AMERICAN INTERNATIONAL GROUP INC
Form 10-Q
November 07, 2007

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

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2007

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
Former name, former address and former fiscal year, if changed since last report: None

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 for 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 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

As of October 31, 2007, there were 2,536,238,141 shares outstanding of the registrant s common stock.

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American International Group, Inc. and Subsidiaries

Part I FINANCIAL INFORMATION

ITEM 1. Financial Statements (unaudited)

CONSOLIDATED BALANCE SHEET

(in millions) (unaudited)

	September 30, 2007	December 31, 2006
Assets:		
Investments and financial services assets:		
Fixed maturities:		
Bonds available for sale, at fair value (amortized cost: 2007 $391,497; 2006 $377,698) (includes hybrid financial instruments: 2007 $566; 2006 $522)	**$ 394,810**	$ 387,391
Bonds held to maturity, at amortized cost (fair value: 2007 $22,053; 2006 $22,154)	**21,576**	21,437
Bond trading securities, at fair value (cost: 2007 $9,604; 2006 $10,292)	**9,459**	10,314
Equity securities:		
Common stocks available for sale, at fair value (cost: 2007 $12,852; 2006 $10,662)	**18,649**	13,256
Common and preferred stocks trading, at fair value (cost: 2007 $17,269; 2006 $13,079)	**19,219**	14,855
Preferred stocks available for sale, at fair value (cost: 2007 $2,620; 2006 $2,485)	**2,606**	2,539
Mortgage loans on real estate, net of allowance (2007 $52; 2006 $55)	**18,854**	17,067
Policy loans	**7,822**	7,501
Collateral and guaranteed loans, net of allowance (2007 $4; 2006 $9)	**4,385**	3,850
Financial services assets:		
Flight equipment primarily under operating leases, net of accumulated depreciation (2007 $10,105; 2006 $8,835)	**41,804**	39,875
Securities available for sale, at fair value (cost: 2007 $46,892; 2006 $45,912)	**47,805**	47,205
Trading securities, at fair value	**4,874**	5,031
Spot commodities	**115**	220
Unrealized gain on swaps, options and forward transactions	**18,608**	19,252
Trade receivables	**6,548**	4,317
Securities purchased under agreements to resell, at contract value	**37,189**	30,291
Finance receivables, net of allowance (2007 $775; 2006 $737) (includes finance receivables held for sale: 2007 $406; 2006 $1,124)	**30,640**	29,573
Securities lending collateral, at fair value (cost: 2007 $87,956; 2006 $69,306)	**86,108**	69,306
Other invested assets	**51,783**	42,111
Short-term investments, at cost (approximates fair value)	**38,998**	27,483
Total investments and financial services assets	**861,852**	792,874

Cash		**2,249**		1,590
Investment income due and accrued		**6,635**		6,091
Premiums and insurance balances receivable, net of allowance (2007 $746; 2006 $756)		**18,199**		17,789
Reinsurance assets, net of allowance (2007 $658; 2006 $536)		**23,426**		23,355
Deferred policy acquisition costs		**40,878**		37,235
Investments in partially owned companies		**1,277**		1,101
Real estate and other fixed assets, net of accumulated depreciation (2007 $5,807; 2006 $5,525)		**6,093**		4,381
Separate and variable accounts		**78,701**		70,277
Goodwill		**8,909**		8,628
Other assets		**23,886**		16,089
Total assets	**$**	**1,072,105**	$	979,410

See Accompanying Notes to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEET *(continued)*
(in millions, except share data) (unaudited)

	September 30, 2007	December 31, 2006
Liabilities:		
Reserve for losses and loss expenses	**$ 83,608**	$ 79,999
Unearned premiums	**27,909**	26,271
Future policy benefits for life and accident and health insurance contracts	**130,759**	122,230
Policyholders contract deposits	**254,109**	248,994
Other policyholders funds	**8,196**	8,281
Commissions, expenses and taxes payable	**6,523**	5,305
Insurance balances payable	**5,304**	3,789
Funds held by companies under reinsurance treaties	**2,456**	2,602
Income taxes payable	**9,288**	9,546
Financial services liabilities:		
Borrowings under obligations of guaranteed investment agreements	**19,495**	20,664
Securities sold under agreements to repurchase, at contract value	**23,368**	19,677
Trade payables	**10,137**	6,174
Hybrid financial instrument liabilities, at fair value	**7,692**	8,856
Securities and spot commodities sold but not yet purchased, at market value	**4,736**	4,076
Unrealized loss on swaps, options and forward transactions	**12,512**	11,401
Trust deposits and deposits due to banks and other depositors	**4,737**	5,249
Commercial paper	**10,120**	8,208
Notes, bonds, loans and mortgages payable	**101,747**	87,816
Commercial paper and extendible commercial notes	**5,845**	4,821
Notes, bonds, loans and mortgages payable	**25,165**	16,874
Junior subordinated debt	**4,681**	
Liabilities connected to trust preferred stock	**1,440**	1,440
Separate and variable accounts	**78,701**	70,277
Securities lending payable	**88,360**	70,198
Minority interest	**10,395**	7,778
Other liabilities (includes hybrid financial instruments: 2007 $99; 2006 $111)	**30,655**	27,016
Total liabilities	**967,938**	877,542
Preferred shareholders equity in subsidiary companies	**100**	191
Commitments and Contingent Liabilities (See Note 6)		
Shareholders equity:		
Common stock, $2.50 par value; 5,000,000,000 shares authorized; shares issued 2007 and 2006 2,751,327,476	**6,878**	6,878
Additional paid-in capital	**2,818**	2,590
Payments advanced to purchase shares	**(1,275)**	

Retained earnings		**94,830**		84,996
Accumulated other comprehensive income (loss)		**6,194**		9,110
Treasury stock, at cost; 2007 201,311,212; 2006 150,131,273 shares of common stock		**(5,378)**		(1,897)
Total shareholders equity		**104,067**		101,677
Total liabilities, preferred shareholders equity in subsidiary companies and shareholders equity	**$**	**1,072,105**	$	979,410

See Accompanying Notes to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF INCOME

(in millions, except per share data) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	**2007**	2006
Revenues:				
Premiums and other considerations	**$ 19,733**	$ 18,890	**$ 58,908**	$ 55,486
Net investment income	**6,172**	6,463	**21,149**	18,579
Net realized capital gains (losses)	**(864)**	(87)	**(962)**	(132)
Other income	**4,795**	3,981	**12,536**	9,446
Total revenues	**29,836**	29,247	**91,631**	83,379
Benefits and expenses:				
Incurred policy losses and benefits	**15,595**	14,963	**47,962**	44,118
Insurance acquisition and other operating expenses	**9,362**	7,983	**26,290**	22,926
Total benefits and expenses	**24,957**	22,946	**74,252**	67,044
Income before income taxes, minority interest and cumulative effect of an accounting change	**4,879**	6,301	**17,379**	16,335
Income taxes	**1,463**	1,943	**4,868**	5,066
Income before minority interest and cumulative effect of an accounting change	**3,416**	4,358	**12,511**	11,269
Minority interest	**(331)**	(134)	**(1,019)**	(694)
Income before cumulative effect of an accounting change	**3,085**	4,224	**11,492**	10,575
Cumulative effect of an accounting change, net of tax				34
Net income	**$ 3,085**	$ 4,224	**$ 11,492**	$ 10,609
Earnings per common share:				
Basic				
Income before cumulative effect of an accounting change	**$ 1.20**	$ 1.62	**$ 4.43**	$ 4.06
Cumulative effect of an accounting change, net of tax				0.01
Net income	**$ 1.20**	$ 1.62	**$ 4.43**	$ 4.07
Diluted				

Income before cumulative effect of an accounting change	**$ 1.19**	$ 1.61	**$ 4.40**	$ 4.03
Cumulative effect of an accounting change, net of tax				0.01
Net income	**$ 1.19**	$ 1.61	**$ 4.40**	$ 4.04
Dividends declared per common share	**$ 0.200**	$ 0.165	**$ 0.565**	$ 0.480
Average shares outstanding:				
Basic	**2,576**	2,607	**2,596**	2,607
Diluted	**2,589**	2,626	**2,609**	2,625

See Accompanying Notes to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF CASH FLOWS

(in millions) (unaudited)

	Nine Months Ended September 30,	
	2007	2006
Summary:		
Net cash provided by operating activities	**$ 27,056**	$ 4,037
Net cash used in investing activities	**(65,929)**	(52,144)
Net cash provided by financing activities	**39,524**	47,576
Effect of exchange rate changes on cash	**8**	59
Change in cash	**659**	(472)
Cash at beginning of period	**1,590**	1,897
Cash at end of period	**$ 2,249**	$ 1,425
Cash flows from operating activities:		
Net income	**$ 11,492**	$ 10,609
Adjustments to reconcile net income to net cash provided by operating activities:		
Noncash revenues, expenses, gains and losses included in income:		
Net gains on sales of securities available for sale and other assets	**(1,110)**	(407)
Foreign exchange transaction (gains) losses	**1,214**	845
Net unrealized (gains) losses on non-AIGFP derivative assets and liabilities	**(103)**	(441)
Equity in income of partially owned companies and other invested assets	**(3,336)**	(2,655)
Amortization of deferred policy acquisition costs	**9,242**	8,785
Amortization of premium and discount on securities	**491**	100
Depreciation expenses, principally flight equipment	**2,072**	1,743
Provision for finance receivable losses	**391**	329
Impairment losses	**1,413**	766
Changes in operating assets and liabilities:		
General and life insurance reserves	**12,131**	10,507
Premiums and insurance balances receivable and payable net	**515**	(173)
Reinsurance assets	**561**	614
Capitalization of deferred policy acquisition costs	**(11,897)**	(11,949)
Investment income due and accrued	**(538)**	(486)
Funds held under reinsurance treaties	**(166)**	(1,732)
Other policyholders funds	**(85)**	(840)
Income taxes payable	**707**	1,905
Commissions, expenses and taxes payable	**1,110**	356
Other assets and liabilities net	**2,181**	(842)
Bonds, common and preferred stocks trading, at fair value	**(2,546)**	(5,535)

Trade receivables and payables net		**1,844**		(163)
Trading securities, at fair value		**158**		677
Spot commodities		**105**		(26)
Net unrealized (gain) loss on swaps, options and forward transactions		**2,059**		(966)
Securities purchased under agreements to resell		**(6,898)**		(10,638)
Securities sold under agreements to repurchase		**3,686**		2,384
Securities and spot commodities sold but not yet purchased, at market value		**660**		(330)
Finance receivables held for sale originations and purchases		**(4,377)**		(7,965)
Sales of finance receivables held for sale		**5,095**		7,888
Other, net		**985**		1,677
Total adjustments		**15,564**		(6,572)
Net cash provided by operating activities	**$**	**27,056**	$	4,037

See Accompanying Notes to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF CASH FLOWS *(continued)*

(in millions) (unaudited)

	Nine Months Ended September 30, 2007	2006
Cash flows from investing activities:		
Proceeds from (payments for)		
Sales and maturities of fixed maturity securities available for sale	**$ 97,068**	$ 86,579
Sales of equity securities available for sale	**6,700**	9,394
Proceeds from fixed maturity securities held to maturity	**175**	265
Sales of flight equipment	**95**	380
Sales or distributions of other invested assets	**9,298**	11,880
Payments received on mortgage, policy, collateral and guaranteed loans	**3,863**	3,081
Principal payments received on finance receivables held for investment	**9,554**	9,131
Purchases of fixed maturity securities available for sale	**(110,037)**	(106,750)
Purchases of equity securities available for sale	**(8,438)**	(11,032)
Purchases of fixed maturity securities held to maturity	**(154)**	(264)
Purchases of flight equipment	**(3,925)**	(4,860)
Purchases of other invested assets and warehoused investments	**(20,677)**	(12,865)
Mortgage, policy, collateral and guaranteed loans issued	**(6,554)**	(5,793)
Finance receivables held for investment originations and purchases	**(11,394)**	(9,947)
Change in securities lending collateral	**(18,723)**	(11,917)
Net additions to real estate, fixed assets, and other assets	**(1,004)**	(620)
Net change in short-term investments	**(11,764)**	(8,787)
Net change in non-AIGFP derivative assets and liabilities	**(12)**	(19)
Net cash used in investing activities	**$ (65,929)**	$ (52,144)
Cash flows from financing activities:		
Proceeds from (payments for)		
Policyholders contract deposits	**$ 46,239**	$ 40,226
Policyholders contract withdrawals	**(43,220)**	(31,201)
Change in other deposits	**(713)**	753
Change in commercial paper	**2,526**	3,216
Notes, bonds, loans and mortgages payable, and hybrid financial instrument liabilities issued	**61,119**	40,345
Repayments on notes, bonds, loans and mortgages payable, and hybrid financial instrument liabilities	**(42,098)**	(16,851)
Issuance of junior subordinated debt	**4,490**	
Issuance of guaranteed investment agreements	**6,430**	9,411
Maturities of guaranteed investment agreements	**(7,545)**	(9,480)
Change in securities lending payable	**18,156**	11,855

Issuance of treasury stock		**204**		94
Payments advanced to purchase shares		**(5,000)**		
Acquisition of treasury stock		**(16)**		(7)
Cash dividends paid to shareholders		**(1,372)**		(1,209)
Other, net		**324**		424
Net cash provided by financing activities	**$**	**39,524**	$	47,576
Supplementary disclosure of cash flow information:				
Cash paid during the period for:				
Interest	**$**	**6,190**	$	4,202
Taxes	**$**	**4,044**	$	3,252
Non-cash financing activities:				
Interest credited to policyholder accounts	**$**	**7,553**	$	7,253
Treasury stock acquired using payments advanced to purchase shares	**$**	**3,725**		
Non-cash investing activities:				
Debt assumed on acquisitions and warehoused investments	**$**	**358**	$	
Liability related to purchase of additional interest in 21st Century	**$**	**759**	$	

See Accompanying Notes to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(in millions) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	**2007**	2006
Net income	**$ 3,085**	$ 4,224	**$ 11,492**	$ 10,609
Other comprehensive income (loss):				
Unrealized (depreciation) appreciation of investments net of reclassification adjustments	**(3,394)**	7,200	**(4,246)**	(1,133)
Deferred income tax benefit (expense) on above changes	**941**	(2,562)	**1,081**	281
Foreign currency translation adjustments	**619**	(115)	**290**	955
Deferred income tax benefit (expense) on above changes	**(109)**	17	**(74)**	(332)
Net derivative gains arising from cash flow hedging activities net of reclassification adjustments	**(93)**	4	**(31)**	12
Deferred income tax benefit (expense) on above changes	**34**	(1)	**39**	(4)
Change in pension and postretirement unrecognized periodic benefit (cost)	**17**		**35**	(3)
Deferred income tax benefit (expense) on above changes	**(8)**		**(10)**	1
Other comprehensive income (loss)	**(1,993)**	4,543	**(2,916)**	(223)
Comprehensive income (loss)	**$ 1,092**	$ 8,767	**$ 8,576**	$ 10,386

See Accompanying Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*

1. Summary of Significant Accounting Policies

Basis of Presentation

These unaudited condensed consolidated financial statements do not include certain financial information required by U.S. generally accepted accounting principles (GAAP) for complete financial statements and should be read in conjunction with the audited consolidated financial statements and the related notes included in the Annual Report on Form 10-K of American International Group, Inc. (AIG) for the year ended December 31, 2006 (2006 Annual Report on Form 10-K).

In the opinion of management, these consolidated financial statements contain the normal recurring adjustments necessary for a fair statement of the results presented herein. All material intercompany accounts and transactions have been eliminated.

Revisions and Reclassifications

In the third quarter of 2007, AIG determined that certain products that were historically reported as separate account assets under Statement of Position 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts (SOP 03-1) should have been reported as general account assets. Accordingly, the December 31, 2006 consolidated balance sheet has been revised to transfer $2.4 billion of assets from separate account assets to general account assets, and the same amount of liabilities from separate account liabilities to policyholders contract deposits. This revision did not have any effect on consolidated income before income taxes, net income, or shareholders equity for any period presented.

Certain reclassifications and format changes have been made to prior period amounts to conform to the current period presentation.

Out of period adjustments

During the three and nine-month periods ended September 30, 2007, AIG recorded the effects of certain out of period adjustments, which reduced net income by $35 million and $408 million, respectively, and diluted earnings per share by $0.01 per share and $0.16 per share, respectively.

During the three and nine-month periods ended September 30, 2006, AIG recorded the effects of certain out of period adjustments which increased (decreased) net income by $73 million and $(135) million, respectively, and diluted earnings per share by $0.03 per share and $(0.05) per share, respectively.

Recent Accounting Standards

Accounting Changes

SOP 05-1

On September 19, 2005, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts (SOP 05-1). SOP 05-1 provides guidance on accounting for internal replacements of insurance and investment contracts other than those specifically described in Statement of Financial Accounting Standards (FAS) No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments (FAS 97). SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverage that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. Internal replacements that result in a substantially changed contract are accounted for as a termination and a replacement contract.

The provisions of SOP 05-1 became effective as of January 1, 2007. On the date of adoption, AIG recorded a cumulative effect reduction of $82 million, net of tax, to the opening balance of retained earnings to reflect changes in unamortized deferred policy acquisition costs (DAC), value of business acquired, deferred sales inducement assets, unearned revenue liabilities and future policy benefits for life and accident and health insurance contracts. This adjustment primarily reflects a shorter expected life related to certain group life and health insurance contracts and the effect on the gross profits of investment-oriented products related to previously anticipated future internal replacements. This cumulative effect adjustment affected only the Life Insurance & Retirement Services segment.

FIN 48

On July 13, 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in income tax positions. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and additional disclosures. AIG adopted the provisions of FIN 48 on January 1, 2007. As a result of the adoption of FIN 48, AIG recognized a $71 million increase in the liability for unrecognized tax benefits, which was accounted for as a decrease to opening retained earnings as of January 1, 2007.

As of the date of adoption and after recognizing the effect of the increase in the liability noted above, the total amount of AIG s unrecognized tax benefit, excluding interest and penalties, was $1.138 billion. Included in this balance are $407 million related to tax positions, the disallowance of which would not

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

1. Summary of Significant Accounting Policies *(continued)*
affect the annual effective income tax rate. Accordingly, the amount of unrecognized tax benefit that, if recognized, would favorably affect the effective tax rate is $731 million.

At September 30, 2007, AIG s unrecognized tax benefit, excluding interest and penalties, was $1.139 billion, which includes $447 million related to tax positions the disallowance of which would not affect the annual effective income tax rate. Accordingly, the amount of unrecognized tax benefit that, if recognized, would favorably affect the effective tax rate was $692 million.

Interest and penalties related to unrecognized tax benefits are recognized in income tax expense. At January 1, 2007 and September 30, 2007, AIG had accrued $176 million and $207 million, respectively, for the payment of interest (net of tax benefits) and penalties.

Neither reserves for uncertain tax positions attributable to prior restatements (including various other remediation-related adjustments) nor the corresponding interest income have been recognized because such amounts are not currently estimable. In addition, certain tax benefits from compensation deductions have not been recognized because of existing uncertainty with respect to documentation supporting these tax benefits.

AIG continually evaluates proposed adjustments by taxing authorities. At September 30, 2007, such proposed adjustments would not result in a material change to AIG s consolidated financial condition. However, AIG believes that it is reasonably possible that the balance of the unrecognized tax benefits could decrease by $0 to $100 million within the next twelve months due to settlements or expiration of statutes.

Listed below are the tax years that remain subject to examination by major tax jurisdiction:

Major Tax Jurisdictions	Open Tax Years
United States	1991-2006
Hong Kong	1997-2006
Malaysia	1999-2006
Singapore	1993-2006
Thailand	2001-2006
Taiwan	2000-2006
Japan	2000-2006
United Kingdom	2003-2006
France	2003-2006
Korea	2001-2006

FSP 13-2

On July 13, 2006, the FASB issued FASB Staff Position (FSP) No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction (FSP 13-2). FSP 13-2 addresses how a change or projected change in the timing of cash flows relating to income taxes generated by a leveraged lease transaction affects the accounting for the lease by the lessor, and directs that the tax assumptions be consistent with any FIN 48 uncertain tax position related to the lease. FSP 13-2 is effective for fiscal years beginning after December 15, 2006. Upon adoption, AIG recorded a $50 million decrease in the opening balance of retained earnings, net of tax, as of January 1, 2007 to reflect the cumulative effect of this change in accounting. The adoption of this guidance is not expected to have a material effect on AIG s results of operations in 2007.

As a result of the adoptions of SOP 05-1, FIN 48 and FSP 13-2, AIG recorded a total decrease to opening retained earnings of $203 million as of January 1, 2007.

Future Application of Accounting Standards

FAS 157

In September 2006, the FASB issued FAS No. 157, Fair Value Measurements (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements. FAS 157 will be effective January 1, 2008. AIG is currently assessing the effect of implementing this guidance.

FAS 159

In February 2007, the FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). FAS 159 permits entities to choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. Subsequent changes in fair value for designated items will be required to be reported in earnings in the current period. FAS 159 also establishes presentation and disclosure requirements for similar types of assets and liabilities measured at fair value. FAS 159 will be effective January 1, 2008. AIG is currently assessing the effect of implementing this guidance, which depends on the nature and extent of items elected to be measured at fair value upon initial application of the standard on January 1, 2008.

SOP 07-1

In June 2007, the AICPA issued Statement of Position No. 07-1 (SOP 07-1), Clarification of the Scope of the Audit and Accounting Guide Audits of Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies. SOP 07-1 amends the guidance for whether an entity may apply the provisions of the Audit and Accounting Guide, Audits of Investment Companies (the Guide). Investment companies that are subject to the Guide must report all investments at fair value regardless of the nature of the investment or the level of ownership. SOP 07-1 also establishes new requirements for whether a parent company can retain specialized investment company accounting in its consolidated financial statements for subsidiaries and equity method investees that are covered by the Guide. At the October 17, 2007 Board

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

1. Summary of Significant Accounting Policies *(continued)*
meeting, the FASB decided it would indefinitely defer the effective date of SOP 07-1. AIG understands that a FASB Staff Position will be issued shortly. AIG is currently monitoring any changes to the existing guidance.

2. Segment Information

AIG identifies its reportable segments by product line consistent with its management structure. These segments are General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management.

In order to better align financial reporting with the manner in which AIG s chief operating decision makers have managed their businesses, commencing in the first quarter of 2007, AIG realigned certain products among reportable segments and major internal reporting units. AIG also began reporting net realized capital gains and losses for the Financial Services and Asset Management segments in the results of these segments. Historically, net realized capital gains and losses were included in the Other category. There has been no change in AIG s management structure or in its reportable segments. All prior period amounts presented in the tables below have been revised to conform to the current year s presentation of these items.

The following table summarizes AIG s operations by major operating segment:

Operating Segments *(in millions)*	Three Months Ended September 30, **2007**	2006	Nine Months Ended September 30, **2007**	2006
Revenues[(a)]:				
General Insurance[(b)]	**$ 12,758**	$ 12,615	**$ 38,589**	$ 36,438
Life Insurance & Retirement Services[(b)]	**12,632**	12,542	**40,337**	37,303
Financial Services[(c)(d)]	**2,785**	3,011	**7,109**	5,923
Asset Management	**1,824**	993	**5,721**	3,647
Other	**13**	215	**407**	443
Consolidation and eliminations	**(176)**	(129)	**(532)**	(375)
Consolidated	**$ 29,836**	$ 29,247	**$ 91,631**	$ 83,379
Operating income (loss)[(a)]:				
General Insurance[(b)]	**$ 2,439**	$ 2,625	**$ 8,511**	$ 7,819
Life Insurance & Retirement Services[(b)]	**1,999**	2,472	**6,900**	7,483
Financial Services[(c)(d)]	**669**	1,179	**1,008**	541
Asset Management	**419**	211	**2,541**	1,445
Other[(e)]	**(627)**	(186)	**(1,557)**	(953)
Consolidation and eliminations	**(20)**		**(24)**	
Consolidated	**$ 4,879**	$ 6,301	**$ 17,379**	$ 16,335

(a) Includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), including the related foreign exchange gains and losses. For the three-month periods ended September 30, 2007 and 2006, respectively, the effect was $(178) million and $165 million in both revenues and operating income. For the nine-month periods ended September 30, 2007 and 2006, respectively, the effect was $(1.06) billion and $(1.13) billion in both

revenues and operating income. These amounts result primarily from interest rate and foreign currency derivatives that are hedging investments and borrowings. These gains (losses) for the three and nine-month periods ended September 30, 2007 include out of period charges of $20 million and $346 million, respectively, including a $380 million charge in the nine months ended September 30, 2007 to reverse net gains recognized on transfers of available for sale securities among legal entities consolidated within AIG Financial Products Corp. and AIG Trading Group Inc. and their respective subsidiaries (collectively, AIGFP). The three and nine-month periods ended September 30, 2006 include an out of period gain of $115 million and a charge of $223 million related to the remediation of the material weakness in accounting for certain derivative transactions under FAS 133.

(b) Includes the effect of out of period adjustments related to the accounting for certain interests in unit investment trusts (UCITS). For the three and nine- month periods ended September 30, 2006, the effect was an increase of $92 million and $472 million, respectively, in both revenues and operating income for General Insurance and an increase of $24 million and $240 million, respectively, in revenues and $24 million and $169 million, respectively, in operating income for Life Insurance & Retirement Services.

(c) Includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three-month periods ended September 30, 2007 and 2006, respectively, the effect was $353 million, and $581 million in both revenues and operating income. For the nine-month periods ended September 30, 2007 and 2006, respectively, the effect was $(250) million and $(1.2) billion in both revenues and operating income. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings. The three and nine-month periods ended September 30, 2007 include out of period charges of $20 million and $346 million, respectively, as discussed above. The three and nine-month periods ended September 30, 2006 include an out of period gain of $115 million and a charge of $223 million as discussed above. In the first quarter of 2007, AIG began applying hedge accounting for certain transactions, primarily in its Capital Markets operations. In the second quarter of 2007, American General Finance, Inc. (AGF) and International Lease Finance Corporation (ILFC) began applying hedge accounting to most of their derivatives hedging interest rate and foreign exchange risks associated with their floating rate and foreign currency denominated borrowings.

(d) For the three and nine-month periods ended September 30, 2007, both revenues and operating income include an unrealized market valuation loss of $352 million on AIGFP s super senior credit default swap portfolio.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

2. Segment Information *(continued)*

(e) Includes AIG parent and other operations which are not required to be reported separately. The following table presents the operating loss for AIG s Other category:

(in millions)	Three Months Ended September 30, 2007	2006	Nine Months Ended September 30, 2007	2006
Other operating income (loss):				
Equity earnings in unconsolidated entities	**$ 37**	$ 48	**$ 128**	$ 178
Interest expense	**(315)**	(227)	**(869)**	(633)
Unallocated corporate expenses	**(157)**	(89)	**(519)**	(337)
Compensation expense SICO Plans	**(9)**	(14)	**(29)**	(104)
Compensation expense Starr tender offer				(54)
Net realized capital gains (losses)	**(199)**	85	**(226)**	31
Other miscellaneous, net	**16**	11	**(42)**	(34)
Total Other	**$ (627)**	$ (186)	**$ (1,557)**	$ (953)

The following table summarizes AIG s General Insurance operations by major internal reporting unit:

General Insurance *(in millions)*	Three Months Ended September 30, 2007	2006	Nine Months Ended September 30, 2007	2006
Revenues:				
Domestic Brokerage Group	**$ 6,736**	$ 7,182	**$ 20,731**	$ 20,330
Transatlantic	**1,088**	1,004	**3,253**	3,035
Personal Lines	**1,252**	1,214	**3,688**	3,652
Mortgage Guaranty	**267**	226	**772**	636
Foreign General*	**3,413**	2,989	**10,150**	8,783
Reclassifications and eliminations	**2**		**(5)**	2
Total General Insurance	**$ 12,758**	$ 12,615	**$ 38,589**	$ 36,438
Operating Income (loss):				
Domestic Brokerage Group	**$ 1,829**	$ 1,543	**$ 5,662**	$ 4,322
Transatlantic	**189**	143	**508**	427
Personal Lines	**28**	133	**252**	352
Mortgage Guaranty	**(216)**	85	**(289)**	301
Foreign General*	**607**	721	**2,383**	2,415
Reclassifications and eliminations	**2**		**(5)**	2

Total General Insurance	**$ 2,439**	$ 2,625	**$ 8,511**	$ 7,819

**Includes the effect of an out of period UCITS adjustment which increased both revenues and operating income by $22 million and $406 million for the three and nine-month periods ended September 30, 2006, respectively.*

The following table summarizes AIG s Life Insurance & Retirement Services operations by major internal reporting unit:

Life Insurance & Retirement Services *(in millions)*	Three Months Ended September 30, **2007**	2006	Nine Months Ended September 30, **2007**	2006
Revenues:				
Foreign:				
Japan and Other	**$ 4,315**	$ 4,339	**$ 13,948**	$ 12,415
Asia*	**4,695**	4,109	**14,205**	12,872
Domestic:				
Domestic Life Insurance	**2,185**	2,259	**7,065**	6,848
Domestic Retirement Services	**1,437**	1,835	**5,119**	5,168
Total Life Insurance & Retirement Services	**$ 12,632**	$ 12,542	**$ 40,337**	$ 37,303
Operating Income:				
Foreign:				
Japan and Other	**$ 1,030**	$ 993	**$ 2,753**	$ 2,946
Asia*	**706**	615	**1,921**	2,087
Domestic:				
Domestic Life Insurance	**61**	261	**774**	862
Domestic Retirement Services	**202**	603	**1,452**	1,588
Total Life Insurance & Retirement Services	**$ 1,999**	$ 2,472	**$ 6,900**	$ 7,483

**Includes the effect of an out of period UCITS adjustment, which increased revenues by $9 million and $208 million and operating income by $9 million and $137 million, respectively, for the three and nine-month periods ended September 30, 2006, respectively.*

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

2. Segment Information *(continued)*

The following table summarizes AIG s Financial Services operations by major internal reporting unit:

Financial Services *(in millions)*	Three Months Ended September 30, **2007**	Three Months Ended September 30, 2006	Nine Months Ended September 30, **2007**	Nine Months Ended September 30, 2006
Revenues:				
Aircraft Leasing*(a)*	**$ 1,237**	$ 950	**$ 3,468**	$ 3,013
Capital Markets*(b)(c)*	**540**	1,118	**701**	30
Consumer Finance*(d)(e)*	**992**	901	**2,824**	2,768
Other, including intercompany adjustments	**16**	42	**116**	112
Total Financial Services	**$ 2,785**	$ 3,011	**$ 7,109**	$ 5,923
Operating income (loss):				
Aircraft Leasing*(a)*	**$ 254**	$ 47	**$ 625**	$ 421
Capital Markets*(b)(c)*	**370**	965	**183**	(457)
Consumer Finance*(d)(e)*	**69**	151	**180**	529
Other, including intercompany adjustments	**(24)**	16	**20**	48
Total Financial Services	**$ 669**	$ 1,179	**$ 1,008**	$ 541

(a) Both revenues and operating income include gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three-month periods ended September 30, 2007 and 2006, the effect was $(19) million and $(111) million, respectively. For the nine-month periods ended September 30, 2007 and 2006, the effect was $(32) million and $(56) million, respectively. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of borrowings. In the second quarter of 2007, ILFC began applying hedge accounting to most of its derivatives hedging interest rate and foreign exchange risks associated with its floating rate and foreign currency denominated borrowings.

(b) Revenues, shown net of interest expense of $1.4 billion and $802 million for the three-month periods ended September 30, 2007 and 2006, respectively, and $3.3 billion and $2.1 billion for the nine-month periods ended September 30, 2007 and 2006, respectively, were primarily from hedged financial positions entered into in connection with counterparty transactions. Both revenues and operating income include gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three-month periods ended September 30, 2007 and 2006, the effect was $428 million and $783 million, respectively. For the nine-month periods ended September 30, 2007 and 2006, the effect was $(185) million and $(1.1) billion, respectively. The three and nine-month periods ended September 30, 2007 include out of period charges of $20 million and $346 million, respectively, including a $380 million charge in the nine months ended September 30, 2007 to reverse net gains recognized on transfers of available for sale securities among legal entities consolidated within AIGFP. The three and nine-month periods ended September 30, 2006 include an out of period gain of $115 million and a charge of $223 million, respectively, related to the

remediation of the material weakness in accounting for certain derivative transactions under FAS 133. In the first quarter of 2007, AIGFP began applying hedge accounting for certain transactions.

(c) *For the three and nine-month periods ended September 30, 2007, both revenues and operating income include an unrealized market valuation loss of $352 million on AIGFP s super senior credit default swap portfolio.*

(d) *Both revenues and operating income include gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three-month periods ended September 30, 2007 and 2006, the effect was $(6) million and $(73) million, respectively. For the nine-month periods ended September 30, 2007 and 2006, the effect was $(21) million and $(65) million, respectively. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of borrowings. In the second quarter of 2007, AGF began applying hedge accounting to most of its derivatives hedging interest rate and foreign exchange risks associated with its floating rate and foreign currency denominated borrowings.*

(e) *The nine-month period ended September 30, 2007 includes a pre-tax charge of $178 million in connection with domestic consumer finance s mortgage banking activities.*

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*

American International Group, Inc. and Subsidiaries

3. Shareholders Equity and Earnings Per Share

Earnings Per Share (EPS)

Basic EPS of AIG is calculated using the weighted average number of common shares outstanding. Diluted EPS is based on those shares used in basic EPS plus shares that would have been outstanding assuming issuance of common shares for all potentially dilutive common shares outstanding.

The following table presents the computation of basic and diluted EPS:

(in millions, except per share data)	Three Months Ended **September 30,** **2007**	Three Months Ended September 30, 2006	Nine Months Ended **September 30,** **2007**	Nine Months Ended September 30, 2006
Numerator for earnings per share:				
Income before cumulative effect of an accounting change	**$ 3,085**	$ 4,224	**$ 11,492**	$ 10,575
Cumulative effect of an accounting change, net of tax				34
Net income applicable to common stock for basic EPS	**$ 3,085**	$ 4,224	**$ 11,492**	$ 10,609
Interest on contingently convertible bonds, net of tax [(a)]		2		8
Net income applicable to common stock for diluted EPS	**$ 3,085**	$ 4,226	**$ 11,492**	$ 10,617
Cumulative effect of an accounting change, net of tax				(34)
Income before cumulative effect of an accounting change applicable to common stock for diluted EPS	**$ 3,085**	$ 4,226	**$ 11,492**	$ 10,583
Denominator for earnings per share:				
Weighted average shares outstanding used in the computation of EPS:				
Common stock issued	**2,751**	2,751	**2,751**	2,751
Common stock in treasury	**(189)**	(153)	**(168)**	(153)
Deferred shares	**14**	9	**13**	9
Weighted average shares outstanding basic	**2,576**	2,607	**2,596**	2,607
Incremental shares from potential common stock:				
Weighted average number of shares arising from outstanding employee stock plans (treasury stock method) [(b)]	**13**	10	**13**	9
Contingently convertible bonds[(a)]		9		9
Weighted average shares outstanding diluted[(b)]	**2,589**	2,626	**2,609**	2,625
Earnings per share:				
Basic:				
Income before cumulative effect of an accounting change	**$ 1.20**	$ 1.62	**$ 4.43**	$ 4.06

Cumulative effect of an accounting change, net of tax								0.01
Net income	**$**	**1.20**	$	1.62	**$**	**4.43**	$	4.07
Diluted:								
Income before cumulative effect of an accounting change	**$**	**1.19**	$	1.61	**$**	**4.40**	$	4.03
Cumulative effect of an accounting change, net of tax								0.01
Net income	**$**	**1.19**	$	1.61	**$**	**4.40**	$	4.04

(a) Assumes conversion of contingently convertible bonds due to the adoption of Emerging Issues Task Force Issue No. 04-8   Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share.

(b) Certain shares arising from employee stock plans were not included in the computation of diluted earnings per share where the exercise price of the options exceeded the average market price for the period and would have been antidilutive. The number of shares excluded was 7 million and 14 million for the nine-month periods ended September 30, 2007 and 2006, respectively.

Shareholders   Equity

From time to time, AIG may buy shares of its common stock for general corporate purposes, including to satisfy its obligations under various employee benefit plans. In February 2007, AIG s Board of Directors increased AIG s share repurchase program by authorizing the repurchase of shares with an aggregate purchase price of $8 billion. In March 2007, AIG entered into a $3 billion structured share repurchase arrangement and AIG entered into additional $1 billion structured share repurchase arrangements in each of May and September 2007. A total of 55,103,845 shares were repurchased during the first nine months of 2007. The portion of the payments advanced by AIG under the structured share repurchase arrangements that had not yet been utilized to repurchase shares at September 30, 2007, amounting to $1.28 billion, has been recorded as a component of shareholders   equity under the caption Payments advanced to purchase shares. Purchases have continued subsequent to September 30, 2007, with an additional 13,964,098 shares purchased from October 1 through November 5, 2007. All shares repurchased are recorded as treasury stock at cost.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

3. Shareholders Equity and Earnings Per Share (EPS) *(continued)*

The quarterly dividend per common share, commencing with the dividend declared in May 2007 and paid on September 21, 2007, was $0.20.

The following table summarizes the changes in retained earnings during the first nine months of 2007:

(in millions)		September 30, 2007
Retained earnings:		
Balance at beginning of year	$	84,996
Cumulative effect of accounting changes, net of tax		(203)
Adjusted balance, beginning of year		84,793
Net income		11,492
Dividends to shareholders		(1,455)
Balance, end of period	$	94,830

4. Benefits Provided by Starr International Company, Inc. and C.V. Starr & Co., Inc.

Starr International Company, Inc. (SICO) has provided a series of two-year Deferred Compensation Profit Participation Plans (SICO Plans) to certain AIG employees. The SICO Plans came into being in 1975 when the voting shareholders and Board of Directors of SICO, a private holding company whose principal asset is AIG common stock, decided that a portion of the capital value of SICO should be used to provide an incentive plan for the current and succeeding managements of all American International companies, including AIG.

None of the costs of the various benefits provided under the SICO Plans has been paid by AIG, although AIG has recorded a charge to reported earnings for the deferred compensation amounts paid to AIG employees by SICO, with an offsetting amount credited to additional paid-in capital reflecting amounts deemed contributed by SICO. The SICO Plans provide that shares currently owned by SICO are set aside by SICO for the benefit of the participant and distributed upon retirement. The SICO Board of Directors currently may permit an early payout of units under certain circumstances. Prior to payout, the participant is not entitled to vote, dispose of or receive dividends with respect to such shares, and shares are subject to forfeiture under certain conditions, including but not limited to the participant s voluntary termination of employment with AIG prior to normal retirement age. Under the SICO Plans, SICO s Board of Directors may elect to pay a participant cash in lieu of shares of AIG common stock. Following notification from SICO to participants in the SICO Plans that it will settle specific future awards under the SICO Plans with shares rather than cash, AIG modified its accounting for the SICO Plans from variable to fixed measurement accounting. AIG gave effect to this change in settlement method beginning on December 9, 2005, the date of SICO s notice to participants in the SICO Plans. See also Note 6(b) Commitments herein.

In January 2006, C.V. Starr & Co., Inc. (Starr) completed its tender offer to purchase Starr interests from AIG employees. In conjunction with AIG s adoption of FAS No. 123R Share-Based Payments (FAS 123R), Starr is considered to be an economic interest holder in AIG. As a result, compensation expense of $54 million was included in the first nine months of 2006 with respect to the Starr tender offer.

Compensation expense with respect to the SICO Plans aggregated $9 million and $14 million for the three-month periods ended September 30, 2007 and 2006, respectively, and $29 million and $104 million for the nine-month periods ended September 30, 2007 and 2006, respectively. Compensation expense for the first nine months of 2006 included various out of period adjustments totaling $61 million, primarily relating to stock splits and other miscellaneous items for the SICO plans.

5. Ownership

According to the Schedule 13D filed on March 20, 2007 by Starr, SICO, Edward E. Matthews, Maurice R. Greenberg, the Maurice R. and Corinne P. Greenberg Family Foundation, Inc., the Universal Foundation, Inc., the Maurice R. and Corinne P. Greenberg Joint Tenancy Company, LLC and the C.V. Starr & Co., Inc. Trust, these reporting persons could be deemed to beneficially own 354,987,261 shares of AIG s common stock at that date. Based on the shares of AIG s common stock outstanding as of October 31, 2007, this ownership would represent approximately 14 percent of the voting stock of AIG. Although these reporting persons have made filings under Section 16 of the Securities Exchange Act of 1934 (Exchange Act), reporting sales of shares of common stock, no amendment to the Schedule 13D has been filed to report a change in ownership subsequent to March 20, 2007.

6. Commitments, Contingencies and Guarantees

In the normal course of business, various commitments and contingent liabilities are entered into by AIG and certain of its

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*

American International Group, Inc. and Subsidiaries

6. Commitments, Contingencies and Guarantees *(continued)*

subsidiaries. In addition, AIG guarantees various obligations of certain subsidiaries.

(a) Litigation and Investigations

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

Litigation Arising from Insurance Operations Caremark. AIG and certain of its subsidiaries have been named defendants in two putative class actions in state court in Alabama that arise out of the 1999 settlement of class and derivative litigation involving Caremark Rx, Inc. (Caremark). The plaintiffs in the second-filed action have intervened in the first-filed action, and the second-filed action has been dismissed. An excess policy issued by a subsidiary of AIG with respect to the 1999 litigation was expressly stated to be without limit of liability. In the current actions, plaintiffs allege that the judge approving the 1999 settlement was misled as to the extent of available insurance coverage and would not have approved the settlement had he known of the existence and/or unlimited nature of the excess policy. They further allege that AIG, its subsidiaries, and Caremark are liable for fraud and suppression for misrepresenting and/or concealing the nature and extent of coverage. In their complaint, plaintiffs request compensatory damages for the 1999 class in the amount of $3.2 billion, plus punitive damages. AIG and its subsidiaries deny the allegations of fraud and suppression and have asserted, *inter alia,* that information concerning the excess policy was publicly disclosed months prior to the approval of the settlement. AIG and its subsidiaries further assert that the current claims are barred by the statute of limitations and that plaintiffs assertions that the statute was tolled cannot stand against the public disclosure of the excess coverage. Plaintiffs, in turn, have asserted that the disclosure was insufficient to inform them of the nature of the coverage and did not start the running of the statute of limitations. The trial court is currently considering, under standards mandated by the Alabama Supreme Court, whether a class action can be certified and whether the defendants in the case brought by the intervenors should be dismissed. AIG cannot reasonably estimate either the likelihood of its prevailing in these actions or the potential damages in the event liability is determined.

Litigation Arising from Insurance Operations Gunderson. A subsidiary of AIG has been named as a defendant in a putative class action lawsuit in the 14th Judicial District Court for the State of Louisiana. The *Gunderson* complaint alleges failure to comply with certain provisions of the Louisiana Any Willing Provider Act (the Act) relating to discounts taken by defendants on bills submitted by Louisiana medical providers and hospitals that provided treatment or services to workers compensation claimants and seeks monetary penalties and injunctive relief. On July 20, 2006, the court denied defendants motion for summary judgment and granted plaintiffs partial motion for summary judgment, holding that the AIG subsidiary was a group purchaser and, therefore, potentially subject to liability under the Act. On November 28, 2006, the court issued an order certifying a class of providers and hospitals. In an unrelated action also arising under the Act, a Louisiana appellate court ruled that the district court lacked jurisdiction to adjudicate the claims at issue. In response, defendants in *Gunderson* filed an exception for lack of subject matter jurisdiction. On January 19, 2007, the court denied the motion, holding that it has jurisdiction over the putative class claims. The AIG subsidiary is appealing the class certification ruling and is seeking an appeal from the jurisdictional ruling. AIG believes that it has meritorious defenses to plaintiffs claims and expects that the ultimate resolution of this matter will not have a material adverse effect on AIG s consolidated financial condition or results of operations for any period.

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

6. Commitments, Contingencies and Guarantees *(continued)*

As a result of these settlements, AIG made payments or placed amounts in escrow in 2006 totaling approximately $1.64 billion, $225 million of which represented fines and penalties. Amounts held in escrow totaling $344 million, including interest thereon, are included in other assets at September 30, 2007. At that date, approximately $326 million of the funds were escrowed for settlement of claims resulting from the underpayment by AIG of its residual market assessments for workers compensation. The National Workers Compensation Reinsurance Pool, on behalf of its participant members, has filed a lawsuit against AIG with respect to the underpayment of such assessments. The National Association of Insurance Commissioners has formed a Settlement Review Working Group directed by the State of Indiana, which has commenced its own investigation into the underreporting of workers compensation premium. In addition, similar lawsuits filed by the Attorney General of the State of Minnesota, the Minnesota Workers Compensation Reinsurance Association and the Minnesota Workers Compensation Insurers Association are pending. AIG cannot currently estimate whether the amount ultimately required to settle these claims will exceed the funds escrowed or otherwise accrued for this purpose.

The remaining escrowed funds, which amounted to $18 million at September 30, 2007, are set aside for settlements for certain specified AIG policyholders. During the first nine months of 2007, approximately $367 million was paid out from escrow in exchange for releasing AIG and its subsidiaries from any alleged liability relating to, among other things, brokerage practices alleged in the NYAG settlement. Any funds remaining at the end of the escrow period can be used to resolve claims asserted by policyholders relating to such insurance brokerage practices, including those described in Private Litigation below.

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

Also, as part of the settlements, AIG agreed to retain, for a period of three years, an independent consultant to conduct a review that will include, among other things, the adequacy of AIG s internal control over financial reporting, the policies, procedures and effectiveness of AIG s regulatory, compliance and legal functions and the remediation plan that AIG has implemented as a result of its own internal review.

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

Private Litigation

Securities Actions. Beginning in October 2004, a number of putative securities fraud class action suits were filed against AIG and consolidated as *In re American International Group, Inc. Securities Litigation.* Subsequently, a separate, though similar, securities fraud action was also brought against AIG by certain Florida pension funds. The lead plaintiff in the class action is a group of public retirement systems and pension funds benefiting Ohio state employees, suing on behalf of themselves and all purchasers of AIG s publicly traded securities between October 28, 1999 and April 1, 2005. The named defendants are AIG and a number of present and former AIG officers and directors, as well as 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 of 1933, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder, Section 20(a) of the Exchange Act, and Section 20A of the Exchange Act. In April 2006, the court denied the defendants motions to dismiss the second amended class action complaint and the Florida complaint. In December 2006, a third amended class action complaint was filed, which does not differ substantially from the prior complaint. Fact and class discovery is currently ongoing.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

6. Commitments, Contingencies and Guarantees *(continued)*

order dated December 12, 2006. AIG filed an answer on February 12, 2007, denying plaintiffs allegations of wrongdoing and asserting affirmative defenses to plaintiffs claims. AIG expects that the ultimate resolution of this matter will not have a material adverse effect on AIG s consolidated financial condition or results of operations for any period.

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 & McLennan Companies, Inc. (Marsh), SICO, Starr, ACE Limited and subsidiaries (ACE), General Reinsurance Corporation, PwC, and certain employees or officers of these entity defendants. Plaintiffs assert claims for breach of fiduciary duty, gross mismanagement, waste of corporate assets, unjust enrichment, insider selling, auditor breach of contract, auditor professional negligence and disgorgement from AIG s former Chief Executive Officer and Chief Financial Officer of incentive-based compensation and AIG share proceeds under Section 304 of the Sarbanes-Oxley Act, among others. Plaintiffs seek, among other things, compensatory damages, corporate governance reforms, and a voiding of the election of certain AIG directors. AIG s Board of Directors has appointed a special committee of independent directors (special committee) to review the matters asserted in the operative consolidated derivative complaint. The court has entered an order staying the derivative case in the Southern District of New York pending resolution of the consolidated derivative action in the Delaware Chancery Court (discussed below). The court also has entered an order that termination of certain named defendants from the Delaware derivative action applies to the New York derivative action without further order of the court. On October 17, 2007, plaintiffs and those AIG officer and director defendants against whom the shareholder plaintiffs in the Delaware action are no longer pursuing claims filed a stipulation providing for all claims in the New York action against such defendants to be dismissed with prejudice. Former directors and officers Maurice R. Greenberg and Howard I. Smith have asked the court to refrain from so ordering this stipulation.

Derivative Actions Delaware Chancery Court. From October 2004 to April 2005, AIG shareholders filed five derivative complaints in the Delaware Chancery Court. All of these derivative lawsuits have been consolidated into a single action. The amended consolidated complaint named 43 defendants (not including nominal defendant AIG) who, like the New York consolidated derivative litigation, were current and former officers and directors of AIG, as well as other entities and certain of their current and former employees and directors. Earlier in 2007, the Court approved an agreement that AIG be realigned as plaintiff, and, on June 13, 2007, acting on the direction of the special committee, AIG filed an amended complaint against former directors and officers Maurice R. Greenberg and Howard I. Smith, alleging breach of fiduciary duty and indemnification. Also on June 13, 2007, the special committee filed a motion to terminate the litigation as to certain defendants, while taking no action as to others. Defendants Greenberg and Smith filed answers to AIG s complaint and brought third-party complaints against certain current and former AIG directors and officers, PwC and Regulatory Insurance Services, Inc. Certain defendants have subsequently filed motions to dismiss plaintiffs complaint, as well as defendants Greenberg and Smith s third-party complaints. On September 28, 2007, AIG and the shareholder plaintiffs filed a combined amended complaint in which AIG continued to assert claims against defendants Greenberg and Smith and took no position as to the claims asserted by the shareholder plaintiffs in the remainder of the combined amended complaint. In that pleading, the shareholder plaintiffs are no longer pursuing claims against certain AIG officers and directors. The factual allegations, legal claims and relief sought in the Delaware action are similar to those alleged in the New York derivative actions, except that shareholder plaintiffs in the Delaware derivative action assert claims only under state law. Certain defendants have filed motions to dismiss the shareholder plaintiffs claims. The shareholder plaintiffs have moved to sever their claims to a separate action. AIG has joined that motion to the extent that, among other things, the claims brought by AIG against defendants Greenberg and Smith remain for prosecution in the pending action. AIG also has moved to stay discovery in the Delaware derivative action pending the resolution of the claims against AIG in the New York consolidated securities action. That motion, together with the motion to sever, is currently pending before the court.

In December 2002, a derivative lawsuit was filed in the Delaware Chancery Court against twenty directors and executives of AIG as well as against AIG as a nominal defendant that alleges, among other things, that the directors of AIG breached the fiduciary duties of loyalty and care by approving the payment of commissions to Starr and of rental and service fees to SICO and the executives breached their duty of loyalty by causing AIG to enter into contracts with Starr and SICO and their fiduciary duties by usurping AIG s corporate opportunity. The complaint further alleges that the Starr agencies did not provide any services that AIG was not capable of providing itself, and that the diversion of commissions to these entities was solely for the benefit of Starr s owners. The complaint also alleged that the service fees and rental

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

6. Commitments, Contingencies and Guarantees *(continued)*

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. On April 20, 2007, the individual defendants and Starr filed a motion seeking leave of the Court to assert a cross-claim against AIG and a third-party complaint against PwC and the directors previously dismissed from the action, as well as certain other AIG officers and employees. On June 13, 2007, the Court denied the individual defendants motion to file a third-party complaint, but granted the proposed cross-claim against AIG. On June 27, 2007, Starr filed its cross-claim against AIG, alleging one count that includes contribution, unjust enrichment and setoff. AIG has filed an answer and moved to dismiss Starr s cross-claim to the extent it seeks affirmative relief, as opposed to a reduction in the judgment amount. Starr has agreed to withdraw its claim for contribution and clarified that it is not seeking any relief on behalf of the individual defendants. AIG s motion to dismiss Starr s claim for affirmative relief is currently pending before the Court. Document discovery and depositions are currently ongoing.

Policyholder Actions. After the NYAG filed its complaint against insurance broker Marsh, policyholders brought multiple federal antitrust and Racketeer Influenced and Corrupt Organizations Act (RICO) class actions in jurisdictions across the nation against insurers and brokers, including AIG and a number of its subsidiaries, alleging that the insurers and brokers engaged in a broad conspiracy to allocate customers, steer business, and rig bids. These actions, including 24 complaints filed in different federal courts naming AIG or an AIG subsidiary as a defendant, were consolidated or will be consolidated by the judicial panel on multi-district litigation and transferred to the United States District Court for the District of New Jersey for coordinated pretrial proceedings. The consolidated actions have proceeded in that court in two parallel actions, *In re Insurance Brokerage Antitrust Litigation* (the *First Commercial Complaint*) and *In re Employee Benefit Insurance Brokerage Antitrust Litigation* (the *First Employee Benefits Complaint,* and, together with the *First Commercial Complaint*, the multi-district litigation).

The plaintiffs in the *First Commercial Complaint* are nineteen corporations, individuals and public entities that contracted with the broker defendants for the provision of insurance brokerage services for a variety of insurance needs. The broker defendants are alleged to have placed insurance coverage on the plaintiffs behalf with a number of insurance companies named as defendants, including AIG subsidiaries. The *First Commercial Complaint* also named ten brokers and fourteen other insurers as defendants (two of which have since settled). The *First Commercial Complaint* alleges that defendants engaged in a widespread conspiracy to allocate customers through bid-rigging and steering practices. The *First Commercial Complaint* also alleges that the insurer defendants permitted brokers to place business with AIG subsidiaries through wholesale intermediaries affiliated with or owned by those same brokers rather than placing the business with AIG subsidiaries directly. Finally, the *First Commercial Complaint* alleges that the insurer defendants entered into agreements with broker defendants that tied insurance placements to reinsurance placements in order to provide additional compensation to each broker. Plaintiffs assert that the defendants violated the Sherman Antitrust Act, RICO, the antitrust laws of 48 states and the District of Columbia, and are liable under common law breach of fiduciary duty and unjust enrichment theories. Plaintiffs seek treble damages plus interest and attorneys fees as a result of the alleged RICO and Sherman Antitrust Act violations.

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

On October 3, 2006, Judge Hochberg of the District of New Jersey reserved in part and denied in part motions filed by the insurer defendants and broker defendants to dismiss the multi-district litigation. The Court also ordered the plaintiffs in both actions to file supplemental statements of particularity to elaborate on the allegations in their complaints. Plaintiffs filed their supplemental statements on October 25, 2006, and the AIG defendants, along with other insurer and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

6. Commitments, Contingencies and Guarantees *(continued)*
broker defendants in the two consolidated actions, filed renewed motions to dismiss on November 30, 2006. On February 16, 2007, the case was transferred to Judge Garrett E. Brown, Chief Judge of the District of New Jersey. On April 5, 2007, Chief Judge Brown granted the defendants renewed motions to dismiss the *First Commercial Complaint* and *First Employee Benefits Complaint* with respect to the antitrust and RICO claims. The claims were dismissed without prejudice and the plaintiffs were given 30 days, later extended to 45 days, to file amended complaints. On April 11, 2007, the Court stayed all proceedings, including all discovery, that are part of the multi-district litigation until any renewed motions to dismiss the amended complaints are resolved.

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

Plaintiffs filed amended complaints in both *In re Insurance Brokerage Antitrust Litigation* (the *Second Commercial Complaint*) and *In re Employee Benefit Insurance Brokerage Antitrust Litigation* (the *Second Employee Benefits Complaint*) along with revised particularized statements in both actions on May 22, 2007. The allegations in the *Second Commercial Complaint* and the *Second Employee Benefits Complaint* are substantially similar to the allegations in the *First Commercial Complaint and First Employee Benefits Complaint*, respectively. The complaints also attempt to add several new parties and delete others; the *Second Commercial Complaint* adds two new plaintiffs and twenty seven new defendants (including three new AIG defendants), and the *Second Employee Benefits Complaint* adds eight new plaintiffs and nine new defendants (including two new AIG defendants). The defendants filed motions to dismiss the amended complaints and to strike the newly added parties. The Court granted (without leave to amend) defendants motions to dismiss the federal antitrust and RICO claims on August 31, 2007 and September 28, 2007, respectively. The Court declined to exercise supplemental jurisdiction over the state law claims in the *Second Commercial Complaint* and therefore dismissed it in its entirety. The *Second Employee Benefits Complaint* is still before the Court, pending a decision on defendants motion for summary judgment on the ERISA claims.

On August 24, 2007, the Ohio Attorney General filed a complaint in the Ohio Court of Common Pleas against AIG and a number of its subsidiaries, as well as several other broker and insurer defendants, asserting violation of Ohio s antitrust laws. The complaint, which is similar to the *Second Commercial Complaint*, alleges that AIG and the other broker and insurer defendants conspired to allocate customers, divide markets, and restrain competition in commercial lines of casualty insurance sold through the broker defendant. The complaint seeks treble damages on behalf of Ohio public purchasers of commercial casualty insurance, disgorgement on behalf of both public and private purchasers of commercial casualty insurance, as well as a $500 per day penalty for each day of conspiratorial conduct.

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 Insurance Group (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 alleged that the proposed per share price was unfair and sought preliminary and permanent injunctive relief to enjoin the consummation of the proposed transaction. On May 23, 2007, a third action was filed alleging breaches of fiduciary duty by the same defendants based upon their entering into the merger agreement and taking steps to complete the contemplated merger, and seeking injunctive relief comparable to that sought in the first two complaints. All three actions were consolidated under the caption *In re 21st Century Shareholder Litigation.* On August 14, 2007, the court dismissed the action at the request of the plaintiffs.

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 en-

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

6. Commitments, Contingencies and Guarantees *(continued)*
richment, 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 SICO s motion for summary judgment is pending.

Regulatory Investigations. Regulators from several states have commenced investigations into insurance brokerage practices related to contingent commissions and other industry-wide practices as well as other broker-related conduct, such as alleged bid-rigging. In addition, various federal and state regulatory agencies are reviewing certain transactions and practices of AIG and its subsidiaries in connection with industry-wide and other inquiries. AIG has cooperated, and will continue to cooperate, in producing documents and other information in response to subpoenas and other requests.

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

Effect on AIG

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

(b) Commitments

Flight Equipment

At September 30, 2007, ILFC had committed to purchase 245 new aircraft deliverable from 2007 through 2017 at an estimated aggregate purchase price of $21.0 billion. ILFC will be required to find customers for any aircraft acquired, and it must arrange financing for portions of the purchase price of such equipment.

Other Commitments

In the normal course of business, AIG enters into commitments to invest in limited partnerships, private equities, hedge funds and mutual funds and to purchase and develop real estate in the U.S. and abroad. These commitments totaled $5.98 billion at September 30, 2007.

On June 27, 2005, AIG entered into an agreement pursuant to which AIG agrees, subject to certain conditions, to make any payment that is not promptly paid with respect to the benefits accrued by certain employees of AIG and its subsidiaries under the SICO Plans (as discussed in Note 4 herein).

(c) Contingencies

Loss Reserves. Although AIG regularly 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, directors and officers 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, in labor and material costs or in the judicial environment, or in other social or economic phenomena affecting claims.

Synthetic Fuel Tax Credits. AIG generates income tax credits as a result of investing in synthetic fuel production. Tax credits generated from the production and sale of synthetic fuel under the Internal Revenue Code are subject to an annual phase-out provision that is based on the average wellhead price of domestic crude oil. The price range within which the tax credits are phased-out was originally established in 1980 and is adjusted annually for inflation. Depending on the price of domestic crude oil for a particular year, all or a portion of the tax credits generated in that year might be eliminated. AIG evaluates the production levels of its synthetic fuel production facilities in light of the risk of phase-out of the associated tax credits. As a result of fluctuating domestic crude oil prices, AIG evaluates and adjusts production levels when appropriate in light of this risk. Recent increases in oil prices have reduced the current estimate of 2007

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

6. Commitments, Contingencies and Guarantees *(continued)*

tax credits. Under current legislation, the opportunity to generate additional tax credits from the production and sale of synthetic fuel expires on December 31, 2007.

Lease Transactions. In June and August, 2007, field agents at the Internal Revenue Service issued Notices of Proposed Adjustment (NOPAs) relating to a series of lease transactions by an AIG subsidiary. In the NOPAs, the field agents asserted that the leasing transactions were lease-in lease-out transactions described in Revenue Ruling 2002-69 and proposed adjustments to taxable income of approximately $203 million in the aggregate for the years 1998, 1999, 2001 and 2002.

(d) Guarantees

AIG and certain of its subsidiaries become parties to derivative financial instruments with market risk resulting from both dealer and end-user activities and to reduce currency, interest rate, equity and commodity exposures. These instruments are carried at their estimated fair values in the consolidated balance sheet. The vast majority of AIG s derivative activity is transacted by AIGFP. See Note 9 below and see Note 19 to the consolidated financial statements in the 2006 Annual Report on Form 10-K.

AIG has issued unconditional guarantees with respect to the prompt payment, when due, of all present and future payment obligations and liabilities of AIGFP arising from transactions entered into by AIGFP.

SAI Deferred Compensation Holdings, Inc., a wholly owned subsidiary of AIG, has established a deferred compensation plan for registered representatives of certain AIG subsidiaries, pursuant to which participants have the opportunity to invest deferred commissions and fees on a notional basis. The value of the deferred compensation fluctuates with the value of the deferred investment alternatives chosen. AIG has provided a full and unconditional guarantee of the obligations of SAI Deferred Compensation Holdings, Inc. to pay the deferred compensation under the plan.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*

American International Group, Inc. and Subsidiaries

7. Employee Benefits

The following table presents the components of the net periodic benefit costs with respect to pensions and other postretirement benefits:

	Pensions			Postretirement		
(in millions)	Non-U.S. Plans	U.S. Plans	Total	Non-U.S. Plans	U.S. Plans	Total
Three Months Ended September 30, 2007						
Components of net periodic benefit cost:						
Service cost	**$ 22**	**$ 30**	**$ 52**	**$ 1**	**$ 3**	**$ 4**
Interest cost	**12**	**45**	**57**	**1**	**3**	**4**
Expected return on assets	**(9)**	**(53)**	**(62)**			
Amortization of prior service cost	**(2)**	**(1)**	**(3)**			
Amortization of net loss	**2**	**9**	**11**			
Amortization of initial net obligation	**1**		**1**			
Settlement loss		**3**	**3**			
Net periodic benefit cost	**$ 26**	**$ 33**	**$ 59**	**$ 2**	**$ 6**	**$ 8**
Three Months Ended September 30, 2006						
Components of net periodic benefit cost:						
Service cost	$ 18	$ 32	$ 50	$ 1	$ 1	$ 2
Interest cost	9	41	50	1	3	4
Expected return on assets	(7)	(48)	(55)			
Amortization of prior service cost	(3)	(1)	(4)		(2)	(2)
Amortization of transitional liability	1		1			
Recognized actuarial loss	4	18	22			
Net periodic benefit cost	$ 22	$ 42	$ 64	$ 2	$ 2	$ 4
Nine Months Ended September 30, 2007						
Components of net periodic benefit cost:						
Service cost	**$ 66**	**$ 90**	**$ 156**	**$ 4**	**$ 8**	**$ 12**
Interest cost	**36**	**134**	**170**	**2**	**11**	**13**
Expected return on assets	**(27)**	**(160)**	**(187)**			
Amortization of prior service cost	**(7)**	**(2)**	**(9)**		**(1)**	**(1)**
Amortization of net loss	**7**	**27**	**34**			
Amortization of initial net obligation	**1**		**1**			
Settlement loss	**1**	**3**	**4**			
Net periodic benefit cost	**$ 77**	**$ 92**	**$ 169**	**$ 6**	**$ 18**	**$ 24**
Nine Months Ended September 30, 2006						
Components of net periodic benefit cost:						

Service cost	$ 55	$ 94	$ 149	$ 3	$ 4	$ 7
Interest cost	26	122	148	2	8	10
Expected return on assets	(21)	(145)	(166)			
Amortization of prior service cost	(7)	(2)	(9)		(5)	(5)
Amortization of transitional liability	1		1			
Recognized actuarial loss	12	56	68			
Net periodic benefit cost	$ 66	$ 125	$ 191	$ 5	$ 7	$ 12

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*

American International Group, Inc. and Subsidiaries

8. Information Provided in Connection with Outstanding Debt

The following condensed consolidating financial statements are provided in compliance with Regulation S-X of the Securities and Exchange Commission.

AIG Life Holdings (US), Inc. (AIGLH), formerly known as American General Corporation, is a holding company and a wholly owned subsidiary of AIG. AIG provides a full and unconditional guarantee of all outstanding debt of AIGLH.

AIG Liquidity Corp. is a wholly owned subsidiary of AIG. AIG provides a full and unconditional guarantee of all obligations of AIG Liquidity Corp.

AIG Program Funding, Inc. is a wholly owned subsidiary of AIG. AIG provides a full and unconditional guarantee of all obligations of AIG Program Funding, Inc., which was established in 2007.

Condensed Consolidating Balance Sheet

(in millions)	American International Group, Inc. (As Guarantor)	AIGLH	AIG Liquidity Corp.	AIG Program Funding, Inc.	Other Subsidiaries	Eliminations	Consolidated AIG
September 30, 2007							
Assets:							
Investments and financial services assets	$ 15,718	$ 40	$	$	$ 865,584	$ (19,490)	$ 861,852
Cash	25	1			2,223		2,249
Carrying value of subsidiaries and partially owned companies, at equity	118,252	24,378			11,451	(152,804)	1,277
Other assets	4,693	2,650			199,420	(36)	206,727
Total assets	$ 138,688	$ 27,069	$	$	$ 1,078,678	$ (172,330)	$ 1,072,105
Liabilities:							
Insurance liabilities	$ 48	$	$	$	$ 518,879	$ (63)	$ 518,864
Debt	28,758	2,136			163,878	(18,587)	176,185
Other liabilities	5,815	3,191			264,348	(465)	272,889

Total liabilities	**34,621**	**5,327**			**947,105**	**(19,115)**	**967,938**
Preferred shareholders equity in subsidiary companies					**100**		**100**
Total shareholders equity	**104,067**	**21,742**			**131,473**	**(153,215)**	**104,067**
Total liabilities, preferred shareholders equity in subsidiary companies and shareholders equity	**$ 138,688**	**$ 27,069**	**$**	**$**	**$ 1,078,678**	**$ (172,330)**	**$ 1,072,105**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*

American International Group, Inc. and Subsidiaries

(in millions)	American International Group, Inc. (As Guarantor)	AIGLH	AIG Liquidity Corp.	AIG Program Funding, Inc.	Other Subsidiaries	Eliminations	Consolidated AIG
December 31, 2006							
Assets:							
Investments and financial services assets	$ 7,346	$	$ *	$	$ 800,350	$ (14,822)	$ 792,874
Cash	76		*		1,514		1,590
Carrying value of subsidiaries and partially owned companies, at equity	109,125	27,967			8,436	(144,427)	1,101
Other assets	3,989	2,622	*		179,183	(1,949)	183,845
Total assets	$ 120,536	$ 30,589	$ *	$	$ 989,483	$ (161,198)	$ 979,410
Liabilities:							
Insurance liabilities	$ 21	$	$	$	$ 497,514	$ (64)	$ 497,471
Debt	15,157	2,136	*		146,206	(14,820)	148,679
Other liabilities	3,681	3,508	*		225,685	(1,482)	231,392
Total liabilities	18,859	5,644	*	$	869,405	(16,366)	877,542
Preferred shareholders equity in subsidiary companies					191		191
Total shareholders equity	101,677	24,945	*		119,887	(144,832)	101,677
Total liabilities, preferred shareholders equity in subsidiary companies and	$ 120,536	$ 30,589	$ *	$	$ 989,483	$ (161,198)	$ 979,410

shareholders
equity

**Less than $1 million.*

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

8. Information Provided in Connection with Outstanding Debt *(continued)*
Condensed Consolidating Statement of Income

(in millions)	American International Group, Inc. (As Guarantor)	AIGLH	AIG Liquidity Corp.	AIG Program Funding, Inc.	Other Subsidiaries	Eliminations	Consolidated AIG
Three Months Ended September 30, 2007							
Operating income (loss)	**$ (587)**	**$ (37)**	**$ ***	**$**	**$ 5,503**	**$**	**$ 4,879**
Equity in undistributed net income of consolidated subsidiaries	**2,343**	**55**				**(2,398)**	
Dividend income from consolidated subsidiaries	**1,109**	**320**				**(1,429)**	
Income taxes	**(220)**	**256**	*****		**1,427**		**1,463**
Minority interest					**(331)**		**(331)**
Net income (loss)	**$ 3,085**	**$ 82**	**$ ***	**$**	**$ 3,745**	**$ (3,827)**	**$ 3,085**
Three Months Ended September 30, 2006							
Operating income (loss)	$ (215)	$ (49)	$ *	$	$ 6,565	$	$ 6,301
Equity in undistributed net income of consolidated subsidiaries	4,223	420				(4,643)	
Dividend income from consolidated subsidiaries	287	134				(421)	
Income taxes (benefits)	71	(17)	*		1,889		1,943
Minority interest					(134)		(134)

Net income (loss)	$ 4,224	$ 522	$ *	$	$ 4,542	$ (5,064)	$ 4,224
Nine Months Ended September 30, 2007							
Operating income (loss)	**$ (1,130)**	**$ (123)**	**$ ***	**$**	**$ 18,632**	**$**	**$ 17,379**
Equity in undistributed net income of consolidated subsidiaries	**9,192**	**546**				**(9,738)**	
Dividend income from consolidated subsidiaries	**3,274**	**978**				**(4,252)**	
Income taxes	**(156)**	**249**	*****		**4,775**		**4,868**
Minority interest					**(1,019)**		**(1,019)**
Net income (loss)	**$ 11,492**	**$ 1,152**	**$ ***	**$**	**$ 12,838**	**$ (13,990)**	**$ 11,492**
Nine Months Ended September 30, 2006							
Operating income (loss)	$ (937)	$ (135)	$ *	$	$ 17,407	$	$ 16,335
Equity in undistributed net income of consolidated subsidiaries	10,990	1,088				(12,078)	
Dividend income from consolidated subsidiaries	854	592				(1,446)	
Income taxes (benefits)	332	(47)	*		4,781		5,066
Minority interest					(694)		(694)
Cumulative effect of an accounting change, net of tax	34						34
Net income (loss)	$ 10,609	$ 1,592	$ *	$	$ 11,932	$ (13,524)	$ 10,609

**Less than $1 million.*

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*

American International Group, Inc. and Subsidiaries

8. Information Provided in Connection with Outstanding Debt *(continued)*

Condensed Consolidating Statement of Cash Flows

(in millions)		American International Group, Inc. (As Guarantor)		AIGLH		AIG Liquidity Corp.		AIG Program Funding, Inc.		Other Subsidiaries		Consolidated AIG
Nine Months Ended September 30, 2007												
Net cash provided by operating activities	$	1,627	$	375	$	*	$		$	25,054	$	27,056
Cash flows from investing:												
Invested assets disposed		782								125,971		126,753
Invested assets acquired		(8,767)								(182,911)		(191,678)
Other		186		(220)		*				(970)		(1,004)
Net cash used in investing activities		(7,799)		(220)		*				(57,910)		(65,929)
Cash flows from financing activities:												
Issuance of debt		13,540								61,025		74,565
Repayments of debt		(1,143)								(48,500)		(49,643)
Payments advanced to purchase shares		(2,955)								(2,045)		(5,000)
Cash dividends paid to shareholders		(1,372)										(1,372)
Other		(1,949)		(154)		*				23,077		20,974
Net cash provided by (used in) financing activities		6,121		(154)		*				33,557		39,524
Effect of exchange rate changes on cash										8		8
Change in cash		(51)		1		*				709		659
Cash at beginning of period		76								1,514		1,590
Cash at end of period	$	25	$	1	$	*	$		$	2,223	$	2,249

Nine Months Ended September 30, 2006						
Net cash (used in) provided by operating activities	$ (2,526)	$ 160	$ *	$	$ 6,403	$ 4,037
Cash flows from investing:						
Invested assets disposed	2,147				118,563	120,710
Invested assets acquired	(5,555)				(166,679)	(172,234)
Other	790	(17)	*		(1,393)	(620)
Net cash used in investing activities	(2,618)	(17)	*		(49,509)	(52,144)
Cash flows from financing activities:						
Issuance of debt	7,445				45,527	52,972
Repayments of debt	(1,345)				(24,986)	(26,331)
Cash dividends paid to shareholders	(1,209)					(1,209)
Other	91	(143)	*		22,196	22,144
Net cash provided by (used in) financing activities	4,982	(143)	*		42,737	47,576
Effect of exchange rate changes on cash					59	59
Change in cash	(162)		*		(310)	(472)
Cash at beginning of period	190				1,707	1,897
Cash at end of period	$ 28	$	$ *	$	$ 1,397	$ 1,425

**Less than $1 million.*

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*
American International Group, Inc. and Subsidiaries

9. Derivatives and Hedge Accounting

AIG uses derivatives and other financial instruments as part of its financial risk management programs and as part of its investment operations. AIGFP also transacts in derivatives as a dealer.

Derivatives, as defined in FAS 133, are financial arrangements among two or more parties with returns linked to or derived from some underlying equity, debt, commodity or other asset, liability, or foreign exchange rate or other index or the occurrence of a specified payment event. Derivative payments may be based on interest rates, exchange rates, prices of certain securities, commodities, or financial or commodity indices or other variables.

Unless subject to a scope exclusion, AIG carries all derivatives on the consolidated balance sheet at fair value. The changes in fair value of the derivative transactions of AIGFP are presented as a component of AIG s operating income.

AIGFP

AIGFP, in the ordinary course of operations and as principal, structures and enters into derivative transactions to meet the needs of counterparties who may be seeking to hedge certain aspects of such counterparties operations or obtain a desired financial exposure. AIGFP also enters into derivative transactions to mitigate risk in its exposures (interest rates, currencies, commodities, credit and equities) arising from such transactions. Such instruments are carried at market or fair value, whichever is appropriate, and are reflected on the balance sheet in Unrealized gain on swaps, options and forward transactions and Unrealized loss on swaps, options and forward contracts.

Beginning in the first quarter of 2007, AIGFP designated certain interest rate swaps as fair value hedges of the benchmark interest rate risk on certain of its interest bearing financial assets and liabilities. In these hedging relationships, AIG is hedging its fixed rate available for sale securities and fixed rate borrowings. AIGFP also designated foreign currency forward contracts as fair value hedges for changes in spot foreign exchange rates of the non-U.S. dollar denominated available for sale debt securities. Under these strategies, all or portions of individual or multiple derivatives may be designated against a single hedged item.

At inception of each hedging relationship, AIGFP performs and documents its prospective assessments of hedge effectiveness to demonstrate that the hedge is expected to be highly effective. For hedges of interest rate risk, AIGFP uses regression to demonstrate the hedge is highly effective, while it uses the periodic dollar offset method for its foreign currency hedges. AIGFP uses the periodic dollar offset method to assess whether its hedging relationships were highly effective on a retrospective basis. The prospective and retrospective assessments are updated on a daily basis. The passage of time component of the hedging instruments and the forward points on foreign currency hedges are excluded from the assessment of hedge effectiveness and measurement of hedge ineffectiveness. AIGFP does not utilize the shortcut, matched terms or equivalent methods.

The change in fair value of the derivative that qualifies under the requirements of FAS 133 as a fair value hedge is recorded in current period earnings along with the gain or loss on the hedged item for the hedged risk. For interest rate hedges, the adjustments to the carrying value of the hedged items are amortized into income using the effective yield method over the remaining life of the hedged item. Amounts excluded from the assessment of hedge effectiveness are recognized in current period earnings.

For the three and nine months ended September 30, 2007, AIGFP recognized net losses of $5 million and $3 million in earnings, respectively, representing hedge ineffectiveness, and also recognized net losses of $152 million and $363 million, respectively, related to the portion of the hedging instruments excluded from the assessment of hedge effectiveness. All these amounts are reflected in Other income. AIGFP did not apply hedge accounting in 2006.

Other Derivative Users

AIG and its subsidiaries (other than AIGFP) also use derivatives and other instruments as part of their financial risk management programs. Interest rate derivatives (such as interest rate swaps) are used to manage interest rate risk associated with investments in fixed income securities, commercial paper issuances, medium and long-term note offerings, and other interest rate sensitive assets and liabilities. In addition, foreign exchange derivatives (principally cross currency swaps, forwards and options) are used to economically mitigate risk associated with non-U.S. dollar denominated debt, net capital exposures and foreign exchange transactions. The derivatives are effective economic hedges of the exposures they are meant to offset.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited) (continued)*

American International Group, Inc. and Subsidiaries

9. Derivatives and Hedge Accounting *(continued)*

In 2007, AIG and its subsidiaries other than AIGFP designated certain derivatives as either fair value or cash flow hedges of their debt. The fair value hedges included (i) interest rate swaps that were designated as hedges of the change in the fair value of fixed rate debt attributable to changes in the benchmark interest rate and (ii) foreign currency swaps designated as hedges of the change in fair value of foreign currency denominated debt attributable to changes in foreign exchange rates and/or the benchmark interest rate. With respect to the cash flow hedges, (i) interest rate swaps were designated as hedges of the changes in cash flows on floating rate debt attributable to changes in the benchmark interest rate, and (ii) foreign currency swaps were designated as hedges of changes in cash flows on foreign currency denominated debt attributable to changes in the benchmark interest rate and foreign exchange rates.

AIG assesses, both at the hedge s inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Regression analysis is employed to assess the effectiveness of these hedges both on a prospective and retrospective basis. AIG does not utilize the shortcut, matched terms or equivalent methods.

The change in fair value of derivatives designated and effective as fair value hedges along with the gain or loss on the hedged item are recorded in net realized capital gains (losses). Upon discontinuation of hedge accounting, the cumulative adjustment to the carrying value of the hedged item resulting from changes in the benchmark interest rate is amortized into income using the effective yield method over the remaining life of the hedged item. Amounts excluded from the assessment of hedge effectiveness are recognized in current period earnings. During both the three and nine months ended September 30, 2007, AIG recognized a loss of less than $1 million in earnings related to the ineffective portion of the hedging instruments. During the three and nine months ended September 30, 2007, AIG also recognized losses of $45 million and $53 million, respectively, related to the change in the hedging instruments forward points excluded from the assessment of hedge effectiveness.

The effective portion of the change in fair value of a derivative qualifying as a cash flow hedge is recorded in Accumulated other comprehensive income (loss), until earnings are affected by the variability of cash flows in the hedged item. The ineffective portion of these hedges is recorded in net realized capital gains (losses). During both the three and nine months ended September 30, 2007, AIG recognized losses of $1 million in earnings representing hedge ineffectiveness. At September 30, 2007, $10 million of the deferred net loss in Accumulated other comprehensive income is expected to be recognized in earnings during the next 12 months. All components of the derivatives gains and losses were included in the assessment of hedge effectiveness. There were no instances of the discontinuation of hedge accounting in 2007.

10. Cash Flows

As part of its ongoing remediation activities, AIG has made certain revisions to the Consolidated Statement of Cash Flows, primarily relating to certain elements of net realized capital gains, the effect of reclassifying certain policyholders account balances from Other policyholder funds to Policyholders contract deposits, the elimination of certain intercompany balances and revisions related to separate account assets. Accordingly, AIG revised the previous periods presented to conform to the revised presentation.

The revisions and their effect on the Consolidated Statement of Cash Flows for the nine months ended September 30, 2006 are presented below:

(in millions)	Originally Reported September 30, 2006	Revisions	As Revised
Cash flows from operating activities	$ 6,004	$ (1,967)	$ 4,037
Cash flows from investing activities	(51,400)	(744)	(52,144)

Cash flows from financing activities	44,865	2,711	47,576
Effect of exchange rate changes on cash	59		59
Change in cash	(472)		(472)

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American International Group, Inc. and Subsidiaries

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Management s Discussion and Analysis of Financial Condition and Results of Operations is designed to provide the reader a narrative with respect to 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 Quarterly Report on Form 10-Q 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 AIG s Annual Report on Form 10-K for the year ended December 31, 2006 (2006 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.

In addition to reviewing AIG s results for the first nine months of 2007, this Management s Discussion and Analysis of Financial Condition and Results of Operations supplements and updates the information and discussion included in the 2006 Annual Report on Form 10-K. 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 loss ratios and combined ratios are presented in accordance with accounting principles prescribed by insurance regulatory authorities because these are standard measures of performance filed with insurance regulatory authorities and used for analysis in the insurance industry and thus allow more meaningful comparisons with AIG s insurance competitors. AIG has also incorporated into this discussion cross-references to additional information included in this Quarterly Report on Form 10-Q and in the 2006 Annual Report on Form 10-K to assist readers seeking related information on a particular subject.

Overview of Operations and Business Results

AIG identifies its reportable segments by product or service line, consistent with its management structure. AIG s segments are General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management. AIG s operations in 2007 and 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.

Outlook

The following paragraphs supplement and update the information and discussion included in Management s Discussion and Analysis of Financial Condition and Results of Operations Outlook, in the 2006 Annual Report on Form 10-K to reflect developments in or affecting AIG s business during 2007.

The commercial property and casualty insurance industry has historically experienced cycles of price erosion followed by rate strengthening as a result of catastrophes or other significant losses that affect the overall capacity of the industry to provide coverage. 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. In October 2007, for example, AIG expanded its Foreign General insurance operations in Germany through the acquisition of Württembergische and Badische Versicherungs-Aktiengesellschaft.

Workers compensation remains under considerable pricing pressure, as statutory rates continue to decline. Rates for aviation, excess casualty, D&O and certain other lines of insurance also continue to decline due to competitive pressures. AIG also expects further price erosion for its foreign commercial lines during 2008. 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; however, AIG seeks to mitigate this risk by constantly seeking out profitable opportunities across its diverse product lines and distribution networks.

AIG has commenced a realignment of its Foreign General insurance operations, many of which were historically conducted through branches of U.S. companies. On December 1, 2007, Landmark Insurance Company Limited, a U.K. subsidiary, will assume all of the insurance liabilities of the U.K. branch of New Hampshire Insurance Company and will change its name to AIG U.K. Ltd.

In AIG s Foreign Retirement Services business, the continued weak yen has resulted in higher than normal surrenders and that trend, if prolonged, could further accelerate the amortization of deferred acquisition costs (DAC). Similarly, in the Domestic Retirement Services business, the competitive environment and the age of the in-force blocks of individual fixed annuities could result in ongoing heightened surrender activity.

In Japan, the National Tax Authority in cooperation with the Life Insurance Association of Japan is reviewing the tax treatment for increasing term life insurance, which may affect the amount of premiums that qualify as tax deductions for business owners. As a result of this review, AIG s life insurance companies in Japan suspended the sale of increasing term life insurance from early April 2007. This action had an adverse effect on life insurance sales in the third quarter of 2007 and AIG expects that trend to continue for the remainder of the year. AIG companies in Japan have taken several measures aimed at increasing sales of other products in the Japanese market, in particular sales of U.S. dollar life insurance products.

In Japan, full deregulation of banks with respect to insurance product sales will become effective in December 2007. AIG expects that it will be able to leverage its existing bank relationships and innovative product expertise to expand sales of both life and accident and health products beginning in 2008.

During the third quarter of 2007, the Internal Revenue Service proposed to change the treatment of the dividends-received deduction on separate account assets held in connection with variable annuity contracts. This proposal was withdrawn later in the quarter for additional study. Should this change be adopted, AIG does not expect it would have a material effect on AIG s consolidated financial position or results of operations for any period.

In March 2007, the U.S. Treasury Department published proposed new regulations that, if adopted in their current form, would limit the ability of U.S. taxpayers to claim foreign tax credits in certain circumstances under the Internal Revenue Code. Should the proposed regulations be adopted in their current form, they would limit AIG s ability to claim foreign tax credits in connection with certain structured transactions entered into by AIG Financial Products Corp. and AIG Trading Group Inc. and their respective subsidiaries (collectively, AIGFP), resulting in a material adverse effect on AIGFP s operating results.

The ongoing disruption in the structured finance markets and the recent downgrades by rating agencies continue to adversely affect AIG s estimates of the fair value of the super senior credit derivatives written by AIGFP. Although it remains difficult to estimate the fair value of these derivatives due to continuing limitations on the availability of market observable data, AIG s best estimate of the further decline in the fair value of AIGFP s super senior credit derivatives since September 30, 2007 is approximately $550 million as of October 31, 2007. The fair value of these derivatives is expected to fluctuate, perhaps materially, in response to changing market conditions, and AIG s estimates of the value of AIGFP s super senior credit derivative portfolio at future dates could therefore be materially different from current estimates. AIG continues to believe that it is highly unlikely that AIGFP will be required to make payments with respect to these derivatives.

The U.S. residential mortgage market is experiencing serious disruption due to credit quality deterioration in a significant portion of loans originated, particularly to non-prime and subprime borrowers, evolving changes in the regulatory environment, a slower residential housing market, increased cost of borrowings for mortgage participants and illiquid credit markets. AIG participates in the U.S. residential mortgage market in several ways: American General Finance, Inc. (AGF) originates principally first-lien mortgage loans and to a lesser extent second-lien mortgage loans to buyers and owners of residential housing; United Guaranty Corporation (UGC) provides first loss mortgage guaranty insurance for high loan-to-value first and second-lien residential mortgages; AIG insurance and financial services subsidiaries invest in mortgage-backed securities and collateralized debt obligations (CDOs) in which the underlying collateral is composed in whole or in part of residential mortgage loans; and AIGFP provides credit protection through credit default swaps on certain super senior tranches of CDOs that have AAA underlying or subordinate layers. The operating results of AIG s consumer finance and mortgage guaranty operations in the United States have been and are likely to continue to be adversely affected by the factors referred to above. The downward cycle in the U.S. housing market is not expected to improve until residential inventories return to a more normal level and the mortgage credit market stabilizes. AIG expects that this downward cycle will continue to adversely affect UGC s operating results for the foreseeable future and will result in a significant operating loss for UGC in 2008. The effect of the downward cycle in the U.S. housing market on AIG s other operations, investment portfolio and overall consolidated financial position could be material if the market disruption continues and expands beyond the U.S. residential mortgage markets, although AIG seeks to mitigate the risks to its business by disciplined underwriting and active risk management.

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

As part of an ongoing project to increase the standardization of AIG actuarial systems and processes throughout the world, adjustments reflecting certain changes in actuarial estimates for future policy benefits and DAC have been recognized in the Life Insurance & Retirement Services segment results during 2006 and 2007. AIG expects further adjustments over time as these new systems and processes are implemented.

AIG has recorded out of period quarterly adjustments in the last two years due to the remediation of control deficiencies. As AIG continues its remediation activities, AIG expects to record additional out of period adjustments.

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Consolidated Results

The following table summarizes AIG s consolidated revenues, income before income taxes, minority interest and cumulative effect of an accounting change and net income:

	Three Months Ended September 30,		Percentage	Nine Months Ended September 30,		Percentage
(in millions)	**2007**	2006	Increase/ (Decrease)	**2007**	2006	Increase/ (Decrease)
Total revenues	**$ 29,836**	$ 29,247	2%	**$ 91,631**	$ 83,379	10%
Income before income taxes, minority interest and cumulative effect of an accounting change	**4,879**	6,301	(23)	**17,379**	16,335	6
Net income	**$ 3,085**	$ 4,224	(27)%	**$ 11,492**	$ 10,609	8%

AIG s consolidated revenues increased slightly for the three months ended September 30, 2007 compared to the same period in 2006. AIG s consolidated income before income taxes, minority interest and cumulative effect of an accounting change decreased for the three-month period ended September 30, 2007 compared to the same period in 2006 primarily due to higher Net realized capital losses and the operating loss in the Mortgage Guaranty business. Net realized capital losses included other-than-temporary declines of $529 million and foreign currency related losses of $361 million.

AIG s consolidated revenues increased for the nine-month period ended September 30, 2007 compared to the same period in 2006 as revenues increased in each of the operating segments. Operating income increased in all segments with the exception of Life Insurance & Retirement Services, which declined due to an increase in Net realized capital losses compared to the same period in 2006.

Operating income for the three and nine-month periods ended September 30, 2007 was significantly affected by the change in accounting treatment for hedging activities. In the first nine months of 2007, AIGFP applied hedge accounting to certain of its interest rate swaps and foreign currency forward contracts hedging its investments and borrowings. As a result, AIGFP recognized in earnings the change in the fair value on the hedged items attributable to the hedged risks, offsetting the gains and losses on the derivatives designated as hedges. In 2006, AIGFP did not apply hedge accounting under FAS 133 to any of its assets and liabilities.

During the three months ended September 30, 2007, AIG recorded certain out of period adjustments. These adjustments collectively decreased pre-tax operating income in that quarter by $33 million and net income by $35 million. The adjustments were primarily comprised of a net charge of $49 million ($32 million after tax) in Capital Markets, a $14 million increase in income tax expense related to the remediation of the material weakness in controls over income tax accounting and an increase to operating income of $16 million ($11 million after tax) primarily related to other remediation activities.

For the nine months ended September 30, 2007, out of period adjustments collectively decreased pre-tax operating income by $536 million ($408 million after tax). The adjustments were comprised of a charge of $380 million ($247 million after tax) to reverse net gains on transfers of investment securities among legal entities consolidated within AIGFP and a corresponding increase to Accumulated other comprehensive income; $58 million of additional income tax expense related to the aforementioned remediation activities; $71 million ($46 million after tax) of net realized capital gains related to foreign exchange; and $227 million ($149 million after tax) of additional expense, primarily relating to other remediation activities.

During the three months ended September 30, 2006, out of period adjustments collectively increased pre-tax operating income by $293 million and net income by $73 million. The adjustments were comprised of an increase in income primarily related to the remediation of the material weakness in accounting for certain derivative transactions under FAS 133 totalling $151 million ($23 million after tax); increases in bad debt expense of $225 million ($146 million after tax) and earned premiums of $99 million ($65 million after tax), both of which relate to balance sheet reconciliations; an increase in partnership income of $121 million ($79 million after tax), which relates to improved valuation information; a further increase in income from certain investments in unit investment trusts (UCITS) of $116 million ($75 million after tax), as described below; other favorable remediation adjustments of $31 million ($16 million after tax) and an increase in income tax expense of $39 million relating to AIG s ongoing remediation of internal controls over income tax accounting. See also the discussion of AIG s reportable segments in Management s Discussion & Analysis of Financial Condition and Results of Operations.

For the nine months ended September 30, 2006, out of period adjustments collectively increased pre-tax operating income by $173 million and reduced net income by $135 million. The adjustments were comprised of $642 million ($417 million after tax) of additional investment income related to the accounting for UCITS; $194 million ($127 million after tax) of charges primarily related to the remediation of the material weakness in accounting for certain derivative transactions under FAS 133; $239 million of additional income tax expense related to the aforementioned remediation activities; $85 million ($55 million after tax) of interest income related to interest earned on deposit contracts; $61 million (before and after tax) of expenses related to the Starr International Company, Inc. (SICO) Deferred Compensation Profit Participation Plans (SICO Plans); $59 million ($38 million after tax) of expenses related to deferred advertising costs; and $240 million ($142 million after tax) of additional expense, primarily related to other remediation activities.

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

AIG s effective income tax rates for the year ended December 31, 2006 and the three-month period ended September 30, 2007 were 30.1 percent and 30.0 percent, respectively. For the nine-month period ended September 30, 2007, the effective income tax rate declined to 28.0 percent, primarily due to recognition of tax benefits associated with the SICO Plans for which the compensation expense had been recognized in prior years. Such tax benefits amounted to $194 million for the nine-month period ended September 30, 2007.

Segment Results

The following table summarizes AIG s operations by major operating segment. (See also Note 2 of Notes to Consolidated Financial Statements.)

	Three Months Ended September 30,		Percentage Increase/	Nine Months Ended September 30,		Percentage Increase/
(in millions)	**2007**	2006	(Decrease)	**2007**	2006	(Decrease)
Revenues[(a)]:						
General Insurance[(b)]	**$ 12,758**	$ 12,615	1%	**$ 38,589**	$ 36,438	6%
Life Insurance & Retirement Services[(b)]	**12,632**	12,542	1	**40,337**	37,303	8
Financial Services[(c)(d)]	**2,785**	3,011	(8)	**7,109**	5,923	20
Asset Management	**1,824**	993	84	**5,721**	3,647	57
Other	**13**	215	(94)	**407**	443	(8)
Consolidation and eliminations	**(176)**	(129)	36	**(532)**	(375)	42
Consolidated	**$ 29,836**	$ 29,247	2%	**$ 91,631**	$ 83,379	10%
Operating income (loss)[(a)]:						
General Insurance[(b)]	**$ 2,439**	$ 2,625	(7)%	**$ 8,511**	$ 7,819	9%
Life Insurance & Retirement Services[(b)]	**1,999**	2,472	(19)	**6,900**	7,483	(8)
Financial Services[(c)(d)]	**669**	1,179	(43)	**1,008**	541	86
Asset Management	**419**	211	99	**2,541**	1,445	76
Other	**(627)**	(186)	237	**(1,557)**	(953)	63
Consolidation and eliminations	**(20)**			**(24)**		
Consolidated	**$ 4,879**	$ 6,301	(23)%	**$ 17,379**	$ 16,335	6%

(a) Includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), including the related foreign exchange gains and losses. For the three-month periods ended September 30, 2007 and 2006, respectively, the

effect was $(178) million and $165 million in both revenues and operating income. For the nine- month periods ended September 30, 2007 and 2006, respectively, the effect was $(1.06) billion and $(1.13) billion in both revenues and operating income. These amounts result primarily from interest rate and foreign currency derivatives that are hedging investments and borrowings. These gains (losses) for the three and nine months ended September 30, 2007 include out of period charges of $20 million and $346 million, respectively, including a $380 million charge in the nine months ended September 30, 2007 to reverse net gains recognized on transfers of available for sale securities among legal entities consolidated within AIGFP. The three and nine-month periods ended September 30, 2006 include an out of period gain of $115 million and a charge of $223 million related to the remediation of the material weakness in accounting for certain derivative transactions under FAS 133.

(b) Includes the effect of out of period UCITS adjustments. For the three and nine-month periods ended September 30, 2006, the effect was an increase of $92 million and $472 million, respectively, in both revenues and operating income for General Insurance and an increase of $24 million and $240 million, respectively, in revenues and $24 million and $169 million, respectively, in operating income for Life Insurance & Retirement Services.

(c) Includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three-month periods ended September 30, 2007 and 2006, respectively, the effect was $353 million, and $581 million in both revenues and operating income. For the nine-month periods ended September 30, 2007 and 2006, respectively, the effect was $(250) million and $(1.2) billion in both revenues and operating income. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings. The three and nine-month periods ended September 30, 2007 include out of period charges of $20 million and $346 million, respectively, as discussed above. The three and nine-month periods ended September 30, 2006 include an out of period gain of $115 million and a charge of $223 million as discussed above. In the first quarter of 2007, AIG began applying hedge accounting for certain transactions, primarily in its Capital Markets operations. In the second quarter of 2007, AGF and ILFC began applying hedge accounting to most of their derivatives hedging interest rate and foreign exchange risks associated with their floating rate and foreign currency denominated borrowings.

(d) For the three and nine-month periods ended September 30, 2007, both revenues and operating income include an unrealized market valuation loss of $352 million on AIGFP s super senior credit default swap portfolio.

General Insurance

AIG s General Insurance operations provide property and casualty products and services throughout the world. Foreign operations provided approximately 25 percent and 27 percent of General Insurance operating income for the three months ended September 30, 2007 and 2006, respectively, and approximately 28 percent and 31 percent for the nine months ended September 30, 2007 and 2006, respectively. The decrease in General Insurance operating income in the three-month period ended September 30, 2007 compared to the same period in 2006 was primarily attributable to operating losses from the Mortgage Guaranty business and a decline in operating income in the Foreign

General and Personal Lines businesses, partially offset by improved underwriting results for the Domestic Brokerage Group (DBG) and higher net investment income.

Operating income grew in the nine-month period ended September 30, 2007 compared to the same period of 2006, driven by strength in DBG, partially offset by operating losses from the Mortgage Guaranty business.

Life Insurance & Retirement Services

AIG s Life Insurance & Retirement Services operations provide insurance, financial and investment products throughout the world. Foreign operations provided approximately 87 percent and 65 percent of Life Insurance & Retirement Services operating income for the three months ended September 30, 2007 and 2006, respectively, and approximately 68 percent and 67 percent for the nine months ended September 30, 2007 and 2006, respectively. Operating income for the three months ended September 30, 2007 declined compared to the same period in 2006, primarily due to the securities market volatility which resulted in lower investment income and higher net realized capital losses compared to the same period in 2006. For the nine months ended September 30, 2007, operating income declined 8 percent compared to the same period in 2006 due to charges related to balance sheet reconciliation remediation, an industry-wide claims review in Japan, the effect of SOP 05-1, trading account losses and realized capital losses.

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 the three-month period and increased in the nine-month period ended September 30, 2007 compared to the same periods in 2006 due, in large part, to differences in the accounting treatment for hedging activities. In the first quarter of 2007, AIGFP began applying hedge accounting to certain of its interest rate swaps and foreign currency forward contracts that hedge its investments and borrowings. In the second quarter of 2007, AGF and International Lease Finance Corporation (ILFC) began applying hedge accounting to most of their derivatives that hedge interest rate and foreign currency denominated borrowings. Prior to 2007, hedge accounting under FAS 133 was not being applied to any of AIG s derivatives and related assets and liabilities. Accordingly, revenues and operating income were exposed to volatility resulting from differences in the timing of revenue recognition between the derivatives and the hedged assets and liabilities. During the three and nine-month periods ended September 30, 2007 operating income was also adversely affected by an unrealized market valuation loss of $352 million on AIGFP s super senior credit default swap portfolio.

ILFC generated strong operating income growth for the three and nine-month periods ended September 30, 2007 compared to the same periods in 2006, driven to a large extent by a larger aircraft fleet, higher lease rates and higher utilization.

AGF s operating income decreased in the three and nine months ended September 30, 2007, in large part due to the reduced residential mortgage origination volumes and lower revenues from its mortgage banking activities. Further, in the first nine months of 2007, AGF s mortgage banking operations recorded pre-tax charges of $178 million, representing the estimated cost of implementing the Supervisory Agreement entered into with the Office of Thrift Supervision (OTS), which are discussed in the Consumer Finance results of operations section.

Asset Management

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

Asset Management operating income increased for the three and nine-month periods ended September 30, 2007 compared to the same periods in 2006, primarily due to higher income from consolidated managed partnerships and funds that is entirely offset in Minority interest expense, which is not a component of operating income. Realized capital losses, principally relating to economically effective hedges not qualifying for hedge accounting, also increased for the three months ended September 30, 2007 compared to the same period in 2006. Asset Management operating income also increased for the nine-month period ended September 30, 2007 compared to the same period in 2006 due to increased investment income from consolidated managed partnerships and funds, and a realized capital gain of $398 million on the sale of a portion of AIG s investment in Blackstone Group, LP in connection with its initial public offering, as well as growth in both the Spread-Based Investment business and the Institutional Asset Management business.

Capital Resources

In the first nine months of 2007, AIG issued an aggregate of $4.49 billion of junior subordinated debentures in four series of securities. Substantially all of the proceeds from these sales, net of expenses, are being used to repurchase shares of AIG s common stock.

At September 30, 2007, AIG had total consolidated shareholders equity of $104.1 billion and total consolidated borrowings of $176.2 billion, of which $20.3 billion represented AIG s net borrowings. At that date, $155.9 billion of total borrowings represented obligations of

AIG s subsidiaries not guaranteed by AIG, matched borrowings by AIG parent or AIGFP, obligations of guaranteed investment agreements, junior subordinated debt, liabilities connected to trust preferred stock and hybrid financial instrument liabilities.

In February 2007, AIG s Board of Directors increased AIG s share repurchase program by authorizing the repurchase of shares with an aggregate purchase price of $8 billion. Share repurchases during 2007 are described under Capital Resources and Liquidity Share Repurchases and in Item 2. of Part II of this Quarterly Report on Form 10-Q.

Liquidity

AIG manages liquidity at both the subsidiary and parent company levels. At September 30, 2007, AIG s consolidated invested assets, primarily held by its subsidiaries, included $41.2 billion in cash and short-term investments. The increase in cash and short-term investments during the quarter was primarily the result of the steps AIG took to enhance the liquidity of its portfolios in light of the market disruption during the quarter. Consolidated net cash provided from operating activities in the first nine months of 2007 amounted to $27.1 billion. 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.

Reserves for Losses and Loss Expenses
(General Insurance):

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

Expected loss ratios for the latest accident year: in this case, accident year 2007 for the loss reserve analyses updated through September 30, 2007. 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.

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:

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 IDC, Bloomberg or Reuters or third-party broker/dealer quotes for use in its models. When such data is not available, AIG uses an internal methodology, which includes interpolation and extrapolation from verifiable recent prices.

Valuation models: utilizing factors, such as market prices, liquidity, commodity prices, credit spreads, and current interest, foreign exchange and volatility rates.

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 exists.

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.

Allowance for Finance Receivable Losses (Financial Services):

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

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

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

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

Operating Review

General Insurance Operations

AIG s General Insurance subsidiaries are multiple line companies writing substantially all lines of property and casualty insurance and various personal lines both domestically and abroad.

Domestic General Insurance operations are comprised of DBG, Reinsurance, Personal Lines and Mortgage Guaranty businesses.

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.

Transatlantic Holdings, Inc. (Transatlantic) subsidiaries offer reinsurance capacity on both a treaty and facultative basis both in the U.S. and abroad. Transatlantic structures programs for a full range of property and casualty products with an emphasis on specialty risk.

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

The main business of the UGC subsidiaries is the issuance of residential mortgage guaranty insurance that covers the first loss for credit defaults on high loan-to-value conventional first-lien mortgages for the purchase or refinance of one to four family residences. UGC subsidiaries also write second-lien and private student loan guaranty insurance.

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.

General Insurance Results

General Insurance operating income is comprised of statutory underwriting results, changes in DAC, net investment income and net realized capital gains and losses.

Operating income, as well as net premiums written, net premiums earned, net investment income and net realized capital gains (losses) and statutory ratios were as follows:

	Three Months Ended September 30,		**Percentage Increase/**	**Nine Months Ended September 30,**		**Percentage Increase/**
(in millions, except ratios)	**2007**	2006	**(Decrease)**	**2007**	2006	**(Decrease)**
Net premiums written:						
Domestic General						
DBG	**$ 6,012**	$ 6,071	(1)%	**$18,460**	$18,407	-%
Transatlantic	**985**	895	10	**2,952**	2,723	8
Personal Lines	**1,253**	1,162	8	**3,685**	3,540	4
Mortgage Guaranty	**303**	232	31	**841**	622	35
Foreign General	**3,270**	2,864	14	**10,130**	8,821	15
Total	**$11,823**	$11,224	5%	**$36,068**	$34,113	6%
Net premiums earned:						
Domestic General						
DBG	**$ 5,942**	$ 6,276	(5)%	**$17,919**	$17,863	-%
Transatlantic	**960**	895	7	**2,873**	2,712	6
Personal Lines	**1,193**	1,158	3	**3,516**	3,484	1
Mortgage Guaranty	**226**	191	18	**657**	536	23
Foreign General	**3,112**	2,697	15	**9,050**	7,770	16
Total	**$11,433**	$11,217	2%	**$34,015**	$32,365	5%
Net investment income:						
Domestic General						
DBG	**$ 854**	$ 880	(3)%	**$ 2,871**	$ 2,438	18%
Transatlantic	**113**	107	6	**348**	317	10
Personal Lines	**59**	56	5	**173**	168	3
Mortgage Guaranty	**42**	35	20	**118**	103	15
Foreign General[(a)]	**325**	291	12	**1,071**	1,075	-
Reclassifications and Eliminations	**1**	1	-	**4**	1	-
Total	**$ 1,394**	$ 1,370	2%	**$ 4,585**	$ 4,102	12%
Net realized capital gains (losses)	**$ (69)**	$ 28	-%	**$ (11)**	$ (29)	(62)%
Operating Income (loss):						
Domestic General						

DBG	**$ 1,829**	$ 1,543	19%	**$ 5,662**	$ 4,322	31%
Transatlantic	**189**	143	32	**508**	427	19
Personal Lines	**28**	133	(79)	**252**	352	(28)
Mortgage Guaranty	**(216)**	85	-	**(289)**	301	-
Foreign General[a]	**607**	721	(16)	**2,383**	2,415	(1)
Reclassifications and Eliminations	**2**	-	-	**(5)**	2	-
Total	**$ 2,439**	$ 2,625	(7)%	**$ 8,511**	$ 7,819	9%
Statutory underwriting profit (loss)[b] :						
Domestic General						
DBG	**$ 1,014**	$ 666	52%	**$ 2,744**	$ 1,791	53%
Transatlantic	**53**	34	56	**106**	97	9
Personal Lines	**(40)**	83	-	**49**	176	(72)
Mortgage Guaranty	**(270)**	48	-	**(438)**	191	-
Foreign General	**266**	391	(32)	**1,039**	1,147	(9)
Total	**$ 1,023**	$ 1,222	(16)%	**$ 3,500**	$ 3,402	3%
Domestic General:						
Loss Ratio	**69.2**	67.0		**68.8**	69.0	
Expense Ratio	**21.1**	23.7		**20.5**	21.2	
Combined Ratio	**90.3**	90.7		**89.3**	90.2	
Foreign General:						
Loss Ratio	**52.4**	48.4		**51.7**	48.7	
Expense Ratio	**37.1**	35.0		**32.9**	32.2	
Combined ratio	**89.5**	83.4		**84.6**	80.9	
Consolidated:						
Loss Ratio	**64.7**	62.6		**64.3**	64.1	
Expense Ratio	**25.5**	26.5		**24.0**	24.1	
Combined Ratio	**90.2**	89.1		**88.3**	88.2	

(a) The three and nine-month periods ended September 30, 2006 include increases of $22 million and $406 million, respectively, relating to an out of period UCITS adjustment.

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American International Group, Inc. and Subsidiaries

(b) 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:

(in millions)	Domestic Brokerage Group	Transatlantic	Personal Lines	Mortgage Guaranty	Foreign General	Reclassifications and Eliminations	Total
Three Months Ended September 30, 2007:							
Statutory underwriting profit (loss)	**$ 1,014**	**$ 53**	**$ (40)**	**$ (270)**	**266**	**$**	**$ 1,023**
Increase (decrease) in DAC	**21**	**8**	**9**	**13**	**40**		**91**
Net investment income	**854**	**113**	**59**	**42**	**325**	**1**	**1,394**
Net realized capital gains (losses)	**(60)**	**15**		**(1)**	**(24)**	**1**	**(69)**
Operating income (loss)	**$ 1,829**	**$ 189**	**$ 28**	**$ (216)**	**607**	**$ 2**	**$ 2,439**
Three Months Ended September 30, 2006:							
Statutory underwriting profit (loss)	$ 666	$ 34	$ 83	$ 48	$ 391	$	$ 1,222
Increase (decrease) in DAC	(29)		(6)	2	38		5
Net investment income	880	107	56	35	291	1	1,370
Net realized capital gains (losses)	26	2			1	(1)	28
Operating income (loss)	$ 1,543	$ 143	$ 133	$ 85	$ 721	$	$ 2,625
Nine Months Ended September 30, 2007:							
Statutory underwriting profit (loss)	**$ 2,744**	**$ 106**	**$ 49**	**$ (438)**	**1,039**	**$**	**$ 3,500**
Increase (decrease) in DAC	**106**	**22**	**31**	**34**	**244**		**437**

Net investment income	**2,871**	**348**	**173**	**118**	**1,071**	**4**	**4,585**
Net realized capital gains (losses)	**(59)**	**32**	**(1)**	**(3)**	**29**	**(9)**	**(11)**
Operating income (loss)	**$ 5,662**	**$ 508**	**$ 252**	**$ (289)**	**2,383**	**$ (5)**	**$ 8,511**
Nine Months Ended September 30, 2006:							
Statutory underwriting profit (loss)	$ 1,791	$ 97	$ 176	$ 191	$ 1,147	$	$ 3,402
Increase (decrease) in DAC	64	7	8	10	255		344
Net investment income	2,438	317	168	103	1,075	1	4,102
Net realized capital gains (losses)	29	6		(3)	(62)	1	(29)
Operating income (loss)	$ 4,322	$ 427	$ 352	$ 301	$ 2,415	$ 2	$ 7,819

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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	**2007**	2006
Growth in original currency*	**4.3%**	8.5%	**4.6%**	8.1%
Foreign exchange effect	**1.0**	0.3	**1.1**	(0.6)
Growth as reported in U.S. dollars	**5.3%**	8.8%	**5.7%**	7.5%

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

Quarterly General Insurance Results

General Insurance operating income decreased in the three months ended September 30, 2007 compared to the same period in 2006. The 2007 combined ratio increased to 90.2, an increase of 1.1 points over 2006, including an increase in the loss ratio of 2.1 points. The loss ratio for accident year 2007 recorded in the three months ended September 30, 2007 was 4.5 points higher than the loss ratio recorded in the three months ended September 30, 2006 for accident year 2006. Increases in Mortgage Guaranty losses accounted for 3.1 points of the higher accident year loss ratio. The downward cycle in the U.S. housing market is not expected to improve until residential inventories return to a more normal level, and AIG expects that this downward cycle will continue to adversely affect UGC s loss ratios for the foreseeable future.

The higher accident year loss ratio was partially offset by favorable development on prior years and increases in the loss reserve discount, reducing losses by $377 million and $41 million for three months ended September 30, 2007

and 2006, respectively. The three months ended September 30, 2006, included an increase to Other expenses of $225 million in connection with balance sheet reconciliation remediation activities which accounted for 2.0 points of the decrease in the expense ratio in the three months ended September 30, 2007 compared to the same period in 2006.
Net premiums written increased for the three months ended September 30, 2007 compared to the same period in 2006, driven by Foreign General growth from both established and new distribution channels and the effect of changes in foreign currency exchange rates.

General Insurance net investment income was essentially unchanged for the three months ended September 30, 2007 compared to the same period in 2006, which included an out of period increase to Net investment income of $213 million related to the accounting for UCITS and additional partnership income arising from improved valuations. Interest and dividend income increased $244 million for the third quarter of 2007 compared to the same period in 2006 as investment in fixed maturities and equity securities increased by $12.0 billion from the investment of operating cash flow and the yield on interest earning investments increased 30 basis points to 4.8 percent. Income from partnership investments increased $10 million for the three months ended September 30, 2007 compared to the same period in 2006, primarily due to improved returns on underlying investments. Other investment income decreased $290 million, primarily due to declining returns on investments in mutual funds and the effect of the $92 million out of period adjustment related to the accounting for UCITS recorded in 2006.

Year-to-Date General Insurance Results

General Insurance operating income increased for the first nine months of 2007 compared to the same period in 2006 due to growth in net investment income and an increase in underwriting profit, driven by an increase in earned premiums as the combined ratio was substantially the same for both periods. The loss ratio for accident year 2007 recorded in the first nine months of 2007 was 1.2 points higher than the loss ratio recorded in the first nine months of 2006 for accident year 2006, primarily due to an increase in Mortgage Guaranty losses in the 2007 period. The higher accident year loss ratio was substantially offset by favorable development on prior years and increases in the loss reserve discount, which combined to reduce losses by $720 million and $255 million in the first nine months of 2007 and 2006, respectively.

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

General Insurance net investment income increased in the first nine months of 2007 to $4.6 billion. Interest and dividend income increased $577 million for the first nine months of 2007 compared to the same period of 2006 as fixed maturities and equity securities increased by $15.3 billion and the yield increased 20 basis points to 4.7 percent. Income from partnership investments increased $312 million for the first nine months of 2007 compared to the same period in 2006, primarily due to improved returns on underlying investments and higher levels of invested assets, which increased by $1.2 billion. Other investment income decreased by $444 million, which reflects the effect of the $472 million out of period UCITS adjustment recorded in 2006. See also Capital Resources and Liquidity and Invested Assets herein.

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

Quarterly DBG Results

DBG s operating income increased in the three months ended September 30, 2007 compared to the same period of 2006. The improvement is also reflected in the combined ratio, which declined 7.4 points in the three months ended September 30, 2007 compared to the same period of 2006 due to an improvement in the loss ratio of 3.7 points and an improvement in the expense ratio of 3.7 points. Favorable prior year development and increases in the loss reserve discount reduced incurred losses by $353 million and increased incurred losses by $67 million for the three months ended September 30, 2007 and 2006, respectively, accounting for 7.0 points of the improvement. The loss ratio for accident year 2007 recorded in the three months ended September 30, 2007 was 1.6 points higher than the loss ratio recorded in the same period of 2006 for accident year 2006. The expected loss ratios for accident year 2006 were reduced for a number of casualty classes of business in the three-month period ended September 30, 2006, accounting for most of the change in the accident year loss ratio compared to the same period in 2006. Net premiums earned in the three months ended September 30, 2006 included a favorable out of period adjustment of $155 million which reduced the loss ratio by 1.7 points.

DBG s net premiums written declined for the three months ended September 30, 2007 compared to the same period in 2006 due to an increase in ceded premiums and declines in premium rates in casualty lines of business. Ceded premiums as a percentage of gross written premiums increased to 24 percent for the three months ended September 30, 2007 compared to 23 percent in the same period in 2006, primarily due to additional reinsurance for property risks to manage catastrophe exposures.

DBG s expense ratio decreased to 19.2 for the three months ended September 30, 2007 compared to 23.0 in the same period in 2006, primarily due to a decrease in charges related to remediation of the material weakness in balance sheet reconciliations which included a $225 million out of period charge in the third quarter of 2006.

DBG s net investment income decreased for the three months ended September 30, 2007 compared to the same period in 2006, which included out of period increases in partnership and other investment income of $121 million and $70 million, respectively. Interest income increased $139 million for the three months ended September 30, 2007, on growth in the bond portfolio resulting from investment of operating cash flows and capital contributions. Income from partnership investments increased $16 million for the three months ended September 30, 2007 compared to the same period in 2006, primarily due to improved returns on the underlying investments.

*Year-to-*date DBG Results

DBG s operating income increased for the first nine months of 2007 compared to the same period in 2006 due to growth in both net investment income and underwriting profit. The improvement is also reflected in the combined ratio, which declined 5.2 points in the first nine months of 2007 compared to the same period in 2006, primarily due to an improvement in the loss ratio of 4.2 points. The loss ratio for accident year 2007 recorded for the first nine months of 2007 was 0.5 points lower than the loss ratio recorded in the same period of 2006 for accident year 2006. The loss ratio for accident year 2006 has subsequently improved in each quarter since September 30, 2006. Prior year development and increases in the loss reserve discount reduced incurred losses by $630 million for the nine months ended September 30, 2007 and increased incurred losses by $35 million for the same period in 2006, accounting for 3.7 points of the improvement.

DBG s net premiums written was essentially unchanged in the first nine months of 2007 compared to the same period of 2006. Ceded premiums as a percentage of gross written premiums increased to 25 percent in the first nine months of 2007 compared to 23 percent for the same period in 2006, primarily due to additional reinsurance for property risks to manage catastrophe exposures.

DBG s expense ratio decreased to 18.6 for the first nine months in 2007 compared to 19.7 in the same period of 2006, primarily due to the 2006 charge related to the remediation of the material weakness in internal control over certain balance sheet reconciliations that accounted for 1.6 points of the decline. The decline was partially offset by increases in operating expenses for marketing initiatives and operations as well as changes in the mix of business towards products with lower loss ratios and higher expense ratios.

DBG s net investment income increased for the first nine months of 2007 compared to the same period in 2006, as interest income increased $334 million for the nine months ended September 30, 2007, on growth in the bond portfolio resulting from investment of operating cash flows and capital contributions. Income from partnership investments increased $215 million for the first nine months of 2007 compared to the same period in 2006, primarily due to improved returns on the underlying investments. Other investment income declined $133 million in the first nine months of 2007 compared to the same period in 2006, primarily due to the out of period adjustment of $151 million recorded in the 2006 period.

Quarterly Transatlantic Results

Transatlantic s net premiums written and net premiums earned increased for the three months ended September 30, 2007 compared to the same period in 2006 due primarily to increased writings in domestic and international operations and the strengthening of certain foreign currencies against the U.S. dollar. Statutory underwriting profit increased due to improved underwriting results from domestic operations for the three months ended September 30, 2007 compared to the same period in 2006. Operating income increased for the three months ended September 30, 2007 compared to the same period in 2006 due primarily to increased net investment income, improved underwriting results and increased net realized capital gains.

*Year-to-*date Transatlantic Results

Transatlantic s net premiums written and net premiums earned increased for the first nine months of 2007 compared to the same period in 2006 due primarily to increased writings in domestic operations. The increase in statutory underwriting profit in the nine months ended September 30, 2007 compared to the same period in 2006 reflects improved underwriting results in Domestic and European operations. Overall, costs from European windstorms and floods and storms in Australia in the nine months ended September 30, 2007 were largely offset by lower estimated net adverse development, related to losses occurring in prior years, compared to the same period of 2006. Operating income increased for the first nine months of 2007 compared to the same period in 2006 due principally to increased net investment income, improved underwriting results and net realized capital gains.

Quarterly Personal Lines Results

Personal Lines operating income for the three months ended September 30, 2007 was $28 million, a decrease of $105 million compared to the same period in 2006, primarily due to a $53 million increase in incurred losses resulting from a change in prior year reserve development, mainly from discontinued businesses, and $28 million of transaction and integration costs related to the acquisition of the minority interest in 21st Century Insurance Group (21st Century), as discussed below. The loss ratio for accident year 2007 recorded for the three months ended September 30, 2007 was 3.21 points higher than the loss ratio for the same period in 2006 primarily due to increasing accident frequency trends in the direct businesses coupled with a decline in average premium, and increasing loss frequencies in the homeowners line of the Private Client Group segment. Prior year development increased incurred losses by $32 million for the three months ended September 30, 2007 and decreased incurred losses by $21 million for the three months ended September 30, 2006, thereby increasing the 2007 loss ratio by 4.52 points relative to the 2006 loss ratio. The transaction and integration costs related to the 21st Century acquisition increased the expense ratio in the third quarter of 2007 by 2.2 points compared to the same period of 2006.

Net premiums written increased 7.8 percent for the three months ended September 30, 2007 compared to the same period of 2006, which represents the highest growth rate since the third quarter of 2005. This increase resulted from continued growth in the Private Client Group, as well as growth in Agency Auto and the Direct segment.

On September 27, 2007, AIG completed its previously announced acquisition of 21st Century. AIG paid $759 million to acquire the remaining 39.2 percent of the shares of 21st Century that it did not previously own. As a result of the acquisition, the AIG Direct and 21st Century operations will be combined as aigdirect.com. Duplicate positions which exist in both the home office and corporate functions and in the field organization will be eliminated. These positions, as well as the locations scheduled for closing over the next two years, have been identified and will affect about 11 percent of the combined workforce.

Under the purchase method of accounting, the assets and liabilities of 21st Century that were acquired were adjusted to their estimated fair values as of the date of the acquisition, and goodwill of $233 million was recorded. A customer relationship intangible asset, initially valued at $290 million, was also established.

*Year-to-*date Personal Lines Results

Personal Lines operating income for the nine months of 2007 was $252 million, a decrease of $100 million compared to the same period in 2006, primarily due to $55 million of less favorable reserve development and $31 million of transaction and integration costs related to the 21st Century acquisition. The loss ratio for accident year 2007 recorded for the first nine months of 2007 increased by 0.36 points compared to the same period in 2006 for accident year 2006. Favorable prior year development reduced incurred losses by $29 million and $84 million for the nine months ended September 30, 2007 and 2006, respectively, resulting in a 1.57 point increase in the loss ratio for the first nine months of 2007 compared to the same period of 2006. The 0.9 point increase in the expense ratio was primarily due to the transaction and integration costs associated with the 21st Century acquisition.

Net premiums written increased 4.1 percent for the first nine months of 2007 compared to the same period in 2006 due to continued growth in the Private Client Group and an increase in the aigdirect.com business, partially offset by a reduction in the Agency Auto segment.

Quarterly Mortgage Guaranty Results

Mortgage Guaranty reported an operating loss of $216 million for the three months ended September 30, 2007 compared to operating income of $85 million in the same period in 2006 due to the unfavorable loss experience in both the domestic first and second-lien businesses as continued deterioration in the U.S. housing market increased the frequency and severity of claims. The second-lien product was the major contributor to the operating loss, comprising $206 million of the third quarter 2007 operating loss. UGC s consolidated loss ratio for the third quarter of 2007 was 197.0 compared to a loss ratio of 47.5 in the same period of 2006. Prior year development reduced incurred losses by $27 million and $22 million for the three months ended September 30, 2007 and 2006, respectively, decreasing the 2007 loss ratio by 0.4 points relative to the 2006 loss ratio.

Net premiums written increased 31 percent in the three months ended September 30, 2007 compared to the same period in 2006 as strong growth in the European markets, Canada and Australia led to higher International premiums of $55 million. The increased use of mortgage insurance for credit enhancement, along with improved persistency, led to higher domestic first-lien premiums of $32 million, an increase of 27 percent compared to the 2006 quarter. Although UGC discontinued accepting new business for the poorly performing third-party originated second-lien product in the fourth quarter of 2006, UGC will continue to receive renewal premiums on the existing portfolio for the life of the loans, estimated to be three to five years. The expense ratio of 16.8 points in the three months ended September 30, 2007 declined from 22.5 points in the same period of 2006 as premium growth offset the effect of increased expenses related to UGC s international expansion and the employment of additional operational resources in the second-lien business.

UGC s domestic mortgage risk in force totaled $28.2 billion as of September 30, 2007 and the 60-day delinquency ratio was 3.0 percent (based on number of policies, consistent with mortgage industry practice) compared to domestic mortgage risk in force of $24.2 billion and a delinquency ratio of 2.0 percent at September 30, 2006. Approximately 81 percent of the domestic mortgage risk is secured by first-lien, owner-occupied properties.

Year-to-date Mortgage Guaranty Results

Mortgage Guaranty s operating loss for the first nine months of 2007 was $289 million compared to operating income of

$301 million for the same period in 2006 as the deteriorating U.S. residential housing market adversely affected losses incurred for both the domestic first-lien and second-lien businesses. Domestic first and second-lien losses incurred increased 254 percent and 611 percent respectively, compared to the first nine months of 2006, resulting in year-to-date loss ratios of 87.6 and 343.1, respectively, for the first nine months of 2007. Increases in domestic losses incurred resulted in a consolidated UGC loss ratio of 140.9 for the first nine months of 2007 compared to 37.4 for the same period in 2006. Prior year development had minimal effect on incurred losses in the first nine months of 2007 compared to a reduction of $86 million for the same period in 2006, which accounted for 16 points of the increase in the loss ratio.

Net premiums written increased 35 percent in the nine months ended September 30, 2007 compared to the same period in 2006 primarily due to growth in the International markets, accounting for 22 percent of the increase in net written premiums. In addition the increased use of mortgage insurance for credit enhancement as well as better persistency resulted in an increase in domestic first-lien premiums. The expense ratio for the first nine months of 2007 was 20.2, down from 23.3 in the same period in 2006 as premium growth offset the effect of increased expenses related to UGC s international expansion.

Quarterly Foreign General Insurance Results

Foreign General s operating income decreased in the three months ended September 30, 2007 compared to the same period in 2006 due to decreases in statutory underwriting profit, partially offset by increases in net investment income and the effect of changes in the currency exchange rates of the Euro and the British Pound. Statutory underwriting profit decreased due to lower favorable loss development on prior accident years of $49 million, additional losses from the June 2007 U.K. floods of $23 million and an increase over the 2006 quarter in severe but non-catastrophic losses of $20 million.

Net premiums written increased 14 percent (11 percent in original currency) for the three months ended September 30, 2007 compared to the same period in 2006, reflecting growth in commercial and consumer lines driven by new business from both established and new distribution channels, including Central Insurance Co. Ltd. in Taiwan. Net premiums written for commercial lines in the U.K. and Europe increased due to new business and decreases in the use of reinsurance, partially offset by declines in premium rates. Growth in consumer lines in Latin America, Asia and Europe also contributed to the increase. Net premiums written also increased by one percent compared to the same period in 2006 due to decreases in the use of reinsurance. Net premiums for the Lloyd s syndicate Ascot and Aviation declined due to rate decreases resulting from increased market competition.

The loss ratio increased 4.0 points for the three months ended September 30, 2007 compared to the same period in 2006. The 2007 loss ratio increased a total of 3.3 points due to the losses described above. The lower favorable loss development on prior accident years was primarily due to increases in the allowance for reinsurance. Also, the loss ratio increased due to higher loss frequency for personal accident businesses in Japan.

The expense ratio increased 2.1 points for the three months ended September 30, 2007 compared to the same period in 2006 due to higher operating expenses relating to new business initiatives. In addition, the 2007 expense ratio increased 1.2 points due to accelerated amortization of advertising costs, the cost of realigning certain legal entities through which Foreign General operates and the increased significance of consumer lines of business, which have higher acquisition costs. AIG expects the expense ratio to increase in the fourth quarter of 2007 as a result of expected decreases in net premiums written due to continuing rate pressures in the commercial lines business, the underlying seasonality of renewals and the growth of the consumer lines of business.

Net investment income increased for the three months ended September 30, 2007 compared to the same period of 2006 reflecting higher interest rates and strong cash flows, partially offset by reductions in mutual fund income. Mutual fund income was $61 million lower than the same quarter in 2006 reflecting a weaker performance in the equity markets and income of $22 million from an out of period UCITS adjustment in the year ago quarter.

Year-to-date Foreign General Insurance Results

Foreign General s operating income decreased in the first nine months of 2007 compared to the same period in 2006, due primarily to decreases in statutory underwriting profits. Statutory underwriting profit decreased due to lower favorable loss development on prior accident years of $101 million, losses from the June 2007 U.K. floods of

$91 million, and an increase in severe but non-catastrophic losses of $48 million compared to the same period in 2006. Net investment income in the nine months ended September 30, 2006 included income of $406 million from out of period UCITS adjustments.

Net premiums written increased 15 percent (11 percent in original currency) for the nine months ended September 30, 2007 compared to the same period in 2006, reflecting growth in commercial and consumer lines driven by new business from both established and new distribution channels.

The loss ratio increased 3.0 points for the nine months ended September 30, 2007 compared to the same period in 2006. The 2007 loss ratio increased 2.6 points, due to the losses described above.

The expense ratio increased 0.7 points for the nine months ended September 30, 2007 compared to the same period in 2006 due to higher commission costs and higher operating expenses resulting from new business initiatives and the costs to realign certain legal entities.

Net investment income was essentially unchanged in the nine months ended September 30, 2007 compared to the same period of 2006 as the 2006 period included the out of period UCITS adjustments, which more than offset increased investment income of $402 million reflecting higher interest rates, strong cash flows and increased partnership and mutual fund income. Partnership income was $97 million higher than prior year due to strong infrastructure fund performance in Africa, Europe and Latin America. Mutual fund income was $117 million higher than the same period of the prior year reflecting strong performance in the equity markets for the nine month period.

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 September 30, 2007 and December 31, 2006 by major line of business on a statutory Annual Statement basis[(a)]:

(in millions)		**September 30, 2007**		December 31, 2006[(b)]
Other liability occurrence	**$**	**20,296**	$	19,327
Workers compensation		**14,994**		13,612
Other liability claims made		**13,546**		12,513
Auto liability		**6,208**		6,070
International		**6,173**		6,006
Property		**4,431**		5,499
Reinsurance		**3,371**		2,979
Medical malpractice		**2,349**		2,347
Products liability		**2,181**		2,239
Accident and health		**1,901**		1,693
Commercial multiple peril		**1,744**		1,651
Aircraft		**1,715**		1,629
Fidelity/surety		**1,248**		1,148
Other		**3,451**		3,286
Total	**$**	**83,608**	$	79,999

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

(b) *Allocations among various lines were revised from the previous presentation.*

AIG s gross reserve for losses and loss expenses represents the accumulation of estimates of ultimate losses, including provisions for losses incurred but not reported (IBNR) and loss expenses. The methods used to determine loss reserve estimates and to establish the resulting reserves are continually reviewed and updated by management. Any adjustments resulting therefrom are reflected in operating income currently. Because loss reserve estimates are subject to the outcome of future events, changes in estimates are unavoidable given that loss trends vary and time is often required for changes in trends to be recognized and confirmed. Reserve changes that increase previous estimates of ultimate cost are referred to as unfavorable or adverse development or reserve strengthening. Reserve changes that decrease previous estimates of ultimate cost are referred to as favorable development.

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

At September 30, 2007, General Insurance net loss reserves were $66.94 billion, an increase of $4.31 billion from the prior year-end. 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:

(in millions)	**September 30, 2007**	December 31, 2006
DBG[(a)]	**$ 46,511**	$ 44,119
Transatlantic	**6,669**	6,207
Personal Lines[(b)]	**2,313**	2,440
Mortgage Guaranty	**1,016**	460
Foreign General[(c)]	**10,428**	9,404
Total Net Loss Reserve	**$ 66,937**	$ 62,630

(a) At September 30, 2007 and December 31, 2006, respectively, DBG loss reserves include approximately $3.16 billion and $3.33 billion ($3.40 billion and $3.66 billion, respectively, before discount), related to business written by DBG but ceded to American International Reinsurance Company Limited (AIRCO) and reported in AIRCO s statutory filings. DBG loss reserves also include approximately $573 million and $535 million related to business included in American International Underwriters Overseas, Ltd. s (AIUO) statutory filings at September 30, 2007 and December 31, 2006, respectively.

(b) At September 30, 2007 and December 31, 2006, respectively, Personal Lines loss reserves include $844 million and $861 million related to business ceded to DBG and reported in DBG s statutory filings.

(c) At September 30, 2007 and December 31, 2006, respectively, Foreign General loss reserves include approximately $3.05 billion and $2.75 billion related to business reported in DBG s statutory filings.

The DBG net loss reserve of $46.5 billion is comprised principally of the business of AIG subsidiaries participating in

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the American Home Assurance Company (American Home)/ National Union Fire Insurance Company of Pittsburgh, Pa. (National Union) pool (10 companies) and the surplus lines pool (Lexington, AIG Excess Liability Insurance Company and Landmark Insurance Company).

DBG cedes a quota share percentage of its other liability occurrence and products liability occurrence business to AIRCO. The quota share percentage ceded was 15 percent for the nine months ended September 30, 2007 and 20 percent for the year 2006 and covered all business written in these years for these lines by participants in the American Home/National Union pool. AIRCO s loss reserves relating to these quota share cessions from DBG are recorded on a discounted basis. As of September 30, 2007, AIRCO carried a discount of approximately $240 million applicable to the $3.40 billion in undiscounted reserves it assumed from the American Home/ National Union pool via this quota share cession. AIRCO also carries approximately $523 million in net loss reserves relating to Foreign General insurance business. These reserves are carried on an undiscounted basis.

The companies participating in the American Home/National Union pool have maintained a participation in the business written by AIU for decades. As of September 30, 2007, these AIU reserves carried by participants in the American Home/ National Union pool totaled approximately $3.05 billion. The remaining Foreign 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 September 30, 2007 by AIUO and AIRCO were approximately $5.04 billion and $3.69 billion, respectively. AIRCO s $3.69 billion in total general insurance reserves consist of approximately $3.16 billion from business assumed from the American Home/National Union pool and an additional $523 million relating to Foreign General Insurance business.

Discounting of Reserves

At September 30, 2007, AIG s overall General Insurance net loss reserves reflect a loss reserve discount of $2.43 billion, including tabular and non-tabular calculations. The tabular workers compensation discount is calculated using a 3.5 percent interest rate and the 1979-81 Decennial Mortality Table. The non-tabular workers compensation discount is calculated separately for companies domiciled in New York and Pennsylvania, and follows the statutory regulations for each state. For New York companies, the discount is based on a five percent interest rate and the companies own payout patterns. For Pennsylvania companies, the statute has specified discount factors for accident years 2001 and prior, which are based on a six percent interest rate and an industry payout pattern. For accident years 2002 and subsequent, the discount is based on the yield of U.S. Treasury securities ranging from one to twenty years and the company s own payout pattern, with the future expected payment for each year using the interest rate associated with the corresponding Treasury security yield for that time period. The discount is comprised of the following: $726 million tabular discount for workers compensation in DBG; $1.46 billion non-tabular discount for workers compensation in DBG; and, $240 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 $12.7 billion as of September 30, 2007. The other liability occurrence and products liability occurrence business in AIRCO that is assumed from DBG is discounted based on the yield of U.S. Treasury securities ranging from one to twenty years and the DBG payout pattern for this business. The undiscounted reserves assumed by AIRCO from DBG totaled approximately $3.40 billion at September 30, 2007.

Quarterly Reserving Process

Management believes that the General Insurance net loss reserves are adequate to cover General Insurance net losses and loss expenses as of September 30, 2007. While AIG regularly reviews the adequacy of established loss reserves, there can be no assurance that AIG s ultimate loss reserves will not develop adversely and materially exceed AIG s loss reserves as of September 30, 2007. In the opinion of management, such adverse development and resulting increase in reserves is not likely to have a material adverse effect on AIG s consolidated financial condition, although it could have a material adverse effect on AIG s consolidated results of operations for an individual reporting period.

The following table presents the reconciliation of net loss reserves:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	**2007**	2006	**2007**	2006
Net reserve for losses and loss expenses at beginning of period	**$ 65,197**	$ 60,214	**$ 62,630**	$ 57,476
Foreign exchange effect	**224**	34	**438**	521
Acquisition*		55		55
Losses and loss expenses incurred:				
Current year	**7,636**	6,957	**22,185**	20,710
Prior years, other than accretion of discount	**(337)**	(41)	**(605)**	(255)
Prior years, accretion of discount	**92**	101	**220**	303
Losses and loss expenses incurred	**7,391**	7,017	**21,800**	20,758
Losses and loss expenses paid	**5,875**	5,807	**17,931**	17,297
Net reserve for losses and loss expenses at end of period	**$ 66,937**	$ 61,513	**$ 66,937**	$ 61,513

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	**2007**	2006	**2007**	2006
Prior Accident Year Development by Reporting Unit:				
DBG	**$ (313)**	$ 67	**$ (465)**	$ 35
Personal Lines	**32**	(21)	**(29)**	(84)
Mortgage Guaranty	**(27)**	(22)		(86)

Foreign General		**(40)**		(89)		**(108)**		(209)
Subtotal		**(348)**		(65)		**(602)**		(344)
Transatlantic		**11**		24		**47**		89
Asbestos settlements*						**(50)**		
Prior years, other than accretion of discount	**$**	**(337)**	$	(41)	**$**	**(605)**	$	(255)

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

	Calendar Year			
(in millions)		**2007**		2006
Prior Accident Year Development by Accident Year:				
2006	**$**	**(898)**		
2005		**(373)**	$	(638)
2004		**(248)**		(416)
2003		**143**		(233)
2002		**200**		156
2001 & prior		**571**		876
Prior years, other than accretion of discount	**$**	**(605)**	$	(255)

In determining the quarterly loss development from prior accident years, AIG conducts analyses to determine the change in estimated ultimate loss for each accident year for each profit center. For example, if loss emergence for a profit center is different than expected for certain accident years, the actuaries examine the indicated effect such emergence would have on the reserves of that profit center. In some cases, the higher or lower than expected emergence may result in no clear change in the ultimate loss estimate for the accident years in question, and no adjustment would be made to the profit center s reserves for prior accident years. In other cases, the higher or lower than expected emergence may result in a larger change, either favorable or unfavorable, than the difference between the actual and expected loss emergence. Such additional analyses were conducted for each profit center, as appropriate, in the third quarter of 2007 to determine the loss development from prior accident years for the third quarter of 2007. As part of its quarterly reserving process, AIG also considers notices of claims received with respect to emerging issues, such as those related to the U.S. mortgage and housing market. Also as part of the quarterly reserving process, beginning with the second quarter of 2007, AIG updated its analysis of the loss reserve discount pertaining to workers compensation reserves. Historically, this review was only performed at year end. As a result of the updated analysis in the third quarter of 2007, AIG increased its loss reserve discount for workers compensation by approximately $70 million in the third quarter of 2007, bringing the total increase in loss reserve discount for workers compensation for the first nine months of 2007 to approximately $255 million.

2007 Net Loss Development

In the three months ended September 30, 2007, net loss development from prior accident years was favorable by approximately $337 million, including approximately $11 million of adverse development from the general reinsurance operations of Transatlantic; and excluding approximately $92 million from accretion of loss reserve discount. Excluding Transatlantic, as well as accretion of discount, net loss development in the three months ended September 30, 2007 from prior accident years was favorable by approximately $348 million. The overall favorable development of $337 million consisted of approximately $764 million of favorable development from accident years 2004 through 2006, partially offset by approximately $299 million of adverse development from accident years 2002 and prior and $128 million of adverse development from accident year 2003. For the three months ended September 30, 2007, most classes of AIG s business continued to experience favorable development for accident years 2004 through 2006. The majority of the adverse development from accident years 2002 and prior was related to developments from excess casualty business within DBG and from Transatlantic. The adverse development from accident year 2003 was primarily related to developments from excess casualty business within DBG, which represented less than a 1 percent change in the ultimate loss estimate for accident year 2003. In the three months ended September 30, 2007, AIG completed an update of its ground up projections of claims exposure for the D&O and related management liability classes of business. AIG utilizes the ultimate loss estimates resulting from these claims projections as a benchmark in determining the appropriate loss reserves for this business. As a result of the updated claims projections, in addition to the quarterly review of reported loss experience as of September 30, 2007 and other relevant factors, AIG recognized approximately $150 million in favorable loss development from prior accident years for the D&O and related management liability classes of business in the three months ended September 30, 2007. This consisted of approximately $200 million of favorable development from accident years 2004 through 2006, partially offset by approximately $50 million of adverse development from accident years 2002 and prior. The overall favorable development of $337 million reflects this $150 million from the D&O and related management liability classes of business within DBG.

In the first nine months of 2007, net loss development from prior accident years was favorable by approximately $605 million, including approximately $47 million of adverse development from the general reinsurance operations of Transatlantic; and excluding approximately $220 million from accretion of loss reserve discount. Excluding Transatlantic, as well as accretion of discount, net loss development in the first nine months of 2007 from prior accident years was favorable by approximately $652 million. The overall favorable development of $605 million consisted of approximately $1.52 billion of favorable development from accident years 2004 through 2006, partially offset by approximately $771 million of adverse development from accident years 2002 and prior and $143 million of adverse development from accident year 2003. For the first nine months of 2007, most classes of AIG s business continued to experience favorable development for accident years 2004 through 2006. The majority of the adverse development from accident years 2002 and prior was related to development from excess casualty business within DBG and from Transatlantic. The adverse development from accident year 2003 was primarily related to developments from excess casualty business within DBG. The overall favorable development of $605 million includes approximately $200 million pertaining to the D&O and related management liability classes of business within DBG, consisting of approximately $235 million of favorable development from accident years 2004 through 2006, partially offset by approximately $35 million of adverse development from accident years 2002 and prior.

2006 Net Loss Development

In the three months ended September 30, 2006, net loss development from prior accident years was favorable by approximately $41 million, including approximately $43 million of adverse development pertaining to the major hurricanes in 2005 and 2004 and $24 million of adverse development pertaining to the general reinsurance operations of Transatlantic. Excluding catastrophes and Transatlantic, as well as accretion of discount of approximately $101 million, net loss development from prior accident years in the three months ended September 30, 2006 was favorable by approximately $108 million. This overall favorable development of $41 million consisted of approximately $511 million of favorable development from accident years 2003 through 2005, partially offset by approximately $470 million of adverse development from accident years 2002 and prior. For the three months ended September 30, 2006, most classes of business throughout AIG experienced favorable development for accident years 2003 through 2005. The adverse development from accident years 2002 and prior reflected developments from excess casualty, workers compensation, and post-1986 environmental liability classes of business, all within DBG, and from Transatlantic.

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In the first nine months of 2006, net loss development from prior accident years was favorable by approximately $255 million, including approximately $80 million of adverse development pertaining to the major hurricanes in 2004 and 2005 and $89 million of adverse development from the general reinsurance operations of Transatlantic, and excluding approximately $303 million from accretion of loss reserve discount. Excluding catastrophes and Transatlantic, as well as accretion of discount, net loss development from prior accident years in the first nine months of 2006 was favorable by approximately $424 million. The overall favorable development of $255 million consisted of approximately $1.29 billion of favorable development from accident years 2003 through 2005, partially offset by approximately $1.03 billion of adverse development from accident years 2002 and prior. For the first nine months of 2006, most classes of business throughout AIG experienced favorable development for accident years 2003 through 2005. The adverse development from accident years 2002 and prior reflected developments from excess casualty, workers compensation, excess workers compensation, and post-1986 environmental liability classes of business, all within DBG, and from Transatlantic.

As a result of the continued favorable experience for accident years 2003 through 2005, the expected loss ratios for accident year 2006 were improved for a number of casualty classes of business in the three months ended September 30, 2006. For those classes of business where the expected loss ratio for accident year 2006 was adjusted in the three months ended September 30, 2006, the revised loss ratio was generally applied to the cumulative 2006 net earned premium for the class. The overall effect on the results for the three months ended September 30, 2006, was approximately a $100 million improvement. This amount represents the application of the revised expected loss ratios to the net premiums earned reported for the first six months of 2006.

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.

As described more fully in the 2006 Annual Report on Form 10-K, AIG s reserves relating to asbestos and environmental claims reflect a comprehensive ground up analysis. In the first nine months of 2007, one large asbestos settlement, as well as a reduction in estimated reinsurance recoverable, resulted in a minor amount of adverse incurred loss development, which was partially offset, on a net basis, by the favorable $50 million effect of several other settlements.

A summary of reserve activity, including estimates for applicable IBNR, relating to asbestos and environmental claims separately and combined:

	Nine Months Ended September 30,			
	2007		2006	
(in millions)	**Gross**	**Net**	Gross	Net
Asbestos:				
Reserve for losses and loss expenses at beginning of year	**$ 4,464**	**$ 1,889**	$ 4,441	$ 1,840
Losses and loss expenses incurred*	**19**	**7**	2	7
Losses and loss expenses paid*	**(614)**	**(363)**	(404)	(151)
Reserve for losses and loss expenses at end of period	**$ 3,869**	**$ 1,533**	$ 4,039	$ 1,696

Environmental:

Reserve for losses and loss expenses at beginning of year	**$ 588**	**$ 290**	$ 926	$ 410
Losses and loss expenses incurred*	**2**	**(1)**	(3)	
Losses and loss expenses paid*	**(89)**	**(46)**	(80)	(43)
Reserve for losses and loss expenses at end of period	**$ 501**	**$ 243**	$ 843	$ 367
Combined:				
Reserve for losses and loss expenses at beginning of year	**$ 5,052**	**$ 2,179**	$ 5,367	$ 2,250
Losses and loss expenses incurred*	**21**	**6**	(1)	7
Losses and loss expenses paid*	**(703)**	**(409)**	(484)	(194)
Reserve for losses and loss expenses at end of period	**$ 4,370**	**$ 1,776**	$ 4,882	$ 2,063

** All amounts pertain to policies underwritten in prior years, primarily to policies issued in 1984 and prior.*

The gross and net IBNR included in the reserve for losses and loss expenses, relating to asbestos and environmental claims separately and combined, were estimated as follows:

	Nine Months Ended September 30,			
	2007		2006	
(in millions)	**Gross**	**Net**	Gross	Net