AMERICAN INTERNATIONAL GROUP INC
Form 10-K/A
June 19, 2006

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

**Form 10-K/ A**
**(Amendment No. 1)**

**(Mark One)**

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

**For the fiscal year ended December 31, 2005**

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

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

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

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

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

| Title of each class |
|---|
| **None** |

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

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

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

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

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

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

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

**Yes o No þ**

**The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of the registrant computed by reference to the price at which the common equity was last sold as of June 30, 2005 (the last business day of the registrant s most recently completed second fiscal quarter), was approximately $127,330,500,000.**

**As of January 31, 2006, there were outstanding 2,596,987,248 shares of Common Stock, $2.50 par value per share, of the registrant.**

This amendment to the Annual Report on Form 10-K for the year ended December 31, 2005 (2005 Annual Report on Form 10-K/A) is being filed for the purpose of amending Item 1 of Part I, Items 7, 7A and 8 of Part II and Item 15 of Part IV of the Annual Report on Form 10-K for the year ended December 31, 2005 of American International Group, Inc. (AIG), which was originally filed on March 16, 2006 (2005 Annual Report on Form 10-K). All other Items of the 2005 Annual Report on Form 10-K are unaffected by the changes described above and have been omitted from this amendment. Information in this 2005 Annual Report on Form 10-K/A is stated as of December 31, 2005 and does not reflect any subsequent information or events.

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Part I

ITEM 1.
***Business***

American International Group, Inc. (AIG), a Delaware corporation, is a holding company which, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and abroad. AIG s primary activities include both General Insurance and Life Insurance & Retirement Services operations. Other significant activities include Financial Services and Asset Management. The principal General Insurance company subsidiaries are American Home Assurance Company (American Home), National Union Fire Insurance Company of Pittsburgh, Pa. (National Union), New Hampshire Insurance Company (New Hampshire), Lexington Insurance Company (Lexington), The Hartford Steam Boiler Inspection and Insurance Company (HSB), Transatlantic Reinsurance Company, American International Underwriters Overseas, Ltd. (AIUO) and United Guaranty Residential Insurance Company. Significant Life Insurance & Retirement Services operations include those conducted through American Life Insurance Company (ALICO), American International Reinsurance Company, Ltd. (AIRCO), American International Assurance Company, Limited together with American International Assurance Company (Bermuda) Limited (AIA), Nan Shan Life Insurance Company, Ltd. (Nan Shan), The Philippine American Life and General Insurance Company (Philamlife), AIG Star Life Insurance Co., Ltd. (AIG Star Life), AIG Edison Life Insurance Company (AIG Edison Life), AIG Annuity Insurance Company (AIG Annuity), the AIG American General Life Companies (AIG American General), American General Life and Accident Insurance Company (AGLA), The United States Life Insurance Company in the City of New York (USLIFE), The Variable Annuity Life Insurance Company (VALIC), SunAmerica Life Insurance Company (SunAmerica Life) and AIG SunAmerica Life Assurance Company. AIG s Financial Services operations are conducted primarily through International Lease Finance Corporation (ILFC), AIG Financial Products Corp. and AIG Trading Group Inc. (AIGTG) and their respective subsidiaries (collectively referred to as AIGFP), and American General Finance, Inc. and its subsidiaries (AGF). AIG s Asset Management operations include AIG SunAmerica Asset Management Corp. (SAAMCo) and AIG Global Asset Management Holdings Corp. (formerly known as AIG Global Investment Group, Inc.) and its subsidiaries and affiliated companies (AIG Global Investment Group). For information on AIG s business segments, see Note 2 of Notes to Consolidated Financial Statements.

At December 31, 2005, AIG and its subsidiaries had approximately 97,000 employees.

AIG s Internet address for its corporate website is *www.aigcorporate.com*. AIG makes available free of charge, through the Investor Information section of AIG s corporate website, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) as soon as reasonably practicable after such materials are electronically filed with, or furnished to, the Securities and Exchange Commission (SEC). AIG also makes available on its corporate website copies of its charters for its Audit, Nominating and Corporate Governance and Compensation Committees, as well as its Corporate Governance Guidelines (which includes Director Independence Standards) and Director, Executive Officer and Senior Financial Officer Code of Business Conduct and Ethics.

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

**The Restatements**

AIG has completed two restatements of its financial statements (the Restatements). In connection with the first restatement (the First Restatement), AIG restated its consolidated financial statements and financial statement schedules for the years ended December 31, 2003, 2002, 2001 and 2000, the quarters ended March 31, June 30 and September 30, 2004 and 2003 and the quarter ended December 31, 2003. In the second restatement (the Second

Restatement), AIG restated its consolidated financial statements and financial statement schedules for the years ended December 31, 2004, 2003 and 2002, along with 2001 and 2000 for purposes of preparation of the Consolidated Financial Data for 2001 and 2000, the quarterly financial information for 2004 and 2003 and the first three quarters of 2005. AIG, however, did not amend its quarterly report on Form 10-Q for the quarter ended September 30, 2005 because the adjustments to the financial statements included therein were not material to those financial statements. All financial information included in this Annual Report on Form 10-K/A reflects the Restatements.

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES

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

| **Years Ended December 31,** *(in millions)* | **2005** | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| General Insurance operations: | | | | | |
| Gross premiums written | **$ 52,725** | $ 52,046 | $ 46,938 | $ 36,678 | $ 28,341 |
| Net premiums written | **41,872** | 40,623 | 35,031 | 26,718 | 19,793 |
| Net premiums earned | **40,809** | 38,537 | 31,306 | 23,595 | 18,661 |
| Net investment income | **4,031** | 3,196 | 2,566 | 2,350 | 2,551 |
| Realized capital gains (losses) | **334** | 228 | (39) | (345) | (189) |
| Operating income*(a)* | **2,315** | 3,177 | 4,502 | 923*(c)* | 1,585 |
| Identifiable assets | **150,667** | 131,658 | 117,511 | 105,891 | 88,250 |
| Statutory measures*(b)*: | | | | | |
| Statutory underwriting profit (loss)*(a)* | **(2,165)** | (564) | 1,559 | (1,843)*(c)* | (947) |
| Loss ratio*(a)* | **81.1** | 78.8 | 73.1 | 83.1 | 79.3 |
| Expense ratio | **23.6** | 21.5 | 19.6 | 21.8 | 24.3 |
| Combined ratio*(a)* | **104.7** | 100.3 | 92.7 | 104.9*(c)* | 103.6 |
| Life Insurance & Retirement Services operations: | | | | | |
| GAAP premiums | **29,400** | 28,088 | 23,496 | 20,694 | 19,600 |
| Net investment income | **18,134** | 15,269 | 12,942 | 11,243 | 10,451 |
| Realized capital gains (losses)*(d)* | **(218)** | 43 | 240 | (372) | (400) |
| Operating income | **8,844** | 7,923 | 6,807 | 5,181 | 4,633*(e)* |
| Identifiable assets | **480,622** | 447,841 | 372,126 | 289,914 | 256,767 |
| Insurance in-force at end of year*(f)* | **1,852,833** | 1,858,094 | 1,583,031 | 1,298,592 | 1,228,501 |
| Financial Services operations: | | | | | |
| Interest, lease and finance charges *(g)* | **10,525** | 7,495 | 6,242 | 6,822 | 6,321 |
| Operating income*(g)* | **4,276** | 2,180 | 1,182 | 2,125 | 1,769 |
| Identifiable assets | **166,488** | 165,995 | 141,667 | 128,104 | 107,719 |
| Asset Management operations: | | | | | |
| Advisory and management fees and net investment income from GICs | **5,325** | 4,714 | 3,651 | 3,467 | 3,565 |
| Operating income | **2,253** | 2,125 | 1,316 | 1,125 | 1,019 |

| | | | | | |
|---|---|---|---|---|---|
| Identifiable assets | **81,080** | 80,075 | 64,047 | 53,732 | 42,961 |
| Other realized capital gains (losses) | **225** | (227) | (643) | (936) | (321) |
| Revenues[(h)] | **108,905** | 97,666 | 79,421 | 66,171 | 59,958 |
| Total operating income[(i)] | **15,213** | 14,845 | 11,907 | 7,808 | 5,917 |
| Total assets | **853,370** | 801,145 | 675,602 | 561,598 | 490,614 |

*(a) Includes catastrophe losses of $2.63 billion, $1.05 billion, $83 million, $61 million and $867 million (including World Trade Center and related losses (WTC losses) of $769 million) in 2005, 2004, 2003, 2002 and 2001, respectively.*

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

*(c) In the fourth quarter of 2002, after completion of its annual review of General Insurance loss and loss adjustment expense reserves, AIG increased its net loss reserves relating to accident years 1997 through 2001 by $2.1 billion.*

*(d) Includes the effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133 and the application of FAS 52. For 2005, 2004, 2003, 2002, and 2001, respectively, the amounts included are $(437) million, $(140) million, $78 million, $(91) million and $(219) million.*

*(e) Includes $100 million in WTC losses.*

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

*(g) Includes the effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For 2005, 2004, 2003, 2002 and 2001, respectively, the amounts included in interest, lease and finance charges are $2.01 billion, $(122) million, $(1.01) billion, $220 million and $56 million, and the amounts included in Financial Services operating income are $1.98 billion, $(149) million, $(964) million, $240 million and $75 million.*

*(h) Represents the sum of General Insurance net premiums earned, Life Insurance & Retirement Services GAAP premiums, net investment income, Financial Services interest, lease and finance charges, Asset Management advisory and management fees and net investment income from Guaranteed Investment Contracts (GICs), and realized capital gains (losses).*

*(i) Represents income before income taxes, minority interest and cumulative effect of accounting changes. Includes segment operating income and other realized capital gains (losses) presented above, as well as AIG Parent and other operations of $(2.70) billion, $(333) million, $(1.26) billion, $(610) million and $(751) million in 2005, 2004, 2003, 2002 and 2001, respectively, and acquisition, restructuring and related charges of $(2.02) billion in 2001.*

**General Insurance Operations**

AIG s General Insurance subsidiaries are multiple line companies writing substantially all lines of property and casualty insurance both domestically and abroad. Domestic General Insurance operations are comprised of the Domestic Brokerage Group (DBG), which includes the operations of HSB; Transatlantic Holdings, Inc. (Transatlantic); Personal Lines, including 21st Century Insurance Group (21st Century); and United Guaranty Corporation (UGC).

AIG s primary domestic division is DBG. DBG s business in the United States and Canada is conducted through its General Insurance subsidiaries including American Home, National Union, Lexington and certain other General Insurance company subsidiaries of AIG.

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

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

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

The AIG Worldsource Division introduces and coordinates AIG s products and services to U.S.-based multinational clients and foreign corporations doing business in the U.S.

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 AIG Direct, the mass marketing operation of AIG, Agency Auto Division and 21st Century, 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 on conventional first lien mortgages for the purchase or refinance of 1-4 family residences. This type of insurance protects lenders in both domestic and international markets against loss if borrowers default. Other UGC subsidiaries write second lien and private student loan guaranty insurance. The second lien coverage protects lenders against loss from default on home equity and closed-end second mortgages used to finance home improvements, repairs or other expenses not directly related to the purchase of a borrower s home. Private student loan guaranty insurance protects lenders against loss if the student, or in many cases the student s parent, defaults on their education loan. UGC had approximately $23 billion of guaranty risk in force at December 31, 2005.

AIG s Foreign General Insurance group accepts risks primarily underwritten through American International Underwriters (AIU), a marketing unit consisting of wholly owned agencies and insurance companies. The Foreign General Insurance group also includes business written by AIG s foreign-based insurance subsidiaries. The Foreign General group uses various marketing methods and multiple distribution channels to write both commercial and consumer lines insurance with certain refinements for local laws, customs and needs. AIU operates in Asia, the Pacific

Rim, the United Kingdom, Europe, Africa, the Middle East and Latin America. See also Note 2 of Notes to Consolidated Financial Statements.

During 2005, DBG and the Foreign General Insurance group accounted for 55 percent and 24 percent, respectively, of AIG s General Insurance net premiums written.

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

Certain of DBG s commercial insurance is reinsured on a quota share basis by AIRCO. Various AIG profit centers, including AIU, AIG Reinsurance Advisors, Inc. and AIG Risk Finance, use AIRCO as a reinsurer for certain of their businesses, and AIRCO also receives premiums from offshore fronting arrangements for clients of AIG subsidiaries. In accordance with permitted accounting practices in Bermuda, AIRCO discounts reserves attributable to certain classes of business assumed from other AIG subsidiaries. See Management s Discussion and Analysis of Financial Condition and Results of Operations Operating Review Reserve for Losses and Loss Expenses.

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES

The utilization of reinsurance is closely monitored by senior management and AIG s Credit Risk Committee. AIG believes that no exposure to a single reinsurer represents an inappropriate concentration of risk to AIG, nor is AIG s business substantially dependent upon any reinsurance contract. See also Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 5 of Notes to Consolidated Financial Statements.

AIG is diversified both in terms of classes of business and geographic locations. In General Insurance, approximately 15 percent of net premiums written for the year ended December 31, 2005 represented workers compensation business. During 2005, of the direct General Insurance premiums written (gross premiums less return premiums and cancellations, excluding reinsurance assumed and before deducting reinsurance ceded), 11 percent and 7 percent were written in California and New York, respectively. No other state accounted for more than five percent of such premiums.

The majority of AIG s General Insurance business is in the casualty classes, which tend to involve longer periods of time for the reporting and settling of claims. This may increase the risk and uncertainty with respect to AIG s loss reserve development. See also the Discussion and Analysis of Consolidated Net Losses and Loss Expense Reserve Development in this Item 1. Business and Management s Discussion and Analysis of Financial Condition and Results of Operations.

A significant portion of AIG s General Insurance operating revenue is derived from AIG s insurance investment operations. For a table summarizing the investment results of General Insurance see Insurance Investments Operations below. See also Management s Discussion and Analysis of Financial Conditions and Results of Operations and Notes 1, 2 and 8 of Notes to Consolidated Financial Statements.

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

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

Loss reserves established with respect to foreign business are set and monitored in terms of the respective local or functional currency. Therefore, no assumption is included for changes in currency rates. See also Note 1(bb) of Notes to Consolidated Financial Statements.

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

The Analysis of Consolidated Net Losses and Loss Expense Reserve Development table presents the development of net losses and loss expense reserves for calendar years 1995 through 2005. Immediately following this table is a second table that presents all data on a basis that excludes asbestos and environmental net losses and loss expense reserve development. The opening reserves held are shown at the top of the table for each year end date. The amount of loss reserve discount included in the opening reserve at each date is shown immediately below the reserves held for each year. The undiscounted reserve at each date is thus the sum of the discount and the reserve held. The upper half of the table shows the cumulative amounts paid during successive years related to the undiscounted opening loss reserves. For example, in the table that excludes asbestos and environmental losses, with respect to the net losses and loss expense reserve of $24.55 billion as of December 31, 1998, by the end of 2005 (seven years later) $24.75 billion had actually been paid in settlement of these net loss reserves. In addition, as reflected in the lower section of the table, the original reserve of $25.45 billion was reestimated to be $30.64 billion at December 31, 2005. This increase from the original estimate would generally result from a combination of a number of factors, including reserves being settled for larger amounts than originally estimated. The original estimates will also be increased or decreased as more information becomes known about the individual claims and overall claim frequency and severity patterns. The

redundancy (deficiency) depicted in the table, for any particular calendar year, shows the aggregate change in estimates over the period of years subsequent to the calendar year reflected at the top of the respective column heading. For example, the deficiency of $3.75 billion at December 31, 2005 related to December 31, 2004 net losses and loss expense reserves of $47.30 billion represents the cumulative amount by which reserves for 2004 and prior years have developed deficiently during 2005. The deficiency that has emerged in the last year can be attributed primarily to the excess casualty, excess workers compensation, and D&O and related management liability classes of business. These classes in total produced approximately $4 billion of adverse development in 2005, primarily related to claims from accident years 2002 and prior. For most other classes, accident years 2002 and prior generally produced adverse development in 2005, whereas accident year 2004 generally produced favorable development. In total, the favorable development for all classes of business for accident year 2004 was approximately $3.85 billion. The accident year emergence can be seen by comparing the respective development in 2005 for each column s loss reserve in the table that follows. Loss development patterns utilized to test the reserves generally rely on the actual historical loss development patterns of prior accident years for each class of business. See also Management s Discussion and Analysis of Financial Condition and Results of Operations for further discussion of loss development in 2005.

The bottom of each table below shows the remaining undiscounted and discounted net loss reserve for each year. For example, in the table that excludes asbestos and environmental losses, for the 2000 year-end, the remaining undiscounted reserves held as of December 31, 2005 are $10.01 billion, with a corresponding discounted net reserve of $9.32 billion.

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

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES

**Analysis of Consolidated Losses and Loss Expense Reserve Development**
**The following table presents for each calendar year the losses and loss expense reserves and the development thereof including those with respect to asbestos and environmental claims. See also Management s Discussion and Analysis of Financial Condition and Results of Operations.**

| *(in millions)* | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | **2005** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net Reserves Held | $ 19,755 | $ 20,496 | $ 20,901 | $ 25,418 | $ 25,636 | $ 25,684 | $ 26,005 | $ 29,347 | $ 36,228 | $ 47,254 | **$ 57,476** |
| Discount (in Reserves Held) | 217 | 393 | 619 | 897 | 1,075 | 1,287 | 1,423 | 1,499 | 1,516 | 1,553 | **2,110** |
| Net Reserves Held (Undiscounted) | 19,972 | 20,889 | 21,520 | 26,315 | 26,711 | 26,971 | 27,428 | 30,846 | 37,744 | 48,807 | **59,586** |
| Paid (Cumulative) as of: | | | | | | | | | | | |
| One year later | 5,416 | 5,712 | 5,607 | 7,205 | 8,266 | 9,709 | 11,007 | 10,775 | 12,163 | 14,910 | |
| Two years later | 8,982 | 9,244 | 9,754 | 12,382 | 14,640 | 17,149 | 18,091 | 18,589 | 21,773 | | |
| Three years later | 11,363 | 11,943 | 12,939 | 16,599 | 19,901 | 21,930 | 23,881 | 25,513 | | | |
| Four years later | 13,108 | 14,152 | 15,484 | 20,263 | 23,074 | 26,090 | 28,717 | | | | |
| Five years later | 14,667 | 16,077 | 17,637 | 22,303 | 25,829 | 29,473 | | | | | |
| Six years later | 16,120 | 17,551 | 18,806 | 24,114 | 28,165 | | | | | | |
| Seven years later | 17,212 | 18,415 | 19,919 | 25,770 | | | | | | | |
| Eight years later | 17,792 | 19,200 | 21,089 | | | | | | | | |

| | | |
|---|---|---|
| Nine years later | 18,379 | 20,105 |
| Ten years later | 19,155 | |

| *(in millions)* | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | **2005** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net Reserves Held (undiscounted) | $ 19,972 | $ 20,889 | $ 21,520 | $ 26,315 | $ 26,711 | $ 26,971 | $ 27,428 | $ 30,846 | $ 37,744 | $ 48,807 | **$ 59,586** |
| Undiscounted Liability as of: | | | | | | | | | | | |
| One year later | 19,782 | 20,795 | 21,563 | 25,897 | 26,358 | 26,979 | 31,112 | 32,913 | 40,931 | 53,486 | |
| Two years later | 19,866 | 20,877 | 21,500 | 25,638 | 27,023 | 30,696 | 33,363 | 37,583 | 49,463 | | |
| Three years later | 19,865 | 20,994 | 21,264 | 26,169 | 29,994 | 32,732 | 37,964 | 46,179 | | | |
| Four years later | 20,143 | 20,776 | 21,485 | 28,021 | 31,192 | 36,210 | 45,203 | | | | |
| Five years later | 19,991 | 20,917 | 22,405 | 28,607 | 33,910 | 41,699 | | | | | |
| Six years later | 19,950 | 21,469 | 22,720 | 30,632 | 38,087 | | | | | | |
| Seven years later | 20,335 | 21,671 | 24,209 | 33,861 | | | | | | | |
| Eight years later | 20,558 | 22,986 | 26,747 | | | | | | | | |
| Nine years later | 21,736 | 25,264 | | | | | | | | | |
| Ten years later | 23,878 | | | | | | | | | | |
| | (3,906) | (4,375) | (5,227) | (7,546) | (11,376) | (14,728) | (17,775) | (15,333) | (11,719) | (4,679) | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Net Redundancy/(Deficiency) | | | | | | | | | | |
| Remaining Reserves (Undiscounted) | 4,724 | 5,158 | 5,658 | 8,091 | 9,922 | 12,226 | 16,486 | 20,666 | 27,690 | 38,576 |
| Remaining Discount | 252 | 299 | 358 | 459 | 568 | 690 | 846 | 999 | 1,212 | 1,568 |
| Remaining Reserves | 4,472 | 4,859 | 5,300 | 7,632 | 9,354 | 11,536 | 15,640 | 19,667 | 26, 478 | 37,008 |

**The table below shows the gross liability (before discount), reinsurance recoverable and net liability recorded at each year-end and the reestimation of these amounts as of December 31, 2005.**

| *llions)* | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Liability, End of | $ 32,298 | $ 32,605 | $ 32,049 | $ 36,973 | $ 37,278 | $ 39,222 | $ 42,629 | $ 48,173 | $ 53,387 | $ 63,431 | **$ 7** |
| urance Recoverable, f Year | 12,326 | 11,716 | 10,529 | 10,658 | 10,567 | 12,251 | 15,201 | 17,327 | 15,643 | 14,624 | **1** |
| ability, End of Year | 19,972 | 20,889 | 21,520 | 26,315 | 26,711 | 26,971 | 27,428 | 30,846 | 37,744 | 48,807 | **5** |
| mated Gross ity | 40,012 | 40,817 | 42,937 | 51,847 | 56,864 | 61,991 | 65,704 | 66,398 | 66,967 | 69,327 | |
| mated Reinsurance erable | 16,134 | 15,553 | 16,190 | 17,986 | 18,777 | 20,292 | 20,501 | 20,219 | 17,504 | 15,841 | |
| mated Net Liability | 23,878 | 25,264 | 26,747 | 33,861 | 38,087 | 41,699 | 45,203 | 46,179 | 49, 463 | 53,486 | |
| lative Gross dancy/(Deficiency) | (7,713) | (8,212) | (10,888) | (14,874) | (19,586) | (22,769) | (23,075) | (18,225) | (13,580) | (5,896) | |

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

**The following table presents for each calendar year the losses and loss expense reserves and the development thereof excluding those with respect to asbestos and environmental claims. See also Management s Discussion and Analysis of Financial Condition and Results of Operations.**

| *(in millions)* | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | **2005** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net Reserves Held | $ 19,247 | $ 19,753 | $ 20,113 | $ 24,554 | $ 24,745 | $ 24,829 | $ 25,286 | $ 28,650 | $ 35,559 | $ 45,742 | **$ 55,227** |
| Discount (in Reserves Held) | 217 | 393 | 619 | 897 | 1,075 | 1,287 | 1,423 | 1,499 | 1,516 | 1,553 | **2,110** |
| Net Reserves Held (Undiscounted) | 19,464 | 20,146 | 20,732 | 25,451 | 25,820 | 26,116 | 26,709 | 30,149 | 37,075 | 47,295 | **57,336** |
| Paid (Cumulative) as of: | | | | | | | | | | | |
| One year later | 5,309 | 5,603 | 5,467 | 7,084 | 8,195 | 9,515 | 10,861 | 10,632 | 11,999 | 14,718 | |
| Two years later | 8,771 | 8,996 | 9,500 | 12,190 | 14,376 | 16,808 | 17,801 | 18,283 | 21,419 | | |
| Three years later | 11,013 | 11,582 | 12,618 | 16,214 | 19,490 | 21,447 | 23,430 | 25,021 | | | |
| Four years later | 12,645 | 13,724 | 14,972 | 19,732 | 22,521 | 25,445 | 28,080 | | | | |
| Five years later | 14,139 | 15,460 | 16,983 | 21,630 | 25,116 | 28,643 | | | | | |
| Six years later | 15,404 | 16,792 | 18,014 | 23,282 | 27,266 | | | | | | |
| Seven years later | 16,355 | 17,519 | 18,972 | 24,753 | | | | | | | |
| Eight years later | 16,798 | 18,149 | 19,960 | | | | | | | | |

| | | |
|---|---|---|
| Nine years later | 17,230 | 18,873 |
| Ten years later | 17,826 | |

| *(in millions)* | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | **2005** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net Reserves Held (undiscounted) | $ 19,464 | $ 20,146 | $ 20,732 | $ 25,451 | $ 25,820 | $ 26,116 | $ 26,709 | $ 30,149 | $ 37,075 | $ 47,295 | **$ 57,336** |
| Undiscounted Liability as of: | | | | | | | | | | | |
| One year later | 18,937 | 19,904 | 20,576 | 24,890 | 25,437 | 26,071 | 30,274 | 32,129 | 39,261 | 51,048 | |
| Two years later | 18,883 | 19,788 | 20,385 | 24,602 | 26,053 | 29,670 | 32,438 | 35,803 | 46,865 | | |
| Three years later | 18,680 | 19,777 | 20,120 | 25,084 | 28,902 | 31,619 | 36,043 | 43,467 | | | |
| Four years later | 18,830 | 19,530 | 20,301 | 26,813 | 30,014 | 34,102 | 42,348 | | | | |
| Five years later | 18,651 | 19,633 | 21,104 | 27,314 | 31,738 | 38,655 | | | | | |
| Six years later | 18,574 | 20,070 | 21,336 | 28,345 | 34,978 | | | | | | |
| Seven years later | 18,844 | 20,188 | 21,836 | 30,636 | | | | | | | |
| Eight years later | 18,984 | 20,515 | 23,441 | | | | | | | | |
| Nine years later | 19,173 | 21,858 | | | | | | | | | |
| Ten years later | 20,379 | | | | | | | | | | |
| | (915) | (1,712) | (2,709) | (5,185) | (9,158) | (12,539) | (15,639) | (13,318) | (9,790) | (3,753) | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Net Redundancy/(Deficiency) | | | | | | | | | | |
| Remaining Reserves (undiscounted) | 2,553 | 2,985 | 3,482 | 5,883 | 7,712 | 10,012 | 14,269 | 18,446 | 25,447 | 36,330 |
| Remaining Discount | 252 | 299 | 358 | 459 | 568 | 690 | 846 | 999 | 1,212 | 1,568 |
| Remaining Reserves | 2,301 | 2,686 | 3,124 | 5,424 | 7,144 | 9,322 | 13,423 | 17,447 | 24,235 | 34,762 |

**The table below shows the gross liability (before discount), reinsurance recoverable and net liability recorded at each year-end and the reestimation of these amounts as of December 31, 2005.**

| *illions)* | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| s Liability, End of | $ 30,356 | $ 30,302 | $ 29,740 | $ 34,474 | $ 34,666 | $ 36,777 | $ 40,400 | $ 46,036 | $ 51,363 | $ 59,897 | **$ 73,** |
| surance Recoverable, of Year | 10,892 | 10,156 | 9,008 | 9,023 | 8,846 | 10,661 | 13,691 | 15,887 | 14,288 | 12,602 | **16,** |
| Liability, End of Year | 19,464 | 20,146 | 20,732 | 25,451 | 25,820 | 26,116 | 26,709 | 30,149 | 37,075 | 47,295 | **57,** |
| timated Gross ility | 30,452 | 31,660 | 34,226 | 43,461 | 48,886 | 54,534 | 58,776 | 59,813 | 60,788 | 63,544 | |
| timated Reinsurance overable | 10,073 | 9,802 | 10,785 | 12,825 | 13,908 | 15,879 | 16,428 | 16,346 | 13,923 | 12,496 | |
| timated Net Liability | 20,379 | 21,858 | 23,441 | 30,636 | 34,978 | 38,655 | 42,348 | 43,467 | 46,865 | 51,048 | |
| ulative Gross undancy/(Deficiency) | (96) | (1,358) | (4,486) | (8,987) | (14,220) | (17,757) | (18,376) | (13,777) | (9,425) | (3,647) | |

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES

**Reconciliation of Net Reserves for Losses and Loss Expenses**

| *(in millions)* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Net reserve for losses and loss expenses at beginning of year | **$ 47,254** | $ 36,228 | $ 29,347 |
| Foreign exchange effect | **(628)** | 524 | 580 |
| Acquisition | | | 391(a) |
| Losses and loss expenses incurred: | | | |
| Current year | **28,426** | 26,793 | 20,509 |
| Prior years[b] | **4,665** | 3,564 | 2,363 |
| | **33,091** | 30,357 | 22,872 |
| Losses and loss expenses paid: | | | |
| Current year | **7,331** | 7,692 | 6,187 |
| Prior years | **14,910** | 12,163 | 10,775 |
| | **22,241** | 19,855 | 16,962 |
| Net reserve for losses and loss expenses at end of year[c] | **$ 57,476** | $ 47,254 | $ 36,228 |

(a) *Reflects the opening balances with respect to the GE U.S.-based auto and home insurance business acquired in 2003.*

(b) *Includes accretion of discount of $(15) million in 2005, including an increase of $375 million in the discount recorded in 2005; $377 million in 2004 and $296 million in 2003. Additionally, includes $269 million in 2005, $317 million in 2004 and $323 million in 2003 for the general reinsurance operations of Transatlantic, and $197 million of additional losses incurred in 2005 resulting from increased labor and material costs related to the 2004 Florida hurricanes.*

(c) *See also Note 6(a) of Notes to Consolidated Financial Statements.*

The reserve for losses and loss expenses as reported in AIG s Consolidated Balance Sheet at December 31, 2005 differs from the total reserve reported in the Annual Statements filed with state insurance departments and, where appropriate, with foreign regulatory authorities. The differences at December 31, 2005 relate primarily to reserves for certain foreign operations not required to be reported in the United States for statutory reporting purposes.

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

For further discussion regarding net reserves for losses and loss expenses, see Management s Discussion and Analysis of Financial Condition and Results of Operations.

**Life Insurance & Retirement Services Operations**

AIG s Life Insurance & Retirement Services subsidiaries offer a wide range of insurance and retirement savings products both domestically and abroad. Insurance-oriented products consist of individual and group life, payout annuities, endowment and accident and health policies. Retirement savings products consist generally of fixed and variable annuities. See also Management s Discussion and Analysis of Financial Condition and Results of Operations.

Life Insurance & Retirement Services operations in foreign countries comprised 78 percent of Life Insurance & Retirement Services GAAP premiums and 59 percent of Life Insurance & Retirement Services operating income in 2005. AIG operates overseas principally through ALICO, AIA, Nan Shan, Philamlife, AIG Star Life, and AIG Edison Life. ALICO is incorporated in Delaware and all of its business is written outside of the United States. ALICO has operations either directly or through subsidiaries in Europe, Latin America, the Caribbean, the Middle East, South Asia and the Far East, with Japan being the largest territory. AIG added significantly to its presence in Japan with the acquisition of GE Edison Life Insurance Company (now AIG Edison Life), which was consolidated beginning with the fourth quarter of 2003. AIA operates primarily in China (including Hong Kong), Singapore, Malaysia, Thailand, Korea, Australia, New Zealand, Vietnam, and India. The operations in India are conducted through a joint venture, Tata AIG Life Insurance Company Limited. Nan Shan operates in Taiwan. Philamlife is the largest life insurer in the Philippines. AIG Star Life operates in Japan. See also Note 2 of Notes to Consolidated Financial Statements.

AIRCO acts primarily as an internal reinsurance company for AIG s foreign life operations. This facilitates insurance risk management (retention, volatility, concentrations) and capital planning locally (branch and subsidiary). It also allows AIG to pool its insurance risks and purchase reinsurance more efficiently at a consolidated level, manage global counterparty risk and relationships and manage global life catastrophe risks.

AIG s principal domestic Life Insurance & Retirement Services operations include AGLA, AIG American General, AIG Annuity, USLIFE, VALIC and SunAmerica Life. These companies utilize multiple distribution channels including independent producers, brokerage, career agents and banks to offer life insurance, annuity and accident and health products and services, as well as financial and other investment products. The domestic Life Insurance & Retirement Services operations comprised 22 percent of total Life Insurance & Retirement Services GAAP premiums and 41 percent of Life Insurance & Retirement Services operating income in 2005.

There was no significant adverse effect on AIG s Life Insurance & Retirement Services results of operations from

economic conditions in any one state, country or geographic region for the year ended December 31, 2005. See also Management s Discussion and Analysis of Financial Condition and Results of Operations.

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

In addition to the above, AIG also has subsidiary operations in Canada, Egypt, Mexico, Poland, Switzerland and Puerto Rico, and conducts life insurance business through a joint venture in Brazil and through an AIUO subsidiary company in Russia, and in certain countries in Central and South America.

The Foreign Life Insurance & Retirement Services companies have over 270,000 full and part-time agents, as well as independent producers, and sell their products largely to indigenous persons in local and foreign currencies. In addition to the agency outlets, these companies also distribute their products through direct marketing channels, such as mass marketing, and through brokers and other distribution outlets, such as financial institutions.

**Insurance Investment Operations**

A significant portion of AIG s General Insurance and Life Insurance & Retirement Services operating revenues are derived from AIG s insurance investment operations. See also Management s Discussion and Analysis of Financial Condition and Results of Operations and Notes 1, 2 and 8 of Notes to Consolidated Financial Statements.

**The following table summarizes the investment results of the General Insurance operations. See also Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 8 of Notes to Consolidated Financial Statements.**

| | Annual Average Cash and Invested Assets | | | | |
|---|---|---|---|---|---|
| **Years Ended December 31,** *(in millions)* | Cash (including short-term investments) | Invested Assets*(a)* | Total | Return on Average Cash and Assets*(b)* | Return on Average Assets*(c)* |
| **2005** | **$ 2,450** | **$ 86,211** | **$ 88,661** | **4.5%** | **4.7%** |
| 2004 | 2,012 | 73,338 | 75,350 | 4.2 | 4.4 |
| 2003 | 1,818 | 59,855 | 61,673 | 4.2 | 4.3 |
| 2002 | 1,537 | 47,477 | 49,014 | 4.8 | 5.0 |
| 2001 | 1,338 | 41,481 | 42,819 | 6.0 | 6.2 |

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

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

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

**The following table summarizes the investment results of the Life Insurance & Retirement Services operations. See also Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 8 of Notes to Consolidated Financial Statements.**

| Years Ended December 31, *(in millions)* | Annual Average Cash and Invested Assets: Cash (including short-term investments) | Invested Assets[(a)] | Total | Return on Average Cash and Assets[(b)] | Return on Average Assets[(c)] |
|---|---|---|---|---|---|
| **2005** | **$ 6,180** | **$ 352,250** | **$ 358,430** | **5.1%** | **5.1%** |
| 2004 | 5,089 | 307,659 | 312,748 | 4.9 | 5.0 |
| 2003 | 4,680 | 247,608 | 252,288 | 5.1 | 5.2 |
| 2002 | 3,919 | 199,750 | 203,669 | 5.5 | 5.6 |
| 2001 | 3,615 | 162,708 | 166,323 | 6.3 | 6.4 |

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

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

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

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

**Financial Services Operations**

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

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES

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

The Capital Markets operations of AIG are conducted primarily through AIGFP, which engages as principal in standard and customized interest rate, currency, equity, commodity, energy and credit products with top-tier corporations, financial institutions, governments, agencies, institutional investors, and high-net-worth individuals throughout the world. AIGFP also raises funds through municipal reinvestment contracts and other private and public security offerings, investing the proceeds in a diversified portfolio of high grade securities and derivative transactions. See also Note 2 of Notes to Consolidated Financial Statements.

Consumer Finance operations include AGF as well as AIG Consumer Finance Group, Inc. (AIGCFG). AGF provides a wide variety of consumer finance products, including real estate mortgages, consumer loans, retail sales finance and credit-related insurance to customers in the United States. AIGCFG, through its subsidiaries, is engaged in developing a multi-product consumer finance business with an emphasis on emerging markets. See also Note 2 of Notes to Consolidated Financial Statements.

Together, the Aircraft Finance, Capital Markets and Consumer Finance operations generate the vast majority of the revenues produced by AIG s consolidated Financial Services operations.

Imperial A.I. Credit Companies also contribute to Financial Services income. This operation engages principally in insurance premium financing for both AIG s customers and those of other insurers. See Note 1 of Notes to Consolidated Financial Statements.

**Asset Management Operations**

AIG s Asset Management operations comprise a wide variety of investment-related services and investment products, including institutional and retail asset management, broker dealer services and spread-based investment business from the sale of guaranteed investment contracts, also known as funding agreements (GICs). Such products and services are offered to individuals and institutions both domestically and overseas.

AIG s principal Asset Management operations are conducted through certain subsidiaries of AIG Retirement Services, Inc. (AIG SunAmerica), including SAAMCo and the AIG Advisor Group broker dealers and AIG Global Investment Group. AIG SunAmerica sells and manages mutual funds and provides financial advisory services through independent-contractor registered representatives. AIG Global Investment Group manages invested assets on a global basis for third-party institutional, retail, private equity and real estate investment funds, provides securities lending and custodial services and organizes and manages the invested assets of institutional private equity investment funds. Each of these subsidiary operations receives fees for investment products and services provided. See also Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 2 of Notes to Consolidated Financial Statements.

**Other Operations**

Certain other AIG subsidiaries provide insurance-related services such as adjusting claims and marketing specialized products. Several wholly owned foreign subsidiaries of AIG operating in countries or jurisdictions such as Ireland, Bermuda, Barbados and Gibraltar provide insurance and related administrative and back office services to a variety of insurance and reinsurance companies. These companies include captive insurance companies unaffiliated with AIG, subsidiaries of AIG and the subsidiaries of holding companies in which AIG holds an interest, such as IPC Holdings, Ltd (IPC) and Allied World Assurance Holdings, Ltd. (AWAC). AIG also has several other subsidiaries which engage in various businesses. Mt. Mansfield Company, Inc. owns and operates the ski slopes, lifts, school and an inn located at Stowe, Vermont. Also included in other operations are unallocated corporate expenses, including the settlement costs more fully described in Item 3. Legal Proceedings and Note 12(i) of Notes to Consolidated Financial Statements.

**Additional Investments**

AIG holds a 24.3 percent interest in IPC, a reinsurance holding company, a 23.4 percent interest in AWAC, a property-casualty insurance holding company, and a 24.5 percent interest in The Fuji Fire and Marine Insurance Co.,

Ltd., a general insurance company. See also Note 1(s) of Notes to Consolidated Financial Statements.

**Locations of Certain Assets**

As of December 31, 2005, approximately 34 percent of the consolidated assets of AIG were located in foreign countries (other than Canada), including $4.4 billion of cash and securities on deposit with foreign regulatory authorities. Foreign operations and assets held abroad may be adversely affected by political developments in foreign countries, including such possibilities as tax changes, nationalization, and changes in regulatory policy, as well as by consequence of hostilities and unrest. The risks of such occurrences and their overall effect upon AIG vary from country to country and cannot easily be predicted. If expropriation or nationalization does occur, AIG s policy is to take all appropriate measures to seek recovery of such assets. Certain of the countries in which AIG s business is conducted have currency restrictions which generally cause a delay in a company s ability to repatriate assets and profits. See also Notes 1 and 2 of Notes to Consolidated Financial Statements and Risk Factors Foreign Operations in Item 1A. Risk Factors.

**Regulation**

AIG s operations around the world are subject to regulation by many different types of regulatory authorities, including insurance, securities, investment advisory, banking and thrift regulators in the United States and abroad. The regulatory environment can have a significant effect on AIG and its business. AIG s operations have become more diverse and consumer-oriented, increasing the scope of regulatory supervision and the possibility of intervention. In addition, the investigations into financial accounting practices that led to the Restatements of AIG s financial statements have heightened regulatory scrutiny of AIG worldwide.

Certain states require registration and periodic reporting by insurance companies that are licensed in such states and are controlled by other corporations. Applicable legislation typically requires periodic disclosure concerning the corporation that controls the registered insurer and the other companies in the holding company system and prior approval of intercorporate services and transfers of assets (including in some instances payment of dividends by the insurance subsidiary) within the holding company system. AIG s subsidiaries are registered under such legislation in those states that have such requirements. See also Note 11 of Notes to Consolidated Financial Statements.

AIG s insurance subsidiaries, in common with other insurers, are subject to regulation and supervision by the states and by other jurisdictions in which they do business. Within the United States, the method of such regulation varies but generally has its source in statutes that delegate regulatory and supervisory powers to an insurance official. The regulation and supervision relate primarily to approval of policy forms and rates, the standards of solvency that must be met and maintained, including risk-based capital measurements, the licensing of insurers and their agents, the nature of and limitations on investments, restrictions on the size of risks that may be insured under a single policy, deposits of securities for the benefit of policyholders, requirements for acceptability of reinsurers, periodic examinations of the affairs of insurance companies, the form and content of reports of financial condition required to be filed, and reserves for unearned premiums, losses and other purposes. In general, such regulation is for the protection of policyholders rather than the equity owners of these companies. See also Management s Discussion and Analysis of Financial Condition and Results of Operations.

In connection with the Restatements, AIG undertook to examine and evaluate each of the items that have been restated or adjusted in its consolidated GAAP financial statements to determine whether restatement of the previously filed statutory financial statements of its insurance company subsidiaries would be required. AIG completed its 2004 audited statutory financial statements for all of the Domestic General Insurance companies in late 2005. The statutory accounting treatment of the various items requiring adjustment or restatement were reviewed and agreed to with the relevant state insurance regulators in advance of the filings. Adjustments necessary to reflect the cumulative effect on statutory surplus of adjustments relating to years prior to 2004 were made to 2004 opening surplus, and 2004 statutory net income was restated accordingly. Previously reported General Insurance statutory surplus at December 31, 2004 was reduced by approximately $3.5 billion to approximately $20.6 billion.

AIG also recently completed its 2005 unaudited statutory financial statements for all of the Domestic General Insurance companies, again after reviewing and agreeing with the relevant state insurance regulators the statutory accounting treatment of various items. The state regulators have permitted the Domestic General Insurance companies to record a $724 million reduction to opening statutory surplus as of January 1, 2005, to reflect the effects of the Second Restatement. See also Management s Discussion and Analysis of Financial Condition and Results of Operations Capital Resources Regulation and Supervision herein.

AIG has taken various steps to enhance the capital positions of the Domestic General Insurance companies. AIG entered into capital maintenance agreements with the Domestic General Insurance companies that set forth procedures through which AIG will provide ongoing capital support. Dividends from the Domestic General Insurance companies were suspended in the fourth quarter of 2005. AIG contributed an additional $750 million of capital into American Home effective September 30, 2005, and contributed a further $2.25 billion of capital in February 2006 for a total of approximately $3 billion of capital into Domestic General Insurance subsidiaries effective December 31, 2005. Furthermore, in order to allow the Domestic General Insurance companies to record as an admitted asset at December 31, 2005 certain reinsurance ceded to non-U.S. reinsurers (which has the effect of increasing the statutory surplus of such Domestic General Insurance companies), AIG has obtained, and entered into reimbursement

agreements for $1.5 billion of letters of credit issued by several commercial banks in favor of certain Domestic General Insurance companies.

AIG s insurance operations are currently under review by various state regulatory agencies. See Item 3. Legal Proceedings for a further description of these investigations and see Risk Factors Regulatory Investigations in Item 1A. Risk Factors for more information on their application to AIG s insurance businesses.

Risk-Based Capital (RBC) is designed to measure the adequacy of an insurer s statutory surplus in relation to the risks inherent in its business. Thus, inadequately capitalized general and life insurance companies may be identified.

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

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

corrective action to placing the insurer under regulatory control.

The statutory surplus of each of AIG s domestic general and life insurance subsidiaries exceeded their RBC standards as of December 31, 2005.

To the extent that any of AIG s insurance entities would fall below prescribed levels of surplus, it would be AIG s intention to infuse necessary capital to support that entity.

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

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

In 1999, AIG became a unitary thrift holding company when the Office of Thrift Supervision (OTS) granted AIG approval to organize AIG Federal Savings Bank. Annually, the OTS conducts an examination of AIG. The OTS examination involves assessing the organization s overall risk profile.

**Competition**

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

The insurance industry in particular is highly competitive. Within the United States, AIG s General Insurance subsidiaries compete with approximately 3,100 other stock companies, specialty insurance organizations, mutual companies and other underwriting organizations. AIG s subsidiaries offering Life Insurance and Retirement Services compete in the United States with approximately 2,000 life insurance companies and other participants in related financial services fields. Overseas, AIG subsidiaries compete for business with foreign insurance operations of the larger U.S. insurers, global insurance groups, and local companies in particular areas in which they are active.

AIG s strong ratings have historically provided a competitive advantage. The effect on the business of AIG of recent regulatory investigations, the Restatements, and subsequent ratings actions is currently unknown, but these developments may adversely affect the competitive position of AIG and its subsidiaries. See Risk Factors AIG Credit Ratings in Item 1A. Risk Factors.

Management s Discussion and Analysis of
Financial Condition and Results of Operations

ITEM 7.

***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Throughout this Management s Discussion and Analysis of Financial Condition and Results of Operations, AIG presents its operations in the way it believes will be most meaningful. Statutory underwriting profit (loss) and combined ratios are presented in accordance with accounting principles prescribed by insurance regulatory authorities because these are standard measures of performance used in the insurance industry and thus allow more meaningful comparisons with AIG s insurance competitors. AIG has also incorporated into this discussion a number of cross-references to additional information included throughout the 2005 Annual Report on Form 10-K to assist readers seeking related information on a particular subject.

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 Annual Report on Form 10-K/A 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 the credit rating downgrades on AIG s businesses and competitive position, the unwinding and resolving of various relationships between AIG and Starr 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 Risk Factors in Item 1A, Part I of the 2005 Annual Report on Form 10-K. AIG is not under any obligation (and expressly disclaims any such obligations) to update or alter any projection or other statement, whether written or oral, that may be made from time to time, whether as a result of new information, future events or otherwise.

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES

**Overview of Operations and Business Results**

In 2003 and prior years, AIG s operations were conducted by its subsidiaries principally through four operating segments: General Insurance, Life Insurance, Financial Services and Retirement Services & Asset Management. Beginning with the first quarter of 2004, AIG reports Retirement Services results in the same segment as Life Insurance, reflecting the convergence of protective financial and retirement products and AIG s current management of these operations. All financial information herein gives effect to the Restatements described in The Restatements under Item 1. Business. Information for years prior to 2005 included herein has been reclassified to show AIG s results of operations and financial position on a comparable basis with the 2005 presentation.

Through these segments, AIG provides insurance 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. The importance of this diversification was especially evident in 2005, when record catastrophe losses, settlements of legal proceedings and charges for increases in reserves for loss and loss expenses, were more than offset by profitability in other segments and product lines. Although regional economic downturns or political upheaval could negatively affect parts of AIG s operations, AIG believes that its diversification makes it unlikely that regional difficulties would have a material effect on its operating results, financial condition or liquidity.

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 one of 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 and offers guaranteed investment contracts (GICs) to institutions and individuals.

A primary goal of AIG in managing its General Insurance operations is to achieve an underwriting profit. To achieve this goal, AIG must be disciplined in its risk selection and premiums must be adequate and terms and conditions appropriate to cover the risk accepted. AIG believes in strict control of expenses.

AIG s 2005 operating performance reflects continuing implementation of various long-term strategies in its various operating segments.

A central focus of AIG operations in recent years is the development and expansion of new distribution channels. In 2005, AIG continued to expand its distribution channels in many Asian countries, which now include banks, credit card companies and television-media home shopping. In late 2003, AIG entered into an agreement with PICC Property and Casualty Company, Limited (PICC), which will enable the marketing of accident and health products throughout China through PICC s branch networks and agency system. AIG participates in the underwriting results through a reinsurance agreement and also holds a 9.9 percent ownership interest in PICC. Other examples of new distribution channels used both domestically and overseas include banks, affinity groups, direct response and e-commerce.

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

Growth for AIG may be generated both internally and through acquisitions which both fulfill strategic goals and offer adequate return on investment. In recent years, the acquisitions of AIG Star Life and AIG Edison Life have broadened AIG s penetration of the Japanese market through new distribution channels and will result in operating efficiencies as they are integrated into AIG s previously existing companies operating in Japan.

AIG provides leadership on issues of concern to the global and local economies as well as the insurance and financial services industries. In recent years, efforts to reform the tort system and class action litigation procedures, legislation to deal with the asbestos problem and the renewal of the Terrorism Risk Insurance Act have been key issues, while in prior years trade legislation and Superfund had been issues of concern.

**The following table summarizes AIG s revenues, income before income taxes, minority interest and cumulative effect of accounting changes and net income for the twelve months ended December 31, 2005, 2004 and 2003:**

| **Years Ended December 31,**<br>*(in millions)* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Total revenues | **$ 108,905** | $ 97,666 | $ 79,421 |
| Income before income taxes, minority interest and cumulative effect of accounting changes | **15,213** | 14,845 | 11,907 |
| Net income | **$ 10,477** | $ 9,839 | $ 8,108 |

*Consolidated Results*

The 12 percent growth in revenues in 2005 and 23 percent growth in revenues in 2004 were primarily attributable to the growth in net premiums earned from global General Insurance operations as well as growth in both General Insurance and Life Insurance & Retirement Services net investment income and Life Insurance & Retirement Services GAAP premiums. An additional factor was the capital gains realized in 2004 rather than the capital losses realized in 2003.

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

AIG s income before income taxes, minority interest and cumulative effect of accounting changes increased 2 percent in 2005 when compared to 2004 and 25 percent in 2004 when compared to 2003. Life Insurance & Retirement Services, Financial Services and Asset Management operating income gains accounted for the increase over 2004 and 2003 in both pretax income and net income. Somewhat offsetting these gains in 2005 was the effect of the charges related to regulatory settlements, as described in Item 3. Legal Proceedings.

**The following table summarizes the net effect of catastrophe losses for December 31, 2005, 2004 and 2003.**

| *(in millions)* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Pretax*(*)* | **$ 3,280** | $ 1,155 | $ 83 |
| Net of tax and minority interest | **2,109** | 729 | 53 |

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

**The following table summarizes the operations of each principal segment for the twelve months ended December 31, 2005, 2004 and 2003. See also Note 2 of Notes to Consolidated Financial Statements.**

| *(in millions)* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Revenues[(a)]: | | | |
| General Insurance[(b)] | **$ 45,174** | $ 41,961 | $ 33,833 |
| Life Insurance & Retirement Services[(c)] | **47,316** | 43,400 | 36,678 |
| Financial Services[(d)] | **10,525** | 7,495 | 6,242 |
| Asset Management[(e)] | **5,325** | 4,714 | 3,651 |
| Other | **565** | 96 | (983) |
| Total | **$ 108,905** | $ 97,666 | $ 79,421 |
| Operating Income[(a)(f)(g)]: | | | |
| General Insurance | **$ 2,315** | $ 3,177 | $ 4,502 |
| Life Insurance & Retirement Services | **8,844** | 7,923 | 6,807 |
| Financial Services | **4,276** | 2,180 | 1,182 |
| Asset Management | **2,253** | 2,125 | 1,316 |
| Other[(h)(i)] | **(2,475)** | (560) | (1,900) |
| Total | **$ 15,213** | $ 14,845 | $ 11,907 |

*(a) Includes the effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For 2005, 2004 and 2003, the effect was $(34) million, $(27) million and $49 million, respectively, in operating income for Aircraft Finance and $2.01 billion, $(122) million and $(1.01) billion in revenues and operating income, respectively, for Capital Markets (AIGFP).*

(b) *Represents the sum of General Insurance net premiums earned, net investment income and realized capital gains (losses).*
(c) *Represents the sum of Life Insurance & Retirement Services GAAP premiums, net investment income and realized capital gains (losses). Included in realized capital gains (losses) is the effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133 and the application of FAS 52 of $(437) million, $(140) million and $78 million.*
(d) *Represents interest, lease and finance charges.*
(e) *Represents management and advisory fees, and net investment income with respect to GICs.*

(f) *Represents income before income taxes, minority interest, and cumulative effect of accounting changes.*
(g) *Catastrophe losses were $3.28 billion, $1.16 billion and $83 million in 2005, 2004 and 2003, respectively.*

(h) *Represents unallocated corporate expenses and other realized capital gains (losses) and includes the NYAG, DOI, SEC and DOJ settlement costs in 2005.*
(i) *Includes $312 million and $96 million in catastrophe related losses from partially owned companies in 2005 and 2004, respectively, and approximately $1.6 billion of regulatory settlement charges in 2005.*

*General Insurance*

AIG s General Insurance operations provide property and casualty products and services throughout the world. The decrease in General Insurance operating income in 2005 compared to 2004 was primarily attributable to catastrophe related losses, increases in the reserve for losses and loss expenses and changes in estimates related to the remediation of AIG s material weakness in control over certain balance sheet reconciliations, partially offset by profitable growth in Foreign General s underwriting results and DBG s and Foreign General s net investment income. In addition, realized capital gains increased in 2005 compared to 2004. General Insurance operating income includes $2.89 billion, $1.05 billion and $83 million in catastrophe related losses in 2005, 2004 and 2003, respectively. DBG s operating income included $197 million of additional losses in 2005 resulting from increased labor and material costs related to the 2004 Florida hurricanes. DBG s 2005 operating income also included $291 million of expenses related to changes in estimates for uncollectible reinsurance and other premium balances related to the remediation of AIG s material weakness in internal control over certain balance sheet reconciliations.

*Life Insurance & Retirement Services*

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

Life Insurance & Retirement Services operating income increased 12 percent in 2005 and 16 percent in 2004 when compared to 2003. Foreign Life Insurance & Retirement Services operating income grew 8 percent in 2005. Realized capital gains included in operating income was $84 million in 2005 compared to $372 million in 2004 and $486 million in 2003. The decline in realized capital gains in 2005 includes the effect of hedging activities that do not qualify for hedge accounting under FAS 133, including the related foreign exchange gains and losses under FAS 52. For 2005, the foreign Life Insurance & Retirement Service segment also incurred higher policy benefit costs for contributions to the participating policyholder fund in Singapore, totaling $137 million related to the settlement of a long disputed local tax issue. The domestic Life Insurance & Retirement Services segment operating income grew by 17 percent in 2005. Realized capital

losses included in operating income was $(302) million in 2005 compared to $(329) million in 2004 and $(246) million in 2003. The 2004 results include increased policy benefits of $178 million associated with the workers compensation arbitration with Superior National. The domestic Life Insurance & Retirement Services segment also includes $12 million and $5 million in catastrophe related losses in 2005 and 2004, respectively.

*Financial Services*

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

Financial Services operating income increased significantly in 2005 compared to 2004 and in 2004 compared to 2003, primarily due to the fluctuation in earnings resulting from not qualifying for hedge accounting treatment under FAS 133. Offsetting this increase in 2004 when compared to 2003 is the effect of ILFC s disposition of approximately $2 billion in aircraft through securitizations in the third quarter of 2003 and the first quarter of 2004. Fluctuations in revenues and operating income from quarter to quarter are not unusual because of the transaction-oriented nature of Capital Markets operations and the effect of not qualifying for hedge accounting treatment under FAS 133 for hedges on securities available for sale and borrowings. The increase in 2005 when compared to 2004 was partially offset by $62 million in catastrophe related losses in the Consumer Finance operations in 2005. The charge relating to the PNC settlement, see Item 3. Legal Proceedings, had a significant negative effect on results in 2004. Consumer Finance operations increased revenues and operating income, both domestically and internationally.

*Asset Management*

AIG s Asset Management operations include institutional and retail asset management and broker dealer services and spread-based investment business from the sale of GICs. These products and services are offered to individuals and institutions, both domestically and overseas.

Asset Management operating income increased 6 percent in 2005 when compared to 2004 as a result of the upturn in worldwide financial markets and a strong global product portfolio; operating income also increased 61 percent in 2004 when compared to 2003 as a result of the same factors.

*Capital Resources*

At December 31, 2005, AIG had total consolidated shareholders equity of $86.32 billion and total consolidated borrowings of $109.85 billion. At that date, $99.42 billion of such borrowings were either not guaranteed by AIG or were matched borrowings under obligations of guaranteed investment agreements (GIAs), liabilities connected to trust preferred stock, or matched notes and bonds payable.

During 2005, AIG repurchased in the open market 2,477,100 shares of its common stock.

*Liquidity*

At December 31, 2005, AIG s consolidated invested assets included $17.24 billion in cash and short-term investments. Consolidated net cash provided from operating activities in 2005 amounted to $25.14 billion. AIG believes that its liquid assets, cash provided by operations and access to short term funding through commercial paper and bank credit facilities will enable it to meet any anticipated cash requirements.

*Outlook*

From March through June of 2005, the major rating agencies downgraded AIG s ratings in a series of actions. Standard & Poor s, a division of the McGraw-Hill Companies, Inc. ( S&P ), lowered the long-term senior debt and counterparty ratings of AIG from AAA to AA (second highest of eight rating categories) and changed the rating outlook to negative. S&P s outlook indicates the potential direction of a rating over the intermediate term (typically six months to two years). A negative outlook means that a rating may be lowered; however, an outlook is not necessarily a precursor to a rating change. Moody s Investors Service ( Moody s ) lowered AIG s long-term senior debt rating from Aaa to Aa2 (second highest of nine rating categories) with a stable outlook. Moody s appends numerical modifiers 1, 2, and 3 to the generic rating categories to show relative position within rating categories. Fitch Ratings ( Fitch ) downgraded the long-term senior debt ratings of AIG from AAA to AA (second highest of nine rating categories) and placed the ratings on Rating Watch Negative. A Fitch Rating Watch notifies investors that there is a reasonable probability of a rating change and the likely direction of such change. A Rating Watch Negative indicates a potential

downgrade. Rating Watch is typically resolved over a relatively short period. In April 2006, Fitch removed AIG from Rating Watch Negative and affirmed its rating with a stable outlook.

The agencies also took rating actions on AIG s insurance subsidiaries. S&P lowered the financial strength ratings of AIG s insurance subsidiaries to AA+ (second highest rating of eight rating categories) and assigned a negative rating outlook. Fitch also lowered the financial strength ratings of AIG s insurance companies to AA+ (second highest of nine rating categories) and placed them on Rating Watch Negative. In April 2006, Fitch removed the financial strength ratings from Rating Watch Negative and affirmed them with a stable outlook. S&P and Fitch ratings may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories. Moody s lowered the insurance financial strength ratings generally to either Aa1 or Aa2 (both within the second highest of nine rating categories) with a stable outlook. A.M. Best downgraded the financial strength ratings of most of AIG s insurance subsidiaries from A++ to A+ (second highest of fourteen rating levels) and the issuer credit ratings from aa+ to aa- (remaining within the second highest of nine rating levels) and placed the ratings under review with negative implications. An under review modifier by A.M. Best is assigned to a company whose rating opinion is under review and may be subject to change in the near-term, generally defined as six months. Negative implica-

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

tions indicates a potential downgrade. In June 2006, A.M. Best upgraded the financial strength ratings from A+ to A++ (highest of fourteen rating levels) and the issuer credit ratings from aa- to aa+ (remaining within the second highest of nine rating levels) for the domestic life & retirement services subsidiaries of AIG. A.M. Best also affirmed the financial strength ratings of A+ (second highest of fourteen rating levels) and the issuer credit ratings of aa- (within the second highest of nine rating levels) of most of AIG s domestic property and casualty subsidiaries. In addition, A.M. Best removed from review all of the ratings of AIG s insurance subsidiaries and assigned an issuer credit rating of aa (within the second highest of nine rating levels) to AIG.

In addition, S&P changed the outlook on the AA- long-term senior debt rating (second highest out of eight rating categories) of International Lease Finance Corporation (a wholly owned subsidiary of AIG) ( ILFC ) to negative. Moody s affirmed ILFC s long-term and short-term senior debt ratings ( A1 / P-1 ) (third highest of nine, and highest of three, rating categories, respectively). Fitch downgraded ILFC s long-term senior debt rating from AA- to A+ (third highest of nine rating categories), placed it on Rating Watch Negative and downgraded ILFC s short-term debt rating from F1+ to F1 (remaining within the highest of five rating categories). In April 2006, Fitch removed ILFC s long-term senior debt rating from Rating Watch Negative and affirmed it with a stable outlook.

Fitch also placed the A+ long-term senior debt ratings (third highest of nine rating categories) of American General Finance Corporation and American General Finance, Inc. (wholly owned subsidiaries of AIG) on Rating Watch Negative. In April 2006, these ratings were also removed from Rating Watch Negative and affirmed with a stable outlook. S&P and Moody s affirmed the long-term and short-term senior debt ratings of American General Finance Corporation of A+ / A-1 (third highest of eight rating categories/ highest of eight rating categories) and A1 / P-1 (third highest of nine rating categories/ highest of three rating categories), respectively.

These debt and financial strength ratings are current opinions of the rating agencies. As such, they may be changed, suspended or withdrawn at any time by the rating agencies as a result of changes in, or unavailability of, information or based on other circumstances. Ratings may also be withdrawn at AIG management s request. This discussion of ratings is not a complete list of ratings of AIG and its subsidiaries. For a discussion of the effect of these ratings downgrades on AIG s businesses, see Risk Factors AIG s Credit Ratings in Item 1A. Risk Factors.

Despite industry price erosion in some classes of general insurance, 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 December 2005, AIUO received a license from the government of Vietnam to operate a wholly owned general insurance company in Vietnam. This license, the first general insurance license granted by Vietnam to a U.S.-based insurance organization, permits AIG to operate a general insurance company throughout Vietnam. In early 2006, AIG announced plans to acquire a leading general insurance company in Taiwan.

In China, AIG has wholly-owned life insurance operations in eight cities. These operations should benefit from China s rapid rate of economic growth and growing middle class, a segment that is a prime market for life insurance. AIG believes that it may also have opportunities in the future to grow by entering the group insurance business. However, in March 2005 it withdrew its application to serve the group insurance market until certain regulatory issues are resolved. Among the regulatory issues to be addressed is the response to AIG s acknowledgment that certain of its Hong Kong based agents sold life insurance to customers on the Chinese mainland in contravention of applicable regulations.

AIG Edison Life, acquired in August 2003, adds to the current agency force in Japan, and provides alternative distribution channels including banks, financial advisers, and corporate and government employee relationships. In January 2005, AIG Star Life entered into an agreement with the Bank of Tokyo Mitsubishi, one of Japan s largest banks, to market a multi-currency fixed annuity. Through ALICO, AIG Star Life and AIG Edison, AIG has developed a leadership position in the distribution of annuities through banks. AIG is also a leader in the direct marketing of insurance products through sponsors and in the broad market. AIG also expects continued growth in India, Korea and Vietnam.

Domestically, AIG anticipates continued operating growth in 2006 as distribution channels are expanded and new products are introduced. The home service operation has not met business objectives, although its cash flow has been strong, and domestic group life/health continues to be weak. The home service operation is expected to be a slow growth business. AIG American General s current ratings remain equal to or higher than many of its principal competitors. AIG American General competes with a variety of companies based on services and products, in addition to ratings. The recent rating actions appear to be having no negative long term effect on independent producer relationships or customer surrender activity.

In the airline industry, changes in market conditions are not immediately apparent in operating results. Lease rates have firmed considerably, as a result of strong demand spurred by the recovering global commercial aviation market, especially in Asia. Sales have begun to increase, and AIG expects an increasing level of interest from a variety of purchasers. AIG also expects increased contributions to Financial Services revenues and income from its consumer finance operations overseas. However, the downgrades of AIG s credit ratings may adversely affect funding costs for AIG and its subsidiaries and AIGFP s ability to engage in derivative transactions and certain structured products. See Risk Factors AIG s Credit Ratings in Item 1A. Risk Factors.

GICs, which are sold domestically and abroad to both institutions and individuals, are written on an opportunistic basis when market conditions are favorable. In September 2005, AIG launched a $10 billion matched investment program in the Euromarkets under which AIG debt securities

will be issued. AIG also expects to launch a matched investment program in the domestic market which, along with the Euro program, will become AIG s principal spread-based investment activity. However, the timing of the launch of the domestic program is uncertain. Because AIG s credit spreads in the capital markets have widened following the ratings declines, there may be a reduction in the earnings on new business in AIG s spread based funding businesses.

AIG has many promising growth initiatives underway around the world. Cooperative agreements such as those with PICC and various banks in the U.S., Japan and Korea are expected to expand distribution networks for AIG s products and provide models for future growth.

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

**Critical Accounting Estimates**

AIG considers its most critical accounting estimates those with respect to reserves for losses and loss expenses, future policy benefits for life and accident and health contracts, deferred policy acquisition costs, 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 2005 for the year end 2005 loss reserve analysis. For low-frequency, high-severity classes such as excess casualty, expected loss ratios generally are utilized for at least the three most recent accident years.
- *Loss development factors:* used to project the reported losses for each accident year to an ultimate amount.

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.

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 deferred policy acquisition costs under FAS 97. 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 (FINANCIAL SERVICES):

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

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

OTHER-THAN-TEMPORARY DECLINES IN THE VALUE OF INVESTMENTS:

Securities are considered a candidate for other-than-temporary impairment based upon 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.
- The probability of non-realization of a full recovery on its investment, irrespective of the occurrence of one of the foregoing events.

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.

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

**Operating Review**

*General Insurance Operations*

AIG s General Insurance subsidiaries are multiple line companies writing substantially all lines of property and casualty insurance both domestically and abroad. See General Insurance Operations in Item 1. Business for more information relating to General Insurance subsidiaries.

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

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

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

GAAP provides for the recognition of expenses at the same time revenues are earned, the accounting principle of matching. Therefore, acquisition expenses are deferred and amortized over the period the related net premiums written are earned. DAC is reviewed for recoverability, and such review requires management judgment. The most comparable GAAP measure to statutory underwriting profit is income before income taxes, minority interest and cumulative effect of an accounting change. A table reconciling statutory underwriting profit to income before income taxes, minority interest and cumulative effect of an accounting change is contained in the footnotes to the key information table below. See also Critical Accounting Estimates herein and Notes 1 and 4 of Notes to Consolidated Financial Statements.

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

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

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

**Key information with respect to General Insurance Operations for 2005, 2004 and 2003 is set forth in the following tables:**

| *(in millions, except ratios)* | **2005** | 2004 | 2003 |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Net premiums written: | | | |
| Domestic General | | | |
| DBG | **$23,128** | $22,506 | $19,563 |
| Transatlantic | **3,466** | 3,749 | 3,341 |
| Personal Lines | **4,653** | 4,354 | 3,732 |
| Mortgage Guaranty | **628** | 607 | 531 |
| Foreign General | **9,997** | 9,407 | 7,864 |
| Total | **$41,872** | $40,623 | $35,031 |
| Net premiums earned: | | | |
| Domestic General | | | |
| DBG | **$22,602** | $21,215 | $16,704 |
| Transatlantic | **3,385** | 3,661 | 3,171 |
| Personal Lines | **4,634** | 4,291 | 3,678 |
| Mortgage Guaranty | **533** | 539 | 496 |
| Foreign General[f] | 9,655 | 8,831 | 7,257 |
| Total | **$40,809** | $38,537 | $31,306 |
| Net investment income: | | | |
| Domestic General | | | |
| DBG | **$ 2,403** | $ 1,965 | $ 1,433 |
| Transatlantic | **343** | 307 | 271 |
| Personal Lines | **217** | 186 | 152 |
| Mortgage Guaranty | **123** | 120 | 142 |
| Intercompany adjustments and eliminations net | **1** | | 7 |
| Foreign General | **944** | 618 | 561 |
| Total | **$ 4,031** | $ 3,196 | $ 2,566 |
| Realized capital gains (losses) | **334** | 228 | (39) |
| Operating income[a] | | | |
| Domestic General | | | |
| DBG | **$ (646)** | $ 777 | $ 1,774 |
| Transatlantic | **(39)** | 282 | 390 |
| Personal Lines | **195** | 357 | 355 |
| Mortgage Guaranty | **363** | 399 | 451 |
| Foreign General | **2,427** | 1,344 | 1,562 |
| Reclassifications and Eliminations | **15** | 18 | (30) |
| Total | **$ 2,315**[b][c][d] | $ 3,177 | $ 4,502 |
| Statutory underwriting profit (loss)[a][g]: | | | |
| Domestic General | | | |
| DBG | **$ (3,227)** [b][c] | $ (1,500) | $ 36 |
| Transatlantic | **(434)** | (77) | 68 |
| Personal Lines | **(38)** | 136 | 170 |
| Mortgage Guaranty | **249** | 234 | 245 |

| | | | |
|---|---|---|---|
| Foreign General[e][f] | **1,285** | 643 | 1,040 |
| Total | **$ (2,165)** [d] | $ (564) | $ 1,559 |

**(continued)**

AMERICAN INTERNATIONAL GROUP, INC. AND SUBSIDIARIES

| *(in millions, except ratios)* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Domestic General: | | | |
| Loss ratio | **89.59** | 83.88 | 78.35 |
| Expense ratio | **21.00** | 19.21 | 17.25 |
| Combined ratio | **110.59** | 103.09 | 95.60 |
| Foreign General: | | | |
| Loss ratio | **53.66** | 61.61 | 55.52 |
| Expense ratio[(e)] | **31.90** | 29.20 | 27.82 |
| Combined ratio[(f)] | **85.56** | 90.81 | 83.34 |
| Consolidated: | | | |
| Loss ratio | **81.09** | 78.78 | 73.06 |
| Expense ratio | **23.60** | 21.52 | 19.62 |
| Combined ratio[(a)] | **104.69** | 100.30 | 92.68 |

(a) *The effect of catastrophe related losses on the consolidated General Insurance combined ratio for 2005, 2004 and 2003 was 7.06, 2.74 and 0.27, respectively. Catastrophe related losses for 2005, 2004 and 2003 by reporting unit were as follows:*

| *(in millions)* | **2005** | | 2004 | 2003 |
|---|---|---|---|---|
| **Reporting Unit** | **Insurance Related Losses** | **Net Reinstatement Premium Cost** | Insurance Related Losses | Insurance Related Losses |
| DBG | **$1,747** | **$122** | $ 582 | $ 48 |
| Transatlantic | **463** | **45** | 215 | 4 |
| Personal Lines | **112** | **2** | 25 | 5 |
| Mortgage Guaranty | **10** | | | |
| Foreign General | **293** | **94** | 232 | 26 |
| Total | **$2,625** | **$263** | $1,054 | $ 83 |

(b) *Includes $197 million of additional losses incurred resulting from increased labor and material costs related to the 2004 Florida hurricanes.*

*(c) The 2005 statutory underwriting loss for DBG includes $291 million of expenses from changes in estimates for uncollectible reinsurance and other premium balances related to the remediation of the material weakness in internal control over certain balance sheet reconciliations and $100 million of accrued expenses in connection with certain workers compensation insurance policies written between 1985 and 1996. See Note 12(i) of Notes to Consolidated Financial Statements.*

*(d) Includes the fourth quarter 2005 increase in net reserves of approximately $1.8 billion.*
*(e) Includes the results of wholly owned AIU agencies.*
*(f) Income statement accounts expressed in non-functional currencies are translated into U.S. dollars using average exchange rates.*
*(g) Statutory underwriting profit (loss) is a measure that U.S. domiciled insurance companies are required to report to their regulatory authorities. The following table reconciles statutory underwriting profit (loss) to income before income taxes, minority interest and cumulative effect of accounting changes for the General Insurance segment for the twelve months ended December 31:*

| | Domestic Brokerage Group | Transatlantic | Personal Lines | Mortgage Guaranty | Foreign General | Reclassifications and Eliminations | Total |
|---|---|---|---|---|---|---|---|
| **2005:** | | | | | | | |
| **Statutory underwriting profit (loss)** | **$ (3,227)** | **$ (434)** | **$ (38)** | **$ 249** | **$ 1,285** | **$** | **$ (2,165)** |
| **Increase (decrease) in deferred acquisition costs** | **(23)** | **14** | **19** | **(8)** | **113** | | **115** |
| **Net investment income** | **2,403** | **343** | **217** | **123** | **944** | **1** | **4,031** |
| **Realized capital gains (losses)** | **201** | **38** | **(3)** | **(1)** | **85** | **14** | **334** |
| **Income before income taxes, minority interest and cumulative effect of accounting changes** | **$ (646)** | **$ (39)** | **$ 195** | **$ 363** | **$ 2,427** | **$ 15** | **$ 2,315** |
| 2004: | | | | | | | |
| Statutory underwriting profit (loss) | $ (1,500) | $ (77) | $ 136 | $ 234 | $ 643 | $ | $ (564) |
| Increase (decrease) in deferred acquisition costs | 160 | 30 | 24 | 44 | 59 | | 317 |
| Net investment income | 1,965 | 307 | 186 | 120 | 618 | | 3,196 |
| Realized capital gains (losses) | 152 | 22 | 11 | 1 | 24 | 18 | 228 |
| Income before income taxes, minority interest | $ 777 | $ 282 | $ 357 | $ 399 | $ 1,344 | $ 18 | $ 3,177 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| and cumulative effect of accounting changes | | | | | | | |
| 2003: | | | | | | | |
| Statutory underwriting profit (loss) | $ 36 | $ 68 | $ 170 | $ 245 | $ 1,040 | $ | $ 1,559 |
| Increase (decrease) in deferred acquisition costs | 351 | 41 | 13 | 19 | (8) | | 416 |
| Net investment income | 1,433 | 271 | 152 | 142 | 561 | 7 | 2,566 |
| Realized capital gains (losses) | (46) | 10 | 20 | 45 | (31) | (37) | (39) |
| Income before income taxes, minority interest and cumulative effect of accounting changes | $ 1,774 | $ 390 | $ 355 | $ 451 | $ 1,562 | $ (30) | $ 4,502 |

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*General Insurance Results*

General Insurance operating income in 2005 decreased after accounting for catastrophe related losses, the fourth quarter increase in reserves and changes in estimates related to remediation of the material weakness in reconciliation of balance sheet accounts. This decrease was partially offset by strong profitable growth in Foreign General s statutory underwriting profit and DBG s and Foreign General s net investment income. DBG s statutory underwriting loss also included additional losses incurred resulting from increased labor and material costs related to the 2004 Florida hurricanes. General Insurance operating income in 2004 showed positive results, even after accounting for catastrophe losses, the charge for asbestos and environmental exposures and the $232 million charge reflecting a change in estimate for salvage and subrogation recoveries. Net investment income and the capital gains realized in 2004 rather than the capital losses realized in 2003 also benefited General Insurance results.

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

The DBG loss ratio increased in 2005 from 2004 principally as a result of adverse loss development, the third and fourth quarter 2005 catastrophe related losses and the $197 million of additional losses resulting from increased labor and material costs related to the 2004 hurricanes.

The DBG expense ratio increased in 2005 from 2004 principally due to an increase in net commissions resulting from the replacement of certain ceded quota share reinsurance, for which DBG earns a ceding commission, with excess-of-loss reinsurance, which generally does not include a ceding commission. Increases in other underwriting expenses at DBG relate to the changes in estimates noted above, as well as unusually high expenses for Personal Lines. The Foreign General expense ratio increased in 2005 from 2004 principally because consumer lines of business, which have higher acquisition costs, have become more significant.

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

Personal Lines net premiums written and net premiums earned for 2005 increased when compared to 2004 as a result of strong growth in the Private Client Group and Agency Auto divisions due to increased agent/broker appointments, greater penetration and enhanced product offerings. AIG direct premiums are down slightly from 2004 due to aggressive re-underwriting of the previously acquired GE business and the discontinuation of underwriting homeowners business. Involuntary auto premiums were down in 2005 due to the decline in the assigned risk marketplace. Statutory underwriting profit declined in 2005 as a result of hurricane losses and related expenses, reserve strengthening, an increase in Agency Auto s current accident year physical damage loss ratio, and expenses incurred related to terminating AIG s relationship with The Robert Plan effective December 31, 2005.

Mortgage Guaranty net premiums written were up slightly for 2005 when compared to 2004, reflecting growth in the second liens and international businesses offset by higher ceded premiums. Higher acquisition costs and lower earned premiums from certain single premium product lines resulted in lower statutory underwriting profit in 2005 compared to 2004. UGC continued to achieve expansion of its international business in 2005.

Foreign General Insurance had strong results in 2005. Growth in net premiums written for 2005 was achieved from new business as well as new distribution channels. In Japan, the purchase in February 2005 of the insurance portfolio of the Royal & SunAlliance branch operations opened new distribution channels. In the Far East, personal accident business exhibited strong growth and had excellent results for 2005. Commercial lines in Europe exhibited healthy growth and had positive results for 2005, partially offset by rate decreases in Australia and the United Kingdom.

Personal lines operations in Brazil and Latin America continue to exhibit strong growth, which translated into improved underwriting results for 2005. The Lloyd s Ascot syndicate continues to grow; however, insurance losses and reinstatement premium costs relating to the hurricanes caused a significant reduction in 2005 underwriting results. Foreign General Insurance also benefited from a decrease in the fourth quarter of 2005 in net reserves for loss and loss expense for non-asbestos and environmental reserves. Approximately half of the Foreign General Insurance net premiums written is derived from commercial insurance and the remainder from consumer lines.

**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.**

| | **2005** |
|---|---|
| Growth in original currency | 2.6% |
| Foreign exchange effect | 0.5 |
| Growth as reported in U.S. dollars | 3.1% |

AIG s General Insurance results reflect the effects of catastrophe related losses of $2.89 billion, $1.05 billion and $83 million in 2005, 2004 and 2003, respectively. Losses caused by catastrophes can fluctuate widely from year to year, making comparisons of recurring type business more difficult. With respect to catastrophe losses, AIG believes that it has taken appropriate steps, such as careful exposure selection and

obtaining reinsurance coverage, to reduce the effect of the magnitude of possible future losses. The occurrence of one or more catastrophic events of unanticipated frequency or severity, such as a terrorist attack, earthquake or hurricane, that causes insured losses, however, could have a material adverse effect on AIG s results of operations, liquidity or financial condition.

General Insurance net investment income grew in 2005 when compared to 2004. AIG is benefiting from strong cash flow, higher interest rates and increased partnership income. Cash flow for Foreign General was lower in 2005 when compared to 2004 due to payments for catastrophe related losses incurred in 2005 and 2004 and for the purchase of the Royal & SunAlliance branch operations. Partnership income was particularly strong for Foreign General due to increases in market valuations of infrastructure fund investments in Africa, Asia, China, Eastern Europe and India. Additionally, net investment income was positively affected by the compounding of previously earned and reinvested net investment income. In 2004, net investment income increased when compared to 2003. See also the discussion under Liquidity herein and Note 8 of Notes to Consolidated Financial Statements.

Realized capital gains and losses resulted from the ongoing investment management of the General Insurance portfolios within the overall objectives of the General Insurance operations. See the discussion on Valuation of Invested Assets herein.

The contribution of General Insurance operating income to AIG s consolidated income before income taxes, minority interest and cumulative effect of accounting changes was 15 percent in 2005, compared to 21 percent in 2004 and 38 percent in 2003. The decrease in contribution percentages in both 2005 and 2004 was largely the result of reserve increases and the effects of catastrophe losses.

*Reinsurance*

AIG is a major purchaser of reinsurance for its General Insurance operations. AIG insures risks globally, and its reinsurance programs must be coordinated in order to provide AIG the level of reinsurance protection that AIG desires. Reinsurance is an important risk management tool to manage transaction and insurance line risk retention at prudent levels set by management. AIG also purchases reinsurance to mitigate its catastrophic exposure. AIG is cognizant of the need to exercise good judgment in the selection and approval of both domestic and foreign companies participating in its reinsurance programs because one or more catastrophe losses could negatively affect AIG s reinsurers and result in an inability of AIG to collect reinsurance recoverables. AIG s reinsurance department evaluates catastrophic events and assesses the probability of occurrence and magnitude of catastrophic events through the use of state-of-the-art industry recognized program models among other techniques. AIG supplements these models through continually monitoring the risk exposure of AIG s worldwide General Insurance operations and adjusting such models accordingly. Although reinsurance arrangements do not relieve AIG from its direct obligations to its insureds, an efficient and effective reinsurance program substantially limits AIG s exposure to potentially significant losses. With respect to its property business, AIG has either renewed existing coverage or purchased new coverage that, in the opinion of management, is adequate to limit AIG s exposures.

AIG s consolidated general reinsurance assets amounted to $23.59 billion at December 31, 2005 and resulted from AIG s reinsurance arrangements. Thus, a credit exposure existed at December 31, 2005 with respect to reinsurance recoverable to the extent that any reinsurer may not be able to reimburse AIG under the terms of these reinsurance arrangements. AIG manages its credit risk in its reinsurance relationships by transacting with reinsurers that it considers financially sound, and when necessary AIG holds substantial collateral in the form of funds, securities and/or irrevocable letters of credit. This collateral can be drawn on for amounts that remain unpaid beyond specified time periods on an individual reinsurer basis. At December 31, 2005, approximately 48 percent of the general reinsurance assets were from unauthorized reinsurers. Many of these balances were collateralized, permitting statutory recognition. Additionally, with the approval of its domiciliary insurance regulators, AIG posted approximately $1.5 billion of letters of credit issued by several commercial banks in favor of certain Domestic General Insurance companies to permit statutory recognition of balances otherwise uncollateralized at December 31, 2005. The remaining 52 percent of the general reinsurance assets were from authorized reinsurers. The terms authorized and unauthorized pertain to regulatory categories, not creditworthiness. At December 31, 2005, approximately 88 percent

of the balances with respect to authorized reinsurers are from reinsurers rated A (excellent) or better, as rated by A.M. Best, or A (strong) or better, as rated by S&P. These ratings are measures of financial strength.

The following table presents each reinsurer representing in excess of five percent of AIG s reinsurance assets at December 31, 2005.

| *(dollars in millions)*<br>Reinsurer | A.M. Best Rating | Gross Reinsurance Assets | Percent of Reinsurance Assets, Net | Collateral Held | Uncollateralized Reinsurance Assets |
|---|---|---|---|---|---|
| Swiss Reinsurance Group | A+ | $ 2,397 | 9.6% | $ 537 | $ 1,860 |
| Lloyd s Syndicates Lloyd s of London | A | $ 1,648 | 6.6% | $ 174 | $ 1,474 |
| Munich Reinsurance Group | A+/A | $ 1,627 | 6.5% | $ 221 | $ 1,406 |
| Berkshire Hathaway Insurance Group | A++ | $ 1,390 | 5.6% | $ 106 | $ 1,284 |

AIG maintains a reserve for estimated unrecoverable reinsurance. While AIG has been largely successful in its previous recovery efforts, at December 31, 2005, AIG had a reserve for unrecoverable reinsurance approximating $992 million. At that date, AIG had no significant reinsurance recoverables due from any individual reinsurer that was financially troubled (e.g., liquidated, insolvent, in receivership or otherwise subject to formal or informal regulatory restriction).

AIG s Reinsurance Security Department conducts ongoing detailed assessments of the reinsurance markets and current

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and potential reinsurers, both foreign and domestic. Such assessments include, but are not limited to, identifying if a reinsurer is appropriately licensed and has sufficient financial capacity, and evaluating the local economic environment in which a foreign reinsurer operates. This department also reviews the nature of the risks ceded and the requirements for credit risk mitigants. For example, in AIG s treaty reinsurance contracts, AIG includes provisions that frequently require a reinsurer to post collateral when a referenced event occurs. Furthermore, AIG limits its unsecured exposure to reinsurers through the use of credit triggers, which include, but are not limited to, insurer financial strength rating downgrades, policyholder surplus declines at or below a certain predetermined level or a certain predetermined level of a reinsurance recoverable being reached. In addition, AIG s Credit Risk Committee reviews the credit limits for and concentrations with any one reinsurer.

AIG enters into intercompany reinsurance transactions, primarily through AIRCO, for its General Insurance and Life Insurance operations. AIG enters into these transactions as a sound and prudent business practice in order to maintain underwriting control and spread insurance risk among AIG s various legal entities. These reinsurance agreements have been approved by the appropriate regulatory authorities. All material intercompany transactions have been eliminated in consolidation. AIG generally obtains letters of credit in order to obtain statutory recognition of these intercompany reinsurance transactions. At December 31, 2005, approximately $3.6 billion of letters of credit were outstanding to cover intercompany reinsurance transactions with AIRCO or other General Insurance subsidiaries.

At December 31, 2005, the consolidated general reinsurance assets of $23.59 billion include reinsurance recoverables for paid losses and loss expenses of $829 million and $19.69 billion with respect to the ceded reserve for losses and loss expenses, including ceded losses incurred but not reported (IBNR) (ceded reserves) and $3.07 billion of ceded reserve for unearned premiums. The ceded reserve for losses and loss expenses represent the accumulation of estimates of ultimate ceded losses including provisions for ceded IBNR and loss expenses. The methods used to determine such estimates and to establish the resulting ceded reserves are continually reviewed and updated by management. Any adjustments thereto are reflected in income currently. It is AIG s belief that the ceded reserve for losses and loss expenses at December 31, 2005 were representative of the ultimate losses recoverable. In the future, as the ceded reserves continue to develop to ultimate amounts, the ultimate loss recoverable may be greater or less than the reserves currently ceded.

*Reserve for Losses and Loss Expenses*

**The table below classifies as of December 31, 2005 the components of the General Insurance gross reserve for losses and loss expenses (loss reserves) by major lines of business on a statutory Annual Statement basis*:**

| *(in millions)* | |
|---|---|
| Other liability occurrence | $18,116 |
| Other liability claims made | 12,447 |
| Workers compensation | 11,630 |
| Auto liability | 6,569 |
| Property | 7,217 |
| International | 4,939 |
| Reinsurance | 2,886 |
| Medical malpractice | 2,363 |
| Aircraft | 1,844 |
| Products liability | 1,937 |
| Commercial multiple peril | 1,359 |
| Accident and health | 1,678 |
| Fidelity/ surety | 1,072 |

| | |
|---|---|
| Other | 3,112 |
| Total | $77,169 |

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

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

At December 31, 2005, General Insurance net loss reserves were $57.5 billion, an increase of $10.22 billion from the prior year-end. The net loss reserve increase includes the fourth quarter 2005 increase in net reserves of approximately $1.8 billion, comprised of $960 million for non-asbestos and environmental exposures, and $873 million for asbestos and environmental exposures. The increase in non-asbestos and environmental reserves includes an increase of $1.44 billion for DBG and decreases of $455 million for Foreign General Insurance and $29 million for Mortgage Guaranty. The DBG increase of $1.44 billion is $140 million greater than the amount previously announced in AIG s press release of February 9, 2006 as a result of an additional change in estimate related to a commuted reinsurance agreement. The aggregate increase in asbestos and environmental reserves includes increases of $706 million and $167 million, respectively, for DBG and Foreign General Insurance.

As discussed in more detail below, the fourth quarter 2005 reserve increase was attributable to adverse development

primarily related to 2002 and prior accident years, partially offset by favorable development for accident years 2003 through 2005. This reserve action reflects the completion of AIG s actuarial studies in the fourth quarter of 2005.

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 table below classifies the components of the General Insurance net loss reserves by business unit as of December 31, 2005.

| *(in millions)* | |
|---|---|
| DBG[(a)] | $40,782 |
| Personal Lines[(b)] | 2,578 |
| Transatlantic | 5,690 |
| Mortgage Guaranty | 340 |
| Foreign General[(c)] | 8,086 |
| Total Net Loss Reserve | $57,476 |

*(a) DBG loss reserves include approximately $3.77 billion ($4.26 billion before discount) related to business written by DBG but ceded to AIRCO and reported in AIRCO s statutory filings. DBG loss reserves also include approximately $407 million related to business included in AIUO s statutory filings.*

*(b) Personal Lines loss reserves include $878 million related to business ceded to DBG and reported in DBG s statutory filings.*

*(c) Foreign General loss reserves include approximately $2.15 billion related to business reported in DBG s statutory filings.*

The DBG net loss reserve of $40.78 billion is comprised principally of the business of AIG subsidiaries participating in the American Home/ National Union pool (11 companies) and the surplus lines pool (Lexington, Starr Excess Liability Insurance Company and Landmark Insurance Company).

Beginning in 1998, DBG ceded a quota share percentage of its other liability occurrence and products liability occurrence business to AIRCO. The quota share percentage ceded was 40 percent in 1998, 65 percent in 1999, 75 percent in 2000 and 2001, 50 percent in 2002 and 2003, 40 percent in 2004 and 35 percent in 2005 and covered all business written in these years for these lines by participants in the American Home/National Union pool. In 1998 the cession reflected only the other liability occurrence business, but in 1999 and subsequent years included products liability occurrence. AIRCO s loss reserves relating to these quota share cessions from DBG are recorded on a discounted basis. As of year-end 2005, AIRCO carried a discount of approximately $490 million applicable to the $4.26 billion in undiscounted reserves it assumed from the American Home/National Union pool via this quota share cession. AIRCO also carries approximately $440 million in net loss reserves relating to Foreign General insurance business. These reserves are carried on an undiscounted basis.

Beginning in 1997, the Personal Lines division ceded a percentage of all business written by the companies participating in the personal lines pool to the American Home/National Union pool. As noted above, the total reserves carried by participants in the American Home/National Union pool relating to this cession amounted to $878 million as of year-end 2005.

The companies participating in the American Home/National Union pool have maintained a participation in the business written by AIU for decades. As of year-end 2005, these AIU reserves carried by participants in the American Home/National Union pool amounted to approximately $2.15 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 year-end 2005 by AIUO and AIRCO were approximately $3.72 billion and $4.21 billion, respectively. AIRCO s $4.21 billion in total general insurance reserves consist of approximately $3.77 billion from business assumed from the American Home/National Union pool and an additional $440 million relating to Foreign General Insurance business.

*Discounting of Reserves*

At December 31, 2005, AIG s overall General Insurance net loss reserves reflects a loss reserve discount of $2.11 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: $512 million tabular discount for workers compensation in DBG; $1.11 billion non-tabular discount for workers compensation in DBG; and, $490 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 $9.5 billion as of year-end 2005. 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 $4.26 billion at December 31, 2005.

*Results of 2005 Reserving Process*

It is management s belief that the General Insurance net loss reserves are adequate to cover General Insurance net losses and

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loss expenses as of December 31, 2005. While AIG annually reviews the adequacy of established loss reserves, there can be no assurance that AIG s ultimate loss reserves will not develop adversely and materially exceed AIG s loss reserves as of December 31, 2005. 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 position, although it could have a material adverse effect on AIG s consolidated results of operations for an individual reporting period. See Risk Factors Casualty Insurance and Underwriting Reserves in Item 1A. Risk Factors.

As part of the 2005 year-end actuarial loss reserve analysis, AIG expanded its review processes and conducted additional studies. In addition, in August 2005, AIG commissioned a third-party actuary to assist in a comprehensive review of the loss reserves of AIG s principal property-casualty insurance operations, including an independent ground up study of AIG s asbestos and environmental exposures. AIG s management carefully considered the analyses provided by its actuarial staff and by the third-party actuary for each class of business in determining AIG s best estimate of its loss reserves.

**The table below presents the reconciliation of net loss reserves for 2005, 2004 and 2003 as follows:**

| *(in millions)* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Net reserve for losses and loss expenses at beginning of year | **$47,254** | $36,228 | $29,347 |
| Foreign exchange effect | **(628)** | 524 | 580 |
| Acquisition | | | 391*(a)* |
| Losses and loss expenses incurred: | | | |
| Current year | **28,426** | 26,793 | 20,509 |
| Prior years*(b)* | **4,665***(c)* | 3,564*(d)* | 2,363 |
| Losses and loss expenses incurred | **33,091** | 30,357 | 22,872 |
| Losses and loss expenses paid: | | | |
| Current year | **7,331** | 7,692 | 6,187 |
| Prior years | **14,910** | 12,163 | 10,775 |
| Losses and loss expenses paid | **22,241** | 19,855 | 16,962 |
| Net reserve for losses and loss expenses at end of year | **$57,476** | $47,254 | $36,228 |

(a) *Reflects the opening balances with respect to the GE U.S.-based auto and home insurance business acquired in 2003.*

(b) *Includes accretion of discount of $(15) million in 2005, including an increase of $375 million in the discount recorded in 2005; $377 million in 2004 and $296 million in 2003. Additionally, includes $269 million in 2005, $317 million in 2004 and $323 million in 2003 for the general reinsurance operations of Transatlantic, and $197 million of additional losses incurred in 2005 resulting from increased labor and material costs related to the 2004 Florida hurricanes.*

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

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

For 2005, AIG s overall net loss reserve development from prior accident years was an increase of approximately $4.67 billion, including approximately $269 million from the general reinsurance operations of Transatlantic. This $4.67 billion adverse development in 2005 was comprised of approximately $8.60 billion for the 2002 and prior accident years, partially offset by favorable development for accident years 2003 and 2004 for most classes of business, with the notable exception being D&O. The adverse loss development for 2002 and prior accident years is attributable to approximately $4.0 billion of development from D&O and related management liability classes of business, excess casualty, and excess workers compensation, and to approximately $900 million of adverse development from asbestos and environmental claims. The remaining portion of the adverse development for 2002 and prior accident years includes approximately $520 million related to Transatlantic with the balance spread across many other classes of business.

For 2004, AIG s overall net loss reserve development from prior accident years was an increase of approximately $3.56 billion, including approximately $317 million from the general reinsurance operations of Transatlantic and approximately $377 million from accretion of loss reserve discount. The overall net adverse development also included approximately $1.01 billion from asbestos and environmental claims, including the $850 million charge reflected in the fourth quarter of 2004. The majority of the remaining net adverse development was attributable to approximately $750 million of adverse development pertaining to accident years 2002 and prior for the D&O and related management liability classes of business, and to approximately $500 million of adverse development pertaining to accident years 2000 and prior for the excess casualty class.

For 2003, AIG s overall net adverse reserve development from prior accident years was approximately $2.36 billion, including approximately $323 million from the general reinsurance operations of Transatlantic, and approximately $296 million pertaining to the accretion of loss reserve discount. The overall net adverse development also included approximately $95 million of net adverse development related to asbestos and environmental claims. The remaining net adverse development was principally attributable to approximately $400 million of adverse development pertaining to accident years 2000 and prior for excess casualty, approximately $450 million of adverse development from D&O and related management liability classes of business pertaining to accident years 2002 and prior, and approximately $250 million of adverse development pertaining to accident years 2002 and prior for healthcare classes of business. The adverse development for excess casualty from accident years 2000 and prior was partially offset by favorable development from accident years 2001 and 2002.

The following is a discussion of the primary reasons for the adverse development in 2005, 2004 and 2003. See Asbestos and Environmental Reserves below for a further discussion of asbestos and environmental reserves and developments.

*D&O and related management liability classes of business:* The adverse development relates principally to accident years 2002 and prior. This adverse development resulted from significant loss cost escalation due to a variety of factors, including the following: the increase in

frequency and severity of corporate bankruptcies; the increase in frequency of financial statement restatements; the sharp rise in market capitalization of publicly traded companies; and the increase in the number of initial public offerings, which led to an unprecedented number of IPO allocation/laddering suits in 2001. In addition, extensive utilization of multi-year policies during this period limited AIG s ability to respond to emerging trends as rapidly as would otherwise be the case. AIG has experienced significant adverse loss development since 2002 as a result of these issues. AIG has taken numerous actions in response to this development, including rate increases and policy form and coverage changes to better contain future loss costs in this class of business.

In the year-end 2003 and 2004 loss reserve reviews, AIG s actuaries responded to the adverse development for D&O and related management liability classes by increasing the loss development factor assumptions. The development factors applicable to accident years 1997 and subsequent were increased by approximately 4 percent in the year-end 2003 reserve study and increased by an additional 5 percent in the year-end 2004 reserve study. In addition, the expected loss ratios for accident years 2001 and subsequent were increased in the 2003 study to take into account the higher ultimate loss ratios for accident years 2000 and prior. In the 2004 study, the expected loss ratios for accident years 2002 and subsequent were increased to take into account the higher ultimate loss ratios for accident years 2001 and prior. The loss ratios for the older accident years increased due to the combination of higher than expected loss development in the year and the increase in the loss development factor assumptions.

For the year-end 2005 loss reserve review, AIG s actuaries responded to the continuing adverse development by further increasing the loss development factor assumptions. The loss development factors applicable to 1997 and subsequent accident years were increased by approximately 4 percent. In addition, AIG s actuaries began to give greater weight to loss development methods for accident years 2002 and 2003, in order to more fully respond to the recent loss experience. AIG s claims staff also conducted a series of ground-up claim projections covering all open claims for this business through accident year 2004. AIG s actuaries benchmarked the loss reserve indications for all accident years through 2004 to these claim projections. Loss reserves pertaining to D&O and related management liability classes of business are included in the Other Liability Claims Made line of business, as presented in the table on page 25.

*Excess Casualty:* The adverse development related principally to accident years 2000 and prior, and to a lesser extent 2001, and resulted from significant loss cost increases due to both frequency and severity of claims. The increase in loss costs resulted primarily from medical inflation, which increased the economic loss component of tort claims, advances in medical care, which extended the life span of severely injured workers, and larger jury verdicts, which increased the value of severe tort claims. An additional factor affecting AIG s excess casualty experience in recent years has been the accelerated exhaustion of underlying primary policies for homebuilders. This has led to increasing construction defect-related claims activity on AIG s excess policies. Many excess casualty policies were written on a multi-year basis in the late 1990s, which limited AIG s ability to respond to emerging market trends as rapidly as would otherwise be the case. In subsequent years, AIG responded to these emerging trends by increasing rates and implementing numerous policy form and coverage changes. This led to a significant improvement in experience beginning with accident year 2001.

In the year-end 2003 and 2004 loss reserve reviews, AIG s actuaries responded to the adverse development for excess casualty by increasing the loss development factor assumptions. In the year-end 2003 study, the development factors applicable to accident years 1997 and subsequent were increased by approximately 6 percent. In the year-end 2004 reserve study, the development factors applicable to accident years 1998 and subsequent were increased by 12 percent. In addition, the expected loss ratios for accident years 2001 and subsequent were increased in the 2003 study to take into account the higher ultimate loss ratios for accident years 2000 and prior. In the 2004 study, the expected loss ratios for accident years 2002 and subsequent were increased to take into account the higher ultimate loss ratios for accident years 2001 and prior.

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

performed by AIG claims staff for accounts with significant exposure to these claims. Loss reserves pertaining to the excess casualty class of business are generally included in the Other Liability Occurrence line of business, with a small portion of the excess casualty reserves included in the Other Liability Claims Made line of business, as presented in the table on page 25.

*Excess Workers Compensation:* The adverse development for prior years was approximately $1.0 billion related to 2002 and prior accident years. This adverse development resulted primarily from significant loss cost increases, primarily attributable to rapidly increasing medical inflation and advances in medical care, which increased the cost of covered medical care and extended the life span of severely injured workers. The effect of these factors on excess workers compensation claims experience is leveraged, as frequency is increased by the rising number of claims that reach the excess layers.

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

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*Overview of Loss Reserving Process*

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

*Short-Tail Reserves*

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

*Long-Tail Reserves*

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

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

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

- Loss trend factors which are used to establish expected loss ratios for subsequent accident years based on the projected loss ratio for prior accident years.
- Expected loss ratios for the latest accident year (i.e., accident year 2005 for the year-end 2005 loss reserve analysis) and, in some cases for accident years prior to the latest accident year. The expected loss ratio generally reflects the projected loss ratio from prior accident years, adjusted for the loss trend (see above) and the effect of rate changes and other quantifiable factors on the loss ratio. For low-frequency, high-severity classes such as excess casualty, expected loss ratios generally are used for at least the three most recent accident years.
- Loss development factors which are used to project the reported losses for each accident year to an ultimate basis. Generally, the actual loss development factors observed from prior accident years would be used as a basis to determine the loss development factors for the subsequent accident years.

AIG records quarterly changes in loss reserves for each of its many General Insurance classes of business. The overall change in AIG s loss reserves is based on the sum of these classes of business changes. For most long-tail classes of business, the process of recording quarterly loss reserve changes involves determining the estimated current loss ratio for each class of coverage. This loss ratio is multiplied by the current quarter s net earned premium for that

class of coverage to determine the current accident quarter s total estimated net incurred loss and loss expense. The change in loss reserves for the quarter for each class is thus the difference between the net incurred loss and loss expense, estimated as described above, and the net paid losses and loss expenses in the quarter. Also any change in estimated ultimate losses from prior accident years, either positive or negative, is reflected in the loss reserve for the current quarter.

*Details of the Loss Reserving Process*

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

A comprehensive annual loss reserve review is completed in the fourth quarter of each year for each AIG general insurance subsidiary. These reviews are conducted in full detail for each class of business for each subsidiary, and thus consist of hundreds of individual analyses. The purpose of these reviews is to confirm the appropriateness of the reserves carried by

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each of the individual subsidiaries, and therefore of AIG s overall carried reserves. The reserve analysis for each class of business is performed by the actuarial personnel who are most familiar with that class of business. In completing these detailed actuarial reserve analyses, the actuaries are required to make numerous assumptions, including the selection of loss development factors and loss cost trend factors. They are also required to determine and select the most appropriate actuarial methods to employ for each business class. Additionally, they must determine the appropriate segmentation of data from which the adequacy of the reserves can be most accurately tested. In the course of these detailed reserve reviews a point estimate of the loss reserve is determined. The sum of these point estimates for each class of business for each subsidiary provides an overall actuarial point estimate of the loss reserve for that subsidiary. The ultimate process by which the actual carried reserves are determined considers both the actuarial point estimate and numerous other internal and external factors including a qualitative assessment of inflation and other economic conditions in the United States and abroad, changes in the legal, regulatory, judicial and social environment, underlying policy pricing, terms and conditions, and claims handling. Loss reserve development can also be affected by commutations of assumed and ceded reinsurance agreements.

*Actuarial Methods for Major Classes of Business*

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

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

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

Bornhuetter Ferguson methods are expected loss ratio methods for which the expected loss ratio is applied only to the expected unreported portion of the losses. For example, for a long-tail class of business for which only 10 percent of the losses are expected to be reported at the end of the accident year, the expected loss ratio would be applied to the 90 percent of the losses still unreported. The actual reported losses at the end of the accident year would be added to determine the total ultimate loss estimate for the accident year. Subtracting the reported paid losses and loss expenses would result in the indicated loss reserve. In the example above, the expected loss ratio of 70 percent would be

multiplied by 90 percent. The result of 63 percent would be applied to the earned premium of $10 million resulting in an estimated unreported loss of $6.3 million. Actual reported losses would be added to arrive at the total ultimate losses. If the reported losses were $1 million, the ultimate loss estimate under the Bornhuetter Ferguson method would be $7.3 million versus the $7 million amount under the expected loss ratio method described above. Thus, the Bornhuetter Ferguson method gives partial credibility to the actual loss experience to date for the class of business. Loss development methods generally give full credibility to the reported loss experience to date. In the example above, loss development methods would typically indicate an ultimate loss estimate of $10 million, as the reported losses of $1 million would be estimated to reflect only 10 percent of the ultimate losses.

A key advantage of loss development methods is that they respond quickly to any actual changes in loss costs for the class of business. Therefore, if loss experience is unexpectedly deteriorating or improving, the loss development method gives full credibility to the changing experience. Expected loss ratio methods would be slower to respond to the change, as they would continue to give more weight to the expected loss ratio, until enough evidence emerged for the expected loss ratio to be modified to reflect the changing loss experience. On the other hand, loss development methods have the disadvantage of overreacting to changes in reported losses if in fact the loss experience is not credible. For example, the presence or absence of large losses at the early stages of loss development

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could cause the loss development method to overreact to the favorable or unfavorable experience by assuming it will continue at later stages of development. In these instances, expected loss ratio methods such as Bornhuetter Ferguson have the advantage of properly recognizing large losses without extrapolating unusual large loss activity onto the unreported portion of the losses for the accident year. AIG s loss reserve reviews for long-tail classes typically utilize a combination of both loss development and expected loss ratio methods. Loss development methods are generally given more weight for accident years and classes of business where the loss experience is highly credible. Expected loss ratio methods are given more weight where the reported loss experience is less credible, or is driven more by large losses. Expected loss ratio methods require sufficient information to determine the appropriate expected loss ratio. This information generally includes the actual loss ratios for prior accident years, and rate changes as well as underwriting or other changes which would affect the loss ratio. Further, an estimate of the loss cost trend or loss ratio trend is required in order to allow for the effect of inflation and other factors which may increase or otherwise change the loss costs from one accident year to the next.

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

*Excess Casualty:* AIG generally uses a combination of loss development methods and expected loss ratio methods for excess casualty classes. Expected loss ratio methods are generally utilized for at least the three latest accident years, due to the relatively low credibility of the reported losses. The loss experience is generally reviewed separately for lead umbrella classes and for other excess classes, due to the relatively shorter tail for lead umbrella business. Automobile-related claims are generally reviewed separately from non-auto claims, due to the shorter tail nature of the automobile related claims. The expected loss ratios utilized for recent accident years are based on the projected ultimate loss ratios of prior years, adjusted for rate changes, estimated loss cost trends and all other changes that can be quantified. The estimated loss cost trend utilized in the year-end 2005 reviews averaged approximately 6 percent for excess casualty classes. Frequency/severity methods are generally not utilized as the vast majority of reported claims do not result in a claim payment. In addition, the average severity varies significantly from accident year to accident year due to large losses which characterize this class of business, as well as changing proportions of claims which do not result in a claim payment.

*D&O:* AIG generally utilizes a combination of loss development methods and expected loss ratio methods for D&O and related management liability classes of business. Expected loss ratio methods are given more weight in the two most recent accident years, whereas loss development methods are given more weight in more mature accident years. Beginning with the year-end 2005 loss reserve review, AIG s actuaries began to utilize claim projections provided by AIG claims staff as a benchmark for determining the indicated ultimate losses for accident years 2004 and prior. In prior years, AIG s actuaries had utilized these claims projections as a benchmark for profitability studies for major classes of D&O and related management liability business. The track record of these claims projections has indicated a very low margin of error, thus providing support for their usage as a benchmark in determining the estimated loss

reserve. These classes of business reflect claims made coverage, and losses are characterized by low frequency and high severity. Thus, the claim projections can produce an accurate overall indicator of the ultimate loss exposure for these classes by identifying and estimating all large losses. Frequency/severity methods are generally not utilized for these classes as the overall losses are driven by large losses more than by claim frequency. Severity trends have varied significantly from accident year to accident year.

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

*Excess Workers Compensation:* AIG generally utilizes a combination of loss development methods and expected loss ratio methods. Loss development methods are given the greater weight for mature accident years such as 1999 and prior. Expected loss ratio methods are given the greater weight for the more recent accident years.

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Excess workers compensation is an extremely long-tail class of business, with loss emergence extending for decades. Therefore there is limited credibility in the reported losses for many of the more recent accident years. Beginning with the year-end 2005 loss reserve review, AIG s actuaries began to utilize claims projections provided by AIG claims staff to help determine the loss development factors for this class of business.

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

*Commercial Automobile Liability:* AIG generally utilizes loss development methods for all but the most recent accident year for commercial automobile classes of business. Expected loss ratio methods are generally given significant weight only in the most recent accident year. Frequency/severity methods are generally not utilized due to significant changes and growth in this business over the years.

*Healthcare:* AIG generally uses a combination of loss development methods and expected loss ratio methods for healthcare classes of business. The largest component of the healthcare business consists of coverage written for hospitals and other healthcare facilities. Reserves for excess coverage are tested separately from those for primary coverage. For primary coverages, loss development methods are generally given the majority of the weight for all but the latest three accident years, and are given some weight for all years other than the latest accident year. For excess coverages, expected loss methods are generally given all the weight for the latest three accident years, and are also given considerable weight for accident years prior to the latest three years. For other classes of healthcare coverage, an analogous weighting between loss development and expected loss ratio methods is utilized. The weights assigned to each method are those which are believed to result in the best combination of responsiveness and stability. Frequency/severity methods are sometimes utilized for pricing certain healthcare accounts or business. However, in testing loss reserves the business is generally combined into larger groupings to enhance the credibility of the loss experience. The frequency/severity methods that are applicable in pricing may not be appropriate for reserve testing and thus frequency/severity methods are not generally employed in AIG s healthcare reserve analyses.

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

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

claims from year to year.
*Personal Auto (Domestic):* AIG generally utilizes frequency/severity methods and loss development methods for domestic personal auto classes. For many classes of business, greater reliance is placed on frequency/severity methods as claim counts emerge quickly for personal auto and allow for more immediate analysis of resulting loss trends and comparisons to industry and other diagnostic metrics.
*Fidelity/ Surety:* AIG generally uses loss development methods for fidelity exposures for all but the latest accident year. Expected loss ratio methods are also given weight for the more recent accident years, and for the latest accident year they may be given 100 percent weight. For surety exposures, AIG generally uses the same method as for short-tail classes.
*Mortgage Guaranty:* AIG tests mortgage guaranty reserves using loss development methods, supplemented by an internal claim analysis by actuaries and staff who specialize in the mortgage guaranty business. The claim analysis projects ultimate losses for claims within each of several categories of default based on actual historical experience and is essentially a frequency/severity analysis for each category of default.
*Short-Tail Classes:* AIG generally uses either loss development methods or IBNR factor methods to set reserves for short-tail classes such as property coverages. Where a factor is used, it generally represents a percent of earned premium or other exposure measure. The factor is determined based on prior accident year experience. For example, the IBNR for a class of property coverage might be expected to approximate 20 percent of the latest year s earned premium. The factor is continually reevaluated in light of emerging claim experience as well as rate changes or other factors that could affect the adequacy of the IBNR factor being employed.
*International:* Business written by AIG s Foreign General sub-segment includes both long-tail and short-tail classes of business. For long-tail classes of business, the actuarial methods utilized would be analogous to those described above. However, the majority of business written by Foreign General is short-tail, high frequency and low severity in

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

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

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

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

*Volatility of Reserve Estimates and Sensitivity Analyses*

As described above, AIG uses numerous assumptions in determining its best estimate of reserves for each class of business. The importance of any specific assumption can vary by both class of business and accident year. If actual experience differs from key assumptions used in establishing reserves, there is potential for significant variation in the development of loss reserves, particularly for long-tail casualty classes of business such as excess casualty, D&O or workers compensation. Set forth below is a sensitivity analysis that estimates the effect on the loss reserve position of using alternative loss trend or loss development factor assumptions rather than those actually used in determining AIG s best estimates in the year-end loss reserve analyses for 2005. The analysis addresses each major class of business for which a material deviation to AIG s overall reserve position is believed reasonably possible, and uses what AIG believes is a reasonably likely range of potential deviation for each class. There can be no assurance, however, that actual reserve development will be consistent with either the original or the adjusted loss trend or loss development factor assumptions, or that other assumptions made in the reserving process will not materially affect reserve development for a particular class of business.

*Excess Casualty:* For the excess casualty class of business, the assumed loss cost trend was approximately six percent. After evaluating the historical loss cost trends from prior accident years since the early 1990s, in AIG s judgment, it is reasonably likely that actual loss cost trends applicable to the year-end 2005 loss reserve review for excess casualty will range from negative four percent to positive 16 percent, or approximately ten percent lower or higher than the assumption actually utilized in the year-end 2005 reserve review. A ten percent change in the assumed loss cost trend for excess casualty would cause approximately a $1.4 billion increase or a $1.0 billion decrease in the net loss and loss expense reserve for this class of business. It should be emphasized that the ten percent deviations are not considered the highest possible deviations that might be expected, but rather what is considered by AIG to reflect a reasonably

likely range of potential deviation. Actual loss cost trends in the early 1990s were negative for several years, including amounts below the negative four percent cited above, whereas actual loss cost trends in the late 1990s ran well into the double digits for several years, including amounts greater than the 16 percent cited above. Thus, there can be no assurance that loss trends will not deviate by more than ten percent. The loss cost trend assumption is critical for the excess casualty class of business due the long-tail nature of the claims and therefore is applied across many accident years.

For the excess casualty class of business, the assumed loss development factors are also a key assumption. After evaluating the historical loss development factors from prior accident years since the early 1990s, in AIG s judgment, it is reasonably likely that actual loss development factors will range from approximately five percent below those actually utilized in the year-end 2005 reserve review to approximately ten percent above those factors actually utilized. If the loss development factor assumptions were changed by five percent and ten percent, respectively, the net loss reserves for the excess casualty class would decrease by approximately $500 million under the lower assumptions or increase by approximately $1.1 billion under the higher assumptions. Generally, actual historical loss development factors are used to project future loss development. However there can be no assurance that future loss development patterns will be the same as in the past, or that they will not deviate by more than the amounts illustrated above. Moreover, as excess casualty is a long-tail class of business, any deviation in loss cost trends or in loss development factors might not be discernible for an extended period of time subsequent to the recording of the initial loss reserve estimates for any accident year. Thus, there is the potential for the reserves with respect to a number of accident years to be significantly affected by changes in the loss cost trends or loss development factors that were initially relied upon in setting the reserves. These changes in loss trends or loss development factors could be attributable to changes in inflation or in the judicial environment, or in other social or economic conditions affecting claims. Thus, there is the

potential for variations greater than the amounts cited above, either positively or negatively.

*D&O and Related Management Liability Classes of Business:* For D&O and related management liability classes of business, the assumed loss cost trend was approximately four percent. After evaluating the historical loss cost trends from prior accident years since the early 1990s, in AIG s judgment, it is reasonably likely that actual loss cost trends applicable to the year-end 2005 loss reserve review for these classes will range from negative six percent to positive 14 percent, or approximately ten percent lower or higher than the assumption actually utilized in the year-end 2005 reserve review. A ten percent change in the assumed loss cost trend for these classes would cause approximately a $625 million increase or a $550 million decrease in the net loss and loss expense reserves for these classes of business. It should be emphasized that the ten percent deviations are not considered the highest possible deviations that might be expected, but rather what is considered by AIG to reflect a reasonably likely range of potential deviation. Actual loss cost trends for these classes in the early 1990s were negative for several years, including amounts below the negative six percent cited above, whereas actual loss cost trends in the late 1990s ran at nearly 50 percent per year, vastly exceeding the fourteen percent figure cited above. Because the D&O class of business has exhibited highly volatile loss trends from one accident year to the next, there is the possibility of an exceptionally high deviation.

For D&O and related management liability classes of business, the assumed loss development factors are also an important assumption but less critical than for excess casualty. Because these classes are written on a claims made basis, the loss reporting and development tail is much shorter than for excess casualty. However, the high severity nature of the claims does create the potential for significant deviations in loss development patterns from one year to the next. After evaluating the historical loss development factors for these classes of business for accident years since the early 1990s, in AIG s judgment, it is reasonably likely that actual loss development factors will range approximately five percent lower or higher than those factors actually utilized in the year-end 2005 loss reserve review for these classes. If the loss development factor assumptions were changed by five percent, the net loss reserves for these classes would increase or decrease by approximately $200 million. As noted above for excess casualty, actual historical loss development factors are generally used to project future loss development. However, there can be no assurance that future loss development patterns will be the same as in the past, or that they will not deviate by more than the five percent.

*Excess Workers Compensation:* For excess workers compensation business, loss costs were trended at six percent per annum. After reviewing actual industry loss trends for the past ten years, in AIG s judgment, it is reasonably likely that actual loss cost trends applicable to the year-end 2005 loss reserve review for excess workers compensation will range five percent lower or higher than this estimated loss trend. A five percent change in the assumed loss cost trend would cause approximately a $250 million increase or decrease in the net loss reserves for this business. It should be emphasized that the actual loss cost trend could vary significantly from this assumption, and there can be no assurance that actual loss costs will not deviate, perhaps materially, by greater than five percent.

For excess workers compensation business, the assumed loss development factors are a critical assumption. Excess workers compensation is an extremely long-tail class of business, with a much greater than normal uncertainty as to the appropriate loss development factors for the tail of the loss development. After evaluating the historical loss development factors for prior accident years since the 1980s, in AIG s judgment, it is reasonably likely that actual loss development factors will range approximately 15 percent lower or higher than those factors actually utilized in the year-end 2005 loss reserve review for excess workers compensation. If the loss development factor assumptions were changed by 15 percent, the net loss reserves for excess workers compensation would increase or decrease by approximately $525 million or $425 million, respectively. Given the exceptionally long-tail for this class of business, there is the potential for actual deviations in the loss development tail to exceed the deviations assumed, perhaps materially.

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

However, for primary workers compensation business the loss development factor assumptions are important. Generally, AIG s actual historical workers compensation loss development factors would be expected to provide a reasonably accurate predictor of future loss development. However, workers compensation is a long-tail class of business, and AIG s business reflects a very significant volume of losses particularly in recent accident years due to growth of the business. After evaluating the actual historical loss developments since the 1980s for this business, in AIG s judgment, it is reasonably likely that actual loss development factors will fall within the range of approximately 2.75 percent below to 7.5 percent above those actually utilized in the year-end 2005 loss reserve review. If the loss development factor assumptions were changed by 2.75 percent and 7.5 percent, respectively, the net loss reserves for workers compensation would decrease or increase by approximately $450 million and $1.25 billion, respectively. For these classes of business, there can be no assurance that actual deviations from the expected loss development factors will not exceed the deviations assumed, perhaps materially.

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

*Asbestos and Environmental Reserves*

The estimation of loss reserves relating to asbestos and environmental claims on insurance policies written many years ago is subject to greater uncertainty than other types of claims due to inconsistent court decisions as well as judicial interpretations and legislative actions that in some cases have tended to broaden coverage beyond the original intent of such policies and in others have expanded theories of liability. The insurance industry as a

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whole is engaged in extensive litigation over these coverage and liability issues and is thus confronted with a continuing uncertainty in its efforts to quantify these exposures.

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

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

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

Estimation of asbestos and environmental claims loss reserves is a subjective process and reserves for asbestos and environmental claims cannot be estimated using conventional reserving techniques such as those that rely on historical accident year loss development factors.

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

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

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

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

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

asbestos (Tiers Three and Four). Through its commitment to appropriate staffing, training, and management oversight of asbestos cases, AIG mitigates to the extent possible its exposure to these claims.

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

In order to ensure its ground-up analysis was as comprehensive as possible, AIG staff produced the information required at policy and claim level detail for nearly 1,000 asbestos defendants and over 1,100 environmental defendants. This represented nearly 90 percent of all accounts for which AIG had received any claim notice of any amount pertaining to asbestos or environmental exposure. AIG did not set any minimum thresholds such as amount of case reserve outstanding, or paid losses to date, that would have served to reduce the sample size and hence the comprehensiveness of the ground-up analysis. The results of the ground-up analysis for each significant account were examined by AIG s claims staff

for reasonableness, for consistency with policy coverage terms, and any claim settlement terms applicable. Adjustments were incorporated accordingly. The results from the universe of modeled accounts, which as noted above reflects the vast majority of AIG s known exposures, were then utilized to estimate the ultimate losses from accounts that could not be modeled and to determine the appropriate provision for all unreported claims.

AIG conducted a comprehensive analysis of reinsurance recoverability to establish the appropriate asbestos and environmental reserve net of reinsurance. AIG determined the amount of reinsurance that would be ceded to insolvent reinsurers or to commuted reinsurance contracts for both reported claims and for IBNR. These amounts were then deducted from the indicated amount of reinsurance recoverable.

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

For asbestos, these tests project the expected losses to be reported over the next twenty years, i.e., from 2006 through 2025, based on the actual losses reported through 2005 and the expected future loss emergence for these claims. Three scenarios were tested, with a series of assumptions ranging from more optimistic to more conservative. In the first scenario, all carried asbestos case reserves are assumed to be within ten percent of their ultimate settlement value. The second scenario relies on an actuarial projection of report year development for asbestos claims reported from 1993 to the present to estimate case reserve adequacy as of year-end 2005. The third scenario relies on an actuarial projection of report year claims for asbestos but reflects claims reported from 1989 to the present to estimate case reserve adequacy as of year-end 2005. Based on the results of the prior report years for each of the three scenarios described above, the report year approach then projects forward to the year 2025 the expected future report year losses, based on AIG s estimate of reasonable loss trend assumptions. These calculations are performed on losses gross of reinsurance. The IBNR (including a provision for development of reported claims) on a net basis is based on applying a factor reflecting the expected ratio of net losses to gross losses for future loss emergence.

For environmental claims, an analogous series of frequency/ severity tests are produced. Environmental claims from future report years, (i.e., IBNR) are projected out ten years, i.e., through the year 2015.

At year-end 2005, AIG considered a number of factors and recent experience, in addition to the results of the respective top-down and ground-up analyses performed for asbestos and environmental reserves. Among the factors considered by AIG was the continued deterioration in its asbestos report year experience. The indication from the third scenario of the top-down analysis for the asbestos reserves was approximately $265 million greater than AIG s carried net asbestos reserves, prior to its increase in the fourth quarter of 2005. This marks a continuation of the trend of adverse report year development for asbestos that has been observed for the past several years. AIG also noted its asbestos paid losses in 2005 increased from 2004 s levels. AIG considered the significant uncertainty that remains as to AIG s ultimate liability relating to asbestos and environmental claims. This uncertainty is due to several factors including:

- The long latency period between asbestos exposure and disease manifestation and the resulting potential for involvement of multiple policy periods for individual claims;
- The increase in the volume of claims by currently unimpaired plaintiffs;
- Claims filed under the non-aggregate premises or operations section of general liability policies;
- The number of insureds seeking bankruptcy protection and the effect of prepackaged bankruptcies;
- Diverging legal interpretations; and
- With respect to environmental claims, the difficulty in estimating the allocation of remediation cost among various parties.

After carefully considering the results of the ground-up analysis, which AIG now plans to update on an annual basis, as well as all of the above factors, including the recent report year experience, AIG determined its best estimate was to recognize an increase of $843 million in its carried net asbestos reserves, and an increase of $30 million in its carried net environmental reserves at December 31, 2005. This increase in carried net asbestos reserves reflects the change from AIG s historical top-down analysis to the ground-up analysis described above. The corresponding increases in gross reserves were approximately $1.97 billion for asbestos and $56 million for environmental, respectively.

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A summary of reserve activity, including estimates for applicable IBNR, relating to asbestos and environmental claims separately and combined at December 31, 2005, 2004 and 2003 follows:

| | **2005** | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| *(in millions)* | **Gross** | **Net** | Gross | Net | Gross | Net |
| Asbestos: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | **$2,559** | **$1,060** | $1,235 | $ 386 | $1,304 | $ 400 |
| Losses and loss expenses incurred* | **2,207***(a)* | **903***(a)* | 1,595*(a)* | 772*(a)* | 175 | 43 |
| Losses and loss expenses paid* | **(325)** | **(123)** | (271) | (98) | (244) | (57) |
| Reserve for losses and loss expenses at end of year | **$4,441** | **$1,840** | $2,559 | $1,060 | $1,235 | $ 386 |
| Environmental: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | **$ 974** | **$ 451** | $ 789 | $ 283 | $ 832 | $ 296 |
| Losses and loss expenses incurred* | **47***(b)* | **27***(b)* | 314*(b)* | 234*(b)* | 133 | 52 |
| Losses and loss expenses paid* | **(95)** | **(68)** | (129) | (66) | (176) | (65) |
| Reserve for losses and loss expenses at end of year | **$ 926** | **$ 410** | $ 974 | $ 451 | $ 789 | $ 283 |
| Combined: | | | | | | |
| Reserve for losses and loss expenses at beginning of year | **$3,533** | **$1,511** | $2,024 | $ 669 | $2,136 | $ 696 |
| Losses and loss expenses incurred* | **2,254***(c)* | **930***(c)* | 1,909*(c)* | 1,006*(c)* | 308 | 95 |
| Losses and loss expenses paid* | **(420)** | **(191)** | (400) | (164) | (420) | (122) |
| Reserve for losses and loss expenses at end of year | **$5,367** | **$2,250** | $3,533 | $1,511 | $2,024 | $ 669 |

* *All amounts pertain to policies underwritten in prior years.*

*(a) Includes increases to gross losses and loss expense reserves of $2.0 billion and $1.2 billion in the fourth quarter of 2005 and 2004, respectively, and increases to net losses and loss expense reserves of $843 million and $650 million for the fourth quarter of 2005 and 2004, respectively.*

*(b)*

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

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

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**The gross and net IBNR included in the reserve for losses and loss expenses, relating to asbestos and environmental claims separately and combined, at December 31, 2005, 2004 and 2003 were estimated as follows:**

| | **2005** | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| *(in millions)* | **Gross** | **Net** | Gross | Net | Gross | Net |
| Asbestos | **$3,401** | **$1,465** | $2,033 | $ 876 | $ 695 | $200 |
| Environmental | **586** | **266** | 606 | 284 | 347 | 80 |
| Combined | **$3,987** | **$1,731** | $2,639 | $1,160 | $1,042 | $280 |

**A summary of asbestos and environmental claims count activity for the years ended December 31, 2005, 2004 and 2003 was as follows:**

| | **2005** | | | 2004 | | | 2003 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Asbestos** | **Environmental** | **Combined** | Asbestos | Environmental | Combined | Asbestos | Environmental | Combined |
| Claims at beginning of year | **7,575** | **8,216** | **15,791** | 7,474 | 8,852 | 16,326 | 7,085 | 8,995 | 16,080 |
| Claims during year: | | | | | | | | | |
| Opened | **854** | **5,253*** | **6,107** | 909 | 2,592 | 3,501 | 669 | 2,106 | 2,775 |
| Settled | **(67)** | **(219)** | **(286)** | (100) | (279) | (379) | (86) | (244) | (330) |
| Dismissed or otherwise resolved | **(1,069)** | **(3,377)** | **(4,446)** | (708) | (2,949) | (3,657) | (194) | (2,005) | (2,199) |
| Claims at end of year | **7,293** | **9,873** | **17,166** | 7,575 | 8,216 | 15,791 | 7,474 | 8,852 | 16,326 |

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

The table below presents AIG s survival ratios for asbestos and environmental claims for year end 2005, 2004 and 2003. The survival ratio is derived by dividing the year end carried loss reserve by the average payments for the three most recent calendar years for these claims. Therefore the survival ratio is a simplistic measure estimating the number

of years it would be before the current ending loss reserves for these claims would be paid off using recent year average payments. Many factors, such as aggressive settlement procedures, mix of business and level of coverage provided, have a significant effect on the amount of asbestos and environmental reserves and payments and the resultant survival ratio. Thus, caution should be exercised in attempting to determine reserve adequacy for these claims based simply on this survival ratio.

**AIG s survival ratios for asbestos and environmental claims, separately and combined were based upon a three-year average payment. These ratios for the years ended December 31, 2005, 2004 and 2003 were as follows:**

| | Gross | Net |
|---|---|---|
| **2005** | | |
| Survival ratios: | | |
| Asbestos | **15.9** | **19.8** |
| Environmental | **6.9** | **6.2** |
| Combined | **13.0** | **14.2** |
| **2004** | | |
| Survival ratios: | | |
| Asbestos | 10.7 | 13.5 |
| Environmental | 6.5 | 6.8 |
| Combined | 9.1 | 10.5 |
| **2003** | | |
| Survival ratios: | | |
| Asbestos | 4.7 | 4.5 |
| Environmental | 4.7 | 4.1 |
| Combined | 4.7 | 4.3 |

*Life Insurance & Retirement Services Operations*

AIG s Life Insurance & Retirement Services subsidiaries offer a wide range of insurance and retirement savings products both domestically and abroad. Insurance-oriented products consist of individual and group life, payout annuities, endowment and accident and health policies. Retirement savings products consist generally of fixed and variable annuities. See also Note 2 of Notes to Consolidated Financial Statements.

Domestically, AIG s Life Insurance & Retirement Services operations offer a broad range of protection products, including life insurance, group life and health products, including disability income products and payout annuities, which include single premium immediate annuities, structured settlements and terminal funding annuities. Home service operations include an array of life insurance, accident and health and annuity products sold through career agents. In addition, home service includes a small block of run-off property and casualty coverage. Retirement services include group retirement products, individual fixed and variable annuities sold through banks, broker dealers and exclusive sales representatives, and annuity runoff operations which include previously-acquired closed blocks and other fixed and variable annuities largely sold through distribution relationships that have been discontinued.

Overseas, AIG s Life Insurance & Retirement Services operations include insurance and investment-oriented products such as whole and term life, investment linked, universal life and endowments, personal accident and health products, group products including pension, life and health, and fixed and variable annuities.

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**Life Insurance & Retirement Services operations presented on a major product basis for 2005, 2004 and 2003 were as follows:**

| *(in millions)* | **2005** | 2004[a] | 2003[a] |
|---|---|---|---|
| **GAAP Premiums:** | | | |
| Domestic Life: | | | |
| Life insurance | **$ 2,108** | $ 1,888 | $ 1,751 |
| Home service | **801** | 812 | 834 |
| Group life/health | **1,012** | 1,128 | 1,046 |
| Payout annuities[b] | **1,473** | 1,484 | 1,272 |
| Total | **5,394** | 5,312 | 4,903 |
| Domestic Retirement Services: | | | |
| Group retirement products | **351** | 313 | 250 |
| Individual fixed annuities | **100** | 59 | 53 |
| Individual variable annuities | **467** | 407 | 331 |
| Individual fixed annuities runoff[c] | **72** | 80 | 86 |
| Total | **990** | 859 | 720 |
| Total Domestic | **6,384** | 6,171 | 5,623 |
| Foreign Life: | | | |
| Life insurance | **15,631** | 14,938 | 13,204 |
| Personal accident & health | **5,002** | 4,301 | 3,126 |
| Group products[d] | **1,925** | 2,215 | 1,267 |
| Total | **22,558** | 21,454 | 17,597 |
| Foreign Retirement Services: | | | |
| Individual fixed annuities | **361** | 395 | 255 |
| Individual variable annuities | **97** | 68 | 21 |
| Total | **458** | 463 | 276 |
| Total Foreign | **23,016** | 21,917 | 17,873 |
| Total GAAP Premiums | **$29,400** | $28,088 | $23,496 |
| **Net investment income:** | | | |
| Domestic Life: | | | |
| Life insurance | **$ 1,411** | $ 1,287 | $ 1,179 |
| Home service | **605** | 608 | 616 |

| | | | |
|---|---|---|---|
| Group life/health | **142** | 123 | 121 |
| Payout annuities | **912** | 801 | 699 |
| Total | **3,070** | 2,819 | 2,615 |
| Domestic Retirement Services: | | | |
| Group retirement products | **2,233** | 2,201 | 2,055 |
| Individual fixed annuities | **3,393** | 3,100 | 2,567 |
| Individual variable annuities | **217** | 239 | 239 |
| Individual fixed annuities runoff[f] | **1,046** | 1,076 | 1,266 |
| Total | **6,889** | 6,616 | 6,127 |
| Total Domestic | **9,959** | 9,435 | 8,742 |

| *(in millions)* | **2005** | 2004[a] | 2003[a] |
|---|---|---|---|
| Foreign Life: | | | |
| Life insurance | **4,844** | 4,065 | 3,356 |
| Personal accident & health | **255** | 179 | 161 |
| Group products | **613** | 431 | 326 |
| Intercompany adjustments | **(36)** | (18) | (15) |
| Total | **5,676** | 4,657 | 3,828 |
| Foreign Retirement Services: | | | |
| Individual fixed annuities | **1,728** | 1,034 | 368 |
| Individual variable annuities | **771** | 143 | 4 |
| Total | **2,499** | 1,177 | 372 |
| Total Foreign | **8,175** | 5,834 | 4,200 |
| Total net investment income | **$ 18,134** | $ 15,269 | $ 12,942 |
| **Realized capital gains (losses):** | | | |
| Domestic realized capital gains (losses)[e] | **$ (302)** | $ (329) | $ (246) |
| Foreign realized capital gains (losses)[f] | **(260)** | 147 | 330 |
| Pricing net investment gains[g] | **344** | 225 | 156 |
| Total Foreign | **84** | 372 | 486 |
| Total realized capital gains (losses) | **$ (218)** | $ 43 | $ 240 |
| Operating Income: | | | |
| Domestic[h] | **3,599** | 3,075 | 2,765 |
| Foreign | **5,245** | 4,848 | 4,042 |

| | | | |
|---|---|---|---|
| Total operating income | **$ 8,844** | $ 7,923 | $ 6,807 |
| **Life insurance in force:** | | | |
| Domestic | **$ 825,151***(i)* | $ 772,251 | $ 645,606 |
| Foreign | **1,027,682** | 1,085,843 | 937,425 |
| Total | **$1,852,833** | $1,858,094 | $1,583,031 |

*(a) Adjusted to conform to 2005 presentation.*

*(b) Includes structured settlements, single premium immediate annuities and terminal funding annuities.*

*(c) Primarily represents runoff annuity business sold through discontinued distribution relationships.*

*(d) Revenues in 2004 includes approximately $640 million of single premium from a reinsurance transaction involving terminal funding business, which is offset by a similar increase of benefit reserves.*

*(e) Includes the effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133 and the application of FAS 52. For 2005, 2004, and 2003, respectively, the amounts included are $63 million, $(6) million, and $19 million.*

*(f) Includes the effect of hedging activities that do not qualify for hedge accounting treatment under FAS 133 and the application of FAS 52. For 2005, 2004, and 2003, respectively, the amounts included are $(500) million, $(134) million, and $59 million.*

*(g) For purposes of this presentation, pricing net investment gains are segregated as a component of total realized gains (losses). They represent certain amounts of realized capital gains where gains are an inherent element in pricing certain life products in some foreign countries.*

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(h) *Operating income includes the effect on deferred policy acquisition cost amortization for FAS 97 products related to realized capital gains (losses) and has reduced amortization costs totaling $59 million, $44 million and $54 million for 2005, 2004 and 2003, respectively.*

(i) *Domestic in-force for 2005 includes the effect of the non-renewal of a single large group life case of $36 billion.*

AIG s Life Insurance & Retirement Services subsidiaries report their operations through the following operating units: Domestic Life AIG American General, including American General Life Insurance Company (AG Life), USLIFE and AGLA; Domestic Retirement Services VALIC, AIG Annuity and AIG SunAmerica; Foreign Life ALICO, AIRCO, AIG Edison Life, AIG Star Life, AIA, Nan Shan and Philamlife.

*Life Insurance & Retirement Services Results*

The increase in operating income in 2005 compared to 2004 was caused by growth in both domestic and overseas operations. Similarly, the increase in operating income in 2004 compared to 2003 was due to strong growth, particularly overseas.

Life Insurance & Retirement Services GAAP premiums grew in 2005 when compared with 2004 as well as 2004 when compared with 2003. AIG s Domestic Life operations had continued growth in term and universal life sales with good performance from the independent distribution channels. GAAP premiums for life insurance grew 12 percent in 2005 reflecting consistently strong sales from the independent distribution channels. Retail periodic life sales increased 18 percent in 2005, representing a compound rate of growth of 16 percent since 2001, compared to modest growth in the industry. Profit margins have been maintained through strict underwriting discipline and low cost. In addition, increases in product prices and retention have offset price increases by reinsurers. Payout annuities declined slightly due to the low interest rate environment and the competitive market conditions for structured settlement and single premium individual annuity business. The domestic group business is below AIG s growth standards, largely because several accounts where pricing was unacceptable were not renewed and loss experience was higher than anticipated. Restructuring efforts in this business are focused on new product introductions, cross selling and other growth strategies. AGLA, the home service business, is diversifying product offerings, enhancing the capabilities and quality of the sales force, and broadening the markets served beyond those historically serviced in an effort to accelerate growth, although it is expected to remain a slow growth business.

Domestic Retirement Services businesses faced a challenging environment in 2005 and 2004, as deposits declined approximately 17 percent for 2005 compared to 2004 and 1 percent for 2004 compared to 2003. The decrease in AIG s individual variable annuity product sales in 2005 was largely attributable to significant variable annuity sales declines at several of AIG s largest distribution firms due to lackluster equity markets, more intense industry competition with regard to living benefit product features and heightened compliance procedures over selling practices. AIG s introduction of more competitive guaranteed minimum withdrawal features was delayed until late in the fourth quarter due to filing delays associated with the Restatements. During 2005, the interest yield curve flattened and, as a result, competing bank products such as certificates of deposit and other money market instruments with shorter durations than AIG s individual fixed annuity products became more attractive. The following table reflects deposit amounts for Domestic Retirement Services:

Domestic Retirement Services Deposits

| *December 31,*<br>**(in millions)** | **2005** | **2004** | **2003** |
|---|---|---|---|
| Group retirement products* | **$ 6,436** | $ 6,502 | $ 5,918 |
| Individual fixed annuities | **7,337** | 9,947 | 11,384 |
| Individual variable annuities | **3,319** | 4,126 | 3,412 |

| | | | |
|---|---|---|---|
| Individual fixed annuities - runoff | **200** | 253 | 350 |
| Total | **$17,292** | $20,828 | $21,064 |

* *Includes mutual funds.*

In 2005, AIG experienced a significant increase in surrender rates in all product lines. Group retirement products experienced higher surrenders as the average participant age increased and a greater percentage of these participants are near retirement age and/or termination of service from their employers. Individual fixed annuities surrender rates are higher in 2005 primarily due to the shape of the interest yield curve and the general aging of the in-force reserves. However, less than 20 percent of the individual fixed annuity reserves are available to surrender without charge. The increase in individual variable annuity surrender rates primarily reflects the higher shock-lapse that occurred following expiration of the surrender charge period on certain 3-year and 7-year contracts (including a large closed block of acquired business). Reflecting a widespread industry phenomenon, this lapse rate, much of which was anticipated when the products were issued, has recently been affected by investor demand to exchange existing policies for new-generation contracts with living benefits or lower fees. In addition, partial withdrawals on certain variable annuity products have increased as AIG has introduced features designed to generate a stream of income to the participants. The following chart shows the amount of reserves by surrender charge category as of December 31, 2005.

Domestic Retirement Services
**Reserves Subject to Surrender Charges**

| *(in millions)* | **Group Retirement Products*** | **Individual Fixed Annuities** | **Individual Variable Annuities** |
|---|---|---|---|
| Zero or no surrender charge | $39,831 | $ 9,324 | $ 9,765 |
| Greater than 0% - 4% | 11,248 | 10,815 | 8,386 |
| Greater than 4% | 2,648 | 31,183 | 10,035 |
| Non-Surrenderable | 892 | 3,148 | 81 |
| Total | $54,619 | $54,470 | $28,267 |

* *Excludes mutual funds.*

A continued increase in the level of surrenders in any of these businesses could increase the amortization of deferred acquisition costs in future years and will negatively affect fee income earned on assets under management. The combination of reduced sales and increased surrenders and withdrawals resulted in significantly lower net flows for total domestic Retirement Services than in the prior year. AIG expects that

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net flows will remain lower than in prior years as long as an environment of lackluster equity market performance persists and the yield curve remains flat. The following table reflects the net flows for Domestic Retirement Services:

Domestic Retirement Services Net Flows[(a)]

| *December 31, (in millions)* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Group retirement products[(b)] | **$ 628** | $ 1,706 | $ 2,756 |
| Individual fixed annuities | **1,759** | 6,169 | 8,679 |
| Individual variable annuities | **(336)** | 1,145 | 927 |
| Individual fixed annuities - runoff | **(2,508)** | (2,084) | (1,967) |
| Total | **$ (457)** | $ 6,936 | $10,395 |

*(a) Net flows are defined as deposits received, less benefits, surrenders, withdrawals and death benefits.*
*(b) Includes mutual funds.*

The majority of the growth in Life Insurance & Retirement Services GAAP premiums in Foreign Life operations was attributable to the life insurance and personal accident & health lines of business. Globally, AIG s deep and diverse distribution, which includes bancassurance, worksite marketing, direct marketing, and strong agency organizations, provides a powerful platform for growth. This growth was most significant in Japan, where AIG has benefited from a flight to quality and development of multiple distribution channels. In Southeast Asia, AIG maintains significant market share by offering an attractive and diverse product line, distributed by its strong agency force. There has been a continuing trend in Southeast Asia, as the insurance market continues to develop, for clients to purchase investment-oriented products at the expense of traditional term or whole life products. For GAAP reporting purposes, only revenues from policy charges for insurance, administration, and surrender charges are reported as GAAP premiums. This product mix shift contributed to the single digit growth rate in Foreign Life Insurance & Retirement Services GAAP premiums.

Also in Japan, AIG Edison Life has improved the quality and productivity of its sales force resulting in higher sales and improved new business persistency. AIG Star Life is growing first year premiums as a result of new product introductions and an expanded agency force, and is benefiting from growth in the bank annuity market.

However, in March of 2006, Japanese tax authorities are expected to announce a reduction in the amount of premium policyholders may deduct from their Japanese tax returns for certain accident and health products. These products are generally sold by independent agents to corporate clients and thus represent a specific niche market segment and not the mainstream accident and health products sold by AIG in Japan. A reduction in the amount of tax deduction related to these products will make them less attractive to the market and will reduce the level of future sales. In addition, a portion of existing policies may be canceled, and depending on the duration of those policies and other factors, could result in a write-off of deferred acquisition costs. At the current time, management does not believe that such losses, should they occur, would be material to AIG s consolidated financial condition, results of operations or liquidity.

The Foreign Retirement Services business continues its strong growth based upon its success in Japan and Korea by expanding its extensive distribution network and leveraging AIG s product expertise. Somewhat offsetting this growth were the negative effects on customer demand for certain multi-currency fixed annuity products in Japan stemming from currency exchange rate fluctuations. AIG is introducing annuity products in new markets. In January 2005, AIG Star Life entered into an agreement with the Bank of Tokyo Mitsubishi, one of Japan s largest banks, to market a

multi-currency fixed annuity.

Foreign Life Insurance & Retirement Services operations produced 78 percent, 78 percent and 76 percent of Life Insurance & Retirement Services GAAP premiums in 2005, 2004 and 2003, respectively.

**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 Life Insurance & Retirement Services GAAP premiums.**

| | **2005** |
|---|---|
| Growth in original currency | 2.7% |
| Foreign exchange effect | 2.0 |
| Growth as reported in U.S. dollars | 4.7% |

The growth in net investment income in 2005 and 2004 parallels the growth in general account reserves and surplus for both Foreign and Domestic Life Insurance & Retirement Services companies. Also, net investment income was positively affected by the compounding of previously earned and reinvested net investment income along with the addition of new cash flow from operations available for investment. The global flattening of the yield curve put additional pressure on yields and spreads, which was partially offset with income generated from other investment sources, including income from partnerships. Partnership income was $273 million and $192 million for 2005 and 2004, respectively. As of first quarter 2004, foreign separate accounts were transferred to the general account per Statement of Position 03-1, resulting in increased net investment income volatility. The positive effect of Statement of Position 03-1 on Foreign Life Insurance & Retirement Services net investment income was $1.34 billion and $271 million for 2005 and 2004, respectively. These amounts do not affect operating income as they are offset in incurred policy benefits.

AIG s domestic subsidiaries invest in certain limited liability companies that invest in synthetic fuel production facilities as a means of generating income tax credits. Net investment income includes operating losses of approximately $143 million, $121 million and $108 million, respectively, for 2005, 2004 and 2003 and income taxes includes tax credits and benefits of approximately $203 million, $160 million and $155 million, respectively, for 2005, 2004 and 2003 from these investments. See also Note 12(k) of Notes to Consolidated Financial Statements Commitments and Contingent Liabilities.

Life Insurance & Retirement Services operating income grew by 12 percent in 2005. Operating income for the AIG

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Domestic Life insurance line of business was up 8 percent and in line with the growth in GAAP premiums for the current year, due in part to growth in the business base and improved mortality results, offset by higher losses recorded in 2005 from limited partnership investments in synthetic fuel production facilities. Operating income for the home service line of business declined as a result of the continued decline in premiums in force and higher insurance and acquisition expenses, combined with an increase in property casualty losses related to hurricanes. The group life/health business and operating income were affected by non-renewal of cases where acceptable margins could not be achieved. In addition, 2005 results were affected by reserve strengthening related to disability income products totaling $12 million compared to reserve strengthening of $178 million for Superior National and $68 million for all other items in 2004. Operating income for the payout annuities line of business increased 22 percent in line with the growth in policy benefit reserves. The group retirement products business recorded a modest increase in operating income due primarily to higher variable annuity fee income and growth in average reserves. Individual fixed annuity results are higher than last year due primarily to 13 percent growth in average reserves, higher surrender charges and reductions in acquisition cost amortization expense resulting from increased capital losses realized on bonds. Individual variable annuity earnings are lower in 2005 when compared to 2004 principally due to favorable deferred acquisition cost amortization variances attributable to changes in assumptions and realized capital loss activity in 2004.

Foreign Life Insurance & Retirement Services operating income of $5.25 billion for 2005 included $84 million of realized capital gains, and for 2004, operating income of $4.85 billion included $372 million of realized capital gains. Underwriting and investment results before the effects of realized capital gains (losses) increased for all lines of business. On this basis, the life insurance line of business benefited in part from lower amortization of acquisition costs for FAS 97 products, reflective of the increasing investment yields for those portfolios, particularly in Japan. In Southeast Asia, operating income growth attributable to life insurance and deposit-based businesses was partially offset by higher incurred policy benefit costs for contributions to the participating policyholder fund in Singapore, totaling $137 million, related to the settlement of a long disputed local tax issue. Growth in the personal accident & health line of business is generally in line with the growth in premiums and reflects stable profit margins. The group products business grew across all segments and maintained profit margins. The largest contributor to the growth in group products is the pension profit center which enjoyed higher fee income emanating from higher assets under management in Brazil and Southeast Asia. Growth in individual fixed annuities, emanating primarily from Japan, is generally in line with the growth in reserves and net spread rates were maintained. The individual variable annuity line of business also grew in line with the growth in reserves.

The contribution of Life Insurance & Retirement Services operating income to AIG s consolidated income before income taxes, minority interest and cumulative effect of accounting changes amounted to 58 percent in 2005, compared to 53 percent in 2004 and 57 percent in 2003.

*Underwriting and Investment Risk*

The risks associated with the life and accident & health products are underwriting risk and investment risk. The risk associated with the financial and investment contract products is primarily investment risk.

Underwriting risk represents the exposure to loss resulting from the actual policy experience adversely emerging in comparison to the assumptions made in the product pricing associated with mortality, morbidity, termination and expenses. The emergence of significant adverse experience would require an adjustment to DAC and benefit reserves that could have a substantial effect on AIG s results of operations.

Natural disasters such as hurricanes, earthquakes and other catastrophes have the potential to adversely affect AIG s operating results. Other risks, such as an outbreak of a pandemic disease, such as the Avian Influenza A Virus (H5N1), could adversely affect AIG s business and operating results to an extent that may be only minimally offset by reinsurance programs.

While to date, outbreaks of the Avian Flu continue to occur among poultry or wild birds in a number of countries in Asia, parts of Europe, and recently in Africa, transmission to humans has been rare. If the virus mutates to a form that can be transmitted from human to human, it has the potential to spread rapidly worldwide. If such an outbreak were to

take place, early quarantine and vaccination could be critical to containment.

Both the contagion and mortality rate of any mutated H5N1 virus that can be transmitted from human to human are highly speculative. AIG continues to monitor the developing facts. A significant global outbreak could have a material adverse effect on Life Insurance & Retirement Services operating results and liquidity from increased mortality and morbidity rates.

AIG s Foreign Life Insurance & Retirement Services companies generally limit their maximum underwriting exposure on life insurance of a single life to approximately $1.7 million of coverage. AIG s Domestic Life Insurance & Retirement Services companies limit their maximum underwriting exposure on life insurance of a single life to $10 million of coverage in certain circumstances by using yearly renewable term reinsurance. See the discussion under Liquidity herein and Note 6 of Notes to Consolidated Financial Statements.

AIRCO acts primarily as an internal reinsurance company for AIG s foreign life operations. This facilitates insurance risk management (retention, volatility, concentrations) and capital planning locally (branch and subsidiary). It also allows AIG to pool its insurance risks and purchase reinsurance more efficiently at a consolidated level, manage global counterparty risk and relationships and manage global life catastrophe risks.

AIG s domestic Life Insurance & Retirement Services operations utilize internal and third-party reinsurance relationships to manage insurance risks and to facilitate capital management strategies. Pools of highly-rated third-party rein-

surers are utilized to manage net amounts at risk in excess of retention limits. AIG s domestic life insurance companies also cede excess, non-economic reserves carried on a statutory-basis only on certain term and universal life insurance policies and certain fixed annuities to AIG Life of Bermuda Ltd., a wholly owned Bermuda reinsurer.

AIG generally obtains letters of credit in order to obtain statutory recognition of these intercompany reinsurance transactions. For this purpose, AIG entered into a $2.5 billion syndicated letter of credit facility in December 2004. Letters of credit totaling $2.17 billion were outstanding as of December 31, 2004, and letters of credit for all $2.5 billion were outstanding as of December 31, 2005, all of which relate to life intercompany reinsurance transactions. The letter of credit facility has a ten-year term, but the facility can be reduced or terminated by the lenders beginning after seven years.

In November 2005, AIG entered into a revolving credit facility for an aggregate amount of $3 billion. The facility can be drawn in the form of letters of credit with terms of up to ten years. As of December 31, 2005 and as of the date hereof, $1.86 billion principal amount of letters of credit are outstanding under this facility, of which approximately $494 million relates to life intercompany reinsurance transactions. AIG also obtained approximately $212 million letters of credit on a bilateral basis.

The investment risk represents the exposure to loss resulting from the cash flows from the invested assets, primarily long-term fixed rate investments, being less than the cash flows required to meet the obligations of the expected policy and contract liabilities and the necessary return on investments. See also the discussion under Liquidity herein.

To minimize its exposure to investment risk, AIG tests the cash flows from invested assets and policy and contract liabilities using various interest rate scenarios to evaluate investment risk and to confirm that assets are sufficient to pay these liabilities.

AIG actively manages the asset-liability relationship in its foreign operations, as it has been doing throughout AIG s history, even though certain territories lack qualified long-term investments or certain local regulatory authorities may impose investment restrictions. For example, in several Asian countries, the duration of the investments is shorter than the effective maturity of the related policy liabilities. Therefore, there is a risk that the reinvestment of the proceeds at the maturity of the initial investments may be at a yield below that of the interest required for the accretion of the policy liabilities. Additionally, there exists a future investment risk associated with certain policies currently in force which will have premium receipts in the future. That is, the investment of these future premium receipts may be at a yield below that required to meet future policy liabilities.

In 2005, new money investment yields increased in some markets and continued to decrease in others, leading to more frequent adjustments in new business premium rates, credited rates, and discontinuance of some products. In regard to the inforce business, to maintain an adequate yield to match the interest necessary to support future policy liabilities, management focus is required in both the investment and product management process. Business strategies continue to evolve to maintain profitability of the overall business. As such, in some countries, sales growth may slow for some product lines and accelerate for others.

The investment of insurance cash flows and reinvestment of the proceeds of matured securities and coupons requires active management of investment yields while maintaining satisfactory investment quality and liquidity.

AIG may use alternative investments in certain foreign jurisdictions where interest rates remain low and there are limited long-dated bond markets, including equities, real estate and foreign currency denominated fixed income instruments to extend the duration or increase the yield of the investment portfolio to more closely match the requirements of the policyholder liabilities and DAC recoverability. This strategy has been effectively used in Japan and more recently by Nan Shan in Taiwan. Foreign assets comprised approximately 33 percent of Nan Shan s invested assets at December 31, 2005, slightly below the maximum allowable percentage under current regulation. In response to continued declining interest rates and the volatile exchange rate of the NT dollar, Nan Shan is emphasizing new products with lower implied guarantees, including participating endowments and variable universal life. Although the risks of a continued low interest rate environment coupled with a volatile NT dollar could increase net liabilities and require additional capital to maintain adequate local solvency margins, Nan Shan currently believes it has adequate

resources to meet all future policy obligations.

AIG actively manages the asset-liability relationship in its domestic operations. This relationship is more easily managed through the ample supply of appropriate long-term investments.

AIG uses asset-liability matching as a management tool worldwide to determine the composition of the invested assets and appropriate marketing strategies. As a part of these strategies, AIG may determine that it is economically advantageous to be temporarily in an unmatched position due to anticipated interest rate or other economic changes. In addition, the absence of long-dated fixed income instruments in certain markets may preclude a matched asset-liability position in those markets.

A number of guaranteed benefits, such as living benefits or guaranteed minimum death benefits, are offered on certain variable life and variable annuity products. AIG manages its exposure resulting from these long-term guarantees through reinsurance or capital market hedging instruments. See Note 21 of Notes to Consolidated Financial Statements for a discussion of new accounting guidance for these benefits.

DAC for Life Insurance & Retirement Services products arises from the deferral of those costs that vary with, and are directly related to, the acquisition of new or renewal business. Policy acquisition costs for life insurance products are generally deferred and amortized over the premium paying period of the policy. Policy acquisition costs which relate to universal life and investment-type products, including variable and fixed annuities (investment-oriented products) are deferred and amortized, with interest, as appropriate, in relation to the historical and future incidence of estimated gross profits to be realized over the estimated lives of the contracts. Amortization expense includes

the effects of current period realized capital gains and losses. With respect to universal life and investment-oriented products, AIG s policy, as appropriate, has been to adjust amortization assumptions for DAC when estimates of current or future gross profits to be realized from these contracts are revised. With respect to variable annuities sold domestically (representing the vast majority of AIG s variable annuity business), the assumption for the long-term annual net growth rate of the equity markets used in the determination of DAC amortization is approximately ten percent. A methodology referred to as reversion to the mean is used to maintain this long-term net growth rate assumption, while giving consideration to short-term variations in equity markets. Estimated gross profits include investment income and gains and losses on investments less interest required as well as other charges in the contract less actual mortality and expenses. Current experience and changes in the expected future gross profits are analyzed to determine the effect on the amortization of DAC. The estimation of projected gross profits requires significant management judgment. The elements with respect to the current and projected gross profits are reviewed and analyzed quarterly and are adjusted accordingly.

AIG s variable annuity earnings will be affected by changes in market returns because separate account revenues, primarily composed of mortality and expense charges and asset management fees, are a function of asset values.

DAC for both insurance-oriented and investment-oriented products as well as retirement services products are reviewed for recoverability, which involve estimating the future profitability of current business. This review also involves significant management judgment. If the actual emergence of future profitability were to be substantially different than that estimated, AIG s results of operations could be significantly affected in future periods. See also Note 4 of Notes to Consolidated Financial Statements.

*Insurance and Asset Management Invested Assets*

AIG s investment strategy is to invest primarily in high quality securities while maintaining diversification to avoid significant exposure to issuer, industry and/or country concentrations. With respect to Domestic General Insurance, AIG s strategy is to invest in longer duration fixed maturity investments to maximize the yields at the date of purchase. With respect to Life Insurance & Retirement Services, AIG s strategy is to produce cash flows required to meet maturing insurance liabilities. See also the discussion under Operating Review: Life Insurance & Retirement Services Operations herein. AIG invests in equities for various reasons, including diversifying its overall exposure to interest rate risk. Available for sale bonds and equity securities are subject to declines in fair value. Such changes in fair value are presented in unrealized appreciation or depreciation of investments, net of taxes, as a component of accumulated other comprehensive income. Generally, insurance regulations restrict the types of assets in which an insurance company may invest. When permitted by regulatory authorities and when deemed necessary to protect insurance assets, including invested assets, from adverse movements in foreign currency exchange rates, interest rates and equity prices, AIG and its insurance subsidiaries may enter into derivative transactions as end users. See also the discussion under Derivatives herein.

In certain jurisdictions, significant regulatory and/or foreign governmental barriers exist which may not permit the immediate free flow of funds between insurance subsidiaries or from the insurance subsidiaries to AIG parent.

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**The following tables summarize the composition of AIG s invested assets by segment, as of December 31, 2005 and 2004:**

| *(dollars in millions)* | General Insurance | Life Insurance & Retirement Services | Asset Management | Total | Percent of Total | Percent Distribution Domestic | Percent Distribution Foreign | Financial Services | Other | Reclassification* | As Reported: Consolidated Balance Sheet |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **2005** | | | | | | | | | | | |
| Fixed maturities: | | | | | | | | | | | |
| Bonds available for sale, at market value | **$ 50,870** | **$ 273,165** | **$ 34,174** | **$ 358,209** | **66.2%** | **59.2%** | **40.8%** | **$ 1,307** | **$** | **$** | **$ 359,516** |
| Bonds held to maturity, at amortized cost | **21,528** | | | **21,528** | **4.0** | **100.0** | | | | | **21,528** |
| Bond trading securities, at market value | | **1,073** | **3,563** | **4,636** | **0.9** | **3.3** | **96.7** | | | | **4,636** |
| Equity securities: | | | | | | | | | | | |
| Common stocks, at market value | **4,930** | **15,558** | **639** | **21,127** | **3.9** | **18.6** | **81.4** | | **59** | **(21,186)** | |
| Common stocks available for sale, at market value | | | | | | | | | | **12,227** | **12,227** |
| Common stocks trading, at market value | | | | | | | | | | **8,959** | **8,959** |
| Preferred stocks available for sale, at market value | **1,632** | **760** | | **2,392** | **0.4** | **88.8** | **11.2** | **10** | | | **2,402** |
| Mortgage loans on real | **19** | **18,406** | **4,594** | **23,019** | **4.3** | **65.5** | **34.5** | | | **(23,019)** | |

| | | | | |
|---|---|---|---|---|
| estate, policy and collateral loans | | | | |
| Mortgage loans on real estate, net of allowance | **71** | | **14,229** | **14,300** |
| Policy loans | **2** | | **7,037** | **7,039** |
| Collateral and guaranteed loans, net of allowance | **1,719** | **98** | **1,753** | **3,570** |
| Financial services assets: | | | | |
| Flight equipment primarily under operating leases, net of accumulated depreciation | **36,245** | | | **36,245** |
| Securities available for sale, at market value | **37,511** | | | **37,511** |
| Trading securities, at market value | **6,499** | | | **6,499** |
| Spot commodities | **92** | | | **92** |
| Unrealized gain on swaps, options and forward transactions | **18,695** | | | **18,695** |
| Trading assets | **1,204** | | | **1,204** |
| Securities purchased under agreements to resell, at contract value | **14,519** | | **28** | **14,547** |
| Finance receivables, net of allowance | **27,995** | | | **27,995** |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Securities lending collateral, at market value | 4,931 | 42,991 | 11,549 | 59,471 | 11.0 | 87.3 | 12.7 | | | | 59,471 |
| Other invested assets | 6,272 | 7,805 | 10,459 | 24,536 | 4.5 | 85.7 | 14.3 | 2,751 | 8 | (28) | 27,267 |
| Short-term investments, at cost | 2,787 | 6,844 | 5,815 | 15,446 | 2.8 | 26.1 | 73.9 | 1,713 | 80 | (1,897) | 15,342 |
| Cash | | | | | | | | | | 1,897 | 1,897 |
| Investment income due and accrued | 1,232 | 4,073 | 402 | 5,707 | 1.1 | 56.9 | 43.1 | 18 | 2 | | 5,727 |
| Real estate, net of accumulated depreciation | 603 | 2,729 | 1,710 | 5,042 | 0.9 | 45.2 | 54.8 | 24 | 32 | | 5,098 |
| Total | $ 94,804 | $ 373,404 | $ 72,905 | $ 541,113 | 100.0% | 62.3% | 37.7% | $ 150,375 | $ 279 | $ | $ 691,767 |
| Less: | | | | | | | | | | | |
| Cash | 305 | 989 | 196 | 1,490 | | | | 331 | 76 | | 1,897 |
| Investment income due and accrued | 1,232 | 4,073 | 402 | 5,707 | | | | 18 | 2 | | 5,727 |
| Real estate, net of accumulated depreciation | 603 | 2,729 | 1,710 | 5,042 | | | | 24 | 32 | | 5,098 |
| Total investments and financial services assets | $ 92,664 | $ 365,613 | $ 70,597 | $ 528,874 | % | % | % | $ 150,002 | $ 169 | $ | $ 679,045 |

* Certain accounts presented separately in the Consolidated Balance Sheet are combined in the above tables.

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| *(dollars in millions)* | General Insurance | Life Insurance & Retirement Services | Asset Management | Total | Percent of Total | Percent Distribution Domestic | Percent Distribution Foreign | Financial Services | Other | Reclassification* | As Reported: Consolidated Balance Sheet |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2004 | | | | | | | | | | | |
| Fixed maturities: | | | | | | | | | | | |
| Bonds available for sale, at market value | **$ 44,376** | **$ 259,602** | **$ 39,077** | **$ 343,055** | **68.5%** | **61.2%** | **38.8%** | **$ 1,344** | **$** | **$** | **$ 344,399** |
| Bonds held to maturity, at amortized cost | **18,294** | | | **18,294** | **3.7** | **100.0** | | | | | **18,294** |
| Bond trading securities, at market value | | **600** | **2,384** | **2,984** | **0.6** | **1.2** | **98.8** | | | | **2,984** |
| Equity securities: | | | | | | | | | | | |
| Common stocks, at market value | **4,165** | **11,280** | **177** | **15,622** | **3.1** | **21.9** | **78.1** | | **44** | **(15,666)** | |
| Common stocks available for sale, at market value | | | | | | | | | | **9,772** | **9,772** |
| Common stocks trading, at market value | | | | | | | | | | **5,894** | **5,894** |
| Preferred stocks | **1,466** | **565** | | **2,031** | **0.4** | **91.9** | **8.1** | **9** | | | **2,040** |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| available for sale, at market value | | | | | | | | | | |
| Mortgage loans on real estate, policy and collateral loans | **22** | **16,858** | **5,093** | **21,973** | **4.4** | **65.6** | **34.4** | | | **(21,973)** |
| Mortgage loans on real estate, net of allowance | | | | | | | | | | |