clients. In accordance with permitted accounting practices 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 of Notes to Consolidated Financial Statements.

Insurance Investment Operations

A significant portion of AIG s General Insurance and Life Insurance & Retirement Services revenues are derived from AIG s

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insurance investment operations, which are summarized in the following table.

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

	Annual Average Cash and Invested Assets				
Years Ended December 31, *(in millions)*	Cash (including short-term investments)	Invested Assets[(a)(b)]	Total	Return on Average Cash and Assets[(c)]	Return on Average Assets[(d)]
General Insurance:					
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
2002	1,537	47,477	49,014	4.8	5.0
Life Insurance & Retirement Services:					
2006	**$7,205**	**$384,724**	**$391,929**	**5.0%**	**5.1%**
2005	6,180	352,250	358,430	5.1	5.1
2004	5,089	307,659	312,748	4.9	5.0
2003	4,680	247,608	252,288	5.1	5.2
2002	3,919	199,750	203,669	5.5	5.6

(a) Including investment income due and accrued and real estate.

(b) Includes collateral assets invested under the securities lending program.

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

(d) 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. Imperial A.I. Credit Companies also contribute to Financial Services income. This operation engages principally in insurance premium financing for both AIG s customers and those of other insurers.

Aircraft Leasing

AIG s 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 its own account, and remarketing and fleet management services for airlines and for financial institutions. See also Note 2 of Notes to Consolidated Financial Statements.

Capital Markets

The Capital Markets operations of AIG are conducted primarily through AIGFP, which engages as principal in standard and customized interest rate, currency, equity, commodity, energy and credit products with top-tier corporations, financial institutions, governments, agencies, institutional investors, and high-net-worth individuals throughout the world. 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). See also Note 2 of Notes to Consolidated Financial Statements.

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, Puerto Rico, and the U.S. Virgin Islands. AIGCFG, through its subsidiaries, is engaged in developing a multi-product consumer finance business with an emphasis on emerging markets.

Asset Management Operations

AIG s Asset Management operations comprise a wide variety of investment-related services and investment products, including institutional and retail asset management, broker-dealer services and institutional spread-based investment business. Such services and products are offered to individuals and institutions both domestically and overseas. Asset Management s spread-based investment business includes the results of AIG s proprietary institutional spread-based investment operation, the Matched Investment Program (MIP), which was launched in September of 2005 and replaced the GIC program.

AIG s principal Asset Management operations are conducted through certain subsidiaries of AIG Retirement Services, Inc., including SAAMCo and the AIG Advisor Group broker dealers (AIG SunAmerica); and through AIGGIG, including AIG Global Investment Corp., AIG Global Real Estate and AIG Private Bank. AIG SunAmerica sells and manages mutual funds and provides financial advisory services through independent-contractor registered representatives. AIGGIG manages invested assets on a global basis for AIG subsidiaries and affiliates, as well as third-party institutional, retail, and private banking clients. AIGGIG offers equity, fixed income and alternative investment funds and provides securities lending and custodial services and numerous forms of structured investment products across all asset classes. Each of these subsidiary operations receives fees for investment products and services provided.

Other Operations

Certain other 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 a variety of affiliated and unaffiliated insurance and reinsurance companies, including captive insurance companies unaffiliated with AIG.

AIG also has several other subsidiaries which engage in various businesses. Mt. Mansfield Company, Inc. owns and operates the ski slopes, lifts, school and an inn located at Stowe, Vermont. Also included in AIG s Other operations are unallocated corporate expenses, including interest expense and the settlement costs more fully described in Item 3. Legal Proceedings and Note 12(a) of Notes to Consolidated Financial Statements.

Additional Investments

AIG s significant investments in partially owned companies (which are accounted for under the equity method) include a 19.4 percent interest in Allied World Assurance Holdings, Ltd. (AWAC), a property-casualty insurance holding company, a 24.5 percent interest in The Fuji Fire and Marine Insurance Co., Ltd., a general insurance company, a 26 percent interest in Tata AIG Life Insurance Company, Ltd. and a 26 percent interest in Tata AIG General Insurance Company, Ltd. For a discussion of AIG s investments in partially owned companies, see Note 1(u) of Notes to Consolidated Financial Statements.

Locations of Certain Assets

As of December 31, 2006, approximately 37 percent of the consolidated assets of AIG were located in foreign countries (other than Canada), including $6.5 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 such possibilities as 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 of Notes 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. 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 measurements, 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.

In preparing both its 2004 and 2005 audited statutory financial statements for its Domestic General Insurance companies, AIG agreed with the relevant regulatory agencies on the statutory accounting treatment of the various items requiring adjustment or restatement. These adjustments and restatements reduced previously reported General Insurance statutory surplus at December 31, 2004 by approximately $3.5 billion to approximately $20.6 billion.

With respect to the 2005 audited statutory financial statements, the state regulators permitted the Domestic General Insurance companies to record a $724 million reduction to opening statutory surplus as of January 1, 2005.

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. Dividends from the Domestic General Insurance companies were suspended from fourth quarter 2005 through 2006, but AIG expects that dividend payments will resume in the first quarter of 2007. AIG 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. Furthermore, in order to allow the Domestic General Insurance companies to record as an admitted asset at December 31, 2006 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 $2 billion of letters of credit issued by several commercial banks in favor of certain Domestic General Insurance companies.

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 RBC formula develops a risk-adjusted target level of statutory 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 and Life Insurance subsidiaries exceeded their RBC target levels as of December 31, 2006.

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 infuse necessary capital to support 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 AIU or other AIG subsidiaries could be prevented from conducting business in certain of the jurisdictions where they currently operate. In the past, AIU 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, amount and type of security deposits, amount and type of reserves, 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 also Management s Discussion and Analysis of Financial Condition and Results of Operations Capital Resources and Liquidity Regulation and Supervision and Note 11 of Notes 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 3,100 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 2,000 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.

AIG s strong ratings have historically provided a competitive advantage. For a discussion of the possible adverse effects on AIG s competitive position as a result of a ratings downgrade, see Item 1A. Risk Factors AIG s Credit Ratings.

Directors and Executive Officers of AIG

Set forth below is information concerning the directors and executive officers of AIG. All directors 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 2002, Mr. Bensinger was Executive Vice President and Chief Financial Officer of Combined Specialty Group, Inc. (a division of Aon Corporation) commencing in March 2002, and served as Executive Vice President of Trenwick Group, Ltd. from October 1999 through December 2001. 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.

Name	Title	Age	Served as Director or Officer Since
Marshall A. Cohen	Director	71	1992
Martin S. Feldstein	Director	67	1987
Ellen V. Futter	Director	57	1999
Stephen L. Hammerman	Director	68	2005
Richard C. Holbrooke	Director	65	2001
Fred H. Langhammer	Director	63	2006
George L. Miles, Jr.	Director	65	2005
Morris W. Offit	Director	70	2005
James F. Orr III	Director	63	2006
Virginia M. Rometty	Director	49	2006
Martin J. Sullivan	Director, President and Chief Executive Officer	52	2002
Michael H. Sutton	Director	66	2005
Edmund S. W. Tse	Director, Senior Vice Chairman Life Insurance	69	1996
Robert B. Willumstad	Director and Chairman	61	2006

Frank G. Zarb	Director	72	2001
Jacob A. Frenkel	Vice Chairman Global Economic Strategies	63	2004
Frank G. Wisner	Vice Chairman External Affairs	68	1997
Steven J. Bensinger	Executive Vice President and Chief Financial Officer	52	2002
Anastasia D. Kelly	Executive Vice President, General Counsel and Senior Regulatory and Compliance Officer	57	2006
Rodney O. Martin, Jr.	Executive Vice President Life Insurance	54	2002
Kristian P. Moor	Executive Vice President Domestic General Insurance	47	1998
Win J. Neuger	Executive Vice President and Chief Investment Officer	57	1995
Robert M. Sandler	Executive Vice President Domestic Personal Lines	64	1980
Nicholas C. Walsh	Executive Vice President Foreign General Insurance	56	2005
Jay S. Wintrob	Executive Vice President Retirement Services	49	1999
William N. Dooley	Senior Vice President Financial Services	54	1992
David L. Herzog	Senior Vice President and Comptroller	47	2005
Robert E. Lewis	Senior Vice President and Chief Risk Officer	55	1993
Brian T. Schreiber	Senior Vice President Strategic Planning	41	2002

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 ultimate loss reserves will not develop adversely and materially exceed AIG s current loss reserves. 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. 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.

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 4 of Notes to Consolidated Financial Statements.

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, 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. 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.

A Material Weakness

The remaining material weakness in AIG s internal control over financial reporting relating to income tax accounting could affect the accuracy or timing of future regulatory filings. As of December 31, 2006, AIG s management concluded that the material weakness relating to the controls over income tax accounting was not fully remediated. Remediation of this material weakness is ongoing. Until remediated, this weakness could affect the accuracy or timing of future filings with the SEC and other regulatory authorities. See also Item 9A. Controls and Procedures Management s Report on Internal Control Over Financial Reporting.

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 cash flows from invested assets being less than the cash flows required to meet the policy and contract liabilities; or
- loss resulting from the actual policy experience adversely emerging in comparison to the assumptions made in the product pricing associated with mortality, morbidity, termination and expenses.

Legal Proceedings

Significant legal proceedings adversely affected AIG s results of operations in 2005. As a result of the settlements discussed below under Item 3. Legal Proceedings, AIG recorded an after-tax charge of approximately $1.15 billion in the fourth quarter of 2005. AIG is party to numerous other legal proceedings and regulatory investigations. It is possible that the effect of the 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.

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.

Foreign Operations

Foreign operations expose AIG to risks that may affect its operations, liquidity and financial condition. AIG provides insurance and investment 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 businesses are conducted outside the United States. Operations outside of the United States 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 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 including tax changes, regulatory restrictions and nationalization of AIG s operations without compensation. Adverse actions from any one country may 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.

Information Technology

A failure in AIG s operational systems or infrastructure or those of third parties could disrupt business, damage AIG s reputation and cause losses. AIG s operations rely on the secure processing, storage and transmission of confidential and other information in its computer systems and networks. AIG s business depends on effective information systems and the integrity and timeliness of the data it uses to run its business. AIG s ability to adequately price its products and services, establish reserves, provide effective and efficient service to its customers, and to timely and accurately report its financial results also depends significantly on the integrity of the data in its information systems. Although AIG takes protective measures and endeavors to modify them as circumstances warrant, its computer systems, software and networks may be vulnerable to unauthorized access, computer viruses or other malicious code and other events that could have security consequences. If one or more of such events occur, this potentially could jeopardize AIG s or its clients or counterparties confidential and other information processed and stored in, and transmitted through, its computer systems and networks, or otherwise cause interruptions or malfunctions in AIG s, its clients , its counterparties or third parties operations, which could result in significant losses or reputational damage. AIG may be required to expend significant additional resources to modify its protective measures or to investigate and remediate vulnerabilities or other exposures, and AIG may be subject to litigation and financial losses that are either not insured against or not fully covered by insurance maintained.

Despite the contingency plans and facilities AIG has in place, its ability to conduct business may be adversely affected by a disruption of the infrastructure that supports AIG s business in the communities in which it is located. This may include a disruption involving electrical, communications, transportation or other services used by AIG. These disruptions may occur, for example, as a result of events that affect only the buildings occupied by AIG or as a result of events with a broader effect on the cities where those buildings are located. If a disruption occurs in one location and AIG s employees in that location are unable to occupy its offices and conduct business or communicate with or travel to other locations, AIG s ability to service and interact with its clients may suffer and it may not be able to successfully implement contingency plans that depend on communication or travel.

AIG s Credit Ratings

Financial strength and credit ratings by 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. Any ratings downgrade may lessen AIG s ability to compete in certain businesses and may increase AIG s interest expense. 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. Historically, AIG s credit and financial strength ratings have provided AIG a competitive advantage.

From March through June of 2005, the major rating agencies downgraded the ratings of AIG and its insurance subsidiaries in a series of actions. Many of the ratings were put on negative watch or negative outlook, which indicates a potential downgrade. Since then, however, the agencies have affirmed the ratings of AIG and all of its subsidiaries with a stable outlook, which indicates that the rating is not likely to change in the near term, except that S&P maintains a negative outlook on Transatlantic and on the senior long-term debt rating of ILFC.

A downgrade of the credit or financial strength ratings of AIG or its subsidiaries 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 and/or lower prices;
- adversely affecting relationships with agents and sales representatives; and
- in the case of a downgrade of AGF or ILFC, increasing their interest expense and reducing their ability to compete in their respective businesses.

As a result of the downgrades in 2005 discussed above, AIG was required to post approximately $1.16 billion of collateral with counterparties to municipal guaranteed investment contracts and financial derivatives transactions. In the event of a further downgrade, AIG would be required to post additional collateral. It is estimated that, as of the close of business on February 15, 2007, 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 $864 million 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.

Liquidity

Liquidity risk represents the potential inability of AIG to meet all payment obligations when they become due. 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. 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. AIG s investments in certain fixed income investments, certain structured securities, direct private equities, limited partnerships, hedge funds and real estate are relatively illiquid. These asset classes represented nine percent of the carrying value of AIG s total cash and invested assets as of December 31, 2006. If AIG requires significant amounts of cash on short notice in excess of normal cash requirements, AIG may have difficulty selling these investments in a timely manner or be forced to sell them for less than what AIG might otherwise have been able to, or both.

Concentration of AIG s investment portfolios in any particular segment of the economy may have adverse effects. The concentration of AIG s investment portfolios in any particular industry, group of related industries or geographic sector could have an adverse effect on the investment portfolios and consequently on AIG s results of operations and financial position. 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, 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 rather than diversified. Further, AIG s ability to sell assets relating to such particular industry, group of related industries or geographic region may be limited if other market participants are seeking to sell at the same time.

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

The Relationships Between AIG and the Starr Entities

The relationships between AIG and the Starr entities may take an extended period of time to unwind and/or resolve, and the consequences of such resolution are uncertain. During 2006, AIG unwound and resolved its most significant relationships with C.V. Starr & Co, Inc. (Starr) and began unwinding and resolving various relationships with Starr International Company, Inc. (SICO). AIG cannot predict what its future relationship with Starr and SICO will be.

The agency relationships between AIG subsidiaries and Starr have been terminated and litigation with Starr has been resolved, but there can be no assurance that AIG will compete successfully for the business previously produced by the Starr agencies. In January 2006, Starr announced that it had completed its tender offers to purchase interests in Starr and that all eligible shareholders had tendered their shares. As a result of completion of the tender offers, no AIG executive currently holds any Starr interest.

AIG has entered into agreements pursuant to which AIG agrees, subject to certain conditions, to assure AIG s current employees that all payments are made under a series of two-year Deferred Compensation Profit Participation Plans provided by SICO (SICO Plans). For a further discussion of the SICO plans, see Note 16 of Notes to Consolidated Financial Statements. Nevertheless, there can be no assurance that AIG will be able to effectively address the consequences for its executives of the unwinding of their participation in the SICO plans and programs. Finally, litigation between AIG and SICO remains pending, and the timing, terms and effect on AIG of any resolution cannot currently be predicted. See also Item 3. Legal Proceedings.

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 precautions AIG takes 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 may 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.

Item 2.

Properties

AIG and its subsidiaries operate from approximately 2,300 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 and Houston, 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, United Kingdom, 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) of Notes to Consolidated Financial Statements, as well as the discussion and analysis of Consolidated Net Losses and Loss Expense Reserve Development and Management s Discussion and Analysis of Financial Condition and Results of Operations herein.

2006 Regulatory Settlements

In February 2006, AIG reached a final settlement with the SEC, the United States Department of Justice (DOJ), the Office of the New York Attorney General (NYAG) and the New York State Department of Insurance (DOI). 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. The 2005 financial statements included in this Annual Report on Form 10-K include a fourth quarter after-tax charge of $1.15 billion relating to the settlements.

As part of the settlement with the SEC, the SEC filed a civil complaint, alleging that from 2000 until 2005, AIG materially falsified its financial statements through a variety of transactions and entities in order to strengthen the appearance of its financial results to analysts and investors. AIG, without admitting or denying the allegations in the SEC complaint, consented to the issuance of a final judgment on February 9, 2006: (a) permanently restraining and enjoining AIG from violating Section 17(a) of the Securities Act of 1933 (Securities Act) and Sections 10(b), 13(a), 13(b)(2) and 13(b)(5) and Rules 10b-5, 12b-20, 13a-1, 13a-13 and 13b2-1 of the Exchange Act; (b) ordering AIG to pay disgorgement in the amount of $700 million; and (c) ordering AIG to pay a civil penalty in the amount of $100 million. The $800 million was deposited into a fund under the supervision of the SEC to be available to resolve claims asserted against AIG by investors, including the shareholder lawsuits described below.

In February 2006, AIG and the DOJ entered into a letter agreement whereby AIG agreed to cooperate with the DOJ in the DOJ s ongoing criminal investigation of violations of federal criminal law in connection with misstatements in periodic financial reports that AIG filed with the SEC between 2000 and 2004 relating to certain transactions, accepted responsibility for certain of its actions and those of its employees relating to these transactions, and paid $25 million in penalties.

In February 2006, AIG entered into agreements with the NYAG and the DOI, resolving claims under New York s Martin Act and insurance laws. Under the agreements, $375 million was paid into a fund under the supervision of the NYAG and the DOI to be available principally to pay certain insureds who purchased AIG excess casualty policies through Marsh & McLennan Companies, Inc. or Marsh Inc. (Marsh). In addition, a fund of approximately $343 million was created to pay obligations resulting from the underpayment by AIG of its workers compensation premium taxes and related fees and assessments. In addition, AIG paid a $100 million fine to the State of New York.

As part of these settlements, AIG has agreed to retain, for a period of three years, an independent consultant who will conduct a review that will include, among other things, the adequacy of AIG s internal controls 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.

PNC Settlement

In November 2004, AIG and AIGFP reached a final settlement with the SEC, the Fraud Section of the DOJ and the United States Attorney for the Southern District of Indiana with respect to issues arising from certain structured transactions entered into with Brightpoint, Inc. and The PNC Financial Services Group, Inc. (PNC), the marketing of transactions similar to the PNC transactions and related matters.

As part of the settlement, the SEC filed against AIG a civil complaint, based on the conduct of AIG primarily through AIGFP, alleging violations of certain antifraud provisions of the federal securities laws and aiding and abetting violations of reporting and record keeping provisions of those laws. AIG, without admitting or denying the allegations in the SEC complaint, consented to the issuance of a final judgment permanently enjoining it and its employees and related persons from violating certain provisions of the Exchange Act, Exchange Act rules and the Securities Act, ordering disgorgement of fees it received in the PNC transactions and providing for AIG to establish a transaction review committee to review the appropriateness of certain future transactions and to retain an independent consultant to examine certain transactions entered into between 2000 and 2004 and review the policies and procedures of the transaction review committee. AIG expects that the review by the independent consultant of transactions entered into by AIG during the 2000 to 2004 period will be completed during 2007.

The settlement with the DOJ consists of separate agreements with AIG and AIGFP and a criminal complaint alleging violations of federal securities laws filed against, and deferred prosecution agreement with, a wholly owned subsidiary of AIGFP. Under the terms of the settlement, AIGFP paid a penalty of $80 million. On January 17, 2006, the court approved an order dismissing the complaint with prejudice.

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 and state regulatory agencies are reviewing certain other transactions and practices of AIG and its subsidiaries in connection with industry-wide and other inquiries. AIG has cooperated, and will continue to cooperate, with all these investigations, including by producing documents and other information in response to subpoenas.

Pending 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 Starr, 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 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, 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.

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 a 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. Plaintiffs allege that defendants violated duties under ERISA by allowing the plans to offer AIG stock as a permitted investment, when defendants allegedly knew it was not a prudent investment, and by failing to provide participants with accurate information about AIG stock. AIG s motion to dismiss was denied on December 12, 2006. Discovery will be consolidated with proceedings in the securities actions.

Derivative Actions Southern District of New York. 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, 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 approved agreements staying the derivative case pending in the Southern District of New York while the special committee performs its work. The current stay extends until March 14, 2007.

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 have been consolidated into a single action. The amended consolidated complaint names 43 defendants (not including nominal defendant AIG) who, like the New York consolidated derivative litigation, are 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 plaintiffs in the Delaware derivative action assert claims only under state law. The court has approved agreements staying the derivative case pending in the Delaware Chancery Court while the special committee performs its work. The current stay extends until March 14, 2007.

An additional derivative lawsuit, filed in the Delaware Chancery Court in December 2002 against twenty directors and executives of AIG as well as against AIG as a nominal defendant, 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, Messrs. Greenberg, Matthews and 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. Discovery is currently ongoing.

Policyholder Actions. After the NYAG filed its complaint against insurance broker Marsh, policyholders brought multiple federal antitrust and the 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 18 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 *Commercial Complaint*) and *In re Employee Benefit Insurance Brokerage Antitrust Litigation* (the *Employee Benefits Complaint*, and together with the *Commercial Complaint*, the multi-district litigation).

The plaintiffs in the *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 *Commercial Complaint* also named ten brokers and fourteen other insurers (one of which has since settled) as defendants. The *Commercial Complaint* alleges that defendants engaged in a widespread conspiracy to allocate customers through bid-rigging and steering practices. The *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 *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 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 Act violations.

The plaintiffs in the *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 *Employee Benefits Complaint* names AIG, as well as eleven brokers and five other insurers, as defendants. The activities alleged in the *Employee Benefits Complaint,* with certain exceptions, track the allegations of contingent commissions, bid-rigging and tying made in the *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. Briefing has been completed on the renewed motions to dismiss, as well as plaintiffs motion for class certification in both cases. On February 16, 2007, Chief Judge Brown of the District of New Jersey transferred the multi-district litigation to himself. Oral argument on the renewed motions to dismiss has been scheduled before Chief Judge Brown on March 1, 2007. Fact discovery in the multi-district litigation is ongoing.

A number of complaints making allegations similar to those in the *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 defendants have also sought to have state court actions making similar allegations stayed pending resolution of the multi-district litigation. 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.

Litigation Relating to 21st Century. Shortly after the announcement in late January 2007 of AIG s offer to acquire the outstanding shares of 21st Century not already owned by AIG and its subsidiaries, two related class actions were filed in the Superior Court of California, Los Angeles County against AIG, 21st Century and the individual members of 21st Century s Board of Directors, two of whom are current executive officers of AIG. The actions were filed purportedly on behalf of the minority shareholders of 21st Century and assert breaches of fiduciary duty in connection with the AIG proposal. The complaints allege that the proposed per share price is unfair and seek preliminary and permanent injunctive relief to enjoin the consummation of the proposed transaction.

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 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 substantially concluded and briefing on SICO s motion for summary judgment is underway.

Effect on AIG

In the opinion of AIG management, AIG s ultimate liability for the unresolved 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 2006.

American International Group, Inc. and Subsidiaries
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 London, Paris, Switzerland 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 2006 and 2005.

	2006			2005		
	High	Low	Dividends Paid	High	Low	Dividends Paid
First quarter	**$70.83**	**$65.35**	**$0.150**	$73.46	$54.18	$0.125
Second quarter	**66.54**	**58.67**	**0.150**	58.94	49.91	0.125
Third quarter	**66.48**	**57.76**	**0.165**	63.73	56.00	0.150
Fourth quarter	**72.81**	**66.30**	**0.165**	64.40	60.43	0.150

The approximate number of holders of common stock as of January 31, 2007, based upon the number of record holders, was 58,000.

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, to take effect with the dividend to be 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.

For a discussion of certain restrictions on the payment of dividends to AIG by some of its insurance subsidiaries, see Note 11 of Notes to Consolidated Financial Statements.

The following table summarizes AIG s stock repurchases for the three-month period ended December 31, 2006:

	Average Price Paid	Total Number of Shares Purchased as Part of Publicly Announced	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs

Period	Total Number of Shares Purchased[(a)(b)]	per Share	Plans or Programs	at End of Month[(b)]
October 1 - 31, 2006		$		36,542,700
November 1 - 30, 2006				36,542,700
December 1 - 31, 2006				36,542,700
Total		$		

(a) Does not include 165,190 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, 2006 or 17,000 shares purchased by ILFC to satisfy obligations under employee benefit plans.

(b) On July 19, 2002, AIG announced that its Board of Directors had authorized the open market purchase of up to 10 million shares of common stock. On February 13, 2003, AIG announced that its Board of Directors had expanded the existing program through the authorization of an additional 50 million shares. The purchase program has no set expiration or termination date. In February 2007, AIG s Board of Directors increased the repurchase program by authorizing the repurchase of shares with an aggregate purchase price of $8 billion.

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 2007 Annual Meeting of Shareholders, which will be filed with the SEC within 120 days of AIG s fiscal year end.

American International Group, Inc. and Subsidiaries

Performance Graph

The following Performance Graph compares the cumulative total shareholder return on AIG common stock for a five-year period (December 31, 2001 to December 31, 2006) with the cumulative total return of the Standard & Poor s 500 stock index (which includes AIG) and a peer group of companies (the New Peer Group) 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. The Performance Graph also compares the cumulative total shareholder return on AIG common stock to the return of a group of companies comprised of The Allstate Corporation, The Chubb Corporation, CNA Financial Corporation, The Hartford Financial Services Group, Inc., Lincoln National Corporation, MetLife, Inc., Prudential Financial, Inc. and The Travelers Companies, Inc. (the Old Peer Group), to which AIG compared itself in the Performance Graph included in its Definitive Proxy Statement in connection with AIG s 2006 Annual Meeting of Shareholders. ACE Limited, Aflac Incorporated, and XL Capital Ltd have been added to the New Peer Group to reflect their status as significant competitors of AIG s business. The Allstate Corporation and CNA Financial Corporation have been excluded because AIG no longer believes these companies to be comparable to AIG in its overall business and operations. Dividend reinvestment has been assumed and returns have been weighted to reflect relative stock market capitalization.

FIVE-YEAR CUMULATIVE TOTAL SHAREHOLDER RETURNS
Value of $100 Invested on December 31, 2001

	2001	2002	2003	2004	2005	**2006**
AIG	$ 100.00	$ 73.07	$ 84.04	$ 83.61	$ 87.67	**$ 92.97**
S&P 500	100.00	77.90	100.25	111.15	116.61	**135.03**
New Peer Group	100.00	86.49	109.07	126.05	155.01	**179.36**
Old Peer Group	100.00	88.84	111.14	134.80	164.51	**196.58**

American International Group, Inc. and Subsidiaries

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)*	**2006**	2005	2004	2003	2002
Revenues[(a)(b)(c)]:					
Premiums and other considerations	**$ 74,083**	$ 70,209	$ 66,625	$ 54,802	$ 44,289
Net investment income	**25,292**	22,165	18,465	15,508	13,593
Realized capital gains (losses)	**106**	341	44	(442)	(1,653)
Other income	**13,713**	16,190	12,532	9,553	9,942
Total revenues	**113,194**	108,905	97,666	79,421	66,171
Benefits and expenses:					
Incurred policy losses and benefits	**59,706**	63,558	58,212	46,034	40,005
Insurance acquisition and other operating expenses	**31,801**	30,134	24,609	21,480	18,358
Total benefits and expenses	**91,507**	93,692	82,821	67,514	58,363
Income before income taxes, minority interest and cumulative effect of accounting changes [(b)(c)(d)(e)]	**21,687**	15,213	14,845	11,907	7,808
Income taxes	**6,537**	4,258	4,407	3,556	1,919
Income before minority interest and cumulative effect of accounting changes	**15,150**	10,955	10,438	8,351	5,889
Minority interest	**(1,136)**	(478)	(455)	(252)	(160)
Income before cumulative effect of accounting changes	**14,014**	10,477	9,983	8,099	5,729
Cumulative effect of accounting changes, net of tax	**34**		(144)	9	
Net income	**14,048**	10,477	9,839	8,108	5,729
Earnings per common share:					
Basic					
Income before cumulative effect of accounting changes	**5.38**	4.03	3.83	3.10	2.20
Cumulative effect of accounting changes, net of tax	**0.01**		(0.06)		
Net income	**5.39**	4.03	3.77	3.10	2.20

Diluted					
Income before cumulative effect of accounting changes	**5.35**	3.99	3.79	3.07	2.17
Cumulative effect of accounting changes, net of tax	**0.01**		(0.06)		
Net income	**5.36**	3.99	3.73	3.07	2.17
Dividends declared per common share	**0.65**	0.63	0.29	0.24	0.18
Total assets	**979,414**	853,051	801,007	675,602	561,131
Long-term debt and commercial paper(f)					
Guaranteed by AIG	**17,126**	10,425	8,498	7,469	7,144
Liabilities connected to trust preferred stock	**1,440**	1,391	1,489	1,682	
Matched/not guaranteed by AIG	**130,113**	98,033	86,912	71,198	63,866
Total liabilities	**877,546**	766,548	721,135	606,180	500,696
Shareholders equity	**$101,677**	$ 86,317	$ 79,673	$ 69,230	$ 58,303

(a) *Represents the sum of General Insurance net premiums earned, Life Insurance & Retirement Services GAAP premiums and net investment income, Financial Services interest, lease and finance charges, Asset Management net investment income from spread-based products and advisory and management fees, and realized capital gains (losses).*

(b) *Includes the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For 2006, 2005, 2004, 2003 and 2002, respectively, the effect was $(1.86) billion, $2.02 billion, $385 million, $(1.50) billion and $(216) million in revenues and $(1.86) billion, $2.02 billion, $671 million, $(1.22) billion and $(58) million in operating income. These amounts result primarily from interest rate and foreign currency derivatives that are economically hedging available for sale securities and borrowings.*

(c) *Includes the effect of out of period adjustments related to the accounting for certain interests in unit investment trusts. For 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) *Includes current year catastrophe-related losses of $3.28 billion in 2005 and $1.16 billion in 2004. There were no significant catastrophe-related losses in 2006.*

(e) *Operating income was reduced by fourth quarter charges of $1.8 billion, $850 million and $2.1 billion for 2005, 2004 and 2002, 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.*

(f) *Including that portion of long-term debt maturing in less than one year. See also Note 9 of Notes to Consolidated Financial Statements.*

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.

Management s Discussion and Analysis of Financial Condition and Results of Operations is designed to provide the reader a narrative explanation of AIG s operations, financial condition and liquidity and certain other significant matters.

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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 position, results of operations, cash flows and liquidity, the effect of credit rating changes on AIG s businesses and competitive position, the unwinding and resolving of various relationships between AIG and SICO 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.

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. AIG s operations in 2006 were conducted by its subsidiaries through these segments. Through these 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 business activities, 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. Expense efficiency is also a primary goal of AIG.

A central focus of AIG operations in recent years has been the development and expansion of distribution channels. In 2006, 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 eleven cities in China 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 both 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. During 2006, AIG acquired Travel Guard International, one of the nation s leading providers of travel insurance programs and emergency travel assistance, and acquired Central Insurance Co., Ltd., a leading general insurance company in Taiwan.

Outlook

The commercial property and casualty insurance industry has historically experienced cycles of price erosion followed by rate strengthening as a result of catastrophe or other significant losses that affect the overall capacity of the industry to provide coverage. 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 U.S. and abroad. Workers compensation remains under considerable pricing pressure, as statutory rates continue to decline. Rates for D&O insurance also continue to decline due to competitive pressures. 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, as well as in personal lines and specialty coverages, such as mortgage guaranty, where the loss ratio has increased due to softening in the U.S. housing market and the weakening performance of non-traditional mortgage products. In Foreign General, opportunities for growth exist in the consumer lines due to increased demand in emerging markets and the trend toward privatization of health insurance. Growth in the Personal Lines marketplace remains challenged from flat renewal pricing, consumer price shopping and increased advertising spending by market leaders. However, 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. AIG expects that the acquisition of the remaining interest in 21st Century will enhance AIG s ability to grow the Personal Lines business while gaining efficiencies of scale.

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 unanticipated 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.

AIG s operations in China continue to expand, but AIG expects competition in China to remain strong and AIG s success in China will depend on its ability to execute its growth strategy.

In India, AIG expects to grow all segments, both organically and through acquisitions and joint ventures.

In Japan, AIG expects its Life Insurance & Retirement Services earnings growth may be challenged by increased competition in light of a new industry-wide mortality table, the continued runoff of the older, higher-margin in-force business of AIG Star Life and AIG Edison Life and lower consumer demand for certain accident and health products in light of tax law changes. The flat yield curve and declining Yen foreign exchange environment may continue to constrain certain fixed annuity production. To leverage

American International Group, Inc. and Subsidiaries

AIG s leadership position in the distribution of annuities through banks in Japan, ALICO launched new life products in this distribution channel. Although ALICO s direct marketing activities in Japan could experience a contraction while it re-positions its brand and products in a very competitive market, AIG expects that further deregulation will provide additional growth opportunities. In addition, AIG expects that the planned integration of AIG Star Life and AIG Edison Life will provide enhanced distribution opportunities and scale economies with an anticipated completion date of 2009.

AIG is a leader in direct marketing through sponsors and in the broad market in Japan and Korea, and AIG is investing in expanding distribution channels in India, Korea and Vietnam.

Through new 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.

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 U.S. 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 home service operation, a slow growth business, has not met business objectives, although its cash flow has been steady. Domestic group life/health operations continue to face competitors with greater scale in group benefits. At the end of 2006, AIG exited the financial institutions credit life business in the U.S. as a result of competition from bank products and low profit margins. The individual fixed annuities business will continue to be challenged due to the interest rate environment and increased competition from bank products, while lower margin variable annuity products with living benefits will continue to be the product of consumer choice in the individual variable annuity markets. The group annuity market is undergoing a transition from group annuities to mutual fund products that have lower profit margins.

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 Japan and Southeast Asia where financial institutions have received remediation orders affecting consumer and policyholder rights.

Within Financial Services, demand for ILFC s modern, fuel efficient aircraft remains strong, and ILFC plans to increase its fleet by purchasing 83 aircraft in 2007. However, ILFC s margins may be adversely affected by further increases in interest rates. AIGFP expects opportunities for growth across its product segments, but AIGFP is a transaction-oriented business, and its operating results will depend to a significant extent on actual transaction flow, which can be affected by market conditions and other variables outside its control. AIG continues to explore opportunities to expand its Consumer Finance operations into new foreign markets. Consumer Finance operations overseas were negatively affected in 2006 by industry-wide credit deterioration in the Taiwan credit card market, however, and operating results in the U.S. could be affected by the residential housing market, interest rates and unemployment.

The GIC portfolio, which is reported within the Asset Management segment, continues to run off and the MIP has replaced the GIC program as AIG s principal institutional spread-based investment activity. The MIP program is expected to continue to grow in 2007. Because the asset mix under the MIP does not include the alternative investments utilized in the GIC program, however, AIG does not expect that the income growth in the MIP will offset the runoff in the GIC portfolio for the foreseeable future.

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, 2006, 2005 and 2004:

Years Ended December 31, *(in millions)*	**2006**	2005	2004
Total revenues	**$113,194**	$108,905	$97,666
Income before income taxes, minority interest and cumulative effect of accounting changes	**21,687**	15,213	14,845
Net income	**$ 14,048**	$ 10,477	$ 9,839

2006 and 2005 Comparison

The 4 percent growth in revenues in 2006 was primarily attributable to the growth in net premiums earned and net investment income from General Insurance operations and growth in Life Insurance & Retirement Services GAAP premiums and net investment income. 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 $2.01 billion in 2005.

Income before income taxes, minority interest and cumulative effect of accounting changes increased 43 percent 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

American International Group, Inc. and Subsidiaries
Management s Discussion and Analysis of
Financial Condition and Results of Operations *Continued*

2005 reflected the negative effect of $3.28 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 charge resulting from the annual review of General Insurance loss and loss adjustment reserves.

2005 and 2004 Comparison

Revenues grew 12 percent in 2005 compared to 2004 primarily due to the growth in net premiums earned from General Insurance operations as well as growth in both General Insurance and Life Insurance & Retirement Services net investment income and Life Insurance & Retirement Services GAAP premiums. Hedging activities for AIGFP that did not qualify for hedge accounting treatment under FAS 133 caused an increase in Financial Services revenues of $2.01 billion in 2005 and a decrease of $122 million in 2004.

AIG s income before income taxes, minority interest and cumulative effect of accounting changes increased 2 percent in 2005 compared to 2004. Life Insurance & Retirement Services, Financial Services and Asset Management operating income gains accounted for the increase over 2004 in both pretax income and net income. Offsetting these gains was the effect of the charges related to regulatory settlements.

Remediation and Other Items

Throughout 2006, as part of its continuing remediation efforts, AIG recorded out of period adjustments. The net effect of out of period adjustments relating to prior years increased 2006 net income by $65 million. The more significant adjustments included increases in unit investment trust income of $773 million ($428 million after tax) (more fully described below) and other expenses of $356 million ($231 million after tax), and a decrease in revenues for certain derivative transactions of $300 million ($145 million after tax).

During the fourth quarter, as part of its ongoing remediation efforts, AIG recorded out of period adjustments. These adjustments collectively increased net income in the fourth quarter by $56 million but were offset by fourth quarter charges to expense within Domestic Life for the adverse ruling in the Superior National arbitration of $125 million ($81 million after tax) and a charge of $66 million ($43 million after tax) in connection with the exit of the financial institutions credit life business. The more significant out of period adjustments included the following: a decrease in income tax expense of $181 million relating to AIG s ongoing remediation of internal controls over income tax accounting, an increase in other expenses of $167 million ($109 million after tax) relating to AIG s remediation of internal controls over reconciliation of certain balance sheet accounts, an increase in incurred policy losses and benefits of $103 million ($67 million after tax) in Domestic General Insurance for corrections of certain reserves for losses and loss expenses, a reduction in incurred policy benefits in the Foreign Life participating policyholder fund stemming from deferred tax adjustments in Foreign Life of $190 million ($124 million after tax), an increase in insurance operating expenses of $61 million ($40 million after tax) within Foreign Life for corrections of expense allocations to certain par fund accounts, and a $79 million ($51 million after tax) charge related to purchases of life insurance policies for AIG s life settlements portfolio that were issued by AIG subsidiaries.

During 2006, AIG identified and recorded out of period adjustments related to the accounting for certain interests in unit investment trusts in accordance with FIN 46(R), Consolidation of Variable Interest Entities and APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. These investments had previously been accounted for as available for sale securities, with changes in market values being reflected in other comprehensive income, net of deferred income taxes. Beginning with the second quarter of 2006, the changes in market values are included in net investment income. The adjustments decreased unrealized appreciation (depreciation) of investments net of reclassification adjustments, and the related deferred income tax benefit (expense), in the Consolidated Statement of Comprehensive Income (Loss) by approximately $659 million and approximately $231 million, respectively, and increased net investment income by $844 million, increased Incurred policy losses and benefits (related to certain participating policyholder funds) by $71 million, increased Income taxes by $231 million and increased minority interest expense by $114 million in the Consolidated Statement of Income. There was no effect on Total shareholders equity at December 31, 2006 or December 31, 2005.

Results for 2006 were negatively affected by a one-time charge relating to the Starr tender offer ($54 million before and after tax) and an additional allowance for losses in AIG Credit Card Company (Taiwan) ($94 million before and after tax).

The effective income tax rate increased from 28.0 percent for 2005 to 30.1 percent for 2006, reflecting changes in the sources of foreign taxable income, the effect of the phase out of synfuel tax credits, the effect of consolidating certain limited partnerships and a reduction in the proportion of total income derived from tax exempt income, which was partially offset by the aforementioned out of period income tax adjustments.

There were no significant catastrophe-related losses for the year ended December 31, 2006.

The following table summarizes the net effect of catastrophe-related losses for the years ended December 31, 2005 and 2004.

(in millions)	2005	2004
Pretax*	$3,280	$1,155
Net of tax and minority interest	2,109	729

**Includes $312 million and $96 million in catastrophe-related losses from partially owned companies in 2005 and 2004, respectively.*

American International Group, Inc. and Subsidiaries

Segment Results

The following table summarizes the operations of each principal segment for the years ended December 31, 2006, 2005 and 2004. See also Note 2 of Notes to Consolidated Financial Statements.

(in millions)	**2006**	2005	2004
Revenues[(a)]:			
General Insurance[(b)(c)]	**$ 49,206**	$ 45,174	$41,961
Life Insurance & Retirement Services[(c)(d)]	**50,163**	47,376	43,402
Financial Services[(e)(f)]	**8,010**	10,525	7,495
Asset Management[(g)]	**5,814**	5,325	4,714
Other[(h)]	**1**	505	94
Total	**$113,194**	$108,905	$97,666
Operating Income[(a)(i)(j)]:			
General Insurance[(c)]	**$ 10,412**	$ 2,315	$ 3,177
Life Insurance & Retirement Services[(c)]	**10,032**	8,904	7,925
Financial Services[(f)]	**524**	4,276	2,180
Asset Management	**2,346**	2,253	2,125
Other[(h)(k)]	**(1,627)**	(2,535)	(562)
Total	**$ 21,687**	$ 15,213	$14,845

(a) Includes the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For 2006, 2005 and 2004, respectively, the effect was $(1.86) billion, $2.02 billion and $385 million in revenues and $(1.86) billion, $2.02 billion and $671 million in operating income. These amounts result primarily from interest rate and foreign currency derivatives that are hedging available for sale securities and borrowings.

(b) Represents the sum of General Insurance net premiums earned, net investment income and realized capital gains (losses).

(c) Includes the effect of out of period adjustments related to the accounting for certain interests in unit investment trusts. For 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) Represents the sum of Life Insurance & Retirement Services GAAP premiums, net investment income and realized capital gains (losses). Included in realized capital gains (losses) and operating income is the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133 and the application of FAS 52, of $355 million, $(495) million and $(140) million for 2006, 2005 and 2004, respectively.

(e) Represents interest, lease and finance charges.

(f)

Includes the effect of hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For 2006, 2005 and 2004, respectively, the effect was $(1.82) billion, $2.01 billion, and $(122) million in both revenues and operating income for Capital Markets. These amounts result primarily from interest rate and foreign currency derivatives that are economically hedging available for sale securities and borrowings. For 2004, the effect was $(27) million in operating income for Aircraft Leasing. During 2006 and 2005, Aircraft Leasing derivative gains and losses were reported as part of AIG s Other category, and were not reported in Aircraft Leasing operating income.

(g) Represents net investment income with respect to spread-based products and management and advisory fees.

(h) Includes consolidation and elimination adjustments which increased revenues and operating income by $296 million and $74 million, respectively, in 2006.

(i) Represents income before income taxes, minority interest, and cumulative effect of accounting changes.

(j) Includes current year catastrophe-related losses of $3.28 billion and $1.16 billion in 2005 and 2004, respectively. There were no significant catastrophe-related losses in 2006. Includes additional losses incurred and net reinstatement premiums related to prior year catastrophes of $165 million and $292 million in 2006 and 2005, respectively.

(k) Includes current year catastrophe-related losses from unconsolidated subsidiaries of $312 million and $96 million in 2005 and 2004. There were no significant catastrophe-related losses in 2006.

General Insurance

AIG s General Insurance operations provide property and casualty products and services throughout the world. The increase in General Insurance operating income in 2006 compared to 2005 was primarily attributable to an improvement in underwriting results for DBG, including the absence of catastrophe-related losses, which amounted to $2.89 billion in 2005. Operating income for 2006 also reflected higher net investment income, including the effect of the out of period adjustments related to the accounting for certain interests in unit investment trusts.

Life Insurance & Retirement Services

AIG s Life Insurance & Retirement Services operations provide insurance, financial and investment products throughout the world. Foreign operations contributed approximately 68 percent, 59 percent and 61 percent of AIG s Life Insurance & Retirement Services operating income in 2006, 2005 and 2004, respectively.

Life Insurance & Retirement Services operating income increased 13 percent in 2006 compared to 2005 on higher GAAP premiums and an increase in net investment income. Net investment income in 2006 included the effect of an out of period adjustment related to the accounting for certain interests in unit investment trusts. Realized capital gains included in revenues and operating income were $88 million in 2006 compared to realized capital losses of $158 million in 2005. Results for 2006 were particularly strong in the Foreign Life operations that were helped by increased net investment income, higher realized gains and lower acquisition costs. Domestic Life Insurance & Retirement Services operating income declined from the prior year on lower realized gains, the charge discussed above relating to the Superior National arbitration and the exiting of the financial institutions credit insurance business.

Financial Services

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

Financial Services operating income decreased in 2006 compared to 2005 primarily due to the effects of hedging activities that did not qualify for hedge accounting treatment under FAS 133. AIG is reinstituting hedge accounting in the first quarter of 2007 for AIGFP. In addition to the effects of FAS 133, fluctuations in revenues and operating income from period to

American International Group, Inc. and Subsidiaries
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period are not unusual because of the transaction-oriented nature of Capital Markets operations.

Asset Management

AIG s Asset Management operations include institutional and retail asset management, broker-dealer services and institutional spread-based investment businesses. The MIP has replaced the GIC program as AIG s principal spread-based investment activity.

Asset Management operating income increased 4 percent in 2006 compared to 2005 due primarily to growth in asset management fees within Institutional Asset Management and income from the MIP. These increases were partially offset by the continued runoff of GIC balances, spread compression in the remaining GIC portfolio as well as decreased performance-based fees. Gains and losses arising from the consolidation of certain variable interest entities (VIEs) and partnerships are included in operating income, but are offset in minority interest expense, which is not a component of operating income.

Capital Resources

At December 31, 2006, AIG had total consolidated shareholders equity of $101.68 billion and total consolidated borrowings of $148.68 billion. At that date, $131.55 billion of such borrowings were not guaranteed by AIG, were matched borrowings by AIG or AIGFP, or represented liabilities connected to trust preferred stock.

AIG did not purchase shares of its common stock under its common stock repurchase authorization during 2006. In February 2007, AIG s Board of Directors increased the repurchase program by authorizing the repurchase of shares with an aggregate purchase price of $8 billion.

In 2007, AIG expects to issue capital securities in one or more series. The proceeds will be used to repurchase shares of common stock or to otherwise improve the efficiency of AIG s capital structure.

Liquidity

AIG manages liquidity at both the subsidiary and parent company levels. At December 31, 2006, AIG s consolidated invested assets, primarily held by its subsidiaries, included $26.8 billion in cash and short-term investments. Consolidated net cash provided from operating activities in 2006 amounted to $6.8 billion. At the parent company level, liquidity management activities are conducted in a manner to preserve and enhance funding stability, flexibility, and diversity through the full 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 and shareholder dividend payments. 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 and repurchases of common stock.

Critical Accounting Estimates

AIG considers its most 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 determinations for certain Capital Markets assets and liabilities, other-than-temporary declines in the value of investments 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. For a discussion regarding the significant accounting policies relating to these estimates, see Note 1 of Notes to Consolidated Financial Statements.

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 2006 for the year end 2006 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.

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 and Sales Inducement Assets under SOP 03-1. Estimated gross profits include investment income and gains and losses on investments less required interest, actual mortality and other expenses.

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

Fair Value Determinations Of Certain Assets And Liabilities (Financial Services):

SD *Valuation models:* utilizing factors, such as market liquidity and current interest, foreign exchange and volatility rates.

Market price data: AIG attempts to secure reliable and independent current market price data, such as published exchange rates from external subscription services such as Bloomberg or Reuters or third-party broker quotes for use in its models. When such data is not available, AIG uses an internal methodology, which includes interpolation and extrapolation from verifiable prices from trades occurring on dates nearest to the dates of the transactions.

Other-Than-Temporary Declines In The Value Of Investments:

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 or amortized cost (if lower) for an extended period of time (nine months or longer);

The occurrence of a discrete credit event resulting in the debtor defaulting or seeking bankruptcy or insolvency protection or voluntary reorganization; or

The probability of non-realization of a full recovery on its investment, irrespective of the occurrence of one of the foregoing events.

At each balance sheet date, AIG evaluates its securities holdings in an unrealized loss position. Where AIG does not intend to hold such securities until they have fully recovered their carrying value, based on the circumstances present at the date of evaluation, AIG records the unrealized loss in income. If events or circumstances change, such as unexpected changes in the creditworthiness of the obligor, unanticipated changes in interest rates, tax laws, statutory capital positions and unforeseen liquidity events, among others, AIG revisits its intent. Further, if a loss is recognized from a sale subsequent to a balance sheet date pursuant to these unexpected 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 loss for debt securities, AIG amortizes the discount or reduced premium over the remaining life of the security in a prospective manner based on the amount and timing of estimated future cash flows.

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 are multiple line companies writing 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 exclusive of investment-related income. When underwriting is not profitable, premiums are inadequate to pay for insured losses and underwriting related expenses. In these situations, the addition of general insurance related investment income and realized capital gains may, however, enable a general insurance business to produce operating income. For these reasons, AIG views underwriting results to be critical in the overall evaluation of performance. See also Liquidity herein.

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 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 (g) to the following table. See also Critical Accounting Estimates herein and Notes 1 and 4 of Notes 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

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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.

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 results, changes in DAC, net investment income and realized capital gains and losses. Operating income, as well as net premiums written, net premiums earned, net investment income and realized capital gains (losses) and statutory ratios for 2006, 2005 and 2004 were as follows:

(in millions, except ratios)	**2006**	2005	2004
Net premiums written:			
Domestic General			
DBG	**$24,345**	$23,128	$22,506
Transatlantic	**3,633**	3,466	3,749
Personal Lines	**4,654**	4,653	4,354
Mortgage Guaranty	**866**	628	607
Foreign General[(a)]	**11,368**	9,997	9,407
Total	**$44,866**	$41,872	$40,623
Net premiums earned:			
Domestic General			
DBG	**$23,936**	$22,602	$21,215
Transatlantic	**3,604**	3,385	3,661
Personal Lines	**4,645**	4,634	4,291
Mortgage Guaranty	**740**	533	539
Foreign General[(a)]	**10,526**	9,655	8,831
Total	**$43,451**	$40,809	$38,537
Net investment income[(b)]:			
Domestic General			
DBG	**$ 3,411**	$ 2,403	$ 1,965
Transatlantic	**435**	343	307
Personal Lines	**225**	217	186
Mortgage Guaranty	**140**	123	120

Intercompany adjustments and eliminations net	**1**	1	
Foreign General	**1,484**	944	618
Total	**$ 5,696**	$ 4,031	$ 3,196
Realized capital gains (losses)	**$ 59**	$ 334	$ 228
Operating income (loss)(b)(c)(d):			
Domestic General			
DBG	**$ 5,985**	$ (646)	$ 777
Transatlantic	**589**	(39)	282
Personal Lines	**432**	195	357
Mortgage Guaranty	**328**	363	399
Foreign General(e)	**3,088**	2,427	1,344
Reclassifications and eliminations	**(10)**	15	18
Total	**$10,412**	$ 2,315	$ 3,177
Statutory underwriting profit (loss)(c)(d)(g):			
Domestic General			
DBG	**$ 2,450**	$ (3,227)	$ (1,500)
Transatlantic	**129**	(434)	(77)
Personal Lines	**204**	(38)	136
Mortgage Guaranty	**188**	249	234
Foreign General(e)	**1,437**	1,285	643
Total	**$ 4,408**	$ (2,165)	$ (564)

(continued)

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(in millions, except ratios)	**2006**	2005	2004
Domestic General*[c][d]*:			
Loss ratio	**69.1**	89.6	83.9
Expense ratio	**21.5**	21.0	19.2
Combined ratio	**90.6**	110.6	103.1
Foreign General*[c][d]*:			
Loss ratio*[a]*	**50.5**	53.7	61.6
Expense ratio*[e][f]*	**33.2**	31.9	29.2
Combined ratio	**83.7**	85.6	90.8
Consolidated*[c][d]*:			
Loss ratio	**64.6**	81.1	78.8
Expense ratio	**24.5**	23.6	21.5
Combined ratio	**89.1**	104.7	100.3

(a) *Income statement accounts expressed in non-functional currencies are translated into U.S. dollars using average exchange rates.*

(b) *Includes the effect of out of period adjustments related to the accounting for certain interests in unit investment trusts in 2006. For DBG, the effect was an increase of $66 million, and for Foreign General, the effect was an increase of $424 million.*

(c) *Catastrophe-related losses increased the consolidated General Insurance combined ratio for 2005 and 2004 by 7.06 points and 2.74 points, respectively. There were no significant catastrophe-related losses in 2006. Catastrophe-related losses for 2005 and 2004 by reporting unit were as follows:*

	2005		2004	
(in millions)	Insurance Related Losses	Net Reinstatement Premium Cost	Insurance Related Losses	Net Reinstatement Premium Cost
Reporting Unit:				
DBG	$1,747	$ 122	$ 582	$
Transatlantic	463	45	215	
Personal Lines	112	2	25	
Mortgage Guaranty	10			
Foreign General	293	94	232	

Total	$2,625	$ 263	$1,054	$

(d) *Includes additional losses incurred and net reinstatement premiums related to prior year catastrophes of $199 million and $277 million, in 2006 and 2005, respectively.*
(e) *Includes the results of wholly owned Foreign General agencies.*
(f) *Includes amortization of advertising costs.*

(g) *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, 2006, 2005 and 2004:*

(in millions)	Domestic Brokerage Group	Transatlantic	Personal Lines	Mortgage Guaranty	Foreign General	Reclassifications and Eliminations	Total
2006:							
Statutory underwriting profit (loss)	**$ 2,450**	**$ 129**	**$ 204**	**$ 188**	**$1,437**	**$**	**$ 4,408**
Increase (decrease) in DAC	**26**	**14**	**2**	**3**	**204**		**249**
Net investment income	**3,411**	**435**	**225**	**140**	**1,484**	**1**	**5,696**
Realized capital gains (losses)	**98**	**11**	**1**	**(3)**	**(37)**	**(11)**	**59**
Operating income (loss)	**$ 5,985**	**$ 589**	**$ 432**	**$ 328**	**$3,088**	**$ (10)**	**$10,412**
2005:							
Statutory underwriting profit (loss)	$(3,227)	$(434)	$ (38)	$ 249	$1,285	$	$ (2,165)
Increase (decrease) in DAC	(23)	14	19	(8)	113		115
Net investment income	2,403	343	217	123	944	1	4,031
Realized capital gains (losses)	201	38	(3)	(1)	85	14	334
Operating income (loss)	$ (646)	$ (39)	$ 195	$ 363	$2,427	$ 15	$ 2,315
2004:							
Statutory underwriting profit (loss)	$(1,500)	$ (77)	$ 136	$ 234	$ 643	$	$ (564)
Increase (decrease) in DAC	160	30	24	44	59		317
	1,965	307	186	120	618		3,196

Net investment income							
Realized capital gains (losses)	152	22	11	1	24	18	228
Operating income (loss)	$ 777	$ 282	$ 357	$ 399	$1,344	$ 18	$ 3,177

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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, 2006 and 2005.

	2006	2005
Growth in original currency*	**7.4%**	2.6%
Foreign exchange effect	**(0.2)**	0.5
Growth as reported in U.S. dollars	**7.2%**	3.1%

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

2006 and 2005 Comparison

General Insurance operating income increased in 2006 compared to 2005 due to growth in net premiums, a reduction in both 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 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 contributed $1.4 billion to the increase in net premiums written. In 2005, Domestic General net premiums written increased by $300 million and Foreign General 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 net premiums written in 2006 compared to 2005 and increased Foreign General 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. These adjustments reflect continuing progress in AIG s ongoing remediation efforts. 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 unit investment trusts, $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.

2005 and 2004 Comparison

General Insurance operating income in 2005 decreased from 2004 due to higher catastrophe-related losses and the fourth quarter 2005 increase in reserves and changes in estimates related to remediation of the material weakness in reconciliation of balance sheet accounts. Catastrophe-related losses were $2.89 billion and $1.05 billion in 2005 and 2004, respectively. These decreases in operating income were partially offset by strong growth in statutory underwriting profit and increases in net investment income. General Insurance operating income in 2004 also included a $232 million charge reflecting a change in estimate for salvage and subrogation recoveries.

General Insurance net investment income grew in 2005 compared to 2004 due to strong cash flows, higher interest rates and increased partnership income. See also Capital Resources and Liquidity Liquidity herein and Note 8 of

Notes to Consolidated Financial Statements.

DBG Results

2006 and 2005 Comparison

DBG s operating income increased to $5.99 billion in 2006 compared to a loss of $646 million in 2005, an improvement of $6.63 billion. The improvement is also reflected in the combined ratio, which declined to 89.4 in 2006 compared to 113.8 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 21.0 points and 8.2 points, respectively, of the improvement.

DBG s net premiums written increased 5 percent 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 $122 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 1.5 percent.

The loss ratio for 2006 declined 24.9 points to 69.4. The 2005 loss ratio was negatively affected by catastrophe-related losses of $1.7 billion and related reinstatement premiums of $122 million. Adverse development on reserves for loss and loss adjustment expenses declined to $110 million in 2006 compared to $4.9 billion in 2005, accounting for 21.0 points of the decrease in the loss ratio.

DBG s expense ratio increased to 20.0 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. Overall allowances decreased, however, due to charge-offs against previously established allowances resulting from AIG s remediation activities.

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 certain investments in unit investment trusts and partnerships and $85 million related to interest earned on a deposit contract that did not exist in the prior year.

2005 and 2004 Comparison

DBG s net premiums written increased modestly in 2005 compared to 2004, reflecting generally improving renewal retention rates and a modest change in the mix of business towards smaller accounts for which DBG purchases less reinsurance. DBG also continued to expand its relationships with a larger number and broader range of brokers. DBG saw improvement in domestic property rates as well as increases in submission activity in the aftermath of the 2005 hurricanes. DBG attributes the increase in submissions to its overall financial strength in comparison to many insurers that experienced significant losses and reductions of surplus as a result of the hurricanes.

The DBG loss ratio increased in 2005 from 2004 principally as a result of adverse loss development, higher catastrophe-related losses and $197 million of losses incurred in 2005 resulting from the 2004 catastrophes.

The DBG expense ratio increased in 2005 from 2004, principally due to an increase in net commissions resulting from the replacement of certain ceded quota share reinsurance, for which DBG earns a ceding commission, with excess-of-loss reinsurance, which generally does not include a ceding commission. Increases in other underwriting expenses reflect a change in estimates for salvage and subrogation recoveries.

DBG s net investment income increased in 2005 compared to 2004 due to strong cash flows, higher interest rates and increased partnership income.

Transatlantic Results

2006 and 2005 Comparison

Transatlantic s net premiums written and net premiums earned increased in 2006 by 5 percent and 6 percent, respectively, 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.

2005 and 2004 Comparison

Transatlantic s net premiums written and net premiums earned for 2005 decreased compared to 2004, principally due to competitive market conditions and increased ceding company retentions in certain classes of business, largely resulting from Transatlantic s domestic operations. Operating income decreased principally as a result of the increased level of catastrophe losses.

Personal Lines Results

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.

2005 and 2004 Comparison

Personal Lines net premiums written and net premiums earned for 2005 increased compared to 2004 as a result of strong growth in the Private Client Group and Agency Auto divisions due to increased agent/broker appointments, greater market penetration and enhanced product offerings. AIG direct premiums in 2005 were down slightly from

2004 due to aggressive re-underwriting of the previously acquired GE business and the discontinuation of underwriting homeowners business. Involuntary auto premiums were down in 2005 due to the decline in the assigned risk marketplace. Statutory underwriting profit declined in 2005 as a result of hurricane losses and related expenses, reserve strengthening, an increase in Agency Auto s current accident year physical damage loss ratio, and expenses incurred related to terminating AIG s relationship with The Robert Plan effective December 31, 2005.

Mortgage Guaranty Results

2006 and 2005 Comparison

UGC s operating income declined $35 million in 2006, down 10 percent 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 UGC s consolidated loss ratio for 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 38 percent from growth in the domestic second lien and international businesses as well as improved persistency in the domestic first lien business. The

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expense ratio remained flat as premium growth covered increased expenses related to expansion internationally and continued investment in risk management resources. UGC had approximately $27 billion of guaranty risk in force at December 31, 2006.

2005 and 2004 Comparison

UGC s net premiums written were up slightly for 2005 compared to 2004 as strong growth in the international and domestic second lien businesses was mostly offset by lower persistency in domestic first lien residential renewal premiums. Statutory underwriting profit rose from 2004 due to lower contract underwriting expenses and favorable loss development.

Foreign General Insurance Results

2006 and 2005 Comparison

Foreign General s operating income increased $661 million or 27 percent in 2006 compared to 2005 due to out of period adjustments related to the accounting for interests in unit investment trusts, the absence of significant catastrophe-related losses in 2006, rate increases and lower current accident year losses by the Lloyd s syndicate Ascot (Ascot) on its U.S. book of business and lower asbestos and environmental reserve increases. Partially offsetting these increases in operating income were lower favorable loss development from prior accident years and adverse loss development on the 2005 hurricanes. Statutory underwriting profit increased $152 million in 2006 compared to 2005. Catastrophes in 2005 resulted in losses of $293 million and reinstatement premiums of $94 million.

Net premiums written increased $1.4 billion or 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 for 2005 were reduced by reinstatement premiums related to catastrophes and a portfolio transfer of unearned premium reserves to DBG related to the Richmond commutation, accounting for 3 percent of the increase in 2006 compared to 2005.

The 2006 combined ratio declined to 83.7, a decrease of 1.9 points from 2005. The 2005 catastrophes added 3.5 points to the 2005 loss ratio. The expense ratio in 2006 increased by 1.3 points as a result of increased amortization of deferred advertising costs and a continued change in the business mix towards products with higher acquisition costs but historically lower loss ratios. The loss ratio decreased 3.2 points in 2006 as the absence of significant catastrophes in 2006 resulted in a decrease of 3.5 points, rate increases and lower current year losses by Ascot on its U.S. book of business accounted for 1.3 points of the decrease and lower asbestos and environmental reserve increases accounted for 1.2 points of the decrease. These declines were partially offset by lower favorable loss development from prior accident years and adverse development on 2005 hurricanes.

The expense ratio increased 1.3 points in 2006 compared to 2005. Underwriting expenses for 2006 increased $59 million due to an out of period adjustment for amortization of deferred advertising costs and premiums were reduced by $61 million due 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. The expense ratio for 2005 increased by 1.2 points due to the decline in net premiums written from reinstatement premiums related to catastrophes and the portfolio transfer of the Richmond unearned premium reserves. Due to the current mix of business, AIG expects the expense ratio to continue to increase during 2007, principally for classes of business with historically lower than average loss ratios.

Net investment income increased $540 million or 57 percent in 2006 compared to 2005 primarily due to a $424 million out of period adjustment related to the accounting for interests in unit investment trusts.

2005 and 2004 Comparison

Foreign General operating income increased 81 percent in 2005 compared to 2004 due primarily to favorable loss development from prior accident years and increased net investment income.

Net premiums written increased 6 percent (4 percent in original currency) in 2005 compared to 2004 as a result of new business as well as new distribution channels such as the February 2005 purchase of the insurance portfolio of the Royal & Sun Alliance branch operations in Japan. The personal accident business in the Far East and the personal lines operations in Latin America also contributed to the growth. Partially offsetting these increases was the portfolio transfer of Richmond s unearned premium reserves to DBG, which reduced net premiums in 2005 and reinstatement premiums related to catastrophes.

The 2005 combined ratio of 85.6 decreased 5.3 points from 2004. The loss ratio decreased 8.0 points in 2005 from 2004. The loss ratio decreased 4.7 points due to favorable loss development from prior accident years, excluding catastrophes, and 2.3 points related to a 2004 loss reserve restatement adjustment. The loss ratio increased 0.9 points due to higher catastrophe losses in 2005 related to hurricanes. The expense ratio increased 2.7 points in 2005 from 2004 principally due to the portfolio transfer of Richmond s unearned premium reserves to DBG in 2005, loyalty business initiatives in the consumer business lines, which have higher acquisition costs, and also due to reinstatement premiums.

Foreign General net investment income increased $326 million in 2005 compared to 2004 on increased partnership income, reflecting increases in market valuations of infrastructure fund investments in Africa, Asia, China, Eastern Europe and India. Additionally, net investment income was positively affected by positive cash flows, higher interest rates and the compounding of previously earned and reinvested net investment income. Cash flow was lower in 2005 compared to 2004 due to payments for

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catastrophe-related losses incurred in 2005 and 2004 and for the purchase of the Royal & Sun Alliance branch operations.

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, 2006 and 2005 by major lines of business on a statutory Annual Statement basis*:

(in millions)	**2006**	2005
Other liability occurrence	**$19,156**	$18,116
Workers compensation	**13,465**	11,630
Other liability claims made	**12,394**	12,447
Property	**6,663**	7,217
Auto liability	**5,931**	6,569
International	**5,810**	4,939
Reinsurance	**2,960**	2,886
Medical malpractice	**2,308**	2,363
Products liability	**2,168**	1,937
Accident and health	**1,649**	1,678
Commercial multiple peril	**1,621**	1,359
Aircraft	**1,562**	1,844
Fidelity/surety	**1,127**	1,072
Other	**3,185**	3,112
Total	**$79,999**	$77,169

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

AIG s gross reserve for losses and loss expenses represents the accumulation of estimates of ultimate losses, including 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.

At December 31, 2006, General Insurance net loss reserves increased $5.15 billion from 2005 to $62.63 billion. The net loss reserves represent loss reserves reduced by reinsurance recoverables, 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 reserves by business unit as of December 31, 2006 and 2005.

(in millions)	**2006**	2005

DBG[a]	**$43,998**	$40,782
Transatlantic	**6,207**	5,690
Personal Lines[b]	**2,440**	2,578
Mortgage Guaranty	**460**	340
Foreign General[c]	**9,525**	8,086
Total Net Loss Reserve	**$62,630**	$57,476

(a) At December 31, 2006 and 2005, respectively, DBG loss reserves include approximately $3.33 billion and $3.77 billion ($3.66 billion and $4.26 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 $535 million and $407 million related to business included in AIUO s statutory filings at December 31, 2006 and 2005, respectively.

(b) At December 31, 2006 and 2005, respectively, Personal Lines loss reserves include $861 million and $878 million related to business ceded to DBG and reported in DBG s statutory filings.

(c) At December 31, 2006 and 2005, respectively, Foreign General loss reserves include approximately $2.87 billion and $2.15 billion related to business reported in DBG s statutory filings.

The DBG net loss reserve of $44.0 billion is comprised principally of the business of AIG subsidiaries participating in the American Home/ National Union pool (11 companies) and the surplus lines pool (Lexington, Starr Excess Liability Insurance Company and Landmark Insurance Company).

Beginning in 1998, DBG ceded a quota share percentage of its other liability occurrence and products liability occurrence business to AIRCO. The quota share percentage ceded was 40 percent in 1998, 65 percent in 1999, 75 percent in 2000 and 2001, 50 percent in 2002 and 2003, 40 percent in 2004, 35 percent in 2005 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. In 1998 the cession reflected only the other liability occurrence business, but in 1999 and subsequent years included products liability occurrence. AIRCO s loss reserves relating to these quota share cessions from DBG are recorded on a discounted basis. As of year-end 2006, AIRCO carried a discount of approximately $330 million applicable to the $3.66 billion in undiscounted reserves it assumed from the American Home/ National Union pool via this quota share cession. AIRCO also carries approximately $467 million in net loss reserves relating to Foreign General insurance business. These reserves are carried on an undiscounted basis.

Beginning in 1997, the Personal Lines division ceded a percentage of all business written by the companies participating in the personal lines pool to the American Home/ National Union pool. As noted above, the total reserves carried by participants in the American Home/ National Union pool relating to this cession amounted to $861 million as of year-end 2006.

The companies participating in the American Home/ National Union pool have maintained a participation in the business written by AIU for decades. As of year-end 2006, these AIU reserves carried by participants in the American Home/ National Union pool amounted to approximately $2.87 billion. The remaining Foreign

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General reserves are carried by AIUO, AIRCO, and other smaller AIG subsidiaries domiciled outside the United States. Statutory filings in the U.S. 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 year-end 2006 by AIUO and AIRCO were approximately $4.57 billion and $3.80 billion, respectively. AIRCO s $3.80 billion in total general insurance reserves consists of approximately $3.33 billion from business assumed from the American Home/ National Union pool and an additional $467 million relating to Foreign General Insurance business.

Discounting of Reserves

At December 31, 2006, AIG s overall General Insurance net loss reserves reflect a loss reserve discount of $2.26 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: $662 million tabular discount for workers compensation in DBG; $1.27 billion non-tabular discount for workers compensation in DBG; and, $330 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 $11.5 billion as of year-end 2006. 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 $3.66 billion at December 31, 2006.

Results of 2006 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, 2006. 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, 2006. 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.

The following table presents the reconciliation of net loss reserves for 2006, 2005 and 2004 as follows:

(in millions)	**2006**	2005	2004
Net reserve for losses and loss expenses at beginning of year	**$57,476**	$47,254	$36,228
Foreign exchange effect	**741**	(628)	524
Acquisition[(a)]	**55**		
Losses and loss expenses incurred:			
Current year	**27,805**	28,426	26,793
Prior years, other than accretion of discount	**(53)**	4,680[(b)]	3,187[(c)]

Prior years, accretion of discount	**300**	(15)	377
Losses and loss expenses incurred	**28,052**	33,091	30,357
Losses and loss expenses paid:			
Current year	**8,368**	7,331	7,692
Prior years	**15,326**	14,910	12,163
Losses and loss expenses paid	**23,694**	22,241	19,855
Net reserve for losses and loss expenses at end of year	**$62,630**	$57,476	$47,254

(a) Reflects the opening balance with respect to the acquisition of the Central Insurance Co., Ltd. in the third quarter of 2006.

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

(c) Includes fourth quarter charge of $850 million attributable to the change in estimate for asbestos and environmental exposures.

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

(in millions)	**2006**	2005	2004
Prior Accident Year Development by Reporting Unit:			
DBG	**$ 110**	$4,871	$2,857
Personal Lines	**(111)**	14	75
UGC	**(115)**	(103)	(102)
Foreign General	**(118)**	(371)	40
Sub total	**(234)**	4,411	2,870
Transatlantic	**181**	269	317
Prior years, other than accretion of discount	**$ (53)**	$4,680	$3,187

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(in millions)	**2006**	2005	2004
Prior Accident Year Development by Major Class of Business:			
Excess casualty (DBG)	**$ 102**	$1,191	$1,240
D&O and related management liability (DBG)	**(20)**	1,627	930
Excess workers compensation (DBG)	**74**	983	279
Reinsurance (Transatlantic)	**181**	269	317
Asbestos and environmental (primarily DBG)	**208**	930	1,006
All other, net	**(598)**	(320)	(585)
Prior years, other than accretion of discount	**$ (53)**	$4,680	$3,187

Accident Year *(in millions)*	Calendar Year **2006**	2005	2004
Prior Accident Year Development by Accident Year:			
2005	**$(1,576)**		
2004	**(511)**	$(3,853)	
2003	**(212)**	(63)	$(1,483)
2002	**373**	1,360	69
2001	**29**	1,749	1,123
2000	**338**	1,323	760
1999	**382**	944	693
1998	**41**	605	536
1997	**197**	281	174
1996 & Prior	**886**	2,334	1,315
Prior years, other than accretion of discount	**$ (53)**	$ 4,680	$ 3,187

The loss ratios recorded by AIG for 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 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.

In 2006, AIG enhanced its process of determining the quarterly loss development from prior accident years. In the first quarter of 2006, AIG began conducting additional 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 now take additional steps to 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 the first, second and third quarters of 2006 to determine the loss development from prior accident years for the first, second and third quarters of 2006. As part of its quarterly reserving process, AIG also considers notices of claims received with respect to emerging issues, such as those related to stock option backdating. In the fourth quarter of 2006, a comprehensive loss reserve review was completed for each AIG general insurance subsidiary. The prior accident year loss reserve development shown in the tables above for 2006 reflects the results of these comprehensive reviews, including the effect of actual loss emergence in the fourth quarter of 2006.

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 the general reinsurance operations of 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. For 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, and from Transatlantic.

For 2005, net loss development from prior accident years was adverse by approximately $4.68 billion, including approximately $269 million from the general reinsurance operations of 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.

For 2004, AIG s overall net loss reserve development from prior accident years was an increase of approximately $3.19 billion, including approximately $317 million from the general reinsurance operations of Transatlantic and excluding approximately $377 million from accretion of loss reserve discount. This $3.19 billion adverse development in 2004 was comprised of approximately $4.67 billion of adverse development for the 2002 and prior accident years, partially offset by approximately $1.48 billion of favorable development for accident year 2003. The adverse development for the 2002 and prior accident years was primarily attributable to excess casualty, D&O and related management liability classes, and asbestos and environmental reserves, all within DBG, and also to Transatlantic. Most classes of business throughout AIG produced favorable development for accident year 2003.

The following is a discussion of the primary reasons for the development in 2006, 2005 and 2004 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 2004 and 2005, but in 2006 there was only a relatively minor amount of adverse development. The adverse development for all periods shown related principally to accident years 2000 and prior, and to a lesser extent 2001, 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 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 the year-end 2004 loss reserve review, AIG s actuaries responded to the adverse development for excess casualty by increasing the loss development factor assumptions. In the year-end 2004 reserve study, the development factors applicable to accident years 1998 and subsequent were increased by approximately 12 percent. In addition, the expected loss ratios for accident years 2002 and subsequent were increased to take into account the higher ultimate loss ratios for accident years 2001 and prior.

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 continues to experience adverse development for this class for accident years prior to 2003.

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 on page 37.

D&O and Related Management Liability Classes of Business: These classes of business experienced significant adverse development in 2004 and 2005, but experienced slightly favorable development in 2006. The adverse development in 2004 and 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 since 2002 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.

In the year-end 2004 loss reserve review, AIG s actuaries responded to the adverse development for D&O and related management liability classes by increasing the loss development factor assumptions. The development factors applicable to accident years 1997 and subsequent were increased by approximately 5 percent in the year-end 2004 reserve study. In addition, the expected loss ratios for accident years 2002 and subsequent were increased to take into account the higher ultimate loss ratios for accident years 2001 and prior. The loss ratios for the older accident years increased due to the combination of higher than expected loss development in the year and the increase in the loss development factor assumptions.

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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.

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 on page 37.

Excess Workers Compensation: This class of business experienced significant adverse development in 2005, and a relatively minor amount of adverse development in 2006. 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.

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.

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 2006 for the year-end 2006 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.

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

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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 utilizes these methods in pricing subclasses of professional liability. However, AIG does not generally utilize 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 2006 reviews averaged approximately 6 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 2006 loss reserve review, claims projections for accident years 2005 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 2000 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 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 the most 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.

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 default based on actual historical experience and is essentially a frequency/severity analysis for each category of default.

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 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 the optimal balance between homogeneity and credibility.

Loss Adjustment Expenses: AIG determines reserves for legal defense and cost containment loss adjustment expenses for each

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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 event. 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 for 2006. 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 six 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 2006 loss reserve review for excess casualty will range from negative four percent to positive 16 percent, or approximately ten percent lower or higher than the assumption actually utilized in the year-end 2006 reserve review. A ten percent change in the assumed loss cost trend for excess casualty would cause approximately a $1.7 billion increase or a $1.2 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 four 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 16 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 3.25 percent below those actually utilized in the year-end 2006 reserve review to approximately ten percent above those factors actually utilized. If the loss development factor assumptions were changed by 3.25 percent and ten percent, respectively, the net loss reserves for the excess casualty class would decrease by approximately $450 million under the lower assumptions or increase by approximately $1.25 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 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 2006 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 2006 reserve review. A 15 percent change in the assumed loss cost trend for these classes would cause approximately a $625 million increase or a $550 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 five percent lower or higher than those factors actually utilized in the year-end 2006 loss reserve review for these classes. If the loss development factor assumptions were changed by five percent, the net loss reserves for these classes would be estimated to increase or decrease by approximately $200 million. 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 five percent.

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 2006 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 $350 million increase or a $225 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 2006 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 2.75 percent below to 7.5 percent above those actually utilized in the year-end 2006 loss reserve review. If the loss development factor assumptions were changed by 2.75 percent and 7.5 percent, respectively, the net loss reserves for workers compensation would decrease or increase by approximately $525 million and $1.5 billion, respectively. It should be noted that loss emergence in 2006 for this class was higher than historical averages, resulting in an increase in loss reserves for prior accident years. However, 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.

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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 inconsistent 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.

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 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 mitigates to the extent possible its exposure to these claims.

To determine the appropriate loss reserve as of December 31, 2006 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 both asbestos reserves and environmental reserves consistent with the 2005 review. 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 analyses were comprehensive, AIG staff produced in the 2006 analyses the information required at policy and claim level detail for over 1,000 asbestos defendants and nearly 1,000 environmental defendants. This represented over 95 percent of all accounts for which AIG had received any claim notice of any amount pertaining to asbestos or environmental 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 the appropriate provision for all 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 2006 analysis reflected an update to the comprehensive analysis of reinsurance recoverability that was first completed in 2005. All asbestos accounts for which there was a significant change in estimated losses in the 2006 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 expected losses to be reported over the next twenty years, i.e., from 2007 through 2026, based on the actual losses reported through 2006 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 2006. 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 2006. 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 ten years, i.e., through the year 2016.

At year-end 2006, 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 determined its best estimate was to recognize an increase of $256 million in its carried net asbestos reserves, and a decrease of $58 million in its carried net environmental reserves at December 31, 2006. The corresponding changes in gross reserves were an increase of approximately $570 million for asbestos and a decrease of approximately $230 million for environmental, respectively. A minor amount of additional incurred loss emergence pertaining to asbestos was reflected in 2006, primarily attributable to the general reinsurance operations of Transatlantic. The majority of the increase in asbestos reserves resulting from the 2006 review is attributable to higher than expected emergence of claims pertaining to new asbestos policy exposures. A significant portion of this increase pertains to higher layers of excess coverage for certain major asbestos defendants on business written by DBG. Approximately $80 million of the overall $256 million net asbestos reserve increase is attributable to business written by Foreign General, approximately $30 million of which is in turn ceded to DBG. In 2006, Foreign General enhanced its capability to identify asbestos exposures, resulting in the identification of additional asbestos defendants in 2006, as well as higher layers of exposure for certain existing defendants. As described above, the ground up analysis as of 2006 now models over 1,000 asbestos defendants and over 95 percent of all known reported asbestos claims.

The decrease in environmental reserves resulting from the 2006 review is primarily attributable to favorable loss trends in recent report years. These favorable trends resulted in a reduced expectation of unreported claims, i.e., IBNR, for future report years.

American International Group, Inc. and Subsidiaries
Management s Discussion and Analysis of
Financial Condition and Results of Operations *Continued*

A summary of reserve activity, including estimates for applicable IBNR, relating to asbestos and environmental claims separately and combined at December 31, 2006, 2005 and 2004 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.

	2006		2005		2004	
(in millions)	Gross	Net	Gross	Net	Gross	Net
Asbestos:						
Reserve for losses and loss expenses at beginning of year	**$4,441**	**$1,840**	$2,559	$1,060	$1,235	$ 386
Losses and loss expenses incurred[(a)]	**571**	**267**	2,207*(b)*	903*(b)*	1,595*(b)*	772*(b)*
Losses and loss expenses paid[(a)]	**(548)**	**(218)**	(325)	(123)	(271)	(98)
Reserve for losses and loss expenses at end of year	**$4,464**	**$1,889**	$4,441	$1,840	$2,559	$1,060
Environmental:						
Reserve for losses and loss expenses at beginning of year	**$ 926**	**$ 410**	$ 974	$ 451	$ 789	$ 283
Losses and loss expenses incurred[(a)]	**(232)**	**(59)**	47*(c)*	27*(c)*	314*(c)*	234*(c)*
Losses and loss expenses paid[(a)]	**(106)**	**(61)**	(95)	(68)	(129)	(66)
Reserve for losses and loss expenses at end of year	**$ 588**	**$ 290**	$ 926	$ 410	$ 974	$ 451
Combined:						
Reserve for losses and loss expenses at beginning of year	**$5,367**	**$2,250**	$3,533	$1,511	$2,024	$ 669
Losses and loss expenses incurred[(a)]	**339**	**208**	2,254*(d)*	930*(d)*	1,909*(d)*	1,006*(d)*
Losses and loss expenses paid[(a)]	**(654)**	**(279)**	(420)	(191)	(400)	(164)
Reserve for losses and loss expenses at end of year	**$5,052**	**$2,179**	$5,367	$2,250	$3,533	$1,511

(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 $1.2 billion in the fourth quarter of 2005 and 2004, respectively, and increases to net losses and loss expense reserves of $843 million and

$650 million for the fourth quarter of 2005 and 2004, respectively.

(c) *Includes increases to gross losses and loss expense reserves of $56 million and $250 million in the fourth quarter of 2005 and 2004, respectively, and increases to net losses and loss expense reserves of $30 million and $200 million for the fourth quarter of 2005 and 2004, respectively.*

(d) *Includes increases to gross losses and loss expense reserves of $2.0 billion and $1.5 billion in the fourth quarter of 2005 and 2004, respectively, and increases to net losses and loss expense reserves of $873 million and $850 million for the fourth quarter of 2005 and 2004, respectively.*

As indicated in the table above, asbestos loss payments increased significantly in 2006 compared to the prior years, primarily as a result of payments pertaining to settlements that had been negotiated in earlier periods.

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, 2006, 2005 and 2004 were estimated as follows:

	2006		2005		2004	
(in millions)	Gross	Net	Gross	Net	Gross	Net
Asbestos	**$3,212**	**$1,469**	$3,401	$1,465	$2,033	$ 876
Environmental	**340**	**173**	586	266	606	284
Combined	**$3,552**	**$1,642**	$3,987	$1,731	$2,639	$1,160

A summary of asbestos and environmental claims count activity for the years ended December 31, 2006, 2005 and 2004 was as follows:

	2006			2005			2004		
	Asbestos	Environmental	Combined	Asbestos	Environmental	Combined	Asbestos	Environmental	Combined
Claims at beginning of year	**7,293**	**9,873**	**17,166**	7,575	8,216	15,791	7,474	8,852	16,326
Claims during year:									
Opened	**643**	**1,383**	**2,026**	854	5,253*	6,107	909	2,592	3,501
Settled	**(150)**	**(155)**	**(305)**	(67)	(219)	(286)	(100)	(279)	(379)
Dismissed or otherwise resolved	**(908)**	**(1,659)**	**(2,567)**	(1,069)	(3,377)	(4,446)	(708)	(2,949)	(3,657)
Claims at end of year	**6,878**	**9,442**	**16,320**	7,293	9,873	17,166	7,575	8,216	15,791

*

The opened claims count increased substantially during 2005 compared to 2004 because a court ruling led AIG to report separate opened claims for previously pending cases relating to alleged MTBE exposures that AIG previously had counted in the aggregate as only a single claim on the assumption that the cases would be consolidated into a single federal court proceeding.

American International Group, Inc. and Subsidiaries

Survival Ratios Asbestos and Environmental

The following table presents AIG s survival ratios for asbestos and environmental claims for year-end 2006, 2005 and 2004. The survival ratio is derived by dividing the year end 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, 2006 survival ratio is lower than the ratio at December 31, 2005 because the more recent periods included in the rolling average reflect higher claims payments. 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. 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, 2006, 2005 and 2004 were as follows:

	Gross	Net
2006		
Survival ratios:		
Asbestos	**11.7**	**12.9**
Environmental	**5.3**	**4.5**
Combined	**10.3**	**10.3**
2005		
Survival ratios:		
Asbestos	15.9	19.8
Environmental	6.9	6.2
Combined	13.0	14.2
2004		
Survival ratios:		
Asbestos	10.7	13.5
Environmental	6.5	6.8
Combined	9.1	10.5

Life Insurance & Retirement Services Operations

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

Domestically, AIG s Life Insurance & Retirement Services operations offer a broad range of protection products, such as 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. Home service operations include an array of life insurance, accident and health and annuity products sold primarily through career agents. In addition, home service includes a small block of runoff property and casualty coverage. Retirement services 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.

Overseas, AIG s 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.

AIG s Life Insurance & Retirement Services subsidiaries report their operations through the following major internal reporting units and business units:

Foreign Life Insurance & Retirement Services

Japan and Other*

- ALICO
- AIG Star Life
- AIG Edison Life

Asia

- AIA
- Nan Shan
- AIRCO
- Philamlife

Domestic Life Insurance

- AIG American General
- USLIFE
- AGLA

Domestic Retirement Services