AMERICAN INTERNATIONAL GROUP INC
Form 10-Q
August 06, 2008

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

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

or

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

For the transition period from to

Commission File Number 1-8787

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

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

Registrant s telephone number, including area code: (212) 770-7000
Former name, former address and former fiscal year, if changed since last report: None

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

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

Large accelerated filer þ	**Accelerated filer o**	**Non-accelerated filer o (Do not check if a smaller reporting company)**	**Smaller reporting company o**

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

Yes o No þ

As of July 31, 2008, there were 2,688,833,724 shares outstanding of the registrant s common stock.

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American International Group, Inc. and Subsidiaries

Part I FINANCIAL INFORMATION

ITEM 1. Financial Statements (unaudited)

CONSOLIDATED BALANCE SHEET

(in millions) (unaudited)

	June 30, 2008	December 31, 2007
Assets:		
Investments and Financial Services assets:		
Fixed maturity securities:		
Bonds available for sale, at fair value (amortized cost: 2008 $400,052; 2007 $393,170)	**$ 393,316**	$ 397,372
Bonds held to maturity, at amortized cost (fair value: 2008 $21,809; 2007 $22,157)	**21,632**	21,581
Bond trading securities, at fair value	**8,801**	9,982
Equity securities:		
Common stocks available for sale, at fair value (cost: 2008 $13,490; 2007 $12,588)	**17,306**	17,900
Common and preferred stocks trading, at fair value	**22,514**	21,376
Preferred stocks available for sale, at fair value (cost: 2008 $2,596; 2007 $2,600)	**2,496**	2,370
Mortgage and other loans receivable, net of allowance (2008 $99; 2007 $77) (held for sale: 2008 $30; 2007 $377 (amount measured at fair value: 2008 $745)	**34,384**	33,727
Financial Services assets:		
Flight equipment primarily under operating leases, net of accumulated depreciation (2008 $11,359; 2007 $10,499)	**43,887**	41,984
Securities available for sale, at fair value (cost: 2008 $1,246; 2007 $40,157)	**1,205**	40,305
Trading securities, at fair value	**35,170**	4,197
Spot commodities, at fair value	**90**	238
Unrealized gain on swaps, options and forward transactions, at fair value	**11,548**	12,318
Trade receivables	**2,294**	672
Securities purchased under agreements to resell, at fair value in 2008	**16,597**	20,950
Finance receivables, net of allowance (2008 $1,133; 2007 $878) (held for sale: 2008 $36; 2007 $233)	**33,311**	31,234
Securities lending invested collateral, at fair value (cost: 2008 $67,758; 2007 $80,641)	**59,530**	75,662
Other invested assets (amount measured at fair value: 2008 $22,099; 2007 $20,827)	**62,029**	58,823
Short-term investments (amount measured at fair value: 2008 $24,167)	**69,492**	51,351
Total Investments and Financial Services assets	**835,602**	842,042
Cash	**2,229**	2,284
Investment income due and accrued	**6,614**	6,587

Premiums and insurance balances receivable, net of allowance (2008 $596; 2007 $662)	**20,050**	18,395
Reinsurance assets, net of allowance (2008 $502; 2007 $520)	**22,940**	23,103
Current and deferred income taxes	**8,211**	
Deferred policy acquisition costs	**46,733**	43,914
Investments in partially owned companies	**628**	654
Real estate and other fixed assets, net of accumulated depreciation (2008 $5,710; 2007 $5,446)	**5,692**	5,518
Separate and variable accounts, at fair value	**73,401**	78,684
Goodwill	**10,661**	9,414
Other assets (amount measured at fair value: 2008 $2,452; 2007 $4,152)	**17,115**	17,766
Total assets	**$ 1,049,876**	$ 1,048,361

See Accompanying Notes to Consolidated Financial Statements.

American International Group, Inc. and Subsidiaries

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

	June 30, 2008	December 31, 2007
Liabilities:		
Reserve for losses and loss expenses	**$ 88,747**	$ 85,500
Unearned premiums	**28,738**	27,703
Future policy benefits for life and accident and health insurance contracts	**147,232**	136,387
Policyholders contract deposits (amount measured at fair value: 2008 $4,179; 2007 $295)	**265,411**	258,459
Other policyholders funds	**13,773**	12,599
Commissions, expenses and taxes payable	**5,597**	6,310
Insurance balances payable	**5,569**	4,878
Funds held by companies under reinsurance treaties	**2,498**	2,501
Current income taxes payable		3,823
Financial Services liabilities:		
Securities sold under agreements to repurchase (amount measured at fair value: 2008 $8,338)	**9,659**	8,331
Trade payables	**1,622**	6,445
Securities and spot commodities sold but not yet purchased, at fair value	**3,189**	4,709
Unrealized loss on swaps, options and forward transactions, at fair value	**24,232**	14,817
Trust deposits and deposits due to banks and other depositors (amount measured at fair value: 2008 $240)	**6,165**	4,903
Commercial paper and extendible commercial notes	**15,061**	13,114
Long-term borrowings (amount measured at fair value: 2008 $53,839)	**163,577**	162,935
Separate and variable accounts	**73,401**	78,684
Securities lending payable	**75,056**	81,965
Minority interest	**11,149**	10,422
Other liabilities (amount measured at fair value: 2008 $6,861; 2007 $3,262)	**31,012**	27,975
Total liabilities	**971,688**	952,460
Preferred shareholders equity in subsidiary companies	**100**	100
Commitments, Contingencies and Guarantees (See Note 6)		
Shareholders equity:		
Common stock, $2.50 par value; 5,000,000,000 shares authorized; shares issued 2008 2,948,038,001; 2007 2,751,327,476	**7,370**	6,878
Additional paid-in capital	**9,446**	2,848
Payments advanced to purchase shares		(912)
Retained earnings	**73,743**	89,029
Accumulated other comprehensive income (loss)	**(3,903)**	4,643
Treasury stock, at cost; 2008 259,225,244; 2007 221,743,421 shares of common stock	**(8,568)**	(6,685)

Total shareholders equity	**78,088**	95,801
Total liabilities, preferred shareholders equity in subsidiary companies and shareholders equity	**$ 1,049,876**	$ 1,048,361

See Accompanying Notes to Consolidated Financial Statements.

American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF INCOME (LOSS)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	**2008**	2007
Revenues:				
Premiums and other considerations	**$ 21,735**	$ 19,533	**$ 42,407**	$ 39,175
Net investment income	**6,728**	7,853	**11,682**	14,977
Net realized capital losses	**(6,081)**	(28)	**(12,170)**	(98)
Unrealized market valuation losses on AIGFP super senior credit default swap portfolio	**(5,565)**		**(14,672)**	
Other income	**3,116**	3,792	**6,717**	7,741
Total revenues	**19,933**	31,150	**33,964**	61,795
Benefits and expenses:				
Incurred policy losses and benefits	**18,450**	16,221	**34,332**	32,367
Insurance acquisition and other operating expenses	**10,239**	8,601	**19,652**	16,928
Total benefits and expenses	**28,689**	24,822	**53,984**	49,295
Income (loss) before income taxes (benefits) and minority interest	**(8,756)**	6,328	**(20,020)**	12,500
Income taxes (benefits)	**(3,357)**	1,679	**(6,894)**	3,405
Income (loss) before minority interest	**(5,399)**	4,649	**(13,126)**	9,095
Minority interest	**42**	(372)	**(36)**	(688)
Net income (loss)	**$ (5,357)**	$ 4,277	**$ (13,162)**	$ 8,407
Earnings (loss) per common share:				
Basic	**$ (2.06)**	$ 1.64	**$ (5.11)**	$ 3.22
Diluted	**$ (2.06)**	$ 1.64	**$ (5.11)**	$ 3.21
Dividends declared per common share	**$ 0.220**	$ 0.200	**$ 0.420**	$ 0.365
Average shares outstanding:				
Basic	**2,605**	2,602	**2,575**	2,607
Diluted	**2,605**	2,613	**2,575**	2,621

See Accompanying Notes to Consolidated Financial Statements.

American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

(in millions, except share and per share data) (unaudited)	Six Months Ended June 30, 2008	
	Amounts	Shares
Common stock:		
Balance, beginning of period	$ **6,878**	**2,751,327,476**
Issuances	**492**	**196,710,525**
Balance, end of period	**7,370**	**2,948,038,001**
Additional paid-in capital:		
Balance, beginning of period	**2,848**	
Excess of proceeds over par value of common stock issued	**6,851**	
Present value of future contract adjustment payments related to issuance of equity units	**(431)**	
Excess of cost over proceeds of common stock issued under stock plans	**(13)**	
Other	**191**	
Balance, end of period	**9,446**	
Payments advanced to purchase shares:		
Balance, beginning of period	**(912)**	
Payments advanced	**(1,000)**	
Shares purchased	**1,912**	
Balance, end of period		
Retained earnings:		
Balance, beginning of period	**89,029**	
Cumulative effect of accounting changes, net of tax	**(1,003)**	
Adjusted balance, beginning of period	**88,026**	
Net loss	**(13,162)**	
Dividends to common shareholders ($0.42 per share)	**(1,121)**	
Balance, end of period	**73,743**	
Accumulated other comprehensive income (loss):		
Unrealized appreciation (depreciation) of investments, net of tax:		
Balance, beginning of period	**4,375**	
Cumulative effect of accounting changes, net of tax	**(105)**	
Adjusted balance, beginning of period	**4,270**	
Unrealized depreciation of investments, net of reclassification adjustments	**(14,254)**	

Income tax benefit		**4,813**	
Balance, end of period		**(5,171)**	
Foreign currency translation adjustments, net of tax:			
Balance, beginning of period		**880**	
Translation adjustment		**1,108**	
Income tax expense		**(124)**	
Balance, end of period		**1,864**	
Net derivative gains (losses) arising from cash flow hedging activities:			
Balance, beginning of period		**(87)**	
Net deferred gains on cash flow hedges, net of reclassification adjustments		**11**	
Deferred income tax expense		**(5)**	
Balance, end of period		**(81)**	
Retirement plan liabilities adjustment, net of taxes:			
Balance, beginning of period		**(525)**	
Net actuarial loss		**18**	
Prior service credit		**(5)**	
Deferred income tax expense		**(3)**	
Balance, end of period		**(515)**	
Accumulated other comprehensive income (loss), end of period		**(3,903)**	
Treasury stock, at cost:			
Balance, beginning of period		**(6,685)**	**(221,743,421)**
Shares acquired		**(1,912)**	**(37,927,125)**
Issued under stock plans		**24**	**443,767**
Other		**5**	**1,535**
Balance, end of period		**(8,568)**	**(259,225,244)**
Total shareholders equity, end of period	**$**	**78,088**	

See Accompanying Notes to Consolidated Financial Statements.

American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF CASH FLOWS

(in millions) (unaudited)

	Six Months Ended June 30,	
	2008	2007
Summary:		
Net cash provided by (used in) operating activities	**$ 16,589**	$ 17,431
Net cash provided by (used in) investing activities	**(21,963)**	(40,314)
Net cash provided by (used in) financing activities	**5,274**	22,947
Effect of exchange rate changes on cash	**45**	(19)
Change in cash	**(55)**	45
Cash at beginning of year period	**2,284**	1,590
Cash at end of year period	**$ 2,229**	$ 1,635
Cash flows from operating activities:		
Net income (loss)	**$ (13,162)**	$ 8,407
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Noncash revenues, expenses, gains and losses included in income (loss):		
Unrealized market valuation losses on AIGFP super senior credit default swap portfolio	**14,672**	
Net gains on sales of securities available for sale and other assets	**(494)**	(732)
Foreign exchange transaction (gains) losses	**857**	639
Net unrealized (gains) losses on non-AIGFP derivatives and other assets and liabilities	**2,086**	(123)
Equity in income of partially owned companies and other invested assets	**(151)**	(2,747)
Amortization of deferred policy acquisition costs	**7,343**	5,911
Depreciation and other amortization	**1,799**	1,608
Provision for mortgage, other loans and finance receivables	**578**	229
Other-than-temporary impairments	**12,416**	884
Changes in operating assets and liabilities:		
General and life insurance reserves	**9,748**	8,238
Premiums and insurance balances receivable and payable net	**(1,104)**	(941)
Reinsurance assets	**196**	434
Capitalization of deferred policy acquisition costs	**(9,160)**	(7,567)
Investment income due and accrued	**118**	(44)
Funds held under reinsurance treaties	**(25)**	(210)
Other policyholders funds	**851**	879
Income taxes receivable and payable net	**(6,960)**	(225)
Commissions, expenses and taxes payable	**52**	724
Other assets and liabilities net	**1,809**	553

Trade receivables and payables net		**(6,446)**	(925)
Trading securities		**930**	(2,258)
Spot commodities		**148**	127
Net unrealized (gain) loss on swaps, options and forward transactions		**(3,993)**	1,317
Securities purchased under agreements to resell		**4,353**	2,116
Securities sold under agreements to repurchase		**1,237**	(226)
Securities and spot commodities sold but not yet purchased		**(1,531)**	221
Finance receivables and other loans held for sale originations and purchases		**(279)**	(3,957)
Sales of finance receivables and other loans held for sale		**492**	4,177
Other, net		**209**	922
Total adjustments		**29,751**	9,024
Net cash provided by operating activities	**$**	**16,589**	$ 17,431

See Accompanying Notes to Consolidated Financial Statements.

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American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF CASH FLOWS *(continued)*

(in millions) (unaudited)

	Six Months Ended June 30,	
	2008	2007
Cash flows from investing activities:		
Proceeds from (payments for)		
Sales and maturities of fixed maturity securities available for sale and hybrid investments	**$ 42,026**	$ 64,563
Sales of equity securities available for sale	**4,861**	4,275
Proceeds from fixed maturity securities held to maturity	**33**	133
Sales of trading securities	**14,120**	
Sales of flight equipment	**372**	28
Sales or distributions of other invested assets	**8,715**	6,208
Payments received on mortgage and other loans receivable	**3,457**	2,270
Principal payments received on finance receivables held for investment	**6,757**	6,430
Purchases of fixed maturity securities available for sale and hybrid investments	**(47,114)**	(72,348)
Purchases of equity securities available for sale	**(5,808)**	(5,852)
Purchases of fixed maturity securities held to maturity	**(88)**	(129)
Purchases of trading securities	**(9,244)**	
Purchases of flight equipment (including progress payments)	**(2,950)**	(3,883)
Purchases of other invested assets	**(11,988)**	(12,171)
Mortgage and other loans receivable issued	**(3,340)**	(5,029)
Finance receivables held for investment originations and purchases	**(8,778)**	(7,387)
Change in securities lending invested collateral	**6,315**	(11,772)
Net additions to real estate, fixed assets, and other assets	**(663)**	(466)
Net change in short-term investments	**(18,832)**	(4,636)
Net change in non-AIGFP derivative assets and liabilities	**186**	(548)
Net cash provided by (used in) investing activities	**$ (21,963)**	$ (40,314)
Cash flows from financing activities:		
Proceeds from (payments for)		
Policyholders contract deposits	**$ 33,322**	$ 28,769
Policyholders contract withdrawals	**(27,926)**	(29,379)
Change in other deposits	**682**	(823)
Change in commercial paper and extendible commercial notes	**1,930**	1,768
Long-term borrowings issued	**55,685**	50,091
Repayments on long-term borrowings	**(56,645)**	(34,937)
Change in securities lending payable	**(6,919)**	12,021
Proceeds from common stock issued	**7,343**	
Issuance of treasury stock	**11**	180
Payments advanced to purchase treasury stock	**(1,000)**	(4,000)

Cash dividends paid to shareholders		**(1,036)**		(859)
Acquisition of treasury stock				(16)
Other, net		**(173)**		132
Net cash provided by (used in) financing activities	**$**	**5,274**	$	22,947
Supplementary disclosure of cash flow information:				
Cash paid (received) during the period for:				
Interest	**$**	**3,493**	$	3,744
Taxes	**$**	**66**	$	3,524
Non-cash financing activities:				
Interest credited to policyholder accounts included in financing activities	**$**	**3,815**	$	5,932
Treasury stock acquired using payments advanced to purchase shares	**$**	**1,912**	$	1,664
Present value of future contract adjustment payments related to issuance of equity units	**$**	**431**	$	
Non-cash investing activities:				
Debt assumed on acquisitions and warehoused investments	**$**	**153**	$	354

See Accompanying Notes to Consolidated Financial Statements.

American International Group, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(in millions) (unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	**2008**	2007
Net income (loss)	**$ (5,357)**	$ 4,277	**$ (13,162)**	$ 8,407
Other comprehensive income (loss):				
Cumulative effect of accounting changes			**(162)**	
Deferred income tax benefit on above changes			**57**	
Unrealized (depreciation) appreciation of investments net of reclassification adjustments	**(3,682)**	(2,161)	**(14,254)**	(852)
Deferred income tax benefit on above changes	**1,065**	598	**4,813**	140
Foreign currency translation adjustments	**(238)**	(164)	**1,108**	(329)
Deferred income tax benefit (expense) on above changes	**127**	7	**(124)**	35
Net derivative gains (losses) arising from cash flow hedging activities net of reclassification adjustments	**144**	61	**11**	62
Deferred income tax benefit on above changes	**(50)**	(22)	**(5)**	5
Change in pension and postretirement unrecognized periodic benefit	**7**	15	**13**	18
Deferred income tax benefit (expense) on above changes	**(5)**	(1)	**(3)**	(2)
Other comprehensive income (loss)	**(2,632)**	(1,667)	**(8,546)**	(923)
Comprehensive income (loss)	**$ (7,989)**	$ 2,610	**$ (21,708)**	$ 7,484

See Accompanying Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*

1. Summary of Significant Accounting Policies

Basis of Presentation

These unaudited condensed consolidated financial statements do not include all disclosures required by accounting principles generally accepted in the United States (GAAP) for complete financial statements and should be read in conjunction with the audited consolidated financial statements and the related notes included in the Annual Report on Form 10-K of American International Group, Inc. (AIG) for the year ended December 31, 2007 (2007 Annual Report on Form 10-K).

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

Changes in Presentation

In the second quarter of 2008, AIG determined that certain accident and health contracts in its Foreign General Insurance reporting unit, which were previously accounted for as short duration contracts, should be treated as long duration insurance products. Accordingly, the December 31, 2007 consolidated balance sheet has been revised to reflect the reclassification of $763 million of deferred direct response advertising costs, previously reported in other assets, to deferred policy acquisition costs. Additionally, $320 million has been reclassified on the consolidated balance sheet as of December 31, 2007 from unearned premiums to future policy benefits for life and accident and health insurance contracts. These revisions did not have a material effect on AIG s consolidated income before income taxes, net income, or shareholders equity for any period presented.

In addition, see Recent Accounting Standards Accounting Changes, below for a discussion of AIG s adoption of FASB Staff Position (FSP) No. FIN 39-1, Amendment of FASB Interpretation No. 39 (FSP FIN 39-1).

Additionally, certain other reclassifications and format changes have been made to prior period amounts to conform to the current period presentation.

Recent Accounting Standards

Accounting Changes

FAS 157

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (FAS) No. 157, Fair Value Measurements (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements but does not change existing guidance about whether an asset or liability is carried at fair value. FAS 157 nullifies the guidance in Emerging Issues Task Force (EITF) Issue No. 02-3, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, (EITF 02-3) that precluded the recognition of a trading profit at the inception of a derivative contract unless the fair value of such contract was obtained from a quoted market price or other valuation technique incorporating observable market data. FAS 157 also clarifies that an issuer s credit standing should be considered when measuring liabilities at fair value. The fair value measurement and related disclosure guidance in FAS 157 do not apply to fair value measurements associated with AIG s share-based employee compensation awards accounted for in accordance with FAS 123(R), Share-Based Payment.

AIG adopted FAS 157 on January 1, 2008, its required effective date. FAS 157 must be applied prospectively, except for certain stand-alone derivatives and hybrid instruments initially measured using the guidance in EITF 02-3, which must be applied as a cumulative effect accounting change to retained earnings at January 1, 2008. The cumulative effect, net of taxes, of adopting FAS 157 on AIG s consolidated balance sheet was an increase in retained earnings of $4 million.

The most significant effect of adopting FAS 157 on AIG s consolidated results of operations for the three- and six-month periods ended June 30, 2008 related to changes in fair value methodologies with respect to both liabilities already carried at fair value, primarily hybrid notes and derivatives, and newly elected liabilities measured at fair

value (see FAS 159 discussion below). Specifically, the incorporation of AIG s own credit spreads and the incorporation of explicit risk margins (embedded policy derivatives at transition only) resulted in a decrease in pre-tax income of $149 million ($97 million after tax) and an increase in pre-tax income of $2.6 billion ($1.7 billion after tax) for the three- and six-month periods ended June 30, 2008, respectively. The effect of the changes in AIG s own credit spreads was a decrease in pre-tax income of $112 million and an increase of $2.5 billion for the three- and six-month periods ended June 30, 2008, respectively. The effect of the changes in counterparty credit spreads for assets measured at fair value at AIG Financial Products Corp. and AIG Trading Group Inc. and their respective subsidiaries (AIGFP) was decreases of $362 million and $3.0 billion for the three- and six-month periods ended June 30, 2008, respectively.

See Note 3 to the Consolidated Financial Statements for additional FAS 157 disclosures.

FAS 159

In February 2007, the FASB issued FAS 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). FAS 159 permits entities to choose to measure at

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

1. Summary of Significant Accounting Policies *(continued)*
fair value many financial instruments and certain other items that are not required to be measured at fair value. Subsequent changes in fair value for designated items are required to be reported in income. FAS 159 also establishes presentation and disclosure requirements for similar types of assets and liabilities measured at fair value. FAS 159 permits the fair value option election on an instrument-by-instrument basis for eligible items existing at the adoption date and at initial recognition of an asset or liability, or upon most events that give rise to a new basis of accounting for that instrument.

AIG adopted FAS 159 on January 1, 2008, its required effective date. The adoption of FAS 159 with respect to elections made in the Life Insurance & Retirement Services segment resulted in an after-tax decrease to 2008 opening retained earnings of $559 million. The adoption of FAS 159 with respect to elections made by AIGFP resulted in an after-tax decrease to 2008 opening retained earnings of $448 million. Included in this amount are net unrealized gains of $105 million that were reclassified to retained earnings from accumulated other comprehensive income (loss) related to available for sale securities recorded on the consolidated balance sheet at January 1, 2008 for which the fair value option was elected.

See Note 3 to the Consolidated Financial Statements for additional FAS 159 disclosures.

FAS 157 and FAS 159

The following table summarizes the after-tax increase (decrease) from adopting FAS 157 and FAS 159 on the opening shareholders equity accounts at January 1, 2008:

	At January 1, 2008		
(in millions)	Accumulated Other Comprehensive Income/(Loss)	Retained Earnings	Cumulative Effect of Accounting Changes
FAS 157	$	$ 4	$ 4
FAS 159	(105)	(1,007)	(1,112)
Cumulative effect of accounting changes	$ (105)	$ (1,003)	$ (1,108)

FSP FIN 39-1

In April 2007, the FASB directed the FASB Staff to issue FSP FIN 39-1. FSP FIN 39-1 modifies FIN No. 39, Offsetting of Amounts Related to Certain Contracts, and permits companies to offset cash collateral receivables or payables against derivative instruments under certain circumstances. AIG adopted the provisions of FSP FIN 39-1 effective January 1, 2008, which requires retrospective application to all prior periods presented. At June 30, 2008, the amounts of cash collateral received and paid that were offset against net derivative positions totaled $7.3 billion and $12.3 billion, respectively. The cash collateral received and paid related to AIGFP derivative instruments were previously recorded in trade payables and trade receivables. Cash collateral received related to non-AIGFP derivative instruments was previously recorded in other liabilities. Accordingly, the derivative assets and liabilities at December 31, 2007 have been reduced by $6.3 billion and $5.8 billion, respectively, related to the netting of cash collateral.

Future Application of Accounting Standards

FAS 141(R)

In December 2007, the FASB issued FAS 141 (revised 2007), Business Combinations (FAS 141(R)). FAS 141(R) changes the accounting for business combinations in a number of ways, including broadening the transactions or events that are considered business combinations; requiring an acquirer to recognize 100 percent of the fair value of assets acquired, liabilities assumed, and noncontrolling (i.e., minority) interests; recognizing contingent consideration arrangements at their acquisition-date fair values with subsequent changes in fair value generally reflected in income; and recognizing preacquisition loss and gain contingencies at their acquisition-date fair values, among other changes.

AIG is required to adopt FAS 141(R) for business combinations for which the acquisition date is on or after January 1, 2009. Early adoption is prohibited.

FAS 160

In December 2007, the FASB issued FAS 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 (FAS 160). FAS 160 requires noncontrolling (i.e., minority) interests in partially owned consolidated subsidiaries to be classified in the consolidated balance sheet as a separate component of consolidated shareholders equity. FAS 160 also establishes accounting rules for subsequent acquisitions and sales of noncontrolling interests and provides for how noncontrolling interests should be presented in the consolidated statement of income. The noncontrolling interests share of subsidiary income should be reported as a part of consolidated net income with disclosure of the attribution of consolidated net income to the controlling and noncontrolling interests on the face of the consolidated statement of income.

AIG is required to adopt FAS 160 on January 1, 2009 and early application is prohibited. FAS 160 must be adopted prospectively, except that noncontrolling interests should be reclassified from liabilities to a separate component of shareholders equity and consolidated net income should be recast to include net income attributable to both the controlling and noncontrolling interests retrospectively. AIG is currently assessing the effect that adopting FAS 160 will have on its consolidated financial statements.

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

1. Summary of Significant Accounting Policies *(continued)*

FAS 161

In March 2008, the FASB issued FAS 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (FAS 161). FAS 161 requires enhanced disclosures about (a) how and why AIG uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), and its related interpretations, and (c) how derivative instruments and related hedged items affect AIG s consolidated financial condition, results of operations, and cash flows. FAS 161 is effective for AIG beginning with financial statements issued in the first quarter of 2009. Because FAS 161 only requires additional disclosures about derivatives, it will have no effect on AIG s consolidated financial condition, results of operations or cash flows.

FAS 162

In May 2008, the FASB issued FAS 162, The Hierarchy of Generally Accepted Accounting Principles (FAS 162). FAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements presented in conformity with GAAP but does not change current practices. FAS 162 will become effective on the 60th day following Securities and Exchange Commission (SEC) approval of the Public Company Accounting Oversight Board amendments to remove GAAP hierarchy from the auditing standards. FAS 162 will have no effect on AIG s consolidated financial condition, results of operations or cash flows.

FSP FAS 140-3

In February 2008, the FASB issued FSP FAS No. 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions (FSP FAS 140-3). FSP FAS 140-3 requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with or in contemplation of the initial transfer to be evaluated as a linked transaction unless certain criteria are met. FSP FAS 140-3 is effective for AIG beginning January 1, 2009 and will be applied to new transactions entered into from that date forward. Early adoption is prohibited. AIG is currently assessing the effect that adopting FSP FAS 140-3 will have on its consolidated financial statements but does not believe the effect will be material.

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

2. Segment Information

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

AIG s operations by major operating segment were as follows:

Operating Segments *(in millions)*	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Total revenues[a]:				
General Insurance	**$ 12,757**	$ 12,928	**$ 25,046**	$ 25,831
Life Insurance & Retirement Services[b]	**10,161**	14,023	**18,913**	27,705
Financial Services[c][d]	**(3,605)**	2,123	**(10,165)**	4,324
Asset Management[e]	**797**	1,781	**648**	3,450
Other	**208**	263	**80**	394
Consolidation and eliminations	**(385)**	32	**(558)**	91
Total	**$ 19,933**	$ 31,150	**$ 33,964**	$ 61,795
Operating income (loss)[a]:				
General Insurance	**$ 827**	$ 2,976	**$ 2,164**	$ 6,072
Life Insurance & Retirement Services[b]	**(2,401)**	2,620	**(4,232)**	4,901
Financial Services[c][d]	**(5,905)**	47	**(14,677)**	339
Asset Management[e]	**(314)**	927	**(1,565)**	1,685
Other[f]	**(715)**	(460)	**(1,483)**	(930)
Consolidation and eliminations	**(248)**	218	**(227)**	433
Total	**$ (8,756)**	$ 6,328	**$ (20,020)**	$ 12,500

(a) *Includes other-than-temporary impairment charges of $6.8 billion and $417 million for the three-month periods ended June 30, 2008 and 2007, respectively, and $12.4 billion and $884 million for the six-month periods ended June 30, 2008 and 2007, respectively. Also includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three-month periods ended June 30, 2008 and 2007, the effect was $272 million and $(430) million, respectively. For the six-month periods ended June 30, 2008 and 2007, the effect was $(476) million and $(882) million, respectively. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings.*

(b) *Includes other-than-temporary impairment charges of $5.2 billion and $324 million for the three-month periods ended June 30, 2008 and 2007, respectively, and $9.6 billion and $716 million for the six-month periods ended June 30, 2008 and 2007, respectively.*

(c) *Includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three-month periods ended June 30, 2008 and 2007, the effect was $5 million and $(443) million, respectively. For the six-month periods ended June 30, 2008*

and 2007, the effect was $(199) million and $(603) million, respectively. These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings.

(d) For the three- and six-month periods ended June 30, 2008, includes unrealized market valuation losses of $5.6 billion and $14.7 billion, respectively, on AIGFP s super senior credit default swap portfolio.

(e) Includes net realized capital losses of $464 million and $1.9 billion for the three- and six-month periods ended June 30, 2008, respectively, including other-than-temporary impairment charges of $882 million and $1.9 billion, respectively.

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

Other *(in millions)*	Three Months Ended June 30, **2008**	Three Months Ended June 30, 2007	Six Months Ended June 30, **2008**	Six Months Ended June 30, 2007
Operating income (loss):				
Equity earnings in partially owned companies	**$ 8**	$ 50	**$ 16**	$ 91
Interest expense	**(452)**	(302)	**(820)**	(554)
Unallocated corporate expenses[(a)]	**(282)**	(210)	**(375)**	(382)
Net realized capital gains (losses)[(b)]	**30**	22	**(235)**	(27)
Other miscellaneous, net	**(19)**	(20)	**(69)**	(58)
Total Other	**$ (715)**	$ (460)	**$ (1,483)**	$ (930)

(a) Includes expenses of corporate staff not attributable to specific operating segments, expenses related to efforts to improve internal controls, corporate initiatives and certain compensation plan expenses. For the three- and six-month periods ended June 30, 2008, includes a charge of $101 million as a result of the settlement of a dispute in connection with the July 2008 purchase of the balance of Ascot Underwriting Holdings Ltd., partially offset by a decrease in certain compensation plan expenses.

(b) The increase in net realized capital losses in the six-month period ended June 30, 2008 reflected higher foreign exchange losses on foreign-denominated debt, a portion of which was economically hedged but did not qualify for hedge accounting treatment under FAS 133, and losses on non-hedged derivatives.

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

2. Segment Information *(continued)*
AIG s General Insurance operations by major internal reporting unit were as follows:

General Insurance *(in millions)*	Three Months Ended June 30, **2008**	2007	Six Months Ended June 30, **2008**	2007
Total revenues:				
Commercial Insurance	**$ 5,937**	$ 6,904	**$ 11,924**	$ 13,995
Transatlantic	**1,103**	1,069	**2,222**	2,165
Personal Lines	**1,259**	1,223	**2,511**	2,436
Mortgage Guaranty	**313**	257	**611**	505
Foreign General Insurance	**4,139**	3,475	**7,767**	6,737
Reclassifications and eliminations	**6**		**11**	(7)
Total	**$ 12,757**	$ 12,928	**$ 25,046**	$ 25,831
Operating income (loss):				
Commercial Insurance	**$ 381**	$ 1,904	**$ 1,166**	$ 3,833
Transatlantic	**141**	168	**303**	319
Personal Lines	**21**	118	**24**	224
Mortgage Guaranty	**(518)**	(81)	**(872)**	(73)
Foreign General Insurance	**796**	867	**1,532**	1,776
Reclassifications and eliminations	**6**		**11**	(7)
Total	**$ 827**	$ 2,976	**$ 2,164**	$ 6,072

AIG s Life Insurance & Retirement Services operations by major internal reporting unit were as follows:

Life Insurance & Retirement Services *(in millions)*	Three Months Ended June 30, **2008**	2007	Six Months Ended June 30, **2008**	2007
Total revenues:				
Foreign:				
Japan and Other	**$ 5,369**	$ 4,863	**$ 9,265**	$ 9,633
Asia	**4,575**	5,019	**8,852**	9,510
Domestic:				
Domestic Life Insurance	**1,234**	2,359	**2,517**	4,880
Domestic Retirement Services	**(1,017)**	1,782	**(1,721)**	3,682

Total	**$ 10,161**	$ 14,023	**$ 18,913**	$ 27,705
Operating income (loss):				
Foreign:				
Japan and Other	**$ 577**	$ 810	**$ 1,060**	$ 1,723
Asia	**196**	844	**448**	1,215
Domestic:				
Domestic Life Insurance	**(1,005)**	368	**(1,875)**	713
Domestic Retirement Services	**(2,169)**	598	**(3,865)**	1,250
Total	**$ (2,401)**	$ 2,620	**$ (4,232)**	$ 4,901

AIG s Financial Services operations by major internal reporting unit were as follows:

Financial Services *(in millions)*	Three Months Ended June 30, **2008**	Three Months Ended June 30, 2007	Six Months Ended June 30, **2008**	Six Months Ended June 30, 2007
Total revenues:				
Aircraft Leasing	**$ 1,298**	$ 1,173	**$ 2,463**	$ 2,231
Capital Markets[(a)]	**(6,088)**	(67)	**(14,831)**	161
Consumer Finance[(b)]	**1,028**	911	**1,959**	1,756
Other, including intercompany adjustments	**157**	106	**244**	176
Total	**$ (3,605)**	$ 2,123	**$ (10,165)**	$ 4,324
Operating income (loss):				
Aircraft Leasing	**$ 334**	$ 207	**$ 555**	$ 371
Capital Markets[(a)]	**(6,284)**	(255)	**(15,211)**	(187)
Consumer Finance[(b)]	**(33)**	75	**(85)**	111
Other, including intercompany adjustments	**78**	20	**64**	44
Total	**$ (5,905)**	$ 47	**$ (14,677)**	$ 339

(a) Revenues are shown net of interest expense of $1.2 billion and $805 million in the three-month periods ended June 30, 2008 and 2007, respectively, and $1.7 billion and $1.9 billion for the six-month periods ended June 30, 2008 and 2007, respectively. In the three- and six-month periods ended June 30, 2008, both revenues and operating income (loss) includes unrealized market valuation losses of $5.6 billion and $14.7 billion, respectively, on AIGFP s super senior credit default swap portfolio.

(b) The three- and six-month periods ended June 30, 2007 included pre-tax charges of $50 million and $178 million, respectively, in connection with domestic Consumer Finance s mortgage banking activities. Based on a current evaluation of the estimated cost of implementing the Supervisory Agreement entered into with the Office of Thrift Supervision (OTS), partial reversals of these prior year charges of $25 million and $43 million, respectively, are included in the three- and six-month periods ended June 30, 2008.

AIG s Asset Management operations consist of a single internal reporting unit.

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

3. Fair Value Measurements

Effective January 1, 2008 AIG adopted FAS 157 and FAS 159, which specify measurement and disclosure standards related to assets and liabilities measured at fair value. See Note 1 to the Consolidated Financial Statements for additional information.

The most significant effect of adopting FAS 157 on AIG s results of operations for the three- and six-month periods ended June 30, 2008 related to changes in fair value methodologies with respect to both liabilities already carried at fair value, primarily hybrid notes and derivatives, and newly elected liabilities measured at fair value (see FAS 159 discussion below). Specifically, the incorporation of AIG s own credit spreads and the incorporation of explicit risk margins (embedded policy derivatives at transition only) resulted in a decrease of $149 million to pre-tax income ($97 million after tax) and an increase of $2.6 billion to pre-tax income ($1.7 billion after tax) for the three- and six-month periods ended June 30, 2008, respectively, as follows:

	Net Pre-Tax Increase (Decrease)			
(in millions)	Three Months Ended June 30, 2008	Six Months Ended June 30, 2008	Liabilities Carried at Fair Value	Business Segment Affected
Income statement caption:				
Net realized capital gains (losses)	$ **(37)**	$ **251**	Freestanding derivatives	All segments - excluding AIGFP
		(155)	Embedded policy derivatives	Life Insurance & Retirement Services
Unrealized market valuation losses on AIGFP super senior credit default swap portfolio	**44***	**109***	Super senior credit default swap portfolio	AIGFP
Other income	**(156)***	**2,427***	Notes, GIAs, derivatives, other liabilities	AIGFP
Net pre-tax increase	$ **(149)**	$ **2,632**		
Liabilities already carried at fair value	$ **20**	$ **1,354**		
Newly elected liabilities measured at fair value (FAS 159 elected)	**(169)**	**1,278**		
Net pre-tax increase	$ **(149)**	$ **2,632**		

* *The effect of changes in AIG s own credit spreads on pre-tax income for AIGFP was a decrease of $112 million and an increase of $2.5 billion for the three- and six-month periods ended June 30, 2008, respectively. The effect of the changes in counterparty credit spreads for assets measured at fair value at AIGFP was decreases in pre-tax income of $362 million and $3.0 billion for the three- and six-month periods ended June 30, 2008, respectively.*

Fair Value Measurements on a Recurring Basis

AIG measures at fair value on a recurring basis financial instruments in its trading and available for sale securities portfolios, certain mortgage and other loans receivable, certain spot commodities, derivative assets and liabilities, securities purchased (sold) under agreements to resell (repurchase), securities lending invested collateral, non-traded equity investments and certain private limited partnership and certain hedge funds included in other invested assets, certain short-term investments, separate and variable account assets, certain policyholders contract deposits, securities and spot commodities sold but not yet purchased, certain trust deposits and deposits due to banks and other depositors, certain long-term borrowings, and certain hybrid financial instruments included in other liabilities. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The degree of judgment used in measuring the fair value of financial instruments generally correlates with the level of pricing observability. Financial instruments with quoted prices in active markets generally have more pricing observability and less judgment is used in measuring fair value. Conversely, financial instruments traded in other-than-active markets or that do not have quoted prices have less observability and are measured at fair value using valuation models or other pricing techniques that require more judgment. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction and general market conditions.

Fixed Maturity Securities Trading and Available for Sale

AIG maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. Whenever available, AIG obtains quoted prices in active markets for identical assets at the balance sheet date to measure at fair value fixed maturity securities in its trading and available for sale portfolios. Market price data generally is obtained from exchange or dealer markets.

AIG estimates the fair value of fixed maturity securities not traded in active markets, including securities purchased (sold) under agreements to resell (repurchase), and mortgage and other loans receivable for which AIG elected the fair value option, by referring to traded securities with similar attributes, using dealer quotations, a matrix pricing methodology, discounted cash flow analyses or internal valuation models. This methodology considers such factors as the issuer s industry, the security s rating and tenor, its coupon rate, its position in the capital structure of the issuer, yield curves, credit curves, prepayment rates and other relevant factors. For fixed maturity instruments that are not traded in active markets or that are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments generally are based on avail-

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

3. Fair Value Measurements *(continued)*

able market evidence. In the absence of such evidence, management s best estimate is used.

Equity Securities Traded in Active Markets Trading and Available for Sale

AIG maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. Whenever available, AIG obtains quoted prices in active markets for identical assets at the balance sheet date to measure at fair value marketable equity securities in its trading and available for sale portfolios. Market price data generally is obtained from exchange or dealer markets.

Non-Traded Equity Investments Other Invested Assets

AIG initially estimates the fair value of equity instruments not traded in active markets by reference to the transaction price. This valuation is adjusted only when changes to inputs and assumptions are corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity capital markets, and changes in financial ratios or cash flows. For equity securities that are not traded in active markets or that are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability and such adjustments generally are based on available market evidence. In the absence of such evidence, management s best estimate is used.

Private Limited Partnership and Hedge Fund Investments Other Invested Assets

AIG initially estimates the fair value of investments in certain private limited partnerships and certain hedge funds by reference to the transaction price. Subsequently, AIG obtains the fair value of these investments generally from net asset value information provided by the general partner or manager of the investments, the financial statements of which generally are audited annually.

Separate and Variable Account Assets

Separate and variable account assets are composed primarily of registered and unregistered open-end mutual funds that generally trade daily and are measured at fair value in the manner discussed above for equity securities traded in active markets.

Freestanding Derivatives

Derivative assets and liabilities can be exchange-traded or traded over the counter (OTC). AIG generally values exchange-traded derivatives using quoted prices in active markets for identical derivatives at the balance sheet date.

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

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

on available market evidence. In the absence of such evidence, management s best estimate is used.

With the adoption of FAS 157 on January 1, 2008, AIG s own credit risk has been considered and is incorporated into the fair value measurement of all freestanding derivative liabilities.

Embedded Policy Derivatives

The fair value of embedded policy derivatives contained in certain variable annuity and equity-indexed annuity and life contracts is measured based on actuarial and capital market assumptions related to projected cash flows over the expected lives of the contracts. These cash flow estimates primarily include benefits and related fees assessed, when applicable, and incorporate expectations about policyholder behavior. Estimates of future policyholder behavior are subjective and based primarily on AIG s historical experience. With respect to embedded policy derivatives in AIG s variable annuity contracts, because of the dynamic and complex nature of the

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

3. Fair Value Measurements *(continued)*
expected cash flows, risk neutral valuations are used. Estimating the underlying cash flows for these products involves many estimates and judgments, including those regarding expected market rates of return, market volatility, correlations of market index returns to funds, fund performance, discount rates and policyholder behavior. With respect to embedded policy derivatives in AIG s equity-indexed annuity and life contracts, option pricing models are used to estimate fair value, taking into account assumptions for future equity index growth rates, volatility of the equity index, future interest rates, and determinations on adjusting the participation rate and the cap on equity indexed credited rates in light of market conditions and policyholder behavior assumptions. With the adoption of FAS 157, these methodologies were not changed, with the exception of incorporating an explicit risk margin to take into consideration market participant estimates of projected cash flows and policyholder behavior.

AIGFP s Super Senior Credit Default Swap Portfolio

AIGFP values its credit default swaps written on the most senior risk layers (super senior) of designated pools of debt securities or loans using internal valuation models, third-party prices and market indices. The specific valuation methodologies vary based on the nature of the referenced obligations and availability of market prices. AIGFP uses a modified version of the Binomial Expansion Technique (BET) model to value its credit default swap portfolio written on super senior tranches of collateralized debt obligations (CDOs) of asset-backed securities (ABS), including maturity-shortening puts that allow the holders of the securities issued by certain CDOs to treat the securities as short-term eligible 2a-7 investments under the Investment Company Act of 1940 (2a-7 Puts). The BET model uses default probabilities derived from credit spreads implied from prices for the individual securities included in the underlying collateral pools securing the CDOs, as well as diversity scores, weighted average lives, recovery rates and discount rates. Prices for the individual securities held by a CDO are obtained in most cases from the CDO collateral managers, to the extent available. The CDO collateral managers obtain these prices from various sources, which include dealer quotations, third party pricing services and in-house valuation models. To the extent there is a lag in the prices provided by the collateral managers, AIGFP rolls forward these prices to the end of the quarter using data provided by a third-party pricing service. Where a price for an individual security is not provided by the CDO collateral manager, AIGFP derives the price from a matrix that averages the prices of the various securities at the level of ABS category, vintage and the rating of the reference security. The determination of some of these inputs requires the use of judgment and estimates, particularly in the absence of market observable data. AIGFP also employs a Monte Carlo simulation to assist in quantifying the effect on the valuation of the CDOs of the unique aspects of the CDOs structures such as triggers that divert cash flows to the most senior part of the capital structure. In the determination of fair value, AIGFP also considers prices from collateral calls by counterparties to these transactions and the price estimates for the super senior CDO securities provided by third parties.

In the case of credit default swaps written on investment-grade corporate debt and collateralized loan obligations (CLOs), AIGFP estimates the value of its obligations by reference to the relevant market indices or third-party quotes on the underlying super senior tranches when available.

In the case of credit default swaps written to facilitate regulatory capital relief for AIGFP s European financial institution counterparties, AIGFP estimates the fair value of these derivatives by considering observable market transactions, including the early termination of these transactions by counterparties, and other market data, to the extent relevant.

Policyholders Contract Deposits

Policyholders contract deposits accounted for at fair value beginning January 1, 2008 are measured using an income approach by taking into consideration the following factors:

Current policyholder account values and related surrender charges,

The present value of estimated future cash inflows (policy fees) and outflows (benefits and maintenance expenses) associated with the product using risk neutral valuations, incorporating expectations about policyholder behavior,

market returns and other factors, and

A risk margin that market participants would require for a market return and the uncertainty inherent in the model inputs.

The change in fair value of these policyholders contract deposits is recorded as incurred policy losses and benefits in the consolidated statement of income (loss).

Fair Value Measurements on a Non-Recurring Basis

AIG also measures the fair value of certain assets on a non-recurring basis, generally quarterly, annually, or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. These assets include held to maturity securities, cost and equity-method investments, life settlement contracts, flight equipment, collateral securing foreclosed loans and real estate and other fixed assets, goodwill, and other intangible assets. AIG uses a variety of techniques to measure the fair value of these assets when appropriate, as described below:

Held to Maturity Securities, Cost and Equity-Method Investments: When AIG determines the carrying value of these assets may not be recoverable, AIG records the assets

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

Fair Value Measurements *(continued)*
3.
at fair value with the loss recognized in income. In such cases, AIG measures the fair value of these assets using the techniques discussed above for fixed maturities and equity securities.

Life Settlement Contracts: AIG measures the fair value of individual life settlement contracts (which are included in other invested assets) whenever the carrying value plus the undiscounted future costs that are expected to be incurred to keep the life settlement contract in force exceed the expected proceeds from the contract. In those situations, the fair value is determined on a discounted cash flows basis, incorporating current life expectancy assumptions. The discount rate incorporates current information about market interest rates, the credit exposure to the insurance company that issued the life settlement contract and AIG s estimate of the risk margin an investor in the contracts would require.

Flight Equipment Primarily Under Operating Leases: When AIG determines the carrying value of its commercial aircraft may not be recoverable, AIG records the aircraft at fair value with the loss recognized in income. AIG measures the fair value of its commercial aircraft using an income approach based on the present value of all cash flows from existing and projected lease payments (based on historical experience and current expectations of market participants) including net contingent rentals for the period extending to the end of the aircraft s economic life in its highest and best use configuration, plus its disposition value.

Collateral Securing Foreclosed Loans and Real Estate and Other Fixed Assets: When AIG takes collateral in connection with foreclosed loans, AIG generally bases its estimate of fair value on the price that would be received in a current transaction to sell the asset by itself.

Goodwill: AIG tests goodwill for impairment whenever events or changes in circumstances indicate the carrying amount of goodwill may not be recoverable, but at least annually. When AIG determines goodwill may be impaired, AIG uses techniques that consider market-based earnings multiples of the unit s peer companies or discounted cash flow techniques based on the price that could be received in a current transaction to sell the asset assuming the asset would be used with other assets as a group (in-use premise).

Intangible Assets: AIG tests its intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount of an intangible asset may not be recoverable. AIG measures the fair value of intangible assets based on an in-use premise that considers the same factors used to estimate the fair value of its real estate and other fixed assets under an in-use premise discussed above.

See Notes 1(c), (d), (e), (t), and (v) to Consolidated Financial Statements included in the 2007 Annual Report on Form 10-K for additional information about how AIG tests various asset classes for impairment.

Fair Value Hierarchy

Beginning January 1, 2008, assets and liabilities recorded at fair value in the consolidated balance sheet are measured and classified in a hierarchy for disclosure purposes consisting of three levels based on the observability of inputs available in the marketplace used to measure the fair values as discussed below:

Level 1: Fair value measurements that are quoted prices (unadjusted) in active markets that AIG has the ability to access for identical assets or liabilities. Market price data generally is obtained from exchange or dealer markets. AIG does not adjust the quoted price for such instruments. Assets and liabilities measured at fair value on a recurring basis and classified as Level 1 include certain government and agency securities, actively traded listed common stocks and derivative contracts, most separate account assets and most mutual funds.

Level 2: Fair value measurements based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Assets and liabilities measured at fair value on a recurring basis and classified as Level 2 generally include certain government securities, most investment-grade and high-yield corporate bonds, certain asset-backed securities, certain listed equities, state, municipal and provincial obligations, hybrid securities, mutual fund and hedge fund investments, derivative contracts, guaranteed investment agreements at AIGFP and physical commodities.

Level 3: Fair value measurements based on valuation techniques that use significant inputs that are unobservable. These measurements include circumstances in which there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. AIG s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment. In

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

Fair Value Measurements *(continued)*
3.
making the assessment, AIG considers factors specific to the asset or liability. Assets and liabilities measured at fair value on a recurring basis and classified as Level 3 include certain distressed ABS, structured credit products, certain derivative contracts (including AIGFP s super senior credit default swap portfolio), policyholders contract deposits carried at fair value, private equity and real estate fund investments, and direct private equity investments. AIG s non-financial-instrument assets that are measured at fair value on a non-recurring basis generally are classified as Level 3.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents information about assets and liabilities measured at fair value on a recurring basis at June 30, 2008, and indicates the level of the fair value measurement based on the levels of the inputs used:

(in millions)	Level 1	Level 2	Level 3	Counterparty Netting	Total June 30, 2008
Assets:					
Bonds available for sale	$ 3,986	$ 370,850	$ 18,480	$	$ 393,316
Bond trading securities	1	8,605	195		8,801
Common stocks available for sale	16,812	267	227		17,306
Common and preferred stocks trading	21,510	999	5		22,514
Preferred stocks available for sale		2,238	258		2,496
Mortgage and other loans receivable		741	4		745
Financial Services assets:					
Securities available for sale	2	831	372		1,205
Trading securities	1,276	30,214	3,680		35,170
Spot commodities		90			90
Unrealized gain on swaps, options and forward transactions		59,493	3,625	(51,570)	11,548
Securities purchased under agreements to resell		16,597			16,597
Securities lending invested collateral[(a)]		40,595	8,489		49,084
Other invested assets[(b)]	2,643	7,588	11,868		22,099
Short-term investments[(c)]	39	24,128			24,167
Separate and variable accounts	69,162	3,061	1,178		73,401
Other assets	94	4,611	353	(2,606)	2,452
Total	$ 115,525	$ 570,908	$ 48,734	$ (54,176)	$ 680,991
Liabilities:					
Policyholders contract deposits	$	$	$ 4,179	$	$ 4,179
Other policyholders funds	2				2
Financial Services liabilities:					
		8,298	40		8,338

Securities sold under agreements to repurchase					
Securities and spot commodities sold but not yet purchased	94	3,095			3,189
Unrealized loss on swaps, options and forward transactions[(d)]		52,897	30,299	(58,964)	24,232
Trust deposits and deposits due to banks and other depositors		240			240
Long-term borrowings		51,150	2,689		53,839
Other liabilities	6	7,005	44	(194)	6,861
Total	$ 102	$ 122,685	$ 37,251	$ (59,158)	$ 100,880

(a) Amounts exclude short-term investments that are carried at cost, which approximates fair value of $10.4 billion.

(b) Approximately 13 percent of the fair value of the assets recorded as Level 3 relates to various private equity, real estate, hedge fund and fund-of-funds investments. AIG s ownership in these funds represented 22 percent, or $1.4 billion of the Level 3 amount.

(c) Level 2 includes short-term investments that are carried at cost, which approximates fair value of $23.1 billion.

(d) Included in Level 3 are unrealized market valuation losses of $26.1 billion on AIGFP super senior credit default swap portfolio.

At June 30, 2008, Level 3 assets totaled $48.7 billion, representing 4.7 percent of total assets, and Level 3 liabilities totaled $37.3 billion, representing 3.8 percent of total liabilities.

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

3. Fair Value Measurements *(continued)*

The following tables present changes during the three- and six-month periods ended June 30, 2008 in Level 3 assets and liabilities measured at fair value on a recurring basis, and the realized and unrealized gains (losses) recorded in income during the three- and six-month periods ended June 30, 2008 related to the Level 3 assets and liabilities that remained on the consolidated balance sheet at June 30, 2008:

(in millions)	Balance Beginning of Period[a]	Net Realized and Unrealized Gains (Losses) Included in Income[b]	Accumulated Other Comprehensive Income (Loss)	Purchases, Sales, Issuances and Settlements-net	Transfers In (Out)	Balance at June 30, 2008	Changes in **Unrealized Gains** (Losses) on Instruments Held at June 30, 2008
Three Months Ended June 30, 2008:							
Assets:							
Bonds available for sale	$ 17,198	$ (679)	$ (58)	$ (34)	$ 2,053	$ 18,480	$
Bond trading securities	116	5	2	15	57	195	7
Common stocks available for sale	251	(3)	(3)	(15)	(3)	227	
Common and preferred stocks trading	25	(1)	1	(13)	(7)	5	
Preferred stocks available for sale	133	(3)	8	(59)	179	258	
Mortgage and other loans receivable					4	4	
Financial Services assets:							
Securities available for sale	294	(3)	2	77	2	372	
Trading securities	3,419	(472)		713	20	3,680	(361)
Securities lending invested collateral	9,622	(1,346)	908	(590)	(105)	8,489	
	11,348	(153)	70	533	70	11,868	166

Other invested assets							
Separate and variable accounts	1,065	(3)		116		1,178	(4)
Other assets	337	(6)		3		334	(6)
Total	$ 43,808	$ (2,664)	$ 930	$ 746	$ 2,270	$ 45,090	$ (198)
Liabilities:							
Policyholders contract deposits	$ (4,118)	$ 129	$ 13	$ (203)	$	$ (4,179)	$ 62
Financial Services liabilities:							
Securities sold under agreements to repurchase	(220)	(3)		(39)	222	(40)	1
Unrealized loss on swaps, options and forward transactions, net	(20,860)	(5,679)		(240)	105	(26,674)	(5,496)
Long-term borrowings	(2,838)	(25)		182	(8)	(2,689)	(12)
Other liabilities	(74)	32	(1)	17	1	(25)	52
Total	$ (28,110)	$ (5,546)	$ 12	$ (283)	$ 320	$ (33,607)	$ (5,393)
Six Months Ended June 30, 2008:							
Assets:							
Bonds available for sale	$ 18,786	$ (1,444)	$ (550)	$ (224)	$ 1,912	$ 18,480	$
Bond trading securities	141	(20)	2	15	57	195	(10)
Common stocks available for sale	224	(5)		11	(3)	227	
Common and preferred stocks trading	30	(1)	2	(19)	(7)	5	
Preferred stocks available for sale	135	(2)	6	(67)	186	258	
Mortgage and other loans receivable					4	4	
Financial Services assets:							
Securities available for sale	285	(3)	8	82		372	

Trading securities	4,422	(1,433)		702	(11)	3,680	(1,233)
Securities lending invested collateral	11,353	(3,138)	1,087	(818)	5	8,489	
Other invested assets	10,373	192	137	1,148	18	11,868	818
Separate and variable accounts	1,003	27		148		1,178	27
Other assets	141			193		334	
Total	$ 46,893	$ (5,827)	$ 692	$ 1,171	$ 2,161	$ 45,090	$ (398)
Liabilities:							
Policyholders contract deposits	$ (3,674)	$ (57)	$ (51)	$ (397)	$	$ (4,179)	$ (221)
Financial Services liabilities:							
Securities sold under agreements to repurchase	(208)	(20)		(34)	222	(40)	1
Unrealized loss on swaps, options and forward transactions, net	(11,718)	(14,562)		(429)	35	(26,674)	(14,693)
Long-term borrowings	(3,578)	90		638	161	(2,689)	
Other liabilities	(503)	(55)		532	1	(25)	28
Total	$ (19,681)	$ (14,604)	$ (51)	$ 310	$ 419	$ (33,607)	$ (14,885)

(a) Certain recharacterizations of amounts previously reported in Level 3 were identified in the second quarter of 2008, and have been adjusted. The effect of these reclassifications and recharacterizations on Level 3 net assets were net decreases of $1.8 billion and $1.0 billion at January 1, 2008 and March 31, 2008, respectively. The Consolidated Statement of Income, the Consolidated Balance Sheet, and the Consolidated Statement of Cash Flows presented in the 2008

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

3. Fair Value Measurements *(continued)*

first quarter Form 10-Q were not affected by these changes. Total Level 3 derivative exposures have been netted on these tables for presentation purposes only.

(b) Net realized and unrealized gains and losses shown above are reported on the consolidated statement of income (loss) primarily as follows:

Major category of Assets/ Liabilities	Consolidated Statement of Income (Loss) Line Items
Financial Services assets and liabilities	Other income
	Unrealized market valuation losses on AIGFP super senior credit default swap portfolio
Other invested assets	Net realized capital gains (losses)
Policyholders contract deposits	Incurred policy losses and benefits
	Net realized capital gains (losses)

3. Fair Value Measurements *(continued)*

Both observable and unobservable inputs may be used to determine the fair values of positions classified in Level 3 in the tables above. As a result, the unrealized gains (losses) on instruments held at June 30, 2008 may include changes in fair value that were attributable to both observable (e.g., changes in market interest rates) and unobservable inputs (e.g., changes in unobservable long-dated volatilities).

AIG uses various hedging techniques to manage risks associated with certain positions, including those classified within Level 3. Such techniques may include the purchase or sale of financial instruments that are classified within Level 1 and/or Level 2. As a result, the realized and unrealized gains (losses) for assets and liabilities classified within Level 3 presented in the table above do not reflect the related realized or unrealized gains (losses) on hedging instruments that are classified within Level 1 and/or Level 2.

Changes in the fair value of separate and variable account assets are completely offset in the consolidated statement of income (loss) by changes in separate and variable account liabilities, which are not carried at fair value and therefore not included in the foregoing tables.

Fair Value Measured on a Non-Recurring Basis

At June 30, 2008, AIG had assets measured at fair value on a non-recurring basis on which it recorded impairment charges totaling $107 million during the six-month period ended June 30, 2008. These charges included a $45 million write-off of goodwill related to the Mortgage Guaranty reporting unit; a $49 million impairment charge on real estate owned, real estate loans held for sale and other intangible assets for American General Finance, Inc.; and impairment charges on other assets of $13 million.

Fair Value Option

FAS 159 permits a company to choose to measure at fair value many financial instruments and certain other assets and liabilities that are not required to be measured at fair value. Subsequent changes in fair value for designated items are required to be reported in income. Unrealized gains and losses on financial instruments in AIG s insurance businesses and in AIGFP for which the fair value option was elected under FAS 159 are classified in incurred policy losses and benefits and in other income, respectively, in the consolidated statement of income (loss).

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

3. Fair Value Measurements *(continued)*

The following table presents the gains or losses recorded during the three- and six-month periods ended June 30, 2008 related to the eligible instruments for which AIG elected the fair value option and the related transition adjustment recorded as a decrease to opening shareholders equity at January 1, 2008[(a)]:

(in millions)	January 1, 2008 prior to Adoption	Transition Adjustment upon Adoption	January 1, 2008 after Adoption	Gain (Loss) Three Months Ended June 30, 2008	Gain (Loss) Six Months Ended June 30, 2008
Mortgage and other loans receivable	$ 1,109	$	$ 1,109	$ 11	$ 79
Financial Services assets[(b)]:					
Trading securities (formerly available for sale)	39,278	5	39,283	(718)	(1,151)
Securities purchased under agreements to resell	20,950	1	20,951	307	575
Other invested assets	321	(1)	320	2	12
Short-term investments	6,969		6,969	43	67
Deferred policy acquisition costs	1,147	(1,147)			
Other assets	435	(435)			
Future policy benefits for life, accident and health insurance contracts	299	299			
Policyholders contract deposits[(c)]	3,739	360	3,379	3	118
Financial Services liabilities[(b)]:					
Securities sold under agreements to repurchase	6,750	(10)	6,760	(120)	(416)
Securities and spot commodities sold but not yet purchased	3,797	(10)	3,807	(34)	(13)
Trust deposits and deposits due to banks and other depositors	216	(25)	241	4	(11)
Long-term borrowings	57,968	(675)	58,643	582	(391)
Other liabilities	1,792		1,792	(286)	(319)
Total gain (loss) for the three- and six-month periods ended June 30, 2008				$ (206)	$ (1,450)
Pre-tax cumulative effect of adopting the fair value option		(1,638)			
Decrease in deferred tax liabilities		526			
Cumulative effect of adopting the fair value option		$ (1,112)			

(a) *Certain of AIG s financial instruments are required to be accounted for at fair value, with changes in fair value included in earnings, under FAS 115, Accounting for Certain Investments in Debt and Equity Securities, or FAS 133 and are not included in the table above.*

(b) *AIGFP elected to apply the fair value option to all eligible assets and liabilities (other than equity method investments, trade receivables and trade payables) because electing the fair value option will allow AIGFP to more closely align its earnings with the economics of its transactions by recognizing concurrently through earnings the change in fair value of its derivatives and the offsetting change in fair value of the assets and liabilities being hedged as well as the manner in which the business is evaluated by management. Substantially all of the gain (loss) amounts shown above are reported in other income on the consolidated statement of income (loss).*

(c) *AIG elected to apply the fair value option to certain single premium variable life products in Japan and an investment-linked life insurance product sold principally in Asia, both classified within policyholders contract deposits in the consolidated balance sheet. AIG elected the fair value option for these liabilities to more closely align its accounting with the economics of its transactions. For the investment-linked product sold principally in Asia, the election will more effectively align changes in the fair value of assets with a commensurate change in the fair value of policyholders liabilities. For the single premium life products in Japan, the fair value option election will allow AIG to economically hedge the inherent market risks associated with this business in an efficient and effective manner through the use of derivative instruments. The hedging program, which was initiated in the second quarter of 2008, results in an accounting presentation for this business that more closely reflects the underlying economics and the way the business is managed, with the change in the fair value of derivatives and underlying assets largely offsetting the change in fair value of the policy liabilities. AIG did not elect the fair value option for other liabilities classified in policyholders contract deposits because other contracts do not share the same contract features that created the disparity between the accounting presentation and the economic performance*.

Interest income and expense and dividend income on assets and liabilities elected under the fair value option are recognized and classified in the consolidated statement of income (loss) depending on the nature of the instrument and related market conventions. At AIGFP, interest and dividends and interest expense are included in other income. Otherwise, interest and dividends are included in net investment income in the consolidated statement of income (loss). See Note 1(a) to the Consolidated Financial Statements included in the 2007 Annual Report on Form 10-K for additional information about AIG s policies for recognition, measurement, and disclosure of interest and dividend income and interest expense.

During the three- and six-month periods ended June 30, 2008, AIG recognized a loss of $169 million and a gain of $1.3 billion, respectively, attributable to the observable effect of changes in credit spreads on AIG s own liabilities for which the fair value option was elected. AIG calculates the effect of these credit spread changes using discounted cash flow techniques that incorporate current market interest rates, AIG s ob-

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

American International Group, Inc. and Subsidiaries

3. Fair Value Measurements *(continued)*

servable credit spreads on these liabilities and other factors that mitigate the risk of nonperformance such as collateral posted.

The following table presents the difference between fair values and the aggregate contractual principal amounts of mortgage and other loans receivable and long-term borrowings, for which the fair value option was elected:

(in millions)	Fair Value at June 30, 2008	Principal Amount Due Upon Maturity	Difference
Assets:			
Mortgage and other loans receivable	$ 745	$ 716	$ 29
Liabilities:			
Long-term borrowings	$ 48,176	$ 47,168	$ 1,008

At June 30, 2008, there were no mortgage and other loans receivable for which the fair value option was elected, that were 90 days or more past due and in non-accrual status.

4. Shareholders Equity and Earnings (Loss) Per Share

Shareholders Equity

From time to time, AIG may buy shares of its common stock for general corporate purposes, including to satisfy its obligations under various share-based employee compensation plans. In February 2007, AIG s Board of Directors increased AIG s share repurchase program by authorizing the purchase of shares with an aggregate purchase price of $8 billion. In November 2007, AIG s Board of Directors authorized the purchase of an additional $8 billion in common stock. In 2007, AIG entered into structured share repurchase arrangements providing for the purchase of shares over time with an aggregate purchase price of $7 billion.

A total of 37,926,059 shares were purchased during the first six months of 2008 to meet commitments that existed at December 31, 2007. At August 5, 2008, $9 billion was available for purchases under the aggregate authorization. AIG does not expect to purchase additional shares under its share repurchase program for the foreseeable future.

The quarterly dividend per common share declared in May 2008 and payable on September 19, 2008 is $0.22.

In May 2008, AIG sold 196,710,525 shares of common stock at a price per share of $38 for gross proceeds of $7.47 billion and 78,400,000 equity units at a price per unit of $75 for gross proceeds of $5.88 billion. The equity units, the key terms of which are summarized below, are recorded as long-term borrowings on the consolidated balance sheet.

Equity Units

Each equity unit has an initial stated amount of $75 and consists of a stock purchase contract issued by AIG and, initially, a 1/40th or 2.5 percent undivided beneficial ownership interest in three series of junior subordinated debentures (Series B-1, B-2 and B-3), each with a principal amount of $1,000.

Each stock purchase contract requires its holder to purchase, and requires AIG to sell, a variable number of shares of AIG common stock for $25 in cash on each of the following dates: February 15, 2011, May 1, 2011 and August 1, 2011. The number of shares that AIG is obligated to deliver on each stock purchase date is set forth in the chart below (where the applicable market value is an average of the trading prices of AIG s common stock over the 20-trading-day period ending on the third business day prior to the relevant stock purchase date).

If the applicable market value is:	then AIG is obligated to issue:
Greater than or equal to $45.60	0.54823 shares per stock purchase contract
Between $45.60 and $38.00	Shares equal to $25 divided by the applicable market value
Less than or equal to $38.00	0.6579 shares per stock purchase contract

Basic earnings (loss) per share (EPS) will not be affected by outstanding stock purchase contracts. Diluted EPS will be determined considering the potential dilution from outstanding stock purchase contracts using the treasury stock method, and therefore diluted EPS will not be affected by outstanding stock purchase contracts until the applicable market value exceeds $45.60.

AIG is obligated to pay quarterly contract adjustment payments to the holders of the stock purchase contracts, at an initial annual rate of 2.7067 percent applied to the stated amount. The present value of the contract adjustment payments, $431 million, was recognized at inception as a liability (a component of other liabilities), and was recorded as a reduction to additional paid-in capital.

In addition to the stock purchase contracts, as part of the equity units, AIG issued $1.96 billion of each of the Series B-1, B-2 and B-3 junior subordinated debentures, which initially pay interest at rates of 5.67 percent, 5.82 percent and 5.89 percent, respectively. For accounting purposes, AIG allocated the proceeds of the equity units between the stock purchase contracts and the junior subordinated debentures on a relative fair value basis. AIG determined that the fair value of the stock purchase contract at issuance was zero, and therefore all of the proceeds were allocated to the junior subordinated debentures.

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

4. Shareholders Equity and Earnings (Loss) Per Share *(continued)*

Share-based Employee Compensation Plans

During the first quarter of 2008, AIG reviewed the vesting schedules of its share-based employee compensation plans, and on March 11, 2008, AIG s management and the Compensation and Management Resources Committee of AIG s Board of Directors determined that, to fulfill the objective of attracting and retaining high quality personnel, the vesting schedules of certain awards outstanding under these plans and all awards made in the future under these plans should be shortened.

For accounting purposes, a modification of the terms or conditions of an equity award is treated as an exchange of the original award for a new award. As a result of this modification, the incremental compensation cost related to the affected awards totaled $24 million and will, together with the unamortized originally-measured compensation cost, be amortized over shorter periods. AIG estimates the modifications will increase the amortization of this cost by $106 million and $46 million in 2008 and 2009, respectively, with a related reduction in amortization expense of $128 million in 2010 through 2013.

In the second quarter of 2008, reversals of previously accrued costs related to certain performance-based compensation plans were made, as performance to date is below the performance thresholds set forth in those plans.

Earnings (Loss) Per Share (EPS)

Basic EPS is based on the weighted average number of common shares outstanding, adjusted to reflect all stock dividends and stock splits. Diluted EPS is based on those shares used in basic EPS plus shares that would have been outstanding assuming issuance of common shares for all dilutive potential common shares outstanding, adjusted to reflect all stock dividends and stock splits.

The computation of basic and diluted EPS was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions, except per share data)	**2008**	2007	**2008**	2007
Numerator for EPS:				
Net income (loss)	**$ (5,357)**	$ 4,277	**$ (13,162)**	$ 8,407
Denominator for EPS:				
Weighted average shares outstanding used in the computation of EPS:				
Common stock issued	**2,850**	2,751	**2,808**	2,751
Common stock in treasury	**(258)**	(161)	**(247)**	(156)
Deferred shares	**13**	12	**14**	12
Weighted average shares outstanding basic	**2,605**	2,602	**2,575**	2,607
Incremental shares arising from awards outstanding under share-based employee compensation plans*		11		14
Weighted average shares outstanding diluted*	**2,605**	2,613	**2,575**	2,621
EPS:				
Basic	**$ (2.06)**	$ 1.64	**$ (5.11)**	$ 3.22

Diluted	**$**	**(2.06)**	$	1.64	**$**	**(5.11)**	$ 3.21

**Calculated using the treasury stock method. Certain potential common shares arising from share-based employee compensation plans were not included in the computation of diluted EPS because the effect would have been antidilutive. The number of potential shares excluded was 7 million for the six-month period ended 2007.*

5. Ownership

According to the Schedule 13D filed on March 20, 2007 by C.V. Starr & Co., Inc. (Starr), Starr International Company, Inc. (SICO), Edward E. Matthews, Maurice R. Greenberg, the Maurice R. and Corinne P. Greenberg Family Foundation, Inc., the Universal Foundation, Inc., the Maurice R. and Corinne P. Greenberg Joint Tenancy Company, LLC and the C.V. Starr & Co., Inc. Trust, these reporting persons could be considered to beneficially own 354,987,261 shares of AIG s common stock at that date. Based on the shares of AIG s common stock outstanding at July 31, 2008, this ownership would represent approximately 13 percent of the voting stock of AIG. Although these reporting persons have made filings under Section 16 of the Exchange Act, reporting sales of shares of common stock, no amendment to the Schedule 13D has been filed to report a change in ownership subsequent to March 20, 2007.

6. Commitments, Contingencies and Guarantees

(a) Litigation and Investigations

AIG and its subsidiaries, in common with the insurance and financial services industries in general, are subject to litigation, including claims for punitive damages, in the normal course of their business. At the current time, AIG cannot predict the outcome of the matters described below, or estimate any potential additional costs related to these matters, unless otherwise indicated. In AIG s insurance operations, litigation arising from claims settlement activities is generally considered in the establishment of AIG s reserve for losses

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

6. Commitments, Contingencies and Guarantees *(continued)*
and loss expenses. However, the potential for increasing jury awards and settlements makes it difficult to assess the ultimate outcome of such litigation.

Various federal, state and foreign regulatory and governmental agencies are reviewing certain public disclosures, transactions and practices of AIG and its subsidiaries in connection with industry wide and other inquiries. These reviews include the inquiries by the SEC and U.S. Department of Justice (DOJ), previously confirmed by AIG, with respect to AIG s valuation of and disclosures relating to the AIGFP super senior credit default swap portfolio. AIG has cooperated, and will continue to cooperate, in producing documents and other information in response to subpoenas and other requests. In connection with some of the SEC investigations, AIG understands that some of its employees have received Wells notices and it is possible that additional current and former employees could receive similar notices in the future. Under SEC procedures, a Wells notice is an indication that the SEC staff has made a preliminary decision to recommend enforcement action that provides recipients with an opportunity to respond to the SEC staff before a formal recommendation is finalized.

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

Litigation Relating to AIGFP s Super Senior Credit Default Swap Portfolio

Securities Actions Southern District of New York. On May 21, 2008, a purported securities fraud class action complaint was filed against AIG and certain of its current and former officers and directors in the United States District Court for the Southern District of New York (the Southern District of New York). The complaint alleges that defendants made statements during the period May 11, 2007 through May 9, 2008 in press releases, the Company s quarterly and year-end filings and during conference calls with analysts which were materially false and misleading and which artificially inflated the price of the Company s stock. The alleged false and misleading statements relate to, among other things, unrealized market valuation losses on AIGFP s super senior credit default swap portfolio as a result of severe credit market disruption. The complaint alleges claims under Sections 10(b) and 20(a) of the Exchange Act. Three additional purported securities class action complaints were subsequently filed in the Southern District of New York, all containing similar allegations. One of the additional complaints filed on June 19, 2008, alleges a purported class period of November 10, 2006 through June 6, 2008. The Court has not yet appointed a lead plaintiff in these actions.

ERISA Actions Southern District of New York. On June 25, 2008, the Company, certain of its executive officers and directors, and unnamed members of the Company s Retirement Board and Investment Committee were named as defendants in two nearly identical separate actions filed in the Southern District of New York. The actions purport to be brought as class actions on behalf of all participants in or beneficiaries of certain pension plans sponsored by AIG or its subsidiaries (the Plans) during the period May 11, 2007 to June 25, 2008 and whose participant accounts included investments in the Company s common stock. Plaintiffs allege, among other things, that the defendants breached their fiduciary responsibilities to Plan participants and their beneficiaries under the Employee Retirement Income Security Act of 1974, as amended (ERISA), by: (i) failing to prudently and loyally manage the Plans and the Plans assets; (ii) failing to provide complete and accurate information to participants and beneficiaries about the Company and the value of the Company s stock; (iii) failing to monitor appointed Plan fiduciaries and to provide them with complete and accurate information; and (iv) breach of the duty to avoid conflicts of interest. The alleged ERISA violations relate to, among other things, the defendants purported failure to monitor and/or disclose unrealized market valuation losses on AIGFP s super senior credit default swap portfolio as a result of severe credit market disruption. Three additional purported ERISA class action complaints were subsequently filed in the Southern District of New York, both containing similar allegations. It is anticipated that these actions will all be consolidated and that the Court will then appoint a lead plaintiff in the consolidated action.

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

On June 9, 2008, a purported shareholder derivative action was filed in the Southern District of New York assert-

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ing claims on behalf of AIG based generally on the same allegations as in the consolidated amended complaint in the 2007 Derivative Litigation. On June 10, 2008, the clerk of the court was informed that the action should be consolidated with the 2007 Derivative Litigation.

Derivative Action Supreme Court of New York. On February 29, 2008, a purported shareholder derivative complaint was filed in the Supreme Court of Nassau County, asserting the same state law claims against the same defendants as in the consolidated amended complaint in the 2007 Derivative Litigation. On May 19, 2008, defendants filed a motion to dismiss or to stay the proceedings in light of the pending 2007 Derivative Litigation.

Action by the Starr Foundation Supreme Court of New York. On May 7, 2008, the Starr Foundation filed a complaint in New York State Supreme Court against AIG, AIG s former Chief Executive Officer, Martin Sullivan, and AIG s Chief Financial Officer, Steven Bensinger, asserting a claim for common law fraud. The complaint alleges that the defendants made materially misleading statements and omissions concerning alleged multi-billion dollar losses in AIG s portfolio of credit default swaps. The complaint asserts that if the Starr Foundation had known the truth about the alleged losses, it would have sold its remaining shares of AIG stock. The complaint alleges that the Starr Foundation has suffered damages of at least $300 million. On May 30, 2008, a motion to dismiss the complaint was filed on behalf of defendants.

2006 Regulatory Settlements and Related Matters

2006 Regulatory Settlements. In February 2006, AIG reached a resolution of claims and matters under investigation with the United States Department of Justice (DOJ), the SEC, the Office of the New York Attorney General (NYAG) and the New York State Department of Insurance (DOI). AIG recorded an after-tax charge of $1.15 billion relating to these settlements in the fourth quarter of 2005. The settlements resolved investigations conducted by the SEC, NYAG and DOI in connection with the accounting, financial reporting and insurance brokerage practices of AIG and its subsidiaries, as well as claims relating to the underpayment of certain workers compensation premium taxes and other assessments. These settlements did not, however, resolve investigations by regulators from other states into insurance brokerage practices related to contingent commissions and other broker-related conduct, such as alleged bid rigging. Nor did the settlements resolve any obligations that AIG may have to state guarantee funds in connection with any of these matters.

As a result of these settlements, AIG made payments or placed amounts in escrow in 2006 totaling approximately $1.64 billion, $225 million of which represented fines and penalties. Amounts held in escrow totaling $334 million, including interest thereon, are included in other assets at June 30, 2008. At that date, all of the funds were escrowed for settlement of claims resulting from the underpayment by AIG of its residual market assessments for workers compensation.

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

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

Other Regulatory Settlements. AIG s 2006 regulatory settlements with the SEC, DOJ, NYAG and DOI did not resolve investigations by regulators from other states into insurance brokerage practices. AIG entered into agreements effective January 29, 2008 with the Attorneys General of the States of Florida, Hawaii, Maryland, Michigan, Oregon, Texas and West Virginia; the Commonwealths of Massachusetts and Pennsylvania; and the District of Columbia; as well as the Florida Department of Financial Services and the Florida Office of Insurance Regulation, relating to their respective industry wide investigations into producer compensation and insurance placement practices. The settlements call for total payments of $12.5 million to be allocated among the ten jurisdictions representing restitution

to state agencies and reimbursement of the costs of the investigation. During the term of the settlement agreements, AIG will continue to maintain certain producer compensation disclosure and ongoing compliance initiatives. AIG will also continue to cooperate with the industry wide investigations. The agreement with the Texas Attorney General also settles allegations of anticompetitive conduct relating to AIG s relationship with Allied World Assurance Company and includes an additional settlement payment of $500,000 related thereto.

AIG entered into an agreement effective March 13, 2008 with the Pennsylvania Insurance Department relating to the Department s investigation into the affairs of AIG and certain of its Pennsylvania-domiciled insurance company subsidiaries. The settlement calls for total payments of approximately $13.5 million, of which approximately $4.4 million was paid under previous settlement agreements. During the term of the settlement agreement, AIG will provide annual reinsurance

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reports, as well as maintain certain producer compensation disclosure and ongoing compliance initiatives.

NAIC Examination of Workers Compensation Premium Reporting. During 2006, the Settlement Review Working Group of the National Association of Insurance Commissioners (NAIC), under the direction of the states of Indiana, Minnesota and Rhode Island, began an investigation into the underreporting of workers compensation premiums. In late 2007, the Settlement Review Working Group recommended that a multi-state targeted market conduct examination focusing on workers compensation insurance be commenced under the direction of the NAIC s Market Analysis Working Group. AIG was informed of the multi-state targeted market conduct examination in January 2008. AIG has been advised that the lead states in the multi-state examination are Delaware, Florida, Indiana, Massachusetts, Minnesota, New York, Pennsylvania, and Rhode Island and that all other states (and the District of Columbia) have agreed to participate. AIG has also been advised that the examination will focus on both legacy issues and AIG s current compliance with legal requirements applicable to AIG s writing and reporting of workers compensation insurance, but as of July 31, 2008 no determinations had been made with respect to these issues.

Securities Action Southern District of New York. Beginning in October 2004, a number of putative securities fraud class action suits were filed in the Southern District of New York against AIG and consolidated as In re American International Group, Inc. Securities Litigation. Subsequently, a separate, though similar, securities fraud action was also brought against AIG by certain Florida pension funds. The lead plaintiff in the class action is a group of public retirement systems and pension funds benefiting Ohio state employees, suing on behalf of themselves and all purchasers of AIG s publicly traded securities between October 28, 1999 and April 1, 2005. The named defendants are AIG and a number of present and former AIG officers and directors, as well as Starr, SICO, General Reinsurance Corporation (General Re), and PricewaterhouseCoopers LLP (PwC), among others. The lead plaintiff alleges, among other things, that AIG: (1) concealed that it engaged in anti-competitive conduct through alleged payment of contingent commissions to brokers and participation in illegal bid-rigging; (2) concealed that it used income smoothing products and other techniques to inflate its earnings; (3) concealed that it marketed and sold income smoothing insurance products to other companies; and (4) misled investors about the scope of government investigations. In addition, the lead plaintiff alleges that AIG s former Chief Executive Officer, Maurice R. Greenberg, manipulated AIG s stock price. The lead plaintiff asserts claims for violations of Sections 11 and 15 of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, Section 20(a) of the Exchange Act, and Section 20A of the Exchange Act. In April 2006, the court denied the defendants motions to dismiss the second amended class action complaint and the Florida complaint. In December 2006, a third amended class action complaint was filed, which does not differ substantially from the prior complaint. Fact and class discovery is currently ongoing. On February 20, 2008, the lead plaintiff filed a motion for class certification. On June 9, 2008, the lead plaintiff filed a motion for leave to amend its complaint to include allegations related to unrealized market valuation losses on AIGFP s super senior credit default swap portfolio. On July 17, 2008, the Court denied lead plaintiffs motion for leave to amend.

ERISA Action Southern District of New York. Between November 30, 2004 and July 1, 2005, several ERISA actions were filed in the Southern District of New York on behalf of purported class participants and beneficiaries of three pension plans sponsored by AIG or its subsidiaries. A consolidated complaint filed on September 26, 2005 alleges a class period between September 30, 2000 and May 31, 2005 and names as defendants AIG, the members of AIG s Retirement Board and the Administrative Boards of the plans at issue, and present or former members of AIG s Board of Directors. The factual allegations in the complaint are essentially identical to those in the securities actions described above. The parties have reached an agreement to settle this matter for an amount within AIG s insurance coverage limits. On July 3, 2008, the Court granted preliminary approval of the settlement. The Court has scheduled a hearing on final settlement approval for October 7, 2008.

Derivative Action Southern District of New York. Between October 25, 2004 and July 14, 2005, seven separate derivative actions were filed in the Southern District of New York, five of which were consolidated into a single

action (the New York 2004/2005 Derivative Litigation). The complaint in this action contains nearly the same types of allegations made in the securities fraud action described above. The named defendants include current and former officers and directors of AIG, as well as Marsh & McLennan Companies, Inc. (Marsh), SICO, Starr, ACE Limited and subsidiaries (ACE), General Re, PwC, and certain employees or officers of these entity defendants. Plaintiffs assert claims for breach of fiduciary duty, gross mismanagement, waste of corporate assets, unjust enrichment, insider selling, auditor breach of contract, auditor professional negligence and disgorgement from AIG s former Chief Executive Officer, Maurice R. Greenberg, and former Chief Financial Officer, Howard I. Smith, of incentive-based compensation and AIG share proceeds under Section 304 of the Sarbanes-Oxley Act, among others. Plaintiffs seek, among other things, compensatory damages, corporate governance reforms, and a voiding of the election of

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certain AIG directors. AIG s Board of Directors has appointed a special committee of independent directors (special committee) to review the matters asserted in the operative consolidated derivative complaint. The court has entered an order staying this action pending resolution of the Delaware 2004/2005 Derivative Litigation discussed below. The court also has entered an order that termination of certain named defendants from the Delaware action applies to this action without further order of the court. On October 17, 2007, plaintiffs and those AIG officer and director defendants against whom the shareholder plaintiffs in the Delaware action are no longer pursuing claims filed a stipulation providing for all claims in this action against such defendants to be dismissed with prejudice. Former directors and officers Maurice R. Greenberg and Howard I. Smith have asked the court to refrain from so ordering this stipulation.

Derivative Actions Delaware Chancery Court. From October 2004 to April 2005, AIG shareholders filed five derivative complaints in the Delaware Chancery Court. All of these derivative lawsuits were consolidated into a single action as In re American International Group, Inc. Consolidated Derivative Litigation (the Delaware 2004/2005 Derivative Litigation). The amended consolidated complaint named 43 defendants (not including nominal defendant AIG) who, as in the New York 2004/2005 Derivative Litigation, were current and former officers and directors of AIG, as well as other entities and certain of their current and former employees and directors. The factual allegations, legal claims and relief sought in this action are similar to those alleged in the New York 2004/2005 Derivative Litigation, except that the claims are only under state law. Earlier in 2007, the court approved an agreement that AIG be realigned as plaintiff, and, on June 13, 2007, acting on the direction of the special committee, AIG filed an amended complaint against former directors and officers Maurice R. Greenberg and Howard I. Smith, alleging breach of fiduciary duty and indemnification. Also on June 13, 2007, the special committee filed a motion to terminate the litigation as to certain defendants, while taking no action as to others. Defendants Greenberg and Smith filed answers to AIG s complaint and brought third-party complaints against certain current and former AIG directors and officers, PwC and Regulatory Insurance Services, Inc. On September 28, 2007, AIG and the shareholder plaintiffs filed a combined amended complaint in which AIG continued to assert claims against defendants Greenberg and Smith and took no position as to the claims asserted by the shareholder plaintiffs in the remainder of the combined amended complaint. In that pleading, the shareholder plaintiffs are no longer pursuing claims against certain AIG officers and directors. On February 12, 2008, the court granted AIG s motion to stay discovery pending the resolution of claims against AIG in the New York consolidated securities action. The court also directed the parties to coordinate a briefing schedule for the motions to dismiss. On April 11, 2008, the shareholder plaintiffs filed the First Amended Combined Complaint, which added claims against former AIG directors and officers Maurice Greenberg, Edward Matthews, and Thomas Tizzio for breach of fiduciary duty based on alleged bid-rigging in the municipal derivatives market. On April 15, 2008, shareholder plaintiffs submitted a stipulation dismissing former AIG director and officer, Evan Greenberg, without prejudice. On June 13, 2008, certain defendants filed motions to dismiss the shareholder plaintiffs portions of the complaint.

AIG is also named as a defendant in a derivative action in the Delaware Chancery Court brought by shareholders of Marsh. On July 10, 2008, shareholder plaintiffs filed a second consolidated amended complaint, which contains claims against AIG for aiding and abetting a breach of fiduciary duty and contribution and indemnification in connection with alleged bid-rigging and steering practices in the commercial insurance market.

Policyholder Antitrust and RICO Actions. Commencing in 2004, policyholders brought multiple federal antitrust and Racketeer Influenced and Corrupt Organizations Act (RICO) class actions in jurisdictions across the nation against insurers and brokers, including AIG and a number of its subsidiaries, alleging that the insurers and brokers engaged in a broad conspiracy to allocate customers, steer business, and rig bids. These actions, including 24 complaints filed in different federal courts naming AIG or an AIG subsidiary as a defendant, were consolidated by the judicial panel on multi-district litigation and transferred to the United States District Court for the District of New Jersey for coordinated pretrial proceedings. The consolidated actions have proceeded in that court in two parallel

actions, In re Insurance Brokerage Antitrust Litigation (the Commercial Complaint) and In re Employee Benefit Insurance Brokerage Antitrust Litigation (the Employee Benefits Complaint, and, together with the Commercial Complaint, the multi-district litigation).

The plaintiffs in the Commercial Complaint are a group of corporations, individuals and public entities that contracted with the broker defendants for the provision of insurance brokerage services for a variety of insurance needs. The broker defendants are alleged to have placed insurance coverage on the plaintiffs behalf with a number of insurance companies named as defendants, including AIG subsidiaries. The Commercial Complaint also named various brokers and other insurers as defendants (three of which have since settled). The Commercial Complaint alleges, among other things, that defendants engaged in a widespread conspiracy to allocate customers through bid-rigging and steering prac-

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

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

The Court in connection with the Commercial Complaint granted (without leave to amend) defendants motions to dismiss the federal antitrust and RICO claims on August 31, 2007 and September 28, 2007, respectively. The court declined to exercise supplemental jurisdiction over the state law claims in the Commercial Complaint and therefore dismissed it in its entirety. On January 14, 2008, the court granted defendants motion for summary judgment on the ERISA claims in the Employee Benefits Complaint and subsequently dismissed the remaining state law claims without prejudice, thereby dismissing the Employee Benefits Complaint in its entirety. On February 12, 2008, plaintiffs filed a notice of appeal to the United States Court of Appeals for the Third Circuit with respect to the dismissal of the Employee Benefits Complaint. Plaintiffs previously appealed the dismissal of the Commercial Complaint to the United States Court of Appeals for the Third Circuit on October 10, 2007. On July 2, 2008, the Third Circuit stayed all proceedings in both appeals pending resolution in the district court of joint motions for approval of class plaintiffs settlement with the Marsh defendants. On July 10, 2008, appellants filed a motion to vacate the stay, which was granted on July 30, 2008. On July 31, 2008, the Third Circuit informed the parties that oral argument in both appeals had been tentatively scheduled for April 20, 2009.

A number of complaints making allegations similar to those in the multi-district litigation have been filed against AIG and other defendants in state and federal courts around the country. The defendants have thus far been successful in having the federal actions transferred to the District of New Jersey and consolidated into the multi-district litigation. These additional consolidated actions are still pending in the District Court, but are currently stayed pending a decision by the court on whether they will proceed during the appeal of the dismissal of the multi-district litigation. The AIG defendants have also sought to have state court actions making similar allegations stayed pending resolution of the multi-district litigation proceeding. These efforts have generally been successful, although plaintiffs in one case pending in Texas state court have moved to re-open discovery; a hearing on that motion was held on April 9, 2008 at which the court deferred ruling on the motion until defendants file their Special Exceptions. AIG has recently settled several of the various federal and state actions alleging claims similar to those in the multi-district litigation, including a state court action pending in Florida in which discovery had been allowed to proceed.

Ohio Attorney General Action Ohio Court of Common Pleas. On August 24, 2007, the Ohio Attorney General filed a complaint in the Ohio Court of Common Pleas against AIG and a number of its subsidiaries, as well as several other broker and insurer defendants, asserting violation of Ohio s antitrust laws. The complaint, which is similar to the Commercial Complaint, alleges that AIG and the other broker and insurer defendants conspired to allocate customers, divide markets, and restrain competition in commercial lines of casualty insurance sold through the broker defendant. The complaint seeks treble damages on behalf of Ohio public purchasers of commercial casualty insurance, disgorgement on behalf of both public and private purchasers of commercial casualty insurance, as well as a $500 per day penalty for each day of conspiratorial conduct. AIG, along with other co-defendants, moved to dismiss the complaint on November 16, 2007. On June 30, 2008, the Court denied defendants motion to dismiss.

Action Relating to Workers Compensation Premium Reporting Northern District of Illinois. On May 24, 2007, the National Workers Compensation Reinsurance Pool (the NWCRP), on behalf of its participant members, filed a

lawsuit in the United States District Court for the Northern District of Illinois against AIG with respect to the underpayment by AIG of its residual market assessments for workers compensation. The complaint alleges claims for violations of RICO, breach of contract, fraud and related state law claims arising out of AIG s alleged underpayment of these assessments between 1970 and the present and seeks damages purportedly in excess of $1 billion. On August 6, 2007, the court denied AIG s motion seeking to dismiss or stay the complaint or, in the alternative, to transfer to the Southern District of New York. On December 26, 2007, the court denied AIG s motion to dismiss the complaint. On March 17, 2008, AIG filed an amended answer, counterclaims and third-party claims against NCCI (in its capacity as attorney-in-fact for the NWCRP), the NWCRP, its board members, and certain of the other insurance companies that are members of the

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NWCRP alleging violations of RICO, as well as claims for conspiracy, fraud, and other state law claims. The counterclaim- and third-party defendants filed motions to dismiss on June 9, 2008. The motions are scheduled for decision on November 20, 2008. Discovery is currently ongoing while the motions are pending.

Action Relating to Workers Compensation Premium Reporting Minnesota. On February 16, 2006, the Attorney General of the State of Minnesota filed a complaint against AIG with respect to claims by the Minnesota Department of Revenue and the Minnesota Special Compensation Fund, alleging that AIG made false statements and reports to Minnesota agencies and regulators, unlawfully reducing AIG s contributions and payments to Minnesota and certain state funds relating to its workers compensation premiums. While AIG settled that litigation in December 2007, a similar lawsuit was filed by the Minnesota Workers Compensation Reinsurance Association and the Minnesota Workers Compensation Insurers Association in the United States District Court for the District of Minnesota. On March 28, 2008, the court granted AIG s motion to dismiss the case in its entirety. On April 25, 2008, plaintiffs appealed to the United States Court of Appeals for the Eighth Circuit and also filed a new complaint making similar allegations in Minnesota state court. On April 30, 2008, substantially identical claims were also filed in Minnesota state court by the Minnesota Insurance Guaranty Association and Minnesota Assigned Risk Plan.

Action Relating to Workers Compensation Premium Reporting District of South Carolina. A purported class action was also filed in the United States District Court for the District of South Carolina on January 25, 2008 against AIG and certain of its subsidiaries, on behalf of a class of employers that obtained workers compensation insurance from AIG companies and allegedly paid inflated premiums as a result of AIG s alleged underreporting of workers compensation premiums. An amended complaint in the South Carolina action was filed on March 24, 2008, and AIG filed a motion to dismiss the amended complaint on April 21, 2008. On July 8, 2008, the South Carolina court granted AIG s motion to dismiss all claims without prejudice and granted plaintiff leave to refile subject to certain conditions.

Litigation Relating to SICO and Starr

SICO Action. In July, 2005 SICO filed a complaint against AIG in the Southern District of New York, claiming that AIG had refused to provide SICO access to certain artwork, and asking the court to order AIG immediately to release the property to SICO. AIG filed an answer denying SICO s allegations and setting forth defenses to SICO s claims. In addition, AIG filed counterclaims asserting breach of contract, unjust enrichment, conversion, breach of fiduciary duty, a constructive trust and declaratory judgment, relating to SICO s breach of its commitment to use its AIG shares only for the benefit of AIG and AIG employees. On June 23, 2008, the Court denied in part and granted in part SICO s motion for summary judgment, and on July 31, 2008 the parties submitted a joint pre-trial order.

Derivative Action Relating to Starr and SICO. On December 31, 2002, a derivative lawsuit was filed in the Delaware Chancery Court against twenty directors and executives of AIG as well as against AIG as a nominal defendant that alleges, among other things, that the directors of AIG breached the fiduciary duties of loyalty and care by approving the payment of commissions to insurance managing general agencies owned by Starr and of rental and service fees to SICO and the executives breached their duty of loyalty by causing AIG to enter into contracts with Starr and SICO and their fiduciary duties by usurping AIG s corporate opportunities. The complaint further alleges that the Starr agencies did not provide any services that AIG was not capable of providing itself, and that the diversion of commissions to these entities was solely for the benefit of Starr s owners. The complaint also alleges that the service fees and rental payments made to SICO and its subsidiaries were improper. Under the terms of a stipulation approved by the court on February 16, 2006, the claims against the outside independent directors were dismissed with prejudice, while the claims against the other directors were dismissed without prejudice. In an opinion dated June 21, 2006, the Court denied defendants motion to dismiss, except with respect to plaintiff s challenge to payments made to Starr before January 1, 2000. On July 21, 2006, plaintiff filed its second amended complaint, which alleges that, between January 1, 2000 and May 31, 2005, individual defendants breached their duty of loyalty by causing AIG to enter into contracts with Starr and SICO and breached their fiduciary duties by usurping AIG s corporate opportunity. Starr is charged with aiding and abetting breaches of fiduciary duty and unjust enrichment for its acceptance of the fees. SICO

is no longer named as a defendant. On June 27, 2007, Starr filed a cross-claim against AIG, alleging one count that includes contribution, unjust enrichment and setoff. On November 15, 2007, the court granted AIG s motion to dismiss the cross-claim by Starr to the extent that it sought affirmative relief from AIG. On February 14, 2008, the court granted a motion to add former AIG officer Thomas Tizzio as a defendant. As a result, the remaining defendants in the case are AIG (the nominal defendant), Starr and former directors and officers Maurice Greenberg, Howard Smith, Edward Matthews and Thomas Tizzio. Trial is currently scheduled to begin in September 2008.

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Litigation Matters Relating to AIG s General Insurance Operations

Caremark. AIG and certain of its subsidiaries have been named defendants in two putative class actions in state court in Alabama that arise out of the 1999 settlement of class and derivative litigation involving Caremark Rx, Inc. (Caremark). The plaintiffs in the second-filed action have intervened in the first-filed action, and the second-filed action has been dismissed. An excess policy issued by a subsidiary of AIG with respect to the 1999 litigation was expressly stated to be without limit of liability. In the current actions, plaintiffs allege that the judge approving the 1999 settlement was misled as to the extent of available insurance coverage and would not have approved the settlement had he known of the existence and/or unlimited nature of the excess policy. They further allege that AIG, its subsidiaries, and Caremark are liable for fraud and suppression for misrepresenting and/or concealing the nature and extent of coverage. In addition, the intervenor-plaintiffs allege that various lawyers and law firms who represented parties in the underlying class and derivative litigation (the Lawyer Defendants) are also liable for fraud and suppression, misrepresentation, and breach of fiduciary duty. The complaints filed by the plaintiffs and the intervenor-plaintiffs request compensatory damages for the 1999 class in the amount of $3.2 billion, plus punitive damages. AIG and its subsidiaries deny the allegations of fraud and suppression and have asserted that information concerning the excess policy was publicly disclosed months prior to the approval of the settlement. AIG and its subsidiaries further assert that the current claims are barred by the statute of limitations and that plaintiffs assertions that the statute was tolled cannot stand against the public disclosure of the excess coverage. The plaintiffs and intervenor-plaintiffs, in turn, have asserted that the disclosure was insufficient to inform them of the nature of the coverage and did not start the running of the statute of limitations. On November 26, 2007, the trial court issued an order that dismissed the intervenors complaint against the Lawyer Defendants and entered a final judgment in favor of the Lawyer Defendants. The intervenors are appealing the dismissal of the Lawyer Defendants and on January 2, 2008, requested a stay of all trial court proceedings pending the appeal. On March 4, 2008, the trial court granted the motion for a stay. No further proceedings at the trial court level will occur until the appeal of the dismissal of the Lawyer Defendants is resolved. AIG cannot reasonably estimate either the likelihood of its prevailing in these actions or the potential damages in the event liability is determined.

Gunderson. A subsidiary of AIG has been named as a defendant in a putative class action lawsuit in the 14th Judicial District Court for the State of Louisiana. The complaint alleges failure to comply with certain provisions of the Louisiana Any Willing Provider Act relating to discounts taken by defendants on bills submitted by Louisiana medical providers and hospitals that provided treatment or services to workers compensation claimants and seeks monetary penalties and injunctive relief. On January 25, 2008, plaintiffs and the AIG subsidiary agreed to resolve the lawsuit on a class-wide basis for approximately $29 million. On May 29, 2008, the court entered a Final Order and Judgment, approving the settlement and fully and finally resolving the litigation.

(b) Commitments

Flight Equipment

At June 30, 2008, International Lease Finance Corporation (ILFC) had committed to purchase 179 new aircraft deliverable from 2008 through 2019 at an estimated aggregate purchase price of $17.6 billion. ILFC will be required to find customers for any aircraft acquired, and it must arrange financing for portions of the purchase price of such equipment.

ILFC ordered 74 Boeing 787 aircraft with the first aircraft now scheduled to be delivered in late 2011. Boeing has made several announcements concerning the delays in the deliveries of the 787s. Boeing has informed ILFC that its 787 deliveries will be delayed 19-30 months with an average delay in excess of 27 months per aircraft and span across ILFC s entire order, with the original contracted deliveries running from 2010 through 2017.

Other Commitments

In the normal course of business, AIG enters into commitments to invest in limited partnerships, private equities, hedge funds and mutual funds and to purchase and develop real estate in the U.S. and abroad. These commitments

totaled $8.7 billion at June 30, 2008.

On June 27, 2005, AIG entered into an agreement pursuant to which AIG agreed, subject to certain conditions, to make any payment that is not promptly paid with respect to the benefits accrued by certain employees of AIG and its subsidiaries under the SICO Plans (as discussed below under Benefits Provided by Starr International Company, Inc. and C.V. Starr & Co., Inc.).

(c) Contingencies

Loss Reserves. Although AIG regularly reviews the adequacy of the established reserve for losses and loss expenses, there can be no assurance that AIG s ultimate loss reserves will not develop adversely and materially exceed AIG s current loss reserves. Estimation of ultimate net losses, loss expenses and loss reserves is a complex process for long-tail casualty lines of business, which include excess and umbrella liability, directors and officers liability (D&O), professional liability, medical malpractice, workers compensation, general liability, products liability and related classes, as well as for asbes-

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tos and environmental exposures. Generally, actual historical loss development factors are used to project future loss development. However, there can be no assurance that future loss development patterns will be the same as in the past. Moreover, any deviation in loss cost trends or in loss development factors might not be discernible for an extended period of time subsequent to the recording of the initial loss reserve estimates for any accident year. Thus, there is the potential for reserves with respect to a number of years to be significantly affected by changes in loss cost trends or loss development factors that were relied upon in setting the reserves. These changes in loss cost trends or loss development factors could be attributable to changes in inflation, in labor and material costs or in the judicial environment, or in other social or economic phenomena affecting claims.

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

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

(d) Guarantees

AIG and certain of its subsidiaries become parties to derivative financial instruments with market risk resulting from both dealer and end-user activities to reduce currency, interest rate, equity and commodity exposures. These instruments are carried at their fair value in the consolidated balance sheet. The majority of AIG s derivative activity is transacted by AIGFP. See Note 8 to the 2007 Annual Report on Form 10-K.

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

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

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

7. Employee Benefits

The components of the net periodic benefit cost with respect to pensions and other postretirement benefits were as follows:

	Pensions			Postretirement		
(in millions)	Non-U.S. Plans	U.S. Plans	Total	Non-U.S. Plans	U.S. Plans	Total
Three Months Ended June 30, 2008						
Components of net periodic benefit cost:						
Service cost	**$ 26**	**$ 32**	**$ 58**	**$ 2**	**$ 2**	**$ 4**
Interest cost	**14**	**50**	**64**	**1**	**4**	**5**
Expected return on assets	**(12)**	**(59)**	**(71)**			
Amortization of prior service cost	**(2)**	**(1)**	**(3)**			
Amortization of net loss	**3**	**5**	**8**			
Settlement loss	**2**		**2**			
Net periodic benefit cost	**$ 31**	**$ 27**	**$ 58**	**$ 3**	**$ 6**	**$ 9**
Three Months Ended June 30, 2007						
Components of net periodic benefit cost:						
Service cost	$ 21	$ 30	$ 51	$ 2	$ 3	$ 5
Interest cost	12	44	56		4	4
Expected return on assets	(9)	(54)	(63)			
Amortization of prior service cost	(3)		(3)		(1)	(1)
Amortization of net loss	3	9	12			
Settlement loss	1		1			
Net periodic benefit cost	$ 25	$ 29	$ 54	$ 2	$ 6	$ 8
Six Months Ended June 30, 2008						
Components of net periodic benefit cost:						
Service cost	**$ 50**	**$ 64**	**$ 114**	**$ 4**	**$ 4**	**$ 8**
Interest cost	**28**	**100**	**128**	**2**	**8**	**10**
Expected return on assets	**(23)**	**(119)**	**(142)**			
Amortization of prior service cost	**(5)**	**(1)**	**(6)**			
Amortization of net loss	**7**	**9**	**16**			
Settlement loss	**2**		**2**			
Net periodic benefit cost	**$ 59**	**$ 53**	**$ 112**	**$ 6**	**$ 12**	**$ 18**
Six Months Ended June 30, 2007						
Components of net periodic benefit cost:						
Service cost	$ 44	$ 60	$ 104	$ 3	$ 5	$ 8

Interest cost	24	89	113	1	8	9
Expected return on assets	(18)	(107)	(125)			
Amortization of prior service cost	(5)	(1)	(6)		(1)	(1)
Amortization of net loss	5	18	23			
Settlement loss	1		1			
Net periodic benefit cost	$ 51	$ 59	$ 110	$ 4	$ 12	$ 16

8. Federal Income Taxes

Interim Period Tax Assumptions and Effective Tax Rates

AIG s interim period tax expense or benefit is measured using an estimated annual effective tax rate. To the extent that a portion of AIG s annual pretax income or loss cannot be reliably estimated, the actual tax expense or benefit applicable to that income or loss is reported in the interim period in which the related income or loss is reported. AIG is unable to reliably estimate other-than-temporary impairments and the operating results of AIGFP. Therefore, the related tax effect of other-than-temporary impairments, which is calculated at the applicable local statutory rate (predominantly 35 percent), and the operating results of AIGFP, which are tax effected at the U.S. statutory tax rate of 35 percent, are reported as discrete adjustments to the estimated annual effective tax rate that AIG applies to all other pretax income.

The effective tax rate on the pre-tax loss for the three-month period ended June 30, 2008 was 38.4 percent. The effective tax rate was higher than the statutory rate of 35

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

8. Federal Income Taxes *(continued)*

percent due primarily to tax benefits from foreign operations and tax exempt interest. The effective tax rate on the pre-tax loss for the six-month period ended June 30, 2008 was 34.4 percent. The effective tax rate was adversely affected by $703 million of tax charges from the first three months of 2008, comprised of increases in the reserves for uncertain tax positions and other discrete period items. The effective tax rate on the pre-tax income for the three- and six-month periods ended June 30, 2007 was 26.5 percent and 27.2 percent, respectively. The effective tax rates were low, due primarily to benefits from remediation adjustments and the recognition of tax benefits associated with the SICO Plan for which the compensation expense was recognized in prior years.

Tax Filings and Examinations

On April 3, 2008, AIG filed a refund claim for tax years 1997 through 2004. The refund claim relates to the tax effect of the restatement of AIG s 2004 and prior financial statements.

There has been no material change to the status of the assertion of additional tax made by the Internal Revenue Service (IRS) in their Statutory Notice of Deficiency as described in AIG s Quarterly Report on Form 10-Q for the quarter ended March 31, 2008. AIG continues to believe that it has adequate reserves for any liability that could result from the IRS actions.

In the second quarter of 2008, three separate court decisions were rendered relating to certain leasing transactions, which were adverse to the affected taxpayers. In accordance with FIN 48 and FSP 13-2, AIG evaluated the effect of these decisions on leasing transactions of AIG subsidiaries and adjusted the timing of cash flows relating to income taxes generated by the transactions. AIG recorded a $100 million after-tax charge in the quarter ended June 30, 2008 as a result of this evaluation.

FIN 48

As of June 30, 2008 and December 31, 2007, AIG s unrecognized tax benefits, excluding interest and penalties, were $2.5 billion and $1.3 billion, respectively. As of June 30, 2008 and December 31, 2007, AIG s unrecognized tax benefits included $965 million and $299 million, respectively, related to tax positions the disallowance of which would not affect the effective tax rate. Accordingly, as of June 30, 2008 and December 31, 2007, the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective tax rate was $1.5 billion and $1.0 billion, respectively. Substantially all of the increase as of June 30, 2008 was attributable to the quarter ended March 31, 2008.

At June 30, 2008, AIG had accrued $429 million for the payment of interest (net of the federal benefit) and penalties.

AIG continually evaluates proposed adjustments by taxing authorities. At June 30, 2008, such proposed adjustments would not result in a material change to AIG s consolidated financial condition, although it is possible that the effect could be material to AIG s consolidated results of operations for an individual reporting period. Although it is reasonably possible that a significant change in the balance of unrecognized tax benefits may occur within the next twelve months, at this time it is not possible to estimate the range of the change due to the uncertainty of the potential outcomes.

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

9. Information Provided in Connection with Outstanding Debt

The following condensed consolidating financial statements reflect the following:

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

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

AIG Program Funding, Inc. is a wholly owned subsidiary of AIG. AIG provides a full and unconditional guarantee of all obligations of AIG Program Funding, Inc.

Condensed Consolidating Balance Sheet

(in millions)	American International Group, Inc. (As Guarantor)	AIGLH	AIG Liquidity Corp.	AIG Program Funding, Inc.	Other Subsidiaries	Eliminations	Consolidated AIG
June 30, 2008							
Assets:							
Investments and Financial Services assets	**$ 28,453**	**$ 40**	**$**	**$**	**$ 829,778**	**$ (22,669)**	**$ 835,602**
Cash	**3**				**2,226**		**2,229**
Carrying value of subsidiaries and partially owned companies, at equity	**91,567**	**19,869**			**19,151**	**(129,959)**	**628**
Other assets	**19,511**	**2,608**			**189,172**	**126**	**211,417**
Total assets	**$ 139,534**	**$ 22,517**	**$**	**$**	**$ 1,040,327**	**$ (152,502)**	**$ 1,049,876**
Liabilities:							
Insurance liabilities	**$**	**$**	**$**	**$**	**$ 557,673**	**$ (108)**	**$ 557,565**
Debt	**47,827**	**2,136**			**149,034**	**(20,359)**	**178,638**
Other liabilities	**13,619**	**2,991**			**220,587**	**(1,712)**	**235,485**
Total liabilities	**61,446**	**5,127**			**927,294**	**(22,179)**	**971,688**

Preferred shareholders equity in subsidiary companies					**100**		**100**
Total shareholders equity	**78,088**	**17,390**			**112,933**	**(130,323)**	**78,088**
Total liabilities, preferred shareholders equity in subsidiary companies and shareholders equity	**$ 139,534**	**$ 22,517**	**$**	**$**	**$ 1,040,327**	**$ (152,502)**	**$ 1,049,876**
December 31, 2007							
Assets:							
Investments and Financial Services assets	$ 14,648	$ 40	$	$	$ 849,144	$ (21,790)	$ 842,042
Cash	84	1			2,199		2,284
Carrying value of subsidiaries and partially owned companies, at equity	111,714	24,396			18,542	(153,998)	654
Other assets	9,414	2,592			191,220	155	203,381
Total assets	$ 135,860	$ 27,029	$	$	$ 1,061,105	$ (175,633)	$ 1,048,361
Liabilities:							
Insurance liabilities	$ 43	$	$	$	$ 534,369	$ (75)	$ 534,337
Debt	36,045	2,136			156,003	(18,135)	176,049
Other liabilities	3,971	2,826			238,362	(3,085)	242,074
Total liabilities	40,059	4,962			928,734	(21,295)	952,460
Preferred shareholders equity in subsidiary					100		100

companies							
Total shareholders equity	95,801	22,067			132,271	(154,338)	95,801
Total liabilities, preferred shareholders equity in subsidiary companies and shareholders equity	$ 135,860	$ 27,029	$	$	$ 1,061,105	$ (175,633)	$ 1,048,361

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

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

(in millions)	American International Group, Inc. (As Guarantor)	AIGLH	AIG Liquidity Corp.	AIG Program Funding, Inc.	Other Subsidiaries	Eliminations	Consolidated AIG
Three Months Ended June 30, 2008							
Operating income (loss)	**$ (52)**	**$ (20)**	**$ ***	**$**	**$ (8,684)**	**$**	**$ (8,756)**
Equity in undistributed net income of consolidated subsidiaries	**(6,164)**	**(1,729)**				**7,893**	
Dividend income from consolidated subsidiaries	**724**					**(724)**	
Income taxes (benefits)	**(135)**	**(4)**	*****		**(3,218)**		**(3,357)**
Minority interest					**42**		**42**
Net income (loss)	**$ (5,357)**	**$ (1,745)**	**$ ***	**$**	**$ (5,424)**	**$ 7,169**	**$ (5,357)**
Three Months Ended June 30, 2007							
Operating income (loss)	$ (282)	$ (13)	$ *	$	$ 6,623	$	$ 6,328
Equity in undistributed net income of consolidated subsidiaries	3,605	340				(3,945)	
Dividend income from consolidated subsidiaries	879	218				(1,097)	
Income taxes (benefits)	(75)	(15)	*		1,769		1,679

Minority interest					(372)		(372)
Net income (loss)	$ 4,277	$ 560	$ *	$	$ 4,482	$ (5,042)	$ 4,277
Six Months Ended June 30, 2008							
Operating income (loss)	**$ (885)**	**$ (41)**	**$ ***	**$**	**$ (19,094)**	**$**	**$ (20,020)**
Equity in undistributed net income of consolidated subsidiaries	**(13,918)**	**(2,975)**				**16,893**	
Dividend income from consolidated subsidiaries	**1,473**					**(1,473)**	
Income taxes (benefits)	**(168)**	**(7)**	*****		**(6,719)**		**(6,894)**
Minority interest					**(36)**		**(36)**
Net income (loss)	**$ (13,162)**	**$ (3,009)**	**$ ***	**$**	**$ (12,411)**	**$ 15,420**	**$ (13,162)**
Six Months Ended June 30, 2007							
Operating income (loss)	$ (543)	$ (86)	$ *	$	$ 13,129	$	$ 12,500
Equity in undistributed net income of consolidated subsidiaries	6,849	491				(7,340)	
Dividend income from consolidated subsidiaries	2,165	658				(2,823)	
Income taxes (benefits)	64	(7)	*		3,348		3,405
Minority interest					(688)		(688)
Net income (loss)	$ 8,407	$ 1,070	$ *	$	$ 9,093	$ (10,163)	$ 8,407

**Less than $1 million.*

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

9. Information Provided in Connection with Outstanding Debt *(continued)*
Condensed Consolidating Statement of Cash Flows

(in millions)	American International Group, Inc. (As Guarantor)	AIGLH	AIG Liquidity Corp.	AIG Program Funding, Inc.	Other Subsidiaries	Consolidated AIG
Six Months Ended June 30, 2008						
Net cash provided by (used in) operating activities	**$ (594)**	**$ 115**	**$ ***	**$**	**$ 17,068**	**$ 16,589**
Cash flows from investing:						
Invested assets disposed	**603**				**79,738**	**80,341**
Invested assets acquired	**(2,096)**				**(87,214)**	**(89,310)**
Other	**(11,466)**	**(116)**	*****		**(1,412)**	**(12,994)**
Net cash provided by (used in) investing activities	**(12,959)**	**(116)**	*****		**(8,888)**	**(21,963)**
Cash flows from financing activities:						
Issuance of debt	**13,080**				**42,605**	**55,685**
Repayments of debt	**(1,912)**				**(54,733)**	**(56,645)**
Proceeds from common stock issued	**7,343**					**7,343**
Payments advanced to purchase shares	**(1,000)**					**(1,000)**
Cash dividends paid to shareholders	**(1,036)**					**(1,036)**
Other	**(3,003)**		*****		**3,930**	**927**
Net cash provided by (used in) financing activities	**13,472**		*****		**(8,198)**	**5,274**
Effect of exchange rate changes on cash					**45**	**45**
Change in cash	**(81)**	**(1)**	*****		**27**	**(55)**
Cash at beginning of period	**84**	**1**			**2,199**	**2,284**
Cash at end of period	**$ 3**	**$**	**$ ***	**$**	**$ 2,226**	**$ 2,229**

Six Months Ended June 30, 2007						
Net cash provided by (used in) operating activities	$ (1,076)	$ 172	$ *	$	$ 18,335	$ 17,431
Cash flows from investing:						
Invested assets disposed	1,768				82,139	83,907
Invested assets acquired	(6,857)				(99,942)	(106,799)
Other	(2,012)	(76)	*		(15,334)	(17,422)
Net cash provided by (used in) investing activities	(7,101)	(76)	*		(33,137)	(40,314)
Cash flows from financing activities:						
Issuance of debt	11,958				38,133	50,091
Repayments of debt	(790)				(34,147)	(34,937)
Proceeds from common stock issued						
Payments advanced to purchase shares	(4,000)					(4,000)
Cash dividends paid to shareholders	(859)					(859)
Other	1,828	(96)	*		10,920	12,652
Net cash provided by (used in) financing activities	8,137	(96)	*		14,906	22,947
Effect of exchange rate changes on cash					(19)	(19)
Change in cash	(40)		*		85	45
Cash at beginning of period	76				1,514	1,590
Cash at end of period	$ 36	$	$ *	$	$ 1,599	$ 1,635

**Less than $1 million.*

During the second quarter of 2008, AIG made certain revisions to the American International Group, Inc. (as Guarantor) Condensed Statement of Cash Flows, primarily relating to the effect of reclassifying certain intercompany and securities lending balances. Accordingly, AIG revised the previous period presented to conform to the revised presentation. There was no effect on the Consolidated Statement of Cash Flows or ending cash balances.

The revisions and their effect on the American International Group, Inc. (as Guarantor) Condensed Statement of Cash Flows for the six months ended June 30, 2007 were as follows:

(in millions)	Originally Reported June 30, 2007	Revisions	As Revised
	$ 743	$(1,819)	$(1,076)

Cash flows provided by (used in) operating activities			
Cash flows provided by (used in) investing activities	(7,215)	114	(7,101)
Cash flows provided by (used in) financing activities	6,432	1,705	8,137

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

10. Cash Flows
During 2007, AIG made certain revisions to the Consolidated Statement of Cash Flows, primarily relating to the effect of reclassifying certain policyholders account balances, the elimination of certain intercompany balances and revisions related to separate account assets. Accordingly, AIG revised the previous periods presented to conform to the revised presentation. There was no effect on ending cash balances.

In addition, the table below reflects the effects of the adoption of FSP FIN 39-1 as discussed in Note 1, Summary of Significant Accounting Policies.

The revisions and their effect on the Consolidated Statement of Cash Flows for the six months ended June 30, 2007 were as follows:

(in millions)	Originally Reported June 30, 2007	Revisions	As Revised
Cash flows provided by (used in) from operating activities	$ 15,071	$ 2,360	$ 17,431
Cash flows provided by (used in) from investing activities	(37,873)	(2,441)	(40,314)
Cash flows provided by (used in) financing activities	22,866	81	22,947

American International Group, Inc. and Subsidiaries

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

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

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Cautionary Statement Regarding Projections and Other Information About Future Events

This Quarterly Report on Form 10-Q and other publicly available documents may include, and AIG s officers and representatives may from time to time make, projections concerning financial information and statements concerning future economic performance and events, plans and objectives relating to management, operations, products and

services, and assumptions underlying these projections and statements. These projections and statements are not historical facts but instead represent only AIG s belief regarding future events, many of which, by their nature, are inherently uncertain and outside AIG s control. These projections and statements may address, among other things, the status and potential future outcome of the current regulatory and civil proceedings against AIG and their potential effect on AIG s businesses, financial condition, results of operations, cash flows and liquidity, AIG s exposures to subprime mortgages, monoline insurers and the residential and commercial real estate markets 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 in Outlook and throughout this Management s Discussion and Analysis of Financial Condition and Results of Operations and in Item 1A. Risk Factors of AIG s Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Annual Report on Form 10-K). AIG is not under any obligation (and expressly disclaims any such obligations) to update or alter any projection or other statement, whether written or oral, that may be made from time to time, whether as a result of new information, future events or otherwise.

In addition to reviewing AIG s results for the three and six months ended June 30, 2008, this Management s Discussion and Analysis of Financial Condition and Results of Operations supplements and updates the information and discussion included in the 2007 Annual Report on Form 10-K. Throughout this Management s Discussion and Analysis of Financial Condition and Results of Operations, AIG presents its operations in the way it believes will be most meaningful. Statutory loss ratios and combined ratios are presented in accordance with accounting principles prescribed by insurance regulatory authorities because these are standard measures of performance filed with insurance regulatory authorities and used for analysis in the insurance industry and thus allow more meaningful comparisons with AIG s insurance competitors. AIG also uses cross-references to additional information included in this Quarterly Report on Form 10-Q and in the 2007 Annual Report on Form 10-K to assist readers seeking related information on a particular subject.

Overview of Operations and Business Results

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

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

Outlook

The following paragraphs supplement and update the information and discussion included in Management s Discussion and Analysis of Financial Condition and Results of Operations Outlook in the 2007 Annual Report on Form 10-K to reflect developments in or affecting AIG s business to date during 2008. These paragraphs also supplement and update Item 1A. Risk Factors in the 2007 Annual Report on Form 10-K.

General Trends

In mid-2007, the U.S. residential mortgage market began to experience serious disruption due to credit quality deterioration in a significant portion of loans originated, particularly to non-prime and subprime borrowers; evolving changes in the regulatory environment; a residential housing market characterized by a slowing pace of transactions and declining prices; increased cost and reduced availability of borrowings for mortgage participants; a rising unemployment rate; increased delinquencies in non-mortgage consumer credit; and illiquid credit markets. The conditions continued and worsened throughout 2007 and to date in 2008, expanding into the broader U.S. credit markets and resulting in greater volatility, less liquidity, widening of credit spreads, a lack of price transparency and increased credit losses in certain markets.

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

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

The operating results of AIG s consumer finance and mortgage guaranty operations in the United States have been and are likely to continue to be adversely affected by the factors referred to above. The downward cycle in the U.S. housing market is not expected to improve until residential inventories return to a more normal level and the mortgage credit market stabilizes. The duration and severity of the downward cycle could be further negatively affected in the event of an economic recession. AIG expects that this

downward cycle will continue to adversely affect UGC s operating results for the foreseeable future and will result in a significant operating loss for UGC through at least the first half of 2009. AIG also incurred substantial unrealized market valuation losses on AIGFP s super senior credit default swap portfolio and substantial other-than-temporary impairment charges on AIG s available for sale securities in the first six months of 2008 and fourth quarter of 2007. The results from AIG s operations with exposure to the U.S. residential mortgage market will be highly dependent on future market conditions. Continuing market deterioration will cause AIG to report additional unrealized market valuation losses and impairment charges. Given the current difficult market conditions, AIG is not able to predict the extent of any future market valuation losses or impairment charges. Moreover, AIG is unable to assess the effect, if any, that recent transactions involving sales of large portfolios of CDOs will have on the pricing of its credit default swaps, referenced CDOs or available for sale securities or on collateral posting requirements. There can be no assurance that increased claims activity, operating losses, unrealized market valuation losses and impairment charges will not be material to AIG s consolidated financial condition or AIG s consolidated results of operations for an individual reporting period.

The ongoing effect of the downward cycle in the U.S. housing market on AIG s consolidated financial condition could be material if the market disruption continues to expand beyond the residential mortgage markets, notwithstanding AIG s efforts to mitigate the risks to its business by disciplined underwriting and active risk management. AIG is also exploring measures to further protect its capital, reduce risks where appropriate and enhance its overall liquidity.

A significant portion of AIGFP s guaranteed investment agreements (GIAs) and financial derivative transactions include provisions that require AIGFP, upon a downgrade of AIG s long-term debt ratings, to post collateral or, with the consent of the counterparties, assign or repay its positions or arrange a substitute guarantee of its obligations by an obligor with higher debt ratings.

It is estimated that, as of the close of business on July 31, 2008, based on AIGFP s outstanding municipal GIAs and financial derivative transactions at that date, a downgrade of AIG s long-term senior debt ratings to A1 by Moody s Investors Service (Moody s) and A+ by Standard & Poor s, a division of The McGraw-Hill Companies, Inc. (S&P), would permit counterparties to make additional calls for up to approximately $13.3 billion of collateral, while a downgrade to A2 by Moody s and A by S&P would permit counterparties to call for approximately $1.2 billion of additional collateral. If either of Moody s or S&P downgraded AIG s ratings to A1 or A+ , respectively, the estimated collateral call would be for up to approximately $10.5 billion, while a downgrade to A2 or A , respectively, by either of the two rating agencies would permit counterparties to call for up to approximately $1.1 billion of additional collateral.

Furthermore, a downgrade of AIG s long-term senior debt ratings to A1 by Moody s or to the same levels by both rating agencies would permit either AIG or the counterparties to elect early termination of contracts resulting in payments of up to approximately $4.6 billion, while a downgrade to A2 by Moody s and A by S&P would permit either AIG or the counterparties to elect early termination of additional contracts resulting in additional payments of up to approximately $800 million. AIGFP believes that it is unlikely that certain of these counterparties would exercise their rights to elect termination of their contracts given the substantial economic benefit that such counterparties would forfeit upon termination.

The actual amount of collateral that AIGFP would be required to post to counterparties in the event of such downgrades, or the aggregate amount of payments that AIG could be required to make, depends on market conditions, the fair value of outstanding affected transactions and other factors prevailing at the time of the downgrade. Additional obligations to post collateral or the costs of assignment, repayment or alternative credit support would increase the demands on AIG s liquidity. Further downgrades could result in requirements for substantial additional collateral, which could have a material adverse effect on AIG s liquidity. For a further discussion of AIG s credit ratings and the potential effect of posting collateral on AIG s liquidity, see Capital Resources and Liquidity Credit Ratings and Liquidity herein.

Globally, heightened regulatory scrutiny of financial services companies in many jurisdictions has the potential to affect future financial results through higher compliance costs. This is particularly true in the United States, where

federal and state authorities have commenced various investigations of the financial services industry, and in Japan and Southeast Asia, where financial institutions have received remediation orders affecting consumer and policyholder rights.

As a result of the disruption of the U.S. residential housing market, AIG recognized other-than-temporary impairment charges over the last three quarters. Accordingly, any accretion to the expected recovery amount will be recognized in earnings in future periods over the expected recovery periods.

AIG tested goodwill for impairment as of June 30, 2008 and no impairment was identified. However, as a result of structural trends in the consumer finance market and the current competitive environment in the personal lines market,

the excess of the fair value over the carrying value of AIG s Consumer Finance and Personal Lines reporting units has narrowed. As of June 30, 2008, goodwill related to each of these reporting units amounted to approximately $700 million. A continuation of these trends could result in impairment in goodwill for these reporting units in the future.

General Insurance

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

Workers compensation remains under considerable pricing pressure, as statutory rates continue to decline. Rates for most casualty lines of insurance continue to decline due to competitive pressures, particularly for aviation, excess casualty and D&O exposures. Rates for commercial property lines are also declining following another year of relatively low catastrophe losses in 2007, a decline that is continuing despite increased natural catastrophe losses in 2008. Further price erosion is expected during the remainder of 2008 for the commercial lines. AIG seeks to mitigate the decline by constantly seeking out profitable opportunities across its diverse product lines and distribution networks while maintaining a commitment to underwriting discipline. There can be no assurance that price erosion will not become more widespread or that AIG s profitability will not deteriorate from current levels in major commercial lines.

The personal lines automobile insurance industry is currently experiencing a soft market. Industry underwriting results are expected to deteriorate due to a generally weakening economy and increasing loss trends. AIG s personal auto business has been affected by these trends, but AIG has filed rate increases, tightened underwriting guidelines and made pricing enhancements to seek to improve the underwriting results.

AIG has capital maintenance agreements with the companies included in the Commercial Insurance and Mortgage Guaranty reporting units that set forth procedures through which AIG will provide ongoing capital support. AIG expects that additional capital contributions may be required during the remainder of 2008 pursuant to these agreements.

Life Insurance & Retirement Services

Disruption in the U.S. residential mortgage and credit markets had a significant adverse effect on Life Insurance & Retirement Services operating results, specifically its net investment income and net realized capital losses in 2007 and the first six months of 2008, and AIG expects that this disruption will continue to be a key factor in the remainder of 2008 and beyond, especially in its U.S.-based operations. The volatility in operating results will be further magnified by the continuing market shift to variable products with living benefits.

In response to the market disruption, AIG, including Domestic Life and Domestic Retirement Services, has been increasing its liquidity position and investing in shorter duration investments. While prudent in the current environment, such actions will reduce overall investment yields for the foreseeable future.

Recent capital markets volatility has put pressure on credit lenders resulting in increased costs for premium financing, which could affect future sales of products where such financing is used, primarily in large universal life policies in Domestic Life Insurance.

The U.S. dollar has significantly weakened against many currencies, resulting in a favorable effect on operating results due to the translation of foreign currencies to the U.S. dollar. However, the weakened dollar has an unfavorable effect on other-than-temporary impairments in Foreign Life Insurance & Retirement Services and will continue to affect operating results throughout 2008.

During the second quarter of 2008, AIG made capital contributions aggregating $1.1 billion to the surplus of certain of its Domestic Life Insurance and Domestic Retirement Services subsidiaries to replace a portion of the capital lost as a result of net realized capital losses, including other-than temporary impairments. In Taiwan, $361 million was contributed to meet the needs of this growing business and increased risk-based capital

requirements. AIG expects that it will make additional capital contributions to these operations during the remainder of 2008, in large measure due to the continued effect of net realized capital losses resulting from severity-related other-than-temporary impairment charges.

Financial Services

During 2008, AIGFP s revenues from certain products have declined, in part, as a consequence of the continued disruption in the credit markets, the general decline in liquidity in the marketplace, and AIGFP s efforts to manage its liquidity. Furthermore, AIGFP has not been able to replace revenues previously generated from certain structured tax and credit derivative transactions that were terminated or matured at the end of 2007 and early 2008. AIG expects that

AIGFP s operating results will continue to be adversely affected for the foreseeable future.

AIG exercises significant judgment in the valuation of its various credit default swap portfolios. AIG uses pricing models and other methodologies to value these portfolios that take into account, where applicable, and to the extent possible, third-party prices, pricing matrices, the movement of indices (such as the CDX and iTraxx), collateral calls and other observable market data. AIG believes that the assumptions and judgments it makes are reasonable and lead to an overall methodology that is reasonable, but other market participants may use other methodologies, including, among other things, models, indices and selection of third-party pricing sources, that are based upon different assumptions and judgments, and these methodologies may generate materially different values.

For additional information regarding AIG s methodology, models and assumptions with respect to the valuation and credit-based analyses of the AIGFP super senior credit default swap portfolio, see Critical Accounting Estimates Fair Value Measurements of Certain Financial Assets and Liabilities AIGFP s Super Senior Credit Default Swap Portfolio, and Valuation of Level 3 Assets and Liabilities Super senior credit default swap portfolio. See Risk Management Credit Derivatives.

The ongoing disruption in the U.S. residential mortgage and credit markets and the downgrades of residential mortgage-backed securities and CDO securities by rating agencies continue to adversely affect the fair value of the super senior credit default swap portfolio written by AIGFP. AIG expects that continuing limitations on the availability of market observable data will affect AIG s determinations of the fair value of these derivatives. The fair value of these derivatives is expected to continue to fluctuate, perhaps materially, in response to changing market conditions, and AIG s estimates of the value of AIGFP s super senior credit default swap portfolio at future dates could therefore be materially different from current estimates. Further declines in the fair values of these derivatives may also require AIGFP to post additional collateral which may be material to AIGFP s financial condition.

At June 30, 2008, the fair value of AIGFP s super senior credit default swap portfolio, a net loss of $26.1 billion, represents AIG s best estimate of the amount it would need to pay a willing, able and knowledgeable third party to assume the obligations under AIGFP s super senior credit default swap portfolio at that date.

At June 30, 2008, AIG used a roll rate analysis to stress the AIGFP super senior multi-sector CDO credit default swap portfolio for potential pre-tax realized credit losses. Two scenarios illustrated in this process resulted in potential realized credit losses of approximately $5.0 billion (Scenario A) and approximately $8.5 billion (Scenario B). Actual ultimate realized credit losses are likely to vary, perhaps materially, from these scenarios, and there can be no assurance that the ultimate realized credit losses related to the AIGFP super senior multi-sector CDO credit default swap portfolio will be consistent with either scenario or that such realized credit losses will not exceed the potential realized credit losses illustrated by Scenario B. For a further discussion of AIG s stress testing using the roll rate analyses, see Risk Management Stress Testing/Sensitivity Analysis.

Approximately $307 billion of the $441 billion in notional exposure on AIGFP s super senior credit default swap portfolio as of June 30, 2008 was written to facilitate regulatory capital relief for financial institutions primarily in Europe. AIG expects that the majority of these transactions will be terminated within the next 9 to 21 months by AIGFP s counterparties when they no longer provide the regulatory capital benefit.

In light of early termination experience to date and after other comprehensive analyses, AIG determined that there was no unrealized market valuation adjustment to be recognized for this regulatory capital relief portfolio for the six months ended June 30, 2008 other than for transactions where AIGFP believes the counterparties are no longer using the transactions to obtain regulatory capital relief. AIG will continue to assess the valuation of this portfolio and monitor developments in the marketplace. Given the significant deterioration in the global credit markets and the risk that AIGFP s expectations with respect to the termination of these transactions by its counterparties may not materialize, there can be no assurance that AIG will not recognize unrealized market valuation losses from this portfolio in future periods, and recognition of even a small percentage decline in the fair value of this portfolio could be material to an individual reporting period. These transactions contributed approximately $156 million to AIGFP s revenues in the six-month period ended June 30, 2008. If AIGFP is not successful in replacing the revenues generated by these transactions, AIGFP s operating results could be materially adversely affected.

The airline industry is experiencing financial stress primarily due to record-high fuel costs, tightening of the credit markets and generally worsening economic conditions. This financial stress is causing a slow-down in the airline industry, and will likely have a negative effect on future lease rates and could begin to influence ILFC s results of operations as some airlines may approach ILFC to renegotiate transactions.

Asset Management

In the Institutional Asset Management business, management fees are earned based on the value of assets under management or committed capital. Declines in the equity and credit markets negatively affect the value of these investments

which may result in lower base management fees. Additionally, real estate investments are made through AIG Global Real Estate Investment Corp. (AIG Global Real Estate), typically for the purpose of development or repositioning and subsequent sale. Softening of the real estate and/or credit markets may delay the timing of development, repositioning and subsequent sale of these investments.

From time to time, AIG Global Asset Management Holdings Corp. and its subsidiaries and affiliated companies (collectively, AIG Investments) acquires alternative investments, primarily consisting of direct controlling equity interests in private enterprises, with the intention of transferring such investments to a to-be-established AIG sponsored fund or acquiring such investments to be held temporarily until distribution to a third party or AIG affiliate is completed (warehoused assets). Market conditions may impede AIG from launching new investment products for which these warehoused assets are being held. Market conditions may also prevent AIG from recovering its investment upon transfer or divestment.

For a description of important factors that may affect the operations and initiatives described above, see Item 1A. Risk Factors in the 2007 Annual Report on Form 10-K.

Consolidated Results

AIG s consolidated revenues, income (loss) before income taxes, minority interest and net income (loss) were as follows:

	Three Months Ended June 30,		Percentage	Six Months Ended June 30,		Percentage
(in millions)	**2008**	2007	Increase/ (Decrease)	**2008**	2007	Increase/ (Decrease)
Total revenues	**$ 19,933**	$ 31,150	(36)%	**$ 33,964**	$ 61,795	(45)%
Income (loss) before income taxes and minority interest	**(8,756)**	6,328		**(20,020)**	12,500	
Net income (loss)	**$ (5,357)**	$ 4,277	%	**$ (13,162)**	$ 8,407	%

AIG s consolidated revenues decreased in the three and six-month periods ended June 30, 2008 compared to the same periods in 2007 due to unrealized market valuation losses of $5.6 billion and $14.7 billion, respectively, on AIGFP s super senior credit default swap portfolio recorded in other income, higher net realized capital losses and a decline in net investment income, which more than offset growth in premiums and other considerations in the Life Insurance & Retirement Services segment. Net realized capital losses of $6.1 billion and $12.2 billion in the three and six-month periods ended June 30, 2008, respectively, included other-than-temporary impairment charges of $6.8 billion and $12.4 billion, primarily related to the significant disruption in the residential mortgage and credit markets and investment-related losses of $241 million and $1.0 billion where AIG lacks the intent to hold the investments to recovery. Total other-than-temporary impairment charges in the three- and six-month periods ended June 30, 2007 were $417 million and $884 million, respectively. See Invested Assets Portfolio Review Other-Than-Temporary Impairments herein. The decline in net investment income reflects higher trading account losses in the U.K., lower returns from yield enhancement income, partnerships, hedge funds and mutual funds as well as lower policyholder trading gains in Life Insurance & Retirement Services. Policyholder trading gains are offset by a charge to incurred policy losses and benefits expense.

Income (loss) before income taxes and minority interest declined in the three- and six-month periods ended June 30, 2008 due primarily to the losses described above.

Income Taxes

The effective tax rate on the pre-tax loss for the three-month period ended June 30, 2008 was 38.4 percent. The effective tax rate was higher than the statutory rate of 35 percent due primarily to tax benefits from foreign operations and tax exempt interest. The effective tax rate on the pre-tax loss for the six-month period ended June 30, 2008 was 34.4 percent. The effective tax rate was adversely affected by $703 million of tax charges from the first three months of 2008, comprised of increases in the reserves for uncertain tax positions and other discrete period items. The effective tax rate on the pre-tax income for the three- and six-month periods ended June 30, 2007 was 26.5 percent and 27.2 percent, respectively. The effective tax rates were low due primarily to benefits from remediation adjustments and the recognition of tax benefits associated with the SICO Plan for which the compensation expense was recognized in prior years. See also Note 8 to Consolidated Financial Statements.

Segment Results

The following table summarizes the operations of each principal segment: (See also Note 2 to Consolidated Financial Statements.)

Operating Segments *(in millions)*	Three Months Ended June 30, **2008**	2007	Percentage Increase/ (Decrease)	Six Months Ended June 30, **2008**	2007	Percentage Increase/ (Decrease)
Total revenues[(a)]:						
General Insurance	**$12,757**	$12,928	(1)%	**$ 25,046**	$25,831	(3)%
Life Insurance & Retirement Services[(b)]	**10,161**	14,023	(28)	**18,913**	27,705	(32)
Financial Services[(c)(d)]	**(3,605)**	2,123		**(10,165)**	4,324	
Asset Management[(e)]	**797**	1,781	(55)	**648**	3,450	(81)
Other	**208**	263	(21)	**80**	394	(80)
Consolidation and eliminations	**(385)**	32		**(558)**	91	
Total	**$19,933**	$31,150	(36)%	**$ 33,964**	$61,795	(45)%
Operating income (loss)[(a)]:						
General Insurance	**$ 827**	$ 2,976	(72)%	**$ 2,164**	$ 6,072	(64)%
Life Insurance & Retirement Services[(b)]	**(2,401)**	2,620		**(4,232)**	4,901	
Financial Services[(c)(d)]	**(5,905)**	47		**(14,677)**	339	
Asset Management[(e)]	**(314)**	927		**(1,565)**	1,685	
Other	**(715)**	(460)		**(1,483)**	(930)	
Consolidation and eliminations	**(248)**	218		**(227)**	433	
Total	**$ (8,756)**	$ 6,328		**$(20,020)**	$12,500	%

(a) *Includes other-than-temporary impairment charges of $6.8 billion and $417 million for the three-month periods ended June 30, 2008 and 2007, respectively, and $12.4 billion and $884 million for the six-month periods ended June 30, 2008 and 2007, respectively. Also includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), including the related foreign exchange gains and losses. For the three-month periods ended June 30, 2008 and 2007, the effect was $272 million and $(430) million, respectively, in both revenues and operating income (loss). For the six-month periods ended June 30, 2008 and 2007, the effect was $(476) million and $(882) million, respectively, in both revenues and operating income (loss). These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings.*

(b) *Includes other-than-temporary impairment charges of $5.2 billion and $324 million for the three-month periods ended June 30, 2008 and 2007, respectively, and $9.6 billion and $716 million for the six-month periods ended June 30, 2008 and 2007, respectively.*

(c)

Includes gains (losses) from hedging activities that did not qualify for hedge accounting treatment under FAS 133, including the related foreign exchange gains and losses. For the three-month periods ended June 30, 2008 and 2007, the effect was $5 million and $(443) million, respectively, in both revenues and operating income (loss). For the six-month periods ended June 30, 2008 and 2007, the effect was $(199) million and $(603) million, respectively, in both revenues and operating income (loss). These amounts result primarily from interest rate and foreign currency derivatives that are effective economic hedges of investments and borrowings.

(d) *For the three- and six-month periods ended June 30, 2008, both revenues and operating income (loss) include unrealized market valuation losses of $5.6 billion and $14.7 billion, respectively, on AIGFP s super senior credit default swap portfolio.*

(e) *Includes net realized capital losses of $464 million and $1.9 billion for the three- and six-month periods ended June 30, 2008, respectively, including other-than-temporary impairment charges of $882 million and $1.9 billion, respectively.*

General Insurance

AIG s General Insurance operations provide property and casualty products and services throughout the world. Revenues in the General Insurance segment represent net premiums earned, net investment income and net realized capital gains (losses). The decrease in General Insurance revenues in the three-month period ended June 30, 2008 compared to the same period in 2007 was due to higher net realized capital losses in the three-month period ended June 30, 2008 compared to the same period in 2007 and lower net investment income as returns on partnership investments declined. The decrease in General Insurance revenues in the six-month period ended June 30, 2008 compared to the same period in 2007 was due to net realized capital losses in the six-month period ended June 30, 2008 compared to net realized capital gains in the same period of 2007 and lower net investment income as returns on partnership investments declined. The decrease in General Insurance operating income in the three- and six-month periods ended June 30, 2008 compared to the same period in 2007 was principally due to lower underwriting profit and net investment income from AIG Commercial Insurance (Commercial Insurance) as well as net realized capital losses incurred by Commercial Insurance in 2008. Operating losses from the Mortgage Guaranty business and a decline in Foreign General Insurance net investment income in 2008 also contributed to the decrease in General Insurance operating income.

Life Insurance & Retirement Services

AIG s Life Insurance & Retirement Services operations provide insurance, financial and investment-oriented products throughout the world. Revenues in the Life Insurance & Retirement Services operations represent premiums and other considerations, net investment income and net realized capital gains (losses). Foreign operations contributed approximately 80 percent of AIG s Life Insurance & Retirement Services premiums and other considerations for both the three- and six-month periods ended June 30, 2008 and 2007.

Life Insurance & Retirement Services reported operating losses in the three- and six-month periods of 2008 compared to operating income in the same period in 2007, primarily due to lower net investment income and higher net realized capital losses in 2008, which were partially offset by the favorable effect of foreign exchange rates, lower deferred

policy acquisition costs (DAC) and sales inducement asset (SIA) amortization related to realized capital losses, growth in the underlying reserves which reflects increased assets under management and increased business in force.

Financial Services

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

Financial Services reported operating losses in the three-and six-month periods ended June 30, 2008 compared to operating income in the same periods in 2007, primarily due to unrealized market valuation losses of $5.6 billion and $14.7 billion in the three- and six-month periods ended June 30, 2008, respectively, on AIGFP s super senior credit default swap portfolio, the remaining operating loss resulting from the change in credit spreads on AIGFP s other assets and liabilities and a decline in operating income for AGF. Capital Markets net operating loss for the three- and six-month periods ended June 30, 2008 was $6.3 billion and $15.2 billion, respectively, reflecting the pre-tax unrealized market valuation loss on the super senior credit default swap portfolio. Included in the unrealized market valuation loss were gains of $44 million and $109 million as a result of the effects of AIG s own credit spreads on the valuation of these derivatives for the three- and six-month periods ended June 30, 2008, respectively. The effect of the changes in AIG s own credit spreads, including the aforementioned amounts reflected in the unrealized market valuation loss, was a decrease in pre-tax income of $112 million and an increase of $2.5 billion for the three- and six-month periods ended June 30, 2008, respectively. The effect of the changes in counterparty credit spreads for assets measured at fair value at AIGFP was a decrease of $362 million and $3.0 billion for the three- and six-month periods ended June 30, 2008, respectively. On January 1, 2008, AIGFP elected the fair value option for almost all of its eligible financial assets and liabilities. Included in the first quarter 2008 net operating loss was the transition amount of $291 million related to the adoption of FAS 157 and FAS 159.

AGF s operating income declined in the three- and six-month periods ended June 30, 2008 compared to the same periods in 2007, primarily due to increases in the provision for finance receivable losses and unfavorable variances related to derivatives which economically hedge AGF debt. AGF s operating income for the three- and six- month periods ended June 30, 2008 also reflected a pre-tax charge of $27 million resulting from AGF s decision to cease its wholesale originations (originations through mortgage brokers).

In the second quarter and first six months of 2007, the domestic consumer finance operations recorded pre-tax charges of $50 million and $178 million, respectively, representing the estimated cost of implementing the Supervisory Agreement entered into with the Office of Thrift Supervision (OTS), which are discussed in the Consumer Finance results of operations section. Based on the current estimated cost of implementing the Supervisory Agreement, partial reversals of these prior year charges of $25 million and $43 million were recorded for the three- and six-month periods ended June 30, 2008, respectively.

Operating income for ILFC increased in the three and six-month periods ended June 30, 2008 compared to the same periods in 2007 driven to a large extent by a larger aircraft fleet, higher lease rates and higher utilization and lower composite borrowing rates.

Asset Management

AIG s Asset Management operations include institutional asset management, broker-dealer related services and mutual funds and the Spread-Based Investment business. Revenues in the Asset Management segment represent investment income with respect to spread-based products, and management and advisory fees, carried interest revenues on the performance of the underlying funds, and realized gains on real estate investments in institutional products.

Asset Management reported operating losses in the three- and six-month periods ended June 30, 2008 compared to operating income in the same periods in 2007, due to other-than-temporary impairment charges on fixed maturity securities, lower partnership income and a decline in carried interest revenues. 2007 results included a gain of $398 million related to the sale of a portion of AIG s investment in The Blackstone Group L.P. in connection with its initial public offering.

Capital Resources

At June 30, 2008, AIG had total consolidated shareholders equity of $78.1 billion and total consolidated borrowings of $178.6 billion. At that date, $68.6 billion of such borrowings were subsidiary borrowings not guaranteed by AIG.

In May 2008, AIG raised a total of approximately $20 billion through the sale of: (i) 196,710,525 shares of AIG common stock at a price per share of $38, for an aggregate amount of $7.47 billion; (ii) 78.4 million equity units at a price per unit of $75, for an aggregate amount of $5.88 billion; and (iii) $6.9 billion of junior subordinated debentures in three series. The equity units and junior subordinated debentures receive hybrid equity treatment from the major rating agencies under their current policies.

Liquidity

AIG manages liquidity at both the subsidiary and parent company levels. At June 30, 2008, AIG s consolidated invested assets, primarily held by its subsidiaries, included $82.2 billion in cash and short-term investments. Consolidated net cash provided from operating activities in the first six months of 2008 amounted to $16.6 billion. At both the subsidiary and parent company level, liquidity management activities are intended to preserve and enhance funding stability, flexibility, and diversity through a wide range of potential operating environments and market conditions. AIG s primary sources of cash flow are dividends and other payments from its regulated and unregulated subsidiaries, as well as issuances of debt and equity securities. Primary uses of cash flow are for debt service, subsidiary funding, shareholder dividend payments and common stock repurchases. Management believes that AIG s liquid assets, cash provided by operations and access to the capital markets will enable it to meet its anticipated cash requirements.

For additional information, see Capital Resources and Liquidity.

Critical Accounting Estimates

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

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

Reserves for Losses and Loss Expenses
(General Insurance):

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

Expected loss ratios for the latest accident year: in this case, accident year 2008 for the year-end 2008 loss reserve analysis. For low-frequency, high-severity classes such as excess casualty, expected loss ratios generally are utilized for at least the three most recent accident years.

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

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

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

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

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

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

Recoverability: based on current and future expected profitability, which is affected by interest rates, foreign exchange rates, mortality/morbidity experience, expenses, investment returns and policy persistency.

Deferred Policy Acquisition Costs (General Insurance):

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

Estimated Gross Profits for Investment-Oriented Products (Life Insurance & Retirement Services):

Estimated gross profits: to be realized over the estimated duration of the contracts (investment-oriented products) affect the carrying value of DAC, unearned revenue liability, SIAs and associated amortization patterns. Estimated gross profits include investment income and gains and losses on investments less required interest, actual mortality and other expenses.

Allowance for Finance Receivable Losses (Financial Services):

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

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

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

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

Flight Equipment Recoverability (Financial Services):

Expected undiscounted future net cash flows: based upon current lease rates, projected future lease rates and estimated terminal values of each aircraft based on expectations of market participants.

Other-Than-Temporary Impairments:

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

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

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

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

The determination that a security has incurred an other-than-temporary decline in value requires the judgment of management and consideration of the fundamental condition of the issuer, its near-term prospects and all the relevant facts and circumstances. The above criteria also consider circumstances of a rapid and severe market valuation decline, such as that experienced in current credit markets, in which AIG could not reasonably assert that the recovery period would be temporary (severity losses). For further discussion, see Invested Assets Portfolio Review Other-Than-Temporary Impairments.

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

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

Fair Value Measurements of Certain Financial Assets and Liabilities:

AIG measures at fair value on a recurring basis financial instruments in its trading and available for sale securities portfolios, certain mortgage and other loans receivable, certain spot commodities, derivative assets and liabilities, securities purchased (sold) under agreements to resell (repurchase), securities lending invested collateral, non-marketable equity investments, included in other invested assets, certain policyholders contract deposits, securities and spot commodities sold but not yet purchased, certain trust deposits and deposits due to banks and other depositors, certain long-term borrowings, and certain hybrid financial instruments included in other liabilities. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The degree of judgment used in measuring the fair value of financial instruments generally correlates with the level of pricing observability. Financial instruments with quoted prices in active markets generally have more pricing observability and less judgment is used in measuring fair value. Conversely, financial instruments traded in other-than-active markets or that do not have quoted prices have less observability and are measured at fair value using valuation models or other pricing techniques that require more judgment. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction and general market conditions.

Fixed Maturity Securities Trading and Available for Sale

AIG maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. Whenever available, AIG obtains quoted prices in active markets for identical assets at the balance sheet date to measure at fair value fixed maturity securities in its trading and available for sale portfolios. Market price data generally is obtained from exchange or dealer markets.

AIG estimates the fair value of fixed maturity securities not traded in active markets, including securities purchased (sold) under agreements to resell (repurchase) and mortgage and other loans receivable, for which AIG elected the fair value option by referring to traded securities with similar attributes, using dealer quotations and matrix pricing methodologies, or discounted cash flow analyses. This

methodology considers such factors as the issuer s industry, the security s rating and tenor, its coupon rate, its position in the capital structure of the issuer, yield curves, credit curves, prepayment rates and other relevant factors. For fixed maturity securities that are not traded in active markets or that are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments generally are based on available market evidence. In the absence of such evidence, management s best estimate is used.

Equity Securities Traded in Active Markets Trading and Available for Sale

AIG maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. Whenever available, AIG obtains quoted prices in active markets for identical assets at the balance sheet date to measure at fair value marketable equity securities in its trading and available for sale portfolios. Market price data generally is obtained from exchange or dealer markets.

Direct Private Equity Securities Not Traded in Active Markets Other Invested Assets

AIG initially estimates the fair value of equity securities not traded in active markets by reference to the transaction price. This valuation is adjusted only when changes to inputs and assumptions are corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity capital markets, and changes in financial ratios or cash flows. For equity securities that are not traded in active markets or that are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability and such adjustments generally are based on available market evidence. In the absence of such evidence, management s best estimate is used. AIG initially estimates the fair value of investments in private limited partnerships and hedge funds by reference to the transaction price. Subsequently, AIG obtains the fair value of these investments generally from net asset value information provided by the general partner or manager of the investments, the financial statements of which generally are audited annually.

Separate and Variable Account Assets

Separate and variable account assets are composed primarily of registered and unregistered open-end mutual funds that generally trade daily and are measured at fair value in the manner discussed above for equity securities traded in active markets.

Freestanding Derivatives

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

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

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

on available market evidence. In the absence of such evidence, management s best estimate is used.

With the adoption of FAS 157 on January 1, 2008, AIG s own credit risk has been considered and is incorporated into the fair value measurement of all freestanding derivative liabilities.

Embedded Policy Derivatives

The fair value of embedded policy derivatives contained in certain variable annuity and equity-indexed annuity and life contracts is measured based on actuarial and capital market

assumptions related to projected cash flows over the expected lives of the contracts. These cash flow estimates primarily include benefits and related fees assessed, when applicable, and incorporate expectations about policyholder behavior. Estimates of future policyholder behavior are subjective and based primarily on AIG s historical experience. With respect to embedded policy derivatives in AIG s variable annuity contracts, because of the dynamic and complex nature of the expected cash flows, risk neutral valuations are used. Estimating the underlying cash flows for these products involves many estimates and judgments, including those regarding expected market rates of return, market volatility, correlations of market index returns to funds, fund performance, discount rates and policyholder behavior. With respect to embedded policy derivatives in AIG s equity-indexed annuity and life contracts, option pricing models are used to estimate fair value, taking into account assumptions for future equity indexed growth rates, volatility of the equity index, future interest rates, and determination on adjusting the participation rate and the cap on equity indexed credited rates in light of market conditions and policyholder behavior assumptions. With the adoption of FAS 157, these methodologies were not changed, with the exception of incorporating an explicit risk margin to take into consideration market participant estimates of projected cash flows and policyholder behavior.

AIGFP s Super Senior Credit Default Swap Portfolio

AIGFP values its credit default swaps written on the most senior risk layers (super senior) of designated pools of debt securities or loans using internal valuation models, third-party prices and market indices. The specific valuation methodologies vary based on the nature of the referenced obligations and availability of market prices. AIGFP uses a modified version of the Binomial Expansion Technique (BET) model to value its credit default swap portfolio written on super senior tranches of CDOs of asset-backed securities (ABS), including maturity-shortening puts that allow the holders of the securities issued by certain CDOs to treat the securities as short-term eligible 2a-7 investments under the Investment Company Act of 1940 (2a-7 Puts). The BET model uses default probabilities derived from credit spreads implied from market prices for the individual securities included in the underlying collateral pools securing the CDOs, as well as diversity scores, weighted average lives, recovery rates and discount rates. Prices for the individual securities held by a CDO are obtained in most cases from the CDO collateral managers, to the extent available. The CDO collateral managers obtain these prices from various sources, which include dealer quotations, third-party pricing services and in-house valuation models. To the extent there is a lag in the prices provided by the collateral managers, AIGFP rolls forward these prices to the end of the quarter using data provided by a third-party pricing service. Where a price for an individual security is not provided by the CDO collateral manager, AIGFP derives the price from a matrix that averages the prices of the various securities at the level of ABS category, vintage and the rating of the referenced security. The determination of some of these inputs requires the use of judgment and estimates, particularly in the absence of market observable data. AIGFP also employs a Monte Carlo simulation to assist in quantifying the effect on the valuation of the CDOs of the unique aspects of the CDOs structure such as triggers that divert cash flows to the most senior part of the capital structure. In the determination of fair value, AIGFP also considers collateral calls and the price estimates for the super senior CDO securities provided by third parties, including counterparties to these transactions. See Note 3 to Consolidated Financial Statements for additional information about fair value measurements.

In the case of credit default swaps written on investment-grade corporate debt and CLOs, AIGFP estimates the value of its obligations by reference to the relevant market indices or third-party quotes on the underlying super senior tranches where available.

In the case of credit default swaps written to facilitate regulatory capital relief for AIGFP s European financial institution counterparties, AIGFP estimates the fair value of these derivatives by considering observable market transactions, including the early termination of these transactions by counterparties, and other market data, to the extent relevant.

Policyholders Contract Deposits

Policyholders contract deposits accounted for at fair value beginning January 1, 2008 are measured using an income approach by taking into consideration the following factors:

Current policyholder account values and related surrender charges,

The present value of estimated future cash inflows (policy fees) and outflows (benefits and maintenance expenses) associated with the product using risk neutral valuations, incorporating expectations about policyholder behavior, market returns and other factors, and

A risk margin that market participants would require for a market return and the uncertainty inherent in the model inputs.

The change in fair value of these policyholders contract deposits is recorded as incurred policy losses and benefits in the consolidated statement of income (loss).

Level 3 Assets and Liabilities

Under FAS 157, assets and liabilities recorded at fair value in the consolidated balance sheet are classified in a hierarchy for disclosure purposes consisting of three levels based on the

observability of inputs available in the marketplace used to measure the fair value. See Note 3 to the Consolidated Financial Statements for additional information about fair value measurements.

At June 30, 2008, AIG classified $48.7 billion and $37.3 billion of assets and liabilities, respectively, measured at fair value on a recurring basis as Level 3. This represented 4.7 percent and 3.8 percent of the total assets and liabilities, respectively, measured at fair value on a recurring basis. Level 3 fair value measurements are based on valuation techniques that use at least one significant input that is unobservable. These measurements are made under circumstances in which there is little, if any, market activity for the asset or liability. AIG s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment.

In making the assessment, AIG considers factors specific to the asset or liability. In certain cases, the inputs used to measure fair value of an asset or a liability may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety is classified is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Valuation of Level 3 Assets and Liabilities

AIG values its assets and liabilities classified as Level 3 using judgment and valuation models or other pricing techniques that require a variety of inputs including contractual terms, market prices and rates, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs, some of which may be unobservable. The following paragraphs describe the methods AIG uses to measure on a recurring basis the fair value of the major classes of assets and liabilities classified in Level 3.

Private equity and real estate fund investments: These assets initially are valued at the transaction price, i.e., the price paid to acquire the asset. Subsequently, they are measured based on net asset value using information provided by the general partner or manager of these investments, the accounts of which generally are audited on an annual basis.

Corporate bonds and private placement debt: These assets initially are valued at the transaction price. Subsequently, they are valued using market data for similar instruments (e.g., recent transactions, bond spreads or credit default swap spreads), comparisons to benchmark derivative indices or movements in underlying credit spreads. When observable price quotations are not available, fair value is determined based on cash flow models with yield curves, bond or single-name credit default swap spreads and estimated recovery rates.

Certain Residential Mortgage-Backed Securities (RMBS): These assets initially are valued at the transaction price. Subsequently, they may be valued by comparison to transactions in instruments with similar collateral and risk profiles, remittances received and updated cumulative loss data on underlying obligations, discounted cash flow techniques, and/or option adjusted spread analyses.

Certain Asset-Backed Securities non-mortgage: These assets initially are valued at the transaction price. Subsequently, they may be valued based on external price/spread data. When position-specific external price data are not observable, the valuation is based on prices of comparable securities.

CDOs: These assets initially are valued at the transaction price. Subsequently, they are valued based on external price/spread data from independent third parties, dealer quotations, matrix pricing, or using the BET model.

Super senior credit default swap portfolio: AIGFP wrote credit protection on the super senior risk layer of diversified portfolios of investment-grade corporate debt, CLOs and multi-sector CDOs. In these transactions, AIGFP is at risk only on the super senior portion related to a diversified portfolio referenced to loans or debt securities, which is the last tranche to suffer losses after significant subordination. AIGFP also wrote protection on tranches below the super senior layer.

At June 30, 2008, the notional amount, fair value and unrealized market valuation loss of the AIGFP super senior credit default swap portfolio, including certain regulatory capital relief transactions, by asset class were as follows:

	Unrealized Market Valuation Loss (Gain)

(in millions)	Notional Amount	Fair Value Loss at June 30, 2008	Three Months Ended June 30, 2008[(a)]	Six Months Ended June 30, 2008[(a)]
Regulatory Capital:[*(b)*]				
Corporate loans	$ 172,717	$	$	$
Prime residential mortgages	132,612			
Other[*(c)(d)*]	1,619	125	125	125
Total	306,948	125	125	125
Arbitrage:				
Multi-sector CDOs[*(e)*]	80,301	24,785	5,569	13,606
Corporate debt/ CLOs	53,767	996	(126)	770
Total	134,068	25,781	5,443	14,376
Mezzanine tranches[*(f)*]	5,824	171	(3)	171
Total	$ 446,840	$ 26,077*(g)*	$ 5,565	$ 14,672

(a) Includes credit valuation adjustment gains of $44 million and $109 million, respectively, for the three- and six-month periods ended June 30, 2008.

(b) Represents predominantly transactions written to facilitate regulatory capital relief.

(c) Represents transactions where AIGFP believes the counterparties are no longer using the transactions to obtain regulatory capital relief.

(d) During the second quarter of 2008, a European RMBS regulatory capital relief transaction with a notional amount of $1.6 billion was not

terminated as expected when it no longer provided regulatory capital relief to the counterparty.

(e) Approximately $57.8 billion in net notional amount includes some exposure to U.S. sub-prime mortgages and approximately $9.6 billion in net notional amount includes CDOs of CMBS.

(f) Represents credit default swaps written by AIGFP on tranches below super senior on certain regulatory capital relief trades.

(g) Fair value amounts are shown before the effects of counterparty netting adjustments.

The valuation of the super senior credit derivatives continues to be challenging given the limitation on the availability of market observable information due to the lack of trading and price transparency in the structured finance market, particularly during and since the fourth quarter of 2007. These market conditions have increased the reliance on management estimates and judgments in arriving at an estimate of fair value for financial reporting purposes. Further, disparities in the valuation methodologies employed by market participants and the varying judgments reached by such participants when assessing volatile markets has increased the likelihood that the various parties to these instruments may arrive at significantly different estimates as to their fair values.

AIGFP s valuation methodologies for the super senior credit default swap portfolio have evolved in response to the deteriorating market conditions and the lack of sufficient market observable information. AIG has sought to calibrate the model to market information and to review the assumptions of the model on a regular basis.

During the second quarter of 2008, AIGFP implemented further refinements to the cash flow waterfall used by the BET model and the assumptions used therein. These refinements reflected the ability of a CDO to use principal proceeds to cover interest payment obligations on lower-rated tranches, the ability of a CDO to use principal proceeds to cure a breach of an overcollateralization test, the ability of a CDO to amortize certain senior CDO tranches on a pro-rata or sequential basis and the preferential payment of management fees. To the extent there is a lag in the prices provided by the collateral managers, AIG refines those prices by rolling them forward to the end of the quarter using prices provided by a third-party pricing service. The net effect of these refinements was an increase in the unrealized market valuation loss of $342 million. Refinements made during the first quarter of 2008 had only a de minimus effect on the unrealized market valuation loss.

AIGFP employs a modified version of the BET model to value its credit default swap portfolio written on the super senior securities issued by CDOs, including the embedded 2a-7 Puts. The BET model uses default probabilities derived from credit spreads implied from market prices for the individual securities included in the underlying collateral pools securing the CDOs. AIGFP obtained prices on these securities primarily from the CDO collateral managers.

The BET model also uses diversity scores, weighted average lives, recovery rates and discount rates. The determination of some of these inputs requires the use of judgment and estimates, particularly in the absence of market observable data. AIGFP also employs a Monte Carlo simulation to assist in quantifying the effect on valuation of the CDO of the unique features of the CDOs structure such as triggers that divert cash flows to the most senior level of the capital structure.

AIG selected the BET model for the following reasons:

it is known and utilized by other institutions;

it has been studied extensively, documented and enhanced over many years;

it is transparent and relatively simple to apply;

the parameters required to run the BET model are generally observable; and

it can easily be modified to use probabilities of default and expected losses derived from the underlying collateral securities market prices instead of using rating-based historical probabilities of default.

AIG s implementation of the BET model uses a Monte Carlo simulation of the cash flows of each underlying CDO for various scenarios of defaults by the underlying collateral securities. The Monte Carlo simulation allows the model to take into account the cash flow waterfall and to capture the benefits due to cash flow diversion within each CDO.

The BET model has certain limitations. A well known limitation of the BET model is that it can understate the expected losses for super senior tranches when default correlations are high. The model uses correlations implied from diversity scores which do not capture the tendency for correlations to increase as defaults increase. Recognizing this concern, AIG tested the sensitivity of the valuations to the diversity scores. The results of the testing demonstrated that the valuations are not very sensitive to the diversity scores because the expected losses generated from the prices of the collateral pool securities are currently high, breaching the attachment point in most transactions. Once the attachment point is breached by a sufficient amount, the diversity scores, and their implied correlations, are no longer a significant driver of the valuation of a super senior tranche.

The credit default swaps written by AIGFP generally cover the failure of payment on the super senior CDO security, which in certain cases may also cover the acceleration of the super senior CDO security upon an event of default of the CDO. AIGFP does not own the securities in the CDO collateral pool. The credit spreads implied from the market prices of the securities in the CDO collateral pool incorporate the risk of default (credit risk), the market s price for liquidity risk and in distressed markets, the risk aversion

costs. Spreads on credit derivatives tend to be narrower than the credit spreads implied from the market prices of the securities in the CDO collateral pool because, unlike investing in a bond, there is no need to fund the position (except when an actual credit event occurs). In times of illiquidity, the difference between spreads on cash securities and derivative instruments (the negative basis) may be even wider for high quality assets. AIGFP was unable to reliably verify this negative basis with market observable inputs due to the accelerating severe dislocation, illiquidity and lack of trading in the ABS market during the fourth quarter of 2007 and the first six months of 2008. The valuations produced by the BET model therefore represent the valuations of the underlying super senior CDO cash securities based on AIG s assumptions about those securities, albeit with no recognition of any potential effect of the basis differential on that valuation. AIGFP also considered the valuation of the super senior CDO securities provided by third parties, including counterparties to these transactions, and made adjustments as necessary.

Valuation Sensitivity

Set forth in the paragraphs below are sensitivity analyses that estimate the effects of using alternative pricing and other key inputs on AIG s calculation of the unrealized market valuation loss related to the AIGFP super senior credit default swap portfolio. While AIG believes that the ranges used in these analyses are reasonable, given the current difficult market conditions, AIG is unable to predict which of the scenarios is most likely to occur. AIG is also unable to assess the effect, if any, that recent transactions involving sales of large portfolios of CDOs will have on the pricing of the AIGFP super senior credit default swap portfolio. Actual results in any period are likely to vary, perhaps materially, from the modeled scenarios, and there can be no assurance that the unrealized market valuation loss related to the AIGFP super senior credit default swap portfolio will be consistent with any of the sensitivity analyses.

The most significant assumption used in developing the estimate is the pricing of the securities within the CDO collateral pools. These prices are used to derive default probabilities and expected losses that are used in the BET model. If the actual pricing of the securities within the collateral pools differs from the pricing used in estimating the fair value of the super senior credit default swap portfolio, there is potential for material variation in the fair value estimate. A decrease by five points (for example, from 87 cents per dollar to 82 cents per dollar) in the aggregate price of the underlying collateral securities would cause an additional unrealized market valuation loss of approximately $4.0 billion, while an increase in the aggregate price of the underlying collateral securities by five points (for example, from 90 cents per dollar to 95 cents per dollar) would reduce the unrealized market valuation loss by approximately $3.9 billion. Any further declines in the value of the underlying collateral securities held by a CDO will similarly affect the value of the super senior CDO securities given their significantly depressed valuations. Given the current difficult market conditions, AIG cannot predict reasonably likely changes in the prices of the underlying collateral securities held within a CDO at this time.

The following table presents other key inputs used in the valuation of the credit default swap portfolio written on the super senior securities issued by multi-sector CDOs, and the potential increase (decrease) to the unrealized market valuation loss at June 30, 2008 calculated using the BET model for changes in these key inputs:

(in millions)	Increase (Decrease) To Unrealized Market Valuation Loss
Weighted average lives	
Effect of an increase of 1 year	$ 519
Effect of a decrease of 1 year	(905)
Recovery rates	
Effect of an increase of 10%	(18)
Effect of a decrease of 10%	254

Diversity scores	
Effect of an increase of 5	(84)
Effect of a decrease of 5	261
Discount curve	
Effect of an increase of 100 basis points	181

These results are calculated by stressing a particular assumption independently of changes in any other assumption. No assurance can be given that the actual levels of the key inputs will not exceed, perhaps significantly, the ranges assumed by AIG for purposes of the above analysis. No assumption should be made that results calculated from the use of other changes in these key inputs can be interpolated or extrapolated from the results set forth above.

In the case of credit default swaps written on investment grade corporate debt and CLOs, AIGFP estimates the value of its obligations by reference to the relevant market indices or third-party quotes on the underlying super senior tranches where available.

The following table represents the relevant market credit indices and index CDS maturity used in the valuation of the credit default swap portfolio written on investment-grade corporate debt and the increase (decrease) to the unrealized market valuation loss at June 30, 2008 corresponding to changes in these market credit indices and maturity:

(in millions)	Increase (Decrease) To Unrealized Market Valuation Loss		
CDS maturity (in years)	5	7	10
CDX Index			
Effect of an increase of 10 basis points	$ (23)	$ (48)	$ (10)
Effect of a decrease of 10 basis points	23	49	10
iTraxx Index			
Effect of an increase of 10 basis points	(11)	(37)	(8)
Effect of a decrease of 10 basis points	11	37	8

These results are calculated by stressing a particular assumption independently of changes in any other assumption. No assurance can be given that the actual levels of the indices and maturity will not exceed, perhaps significantly, the ranges assumed by AIG for purposes of the above analysis. No assumption should be made that results calculated from the use of other changes in these indices and maturity can be interpolated or extrapolated from the results set forth above.

For additional information about AIGFP s super senior credit default swap portfolio, see Risk Management Credit Derivatives.

Other derivatives. Valuation models that incorporate unobservable inputs initially are calibrated to the transaction price. Subsequent valuations are based on observable inputs to the valuation model (e.g., interest rates, credit spreads, volatilities, etc.). Model inputs are changed only when corroborated by market data.

Transfers into Level 3

During the three-months ended June 30, 2008, AIG transferred from Level 2 to Level 3 approximately $2.3 billion of assets, primarily representing fixed maturity securities for which the significant inputs used to measure the fair value of the securities became unobservable primarily as a result of the significant disruption in the credit markets. See Note 3 to the Consolidated Financial Statements for additional information about transfers into Level 3.

Valuation Controls

AIG is actively developing and implementing a remediation plan to address the material weakness in internal control relating to the fair value valuation of the AIGFP super senior credit default swap portfolio, and oversight thereof as described in Item 9A. of the 2007 Annual Report on Form 10-K. AIG is developing new systems and processes to reduce reliance on certain manual controls that have been established as compensating controls over valuation of this portfolio and in other areas, and is strengthening the resources required to remediate this weakness. Notwithstanding this need to continue strengthening these controls, AIG has an oversight structure that includes appropriate segregation of duties with respect to the valuation of its financial instruments. Senior management, independent of the trading and investing functions, is responsible for the oversight of control and valuation policies and for reporting the results of these controls and policies to AIG s Audit Committee. AIG employs procedures for the approval of new transaction types and markets, price verification, periodic review of profit and loss, and review of valuation models by personnel with appropriate technical knowledge of relevant products and markets. These procedures are performed by personnel independent of the trading and investing functions. For valuations that require inputs with little or no market

observability, AIG compares the results of its valuation models to actual subsequent transactions.

Operating Review

General Insurance Operations

AIG s General Insurance subsidiaries are multiple line companies writing substantially all lines of property and casualty insurance and various personal lines both domestically and abroad and constitute the AIG Property Casualty Group (formerly known as Domestic General Insurance) and the Foreign General Insurance Group.

AIG Property Casualty Group is comprised of Commercial Insurance, Transatlantic, Personal Lines and Mortgage Guaranty businesses.

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

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

AIG s Personal Lines operations provide automobile insurance through aigdirect.com, its direct marketing distribution channel, and the Agency Auto Division, its independent agent/broker distribution channel. It also

provides a broad range of coverages for high net worth individuals through the AIG Private Client Group (Private Client Group). Coverages for the Personal Lines operations are written predominantly in the United States.

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

AIG s Foreign General Insurance Group writes both commercial and consumer lines of insurance which is primarily underwritten through American International Underwriters (AIU), a marketing unit consisting of wholly owned agencies and insurance companies. The Foreign General Insurance Group also includes business written by AIG s foreign-based insurance subsidiaries.

General Insurance Results

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

(in millions, except ratios)	Three Months Ended June 30, 2008	2007	Percentage Increase/ (Decrease)	Six Months Ended June 30, 2008	2007	Percentage Increase/ (Decrease)
Net premiums written:						
AIG Property Casualty Group						
Commercial Insurance	**$ 5,988**	$ 6,439	(7)%	**$ 11,101**	$ 12,448	(11)%
Transatlantic	**988**	983	1	**2,024**	1,967	3
Personal Lines	**1,230**	1,203	2	**2,518**	2,432	4
Mortgage Guaranty	**288**	272	6	**592**	538	10
Foreign General Insurance	**3,726**	3,242	15	**8,065**	6,860	18
Total	**$ 12,220**	$ 12,139	1%	**$ 24,300**	$ 24,245	%
Net premiums earned:						
AIG Property Casualty Group						
Commercial Insurance	**$ 5,912**	$ 5,996	(1)%	**$ 11,329**	$ 11,977	(5)%
Transatlantic	**1,023**	948	8	**2,040**	1,913	7
Personal Lines	**1,209**	1,168	4	**2,408**	2,323	4
Mortgage Guaranty	**269**	221	22	**525**	431	22
Foreign General Insurance	**3,740**	3,030	23	**7,208**	5,938	21
Total	**$ 12,153**	$ 11,363	7%	**$ 23,510**	$ 22,582	4%
Net investment income:						
AIG Property Casualty Group						
Commercial Insurance	**$ 587**	$ 984	(40)%	**$ 1,330**	$ 2,017	(34)%
Transatlantic	**120**	119	1	**237**	235	1
Personal Lines	**56**	57	(2)	**113**	114	(1)
Mortgage Guaranty	**44**	39	13	**88**	76	16
Foreign General Insurance	**357**	427	(16)	**599**	746	(20)
Reclassifications and eliminations	**3**	2	50	**5**	3	67
Total	**$ 1,167**	$ 1,628	(28)%	**$ 2,372**	$ 3,191	(26)%
Net realized capital gains (losses)	**$ (563)**	$ (63)	%	**$ (836)**	$ 58	%
Operating income (loss):						
AIG Property Casualty Group						
Commercial Insurance	**$ 381**	$ 1,904	(80)%	**$ 1,166**	$ 3,833	(70)%

Transatlantic	**141**	168	(16)	**303**	319	(5)
Personal Lines	**21**	118	(82)	**24**	224	(89)
Mortgage Guaranty	**(518)**	(81)		**(872)**	(73)	
Foreign General Insurance	**796**	867	(8)	**1,532**	1,776	(14)
Reclassifications and eliminations	**6**			**11**	(7)	
Total	**$ 827**	$ 2,976	(72)%	**$ 2,164**	$ 6,072	(64)%
Statutory underwriting profit (loss)[(b)]:						
AIG Property Casualty Group						
Commercial Insurance	**$ 357**	$ 946	(62)%	**$ 575**	$ 1,730	(67)%
Transatlantic	**66**	37	78	**120**	53	126
Personal Lines	**(42)**	56		**(105)**	89	
Mortgage Guaranty	**(564)**	(126)		**(971)**	(168)	
Foreign General Insurance	**443**	371	19	**807**	773	4
Total	**$ 260**	$ 1,284	(80)%	**$ 426**	$ 2,477	(83)%
AIG Property Casualty Group:						
Loss Ratio	**80.6**	68.2		**79.6**	68.5	
Expense Ratio	**21.4**	19.6		**22.8**	20.3	
Combined Ratio	**102.0**	87.8		**102.4**	88.8	
Foreign General Insurance:						
Loss Ratio	**53.7**	52.1		**52.8**	51.4	
Expense Ratio[(a)]	**34.6**	33.3		**32.2**	30.8	
Combined ratio	**88.3**	85.4		**85.0**	82.2	
Consolidated:						
Loss Ratio	**72.3**	63.9		**71.4**	64.0	
Expense Ratio	**25.4**	23.2		**25.9**	23.3	
Combined Ratio	**97.7**	87.1		**97.3**	87.3	

(a) Includes amortization of advertising costs.

(b) Statutory underwriting profit (loss) is a measure that U.S. domiciled insurance companies are required to report to their regulatory authorities. The following table reconciles statutory underwriting profit (loss) to operating income for General Insurance:

(in millions)	Commercial Insurance	Transatlantic	Personal Lines	Mortgage Guaranty	Foreign General Insurance	Reclassifications and Eliminations	Total
Three Months Ended June 30, 2008:							
Statutory underwriting profit (loss)	**$ 357**	**$ 66**	**$ (42)**	**$ (564)**	**$ 443**	**$**	**$ 260**
Increase (decrease) in DAC	**(1)**	**(5)**	**13**	**2**	**(46)**		**(37)**
Net investment income	**587**	**120**	**56**	**44**	**357**	**3**	**1,167**
Net realized capital gains (losses)	**(562)**	**(40)**	**(6)**		**42**	**3**	**(563)**
Operating income (loss)	**$ 381**	**$ 141**	**$ 21**	**$ (518)**	**$ 796**	**$ 6**	**$ 827**
Three Months Ended June 30, 2007:							
Statutory underwriting profit (loss)	$ 946	$ 37	$ 56	$ (126)	$ 371	$	$ 1,284
Increase (decrease) in DAC	50	10	7	9	51		127
Net investment income	984	119	57	39	427	2	1,628
Net realized capital gains (losses)	(76)	2	(2)	(3)	18	(2)	(63)
Operating income (loss)	$ 1,904	$ 168	$ 118	$ (81)	$ 867	$	$ 2,976
Six Months Ended June 30, 2008:							
Statutory underwriting profit (loss)	**$ 575**	**$ 120**	**$ (105)**	**$ (971)**	**$ 807**	**$**	**$ 426**
Increase (decrease) in DAC	**(4)**	**1**	**26**	**13**	**166**		**202**
Net investment income	**1,330**	**237**	**113**	**88**	**599**	**5**	**2,372**
Net realized capital gains (losses)	**(735)**	**(55)**	**(10)**	**(2)**	**(40)**	**6**	**(836)**

Operating income (loss)	**$ 1,166**	**$ 303**	**$ 24**	**$ (872)**	**$ 1,532**	**$ 11**	**$ 2,164**
Six Months Ended June 30, 2007:							
Statutory underwriting profit (loss)	$ 1,730	$ 53	$ 89	$ (168)	$ 773	$	$ 2,477
Increase (decrease) in DAC	85	14	22	21	204		346
Net investment income	2,017	235	114	76	746	3	3,191
Net realized capital gains (losses)	1	17	(1)	(2)	53	(10)	58
Operating income (loss)	$ 3,833	$ 319	$ 224	$ (73)	$ 1,776	$ (7)	$ 6,072

AIG transacts business in most major foreign currencies. The effects of changes in foreign currency exchange rates on the growth of General Insurance net premiums written were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	**2008**	2007
Growth in original currency*	**(2.2)%**	3.3%	**(2.8)%**	4.7%
Foreign exchange effect	**2.9**	1.0	**3.0**	1.2
Growth as reported in U.S. dollars	**0.7%**	4.3%	**0.2%**	5.9%

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

Quarterly General Insurance Results

General Insurance operating income decreased in the three-month period ended June 30, 2008 compared to the same period in 2007 due to declines in both underwriting profit and net investment income as well as increased net realized capital losses in the three month-period ended June 30, 2008. The combined ratio for the three-month period ended June 30, 2008 increased to 97.7, an increase of 10.6 points compared to the same period in 2007, primarily due to an increase in the loss ratio of 8.4 points. The loss ratio for accident year 2008 recorded in the three-month period ended June 30, 2008 was 6.2 points higher than the loss ratio recorded in the three-month period ended June 30, 2007 for accident year 2007. Increases in Mortgage Guaranty losses accounted for 3.6 points of the increase in the 2008 accident year loss ratio. The downward cycle in the U.S. housing market is not expected to improve until residential inventories return to a more normal level, and AIG expects that this downward cycle will continue to adversely affect Mortgage Guaranty s loss ratios for the foreseeable future. The loss ratio also increased for other property and casualty lines due to premium rate decreases and changes in loss trends. Unfavorable prior year development increased incurred losses by $93 million in the three-month period ended June 30, 2008 while favorable prior year development decreased incurred losses by $87 million in the three-month period ended June 30, 2007, accounting for 1.5 points of

the increase in the loss ratio.

General Insurance net premiums written increased in the three-month period ended June 30, 2008 compared to the same period in 2007, as a decline in Commercial Insurance resulting from declining rates was offset by growth in Foreign General Insurance from both established and new distribution channels, and the positive effect of changes in foreign currency exchange rates.

General Insurance net investment income declined in the three-month period ended June 30, 2008 by $461 million compared to the same period in 2007. Interest and dividend income increased $60 million in the three-month period ended June 30, 2008 compared to the same period in 2007 as investments in fixed maturities and equity securities increased by $9.0 billion and the average yield was substantially unchanged for both periods. Income from partnership and mutual fund investments declined $413 million in the three-month period ended June 30, 2008 compared to the same period in 2007, primarily due to weaker equity market performance in 2008.

Net realized capital losses in the three-month period ended June 30, 2008 include other-than-temporary

impairment charges of $685 million principally on fixed maturity securities, compared to $84 million in the same period of 2007. See also Capital Resources and Liquidity and Invested Assets herein.

*Year-to-*Date General Insurance Results

General Insurance operating income decreased in the six-month period ended June 30, 2008 compared to the same period in 2007 due to declines in both underwriting profit and net investment income as well as net realized capital losses in the six month-period ended June 30, 2008 compared to net realized capital gains in the same period in 2007. The combined ratio for the six-month period ended June 30, 2008 increased to 97.3, an increase of 10.0 points compared to the same period in 2007, primarily due to an increase in the loss ratio of 7.4 points. The loss ratio for accident year 2008 recorded in the six-month period ended June 30, 2008 was 5.2 points higher than the loss ratio recorded in the six-month period ended June 30, 2007 for accident year 2007. Increases in Mortgage Guaranty losses accounted for 3.3 points of the increase in the 2008 accident year loss ratio. The loss ratio also increased for other property and casualty lines due to premium rate decreases and changes in loss trends. Favorable development from prior years and increases in the loss reserve discount reduced incurred losses by $84 million and $342 million in the six-month periods ended June 30, 2008 and 2007, respectively. The favorable development in the six-month period ended June 30, 2008 includes $339 million of favorable development recognized in the first three months of 2008, related to policies whose premiums vary with the level of losses incurred (loss sensitive policies). Loss sensitive policies did not have a significant effect in 2007. The favorable development on loss sensitive policies had no effect on underwriting profit as it was entirely offset by a reduction in earned premiums. The reduction in incurred losses and earned premiums resulting from loss sensitive policies reduced the loss ratio by 0.4 points compared to the same period in 2007. Other unfavorable loss development, partially offset by increases in the loss reserve discount for the six-month period ended June 30, 2008, increased incurred losses by $255 million, accounting for 2.6 points of the increase in the loss ratio compared to the same period of 2007. Favorable loss development in the six-month periods ended June 30, 2008 and 2007, of $37 million and $50 million, respectively (recognized in consolidation and related to certain asbestos settlements), reduced overall incurred losses.

General Insurance net premiums written were essentially unchanged in the six-month period ended June 30, 2008 compared to the same period in 2007, as a decline in Commercial Insurance rates was offset by growth in Foreign General Insurance from both established and new distribution channels; the positive effect of changes in foreign currency exchange rates; and, to a lesser extent, growth in the Private Client Group of Personal Lines and in Mortgage Guaranty.

General Insurance net investment income declined in the six-month period ended June 30, 2008 by $819 million compared to the same period in 2007. Interest and dividend income increased $169 million in the six-month period ended June 30, 2008 compared to the same period in 2007 as investment in fixed maturities and equity securities increased by $9.0 billion and the average yield was substantially unchanged for both periods. Income from partnership and mutual fund investments declined $937 million in the six-month period ended June 30, 2008 compared to the same period in 2007, primarily due to poor performance in the equity markets in 2008. Investment expenses declined $55 million the six-month period ended June 30, 2008 compared to the same period in 2007, primarily due to decreased interest expense on deposit liabilities.

Net realized capital losses in the six-month period ended June 30, 2008 include other-than-temporary impairment charges of $840 million compared to $130 million in the same period of 2007. See also Capital Resources and Liquidity and Invested Assets herein.

Quarterly Commercial Insurance Results

Commercial Insurance s operating income decreased in the three-month period ended June 30, 2008 compared to the same period in 2007 primarily due to declines in both underwriting profit and net investment income as well as increased net realized capital losses in the three-month period ended June 30, 2008. The decline is also reflected in the combined ratio, which increased 10.8 points in the three-month period ended June 30, 2008 compared to the same period in 2007. The loss ratio for accident year 2008, recorded in the three-month period ended June 30, 2008 was 5.1 points higher than the loss ratio recorded in the three-month period ended June 30, 2007 for accident year 2007. The increase in the 2008 accident year loss ratio includes 1.4 points for losses related to the Midwest floods with the

remaining increase due to higher casualty losses and the effect of premium rate declines and several large fire losses. Unfavorable prior year development increased incurred losses by $75 million in the three-month period ended June 30, 2008 while favorable prior year development decreased incurred losses by $65 million in the three-month period ended June 30, 2007, accounting for 2.3 points of the increase in the loss ratio. Increases in the loss reserve discount reduced incurred losses by $50 million and $125 million in the three-month periods ended June 30, 2008 and 2007, respectively, accounting for 1.2 points of the increase in the loss ratio. Commercial Insurance s net premiums written declined in the three-month period ended June 30, 2008 compared to the same period in 2007 primarily due to declines in workers compensation premiums and other casualty lines of business.

Commercial Insurance s expense ratio increased to 19.6 in the three-month period ended June 30, 2008 compared to 17.5 in the same period of 2007. The increase in the expense ratio was due to changes in property reinsurance programs, increases in the provision for uncollectible premiums and changes in the mix of business. The 2008 property reinsurance programs include more excess of loss treaties, which have little or no ceding commissions, and less pro rata treaties, which have ceding commissions, compared to the 2007 property reinsurance programs. Provision for uncollectible premiums increased by $39 million in the three-month period ended June 30, 2008 compared to the same period in 2007, primarily due to increased provisions for uncollectible workers compensation premium receivables. In general, net premiums written increased in lines of business with higher expense ratios and lower loss ratios compared to other Commercial Insurance lines of business, contributing to the increase in the expense ratio for the three-month period ended June 30, 2008 compared to the same period in 2007. In addition, Commercial Insurance continued to invest in systems and process improvements to enhance operating efficiency and controls over the long term.

Commercial Insurance s net investment income declined in the three-month period ended June 30, 2008 compared to the same period in 2007, primarily due to a decline in income from partnership and mutual fund investments which decreased $290 million in the three-month period ended June 30, 2008 compared to the same period in 2007.

Commercial Insurance recorded net realized capital losses in the three-month period ended June 30, 2008 compared to net realized capital gains in the same period of 2007, primarily due to other-than-temporary impairment charges of $632 million in the three-month period ended June 30, 2008, principally related to fixed maturity securities, compared to $77 million in the same period in 2007.

*Year-to-*Date Commercial Insurance Results

Commercial Insurance s operating income decreased in the six-month period ended June 30, 2008 compared to the same period in 2007, primarily due to declines in both underwriting profit and net investment income, as well as net realized capital losses in the six-month period ended June 30, 2008. The decline is also reflected in the combined ratio, which increased 10.6 points in the six-month period ended June 30, 2008 compared to the same period in 2007. The loss ratio for accident year 2008 recorded in the six-month period ended June 30, 2008 included a 1.4 point effect related to the Atlanta tornado and Midwest flood catastrophe losses, and was 4.4 points higher than the loss ratio recorded in the six-month period ended June 30, 2007 for accident year 2007. Prior year development and increases in the loss reserve discount reduced incurred losses by $192 million and $276 million in the six-month periods ended June 30, 2008 and 2007, respectively. The favorable development for 2008 includes $339 million of favorable development related to loss sensitive polices. The favorable development on loss sensitive policies had no effect on underwriting profit as the reduction in incurred losses was entirely offset by a reduction in earned premiums. However, the reductions in both earned premiums and incurred losses accounted for a reduction in the loss ratio of 0.8 points compared to the same period of 2007 related to loss sensitive policies. Other unfavorable loss development less the increase in the loss reserve discount resulted in a net increase in incurred losses of $147 million, accounting for 3.6 points of the increase in the loss ratio compared to the same period in 2007.

Commercial Insurance s net premiums written declined in the six-month period ended June 30, 2008 compared to the same period in 2007 primarily due to declines in workers compensation premiums and the effect of the loss sensitive policies described above and other casualty lines of business.

Commercial Insurance s expense ratio increased to 21.6 in the six-month period ended June 30, 2008 compared to 18.3 in the same period of 2007. Return premiums on loss sensitive policies reduced net premiums written, without a corresponding reduction in expenses, increasing the expense ratio by 0.6 points for the six-month period ended June 30, 2008 compared to the same period in 2007. The remaining increase in the expense ratio primarily resulted from changes in property reinsurance programs, increases in the provision for uncollectible premiums and changes in the mix of business as discussed above.

Commercial Insurance s net investment income declined in the six-month period ended June 30, 2008 compared to the same period in 2007, primarily due to a decline in income from partnership and mutual fund investments which decreased $699 million in the six-month period ended June 30, 2008 compared to the same period in 2007.

Commercial Insurance recorded net realized capital losses in the six-month period ended June 30, 2008 compared to net realized capital gains in the same period in 2007, primarily due to other-than-temporary impairment charges of $776 million in the six-month period ended June 30, 2008, related to both fixed maturity and equity securities, compared to $113 million in the same period in 2007.

Quarterly Transatlantic Results

Transatlantic s operating income decreased in the three-month period ended June 30, 2008 compared to the same period in 2007, primarily due to an increase in net realized capital losses, partially offset by an increase in statutory underwriting profit. The increase in net realized capital losses is due principally to other-than-temporary impairment charges primarily related to domestic residential asset-backed fixed maturity securities and, to a much lesser extent, equity securities. The increase in statutory underwriting profit in the three-month period ended June 30, 2008 compared to the

same period in 2007 reflects improved underwriting results in domestic operations.

Year-to-Date Transatlantic Results

Transatlantic s operating income decreased in the six-month period ended June 30, 2008 compared to the same period in 2007 primarily due to an increase in net realized capital losses, partially offset by an increase in statutory underwriting profit. The increase in net realized capital losses is due principally to other-than-temporary impairment charges primarily related to domestic residential asset-backed fixed maturity securities and, to a much lesser extent, equity securities. The increase in statutory underwriting profit in the six-month period ended June 30, 2008 compared to the same period in 2007 reflects improved underwriting results in domestic and international operations. The 2007 international underwriting results were adversely affected by European windstorm related losses.

Quarterly Personal Lines Results

Personal Lines operating income decreased in the three-month period ended June 30, 2008 compared to the same period in 2007 due to a deterioration in underwriting performance as reflected by the combined ratio, which increased to 103.0 in the three-month period ended June 30, 2008 compared to 94.5 in the same period in 2007. The loss ratio increased 6.5 points, including an increase in the 2008 accident year loss ratio of 1.4 points, due primarily to an increase in the accident year loss ratio for automobile policies, partially offset by a decline in the accident year loss ratio for the Private Client Group. The 2008 accident year loss ratio for automobile polices increased 3.6 points compared to the loss ratio recorded in the three-month period ended June 30, 2007 for the 2007 accident year, due to declining premium rates and increased frequency and severity of losses. Prior year loss development increased incurred losses by $29 million in the three-month period ended June 30, 2008 compared to a reduction of $32 million in the same period in 2007, accounting for 5.1 points of the increase in the loss ratio. The current period adverse loss development on prior years is primarily related to greater than expected bodily injury severity and property damage frequency.

The expense ratio increased 2.0 points in the three-month period ended June 30, 2008 compared to the same period in 2007, primarily due to a change in business mix as the Private Client Group, which carries a higher expense ratio, represented an increased percentage of the Personal Lines division s net premiums written. Additionally, a decrease to ceding commissions as a result of a restructured reinsurance program, integration costs relating to 21st Century Insurance Group (21st Century) and a litigation charge contributed to the overall increase in the expense ratio.

Net premiums written increased in the three-month period ended June 30, 2008 compared to the same period in 2007, primarily due to continued growth in the Private Client Group, partially offset by reductions in both the aigdirect.com and Agency Auto businesses. The growth in the Private Client Group reflects the execution of a plan to expand its distribution network. Since June 2007, the Private Client Group has expanded its agency network by 23 percent. Additionally, the Private Client Group s net premiums written increased as a result of a restructured reinsurance program which decreased premiums ceded to reinsurers. The decrease in the aigdirect.com and Agency Auto business reflects the effects of planned reductions in these lines as the underlying loss experience has deteriorated.

Year-to-Date Personal Lines Results

Personal Lines operating income decreased in the six-month period ended June 30, 2008 compared to the same period in 2007 due to a deterioration in underwriting performance as reflected by the combined ratio, which increased to 103.2 in the six-month period ended June 30, 2008 compared to 95.0 in the same period in 2007. The loss ratio increased 7.5 points, including an increase in the 2008 accident year loss ratio of 2.2 points due to an increase in the accident year loss ratio for automobile policies. The 2008 accident year loss ratio for automobile polices increased 3.7 points compared to the loss ratio recorded in the six-month period ended June 30, 2007 for the 2007 accident year, due to declining premium rates and increased frequency and severity of losses. Prior year development increased incurred losses by $65 million in the six-month period ended June 30, 2008 compared to a reduction of $61 million in the same period in 2007, accounting for 5.3 points of the increase in the loss ratio. The current period adverse loss development on prior years is primarily related to greater than expected bodily injury severity and property damage frequency.

The expense ratio increased 0.7 points in the six-month period ended June 30, 2008 compared to the same period in 2007, primarily due to a change in business mix as the Private Client Group, which carries a higher expense ratio,

represented an increased percentage of the Personal Lines division s net premiums written. Also, a decrease to ceding commissions as a result of a restructured reinsurance program, integration costs relating to 21st Century and a litigation charge contributed to the increase in the expense ratio.

Net premiums written increased in the six-month period ended June 30, 2008 compared to the same period in 2007, primarily due to continued growth in the Private Client Group, partially offset by reductions in both the aigdirect.com and Agency Auto businesses. The growth in the Private Client Group reflects the execution of a plan to expand the distribution network. Additionally, the Private Client Group s net premiums written increased as a result of a

restructured reinsurance program which decreased premiums ceded to reinsurers. The decrease in the aigdirect.com and Agency Auto business reflect the effects of planned reductions in these lines as the underlying loss experience has deteriorated.

Quarterly Mortgage Guaranty Results

Mortgage Guaranty s operating loss in the three-month period ended June 30, 2008 increased compared to the same period in 2007 as the deteriorating U.S. residential housing market adversely affected losses incurred for both the domestic first- and second-lien businesses. Historically, a large percentage of reported defaults were cured resulting in no loss to UGC. A cure can occur when a borrower brings the mortgage current, refinances the existing mortgage, sells the home and pays off the current balance or enters into a payment plan with the lender to bring the mortgage current. In the current market, loans are less likely to cure, increasing the probability that a defaulted loan will result in a claim payment. UGC has reflected that lower cure probability in its current estimate of unpaid losses resulting in higher loss reserves and an increase in incurred losses. Domestic first- and second-lien losses incurred increased 264 percent and 107 percent respectively, compared to the same period in 2007, resulting in loss ratios of 253.9 and 556.0, respectively, in the three-month period ended June 30, 2008. Increases in domestic losses incurred resulted in an overall loss ratio of 292.0 in the three-month period ended June 30, 2008 compared to 129.9 in the same period in 2007.

Net premiums written increased in the three-month period ended June 30, 2008 compared to the same period in 2007, primarily due to growth in domestic first-lien premiums as a result of the increased use of mortgage insurance for credit enhancement as well as a higher persistency rate. UGC has taken steps to strengthen its underwriting guidelines and increase rates. It also discontinued new production for certain programs in the second-lien business beginning in the fourth quarter of 2006. However, UGC will continue to receive renewal premiums on that portfolio for the life of the loans, estimated to be three to five years, and will continue to be exposed to losses from future defaults.

The expense ratio in the three-month period ended June 30, 2008 was 16.5, down from 22.4 in the same period of 2007 as expenses declined 22 percent. UGC has tightened its monitoring and control over expenses in response to the adverse conditions in the U.S. residential housing market, resulting in the decline in operating expenses and the related expense ratio.

UGC domestic mortgage risk in force totaled $31.8 billion as of June 30, 2008 and the 60-day delinquency ratio was 4.9 percent (based on number of policies, consistent with mortgage industry practice) compared to domestic mortgage risk in force of $26.5 billion and a delinquency ratio of 2.5 percent at June 30, 2007. Approximately 83 percent of the domestic mortgage risk is secured by first-lien, owner-occupied properties.

*Year-to-*Date Mortgage Guaranty Results

Mortgage Guaranty s operating loss in the six-month period ended June 30, 2008 increased compared to the same period in 2007 as the deteriorating U.S. residential housing market adversely affected losses incurred for both the domestic first- and second-lien businesses. Domestic first- and second-lien losses incurred increased 302 percent and 113 percent respectively, compared to the six-month period ended June 30, 2007, resulting in loss ratios of 229.0 and 500.7, respectively, in the six-month period ended June 30, 2008. Increases in domestic losses incurred resulted in an overall loss ratio of 264.5 in the six-month period ended June 30, 2008 compared to 111.5 in the six-month period ended June 30, 2007.

Net premiums written increased in the six-month period ended June 30, 2008 compared to the same period in 2007, primarily due to growth in domestic first-lien premiums due to the increased use of mortgage insurance for credit enhancement as well as a higher persistency rate.

The expense ratio in the six-month period ended June 30, 2008 was 18.2 percent, down from 22.1 percent in the same period in 2007 as premium growth combined with a 9 percent reduction in expenses resulted in the decline in the expense ratio.

Quarterly Foreign General Insurance Results

Foreign General Insurance operating income decreased in the three-month period ended June 30, 2008 compared to the same period in 2007, primarily due to a decrease in both underwriting profit and net investment income.

Net premiums written increased 15 percent (5 percent in original currency) in the three-month period ended June 30, 2008 compared to the same period in 2007, reflecting growth in commercial and consumer lines driven by new business from both established and new distribution channels, including the late 2007 acquisition of Württembergische und Badische Versicherungs AG (WüBa) in Germany. Net premiums written for commercial lines increased due to new business, mainly in European markets, and decreases in the use of reinsurance, partially offset by declines in premium rates. Aviation production increased due to improved account retention and increased production in the space aviation business. Net premiums written for the Lloyd s syndicate continued to decline due to rate decreases and increased market competition.

The loss ratio in the three-month period ended June 30, 2008 increased 1.5 points compared to the same period in

2007, primarily due to an increase in severe but non-catastrophe losses and higher loss frequency in the current accident year. Partially offsetting these increases was a 2.1 point loss ratio improvement due to $67 million of catastrophe losses in the prior year period with no significant catastrophe losses in the current period.

The expense ratio in the three-month period ended June 30, 2008 increased 1.3 points compared to the same period in 2007. This increase reflects the cost of realigning certain legal entities through which Foreign General Insurance operates, and the increased significance of consumer lines of business, which have higher acquisition costs. AIG expects the expense ratio to continue to increase in 2008 due to the cost of realigning certain legal entities through which Foreign General Insurance operates.

Net investment income decreased in the three-month period ended June 30, 2008 compared to the same period in 2007. Mutual fund income was $67 million lower than the three-month period ended June 30, 2007 reflecting weaker performance in the equity markets in 2008, partially offset by higher interest and dividend income of $41 million.

*Year-to-*Date Foreign General Insurance Results

Foreign General Insurance operating income decreased in the six-month period ended June 30, 2008 compared to the same period in 2007, primarily due to decreases in net investment income and net realized capital losses.

Net premiums written increased 18 percent (8 percent in original currency) in the six-month period ended June 30, 2008 compared to the same period in 2007, reflecting strong growth in commercial and consumer lines driven by new business from both established and new distribution channels, including the WüBa acquisition. Net premiums written for commercial lines increased due to new business in the U.K. and Europe and decreases in the use of reinsurance, partially offset by declines in premium rates. Growth in personal accident business in Latin America, Asia and Europe also contributed to the increase. Net premiums written for the Lloyd s syndicate Ascot continued to decline due to rate decreases and increased market competition.

The loss ratio in the six-month period ended June 30, 2008 increased 1.4 points compared to the same period in 2007. Prior accident year development reduced incurred losses by $16 million and $68 million in the first six months of 2008 and 2007, respectively, accounting for 0.9 points of the increase. The current accident year loss ratio excluding catastrophe losses increased by 1.6 points primarily due to higher severe but non-catastrophe losses and higher loss frequency. Partially offsetting this increase in loss ratio is $67 million of catastrophe losses in the prior year period with no significant catastrophe losses in the current period, resulting in a loss ratio decrease of 1.1 points.

The expense ratio in the six-month period ended June 30, 2008 increased 1.4 points compared to the same period in 2007 reflecting the continued cost of realigning certain legal entities through which Foreign General Insurance operates, and the increased significance of consumer lines of business, which have higher acquisition costs.

Net investment income decreased in the six-month period ended June 30, 2008 compared to the same period in 2007. Mutual fund income was $172 million lower than the six-month period ended June 30, 2007, reflecting weaker performance in the equity markets in 2008, partially offset by higher interest and dividend income of $70 million.

Reserve for Losses and Loss Expenses

The following table presents the components of the General Insurance gross reserve for losses and loss expenses (loss reserves) by major lines of business on a statutory Annual Statement basis*:

(in millions)		**June 30, 2008**		December 31, 2007
Other liability occurrence	$	**21,233**	$	20,580
Workers compensation		**15,234**		15,568
Other liability claims made		**13,896**		13,878
International		**8,372**		7,036
Auto liability		**6,240**		6,068
Property		**4,554**		4,274
Reinsurance		**3,395**		3,127

Products liability		**2,430**		2,416
Medical malpractice		**2,307**		2,361
Mortgage guaranty/credit		**2,291**		1,426
Accident and health		**1,831**		1,818
Commercial multiple peril		**1,796**		1,900
Aircraft		**1,725**		1,623
Fidelity/surety		**1,221**		1,222
Other		**2,222**		2,203
Total	**$**	**88,747**	$	85,500

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

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

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

At June 30, 2008, General Insurance net loss reserves increased $3.04 billion from the prior year-end to $72.33 billion. The net loss reserves represent loss reserves reduced by reinsurance recoverable, net of an allowance for unrecoverable reinsurance and applicable discount for future investment income.

The following table classifies the components of the General Insurance net loss reserve by business unit:

(in millions)	**June 30, 2008**	December 31, 2007
Commercial Insurance[(a)]	**$48,443**	$47,392
Transatlantic	**7,317**	6,900
Personal Lines[(b)]	**2,448**	2,417
Mortgage Guaranty	**2,057**	1,339
Foreign General Insurance[(c)]	**12,066**	11,240
Total Net Loss Reserve	**$72,331**	$69,288

(a) At June 30, 2008 and December 31, 2007, Commercial Insurance loss reserves include approximately $2.89 billion and $3.13 billion, respectively, ($3.08 billion and $3.34 billion, respectively, before discount), related to business written by Commercial Insurance but ceded to American International Reinsurance Company Limited (AIRCO) and reported in AIRCO s statutory filings. Commercial Insurance loss reserves also include approximately $648 million and $590 million related to business included in AIUO s statutory filings at June 30, 2008 and December 31, 2007, respectively.

(b) At June 30, 2008 and December 31, 2007, Personal Lines loss reserves include $1.03 billion and $894 million, respectively, related to business ceded to Commercial Insurance and reported in Commercial Insurance s statutory filings.

(c) At June 30, 2008 and December 31, 2007, Foreign General Insurance loss reserves include approximately $2.04 billion and $3.02 billion, respectively, related to business reported in Commercial Insurance s statutory filings.

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

Commercial Insurance cedes a quota share percentage of its other liability occurrence and products liability occurrence business to AIRCO. The quota share percentage ceded was 10 percent in the six-month period ended 2008

and 15 percent in 2007 and covered all business written in these years for these lines by participants in the American Home/ National Union pool. AIRCO s loss reserves relating to these quota share cessions from Commercial Insurance are recorded on a discounted basis. As of June 30, 2008, AIRCO carried a discount of approximately $190 million applicable to the $3.08 billion in undiscounted reserves it assumed from the American Home/ National Union pool via this quota share cession. AIRCO also carries approximately $532 million in net loss reserves relating to Foreign General Insurance business. These reserves are carried on an undiscounted basis.

The companies participating in the American Home/ National Union pool have maintained a participation in the business written by AIU for decades. As of June 30, 2008, these AIU reserves carried by participants in the American Home/ National Union pool totaled approximately $2.04 billion. The remaining Foreign General Insurance reserves are carried by American International Underwriter Overseas, Ltd. (AIUO), AIRCO, AIG U.K., and other smaller AIG subsidiaries domiciled outside the United States. Statutory filings in the United States by AIG companies reflect all the business written by U.S. domiciled entities only, and therefore exclude business written by AIUO, AIRCO, and all other internationally domiciled subsidiaries. The total reserves carried at June 30, 2008 by AIUO and AIRCO were approximately $3.63 billion and $3.42 billion, respectively. AIRCO s $3.42 billion in total general insurance reserves consist of approximately $2.89 billion from business assumed from the American Home/ National Union pool and an additional $532 million relating to Foreign General Insurance business.

Discounting of Reserves

At June 30, 2008, AIG s overall General Insurance net loss reserves reflect a loss reserve discount of $2.48 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 companies own payout patterns, with the future expected payment for each year using the interest rate associated with the corresponding Treasury security yield for that time period. The discount is comprised of the following: $794 million tabular discount for workers compensation in Commercial Insurance; $1.49 billion non-tabular discount for workers compensation in Commercial Insurance; and $190 million non-tabular discount for other liability occurrence and products liability occurrence in AIRCO. The total undiscounted workers compensation loss reserve carried by Commercial Insurance is approximately $13.5 billion as of June 30, 2008. The other liability occurrence and products liability occurrence business in AIRCO that is assumed from Commercial Insurance is discounted based on the yield of U.S. Treasury securities ranging from one to twenty years and the Commercial Insurance payout pattern for this business. The undiscounted reserves assumed by AIRCO from Commercial Insurance totaled approximately $3.08 billion at June 30, 2008.

Quarterly Reserving Process

AIG believes that the General Insurance net loss reserves are adequate to cover General Insurance net losses and loss expenses as of June 30, 2008. While AIG regularly reviews the adequacy of established loss reserves, there can be no assurance that AIG s ultimate loss reserves will not develop adversely and materially exceed AIG s loss reserves as of June 30, 2008. In the opinion of management, such adverse development and resulting increase in reserves is not likely to have a material adverse effect on AIG s consolidated financial condition, although it could have a material adverse effect on AIG s consolidated results of operations for an individual reporting period.

The reconciliation of net loss reserves was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	**2008**	2007	**2008**	2007
Net reserve for losses and loss expenses at beginning of period	**$ 70,507**	$ 64,034	**$ 69,288**	$ 62,630
Foreign exchange effect	**193**	252	**263**	214
Losses and loss expenses incurred:				
Current year	**8,620**	7,334	**16,641**	14,549
Prior years, other than accretion of discount	**93**	(120)	**(71)**	(268)
Prior years, accretion of discount	**72**	12	**176**	128
Losses and loss expenses incurred	**8,785**	7,226	**16,746**	14,409
Losses and loss expenses paid	**7,154**	6,315	**13,966**	12,056
Net reserve for losses and loss expenses at end of period	**$ 72,331**	$ 65,197	**$ 72,331**	$ 65,197

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

	Three Months Ended June 30,	Six Months Ended June 30,

(in millions)	**2008**	2007	**2008**	2007
Prior Accident Year Development by Reporting Unit:				
Commercial Insurance	**$ 75**	$ (65)	**$ (142)**	$ (152)
Personal Lines	**29**	(32)	**65**	